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European Commission
Directorate-General for Financial Stability, Financial Services and Capital Markets Union
Mr John Berrigan
1049 Brussels

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Subject: Response to the Public consultation on the review of the MiFID II/MiFIR framework

Dear Mr Berrigan,

The Association of Proprietary Traders (APT) would like to respond to the Public consultation on the review of the MiFID II/MiFIR regulatory framework.

APT represents 23 independent proprietary trading firms based in the Netherlands (see Annex). Amsterdam is a global centre for proprietary trading, with a concentration of bigger and smaller firms. Our members commit to continuously providing liquidity to the market under all circumstances. To the benefit of institutional and retail investors alike, our activities contribute to transparent and liquid capital markets and tightening spreads between bid and offer prices.

This letter sets out our remarks about:

- Overall functioning of the regulatory framework and suggested improvements
- Market data and consolidated tape
- SIs, the STO, the waivers and creating a level playing field
- Waivers and the double volume cap
- Research unbundling rules and SME research coverage
- Derivatives trading obligation

Overall functioning of the regulatory framework

In principle, we believe that platforms and flow should be accessible and subject to an interaction between supply and demand. Below large sizes, (i) all transactions should be price-forming and transparent and (ii) all liquid instruments should be traded on LIT markets. To promote market transparency, enhance a robust price formation process and prevent disorderly markets at the same time means striking the right balance between protecting LIT market price discovery and recognizing the contribution of dark orders to orderly markets.

This balance seems to be missing in parts of the equity markets at the moment. For example, on the basis of public RTS 28 reports, we assess that a substantial size of Dutch retail flow ends up at aggregators and third country investment banks. While some of the flow may be routed back to LIT venues, we have strong indications that a sizeable portion of the flow is executed without being subject to the price formation process, i.e. is held captive and internalized. Pricing might have been better if the order would have interacted with the supply and demand dynamics on LIT venues. Furthermore, even while PFOF is prohibited, there are indications that aggregators, including non-EU investment banks, are still able to offer other soft inducements that provide benefits to the party routing flow, f.e. because the trade cycle of execution, clearing and custody is bundled into one cost package.

Increasing internalisation of retail flow could lead to a decreasing appetite amongst market makers to be at risk with their pricing and to a widening of spreads. This will come at the expense to price discovery and the Capital Markets Union's objective to make Europe less dependent on banks. The end investor will end up – albeit unconsciously – paying the bill.

MiFID also introduced much needed competition and highly necessary pricing pressure on (oligopolistic) incumbent trading venues. To get more insight into these developments, we would recommend to analyse what is holding back parties to trade on exchange: better metrics on other platforms, a more fitting offering, costs and/or competition? Can exchanges be persuaded to provide the services the market is looking for and make reasonable changes to cut back inefficiencies and lower costs and fees?

Furthermore, we believe the following improvements to the current framework are desirable:

- **Further transparency is needed for derivatives and bonds**
  Derivatives with identical features receive different ISINs, making them impossible to compare. Bond markets pricing is opaque, among others because there is inadequate post-trade transparency: many instruments are deemed illiquid (while they are included in leading bond indices) or traded under a waiver for scale, which postpones or disapplies pre- and post-trade transparency to unusable levels, ultimately hampering price formation and liquidity. We would welcome an ambitious level of disclosure in terms of bonds included (i.e. reducing the illiquidity threshold) paired with short publication times, comparable to equities and the US bond disclosure requirements. This will improve bond liquidity and price discovery.

- **Warrants, structured products, mutual funds, CFD pricing/platforms controlled by issuers**
  (Retail) investors effectively trade against the issuer (or an affiliate), which makes pricing non-transparent. Investors are entirely dependent on the issuer often also serving as broker. More transparency and competition in this field would greatly benefit end-investors. We will go into this in more detail in our remarks on the Derivatives Trading Obligation below.

- **The post-trading infrastructure is still local, closed and inefficient**
  It is almost impossible to book a position from one Member State, in the same ISIN, to the CCP of another Member State. This maintains market friction, evidenced by deviating prices for the same ISIN that is listed in multiple venues. These inefficiencies and local barriers (identified earlier by the European Post-Trading Forum) are particularly visible during the current crisis, leading to sizeable amounts of unsettled trades, manual corrections, exposure and pricing uncertainties. We believe this is a pressing area to address in order to achieve a harmonized

market structure in the Union.

