
CP22/18: FCA Guidance on the Trading Venue Perimeter

AFME Response

25 November 2022

Introductory remarks

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to comment on the **FCA consultation paper CP 22/18 Guidance on the Trading Venue Perimeter**. AFMEs response is jointly supported by The Global Foreign Exchange Division (GFXD).

AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.

AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia.

AFME is registered on the EU Transparency Register, registration number 65110063986-76.

The Global Foreign Exchange Division ('GFXD') of the Global Financial Markets Association ('GFMA') was formed in co-operation with the Association for Financial Markets in Europe ('AFME'), the Securities Industry and Financial Markets Association ('SIFMA') and the Asia Securities Industry and Financial Markets Association ('ASIFMA'). Its members comprise 25 global FX market participants, collectively representing the majority of the FX inter-dealer market (according to Euromoney league table).

Question Responses

- 1. Question: Do you agree with our approach that following issuance of our final guidance, Q&As 7, 10, 11 and 12 in Section 5 of the ESMA market structures Q&As should not form part of our supervisory expectations?**

Response: Yes. AFME and GFXD believe that, for the sake of unambiguous clarity, the FCA's final guidance on the trading venue perimeter, when issued, should replace existing guidance from ESMA contained in Q&As 7, 10, 11 and 12 in Section 5 of the ESMA market structures Q&As.

- 2. Question: Do you agree with our interpretation of the definition of a multilateral system?**

Response: AFME and GFXD have the following comments to make on the "New guidance on the definition of a multilateral system" in sections 3.8 to 3.28 of the consultation paper and Q24C of PERG13:

Association for Financial Markets in Europe

London Office: 39th Floor, 25 Canada Square, London E14 5LQ, United Kingdom T: +44 (0)20 3828 2700

Brussels Office: Rue de la Loi 82, 1040 Brussels, Belgium T: +32 (0)2 788 3971

Frankfurt Office: Bürohaus an der Alten Oper, Neue Mainzer Straße 75, 60311 Frankfurt am Main, Germany
T: +49 (0)69 153 258 963

www.afme.eu

- a) AFME and GFXD believe that the four main elements of a multilateral system as defined in paragraph 3.9 of the CP and Q24C on PERG 13 should be explicitly cumulative and therefore read as follows:

"A multilateral system, for these purposes, comprises the following main elements:

- it has the characteristics of a trading system or facility; **and**
- it comprises multiple third-party buying and selling trading interests; **and**
- it allows trading interests to interact in the system; **and**
- trading interests need to be in financial instruments.

- b) In relation to the multiple third party concept, AFME and GFXD members note that the FCA states in Q24C "The fact that when any two persons negotiate within the system they do so between themselves does not mean that the system is bilateral rather than multilateral. Instead, what matters is whether the system, at the point of entry, enables one person to interact potentially with multiple others (other than the operator). This is the service a person receives as a user of the system.". We would highlight that it is important to differentiate between systems which enhance bilateral interactions and which constitute "one to many" as opposed to interactions within the scope of the MiFID 2 perimeter that are "many to many". The definition requires that **multiple** third party interests must interact and Article 18(7) MiFID 2 clarifies this "many to many" requirement in that MTFs and OTFs must "have **at least three** materially active members or users, each **having the opportunity** to interact with **all the others** in respect to price formation."

In addition, AFME and GFXD believe that in considering whether a platform has the "characteristics of a trading system or facility" the FCA should have regard for whether a system is operating as a multilateral venue in practice. The satisfaction of a majority of these practical criteria could indicate that the system is operating as a multilateral venue, where a system operator (or organiser):

- Is a provider of the trading protocol; and
- Has provisions governing the execution protocol (which within our response we will refer to as the "execution organiser"); and
- Has full control of rules (business and software); and
- Has visibility of and is able to monitor trade, pricing and execution data; and
- Has the ability to reject or reverse a trade, for example, in specified situations and according to its set of rules; and

And within such system most of the following features exist:

- Trades are formed when the trading venue executes them i.e., on acceptance of the AIOT or RFQ response (a firm offer to buy or sell or enter into an instrument);

- The trading venue has the power to cancel a trade/ orders/ RFQs in a pre-determined situation;
- The system determines the exchange methodology protocols;
- The system has access to the pricing and trade data and offers facilities to report the trade;
- The system may charge fees to enable trading activity (e.g., connectivity and transaction fees);
- The system maintains records and centrally authenticates all members/participants that are involved in the arrangement of the trade in the system;
- The service is generally standardised, so that the capabilities on offer are the same for all members;
- The operation of the system is subject to a set of rules which form part of a contract between members/ participants and the operator of the venue and which set out how trades are formed on the venue; and

Critical questions to determine the execution “organiser” would include:

- Who is providing the terms around how execution is done, and the execution time stamp: is it the dealer or aggregator?
- Is the operator of the platform or provider of the software tool aware of the transaction?
- Who is organising that execution?

Moreover, it should be clearly recognised that Electronic trading is not synonymous with on venue trading. There is a need to protect the OTC market, which should continue to exist in a digitalised world, and for the FCA and regulation to support the ongoing digitalisation of trading workflows.

There should be a clear distinction between:

- systems where key parameters or rules which influence the interaction of trading interests are determined or applied centrally by an organising or operating entity in common to all users who may interact; and
- systems which provide such capabilities but allow for each user of the system to apply, disapply or customise the parameters or rules independently such that the system cannot be said to operate under a single set of rules, or to be under the control of a single party responsible for the integrity of the system, meaning the way in which the trading interests interact.

- c) AFME and GFXD welcome the additional clarity offered by the proposed revised wording of PERG 13 Q24C in the section pertaining to general purpose communications systems. However we retain some concerns around the proposed wording specifically in the context of where a broad-based technology and systems provider operates both a licensed MTF system as well as a general communications system and where the boundary lies between the two. This is particularly important to establish in technology offerings where certain functionalities link the two systems, for example where the basic terms of an OTC trade that has been communicated and negotiated bilaterally on the messaging system are automatically extracted from the text in the messages and replicated in a codified form onto a trade ticket or confirmation.

AFME and GFXD would support wording that more clearly distinguishes between actions on such above mentioned market services that 'co-habit' within the services of one provider. It is important to make clear that genuinely bilateral exchanges on the messaging system that result in an OTC trade AND that have no further downstream interaction with the 'co-habiting' MTF system remain defined as bilateral OTC trades.

In addition, we believe that the FCA guidance should make clear that any type of digitisation or electronification of already existing 'general purpose communications systems' such as telephone networks/instant messaging/e-mails, should also be explicitly excluded from the scope.

On the above bases we propose the following amendment to the FCA Handbook text:

General purpose communications systems would not as such amount to trading systems or facilities. This means that the following services in and of themselves would not amount to operating a multilateral system: acting as an internet services provider, providing a telephone network, operating a website or providing chatroom facilities. **Similarly, any digitised form and electronification of these general purpose communications, should also be excluded from the scope as long as the intention remains the same and the digitisation is purely put in place to increase efficiency in the market.**

- d) One further segment of what could be characterised as typical sell-side workflows that AFME and GFXD members feel would benefit from more explicit guidance to the effect that it is not viewed to be in scope of the trading venue regime is that of software commonly known as an 'Aggregator' or sometimes 'sell-side EMSs' (Execution Management Systems.) These tools have seen a good deal of innovation and evolution over recent years and for all but the smallest institutions now play a critical role in workflows. This has been driven substantially by the increased levels of electronic execution over multiple channels as well as real-time trade reporting now required under MiFID II. It should be noted that some institutions have built their own in-house applications whilst others rely on solutions bought from third party technology providers.

