esma European Securities and Markets Authority

Reply form

For the Consultation Paper (CP) on ESMA's Opinion on the trading venue perimeter

28 January 2022 | ESMA70-156-5287

Responding to this paper

ESMA invites comments on all matters in this paper and in particular on the specific questions. Comments are most helpful if they:

1. respond to the question stated;

2. indicate the specific question to which the comment relates;

3. contain a clear rationale; and

4. describe any alternatives ESMA should consider.

ESMA will consider all comments received by **29 April 2022**.

All contributions should be submitted online at www.esma.europa.eu under the heading 'Your input - Consultations'.

Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESMA's rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESMA's Board of Appeal and the European Ombudsman.

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Who should read this paper

This document will be of interest to all stakeholders involved in the securities markets. It is primarily of interest to competent authorities, investment firms and market operators that are subject to MiFID II and MiFIR. This paper is also important for trade associations and industry bodies, institutional and retail investors, their advisers, consumer groups, as well as any market participants because the MiFID II and MiFIR requirements concern the market structure of the EU and the perimeter of trading that should be considered as multilateral and regulated as such.

Q1 Do you agree with the interpretation of the definition of multilateral systems?

<ESMA_QUESTION_TVPM_1>

Bundesverband der Wertpapierfirmen (bwf) comment:

In some aspects we agree, in other aspects, we emphatically disagree with ESMA's interpretation of the definition of "multilateral systems".

Unlike in MiFID I, MiFID II Article 4(19) contains a distinct definition of a "multilateral system", which "means any system or facility in which multiple third-party buying and selling trading interests in financial instruments are **able to interact** *(emphasize added)* in the system". However, MiFID I contained definitions of trading venues, namely "regulated markets" and "multilateral trading facilities" (MTFs), which by definition are "multilateral" and are distinct from "bilateral" trading (cf. MiFID I, recital 6).

Whereby according to Article 4(14) of MiFID I a "'Regulated market" means a multilateral system operated and/or managed by a market operator, which **brings together or facilitates the bringing together** *(emphasize added)* of multiple third-party buying and selling interests in financial instruments - in the system and in accordance with its non-discretionary rules - in a way that results in a contract, in respect of the financial instruments admitted to trading under its rules and/or systems, and which is authorised and functions regularly and in accordance with the provisions of Title III."

And according to Article 4(15) of MiFID I a "'Multilateral trading facility (MTF)" means a multilateral system, operated by an investment firm or a market operator, which **brings together** *(emphasize added)* multiple third-party buying and selling interests in financial instruments - in the system and in accordance with non-discretionary rules - in a way that results in a contract in accordance with the provisions of Title II."

Therefore, while MiFID I does not contain an abstract definition of "multilateral systems", it defines two types of multilateral trading venues with the same level of detail as the abstract definition of "multilateral system" in MiFID II Article 4(19). However, to our understanding, the concept of "multilateral" under MiFID I was wider than under MiFID II, simply because "brings together or facilitates the bringing together" (MiFID I requirement) does not require that the trading interests which have been brought together "interact" (MiFID II requirement). Even though MiFID II does not further specify what is required by an "interaction" or in which way it shall be understood, we think it is clear that it goes beyond a simple collection or aggregation which would satisfy the requirement of "brings together".

However, also the requirement that trading interests need to be able to "interact" remains an indeterminate legal concept. In a more narrow sense it could require that trading interests need to be able to "match" (and thereby resulting in a "contract", while in a broader sense the contribution of information in a price formation process (in practice, orders collected in an order book) might be deemed sufficient.

In this context, we find it of rather limited benefit or even misleading that ESMA refers to the legal reasoning established in the Court of Justice of the European Union (CJEU) Case C-658/15 *(Robeco and others vs. AFM)* and concludes that "in the scope are also systems where only two trading interests interact, provided such trading interests are brought together under the rules of a third-party operator" (CP paragraph 24).

First of all, this case had to clarify a situation under the MiFID I regime and therefore is not directly applicable to MiFID II (we already mentioned that the concept of "multilateral" was narrowed under MiFID II). Second, the market model of facilitating the buying and selling of open end investment funds without any price formation based on the expressed buying and selling interests taking place is in no means representative for regulated markets and also MTF market models. However, in the result, the court ruling might have been justified because MiFID I required only the "bringing together" and not the "interaction" of trading interests.

