Consultation Response

ESMA Consultation Paper on Algorithmic Trading

Q1: What is your overall assessment of the MiFID II framework for algorithmic trading, HFT and DEA?

AFME members consider that overall, the current framework addresses the key issues of algorithmic trading. As ESMA notes, the framework has held up well during a period of high volatility, which reflects well not only on the market infrastructure providers but also their members' readiness. In fact, AFME members' greatest concerns over 2020 revolved not around the volatility that was experienced but instead with the unconnected venue outages which revealed weaknesses in venue protocols (including in communications) and the drawbacks of regulation over-relying on individual regulated markets. In other developed markets, trading is able to migrate in an orderly fashion to other venues. To that end, we provide some short term and medium-term proposals to achieve greater resilience for European financial markets which we hope are acted upon as soon as possible.

Regarding the MiFID II framework for algorithmic trading, given that it is generally still fit for purpose, we see no reason for a complete overhaul and agree that only targeted amendments should be made. That being the case, we have some doubts about some of the proposals. For example, the proposals for standardisation of self-assessments could lead to a 'tick the box' culture and defeat the purpose of conducting a robust self-assessment that considers the nature, scale, and complexity of an individual firm's electronic business. In addition, we see potential interpretation issues and member state divergence with regards to the authorisation regime for both DEA users and HFT firms. With regards to HFT firms we question the need for some of the new proposals put forward in this consultation paper.

The MiFID II framework for algorithmic trading that was originally designed to address the risk inherent to high frequency trading is being applied in the same way since its implementation, however technology has advanced since then and the delineation between high frequency trading and other trading strategies has become more difficult to assess.

Furthermore, AFME members note that the MiFID II framework for algorithmic trading at present is heavily skewed towards the trading of equity instruments, as several of the principles outlined within the MiFID II framework do not align with other asset classes. Some of the proposals (e.g. for a definition of disorderly trading) do not take account of the differences in trading modes and market structure in other asset classes which would likely make matters worse.

In addition, members note that there may be some misunderstanding about the concept of a Systematic Internaliser (SI) in relation to the current algorithmic trading definition. Under the current MiFID II framework, investment firms can opt in to become an SI if they do not meet the trading volume threshold in order to classify as a mandatory SI in that asset class. It is not unusual for such a scenario to occur and for dealers to opt into the SI regime to assist clients with their post-trade transparency reporting requirements. Thus, not all SIs are providing systematic liquidity or employ algorithmic trading strategies.

Q2: In your views, are there risks other than the one mentioned in MiFID II or impacts on market structure developments due to market electronification/ algorithmic trading that would deserve further regulatory attention? Please elaborate.

Despite strong requirements within the MIFID framework for both investment firms and operators of trading venues to deploy business continuity arrangements, the industry is still experiencing regular IT and system outages on trading venues, in particular from venues which are deemed the most relevant markets under MiFID. This lack of resiliency has a direct impact on the ability of the investment community to continue to operate and we believe the framework under which we can assure business continuity should be strengthened further, especially in equities markets where competition and asset fungibility should ensure such resiliency exists. Please see our responses to Q35 and Q36.

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Q3: Do you consider that the potential risks attached to algorithmic trading should also be given consideration in other trading areas? Please elaborate.

AFME members agree with ESMA's assessment that the risks arising from algorithmic trading are likely to create more detrimental consequences to orderly markets when trading takes place on multilateral systems rather than with bilateral off-venue trading as detailed in our response to Q9.

AFME members also agree with ESMA's conclusion as to the scope set out in the Market Structure Q&A (section 3, question 7), which clarifies that algorithms which only inform a trader about a particular investment opportunity is not considered algorithmic trading, provided that the execution is not algorithmic. Further, AFME members consider that the characteristics of algorithmic trading outlined in Article 17 of MiFID II Directive (EU 2014/65) are incompatible with the characteristics of other trading areas, in addition, potential risks attached to these trading areas also differ.

Q4: Do you agree with this analysis? If not, please explain why.

AFME members agree that the definition of algorithmic trading in Article 4 (1) (39) does not expressly exclude firms trading on venue via DEA, and that this has caused some uncertainty. However, the greater uncertainly has resulted from the lack of express exclusion of firms trading on venue via DEA in the definition of high frequency algorithmic trading technique in Article 4 (1) (40), which, we do not believe was the legislative intent. Given the uncertainty, we understand that ESMA concludes that:

1) A firm can be considered to be trading algorithmically on a trading venue also in instances where it is accessing the market via DEA.
2) A firm can be considered an HFT firm where it trades via DEA (as set out in ESMA Q&A).

AFME members agree that investment firms that engage in algorithmic trading should have in place appropriate systems and controls for that activity, regardless of whether they are direct members of a venue or accessing it via DEA, to avoid uncertainty, and maintain an even playing field between EU and non-EU firms trading via DEA. However, we consider that it would be better to clarify that the definition is limited to trading directly on the market. In cases where any entity is trading algorithmically via DEA, rules can be, and are, applied to it by the exchange member (the DEA provider), pass through the controls of the DEA provider, and can be enforced by them. Our rationale is outlined in further detail below:

A firm can be considered to be trading algorithmically also in instances where it is accessing the market via DEA

As set out in more detail to our answer to Q10, the regulatory regime should assess the various entry points into the EU markets and ensure each entry point has rules that protect the fair and orderly functioning of the EU markets. In the case of a direct member who trades algorithmically, the MiFID II algorithmic trading and HFT rules apply to the member (for example MiFID Article 17 Article 1 to 18 of RTS 6). In the case of a member who provides DEA, MIFID Article 175) and RTS 6 Article 20 to 23 require the DEA provider to ensure that any DEA client trading algorithmically will be subject to the DEA provider's controls which prevent the emergence of disorderly markets, and that they comply with the requirements of MiFID II and the rules of the trading venue.

The rules therefore already ensure that any algorithmic activity by the DEA client will be subject to a robust set of due diligence and controls imposed by the DEA provider and the DEA provider will retain regulatory responsibility for their clients' activity in line with the requirements of Article 17 of MiFID II. Thus, contractually DEA clients are brought within scope of the algorithmic requirements, with both MiFID requirements and DEA agreements including provisions which echo RTS 6 requirements further highlighting that the obligation on the DEA provider is sufficient.

An EU firm trading on venue via DEA using HFT must seek to be authorised as an investment firm.

In line with our response to question 10, we are supportive of the proposal to not require EU firms to be authorised as investment firms for "the sole purpose of having DEA access" in respect of own account trading, given, as ESMA identifies, that the costs outweigh the benefits. ESMA notes in reaching that conclusion that the DEA provider is required to ensure that the service is properly monitored and that appropriate risk controls are in place to prevent disorderly trading. Finally, ESMA correctly identifies that this means that EU firms and non-EU firms are not treated differently.

In addition to supporting that position, in our response to Q10, we believe that rather than imposing an authorisation requirement on non-EU firms that conduct HFT activity on EEA markets, we think that both EU and international firms that conduct HFT activity on EEA markets should do so via DEA, unless the firm conducting HFT strategy is already regulated in the EU as an investment firm. We do not see the need to treat non-HFT DEA and HFT DEA activity differently. Any risks of HFT activity can be addressed via the DEA provider (who is responsible for their clients' trading). This also has the benefit of ensuring equal treatment between EU and non-EU HFT firms.

Q5: Did you encounter any specific issue with the definition of HFT? Do you consider that the definition should be amended? Do you have any suggestion to replace the high message intraday rates with other criteria or amend the thresholds currently set in Level 2? Please elaborate and provide data supporting your response where available.

AFME members have encountered two principal issues with the definition of HFT. Firstly, the level 1 definition seems to capture activity not envisaged by the co-legislators. Secondly, the high message intra-day definition in Level 2 requires further clarification, currently the definition outlined in level 2 allows for a level of ambiguity. We provide more detail on these issues in this response. Please also see our response to Q10 which discusses AFME members' views on an appropriate approach to non-regulated entities who trade at high frequency on EU markets.

