MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK

Via Electronic Submission

European Securities and Markets Authority
CS 60747
103 rue de Grenelle
75345 Paris Cedex 07
France

March 17, 2020

Re: Consultation Papers on MiFID II/MiFIR

Dear Sir or Madam:

Managed Funds Association[1] ("**MFA**") welcomes the opportunity to provide comments to the European Securities and Markets Authority ("**ESMA**") in response to its consultation paper "*MiFID II / MiFIR review report on the transparency regime for equity and equity-like instruments, the double volume cap mechanism and the trading obligations for shares*" (the "**Equity CP**") dated February 4, 2020[2] and its consultation paper *"MiFIR report on Systematic Internalisers in non-equity instruments"* (the "**SI Non-Equity CP**", and together with the Equity CP the "**Consultation Papers**") dated February 3, 2020. [3]

MFA supports a regulatory framework that promotes market transparency and efficiency. MFA therefore appreciates ESMA's efforts to implement a Level 2 regime that is intended to improve market transparency and ensure depth and liquidity of markets.

Given the scope of the Consultation Papers and for ease of review, we have consolidated in this letter the points raised in our electronic response submitted for each Consultation Paper.

I. Pre-Trade Transparency Requirements for Equities

[1] Managed Funds Association represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry's contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, the Americas, Australia and many other regions where MFA members are market participants.

[2] https://www.esma.europa.eu/sites/default/files/library/cp_review_report_transparency_equity_dvc_tos.pdf

[3] https://www.esma.europa.eu/sites/default/files/library/esma70-156-1757_consultation_paper_-_mifir_report_on_si.pdf

- Whilst MFA supports ESMA's aims of increasing pre-trade transparency and simplifying the currently complex regime of pre-trade transparency waivers in the Markets in Financial Instruments Regulation ("**MiFIR**"),[4] MFA does not consider there to be a need to reduce the available pre-trade transparency waivers (or otherwise amend the application of the waivers) at this stage. Conversely, MFA considers there to be merit with retaining the reference price ("**RP**") waiver and negotiated transaction ("**NT**") waiver, both of which ESMA has proposed to remove.

- With respect to the RP waiver, the waiver is available only where the trade price is determined by reference to either the mid-point of the current bid and offer prices where the instrument was first traded or the most relevant market in terms of liquidity, or, when this price is not available, the opening or closing price of the relevant trading session. Accordingly, as the prices of such transactions are not subject to the usual price formation process, publication of those prices could risk undermining general price formation in the market in the particular financial instrument.

- For example, the removal of the RP waiver in its entirety could potentially be a detriment to market stability and / or contribute to market distortion. The publication of prices that would have otherwise benefited from the RP waiver could, in times of market duress / high volatility, exacerbate distressed prices.

- With respect to the NT waiver, the NT waiver is only available where price formation is subject to conditions other than the current market price of the financial instrument. Accordingly, as a similar concern to that with removing the RP waiver, publication of prices that would otherwise be subject to the NT waiver could risk undermining general price formation in the market in the particular financial instrument.

- Furthermore, these waivers are legitimately used by end-investors (amongst the other waivers currently permitted by MiFIR) to avoid market conditions moving against them and, accordingly, removal of these waivers would further expose end-investors to such a risk.

II. Double Volume Cap

- MFA supports the retention of the double volume cap mechanism ("**DVC**") which limits the usage of the RP and NT waivers to prevent their misuse.

- We note ESMA's observation in the Equity CP that "… *the percentage of suspensions from TV level to EU level is much larger than the re-suspensions at TV level. This means that due to the dark trading suspension on a venue (4% breach), dark trading was re-distributed on the other dark-pools, thus leading to a breach of the 8% cap.*"[5]

- Given that the efficacy of the 4% trading venue level threshold in reducing unlit trading in general appears to be limited, of the options to amend the DVC as suggested by

[4] Regulation (EU) No 600/2014.
[5] Paragraph 185 of the Equity CP.

ESMA (and on the assumption that the availability of the RP and NT waivers are retained), we support the proposal to eliminate the 4% trading venue level threshold and keep the EU level threshold at 8%. This appears to MFA to be the simplest, but still effective, approach to preventing the misuse of the RP and NT waivers, without the need to eliminate these waivers.

III. Pre-Trade Transparency of Systematic Internalisers (Equities)

- MFA supports ESMA's proposal to increase the minimum quoting size of Systematic Internalisers ("**SI**") for equity and equity-like instruments in the interest of promoting greater market liquidity in these instruments.

