Draft Response to FCA; CP22/18: Guidance on the trading venue perimeter

Executive Summary If you would like to provide an executive summary to your response. Please provide it here.

Consistency provides for both competition and cross-border access

i. EVIA members welcome the chance to respond to this consultation which is fundamental to the construction of wholesale markets structure, fair and effective outcomes, and its connection to regulatory supervision. As commonly stated, we emphasise that the core principle of, "***Same activity – Same Regulation***" needs to the primary factor r when considering the regulated perimeter and the meaning of multilateral activity

Common response to UK and to ESMA

ii. EVIA[1] responded to the similar consultation by ESMA[2] in April of this year [EVIA response to Consultation Paper on ESMA's Opinion on the trading venue perimeter; 21 April 2022.pdf] and the comments below build on those submissions. In that light. we consider wholesale market frameworks, along with reporting regimes, need to be functionally similar across the G20.

Market participants seek to evade the trading venue perimeter on costs grounds…

iii. A summary examination of the market wide responses to the earlier ESMA consultation demonstrates how widespread is the interest in segments of market activities to operate outside the trading venue perimeter. We consider that these evidence an unfair environment where business behaviour standards , functional responsibilities, and meaningful costs are borne by trading venues r to comply with trading venue related regulatory demands, . It seems that the guise of innovation is allowing the known perimeter to be threatened, , and therefore the regulatory challenge is to devise clearer segmentation of permitted activities whilst not allowing proportionality to undermine the supervision process.

yet it forms a key building block for G20 cross border risk sharing by creating a tool for mutual recognition…

iv. We note a now frequent number of regulatory interventions, especially in the US by both the CFTC and the SEC against the unregistered operation of venues and the solicitation of services without the required permissions. At its core, this impacts the reporting of relevant activities, minimum conduct, the ability for cross-border services to exist, and the policing of money laundering. The creation of a purposeful trading venue perimeter underpinned by a clear understanding of a multilateral

[1] EVIA - Home Page
[2] https://www.esma.europa.eu/press-news/consultations/consultation-paper-opinion-trading-venue-perimeter

system accords with the Paul Tucker[3] view of deploying mutual recognition by standardising and containerising risks via the institutionalisation of trading venue rules. That the trading venue perimeter essentially turns on the definition of a multilateral system has become increasing evident in the years following the implementation of the G20 Pittsburgh reform agenda. There remains a systemic rationale to the existence of the perimeter such that activity can be monitored and assessed. In particular the importing of risk either between nation-states or between the banking and the non-banking sectors still remains very relevant[4].

… which ideally would be a core principle…

i. As a consequence, EVIA has advocated to both the European Commission and to the UK government that a robust definition of a multilateral system should be held forth in primary legislation rather than in the tertiary rules of the regulatory agencies. This would provide a more objective principle from which any supervisory review could occur. . We consider the optimal definition is: :

- *"Providing or making available a service, or operating or making available a system, to arrange, negotiate or match, trading interests in financial instruments constitutes an authorised activity in the United Kingdom or recognised jurisdictions."*

In the absence of primary legislation, EVIA does support the approach undertaken by the FCA in defining a multilateral system. This shall also be applicable in the application of cross border mutual recognition.

… but the broad-brush approach with certain exemptions can work.

ii. We reiterate the Important principle that a wide perimeter should be welcomed in order to facilitate competition within a level playing field, but basic licensing should be simple facilitated by a low degree of supervisory proportionality within the perimeter, based solely on activities.. For instance, any multilateral system that meets the overarching FCS definition should be obligated to register as a venue despite the impression that its activities are otherwise perceived as limited. Such an outcome would simplify the required permissions between bilateral activities under RTO/ arranging and those multilateral activities in scope of this consultation.

… the principal matter in the CP is how to deal with pre-arranging systems in a way that doesn't create an evasive opportunity .

iii. We consider the core topic is application of the definition of a multilateral system to pre-arranging facilities and services. We consider that the correct approach should be to provide appropriate regulation exclusions subsequent to the

[3] Global Discord: *Values and Power in a Fractured World Order*
[4] Risks from leverage: how did a small corner of the pensions industry threaten financial stability? – speech by Sarah Breeden | Bank of England

application of the principle only after a thorough assessment of the minimum conditions being met.

… MIFID created a reliance on the concept of trade execution that the pre-existing ISD did not have…

iv. We underline that the cause of the requirement stems from an over reliance in regulatory structure relating to the concept of "trade execution," as opposed to the proper and uniform licencing of qualifying activities. Whilst the point of formal "trade execution" may be marked by the inability to void or to reverse the legal contract, , the creation and communication of a trade match or an "allege" together with the collation of these into a wholesale transaction can occur before the technical point of execution.. However, the FCA should scrutinise these workflows to ensure that operators are not consummating transactions themselves only to avoid venue registration.

… the FCA should re-embrace activity-based supervision

v. In sum therefore, any consideration of the trading venue perimeter should focus entirely on the nature of the activity , whilst being mindful of the trade registration process as important for the post-trading regulations and trade identifiers.