In essence, these Aggregator solutions act as a 'middleware' hub that sits at the centre of the trading desk's activity. They connect to the various electronic trade channels on which the desk is active (whether they be regulated third party venues such as RMs, MTFs & OTFs or other bilateral channels such as the SI's single dealer platform or direct APIs) as well as to the manual ticket booking system for trades conducted via voice / e-mail / chat. They further connect to the

internal risk management system as well as trade and transaction reporting solutions. It should be further noted that as well being connected to the above various channels for inbound / client trade enquiries they also facilitate outbound trade enquiries generated by the desk for, for example, trade hedging purposes where likewise the channels can be electronic or manual.

In essence then, AFME and GFXD believe these software solutions should be viewed as internal trade channel and wider connectors for internal workflow purposes only rather than a 'venue' where trading interests actually interact indeed they purely connect the trading desk electronically TO the venues, be they RM, MTF, OTF or SI in nature, and it is the venue where the trading interests interact. For the purposes of illustration please refer to the diagram in Appendix I at the end of this document.

3. Question: Are there any other relevant characteristics to a multilateral system that should be taken into account?

Response: The nature and structure of the commercial terms under which users of the system operate, being established and enforced by the system operator, might also be taken into account. In particular, the existence of a 'per trade execution fee', whether applied to one or both counterparties to any trade might be considered to be a characteristic of a multilateral trading system.

4. Question: Do you agree with our proposed guidance in relation to voice broking?

Response: Yes AFME and GFXD agrees that arranging or executing trades over the phone is not a sufficient condition for a firm to seek authorisation as a trading venue. The characteristics referred to in question 2 and 3 would need to be considered when determining whether a voice broking system constituted a trading venue. Voice/ e-mail/ chat broking requires support from systems and automation for adequate risk management, reg compliance (post-trade reporting), and trade hedging where the channels can be electronic or manual. AFME and GFXD members are of the view that high touch activities at broker firms do not constitute multilateral trading and the degree to which this activity relies on systems and automation to enhance workflows does not change the nature of these interactions. On this basis we propose the following amendments to the FCA Handbook text:

"Q24D. Does voice broking involve the operation of a multilateral system?

Voice broking may but need not comprise the operation of a multilateral system. Merely arranging or executing client orders over the telephone **or submitting client orders to execution venues** does not constitute a multilateral system, although it may amount to other investment services such as reception and transmission or execution of orders on behalf of clients.

A trading system or facility could, however, take the form of a voice trading system or a hybrid system (as referred to in Annex I MiFID RTS 2 and Annex I MiFID RTS 1). For example, a firm that operates a platform where trading interests of clients are broadcast to other users and then engages in voice broking to enable negotiation between these parties would operate a trading system or facility, unless Q24F or Q24I applies. Voice broking may also be part of a multilateral system when operating in conjunction with other modes of execution such as electronic order books **operated by that broker."**

5. Question: Do you agree with our proposed guidance relating to internal crossing by portfolio managers?

Response: AFME and GFXD members defer to portfolio managers to respond to this question but note we are supportive of guidance that reduces regulatory burden and costs of trading for AFME and GFXD members' clients, and thereby improving end investor execution outcomes.

6. Question: Do you agree with our proposed guidance relating to blocking onto trading venues?

Response: From a fixed income perspective 'blocking trades' is not terminology that AFME and GFXD members are particularly familiar with. However, AFME and GFXD would comment that the process of 'blocking trades' onto a venue by a third party investment firm *as described* in paragraphs 3.37 & 3.38 of this CP is not, as far as members are aware, common practice in the cash fixed income markets. As far as this practice does take place in these markets, AFME and GFXD members agree with the proposed guidance as described.

From an equities perspective, although "blocking trades" is not the common nomenclature, we understand that the FCA has in mind trades that are pre-arranged under an equities pre-trade transparency waiver which are formalised on a trading venue in accordance with its rulebook.

7. Question: Do you agree with our interpretation to regard a crowdfunding platform operating only in primary markets as not involving the operation of a multilateral system?

Response: AFME and GFXD members agree with the FCA's interpretation and guidance outlined in paragraphs 3.40 to 3.42 and Q24G of this CP as far as they relate to the primary market activities of a crowdfunding platform only.