- **Benefits of reporting and data storage requirements are debatable**
  Storing data that also resides with trading venues in multiple data centers is costly and unnecessary. Where data is available and stored at the trading venue, or published/reported into an APA/NCA, no duplicative records should have to be stored by individual participants.

Market data and consolidated tape

We believe that next to working on supervisory guidance on how the RCB requirements should be complied with, the targeted amendments recommended by ESMA are helpful to strengthen the overall concept that market data should be charged based on the costs of producing and disseminating the information. Furthermore, it would be good to improve data quality. APA data and those of the trading venues should made available in a uniform format (subject to minimum requirements), raising the quality and accessibility of the feeds for streaming and downloading. This will make markets more transparent post-trade.

We believe a consolidated tape (CT) should be a near real-time, post-trade tape that democratizes and collates market data to allow small investors to have low-cost access to comparable information as large investors. This will ensure that consistent and accurate data is made available to participants and investors to obtain a full picture of trading volumes of a product listed across multiple exchanges.

The CT should not be mandatory to consume (like in the US). The use of the CT by market participants should be optional. We should make the European CT a product of genuine utility and value for large and small investors, such that the demand for it arises naturally. Mandatory consumption would be unreasonable for smaller players, considering their limited and/or more local market coverage.

Trading venues and APAs must mandatorily contribute post-trade data at no charge. As a corollary, we explicitly support the proposal the redistribute revenues to contributing entities. The CT then has a lower expense base to recover by means of fees charged to users, which makes the business case for a CT much more viable and increases the chances of achieving the goal that the consolidated tape can serve as a transparency tool at an affordable price for ordinary investors.

We believe it is important, for the CT to achieve a complete picture of Europe's fragmented liquidity, that the CT include *all mandatory* trade-related information. Nothing should be left out – rather, we should allow market participants to filter what information they find useful.

We believe near-real-time data is crucial if the CT aims to provide a neutral and reliable source of the current market price, giving investors' confidence to trade and supporting best execution. Providing a near-real-time view of trading activity also consolidates EU financial markets, supports the CMU and could serve for wider use, including reconciliation purposes.

SIs, the STO, the waivers and creating a level playing field

SIs have shown to respond to a demand for investors to have lower cost, less-hassle trading, particularly for larger sizes. However, some SIs do not contribute to price discovery, are "closed shops" and aggregate or internalise non-interactable/addressable flow that could well be executed on (open) platforms that do.

Furthermore, Internalisation activity combined with other services/business lines can introduce serious conflicts of interest, obscure true costs of trading and post-trade services for investors. Such 'bundled' arrangements reduce competition available on an order-by-order/overall basis to investor's orders when traded in these models. SIs significantly contribute to the ability for firms to operate in this way. Between these embedded advantages that SIs offer investors and the fact that these liquidity pools are 'closed' to competition by other participants, there is a risk that existing SI operators become difficult to unseat.

Therefore, flow should interact with the best possible price formation process (regardless of which platform is being used), and such platforms are to be subject to the same rules/level playing field. However, removing SIs as an eligible platform for purposes of the STO should not be a goal in itself. Such measure should be considered a possible *means* to the end of a healthy price formation process and creating the offer of deep pools of liquidity to as many investors as possible. More harmonization of the requirements for SIs, RM & MTFs to ensure accessibility and addressability of flow, particularly below large sizes, could also be a means to ensure a contribution to price discovery and a deep pool of liquidity.

A level playing field between SIs and other trading venues can be created by:
- banning paying or receiving Payment For Order Flow in the whole EU and enforcing such a ban, as well as to instigate a ban for soft inducements or cross-selling benefits; and
- ensuring that flow up to large size is addressable on accessible, competitive and transparent platforms, after analysis of a sensible threshold for wholesale sizes for relevant instruments (which we assume lies somewhere between SMS and LIS); and
- ensuring that investor flow is adequately competed for by scrutinizing arrangements that can open the door for undue internalization or conflicts of interest, f.e. when a large institution offers additional services (f.e. transaction reporting) or cross-subsidizes other business lines in exchange for flow from particular (retail) investors;
- but also by ensuring that costs of trading on exchange are not prohibitive to incentives to revert to LIT.