… a common law approach might be narrower, but a broad definition with exemptions suits a more international construction

vi. Pre-arranging systems which would normally qualify under the broad definition of a multilateral system as proposed should be exempt only where any of the following three conditions exist:

- *there is a fixed mechanism between the activities of trade arranging and for trade registration within the same legal group entity, or*
- *there is a formal terms of business arrangement between the pre-arranging system and its client market participants, to specify that trade alleges, and matches, shall be subsequently registered on a UK MiFIR trading venue, an ROIE, or an exempt overseas regulated trading venue.*
- *there is an alternative and more appropriate regulatory regime which should apply (for example payments, commodities, SFTs etc.)*

… the ESMA approach would not be commercial…

vii. Whilst the FCA does not propose a formal outsourcing of any registration trading venue rules and supervision onto any pre-arranging system, we reiterate our opposition to the ESMA approach in paragraph 48 and paragraph 80 in their April Consultation Paper Opinion on the trading venue perimeter. Any requirement for a pre-arranging facility or service to be in close contractual delegation with the final formalising trading venue would contravene the principles of MiFID wherein choice is fostered under the aspirational benefits of competition. Moreover, the

outsourcing of venue rules and commercial models would impose insurmountable obstacles for the commercial and cross-border operation of wholesale liquidity.

… the illustrative use-cases presented to the French EU Presidency are in the annex

viii. We set out three different use-case examples in the attached supporting annex [PDF Annex to EVIA Response to FCA CP22_18; Guidance on the trading venue perimeter; 25Nov2022.pdf] to demonstrate that any pre-arranging system is commercially independent of any trading venue and may in some aspects of its activities anyway be already organised as a trading venue in its own right. There is also a common outcome whereby a pre-arranging system supports transactions that are not concluded on any trading venue, or ultimately are concluded on a different trading venue than it might have expected or ultimately need to be formalised in a third country or bilaterally. These are all perennial features of the wholesale derivatives markets, in which transactions are arranged via the "core economic terms," often on a "name give up" basis where substantive legal details are negotiated on at the point of formalisation. Indeed, despite a preponderance of standardised credit annex agreements, in some cases, one or both counterparties decline and exit from the transaction before it is formalised; whilst in others, the counterparties agree later to submit the transaction to a nominated trading venue. In general, once the counterparties have agreed and affirmed the detailed terms with the arranging facility, only then does that intermediary submit the required and complete details to the final and formalising trading venue and only then could the alleged match be compliant to the end rulebook.

EVIA members would also make the following high-level observations:

… the UK should seek to remove the incentives and the encouragements to trade outside the multilateral perimeter …

ix. To date there have been no supervisory conduct expectations, nor any prudential incentives, nor any industry protocols, standards, or best-practice guides to avoid dealing on unauthorised facilities, systems, or technologies. In their place, cost differentials have been a focus, and even in the non-equities products, the cheaper route to non-registered aggregators has been a prime factor in the market appetite to evade organised trading venues.

x. The current MiFID organisational requirements for trading venues have limited exemptions and do not offer the possibility for segmental application to cater for a heterogeneity of business models and specialisations. Rather, extensive, , inflexible and complex requirements at product and business level have delivered such a framework as to provide for substantial benefits and incentives to any market participant or servicing firm to circumvent the trading venue perimeter. The reverse should be the case.

xi. By arranging or transacting outside of organised trading venues, market abuse and financial crime monitoring, including the application of KYC and AML onboarding requirements under MAR are not applied.

… and enforce the regulatory perimeter, but consider the role of proportionality and different business models across the licenced activities…

xii. The location of the boundary within the FSMA ambit between arranging services and a trading venue will depend upon both the further consideration of how Article 25 of the RAO should be supervised together with a target operating model for the supervision of trading venues.

xiii. Currently the FCA has authorized 124 segment MICs operated under some 50 LEIs by 35 corporate entities. Should the FCA decide that the correct or optimal number of MTFs/OTFs should be some great multiple of this total, then the current understanding that each requires a comprehensive rulebook across all sourcebooks should be revised by the application of supervisory exemptions to capture only the required activities for each separate segment MIC registration.

xiv. Failing this, should the FCA seek to retain the scope of trading venue sourcebook requirements then the limited activities under RAO Article 25 "arranging and bringing about" should be broadened out with deeper supervision and the trading venue perimeter constricted to those activities requiring a direct connection to CCPs, CSDs, or match principal facilities.

… the things it's important to keep …

xv. In relation to the European framework. there exist some substantive differences to UK approach which are helpful to the organisation of wholesale markets. These should be preserved and include:

a. Article 25 of the RAO.
b. Specific guidance or rules for wholesale market activities such as references to codes of conduct and targeted exemptions such as, "*with and through.*"
c. Cross border access through the OPE, ROIE, mutual recognition exemptions and also considerations for the forward intent of the government to build upon these.

… the amount of activity outside the perimeter is substantial …

xvi. The scale and sheer amount of arranging and trade execution activities occurring on systems and facilities outside appropriate licenses is substantive. Those activities should likely not be discontinued, but rather brought inside the perimeter. Without this enlargement, unfortunate outcomes and consequences will persist, notable in respect of outcomes related to: competition; competitiveness; innovation; and reporting.

… the term, "OTC derivative" hurts competition because it contravenes the principle of, "same activity – same regulation"

xvii. Ongoing use of the term "OTC Derivative" across the onshored regulations, in particular where that term refers to venue trades on MTF and OTF is

counterproductive, commercially penalising, and generally confusing[5]. The term should solely be reserved for trades which would be reported as "X-OFF" or "XXXX"

… these example typologies of how the trading venue perimeter is evaded …

xviii. At a high level, EVIA members have observed the following types of relevant activity persisting outside the perimeter:

a. Characterisation of activities as not providing formal trade execution or not holding forth any approved rulebook.
b. Recasting of instruments as outside the MiFID C1 to C10 annex scope
c. Recasting of activities as bilateral arranging or calling around, rather than as a clearly multilateral business model
d. Recasting of activities as tertiary activities to the main business, especially where that may be operating an EMS/ OMS or provision of a technology interface or instrument classification
e. Provision of outsourcing and such technology tools that give effect to an interactive bulletin board
f. Characterisation of activities undertaken outside the FCA Sandbox[6] as "FinTech" or "Crypto" and therefore worthy of lesser and different regulation by dint of governmental aspirations and specifically from the Kalifa Review.
g. Characterisation of activities where registration is finalised in a third country, but where the substantive governance and technology resides within the UK.