8. Question: Do you agree with our interpretation of the characteristics of a bulletin board?

Response: Yes, AFME and GFXD members agree with the FCA's interpretation of the characteristics of a bulletin board as described in paragraphs 3.43 to 3.46 and Q24H to Q24L in this CP. AFME and GFXD members believe that the key missing element and associated functionalities that preclude bulletin boards, as described, being classified as a multilateral system is the absence of the ability for trading interests to *interact within the system*.

9. Question: Do you agree with our approach to updating the Glossary definition of a service company in relation to client limitation types?

Response: Yes. AFME and GFXD believe that, for the sake of unambiguous clarity, the definition of a service company should be updated in the relevant section of the Glossary Terms of the FCA Handbook to include client type definitions contained in MiFID terminology and further notes the statement in paragraph 3.51 of this CP that "This is intended as a mechanical change and, therefore, should have no adverse impact for firms."

10. Which regulatory requirements applicable to MTFs and OTFs are most likely to create barriers to entry to the trading venue market for smaller firms?

Response: AFME and GFXD members would make the following observations:

- a) Costs that could be generally associated with platform oversight and regulatory compliance are very substantial and should not be underestimated in the context of the opportunity cost of resource consumption and therefore potentially causing high barriers to entry. These would be particularly onerous for smaller operating companies with relatively nascent businesses, and therefore relatively low operating revenues, where these costs would consume a significantly higher proportion of operating revenues and / or capital than is the case for more established businesses. More specifically, we would cite costs associated with overall regulatory compliance, market and trade monitoring, general operational and platform resiliency work and infrastructure, trade reporting mechanisms and maintenance as well as general legal work associated with some or all of the above.

To be very clear, AFME and GFXD members are not advocating for the reduction or removal of any regulations or requirements that are critical to the robust, effective and compliant operation of public trading venues. We would however recommend thorough and detailed consultations with operators of well-established MTFs and OTFs as well as more recent market entrants to see if / where these costs might be ameliorated in a safe and fully compliant manner.

- b) The application process for authorisation as an MTF or OTF is time consuming and can take many months or even years. This can create what may be unnecessary uncertainty in the areas of strategic and financial planning for potential new market entrants and therefore act as a de facto higher barrier to entry than might otherwise be the case.

11. Does the existing service company regime already address concerns regarding these barriers to entry?

Response: AFME and GFXD members as investment firms have not previously sought to utilise this regime and feel that the regime would benefit from a greater awareness in the community that may seek to utilise it in future.

AFME and GFXD members appreciate the benefits afforded to technology companies that operate under the service company regime and the associated light-touch regulatory stance consequently adopted by the FCA towards these companies and their services. Members also support the endeavours of the FCA, as articulated in Section 4 of this Consultation Paper, to reduce barriers to entry and therefore costs to market participants of the markets' broader trading technology infrastructure and services sector. We are also fully supportive of the absolute requirement to maintaining the highest standards of regulation as stated in paragraph 4.4 of this CP.