Breadth of the definition of HFT

Recital 61 of MiFID refers to HFT being a subset of algorithmic trading where a system "analyses data or signals from the market at high speed and then sends or updates large number of orders within a short time period in response to that analysis". It goes on to say that it uses sophisticated technology to "implement more traditional trading strategies such as market making or arbitrage".

We think broadly that is right. Nonetheless, the definition in Article 4 is wider and can capture activity not envisaged by the recital. A firm is considered to be HFT if it trades on own account and satisfies the following criteria:

a) Low latency venue access
b) System determination of orders/quotes and;
c) High message intraday rates.

Unlike the recital, the definition does not make reference to the pursuit of a trading strategy. This means that larger firms' activity, such as inventory building for client facilitation that happens algorithmically, can meet the definition of HFT even though no trading strategy is being pursued.

We note that AFME members' trading activity is predominantly focused on serving their clients' investment needs. We believe that client servicing activity would typically fall outside the intended scope of the HFT provisions, given the drafting of recital 61. We set out two examples of activity that presently is (we think unintentionally) captured.

(i) Inventory building for satisfaction of a client order

In equities, typically client facilitation will happen through orders for the purchase or sale of cash securities through various channels. However, certain clients' trading positions are established other than via directly intermediated purchases of securities and are instead established by different means, including by entering into OTC derivatives. In such instances, a client may ask a firm for price information (including via a request for market data) and following such a request, the firm will provide them with its response. Prior to providing the response, the firm will assess the channel through which the request is received and the relevant inventory position for that channel. For electronic channels, algorithms trade on venue to establish a price and the average prices at which we establish the inventory will influence our response to the client. The client may subsequently decide to accept that price and enter into an OTC derivative with the firm or ask them to give up the position to their prime broker (who may enter into the OTC derivative with them).

Given that our member firms will frequently have low latency access to venues, they will satisfy the first criterion. When an algorithm decides whether and how to establish inventory this satisfies the system determination of orders criterion (even though in building inventory, firms are not doing so to pursue a particular strategy on a venue but instead are doing

so to establish a price for their client). Finally, larger firms who do this will, by virtue of their size, rather than function, satisfy the final high message intraday rate criterion.

(ii) Acting as market maker or primary dealer

Whilst recital 61 refers to market making, we believe that HFT should be understood as an entity that uses sophisticated technology to transact in the manner described in recital 61, i.e. "short time-frame for establishing and liquidating positions, high daily portfolio turnover, high order-to-trade ratio intraday and ending the trading at or close to a flat position." We believe that market making is referred to in this recital as an example of how two-way price streaming methodologies can be used by high frequency traders as a trading strategy. We do not believe that the co-legislators intended that all market-makers and primary dealers should have to consider whether that activity, in many cases conducted in line with agreements mandated by trading venues pursuant to MiFID II, would cause their firms to be deemed HFT even in the absence of any trading behaviour of the sort described in recital 61.

By way of example, where a firm is appointed primary dealer, the relevant DMO will generally require the primary dealer to participate in the secondary market on e-trading platforms and comply with its quoting obligations on the primary venue. For instance, in Italy, primary dealers are required to support the liquidity of the overall market for Treasury Securities. On MTS Italy a PD is allocated financial instruments and is required to send double sided quotes continuously with competitive prices for at least 4 hours and 45 minutes during each trading day. The dealer also cannot have differences in the quantity of bid vs ask of greater than 50%. The MTS would also set guidelines on the maximum bid – offer spreads. A primary dealer is ranked based on the quality and performance of the quotes and can be deemed non-compliant should the performance be consistently poor.

In addition to formal market maker obligations pursuant to MiFID II, AFME member firms may from time to time undertake contractual obligations to provide two-way pricing in relation to an issuer client's securities, for a specified period of time. This activity is done as part of a capital markets relationship, typically to support liquidity in the client's securities. Many issuers, particularly smaller issuers, value this service and it appears in line with wider EU efforts to support entrants to the capital markets.

We believe that firms providing this type of service – which is plainly not a trading strategy - ought not to be captured by the HFT definition.

We therefore believe that the second criterion in the definition should be aligned with the associated recital by clarifying that system determination of orders/quotes is done in pursuit of a trading strategy on one or more trading venues. AFME and its members offer their assistance to work with ESMA further to define the scope of the definition.

However, as we acknowledged there may be instances where AFME member firms do trade on venue in pursuit of a trading strategy. In those instances, they would continue to be subject to the HFT requirements.

High Message Intraday rate

AFME members share ESMA's concerns about the static nature of high message intraday rate. However, we do not have any specific recommendations for its replacement that will achieve the outcomes envisaged by the recitals. Should other respondents to this consultation identify other ways to capture HFT activity, we stand ready to engage with ESMA in assessing them. In mitigation to the concern about the static nature of the criterion, we note that should future technological advancements merit a review of the thresholds, it would be possible for ESMA to recommend to the Commission that a targeted consultation for updating them is conducted.

Should no other method for capturing this activity be identified (and therefore the high message intraday rate is retained), AFME members believe that the Level 2 definitions should be clarified to provide firms with greater legal certainty as to the scope of their assessment. There is currently ambiguity in the Level 2 text about the time period over which the average of high message intraday rate is assessed, namely how long the high message intraday rate has to persist for a firm be classified as a HFT firm. For example, if a firm exceeds the threshold on one day but does not otherwise exceed the threshold thereafter, it is not clear from the text whether they would be caught by the HFT rules.

In addition to the above, there is also ambiguity above the venue element of the assessment. We believe that the intention of Article 19(1) of Commission Delegated Regulation (EU) 2017/565 is to require firms to assess their activity on a per venue basis (rather than a pan-EU basis).

For example, when a firm is seeking to assess if it meets the message rates set out in Art 19 (1)(b) (i.e. if it is submitting on average "4 messages per second with respect to all financial instruments traded on a trading venue"), we think that the intention is for the assessment to be done for its activity on all the instruments traded on a particular venue (e.g. on all the shares that can be traded on Euronext Paris). This means if a firm submits on average more than 4 messages per second to Euronext Paris it is considered an HFT on Euronext Paris only (rather than on other venues on which it submits messages at a rate of less than 4 per second on average). Similarly, for the purposes of Art 19(1)(a) a firm will satisfy the requirement if it submits on average more than 2 messages per second with respect Total SA on Euronext Paris (and is an HFT on Euronext Paris only) rather than be considered an HFT in respect of its trading in Total SA on other venues on which it does not meet the 2 messages per second criterion. We believe that this point could usefully be clarified in any amendments to the level 2 text.

Why is the scope of HFT important?

AFME members note and accept that at present the result of being deemed HFT is the requirement to satisfy enhanced record-keeping requirements for in-scope messages, which member firms have no objections to doing as it corresponds with other record keeping obligations they have. However, where a firm is deemed HFT, there could be further consequences under other legislation or regulation in future, with the result that firms, or firms' activity, that are not within the intended scope of HFT, find themselves with obligations or restrictions that are not appropriate or workable and/or that could increase operational and other burdens to the detriment of clients.

Q6: Based on your experience, is sub-delegation of DMA access a frequent practice? In which circumstances? Which benefits does it provide to the DEA user and to the subdelegatees? Are you aware of sub delegation arrangements in the context of Sponsored access? If so, please elaborate.

Sub-delegation of DMA access is very important for investment firms and intermediaries that are not members of every EU venue. A broker may be offering DEA to its client either on its own membership or sub-delegating from local brokers, especially for accessing smaller EU venues such as eastern European exchanges. In addition, sub delegation of DMA will also be triggered when a broker invokes its business continuity arrangements, which often includes the use of a broker in case of technical issue on a membership access.

As described further in our response to Q7, sub delegation of DMA is also essential to facilitate access of international clients to EU venues.

The framework for sub-delegation is well calibrated and allows for the right balance between giving the means to the DEA provider to monitor underlying sub-delegate flow.

Q7: (for DEA Tier 1clients) Do you sub-delegate direct electronic access? If so, are your Tier 2 clients typically regulated entities/investment firms? Are they EU-based or third country based?