Answers to questions:

Q1: Do you agree with our approach that following issuance of our final guidance, Q&As 7, 10, 11 and 12 in Section 5 of the ESMA market structures Q&As should not form part of our supervisory expectations?

Agree

Q&A 7; *"Can a trading venue use its trading systems and platforms to arrange transactions that are then reported and ultimately executed on another trading venue?"*

- Substantive part of the ESMA review
- The main area where EVIA disagreed with the ESMA proposals in the CP

[5] Regulatory texts, such as those currently under development concerning EU energy markets, cite trades carried out on MTF and OTF as "dark and opaque" by dint of the EMIR definition of OTC derivatives. In reality, whether they are on own venue or RM, the same instruments are arranged by the self-same investment firms who operate MTFS and OTFs but submitted as blocks to RMs for CCP post-trade access.

[6] Or other equivalent incubators such as the "*Regulatory-Sandbox*", the "*Digital-Sandbox*" or the "*Scale-Box*" under the label of 'Early and High Growth Oversight'.

- Both confusing and inaccurate:
  - *"No, the fundamental characteristic of a trading venue is to execute transactions."*
  - *"Therefore, a trading venue should not be allowed to arrange transactions without formalising the execution of those transactions under its rules and systems. ESMA has also already clarified that a transaction cannot be concluded on more than one trading venue at the same time.*
- Better to be removed and addressed in the UK in line with global standards

Q&A 10: "*What are the characteristics of an OTF? When is the authorisation for the operation of an OTF required?"*

- Given that the UK intends to transfer the OTF and MTF legal categorisations into the FCA handbook, this Q&A would have no standing, despite the contextual aspects to the answer perhaps being helpful.
- The FCA Handbook shall set out the venue definitions and characteristics currently in Levels 1 and 2 of MiFIR

Q&A 11: *"Does the concept of OTF apply to voice trading and, if yes, when an investment firm executing transactions through voice negotiation should be considered as falling under the definition of OTF?"*

- This is an important and relevant point, but it misses the notion of multilateralism, and it also unhelpfully doesn't define 'trading'.
- The FCA handbook should therefore address this specific methodology concerning voice and hybrid transaction arrangements and trade execution being multilateral in the OTF context, and therefore distinct from the activity of "arranging and bringing-about"
- The FCA handbook already deals with the broad approach being technology neutral, and the UK needs to reaffirm this point in light of the Kalifa Review, amongst others, giving the appearance that activities recasting themselves as "Fintech" should not be subject to a level playing field approach.

Q&A 12: "*What distinguishes an OTF from an MTF?"*

- Clearly the proposed revisions within the FRF make most of this guidance non-applicable.
- The FCA handbook should therefore take up the existing level 1 and level 2 derogation concerning the application of discretion within the system.

Q2: Do you agree with our interpretation of the definition of a multilateral system?

Strongly agree

The FCA interpretation of the definition of multilateral system is both correct and is able to be simply mapped to that set out by ESMA in their recent consultation as well as those in other relevant third country market infrastructure regulations.

We would underline that the intent set out in 3.22 concerning the service of a system is absolutely key. We are very clear that the idea that multilateralism should be interpreted at a 'system' or a 'facility' level, and not at any order-by-order level. It is helpful to recall that in respect of the application of the SEF rules in the UK, the CFTC considers not what any SD/MSP venue member actually does, but rather what they are able to do within the system or facility that's more relevant.

Whilst beyond the scope of this consultation, we would reiterate EVIA comments to the HMT RFR process that a because trading venue is legally defined under Art 4 (22) of MiFID which incorporates organisational arrangements into the assessment, so the definition of multilateral system should be set out in legislation as a principle in such a way that the FCA could refer to it in settling out the Handbook, rather than creating it within.

Core to these proposals is the sufficiency criterion such that anyone doing multilateral activity, regardless of scale, needs to be organised as a trading venue. Accordingly, we would again note our strong preference for a revised and more accurate definition within the Financial Services and Markets Bill itself:

- *"Providing or making available a service, or operating or making available a system, to arrange, negotiate or match, trading interests in financial instruments constitutes an authorised activity in the United Kingdom."*

We agree with the FCA proposal to onshore the current scope into the harmonised interpretation when considering whether any enterprise is:

i. a system or facility;
ii. has multiple third party buying and selling interests;
iii. where those trading interests need to be able to interact; and,
iv. those trading interests include financial instruments.

We would support the inclusion of guidance that where services are offered under the label of outsourced technology, specifically as 'Software as a Service' ["SaaS,"] or related ["IaaS" or "PaaS"[7]] provisions, then the same four considerations should also be expressly included when considering the application of the scope of any system or facility.