Waivers and double volume cap

The current set of waivers is too extensive and has not steered the market in the right direction. Combinations of waivers for smaller size trades are used to circumvent transparency and print negotiated trades on trading venues, while there has been no accessible price formation process. It should be ensured that smaller size trades (retail) are being traded on the LIT markets.

However, a waiver for trading above-LIS (wholesale) trades is legitimate. The LIS thresholds may be set differently for classes of liquidity, thereby addressing the instrument's characteristics. This would also solve the question of the double volume cap. Before removing any waivers APT would encourage further analysis of the consequences of removal. We are concerned that the volume that previously would have traded via the NT/RP waiver ends up being traded somewhere else than the lit markets (eg SIs).

Research unbundling rules and SME research coverage

We would welcome reinforcing the independence of research. It is important to have a lively market, particularly in small- and midcap shares. Previously, research could be offered to brokerage clients in return for transactional flow or orders which could present a potential conflict of interest and inflated pricing. Keeping research independent is essential for a trustworthy capital market.

Unbundling has given institutional investors the opportunity to compare actual pricing for trading. It is

attractive to trade through direct channels, without the obligation to order through to a given value-added broker charging higher fees. It has improved competition for straight-forward trading. It also resulted in new entrants, including electronic liquidity providers. On the whole this has made the market more competitive and transparent, saving institutional investors and their clients (including pensioners) significant amounts of money.

We have seen that the level of coverage has dropped. This may be a particular concern for SME stocks. This deserves attention, particularly for smaller companies that seek a listing and attract capital through the financial markets. Initiatives in this field are welcomed, when these come with transparent pricing and independence of the individual services the researching firm or institution offers.

Derivatives trading obligation (DTO)

The DTO is critical to bringing more competition to derivatives trading, allowing investors increased choice and better pricing and at the same time increasing transparency. The application of the DTO in the market is still in its early stages and we see three main areas for improvement:

- **Scope of instruments.** Across the market, many of the derivatives traded today are very much standardized contracts. Those that are created as bespoke instruments are often small changes to standardized contracts that allow issuers to avoid the DTO. Furthermore, some on-exchange derivatives instruments (such as warrants, sprinters and turbo's) are still highly illiquid "closed shops" due to advantages held by the issuer (such as only the issuer can short sell the instrument). The DTO should extend to bespoke instruments that have limited bespoke qualities and seek to push for further standardization and usage of truly competitive multilateral listed instruments, discouraging/ eliminating look-alike products, in order improve competition and tighten spreads for investors.
- **Scope of counterparties covered**. The DTO currently has an exemption for "small financial counterparties". There appear to be large volumes trading under these exemptions in SIs. We question whether these volumes truly represent small counterparties. APT recommends monitoring off-venue trading volumes in derivatives to ensure the volumes transacted under exemptions is not out of line with the intended thresholds.
- **Pre-arranged trades.** Pre-arranged trading is currently permitted for derivatives subject to the trading obligation as long as the transaction is eligible for the large-in-scale waiver from pre-trade transparency. In our view, allowing transactions to be entered into completely away from an MTF or OTF undermines the DTO. The current exemption allows for significant volume to be traded off-venue because these pre-trade levels are very low. At a minimum, we believe that pre-arrangement should only be permitted above the post-trade LIS threshold, which would be more consistent with the US approach, if such an exemption is retained at all.

We trust the above comments will be helpful with the review of the current framework. We would be very happy to answer any further questions and provide you with additional information.

Yours sincerely,

Matthijs Pars
Director APT

Annex: APT's members

- Algorithmic Trading Group
- All Options
- Criterion Arbitrage & Trading
- Cross Options
- Da Vinci Derivatives
- DRW
- Flow Traders
- Gelber Group
- IMC
- Jane Street
- Jump Trading
- Mako
- Market Wizards
- Nino Options
- Nyenburgh
- Optiver
- ORA Traders
- Peregrine Traders
- Tower Research
- Quantlab
- Utr8 Group
- WEBB Traders
- 323 Trading