Many AFME members provide sub-delegation. We highlight that sub-delegation is commonly used in intragroup arrangements. For example, due to licensing restrictions it is impossible to provide brokerage services to US accounts without the intermediation of a US broker. This means that an EU firm seeking to provide DEA access to an EU venue to a US client is required to have a sub-delegation arrangement with a US broker. The US broker is not able to provide DEA directly, as it is not authorised in the EU and cannot be authorised in the EU as their place of establishment is not in the EU

Consistent with our response to Q4, AFME's view is that the regulatory obligation is on the DEA provider established in the Union and their ability to understand the flow to the end client when there is a sub-delegation chain. The DEA

provider, as a result of Article 17(5) MiFID II, is required to have in place effective systems and controls which ensure a proper assessment and review of clients using the service, which includes, for clients who subdelegate, a requirement to monitor that client's activity as well as its sub-delegated clients' activity.

Q8: Do you agree with this analysis? If not, please explain why. Do you consider that further clarification is needed in this area? If so, what would you suggest?

AFME members agree with ESMA's analysis.

Q9: Do you agree with ESMA's proposal? If so, do you consider that the requirements considered above relevant? Should there be additional ones? If you disagree with ESMA's proposal, please explain why.

AFME members do not agree with ESMA's proposal, we consider that it is appropriate for firms acting as SIs to be required to apply governance, testing and appropriate risk controls to the algorithms that they use for quote generation, with the purpose that the quotes displayed, streamed, or sent to counterparties or clients are not a source of risk for the SI itself and/or a source of confusion, disruption, or potential chain reactions in the wider market.

However, AFME believes it is important to make the important distinction between the quoting activity that SIs carry out and the activity that takes place on trading venues, as SIs are not trading venues. As ESMA highlights the potential risks attached to algorithmic trading and potential damaging consequences to orderly markets are more salient with respect to multilateral trading where multiple buying and selling interests may interact and, therefore, where there is a greater risk of creating a disorderly market as a result of an errant algorithm.

That said, should ESMA determine that specific provision is needed, we do not agree that this should be achieved by amending the Level 1 definition of algorithmic trading. As well as being used to determine when firms must apply controls to relevant systems and processes the term is used in the context of HFT requirements and regulatory perimeter requirements in MiFID II article 2. We perceive that there could be unintended impacts on these concepts and requirements if SIs are included in the article 4(1)(39) definition.

Furthermore, the way that SIs operate can differ between asset classes and it is important to ensure that any requirements are capable of adaptation to the relevant asset class to avoid disruption for clients interacting with SIs. As such any legislative provision that would extend some of the MiFID II article 17 requirements to SIs would need careful drafting. For example, AFME members consider that requirements such as conformance testing, and pre-trade controls are less applicable to the quotes issued by an SI and should not be applied to SI quoting activity.

Q10: Do you agree with ESMA's proposals above? Please elaborate.

AFME agrees that assessing whether a person is a DEA user in relation to the application of EU licensing regulations had been challenging, and fully supports ESMA's intent to clarify the framework, and in particular welcomes ESMA's intent to provide clarity without undermining the efficiency of access to EU trading venues.

We agree with ESMA's analysis that there would appear to be insufficient benefit to maintain an authorisation requirement for EU firms merely because they are accessing trading venues via DEA. As investment firms providing DEA are already authorised in the Union, all applicable conduct requirements can be satisfied through the supervision of the investment firms providing DEA. It is also imperative international clients are able to access European trading venues through a DEA channel, without any doubt as to whether this requires licencing in the EU. International access to European trading venues allows for higher concentration of liquidity to coalesce on European markets and is therefore beneficial to European competitiveness.

We agree with ESMA that the existing regime requiring authorisation for members of trading venues in the Union providing DEA should continue and have no objection to it being further restated in Level 1, although we do believe this is already well understood and enforced by EU trading venues.

However, we do not agree with the proposal to include the term DEA sub-delegation in the definition of DEA. The insertion of sub-delegation into the definition of DEA coupled with the proposal for Article 1 to require a DEA provider to seek authorisation could inadvertently lead to an authorisation requirement for both sub-delegator and the market member. This could have the effect of preventing the provision of DEA to international clients to which EU investment firms are not authorised to provide services. This outcome does not appear to be in line with ESMAs intention and would be detrimental to European venues as it would disrupt access of international flows into the EU. For example, due to licensing restrictions it is impossible for EU investment firms to provide brokerage services to US accounts without the intermediation of a US broker. This means that an EU firm seeking to provide DEA access to an EU venue to a US client is required to have a sub-delegation arrangement with a US broker. It is not possible for a US authorised broker to also be authorised in the EU, as their place of establishment is not in the EU. This would prevent US and other international investors accessing EU markets via DEA which would undermine EU competitiveness.

We understand and agree with ESMA's objective to ensure that there is no dilution of controls due to sub delegation of DEA. As stated in our response to Q5 above, our view is that the regulatory burden is on the DEA provider established in the Union and their ability to understand the flow to the end client when there is a sub-delegation chain. The DEA provider, as a result of Art. 17(5) MiFID II, is already required to have in place effective systems and controls which ensure a proper assessment and review of clients using the service, which includes, for clients who subdelegate, a requirement to monitor that client's activity as well as its sub-delegated clients' activity. Additionally, the ESMA Q&A clarifies that the DEA provider retains responsibility for all clients accessing an EU trading venue through its DEA, including the sub-delegated DEA clients[1].

It is important for trading on EU trading venues to be appropriately supervised, enabling regulators to have timely and accurate information about the various participants (direct and indirect) that trade on EU venues and have sufficient means of enforcing the rules that apply. Therefore, the regulatory regime should take stock of the various entry points into the EU markets and ensure that means exist by which the rulebook can be enforced.

The two entry routes to the markets are as a direct member or via direct electronic access:

- With respect to direct members of EU trading venues, the trading venue rulebooks are directly applicable to the members and they are subject to direct supervision by the venue. Any breach of those rules, can lead to sanctions against the member, including fines, suspension, or withdrawal of membership.
- In the case of direct electronic access, by ensuring that any member providing direct electronic access is authorised in the EU and takes responsibility for their clients' trading (including sub-delegated entities' trading), regulators are able to ensure that where there is any trading activity that gives rise to concerns there is an EU entity with whom they can liaise to ensure that concerns are addressed and if necessary, against whom they can enforce the rules.

The combination of a robust set of rules that apply to either a direct member or DEA provider (as an EU regulated entity) means that is possible to delete the exemption in Art (2)(1)(d) in respect of DEA users without diminishing the level of oversight available to regulators and venues over EU markets and their direct and indirect participants. This also has the benefit of ensuring that there is no difference in treatment between EU firms and non-EU firms and there is consistency of regulation across the EU.

Given that there is robust oversight of the "entry points" to EU markets, AFME disagrees with ESMA's proposal to introduce a requirement for third country firms to be authorised if they are HFT firms. In the case of third country firms, this would be particularly onerous (if not impossible) as it would require them to simultaneously be authorised in every EU jurisdiction on which they conduct activity. A better alternative would be to require both EU and international firms that conduct HFT activity on EEA markets to do so via DEA, unless the firm conducting HFT strategy is already regulated in the EU as an investment firm. In such a scenario, the activity is monitored by the DEA provider who also has responsibility for their trading. This strikes the right balance between providing equal access to, and oversight over, EU and international HFT firms. In the case of EU firms, they could also be allowed to seek authorisation to conduct HFT activity as a direct member of a venue (but would not be required to be authorised if they only conduct HFT activity via DEA).

[1] ESMA Q&A on MiFID II and MiFIR market structures topics, Section 3, Question 22

Finally, we do not believe that there should be a new annual reporting obligation for investment firms with respect to DEA as it would be duplicative of information that is already otherwise available to NCAs. DEA is flagged to the venues on which investment firms trade and thus it would be possible for venues to provide this information on an annual basis.

Q11: Do you agree with ESMA's proposal? Please elaborate.

See AFME's response to Q10.

Q12: Do you see merit in ESMA developing a template for notifications to NCAs under Articles 17(2) and 17(5) of MiFID II? If not, please justify your position.