For context, the two prime failings to establish a clear perimeter for the scope of multilateral systems are:

[7] Infrastructure as a service (IaaS); Platform as a service Platform as a service (PaaS)

i. There are trading platforms operating in the UK and Europe which should be operated by regulated investment firms or trading venue operators as multilateral systems; but which, because of literal interpretations, have been able to remain outside of the perimeter of MiFID 2/R. The result is that a discriminatory two-tier system has been created: (a) regulated trading venues, which contribute trade data and transaction reporting to the overall system, and which are subject to defined governance and operating requirements in accordance with the MiFID II regime; and (b) unregulated trading systems or platforms, which operate outside of supervision and are not subject to any reporting, governance or operating requirements under the MiFID 2/R regime. These evasions range from the small firms who choose not to pay the price of financial supervision to the providers of technological systems and protocols who present themselves as "FinTech" though tool suppliers while acting in a way functionally the same to an investment firm or venue operator to firms registered overseas but carry on actively soliciting in the UK. The same wholesale market participants make use of both tiers without any recourse to practice standards or the prudential and systemic benefits from working with those facilities operating under the .auspices of the regulated perimeter or of its mutual recognition.
ii. The use of the "multilateral" versus "bilateral" concepts has been applied haphazardly, so that firms bringing together trading interests using the same methods and models have been subject to different requirements. This has generally been dependent on how they have held themselves up to their supervisors together with the size and scale of their business operations. It is consequent on the resolution of the boundary between "RTO" (which is much more broadly drawn under the UK RAO) as against carrying on a multilateral activity. The conflagration has resulted in a two-tier system, not only in the UK but also across Europe: (a) larger firms where NCAs have required them to reorganise their activity as a trading venue; while (b) smaller firms or operating units under the same or other authorities who have not.

The solution to the first problem is to adopt the proposal set out in Chapter 3 of the consultation by clarifying where bringing together trading interests related to financial instruments as an intermediary, whether using personnel or electronic trading systems, is a MiFID activity and an investment service. This may be either under the RAO as an arranging activity, or as a multilateral system.

Consequent to this, a clear distinction should be made between RTO/arranging and the operation of a trading venue, whether MTF or OTF The supply of electronic platforms, facilities or trading systems fits within the perimeter when it is for the purpose of bringing together trading interests involving multiple users within that same trading system.

The solution to the second problem is to clarify that trading activity is "multilateral" when, taken as a whole and not with respect to a specific trading interest in isolation, there is the possibility for more than one person to engage with a trading interest despite there only being one buyer and one seller in the resulting transaction. Not only

does this concur with the current ESMA stance, but it is explicitly the adopted position of the CFTC.

Resolving the first problem will bring more firms clearly within the MiFID perimeter, whether in the UK or via mutual recognition. Resolving the second issue will require more firms to organise their activity on the basis of being a trading venue. These are both desirable outcomes from the standpoint of harmonisation of the conduct, reporting and operational resilience rules across the G20, ensuring consistency of regulation for cross-border investors and the appropriate capture of a greater level of information about market activity and AML/KYC supervision.

Q3: Are there any other relevant characteristics to a multilateral system that should be taken into account?

Yes.

Further direct considerations would complicate what should be a clear and principled approach., fulfilling the criterion of being both predicable and simply applied. We caution against a fixation that pivots solely upon multilateralism, as the system or facility condition requires other concepts to be taken into account such as a common set of rules and contractual terms and standards.

However, mindful of current realities we would add the considerations below.

i. A technology labelling should not be a bypass to the regulatory perimeter. Sandboxes exist where appropriate and the recent events with FTX illustrate the need for a common baseline if that wasn't already evident. All relevant jurisdictions have adopted a "technology-neutral approach" to their financial inclusion and it's clear that all firms, whether TradFi or Fintech seek to adopt the most effective tools and solutions in a competitive environment.
ii. Self-selection; to what extent should platforms, or segments of those platforms; be able to choose and to represent what capacity they are offering services. This should be reserved to permissions within the perimeter, but a platform or person that self-represents that their client counterparties set the rules and the contractual terms individually may consider themselves an arranger rather than a system or facility.
iii. We would reiterate that the FCA Handbook should contemplate where services are offered under the guise of "outsourcing" and therefore possibly included under the Critical Third Parties regime ["CTPs[8]"], especially under 'Software as a Service' or related ["SaaS," "IaaS" or "PaaS"] provisions, that these be expressly included under the scope of being a system or facility and not excluded or exempted on those grounds..

[8] DP22/3: Operational resilience: critical third parties to the UK financial sector | FCA

iv. Whilst any multilateral system under the FCA Handbook should demonstrably include financial instruments, it is also true that the scope of any system cannot not be limited to only those because of the nature of related arranging and trading interests accruing from risk transfer.
    a. Indeed, beyond the immediate hinterland of money markets, funding markets, currencies, payments, and commodities, this is also becoming relevant for the arrangements and trading of cryptoassets such as CBDCs, tokenised assets, digital tokens and digital natives.
    b. Financial instruments are typically included with other such instruments when arranging packages, spreads, and portfolio's and in this way the facility, system or service coming within the perimeter will very often include a much wider gamut of instruments for which it should owe the broader set of conduct and organisational requirements.
v. EVIA is aware of many unregistered technology offerings, together with EMS/OMS, as well as trading system operators in third countries who now all routinely provide chat or messaging facilities integrated into their services. Across many use cases, it is evident that in a number of instances such tools routinely and directly lead to sufficient arrangements and to transactions outside of any regulated perimeter.
    a. Such systems exist through the broadcast of indications of interest and the subsequent interactions of users to negotiate those core economic terms all outside of any permissions for the transmission of orders or the rules of any trading venue. Commonly across such cases, the system or facility operator who is providing the messaging service purports to enable these interactions to be undertaken with the goal of concluding the finalised trades "OTC."
    b. We observe similar outcomes where firms that do come under the CRD/CRR bring together trading interests and risk transfer through their OMS/EMS systems. These are often characterised as ancillary to the operation of the order management protocols, but in such cases clearly fulfil the characteristics of a multilateral system. In the United States we note two enforcement actions over the past 12 months by the CFTC and a further one by the SEC to take steps against unlicensed systems operated by financial firms. These models, or ones ostensibly similar are being offered and utilised in the EU and we have in the past provided the FCA with further details.
    c. The relevant characteristics may take the form of several models, including the matching of trading interests through either or both decentralised and centralised tools, and therefore EVIA supports activity-based regulation which is agnostic to the technology and does not treat software providers on how they characterise themselves in relation to the regulated perimeter, but rather on what activities they undertake. As such, we advocate a categorization into two buckets, those that engage in multilateral activity (and therefore should be regulated as venues) and those that do not.
vi. In order to determine whether a facility or service falls within the first or the second activity bucket, it is helpful to distinguish between two types of software