- Additionally, in the interest of promoting greater market liquidity in illiquid equity and equity-like instruments under the SI regime, MFA supports extending the obligation for SIs to publish firm quotes (as currently applicable to quotes in liquid equity and equity-like instruments) to those in illiquid equity and equity-like instruments also.

IV. Share Trading Obligation

Identification of Third Country Shares

- MFA agrees with ESMA's assessment of the practical difficulties faced with applying the share trading obligation to third country shares (i.e. shares with the main pool of liquidity located outside of the EU), being:

    - the lack of liquidity in third country shares on EU trading venues;

    - difficulties as pertaining to the equivalence regime used for the purposes of the share trading obligation (in particular, we note ESMA's statement that "*it appears unrealistic to think that the Commission could undertake this analysis for all third-countries in the near future*");[6] and

    - overlap with equivalent trading obligations applicable in other third countries with respect to third country shares.

- As an example of where these practical difficulties came to the fore, MFA recalls the complications during 2019 as pertaining to ESMA's approach to the EU share trading obligation in the eventuality of the UK leaving the EU without a withdrawal agreement (a "**no-deal Brexit**").

- In particular, on March 19, 2019, ESMA had published a statement (the "**ESMA Statement**") which would have required in a no-deal Brexit situation for the MiFIR share trading obligation to apply to shares with ISINs containing an EU member state prefix and also to a list of shares with ISINs containing the "GB" prefix.

[6] Paragraph 261 of the Equity CP.

- As a result of the ESMA Statement, had a no-deal Brexit occurred (and in the absence of equivalence for UK trading venues), EU27 MiFID firms would have been prohibited from trading those in-scope shares on UK trading venues.

- Conversely, had a no-deal Brexit occurred and had the FCA adopted the same approach as ESMA for the purposes of the separate share trading obligation in the UK's onshored version of MiFIR (which would have come into effect upon a no-deal Brexit), UK MiFID firms would have been prohibited from trading shares with a "GB" ISIN prefix and certain shares with an "EU" ISIN prefix that had sufficient UK liquidity on EU trading venues.

- The overlap of shares being subject to both the share trading obligation in MiFIR and the equivalent share trading obligation in the UK's onshored version of MiFIR was concerning for MFA members given the high expectation that this would have resulted in a liquidity split occurring for such shares as between EU and UK trading venues and, as a corollary, would have impacted the ability for EU and UK firms to achieve best execution.

- The concerns about the STO remain particularly valid in the eventuality that EU and UK trading venues do not receive mutual equivalence for the purposes of the EU's and UK's respective share trading obligation before the end of the Brexit implementation period (occurring on December 31, 2020).

- Given the practical difficulties identified, MFA supports the exclusion of third country shares from the scope of the share trading obligation.

- Of the alternative approaches to identifying third country shares as proposed by ESMA, MFA considers the ISIN approach to have the benefit of simplicity and is likely to be the most effective.

- However, we note that even the ISIN approach has its limitations given that having an EU ISIN prefix is merely a proxy for indicating that there is sufficient EU liquidity in those shares and such prefix is not, in itself, evidence of sufficient EU liquidity. As acknowledged by ESMA "*... it fails to take into account that some non-EU ISINs are primarily or only traded in the EU (and therefore should be subject to the share trading obligation) while some EU ISINs barely trade on EU trading venues (even though those instruments are available for trading on EU trading venues)"*.[7]

- Though ESMA states that the limitation described above *"... only concerns a limited number of ISINs"*, it would be helpful to understand how ESMA had come to this conclusion (in particular, on what data has ESMA relied) given that the need for ESMA to determine an alternative approach to identifying third country shares is, in part, due to ESMA's limited access to third country liquidity data. By ESMA's own

[7] Paragraph 274 of the Equity CP.

acknowledgement, "*ESMA only has access to EU data and, in the past months, had to rely on other criteria and proxies to identify third country shares*."[8]

- In the event that ESMA decides to adopt the ISIN approach, MFA does not agree with ESMA's proposals to supplement this approach with the inclusion of non-EU ISIN prefixed shares for which its issuer had actively sought for those shares to be admitted on an EU trading venue.

- MFA considers that the adoption of this supplemental approach would lead to the materialisation of the main concern previously raised in the eventuality of a no-deal Brexit (in particular, as pertaining to the overlapping of equivalent share trading obligations as applicable in the EU and in third countries and its effect on the market).