AFME members broadly support ESMA's proposal to develop a template for notifications to NCAs under article 17 (2) and 17 (5) of MiFID II provided the information required does not extend beyond the assessment criteria outlined in article 17.

However, we would wish to see how ESMA would propose to implement a more detailed notification procedure noting that many AFME member firms (as described in Q16) do not have singular algorithms that connect to individual markets. Instead, their algorithmic trading infrastructure is made up of multiple components that can interact, with only the market access gateway typically submitting orders/quotes to venues. This level of complexity does not lend itself well to a standard template.

To further streamline the process and prevent duplication of work or NCAs receiving an excess of notifications, AFME members propose that declarations should only be submitted to the firm's homes state regulator rather than every EU NCA.

AFME suggests that ESMA liaise with the industry to determine what information should be included in such a template.

Q13: Do you agree that it would be useful to clarify that notifications should be done 'without undue delay'?

AFME members agree.

Q14: Do you agree with ESMA's approach for the exchange of information between NCAs? If not, please justify your position.

AFME members agree.

Q15: What is your view on clarifying the definition of algorithmic trading? If you deem it beneficial to refine the definition and account for further types of algorithms or algorithmic trading strategies, please provide your suggestion as well as underlying rationale.

AFME members do not believe that the definition of algorithmic trading requires a full revision. As we have discussed previously, we think the regime has broadly worked well so far and so changes to the definition are not required.

That said, AFME members do not believe the definition should apply when trading via DEA or OTC (as set out in our answers to Questions 4 and 9). On that basis, the only clarification we would suggest is to clarify this either in the definition or the operative provisions in the articles that refer to it.

Rather than focus on the definition of algorithmic trading, AFME members recommend that ESMA focus on assessing the necessity of the HFT regime and its definition. We have provided an overview of our concerns in Q4.

The concept of algorithmic trading is an extremely complex area. Should any intention to clarify the definition of algorithmic trading be sought in the future, AFME and its members urge ESMA to liaise with market stakeholders,

including the algorithmic trading specialists and expertise within AFME member firms and other parts of the industry to ensure a comprehensive understanding of the subject, as the potential ramifications on the markets if improper guidance is issued could be significant. To illustrate this point, there follows a high-level description of some of the differences between algorithms and trading modalities in equity and fixed income markets.

Algorithms used within equity markets focus on order execution on a venue and where factors such as quantity, price and time in force can be constrained on entry. Whereas, within fixed income, broadly speaking, bond algorithms cover two capabilities, pricing, and risk-management:

1. At its core, pricing algorithms decide on the liquidity that is provided to clients; the liquidity factors the algorithms need to determine does vary depending on the market structure, but may include, bid/offer spread, size, refresh-rates, and other factors as applicable. Furthermore, in certain business contexts, additional commercial constraints or factors may have to be considered.

2. 'Risk management' algorithms are concerned with analysing the portfolios in real-time and constraining either positions or risk-factors to within pre-defined limits. Usually, risk management algorithms have access to venues and/or exchanges which provides the algorithms with the possibility to execute trades to manage risk proactively.

3. Pricing and risk management algorithms tend to operate in unison because the current position and risk exposures are inputs into the pricing algorithms, e.g. pricing algorithms adjust ('skew') prices as a function of current position in an attempt to attract position / risk offsetting trades.

As the above demonstrates, AFME members emphasise that there are different risk profiles for different types of algorithms and algorithmic trading strategies employed by different asset classes. As a further example, RFQ style trading has an even lower risk profile than automated execution processes. Thus, the design, testing and controls for algorithms must be aligned to the operation and risk profile of the relevant algorithm and regulation must allow for this.

Q16: Do you think there should be specific requirements for different type of algorithms or algorithmic trading strategies in RTS 6? Please explain.

AFME members do not believe that RTS 6 should outline specific requirements for different types of algorithms or algorithmic trading strategies. RTS 6 should remain principle based to ensure all algorithms are captured and treated in a fair, consistent, and proportionate manner.

Therefore, we call for a principles-based approach for conformance testing. A more principles-based approach to conformance testing that takes into account different types of firms' infrastructure would lead to better more proportionate and consistent outcomes.

By way of background, the majority of differences between individual EU trading venues for a specific asset class lie in the messaging protocols used by the venues to transmit market data and receive orders. In reality, trading algorithms used by AFME members rarely deal with these protocol differences directly: These tasks are performed by dedicated infrastructure which "normalises" the differences in venue-protocols and presents the trading algorithm with a common interface to all venues. Naturally, such pieces of exchange-facing infrastructure must be tested thoroughly against each individual market that they interact with. However, conformance testing a change to a venue-agnostic trading algorithm that has no direct connectivity to a venue provides little benefit and promotes a box ticking culture in which the testers' attention is diverted from exercising reasonable discretion as to how to eliminate risk efficiently.

By way of example, a change to a scheduling algorithm (e.g. for a time weighted average price) that can send an order to a smart order router (which selects the venue) that then utilises a market access gateway to correctly form an order message to the venue has to be conformance tested with the venue However, AFME believes that conformance testing of the scheduling algorithm does not make sense, given that the scheduling algorithm has no direct interaction with the market and sends orders to two other components of the infrastructure that have not changed. Other forms of testing (e.g. behavioural testing) would still be relevant to the scheduling algorithm but conformance testing is not.

We recognise that there are investment firms that operate proprietary trading algorithms with a simpler infrastructure (e.g. for latency reasons) and as such will often either connect the algorithm to market access and market data gateways, or even have the algorithm connect to the trading venue directly. We agree that conformance testing continues to be relevant to these algorithms.

Q17: What is your experience with testing environments? Are they used frequently? If not, why? Do you see a need for any improvements?

As per AFME's response to Q15, many of the variables that contribute to the testing of an algorithm, including the scenario, stress conditions and environment in which algorithms are tested, depend on the nature and technical implementation of each algorithm.

Firms have developed their own set of behavioural and stress testing environments which have been calibrated to the nature and operations of their algorithms and as such these arrangements will vary from firm to firm.

Stress testing of algorithms should be reviewed and not prescribed at a mandatory level based on the last 6 months trading. Stress testing should allow for firms to choose realistic scenarios. Recent market events such as COVID volatility in Q1 2020 are illustrative for this purpose.

AFME members also challenge the need to run conformance testing of algorithms with trading venues where such algorithms do not directly connect to the venue but uses a trading gateway or a DEA provision (see our response to Q16 above). In such a case, testing should cover the connectivity to the gateway or DEA provider and only where relevant, i.e., where the gateway/DEA provider and, or the algorithm undergoes material change likely to impact such connectivity.

Testing environments provided by exchanges are mostly fit for the purpose of testing trading gateways and direct connectivity to exchange but would rarely be able to meet the requirements, design, functional scope required to cater for all type of businesses and algorithms. Requiring exchanges to provide a testing platform able to address all users' requirements would not only be expensive to deploy but unlikely to achieve the desired outcome. In order to test algorithms behaviour, often it requires the simulation of several venues and data sources at the same time. The behavioural testing of algorithms is best left to the sole responsibility of the investment firm.

Nevertheless, AFME members consider that some improvements could be made to the existing testing facilities of European venues. Members note that some trading venues within Europe already provide test symbols within their production environment, this enables Firms to use such test dummy symbols to trade in actual production without effecting any transactions. The inclusion of dummy instruments within the testing environment allows for firms to run critical start of day checks as well as providing firms with the means to deploy material changes to the production environment in a very secure way. We would be very supportive to see such initiatives deployed wider in Europe and do not believe it presents any risk to orderly markets.

Q18: Do you agree that the definition of "disorderly trading conditions" should be clarified? If yes, how would you define such trading conditions?