companies: those that provide distributed trading mechanisms through their decentralised tools, and those that provide insourced or centralised trading mechanisms.

a. Distributed Trading Mechanisms; A model, wherein a technology provider makes available to its clients' technology that enables trading interests entered by each client to be made visible to and actionable by other clients.
    i. The argument appears to be that, in this model, the technology provider is not operating a system for the purposes of MiFID II. The software is licensed to each of its clients, and their interactions are cast as bilateral because they are client-client/peer-peer.
    ii. These arguments are spurious and demonstrate a poorly conceived attempt to evade the regulatory perimeter. While there is no question that the simple provision of technology, such as an order management system, is not within the trading venue perimeter, this technology is clearly provided and serviced for the purpose of bringing together the trading interests of multiple clients in order to lead to transactions in ways prescribed by the software logic.
    iii. It should make no difference under MiFID whether the provider or a system or facility does so on a client-server or peer-peer distributed basis. If the nature of the system is to allow the trading interests of multiple users to interact, then it must be a multilateral system. It likely also involves the regulated activities of reception and transmission of order and/or execution of orders on behalf of clients.
b. Insourced Trading Mechanisms; *The second case that needs to be considered is the insourced trading mechanism. The provider of such mechanism allows multiple buyers and sellers to interact, but under the supervision and control of an investment firm which has procured the service from the provider*.
    i. One of the better-known examples of this, but by no means singular, is Trayport, one of the leading software networks for the wholesale energy markets in Europe and provides for OTC, OTF, MTF and RM connectivity. Trayport is not a multilateral system in and of itself, it is an insourced trading mechanism. Their technology forms part of the broker's own system, which may be a combination of voice and electronic components.
    ii. The broker retains the regulatory responsibility within the perimeter and needs either a venue and/or 'reception and transmission of orders' authorization. The provider of the insourced trading mechanism does not.
c. Agency Broking; *A broker may be engaged by a client to assist with a transaction; for example, to sell a position in a collective investment scheme or an illiquid bond. In order to find the best price for the client or ensure sufficient volumes can be traded, the broker may speak with multiple market participants. Those market participants may also be clients of the broker in other contexts*.

i. It is possible to argue that this arrangement makes use of a system – the broker and the broker's tools – to allow multiple buying and selling interests to interact through the broker. The system can be described as a simplistic version of the systems used by brokers who organise more sophisticated markets using voice and electronic systems to bring together wholesale market participants; generally, in the framework of OTFs.
ii. However, in this case, the broker may approach possible buyers who are SIs. An SI cannot interact with an interest that is inside an OTF, so the engagement with the broker intermediary can only work if the approach is understood within the framework of the SI rules. In practice, this is the best understanding of the way that the transaction is being arranged: the broker is being instructed by their client to approach potential buyers on their behalf.
iii. There are different versions of this model. For example, SIs might be willing to provide quotes to the broker on a continuous basis (i.e., streamed quotes), and the SI might be responsible to pay fees to the broker as a client. This can give rise to considerations of conflicts of interest and their management, but it should not lead to the conclusion that there is a multilateral system being organised by the broker. At the core of these models, each SI is performing its functions, and the broker is acting as "a pair of hands" for the non-SI client who is seeking quotes. The interaction between the SI and the end client is best regarded as bilateral, notwithstanding that the broker facilitates multiple bilateral engagements.

Q4: Do you agree with our proposed guidance in relation to voice broking?

Agree.

The FCA has proposed a technology neutral approach with respect to voice broking and we note that any other approach would present definitional and technological challenges, as well as differing from global practice standards.

Q5: Do you agree with our proposed guidance relating to internal crossing by portfolio managers?

Neutral

No comment.

Q6: Do you agree with our proposed guidance relating to blocking onto trading venues?

Agree.

EVIA does agree with the principles set out by the FCA in determining their approach. We consider that the model specific criteria as set out in question 3 above should be brought to bear in the application of supervision given the 'level playing field' and 'competitiveness' framework. 'Blocking' is done in adherence, but not under, with rules laid out by the registering trading venue. Those rules clearly form the main part of the permissions and supervision of that registering trading venue and are therefore vetted both at application and ongoing.

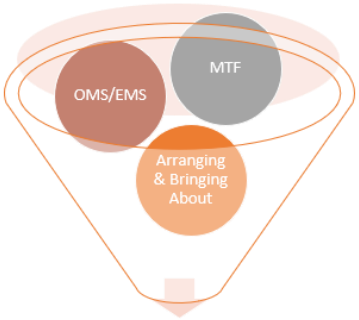
EVIA does not agree that any multilateral system which passes trade matches to a formalising venue should be exempt purely by dint of that registration. Clearly the arranging aspects and competition implications remain germane, and the locus of trade execution is nether determinative, and nor does it require any formal outsourcing of rule-books. Rather a view towards substantive outcomes needs to the held, and with a cross-border or mutual recognition lens.

