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Finance for Europe

**Association for Financial Markets in Europe**

# Discussion Paper Response

## FCA PS24/14: Chapter 9 on the future of the SI regime

Date: 10 January 2025

**Question Responses**

| No | Question |
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| **1** | Do you think the current transparency regime for SIs is effectively contributing to the price formation process for equities? Please explain your answer. |

**Response**

**In the context of Equities**, AFME believes that the systematic internaliser framework continues to be an important regulatory construct. It serves the rightful delineation in the trading venue perimeter for bilateral, systematic, frequent trading as distinct from multilateral on-venue trading. Our analysis shows that bank SIs represent ~70% of addressable reported SI liquidity on a pan-European basis[1], providing valuable and bespoke liquidity to investors that is complementary to the mechanisms provided by trading venues. Our members and their clients consistently find that the provision of this risk capital can offer improved execution performance, limiting market impact when seeking to trade institutional orders.

AFME members recognise the importance of having a robust price formation process for the UK equity markets that emanates from effective pre and post trade transparency, news, market sentiment, earnings and other issuer information disclosed under issuers' continuous disclosure obligations, amongst other factors. Clearly the UK market is now a fragmented one following the implementation of MiFID I and II and the focus on the creation of a consolidated tape will enhance market user ability to easily obtain both pre and post trade data. In terms of SIs' contribution to price formation, most value to price discovery is currently generated through post trade transparency, which contributes price and volume information on actual sizes transacted when compared with quotes. Bank SIs are committing capital on a regular basis across the size spectrum including larger sizes, providing important price information to the market.

AFME members acknowledge that there may be ways that the existing SI pre trade transparency regime might be enhanced to improve its contribution to price discovery. Quoting obligations require SIs to provide quotes on a "regular and continuous basis during normal trading hours" and which must reflect "prevailing market conditions" (Articles 14 and 15 of UK MiFIR). Article 10 of UK RTS 1 clarifies that such quotes must be "close in price…to quotes of equivalent sizes … on the most relevant market in terms of liquidity". This generally ties SI quotes to prices on the primary market and the removal of this obligation could enable SI to present more meaningful prices. In addition, it would also enable such prices to continue to be provided when the most relevant market fails (e.g. because of an outage).

Once a quote has been made, and on receipt of an order that is lower than the standard market size for that share, SIs are generally bound to trade at their quoted price. This restricts firms' ability to price improve (unless at mid-point) and it would improve execution outcomes if firms were not restricted in this way.

Regarding transparency more broadly, we believe that the FCA has already made a marked improvement to the quality of OTC reporting with its removal of give-ups/ins and inter-affiliate risk transfers from the

[1] Rosenblatt/BigXYT

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| tape. It may be beneficial to consider further measures to review transparency obligations in other growing segments of the market (including trades that are brought on venue). Continuing the important work that the FCA has started to assess what activity should be on the tape and how it should be flagged enables market participants to have greater confidence in understanding available liquidity (rather than looking at lit continuous, which underrepresents the true size of the UK market). Better quality post-trade transparency will enable global investors to fully appreciate the traded volumes in UK names which we would expect to enhance investment and asset allocation into the region. |

| No | Question |
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| 2 | Are there specific changes that you think should be made to the threshold under which the pre-trade transparency regime applies to SIs and the minimum quote size for SIs? Please explain your answer. |
| **Response** | |
| We refer the FCA to comments on potential enhancements to the quoting regime made more broadly in our response to Question 1 above. In response to a recent ESMA consultation paper on equity transparency, which included a substantial section on SI quoting in the EU, AFME noted that the changes introduced by the MiFIR review would increase the relevant quoting and trading thresholds in the EU (noting that these do not exist in other jurisdictions). Responding to ESMA's proposals, AFME noted that, in the context of taking account of international best practices, the changes would disadvantage EU investment firms. If the FCA were to imitate the EU, AFME considers that UK firms would be at a similar disadvantage when compared to foreign jurisdictions. This would also mean that, like in the EU, UK investment firms would be limited in their capacity to offer improved prices to their clients in larger sized trades. | |

| No | Question |
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| 3 | Does the SI flag on post-trade transparency reports 'SINT' provide useful information? Please explain your answer. |
| **Response** | |
| **In terms of fixed income securities**, AFME members do not consider the SINT flag adds any value as from the perspective of participants there is no additional benefit in identifying trades undertaken by consistent providers of liquidity separately from those providing liquidity on an occasional basis. In addition, post-trade transparency is anonymous and not designed to identify the specific liquidity provider. On this basis AFME members strongly support using XOFF for all off venue trades for fixed income instruments.<br><br>**However, for equities** we believe, per our response to Question 1, that the SI regulatory construct continues to be valuable to market participants and denoting fills leveraging the SINT flag provides important transparency to clients. Since the meaningful introduction of the SI regime in Europe with MiFID II, market participants have become familiar with what getting an SI fill means and how this order will have been executed. SI post trade reports importantly contribute to price discovery and in an equities context the SINT flag allows participants to identify this liquidity within the market. Accordingly, we believe qualitatively similar activity should be regulated and reported under the same rules across Europe. Continuing to support this enhanced understanding of the nature of this unique form of liquidity is an important component of the UK equities markets. | |