AFME members reiterate that the original reasons for deleting the definition of RTS 6 still stands. Furthermore, AFME members highlight that over the last year the industry has experienced one of its most volatile markets given the impact of the Covid-19 crisis on the industry. Nevertheless, under such conditions and notwithstanding the lack of clarification concerning the definition of "disorderly trading conditions" investment firms' infrastructure and algorithms and controls have functioned well, with no disorderly trading experienced. Thus, AFME and its members do not feel there is any justification for defining disorderly trading conditions. We also note the concerns we identified in our response to Q1 that the framework for algorithmic trading at present is heavily skewed towards the trading of equity instruments. Attempting to formulate a definition that will be able to account for the differences in trading modes and market structure in all asset classes would not be possible. The status quo requires firms to ensure that they take into account the risks that arise in the markets they trade in and design appropriate tests for them.

Instead, AFME encourages ESMA to require venues to improve the tools available to firms, in particular the test symbols in production, which could contribute to market participants having a better testing system in place.

Q19: Do you agree that ESMA should provide additional guidance on the expectations concerning the checks and testing to be done, in particular for testing on disorderly trading conditions?

AFME members consider that the development of such guidance would be very complex and unlikely to provide material benefits/insights to prevent disorderly markets, further information on this point can be found in our responses to Q17 and Q18. Focusing behavioural testing in particular to detect whether the tested algorithm contributes to the amplification of market movements, as noted in paragraph 116, is unworkable. This would require the design of a fully simulated market and in this area, AFME would emphasise that firms are highly dependent on trading venues to provide them with the appropriate tools and testing environment. Such a simulation would require massive resources and assumptions to build and run– the output of such testing is unlikely to be of value in terms of achieving the shared objectives of ESMA and market participants.

Q20: Would you agree that it could be beneficial if ESMA develops a prescribed format for the self-assessment foreseen in Article 9 of RTS 6?

On reviewing paragraph 119 – 124 on the self-assessment process outlined in this consultation paper, AFME members question whether this proposal is a request representative of the majority of EU NCAs. As paragraph 120 states that "a minority of NCAs currently request this self-assessment for review". This suggests there is no real issue with the current process. As a result, we recommend that ESMA undertake a full cost-benefit analysis to examine the extent of this proposal before continuing.

Furthermore, any self-assessment will have to take into account the nature, scale, and complexity of a firm's business. AFME questions whether having a prescribed self-assessment form which every firm has to follow would allow for the level of assessment which enables a firm to adequately reflect the complexity and structure of their business.

Q21: Do you agree with the changes proposed to the self-assessment of Article 9 of RTS 6?

In addition to our comments in Q20, AFME members advise that a formal assessment should only be required every two years. It is also noted that the proposed changes concerning test environments may not serve a useful purpose but will likely add further complexity for reporting firms and NCAs.

Q22: Would you propose any other targeted legislative amendments to RTS 6? Please include a detailed explanation of the proposed amendment and of the underlying issue that this amendment would aim to tackle.

Other than those already stated within this response, AFME does not believe that any other targeted amendments are required to RTS 6.

Q23: Do you agree with ESMA's proposal to harmonise and create a clear structure for the performance of the self-assessment?

As this question is aimed at the trading venues, AFME will not provide comment but defer to trading venues to opine on ESMA's proposal.

Q24: Do you agree with limiting the self-assessment to every two years and to require trading venues to share it with their relevant NCA?

As this question is aimed at the trading venues, AFME will not provide comment but defer to trading venues to opine on ESMA's proposal.

Q25: Do you agree with ESMA's analysis about the overlapping requirements between RTS 6 and 7? Are those overlaps considered beneficial, should they be removed or are there any gaps? Are there any further points that should be clarified?

As per AFME's response to Q17, it is not the purpose nor the responsibility of the exchange to determine how an algorithm should be tested. Furthermore, the exchange does not possess the resources or the intricate knowledge to provide the means to test complex market wide scenarios. Investment firms have developed their own set of behavioural and stress testing environments which have been calibrated to account for the nature and operations of their algorithms. Even if exchanges were able to provide a platform to test the behaviour of algorithms it is unlikely such testing environment will cater for all types of business and the nuances of each algorithm. Instead, the testing environments provided by exchanges should be of high quality to allow for the conformance testing of application directly connecting to the exchanges matching engine.

Q26: What is your view with regards to the testing of algorithms requirements? Do you agree that more robust testing scenarios should be set?

AFME members continue to support testing of algorithms to ensure the efficient and orderly functioning of the markets. We reiterate that testing requirements should be aligned with the 'proportionality principle 'and be principles based. As set out in our answer to Q16. AFME members disagree with the requirement outlined in RTS 6 of MiFID II which requires firms to retest against the exchange when the configuration is of anon-structural modification that does not introduce a new order type, alter the technical format of the messages sent to the exchange meaning there is no impact in how the algorithm sends orders to the venue. Firms regularly introduce changes such as recalibration or adjustments in parameters that should not necessarily be tested for purposes of compliance with the venue provisions, as these changes have no bearing on the connectivity between the algorithm and the exchange, instead AFME members consider that it would be more advantageous to test between the trading gateway/DEA provider and the algorithms that may be required.

AFME members propose that testing requirements should be limited to instances where the firm has introduced material changes (e.g. functioning, substantial or structural changes to the algorithm). Excessive testing provisions and monitoring may prevent market makers from providing liquidity as every algorithm adjustment to market circumstances would require the deployment of onerous testing deployment. AFME notes that firms monitor the performance of their algorithms on a continuous basis after changes have been deployed, which seek to ensure suitability in their performance once changes have occurred.

In addition to the above, AFME members consider that it may be beneficial to set out principles as to the outcomes that testing should achieve. This would enable firms and trading venues to design their testing using scenarios that are relevant to the particular algorithm and market. This would also enable dynamic development of tests based on technological and other developments. Members surmise that concrete scenarios could quickly become outdated given technological advancements and this would leave firms obliged to undertake tests which are no longer pertinent.

Q27: Are the testing environments available for the testing of algorithms appropriate for this purpose?

To improve the current situation trading venues would have to provide firms and/or clients of firms access to a replica of the production environment, provide all order types and provide all the different technical details. Furthermore, AFME questions whether exchanges will be able to provide firms and/or firms clients with testing environments that will allow for the adequate and valid testing of algorithms given the continuous and rapid advances in digital technology that is occurring within the industry. AFME members consider that the testing of algorithms remains an internal practice because firms already recreate market conditions in their testing environment which is independent of the exchange

testing environment in order to cater for complex testing and regression scenarios. With firms monitoring the performance of their algorithms on a continuous basis, which seeks to ensure suitability in their performance.

Q28: Do you agree with ESMA's analysis that the circuit breaker mechanism achieved its objective to avoid significant disruptions to the orderliness of trading?

Members observations of the effectiveness of circuit breakers does not align with ESMA's findings. Members stress that the specification, calibration, and transparency of such circuit breakers is critical and further improvement is required.

Q29: Do you agree that the requirements under Article 48(5) of MiFID II complemented by RTS 7 and the guidelines on the calibration of circuit breakers and publication of trading halts under MiFID II remain appropriate? If not, what regulatory changes do you deem necessary?

We believe that the calibration of circuit breakers would benefit with further member consultation. We re-iterate our concerns raised in Q50 about critical changes made to trading venue operations not being subject to comprehensive input from member firms (or where member concerns are raised, insufficient weight being given to those concerns) and suggest that greater regulatory scrutiny should be applied to the processes venues use when updating their rulebooks and procedures.

Specifically, with respect to Article 48(5), an obligation should be inserted for venues to provide additional information on the operation of circuit breakers to their members. While we agree that their design is something for the venue to determine, that does not prevent venues from providing information about their operation. Specifically, venues should be obliged to provide information that allows firms to implement logic to electronically recognise and respond to trading halts, the entry into the volatility auction, the end of the volatility auction and the resumption of trading (including the timings and triggers between each step). Circuit breaker mechanisms, and the process/timing for resumption of trading should be deterministic, with human discretion (whether to interrupt or resume trading) being relied upon only in extreme circumstances, and in such circumstances to be supported with an obligation to ensure proactive communication to all members.

ESMA should work with major venues active in main EU indices (for example. EURO STOXX 50) to ensure prompt re-opening of markets post-event. This would ensure adequate liquidity in accessing each component of the index.