Whilst systems which are 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 provided that the waiver thresholds are observed, this should not be the mechanical exclusion which the FCA propose. Nor should "close links", or contractual delegation with any final formalising trading venue exempt the pre-arranging facility or service from being authorised in any appropriate permission or licence. Wider considerations, including choice, competition, the capability of wholesale counterparties and intermediaries for shopping around and the role and identification of Critical Third Parties are all relevant in fostering a resilient and effective wholesale marketplace. In this way a "*Handbook Principles [R, G], + Have Regards + Supervision*," approach is likely the most pragmatic. Clearly an appropriate outcome will require proportionality of supervision rather than exemption, but that may well countenance transactions comprising many trade and at scale as coming under more than one trading venue and in more than a single jurisdiction.

We set out three different use-case examples in the attached supporting annex[9], but specifically we remain concerned that systems which pre-arrange transactions, which are then submitted to a trading venue for formalisation, generally are not extensions of the trading venue; nor is the pre-arranging system delegating formalisation of the transaction to the tertiary trading venue. Pre-arranging systems such as Neptune Networks[10] and Ediphy Markets[11] provide high profile cases-in-point. The former remains entirely unregulated, whilst the latter holds a permission only as an arranger.

[9] Annex to EVIA Response to FCA CP22_18; Guidance on the trading venue perimeter; 25Nov2022.pdf
[10] https://neptunefi.com/about-us/
[11] https://www.ediphy.io/how-it-works

Both compete daily with regulated trading venues, neither comprise any market supervision nor reporting requirements, and neither are subject to any best practice reservations from authorised market participants nor industry conduct codes.



Such cases raise the question as to where the boundary should be drawn between an order management system (OMS), an Execution Management System (EMS) and the multilateral trading venue perimeter. We do consider that there is a substantive difference between these systems and clearly facilities operating solely as OMS and EMS should not fall within the scope. However, many such firms do bundle multilateral trading systems together with their OMS and EMS systems and recast this service outside the regulatory perimeter. In such cases the usual licencing requirements should apply as there exists a strong commercial incentive to evade this. The first step should be to identify those firms' making arrangements with a view to concluding transactions or transmitting orders under the MiFID scope of RTO/ arranging licencing requirements. Subsequent evaluation focused on any multilateral qualification, may determine whether these should constitute a rules-based trading venue, even where no trade execution occurs within the system. Technology and the evolution of communications systems have delivered us 'Smart' OMS and further attenuations that can only call for a supervisory approach based upon a determinative set of principles. In such a case if a "smart system" has the outcome effect of only connecting buyers and sellers with venues then the situation remains clear, however should such systems, as we do witness, hold the capability for connecting liquidity takers to liquidity providers, then it is equally clear that any "Duck Test" determines a trading venue, and they should be regulated as one.

Clearly any broader inclusion of currently entirely unregulated activities into MiFID as RTO licences would bring them under supervision, prudential and reporting requirements to constitute a major step forward from the current position.

There is no formal link between the pre-arranging system as an extension of the trading venue where the transaction is ultimately formalised. The pre-arranging system is usually commercially independent of any trading venue and may in some aspects of its activities anyway be already organised as a trading venue in its own right. In this way almost all of our member firms arrange and execute multilateral trading under their own rules which does not go to a tertiary or finalising trading venue

for formalisation; but alongside this their facilities also arrange wholesale packages involving the submission of pre-arranged trade legs to exchanges.

It is not uncommon for a pre-arranging system to supporting transactions that are not subsequently concluded on a trading venue, or which may be concluded on a different trading venue than it might have expected or indeed ultimately need to be formalised in a third country or even bilaterally. These situations may arise where the trading counterparties do not proceed with a transaction or agree between themselves to submit a transaction to a different trading venue or if it is rejected. Any of these situations would highlight the ineffectiveness of a prescribed exclusion. These are all perennial features of the wholesale derivatives markets, in which transactions are arranged via the "core economic terms," often on a "name give up" basis where substantive legal details are negotiated on at the point of formalisation. Indeed, despite a preponderance of standardised credit annex agreements, in some cases, one or both counterparties resiles from the transaction before it is formalised; whilst in others, the counterparties agree later to submit the transaction to a nominated trading venue. In general, once the counterparties have agreed and affirmed the detailed terms with the arranging facility, only then does that intermediary submit the required and complete details to the final and formalising trading venue and only then could the alleged match be compliant to the end rulebook.

Should any pre-arranging system benefit from an automatic exclusion, all rules, especially those relating to conduct, non-discriminatory access and organisational requirements would be waivered, leading to a direct distortion of the effective marketplace and other regards which the industry and government both seek the FCA to deploy.

Organisationally, we note that these roles are separate and distinct. As the operator of the pre-arranging system which is a member/ registering broker on the tertiary trading venue, trading interests will be brought together on an "XOFF" basis; such that they are matched outside of any order book [if any] pertaining to the trading venue but subject to its acceptance and registration under its rules. Indeed, most exchanges as RIEs/RMs are set up to accept pre-arranged transactions from members as few, if any of their admitted contracts will have an effective CLOB. On this basis the registering broker is subject to the rules and discipline of the trading venue at that point when they submit the transaction. The trading venue does not need to treat the registering broker as being part of its own systems, or act as if there is a delegation of functions, any more than it does when any other members submit single trading interests to be matched in its own order book.