Nevertheless, the opinion expressed by the Advocate General "that the involvement of a third party as an independent operator, in contrast to bilateral trading, shows in my view, that EFS is a multilateral system" (cf. ECLI:EU:C:2017:304, paragraph 92), which was – with minor adjustments – adopted in the judgement of the CJEU (ECLI:EU:C:2017:870, paragraph 34) and which now seems to become a core consideration of ESMA with respect to the definition of a "multilateral" system (cf. CP paragraph 24) is clearly to be rejected: In our view, it needs to be emphasised that in the context discussed here, the terms "bilateral" and "multilateral" can only have a meaningful interpretation with respect to the relationship among the contracting parties (buying and selling interests) which are "brought together" (MiFID I) respectively "interact" (MiFID II) within the "system" and it is completely irrelevant who "owns" or "operates" this system.

In this context, we would like to recall that the FCA's definition of multilateral trading (which was published pre Brexit as a clarification of the MiFID trading system/venue typology and which is still applied today) refers solely to the (mutual) interaction of trading interests without any reference to the legal entity which "owns" and technologically operates the "system":

"Any multilateral trading facility or an organised trading facility operated by the [UK RIE] must have **at least three materially active members or users who each have the opportunity to interact with all the others** (emphasis added) in respect of price formation" (cf. FCA handbook REC 2.16A (5),

URL: https://www.handbook.fca.org.uk/handbook/REC/2/16A.html).

And even if one would argue that the requirement of at least three parties which have at least the ability to mutually interact with "each other" is a necessary but not sufficient condition, it can hardly be interpreted in a different way but that the possibility of an "N-to-N" interaction is required at a minimum. Accordingly, "N x 1-to-1" can never be considered "multilateral", notwithstanding if there are any further requirements to be fulfilled (what we think is not the

case, even more since the definition, according to ESMA, shall be expressly “technologically neutral”)

Therefore, once again we strongly advocate the conviction that “bilateral” or “multilateral” has nothing to do with the question who is operating a system or a market (or whether there is an operator at all). ESMA itself supports this view insofar as it rightfully claims that the understanding of “system” is to be “technology-neutral” (cf. CP paragraphs 21, 39 & 46) and we are fully supportive of this view. E.g. even a very simple “open outcry” market without any further technology involved, would qualify as a “system” in this regards.

Accordingly, we also fully agree that the “set of rules” based on and in accordance with general legal provisions (either set by the operator or in the simplest form by mutual understanding resulting in an implied action among system/market participants) are paramount in the definition of “system” in a legal sense as stipulated by Article 4(19) of MiFID II (cf. CP paragraph 19). In fact, it is the “set of rules” applied, which is the point of reference in order to decide whether we are talking about “bilateral” or “multilateral”.

Consequently, we reject ESMA’s conclusion that a “single dealer system” to be understood “as a system where a single market is the counterpart to every trade in the system” (cf. CP, footnote 15) should be considered “multilateral” simply because the system is operated by someone other than the market maker (cf. CP paragraph 25, see also in more detail our answer to Q6).

However, it is equally important to emphasise that a trading system can be still be “multilateral” despite of the fact that a dedicated “single market maker/liquidity provider” (on an instrument by instrument basis) in practical terms (either because of market illiquidity constrains or in order to facilitate regulatory provisions, e.g. fast execution as a “best ex”-requirement) de facto becomes the counterparty of the vast majority of trades. Accordingly, as long as there is the functional opportunity and the legal possibility that any third party trading interests “match” within the system without the market maker’s/liquidity provider’s involvement, the system should be characterised as “multilateral”. In other words, “multilateral” to our understanding means a potential “N-to-N” relationship among trading interests/market participants, without prohibiting that in practice a market maker/liquidity provider fulfils a prominent role and becomes a counterpart in the majority of trades.

In so far we fully support ESMA’s view that the “criterion of trading interests being “able to interact” in the system (…) the system must allow not only the communication of the different trading interests but also that the members must be able to react to those trading interests, i.e. it should be possible to act upon those trading interests and match, arrange and/or negotiate on essential terms (being price, quantity) with a view to dealing in those financial instruments” (cf. CP paragraph 28). However, ESMA’s assessment seems to be inconsistent insofar, as this would not be the case for “single dealer systems” discussed before (and in more detail in our response to Q6), where dealing with a single counterpart is not only functional but also legally the only option, as well as in the fund trading system on which the above mentioned CJEU ruling (under MiFID I conditions) was based. However, it was

already mentioned that under MiFID I “bringing together”, which in a broad sense could be understood as the collection/aggregation of trading interests was a sufficient criteria for multilaterallity. (And just for the sake of completion, it should be noted that under the conditions of MiFID I, “bilateral” trading in form of systematic internalisation, was defined as a “trading venue” (cf. MiFID I 44(1)), while the concept was given up in MiFID II.)