Moreover, in terms of index calculation, it would be appropriate to assess the possibility of including all markets that trade those instruments with non-negligible volumes to ensure continuity of trading. The goal would be to end the sole dependence on a single market, especially when there is an alternative.

Though not part of the consultation, we think that additional consideration should be given to improving the operation of Article 48(4) on the systems and procedures that trading venues have to reject orders. An additional provision should be inserted that requires venues to cancel orders on the order book in certain instances (e.g. for orders remaining on the order book where there has been a corporate action, such as a stock split or consolidation).

Q30: Do you agree that the co-location services and fees structures are fair and non-discriminatory? Please elaborate.

AFME member firms have not reported any material concerns in either of these areas. While no specific concerns are raised about trading fees (an area in which there is effective competition), AFME would like to reiterate its longstanding concerns about the costs of market data (where there is no effective competition).

Q31: Do you think that the disclosures under RTS 10 made by the trading venues are sufficient or should they be harmonised among the different entities? Please explain.

AFME member firms have not reported any material concerns about trading venue disclosures for trading fees.

Q32: Do you agree with ESMA's proposal to set out the maximum OTR ratio, calibrated per asset class?

Members consider the regulation of Order-Transaction-Ratios to be counter-productive to the stated regulatory intention of increasing liquidity and market efficiency. Both trading venues and market-makers cannot manufacture transactions at a specified rate, a transaction requires two parties to agree. Price transparency improves when a larger number of products have tighter bid-ask markets. Liquidity, as measured by the cost per unit of transaction, increases when the bid-ask spread decreases. A reduction in mandated order-to-transaction ratio has certain direct impact on the market meaning market-makers must reduce the number of orders they send, since this is the only quantity they can control. For a market-maker to reduce the number of orders while ensuring orders are economically viable, the market-maker must increase the bid-offer spread between those orders. Therefore, any limitation on OTR is destructive to a tight, liquid, efficient, transparent market.

AFME members consider that it should be left to the venue to decide how to deal with excessive OTRs (which may include throttling rates or fees). Venue operators are under an obligation to achieve a balance with liquidity and investor protection thus it would be difficult for ESMA to achieve this with a standardised OTR.

Q33: Do you agree that the maximum limits are not frequently exceeded? Please explain any potential underlying issues in this respect that should be recognised.

From the experience of AFME members, we agree that the maximum limits do not appear to be frequently exceeded, indicating that venues have used their discretion to set them at appropriate levels for their relevant markets. Since the implementation of MiFID II, the OTR has been a driver for firms to adjust the way they trade and become more pragmatic concerning the operation of trade messaging. In that regard, it is important to permit venues to exercise their judgement in setting them.

Q34: Do you agree with the consequences as described of exceeding the maximum limits or should there be a more convergent approach? Please provide any comment or suggestion regarding the procedures in place by trading venues in case of a member exceeding the prescribed limit.

AFME members state that the use of fees is an efficient consequence employed by trading venues in the event that a member exceeds the prescribed limit.

Q35: Do you agree with the need to improve the notification process in case of IT incidents and system outages? Beyond the notification process between NCAs and ESMA, which improvements could be done regarding communication of incidents to the public?

There is a significant need to improve the notification process surrounding exchange outages which can be ad hoc, inconsistent and incomplete. Improvements should give consideration to the following:

- Outage communication channels should be agreed up front and procedures then followed during an outage
- Any communications should be made in a clear and timely manner with updates ideally available real time via group conference call or website functionalities. Exchanges must appoint a designated senior individual who will be accountable for communication to participants in the event of an outage
- Historic outages have shown that switchboards and websites designed to help manage communication with members often have insufficient capacity which can exacerbate the situation and frustration felt by firms. Open conference calls as described below can therefore be a good way of allowing for large numbers of firms to communicate in a timely way and help find swift resolution to problems

- **"Incident Line" (Conference call):**
    - AFME believes that exchanges should support open conference call lines during an outage into which all members can dial-in and the venue can provide periodic updates. Members could share their experience of

the system to aid diagnosis of the issue and increase confidence that the decision to reopen is not premature.
    - This "multi-cast" approach is preferable to sequential bilateral conversations and should be established as standard procedure even if venues have a preference for written communications.
    - Utilising bilateral telephone conversations to communicate to clients will inevitably be out of sync as they can only happen sequentially in an environment where understanding of the situation is constantly evolving.
    - Exchanges must have an automated process/capability to reliably generate confirmed lists of trades/cancellations in formats required by participants and CCPs.

- **Reopening of the market:**
    - Given the growing focus of building in resilience into the marketplace and ability to trade on alternative venues in an outage situation, it is important that the primary markets follow a clear and pre-agreed process when re-opening the market allowing participants time to respond in a way that does not create any undue operational risk.
    - The market is currently working on a suggested approach to outage management that will include thoughts around the timings for market reopening. Current suggestions for improvement include a minimum time between announcement of an outage and the possibility of the market reopening in addition to a minimum time between a market reopening notice and then the actual reopen
    - Outage management and all of the scenarios that need to be considered is a complex process and would warrant a wider consultation process of its own. Industry discussions continue and AFME looks forward to engaging with ESMA further on this important topic

- **Maintenance:**
    - Venues should work with members to maintain contact details and appropriate methods of communication, including website updates and group email alerts.

Q36: Do you believe any initiative should be put forward to ensure there is more continuity on trading in case of an outage on the main market, e.g. by requiring algo traders to use more than one reference data point?

AFME believes it is important that the market addresses the current situation whereby essentially all trading stops in the event of a primary market outage. Ideally, the market will be able to develop a solution with the assistance of regulators where needed to ensure a robust process is put in place.

One area where the market will not be able to arrive at an adhered to standard is "minimum outage time", and this is therefore worthy of early regulatory intervention. While it is initially counterintuitive to ask for a market to be forced to be down for longer than might otherwise be required, every venue is commercially incentivised to minimise the duration of an outage and often this leads to a market reopening too soon.

A lot of the dislocation of markets caused by outages is brought about by participants standby behaviour, eagerly hoping that the outage is indeed of a very short duration. However, such "flickers" of the market are in many ways worse than a more material outage because of the subjectivity involved in making estimates of how quickly the market may come back.

Even more damaging is the natural eagerness of a venue to be back just as quickly as is feasible, as that has often been far sooner than would have been prudent. Thus, one outage can lead to another or to a market malfunctioning after reopening but in a way not quite bad enough to force another closure, but certainly damaging to the interests of some members and their clients. It is preferable that the venue take the time to ensure systems are operating normally and to give market participants a clearly defined minimum outage time, during which communications channels can be monitored and as described above, used to further establish the prudence of a reopening decision.

We further propose the removal or amendment of Article 15(2), RTS 7 which refers to exchanges' requirement to "*ensure that trading can be resumed **within or close to two hours** of a disruptive incident*". This is counterproductive as it creates an

incentive to resume trading at an arbitrary point in time even if there are still system issues. It is also ignoring the nature of outages which dictate that a venue will be unable to control whether it can resume orderly trading within that timeframe.

Our suggestions for moving forward in this area are as follows:

- **Medium term solutions for outages:**
  - Regulators should propose a consultation process that involves buy-side, sell side, trading venues and market data providers. This process should consider amendments to other directives (where relevant) rather than MiFID alone as well as what is appropriate for regulatory intervention versus what can be achieved by the industry adopting protocols.
  - The involvement of buy-side organisations is critical as their willingness to trade during an outage can determine how much activity can migrate to other venues. Their willingness to migrate may be determined or encouraged by market data providers' (such as equity index publishers) ability to utilise non-primary venue prices.