Where the pre-arranging system is located in a third country, it should still submit pre-arranged matched trades and alleges that are compliant to the trading venue rules, and it should be recognised under some form of mutual recognition or register, such that all broader conduct requirements are deemed to have been met . Where it is the registering TV that is located in a third country, it should recognise those FCA permissions and licences of the prearranging system to validate conduct, integrity, and prudential outcomes.

Pre-arrangements between wholesale counterparties are typically made through the provision of an execution policy document that sets out terms of business such as the trading venue options and the instructions from the trading counterparties at the outset of any client or market participant relationship. Such policy provision is the ambit of licensing and supervision. It therefore can straightforwardly become the basis for cross-border recognition, equivalence, and deference.

Clearly, any superposition and duplication of the rules of any considered registering or formalising trading venue onto any that would be applied by pre-arranging systems would create a set of conflicts and complexities that would be commercially difficult, complex to resolve and ill serve the public policy objectives. For example, which rules would apply in the case of a large bond trade, where there are multiple trading venue options? How would different requirements in the rules of the possible trading venues be reconciled? Which trading venue would have the jurisdiction to assert its discipline over the transaction, and from what point? How could this be applied where trade legs within the contingent transaction package are to be executed in third countries?

In general, therefore, the regulatory principle which the FCA should adopt would be to treat any pre-arranging facility in the first place as an arranger and then consider its multilateral nature where seeking to offer, '*invitations to treat*' any trading interests in ways that may bring about a transaction within the system. Clearly those conditions which should apply to such qualifying pre-arranged systems are the general licencing and authorisations under each MiFID/R, MAD/R and the IFD/R that would normally apply to the RTO activities. From that basis, and from inside the perimeter, supervisory derogations may then be applied on the evidential basis of outcomes and close links.

Q7: Do you agree with our interpretation to regard a crowdfunding platform operating only in primary markets as not involving the operation of a multilateral system?

Agree.

We concur with the view of the FCA that a crowdfunding platform does not constitute a system for the interaction of trading interests referred to in the definition.

Q8: Do you agree with our interpretation of the characteristics of a bulletin board?

Strongly agree.

Whilst concurring with the approach of the FCA in seeking to set out a guidance framework for the scope and characteristics of a bulletin board, we also appreciate that such tools are becoming more commonplace and multifaceted as technology allows and enables.

Therefore, the core concept, which is held out by the FCA of whether any such system allows and enables trading interests to either interact or to match within the system is key. We appreciate the exposition of interaction is set out effectively by the FCA in the proposed bullet points which consider users responding within the system to other users' trading interests, negotiations, that acceptance of essential terms to a transaction; and the commitment to enter into contracts.

Q9: Do you agree with our approach to updating the Glossary definition of a service company in relation to client limitation types?

Strongly agree.

EVIA considers that where effective limitations can be demonstrated within a firms' permission such that the effect is made to delineate a "wholesale market," then a far more streamlined and effective supervisory regime can be simply applied. By adding professional clients or eligible counterparties to the definition of a service company, this route is attained, and by preserving market counterparties together with intermediate customers, so the open access to trading venues by other wholesale non-financial and third-country firms is retained.

Chapter 4: For discussion - potential areas for future change

Q10: Which regulatory requirements applicable to MTFs and OTFs are most likely to create barriers to entry to the trading venue market for smaller firms?

In general, barriers are erected where any process requirements are interposed that require an excess expense to be incurred. Each of these marginally incentivizes activity to relocate or recast outside the multilateral perimeter. One example would be the requirement to use an ISIN/UPI from a particular monopoly source rather than competitive offerings or the distributed creation via an open standard. Forthcoming CTP requirements may provide a further example.

As EVIA have advocated over the number of years that MiFID2 has been in force, the most punitive measure for erecting barriers to access, and indeed for dissuading qualifying systems as casting themselves within the perimeter is the requirement for a standardised fee structure or the fixed "Rate Cards" which NCAs together with ESMA have deduced from MiFID II Article 48(12)(d) and Article 4 of RTS 10.

- *Trading venues shall charge the same fee and provide the same conditions to all users of the same type of services based on objective criteria. Trading venues shall only establish different fee structures for the same type of services where those*

fee structures are based on non-discriminatory, measurable and objective criteria […][12]

There are four sets of permissible criteria for establishing different fees. The first includes trading volumes, numbers of trades, and total fees. The second includes the type of services or packages of services. The third is the 'scope or field of use demanded' – a condition that is relevant to data, rather than execution, services. The fourth includes rebates for the provision of liquidity or acting as a market maker. The consequence of these restrictions is that the fee structure of a trading venue is mainly based upon the level of business undertaken with it, at rates which are standardised for all participants. Other criteria, such as whether the member or participant is a direct clearing member of a CCP are prohibited as a means of access and would be impermissible as the basis of a fee structure.[13]

Further barriers to entry have concerned the restrictions on OTF-OTF Interactions, the inexplicable capital treatment regarding Margin Period of Risk ["MPOR"] against OTFs and MTFs; and the restrictions on OTFs admitting equities.

Regarding the former, we conclude that the migration of the licencing activity from FSMA into the FCA handbook should mitigate this, as should the equities constriction in respect of reading the HMT intentions for the Future Regulatory Financial Framework.

As it stands however, OTFs are unable to share liquidity with other OTFs and this constriction may be worth elaborating. This creates a barrier to the linking of liquidity pools using voice and hybrid trading systems, although there is no equivalent barrier for automated—MTF-MTF, RM-RM or RM-MTF—interactions. The explanation given by the EU is that this is necessary because there can only be one venue for the execution of a transaction; however, there is no conceptual difficulty distinguishing between an arranging venue and an execution venue. This is demonstrated by the level of trading that is taking place outside of trading venues with the intention of finalising transactions through submission to one of them. If trading systems can operate outside of trading venues and submit executed or pending transactions to a venue, then there is no technical reason why a trading system cannot operate inside of one trading venue and submit pending transactions to another.