| No | Question |
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| 4 | If firms trading bonds and derivatives OTC no longer had to identify themselves as SIs do you think there is a case for adding any new trade flags to post-trade reports to help identify addressable liquidity? If so, please explain your proposal for an additional flag. |

| Response |
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| AFME members note that maintaining the SI status for firms trading bonds and derivatives does not add any value. We are therefore supportive of an FCA approach where firms should no longer have to identify themselves as SIs for non-equity. Therefore, AFME members do not see any need to include an additional flag to identify consistent liquidity providers, this would require the FCA to undertake additional calibrations to determine what constitutes a 'consistent provider of liquidity' and the provision / analysis of data from AFME member firm. Both requirements would go against the aim of simplifying the regime. As further explained in our response to Question 3 above as regards fixed income securities, we think that XOFF is wholly sufficient for all off venue trades in this context. |

| No | Question |
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| 5 | What do you think might be the consequences if the restrictions in MAR 5.3.1A (3) no longer applied? Please explain your answer. |
| **Response** | |
| Removal of specific requirements for OTFs in MAR 5A.3.1 which refer to the applicability of the 2 restrictions regarding SI and OTF interaction is not anticipated to have any negative consequence, given that conflict of interest rules and market abuse surveillance procedures would continue to apply in the conduct of business and would cover both of the scenarios highlighted in paragraph 9.19 of PS24/14. | |

| No | Question |
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| 6 | If the restrictions in MAR 5.3.1A (3) no longer applied, would it be necessary to apply new limitations? |
| **Response** | |
| AFME note that the existing MiFID framework does not allow a trading venue to also operate as market maker and therefore we do not think that any new limitations should apply. Please also refer to MAR 5A.3.4 which provides that an OTF should not have close links with an investment firm which carries out market-making on an independent basis on that OTF as well as to our response to Question 5 above regarding current provisions in place for conflicts of interest and market abuse surveillance procedures. | |

| No | Question |
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| 7 | Do you think that the inclusion of 'SINT' in contract notes provides any meaningful information for retail clients? Please explain your answer. |
| **Response** | |
| **In the view of AFME Fixed Income members**, Article 59 reports are firm specific and sent directly to the client from the firm, as the result of a transaction. As a consequence, the client already knows the executing firm that has sent them the trade confirmation. Therefore, including the SINT code is superfluous information and, in our opinion, does not add any value to clients receiving this confirmation.<br><br>**AFME members that are equities SIs** generally have an institutional client base and accordingly have no comment on this matter. | |

| No | Question |
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| 8 | Do you think that there will be any implications for best execution if in respect of bonds and derivatives firms are no longer identified as SIs? |
| **Response** | |
| No. Most trades executed off venue are performed on an RFQ basis, the letter from the European Commission to the Committee of European Securities Regulations, as referenced in paragraph 9.26 in FCA | |

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| FS24/14, outlines that these types of trades are not considered in scope of best execution (irrespective of whether the executing firm is an SI or not), note point 7 (Pg. 5 of the letter) and point 8 second bullet which reads:<br><br>‘*Questions of market practice will help to determine whether it is legitimate for clients to rely on the firm. For example, in the wholesale OTC derivatives and bond markets buyers conventionally ‘shop around’ by approaching several dealers for a quote, and in these circumstances there is no expectation between the parties that the dealers chosen by the client will owe best execution.’*<br><br>Therefore, whether a firm is an SI or not when responding to an RFQ has no relevance to best execution information. |

| No | Question |
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| **9** | Do you think that SI users have access to adequate information to assess the role that SIs play in helping the clients to meet their best execution obligations? If not, how best do you think the information gap should be addressed? |
| **Response** | |
| **For fixed income**, as highlighted in our response to Question 8, a firm's status as an SI when responding to an RFQ is irrelevant to best execution information.<br><br>**For bank SIs trading equities**, we believe that clients have access to high quality information on how leveraging a given SI contributes to the provision of best execution. Bank SI liquidity will generally be accessed by that bank’s smart order router following the processes outlined in their respective best execution policies. Any such fills will then be marked as SINT post trade meaning that the client can perform post trade analytics on the quality of fill to complement the analytics provided by any given bank to ensure that execution quality is as expected.<br><br>Additionally, in consultation with the Investment Association, representing the buy side, AFME has jointly drafted an Equities Electronic Order Handling Questionnaire to address members’ clients’ informational needs. Buy-side firms can submit this questionnaire bilaterally to their sell-side counterparts to obtain information about the way in which their orders are handled via SI, including details of best execution. The Questionnaire is a long-standing tool used by market participants since 2015. It was last updated in March 2024. | |