- **Short term solutions for outages:**
  - In terms of this consultation paper, we think that there are four critical first steps that can be taken:

  - 1) As described in Q35, requiring trading venues to adopt robust, predictable venue outage communication protocols. These should include timely automated information about what trades the venue considers concluded and which are cancelled.
  - 2) Removing or amending the requirement in Article 15(2) in RTS 7.
  - 3) As described in Q35, requiring venues to adopt minimum notice times before recommencing trading to allow any alternative trading processes that have initiated to complete. Venues should also be required to ascertain venue participants' ability to resume trading through the incident line (e.g. in the last 10-15 minutes before scheduled resumption) before actually resuming trading. The effectiveness of these time frames (and the impact they have had on the ability to migrate volumes) can be reviewed and updated during the wider consultation process.
  - 4)Reviewing and updating regulatory provisions as regards reference prices. We have set out more detailed proposals below

- **Proposed regulatory changes for reference prices:**
  - Certain changes introduced by MiFID II have increased the likelihood that trading will not migrate to other venues where the "main" market (i.e. the market where the instrument is admitted to trading) is not operating. These concentrate financial markets' reliance on individual venues (exacerbating or contributing to disorderly markets), inhibit investors' ability to manage their investments and prevent the migration of activity to other markets (where it could safely otherwise take place in an orderly manner).
  - We believe that the definition of the most relevant market in terms of liquidity (Article 4, RTS 1) should be amended and its use reviewed. This definition is important as it currently drives the reference price for the reference price waiver, provides a reference price for SI quoting (Article 10 RTS 1) and is relied on for the material market definition to determine the venue that communicates announcements on trading halts (Article 1 RTS 12).
  - In calculating the most relevant market in terms of liquidity, the opening and closing auction turnover should be excluded from the calculation (as are other forms of trading such as negotiated and large in scale transactions). These are quasi monopolistic trading phases which do not take place on other venues and so decrease the likelihood that a market other than the main market will be the most relevant market. It prevents like-for-like comparison of the continuous trading phase (that happens on multiple markets).
  - There is no reason that reference price waiver (Art 4(1)(a) of MiFIR) should rely on the most relevant market in terms of liquidity. Such reliance increases dependencies in the market and prevents the orderly migration of trading. It should revert to a definition similar to the one that existed in MiFID I (e.g. a price that is "widely published and is regarded generally by market participants as a reliable reference price")
  - SIs should be able to formulate their quotes on the basis of prices other than that most relevant market where that market is not in operation. An amendment should be made to Article 10 of RTS 1 to permit this (e.g. by adding "unless the most relevant market in terms of liquidity is not operating or not operating in an

orderly fashion, in which cases the SI may use other reference prices that it determines reflect prevailing market conditions").

Q37: Do you agree with the view that the tick size regime had overall a positive effect on market depth and transaction costs?

AFME remains concerned by the application of changes to the tick size regime under the Investment Firm Review which have resulted in both trading venues and SIs being unable to execute at the mid-point. We note that the original intention of the tick size regime was to ensure that orderly and transparent trading takes place on trading venues through promoting effective formation of prices on displayed order books while also maintaining a reasonable depth of liquidity and allowing spreads to fluctuate appropriately.

We strongly believe that for trades of all sizes, mid-point should be a valid execution price and that firms should be able to trade at half tick, regardless of whether the activity takes place on a trading venue or SI. This allows for a fair execution price between counterparties and avoids scenarios where trading venues or SIs are forced to preference one side of the trade.

We note that that Europe is a global outlier in preventing execution at mid-point, putting EU firms at a distinct disadvantage when seeking to access European markets and ultimately undermining EU competitiveness.

Q38: Is there any further issue you would like to highlight regarding tick size regime?

Please refer to AFME's response to Q37.

Q39: Do you agree with the proposal not to amend the tick size regime for third country shares? Please explain.

Since its introduction, AFME members have not reported any material issues with respect to the tick size regime for third country shares. However, given the preponderance of pan-EU share trading previously being concentrated in the UK, we suspect the FCA would have had a role in ensuring third country liquidity was reflected in the EU's data for a number of shares. Post Brexit, the shares for which FCA would have been responsible for will likely shift to other NCAs (and perhaps be spread among a handful that supervise MTFs that trade non-EEA shares). Given NCAs are able, but not required, to update EU data with third country liquidity, we would urge the newly responsible NCAs to focus on this area and ensure the data is, in fact, updated. Not doing so, or any delays in so doing, may cause liquid securities to suddenly have an inappropriate tick size causing disorderly trading conditions and/or a shift of liquidity away from EU MTFs to third country primary markets (where the share will continue to have the 'right' tick size).

Q40: Do you agree with the proposal to widen the scope of the tick size regime to all ETFs? Would this pose challenges in your view? Please explain.

AFME members suggest that a cost-benefit analysis be undertaken to ensure that extending the scope of the tick size regime to all ETFs does not have unintended consequences. Sufficient analysis has not yet taken place for AFME to opine on this proposal. However, our initial impressions are that the extension of the tick size regime to all ETFs could be problematic for ETFs whereby the underlying instruments are non-cash instruments, non-equity instruments including cash bonds and non-equity illiquid instruments. Due to time constraints, AFME has been unable to undertake a cost-benefit analysis.

Q41: Do you agree with the proposal not to widen the scope of the tick size regime to non-equity instruments? Please explain.

AFME members fully support ESMA's proposal not to widen the scope of the tick size regime to non-equity instruments. AFME members agree that a tick size regime for non-equity instruments is not appropriate.

Q42: Do you agree with ESMA findings and assessment of the current MiFID II market making regime?

AFME members do not believe that the current provisions of the market making regime, or the suggested amendments to improve liquidity are productive.

Q43: What do you think of ESMA proposals and suggested amendments to RTS 8? In your view, what other aspects of the market making regime require to be amended and how?

The regulation has the stated intention of increasing the resilience of liquidity, but the requirements have the opposite effect by reducing liquidity and the number of liquidity providers. Members suggest that commercial incentive should be aligned to ensure fair and equal treatment of market makers by venues.

Regarding incentives to improve liquidity in Stressed or Disorderly Markets. Participation in stressed and disorderly markets will invariably produce poor market risk for the market-makers. There is no amount of fee incentive that will induce market-makers to take on "bad" market risk, because the losses due to market risks are many orders of magnitude larger than fee incentives. Therefore, the focus of regulation should be to 1) minimise the occurrence of stressed and disorderly markets, 3) recognise that can be accomplished by having the largest and most diverse pool of market-makers participating in a product, 4) recognise that RTS 8 Article 1 is contrary to these objectives as are all highly-prescriptive limitations on electronic and high-frequency trading activity, such as order-to-trade ratio requirements, from which market-makers should certainly be exempt.

Q44: What are market participants views regarding the flexibility left in the MiFID II market making regime? Would you agree with ESMA further clarifying certain relevant concepts? If yes, which ones?

As per our response in Q5, AFME and its members are open to further discussing and assisting ESMA with the concept and definition of market making if required.

Q45: Could you please describe how Primary Dealers agreements are designed (number of designated Primary Dealers, transparency about investment firms having signed such agreements, typical obligations contained, etc…). Do you consider that Primary Dealers should be exempted from the Article 1 of RTS 8? Do you consider that this can introduce a regulatory loophole?

AFME welcomes ESMA's proposal to exempt Primary Dealers (PD) from the MiFID II Market Making (MM) agreement requirements for each trading venue (TV) on which they are active. AFME members do not envisage any specific loophole that could arise from such an exemption. As a result, AFME members consider whether it may be more appropriate to exempt the EU government bond asset class, rather than exempting primary dealers.

Primary Dealers (PDs) in EU government bond markets have obligations defined in agreements with specific DMOs. Those obligations are set to promote liquidity and transparency in the secondary markets and include quoting obligations in terms of:

- minimum duration of the quotation,
- maximum bid-offer spreads,
- minimum size to be displayed.

PDs, as per their primary dealer agreements with DMOs are free to fulfil their quoting obligations on one eligible trading venue. Since 2018, the MiFID II Market Making requirements (which were defined for Equities markets), forced PDs in EU government bonds to fulfil MM obligations on each trading venue on which they are active, this has led to:

- Confusion for PDs between MiFID II MM obligations, trading venue (TV) rules and DMO obligations, as also reflected by ESMA under paragraph 306 of this consultation paper

- Additional and unnecessary risk exposure and management for PDs to maintain liquidity and transparency; and
- additional, burdensome, and unnecessary regulatory obligations, MM agreements and supervision by trading venues and NCAs.