A feature of the EU (and, post-Brexit, UK) markets is that a number of OTFs are operated by affiliated firms. Brokers may withdraw trading interests from one of the venues and submit it to another, in order to avoid breaching Art 20(4) of MiFID II, but this adjustment introduces inefficiency. In fast-moving, voice-enabled markets, where trading interests match through open outcry, any restrictions on access could reduce the chances of

[12] Article 3, Commission Delegated Regulation (EU) 2017/573 of 6 June 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards on requirements to ensure fair and non-discriminatory co-location services and fee structures [2017] L87/145 (RTS 10).
[13] Market Structure Q&A 38-39 [sec 5.1, Q&A3].

clients obtaining best execution. The Balkanisation of liquidity does not improve outcomes for market participants.

The adverse consequences of fragmentation can be overcome by encouraging connectivity between trading venues. Under the US model for cash equities, reflected in Regulation NMS, the ability to place an order on one venue and execute on another enables market participants to benefit from the best available prices on trading venues. As the CFA Institute argued in the wake of MiFID I:

The key to avoiding the detrimental effects of fragmentation is to ensure connectivity between trading venues so that orders submitted to different platforms can interact with each other. Order interaction centralises the market place (it consolidates liquidity) and counteracts the opposing effect of fragmentation.

David C. Donald has argued, in the context of Asian equities markets, that creating direct connectivity between trading venues has the advantage that 'liquidity is increased rather than fragmented as the market becomes more diffuse and transparency remains largely unaffected.' With Shenzhen Connect and Shanghai Connect, the Hong Kong and mainland Chinese markets have started to overcome the fragmentation of liquidity for cash equities. Donald explains:

Liquidity increases because the matching activity of each participating exchange retained the concentrated network externalities it originally enjoyed, and then receives the network benefits of each additional set of exchange brokers added to the system, so that the network of each participating exchange becomes equal to the sum of the network of all participating exchanges.

The OTC derivatives markets and cash equities markets have different features. Pricing of OTC derivatives is less dependent on pre-trade transparency than cash equities because they are less standardised and are reliant on counterparty credit risk assessments. They are not fungible, even when the parameters are similar. Without distinguishing between the market features for different asset classes, the CFA Institute argues:

In order for order interaction to be permissible, it is necessary for markets to be transparent—so that investors can access prices and trading interest in all markets—and that markets are linked, so that orders can be routed to the best market for execution. This requires a market framework based upon pre-trade and post-trade transparency principles and a best execution requirement to ensure that brokers seek out (via order-routing technology or otherwise) the best markets. It follows that impediments to transparency and market connectivity can mean that fragmentation could prove detrimental, decentralising liquidity and deteriorating the quality of price discovery.

This argument remains at least partially cogent for OTC derivatives. While pre-trade transparency is less important, the ability of trading interests to interact does depend upon the broadcasting of interests by the trading venue. In voice-driven markets, the

only practical way for that to happen is for access to be provided to other OTFs. Otherwise, there is a timing advantage for participants in different venues. The OTF-OTF restriction cannot be overcome by having OTF brokers participating in multiple venues at the same time, in different capacities (so-called 'dual hatting'):

ESMA highlights that a trading interest in an OTF may not be executed against an opposite order or quote on another execution venue. For a transaction to take place, the two opposite trading interests must be placed with the same execution venue. However, this does not prevent the investment firm or the market operator operating an OTF from retracting the order from the OTF and sending it to another OTF, to an SI, an MTF or a regulated market, where consistent with the investment firm's or the market operator's execution policy and exercise of discretion. ESMA's position appears go further than the restrictions in Article 20(4) of MiFID II.

The antipathy of regulators to OTFs connecting to other pools of liquidity appears to be to protect the concentration of liquidity for cash securities at incumbent RMs and MTFs. It does not take account of the particular features of the OTC derivatives markets. Removing the restriction in Article 20(4) of MiFID II arguably would improve the access of market participants to liquidity, while encouraging price discovery through the broadcasting of bids and offers. If the risks in relation to cash equities are too great, then at least the OTC derivatives markets should be considered.

With respect to MPOR, EMIR treats any derivative trade concluded on an MTF or an OTFs as being an "OTC" transaction. It therefore applies a much longer MPOR Risk weighting then if that same trade were traded on an RM, RIE or equivalent overseas venue. The rationale was cited that futures contracts were more liquid and carried less risk. Clearly where the same derivative is traded, that cannot be the case, and indeed evidenced volatility from Gilt and TTF gas futures to shape of the LiBOR transition would disprove this. Whilst a great many more derivatives contracts are now CCP cleared, and therefore the MPOR considerations are greatly reduced, this still presents a barrier to entry for a firm considering setting up an MTF or OTF as compared to one seeking only to arrange trades for submission onto an overseas RM/DCM.

Q11: Does the existing service company regime already address concerns regarding these barriers to entry?

EVIA has no further comments on the existing service company regime.

Q12: Based on which criteria should firms be potentially subject to a more scalable set of requirements?

Regulatory requirements, particularly those supporting the trading venue perimeter, should be applied via a thorough assessment of the nature of the activity and not the scale or scope of that underlying activity. If an activity meets the definition of multilateral

activity, then the reach of the activity should be irrelevant, and a scalable set of requirements should not apply.

Ends.