At the same time, we strongly disagree with ESMA that “the conclusion of a contract is not a prerequisite for a firm to be required to request authorisation as a trading venue for the system or facility it operates” (cf. CP paragraph 28).

However, we think that this assumption might be simply based on a misunderstanding on ESMA’s side. It is, the “trading venue”, not the “multilateral system” as such which requires authorisation (the CP itself is titled “trading venue perimiter”). Therefore, it is also not the IT-company which provides a piece of software or the computer centre used by the trading venue but the legal entity of the trading venue itself, which needs to get authorised. The “multilateral system” as defined by MiFID II Article 4(19) is the technical backbone of a trading system and as such a necessary but not sufficient condition to constitute a “trading venue” (which as mentioned before under MiFID II needs always to be “multilateral”).

However, the fact that on a trading venues “contracts” are concluded, to our understanding, goes without saying, since there simply is no “trade” without a legally binding contract. And furthermore, only from the economic consequences resulting from a contract/trade regulatory concern could arise. This does not mean that the technical infrastructure of trading venues should not be subject to regulatory monitoring but only there, where a trading venue exists in the first place, which is logically unthinkable without “contracts” about buying and selling (financial instruments).

In this respect, we are in full accordance with our NCA BaFin, who states in its “Merkblatt für die Betreibung eines multilateralen Handelssystems” (“Information sheet for the operation of a multilateral trading facility”,

URL:
https://www.bafin.de/SharedDocs/Veroeffentlichungen/DE/Merkblatt/mb_091208_tatbestand_multilaterales_handelssystem.html):

“Es muss zu einem Vertragsabschluss kommen” (“A contract must be concluded”) - and the same must necessarily hold true of course for a regulated market.

Equally true but worthwhile to mention, not all aspects of the trade, in particular as clearing and settlement instructions are concerned, need to be specified in the original contract and can be arranged outside the scope of the trading venue (cf. ibid).

<ESMA_QUESTION_TVPM_1>

Q2 Are there any other relevant characteristics to a multilateral system that should be taken into consideration when assessing the trading venue authorisation perimeter?

<ESMA_QUESTION_TVPM_2>

Bundesverband der Wertpapierfirmen (bwf) comment:

As already mentioned in our answer to Q1, we think it is important to emphasise that any "trading venue" (in accordance with MiFID II provisions) employs a "multilateral system" as defined by MiFID II Article 4(19) but the trading venue, which requires authorisation is not fully characterised by this technical system alone. In particular, without contracts about the buy and sell of financial instruments being concluded, a "trading venue" would not be one simply because there are no "trades", which legally always require a binding contract.

Furthermore, in our view, a system can only be characterised as "multilateral" long as there is the functional opportunity and the legal possibility that the trading interests of all participants in the system can principally "match". In other words "multilateral" requires a potential "N-to-N" relationship among trading interests/market participants. – However, as mentioned before, it is not required that in practice the matching of trading interests and conclusion of contracts are equally distributed among participants in the system; therefore also in a "multilateral system" a market maker/liquidity provider might fulfil a prominent role and consequently become a counterpart in the majority of trades.

<ESMA_QUESTION_TVPM_2>

Q3 In your experience, is there any communication tool service that goes beyond providing information and allows trading to take place? If so, please describe the systems' characteristics.

<ESMA_QUESTION_TVPM_3>

Bundesverband der Wertpapierfirmen (bwf) comment:

While we would like to refrain from analysing existing "communication tools" available in today's markets in detail, we fully agree with ESMA's assessment and conclusion on recital 8 MiFIR in so far as "facilities where there is no genuine trade execution or arranging should not be required to seek authorisation as a trading venue. (And) therefore, if a platform simply provides pricing data or other tools used to make trading decisions, this is not sufficient to conclude that such platform should require authorisation as a trading venue" (cf. CP paragraph 44).

However, ESMA's following assumption that "there needs to be genuine interaction (for example by including a button, or by providing the ability to communicate) where the intention

to enter into a transaction can be confirmed between the users of such a platform in order for it to qualify it as a multilateral system" (cf: ibid), in our view remains somehow vague and insufficient. First, it must be remembered that it is not the system in its technological sense (nowadays usually a piece of software running on computer hardware) which requires authorisation but the "trading venue". In other words, only when the "system" is put in practice in a way that transactions in financial instruments are actually executed, "trading", which might require proper authorisation, takes place. Second – and equally important – only system designs which enable (respectively do not exclude) the possibility of an "N-to-N" interaction among multiple third party trading interests represented, should qualify as "multilateral" as a pre-requisite for the requirement of the operator to see authorisation for such a "trading venue" under the current MiFID II/MiFIR framework.