AFME members state that Primary Dealers should be free to fulfil their obligation of liquidity and transparency on any specific TV, and act as any other investment firm / liquidity taker on other TVs.

AFME's Fixed Income Division considers that the regulatory requirements outlined in MiFID II for market making agreements were primarily drafted for Equities markets and were not aimed at other asset classes such as EU government bonds which already had an existing and proven framework to ensure liquidity and transparency, based on DMOs requirements and monitoring on one side, and free competition between investment firms on the other side. The current set-up represents of DMOs PD agreements and MiFID II MM agreements represent an unnecessary burden.

Therefore, AFME welcomes ESMA proposal to exempt PDs from the MiFID II MM agreement requirements for each TV on which they are active. To be very specific and related to ESMA paragraph 309 which is referring to "designated platforms", the exemption would need to be valid on ANY TV, not only on the TV on which the PD has chosen to fulfil its obligation. For example, assuming a PD is fulfilling its PD obligations on one Trading Venue this PD should not be forced to be a MiFID II Market Maker on another Trading Venue.

Brief Description and key features of Primary Dealerships: EU Government Bond Markets

AFME encourages ESMA to review AFME's European Primary Dealer Handbook, for a comprehensive overview of the operation and functioning of the European Primary Dealer market and its secondary trading. 2

A brief summary is provided below, regarding the operation of primary dealerships in EU government bond market:

- Each primary dealer signs an agreement contract with each DMO which defines rights and obligations of the primary dealer vis-à-vis the DMO.

Whilst the rights, obligations and the auction procedures for each EU government bond market can vary the key characteristics are consistent and outlined below:

- Primary dealer obligations
  - Active participation to auctions in a competitive and transparent manner
  - Promoting liquidity and transparency to contribute to the efficiency of the secondary market (greater liquidity – minimised bid-offer spreads)
  - Quotation on electronic markets – comparative ranking – in a manner that supports market liquidity (time, bid-offer spreads, quantities)
  - Transaction reporting to DMOs: Monthly European harmonized reports (trade by trade reporting: ISIN, size, counterparty type, geographical area of residence & trading system)
  - Advisory services and research activity to contribute to the management of the public debt
  - Organizational structure (admin, accounting & risk control) to ensure a robust control environment

- Primary dealers' rights
  - Non-competitive bids before and after the auction
  - Privileged access to information (borrowing needs, new issues, new financial instruments….)
  - Privileged access to syndications

- Auction procedures
  - Multi prices or single price auction systems depending on DMOs

[2] https://www.afme.eu/Portals/0/DispatchFeaturedImages/PD%20Handbook%20Updated%202019%202020.pdf

- Good market practice on regular meetings of PDs/DMOs ahead of auctions, announcements, auctions bidding, competitive and non-competitive bids, settlement

Q46: Do you think that venues which introduced asymmetric speedbumps provide enough information regarding the mechanism used? If not, what additional information would be useful to disclose to market participants?

Please refer to AFME's response to Q50.

Q47: Reflecting on those mechanisms which allow liquidity providers to provide quotes that can be filled only against retail order flow, do you think that such mechanisms are beneficial in terms of market quality? Is there any specific aspect that you think should be further taken into account, also considering the type of instruments traded? Please specify the venue of reference and the type of arrangement discussed.

Please refer to AFME's response to Q50.

Q48: Do you think that venues which introduce asymmetric speedbumps should set tighter market making requirements? Please explain why and how tight those new requirements should be.

Please refer to AFME's response to Q50.

Q49: Do you agree on the conclusion that speedbumps might not be a well-suited arrangement for equity markets? If yes, do you think that such arrangements for equities should be prohibited in Level 1? Please explain.

Please refer to AFME's response to Q50.

Q50: Do you think that the introduction and functioning of speedbumps should be further regulated? If yes, which specific requirements would you like to be included in EU legislation?

ESMA or regulators should not mandate whether or how speedbumps are introduced, and trading venues should be able to innovate in this area if they wish. However, noting that the introduction of any such mechanisms would amount to significant change in any one market, AFME believes that ESMA should take the opportunity to push for more robust and auditable consultation processes by venues when making such changes. In line with its management of conflicts of interest's obligations, a trading venue should be obligated to take into account all, rather than a narrow subset of, member firms' concerns as well as the overall health of the market, not just its own commercial objectives.

Although organisational requirements exist under Article 47 of MiFID for the management of conflicts of interest between the market and its owners and the sound functioning of the market, as users of these trading venues, AFME members have experienced many instances where venues have forced through changes that have been considered to be harmful to both its members and the orderly functioning of markets.

ESMA therefore should focus on bolstering the rules around management of conflicts of interest which will lead to better outcomes for the markets, including instances where speed bumps are introduced.

Similarly, AFME members share ESMA's concern that certain mechanisms, including order types that are limited to certain participants, can have detrimental effect on the order book. We do not believe that it is appropriate to have order types that are not available to all participants on a trading venue and believe that additional analysis is required as to whether mechanisms or order types that are not universally available to all participants are compliant with the conflicts of interest management rules in MiFID II.

Q51: Is there any specific issue you would like to highlight about speedbumps?

Please refer to AFME's response to Q50.

Q52: What are your views on the relative timing of private fill confirmations and public trade messages? If you are a trading venue, please provide in your answer an explanation of the model you have in place.

In reviewing section 6.4 of this CP, AFME members consider that ESMA is assuming a number of conclusions in relation to the asymmetry of private fill confirmations and public trade messages. Our understanding is that ESMA considers that when a firm receives a private confirmation that a trade has been filled this means the transaction was concluded on a venue and that a public trade message/feed is published very shortly after. AFME members are concerned that ESMA considers such asymmetry of information directly contributes to a range of risks, particularly in relation to market abuse.

AFME members observe that a number of statements made by ESMA in paragraph 367 (pg. 94) of this CP such as the third bullet point which reads **"there** ***are examples of triggering trades that are smaller than the reaction to the private fill confirmation. This would demonstrate that the orders and positions taken are based on the private fill confirmation and are therefore not intended to manage risk but to take risk. For such trigger trades there may in particular be benefits in case of iceberg orders"*** lacks empirical evidence to support such positions.

AFME members highlight that if investment firms and clients do not receive confirmation of their trades before the market, firms will be put at a significant disadvantage in terms of being able to adequately manage their risk prior to the market reacting. There could also be unintended consequences for clients that do not use HFT mechanisms, as HFT market participants would in effect receive information about a client's market position prior the client receiving such information.

A delayed private feed providing trade confirmation to the trading counterparties disadvantages the participants actively contributing to price formation due to being part of a trade. It preferences other participants (esp HFT) by providing them with an ability to react faster without needing to commit capital to a trade. Non-contributing participants will gain the information and will be able to react on it faster than the active trading participants who need to await confirmation on whether it is their trade or not.

Members also consider that there are a number of architectural issues concerning the simultaneous publication of feeds. Many members have their own set-ups concerning direct connections on which they trade and receive notifications that a trade has an occurred. Furthermore, members consider that the likelihood of firms securing an advantage over the timing of the private fill confirmation ahead of the public trade message is miniscule as this would require firms to perfectly match public feeds with the firms internal processing mechanisms.

AFME members suggest further research including a cost benefit analysis is undertaken and the results shared with the market before any further consideration is given to publishing private and public post-trade feeds simultaneously. Members would also encourage to ESMA provide from their macro experience further analysis pertaining to any differences they have observed between markets that publish a public feed first compared to those markets that publish a private feed first.

Q53: Do you consider information on the sequencing of these two feeds at trading venues to be easily available? If you are a trading venue, please provide a link to where this information can be found publicly.

AFME members do not consider that the information on the sequencing of the private and public feeds is easily available from trading venues.

Q54: Do you think there should be any legislative amendments or policy measures in respect of these feed dynamics?

As mentioned in our response to Q52 AFME members seek further clarity as to what ESMA is trying to solve for. We also refer ESMA to our previous comments in Q52 regarding the negative impact to participants actively contributing to price formation, of a delayed private feed. However, AFME members do agree that it would be beneficial to the market if there was harmonisation across the market as to which feeds are published first.