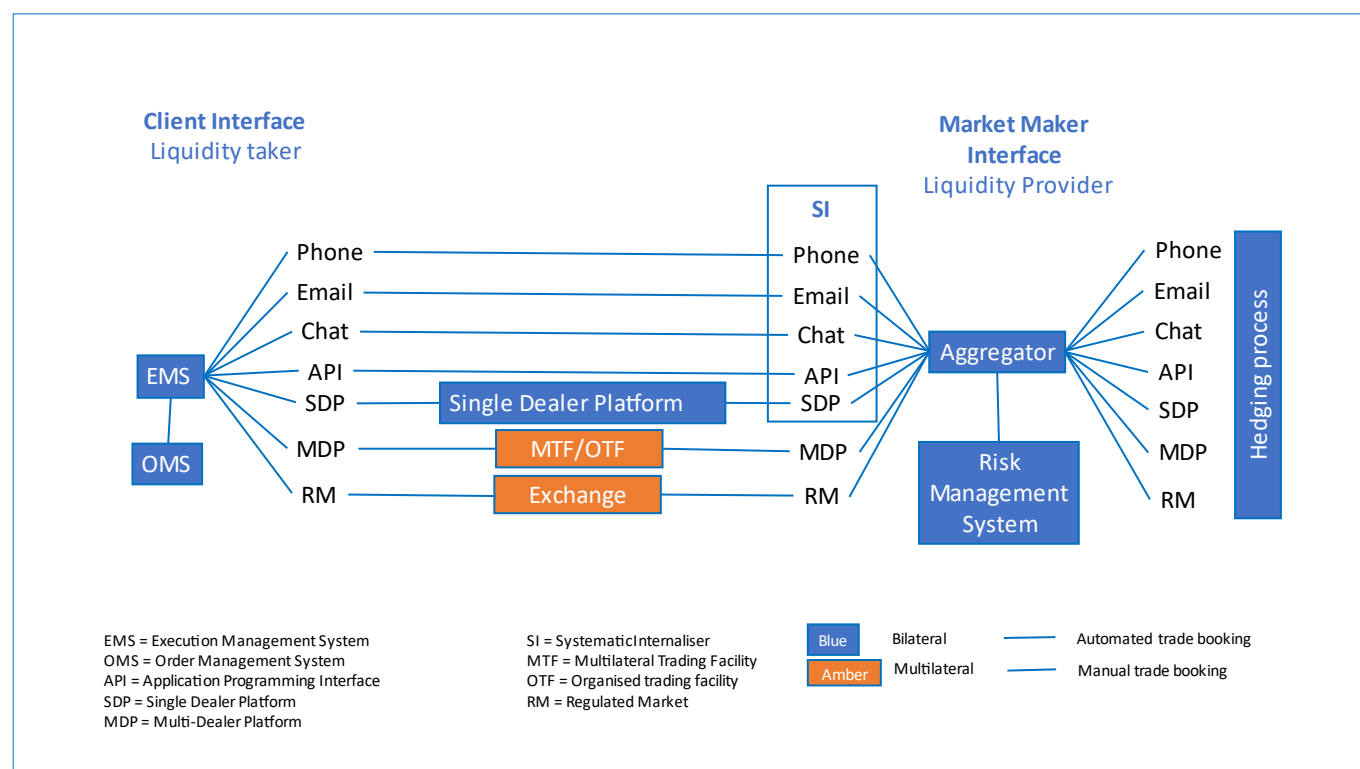
As far as AFME and GFXD members are aware, the service company regime as currently implemented and applied does not cause undue costs or barriers to entry to companies that appropriately fall within the scope of the regime. For the same reasons that AFME and GFXD are supportive of the FCA's stated desire to reduce costs and burdens to firms, AFME and GFXD would not be supportive of an extended scope of companies and services that are deemed to operate under the service company regime unless they were appropriately moving from a different regime that they felt to be more burdensome and costly.

In summary, AFME and GFXD members are fully supportive of the FCA's efforts to reduce firms' burdens and costs as long as they do not result in diminished regulatory standards and market integrity.

12. Based on which criteria should firms be potentially subject to a more scalable set of requirements?

Response: AFME and GFXD believe that existing financial technology companies, both established and more recently created would be best placed to answer this specific question. As previously stated, AFME and GFXD is generically very supportive of the FCA's efforts to facilitate enhanced competitive dynamics and a reduction in costs in the market for wholesale financial technology so long as regulatory standards and market integrity are maintained.

Appendix I



AFME Contacts

Rupert Warmington
Rupert.Warmington@afme.eu
+44 (0)20 3828 2701

Victoria Webster
Victoria.Webster@afme.eu
+44 (0)20 3828 2689

GFXD Contacts

Andrew Harvey
AHarvey@eu.gfma.org
+44 (0)20 3828 2694

Sara Scognamiglio
SScognamiglio@eu.gfma.org
+44 (0) 20 3828 2711