<ESMA_QUESTION_TVPM_3>

Q4 Are you aware of any EMS or OMS that, considering their functioning, should be subject to trading venue authorisation? If yes, please provide a description.

<ESMA_QUESTION_TVPM_4>

Bundesverband der Wertpapierfirmen (bwf) comment:

We fully agree with ESMA's assumption that "order management systems" ("OMS") which are intended to be structuring order flow, to help to easily follow up the life cycle of an order (cf. CP paragraph 49), to manage orders across multiple execution venues, to provide algorithmic support to traders, e.g. by slicing orders (cf. CP paragraph 51) and/or facilitate order execution by offering an overview of liquidity and prices on various venues and subsequently sending the orders to the preferred trading venue or trading venues for execution (cf. CP paragraph 52 – usually referred to as "smart order routing") should not be considered as multilateral systems since such EMS do not allow the interaction of multiple third party buying and selling interests and hence would not need to seek an authorisation as a trading venue (cf. CP paragraph 50 & 52).

However, ESMA considers that the situation would be different for "execution management systems" ("EMS"), "where the EMS sends orders for execution directly to specific counterparties instead of trading venues, and hence might be considered multilateral in nature and hence in scope of trading venue authorisation" (cf. CP paragraph 54). We think that such an assumption is fundamentally wrong, simply because the "N-to-N" relationship required as a pre-requisite to qualify a system as "multilateral" is missing. No matter to how many specific counterparties such an EMS is sending orders for execution, the resulting trades between the EMS operator and the specific counterparts (who are unable to interact with respect to the orders among themselves and usually do not even know orders are being send at the same time to various counterparties) remain "bilateral" in nature (as long as the order is not send to a trading venue, where the execution becomes "multilateral" as a result of the system of the

venue but not because of the EMS sending the order). Accordingly, as long as each trade is the result of a “1-to-1” relationship it remains “bilateral”. In other words “N x 1-to-1” does not change the bilateral nature of the trades, no matter how large “N” might be.

The wrong assumption that an EMS which sends orders for execution directly to specific counterparties instead of trading venues could be characterized as “multilateral” also becomes apparent when analysing Figure 2 where one of the counterparties is a “systematic internaliser” (“SI”) (cf. ibid). It is undisputed that trading between an SI and its clients always takes place on a bilateral basis (cf. CP paragraph 68: “The key characteristic of SIs is to deal in a bilateral manner”), a fundamental legal assessment which is not altered by the fact that on the side of the SI’s client a piece of software in form of an EMS is generating and sending the order which is then executed by the SI. Furthermore, the assessment that trading between an SI and its clients is always “bilateral” in nature is completely independent from any other trading activities with different counterparties the client might be involved in at the same time (by technical support of an EMS operated by the client or without).

The other way round, if an EMS which sends orders for execution directly to specific counterparties would have to be characterised as a “multilateral system”, the same would hold true for any market participant who is involved in multiple trading activities with different counterparties at the same time no matter how such activities are technically coordinated and facilitated since as we have learned – and we agree – the definition of “system” in ESMA’s understanding has to be “technology-neutral” (cf. CP paragraph 20). The absurd consequence would be that practically every investment firm or credit institution trading financial instruments would have to seek an authorisation as a “trading venue” accordingly.

<ESMA_QUESTION_TVPM_4>

Q5 Do you agree that Figure 4 as described illustrates the operation of a bilateral system operated by an investment firm that should not require authorisation as a trading venue?

<ESMA_QUESTION_TVPM_5>

Bundesverband der Wertpapierfirmen (bwf) comment:

Yes, we fully agree that Figure 4 illustrates a “bilateral” system, since “each client N can only interact with bank A which is also the operator of the system” (cf. CP paragraph 66).

The characterisation as “bilateral” is further independent from the question how many clients N interact with bank A and – in our view – whether bank A operates the “system” from a technological by itself or whether the technological administration is outsourced to an IT-service-provider.

We also agree that such a system design is typical for “systematic internalisers” (“SIs”) (cf. CP paragraph 68). Furthermore, even if Bank A would be able to initiate a request for quote to its clients (which ESMA rules out, even though it does not become apparent by the illustration in Figure 4), such a request by bank A – in our view – would not change the bilateral character of the system, even though it would not correspond to the typical business model of an SI.

<ESMA_QUESTION_TVPM_5>

Q6 Do you agree that a “single-dealer” system operator by a third party, as described in Figure 5, should be considered as a multilateral system? If not, please explain.