- For example, adoption of this supplemental approach would likely lead to the UK Financial Conduct Authority ("**FCA**") following suit for the purposes of the share trading obligation in the UK's onshored version of MiFIR, which will come into effect at the end of the Brexit implementation period.

- Should this occur and assuming EU and UK trading venues do not receive mutual equivalence by this date, it is likely that a high number of shares would be subject to both the EU and UK share trading obligation. In turn, this would likely result in a liquidity split in such shares as between EU and UK trading venues and, as a corollary, would impact the ability for EU and UK firms to achieve best execution.

- The adoption of the ISIN approach, without supplementing the approach as described by ESMA, would significantly mitigate the risk of EU / third country overlap as regards to equivalent share trading obligations and, as a corollary, would avoid market fragmentation in in-scope shares.

- Additionally, in the absence of a mechanism to comprehensively and accurately identify third country shares, ESMA may wish to consider weighing the utility of retaining the share trading obligation against the potential risk of damage to markets in shares that are caught as in-scope of the MiFIR share trading obligation but for which there is insufficient EU liquidity.

- Given the practical difficulties with constructing a share trading obligation that achieves the objectives of greater transparency and best execution for investors, MFA agrees with the recent German Finance Ministry position paper which says that "*the intended benefits and the shortcomings of the [share trading obligation] should be thoroughly analysed*". We further agree with the German Finance Ministry that the MiFIR share trading obligation could be repealed if necessary. In our view, if the share trading obligation is not clearly facilitating best execution for investors, policymakers should reconsider whether a robustly enforced best execution principle would be more effective than retaining the share trading obligation.

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[8] Paragraph 272 of the Equity CP.

Ability to Trade In-Scope Shares with SIs

- Whilst MFA supports ESMA's aim to reduce market fragmentation, MFA does not support ESMA's proposal to remove the ability for firms to trade shares that are in-scope of the share trading obligation on SIs.

- The ability to directly purchase shares from an SI, rather than on a trading venue, adds optionality to the manner in which a firm may execute its trades. In particular, the ability to execute a share trade on the basis of a quote obtained from an SI produces an advantage for the SI's client with respect to price certainty and execution certainty that is not always present when placing an order on a trading venue.

- MFA considers maintaining the current breadth of execution optionality is an important tool to enable firms to achieve best execution.

V. OTC Transactions Not Subject to the Share Trading Obligation

- MFA requests clarification on ESMA's proposal for transactions not subject to the trading obligation for shares but subject to post-trade transparency requirements to be reported to FITRS.

- In particular, MFA requests clarification on how, practically, ESMA envisages firms should report this data to FITRS.

VI. Pre-Trade Transparency of Systematic Internalisers (Non-Equities)

- MFA supports ESMA's aim to simplify the requirements for SI quotes in non-equity instruments.

- We note ESMA's observation that, in its current form, the pre-trade transparency regime for SIs in illiquid non-equity instruments has limited practical utility. In particular, we refer to ESMA's statement that "*In practice, as evidenced by the ad-hoc SI data and the magnitude of quoted volumes provided under a pre-trade transparency waiver, it would appear that the obligation to "disclose quotes to clients on request" is hardly ever applied."*[9]

- MFA agrees with ESMA that (as one of the alternative options noted by ESMA as available) to impose the quote publication requirement as currently applicable to liquid non-equity instruments also to illiquid non-equity instruments, but then to provide a waiver for illiquid instruments to ensure a level playing field between SIs and EU trading venue, would indeed be "*circular, complex and suboptimal*".[10]

- Given the limited options remaining, MFA supports ESMA's alternative proposal to remove the obligation to "*disclose quotes to clients on request*" for illiquid non-equity

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[9] Paragraph 47 of the SI Non-Equity CP.
[10] Paragraph 49 of the SI Non-Equity CP.

instruments (i.e. to delete Article 18(2) of MiFIR) and, instead, for ESMA to develop ad-hoc supervisory convergence tools for SIs to better determine which quotes are in instruments that are sufficiently liquid and, hence, should be subject to the pre-trade transparency requirement.

MFA would be pleased to discuss the issues addressed in this letter with ESMA. Please do not hesitate to contact Michael Pedroni (mpedroni@managedfunds.org) or Matthew Newell (mnewell@managedfunds.org) in relation to the issues raised in this letter.

Respectfully submitted,

/s/ Michael N. Pedroni

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