<ESMA_QUESTION_TVPM_6>

Bundesverband der Wertpapierfirmen (bwf) comment:

No, as already argued in our response to Q1 and throughout other questions within this CP, we are fully convinced that in the context discussed here, the terms “bilateral” and “multilateral” can only have a meaningful interpretation with respect to the relationship among the contracting parties (buying and selling interests) which are “brought together” (MiFID I) respectively “interact” (MiFID II) within the “system” and it is completely irrelevant who “owns” or technically “operates” this system.

It is neither in material/technological nor legal terms a sufficient justification for a system to be “multilateral” that it is “owned” and “operated” by a “neutral” party. This also applies to the “single dealer” system described in Figure 5, which we think is clearly “bilateral” in nature since all clients – just like in Figure 4 – can only trade with bank A (“N x 1-to-1” structure) and the “N-to-N” structure which characterizes a “multilateral” system does not result from the fact that the operator is independent with respect to the transactions concluded within the system.

Once again, (as already mentioned in our answer to Q1) it is worth remembering that the FCA’s definition of multilateral trading (which was published pre Brexit as a clarification of the MiFID trading system/venue typology and which is still applied today) refers solely to the (mutual) interaction of trading interests without any reference to the legal entity which “owns” and technologically operates the “system”:

“Any multilateral trading facility or an organised trading facility operated by the [UK RIE] must have **at least three materially active members or users who each have the opportunity to interact with all the others** (emphasis added) in respect of price formation” (cf. FCA handbook REC 2.16A (5),

URL: https://www.handbook.fca.org.uk/handbook/REC/2/16A.html).

And even if one would argue that the requirement of at least three parties which have at least the ability to mutually interact with “each other” is a necessary but not sufficient condition, it can hardly be interpreted in a different way but that the possibility of an “N-to-N” interaction is required at a minimum. Accordingly, “N x 1-to-1” can never be considered “multilateral”, notwithstanding if there are any further requirements to be fulfilled (what we think is not the case, even more since the definition, according to ESMA, shall be expressly “technologically neutral”)

We therefore emphatically reject ESMA's assumption (which seems to be influenced by the in our view misleading and false conclusion by the Advocate General and the CJEU in the case cited by ESMA above (cf. CP paragraph 24, ECLI:EU:C:2017:304, paragraph 92)) that “the bilateral structure of a system cannot refer only to the parties that agree on the transaction and disregard the operator of the trading system” (cf. CP paragraph 70).

In fact, if the use of an “independent” system would be a sufficient requirement to characterise a system as “multilateral”, every sales trading desk of an investment firm or credit institution in principle would be required to get an authorization as a trading venue under the “technology-neutral” (cf. CP paragraph 20) paradigm as soon as its traders are utilizing an “independent” phone company and/or internet service provider in order to facilitate/conclude transactions. And even though they would still be excluded in practice, because “general purpose communication systems” shall remain outside the scope (cf. CP paragraph 14), such an exemption would not be convincing from a regulatory perspective since the economic consequences for the “buying and selling interests” which interact are the same, no matter whether a trade is concluded by phone or by using a specifically developed more sophisticated peace of software.

It is a completely different question whether certain exiting bilateral trading structures might have reached a level of importance which would justify a higher level of regulatory monitoring and awareness beyond the exiting SI regime which could also result in a wider authorisation requirement and the possible (re)classification of bilateral systems as trading venues (cf. MiFID I 44(1) with respect to SIs). – However, this would be something for the legislator and not the regulator to decide and would require a change in the legal MiFID II/MiFIR framework.

<ESMA_QUESTION_TVPM_6>

Q7 Do you agree that systems pre-arranging transactions that are formalised on a trading venue, even when arranged in a multilateral way, should not be required to be authorised as trading venues? Do you agree with the justification for such approach?

<ESMA_QUESTION_TVPM_7>

Bundesverband der Wertpapierfirmen (bwf) has no comment on Q7.

<ESMA_QUESTION_TVPM_7>

Q8 Are there any other conditions that should apply to these pre-arranged systems?

<ESMA_QUESTION_TVPM_8>

Bundesverband der Wertpapierfirmen (bwf) has no comment on Q8.

<ESMA_QUESTION_TVPM_8>

Q9 Are there in your views any circumstances where it would not be possible for an executing trading venue to sign contractual arrangements with the pre-arranging platforms? If yes, please elaborate

<ESMA_QUESTION_TVPM_9>

Bundesverband der Wertpapierfirmen (bwf) has no comment on Q9.

<ESMA_QUESTION_TVPM_9>