European Fund and Asset Management Association

EFAMA REPLY TO ESMA's CONSULTATION PAPER ON THE AMENDMENT TO RTS 11 (ESMA70-156-357)

From an EFAMA's perspective, our comments are mostly oriented towards the importance of the tick size regime in its influence on the pricing and liquidity assessment of the markets.

From a general standpoint

1. We support efforts to drive consistency of the application of the tick size regime across the European member states, with the intend to reduce risk of increase in spreads on European trading venues;
2. Whilst each of the four options proposed by ESMA has merit, our preference is for option (d). "Coordination" however it means meaningful dialogue between trading venue and regulator, the outcomes of which should adequately reflect the technical expertise of the relevant trading venue;
3. We also wish to insist on the fact that ESMA must maintain in its regime the possibility to cross prices at mid-market prices across multiple venues and multiple venues type. Without this possibility, transactions below Large in Scale thresholds will lose economical interest and market would face liquidity issues.
4. Additionally, regarding the operation of the ETF tick size regime to date, we note and ask ESMA to consider:
    - Where tick size application has been detrimental to spreads based on an ETF's price i.e. DAXEX where bucketing is based on price has widened spread significantly, from 1bp to 2bp.
    - Inconsistent application, where some trading venues apply the regime by ETF underlying holding location (ETF holds EU equities), and others by listing location (EU listed ETF holding no EU "underliers").
    - We also consider that regulating tick sizes should not apply to ETFs, as expressed already in 2014 in our reply to ESMA Discussion Paper on MiFIR. We believe that the evolution in the market has reached a point where the tick size for ETFs are considered by the market participants as the right ones. Setting an inappropriate tick size for ETFs could drive trading back to OTC trading and harm price discovery.

We would like to add some elements that we believe are important to set a tick size regime:

- ESMA should develop standards allowing the trading venues to fine-tune their offer according to their existing structure and products;
- ESMA should be cautious in setting its limits as to reducing liquidity or increasing spreads (in both situation, this would push trading out of trading venues);
- ESMA should provide a regime flexible enough to be able to follow market evolution, to maintain the availability of liquidity for smaller issuances.

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7. **: Do you agree with the proposed amendments to RTS 11 described above? If you do not, please explain why and what alternative you would suggest.**

Overall, we are supportive of tick-size harmonisation below LIS, subject to retaining the ability of venues (exchanges, MTFs and SIs) to execute at the midpoint.

We have also several comments on the modification proposed.

Regarding the proposed additional point 8 on coordination between competent authorities, we agree with ESMA's suggestion to use the fourth option proposed, porting the obligation to coordinate with other Competent Authorities.

However, we consider that if the issue is ultimately a competition issue between European and non-European venues, this issue should be handled by the European Commission, either in its DG Competition or in cross countries negotiations (independently of any Brexit aspects).

We would consequently propose:

Proposed Art. 3, 8, para. 1	
8. The competent authority for a specific share which has its main pool of liquidity located outside **the Union** may, for that share, adjust the average daily number of transactions calculated as per the procedure prescribed under paragraphs 2 to 7 so as to take into account more comprehensive trading data and ensure that trading in the concerned share is not unduly constrained and does not create disorderly trading conditions.	8. The competent authority for a specific share which has its main pool of liquidity located outside **the Union its country of issuance** may, for that share, adjust the average daily number of transactions calculated as per the procedure prescribed under paragraphs 2 to 7 so as to take into account more comprehensive trading data and ensure that trading in the concerned share is not unduly constrained and does not create disorderly trading conditions.

Regarding the proposed additional point 9, we challenge the location criteria "outside of the Union".

Indeed, we do not consider that it is neither ESMA's role nor any CA to collect data on most traded venues for shares traded outside of the Union. Should European venues consider that they are subject to unlevelled playing field at international level.

Conversely, if the comparison is made between European venues, ESMA must ensure harmonised application of the MiFID II rules and should enforce coordination mechanisms between CA.

We would therefore propose:

Proposed Art. 3, 9, (a)	
(a) the competent authority for the relevant share proposing the adjustment shall be able to reasonably demonstrate, based on numerical	(a) the competent authority for the relevant share proposing the adjustment shall be able to reasonably demonstrate, based on numerical

evidence, that the most liquid trading venue for that share is located outside **the Union**;	evidence, that the most liquid trading venue for that share is located outside **the Union its country of issuance**;

Regarding the proposed additional point 10, we agree with ESMA's proposed implementing approach.

1. **: Do you agree not to include depositary receipts in the scope of instruments for which the ADNT could be adjusted? If not, please provide evidence supporting their inclusion.**

We agree with the proposed approach, considering the different nature of DRs.

2. **: Do you agree with ESMA's assessment that the first months of application of the new tick size regime have not fundamentally called into question the calibration of this regime? If not, please provide evidence of any detrimental effects that you consider the current regime is causing.**

With the same figures and relying also on the AMF report used as reference by ESMA, we reach the opposite conclusion. From our perspective, the recognition of impacts on spread demonstrates at this early stage the need to revise the tick size regime as currently defined, also for the regime of SIs (see below).

3. **: Do you consider that ESMA should introduce some clarifications regarding ETFs within the scope of the mandatory tick size regime? If yes, please explain which ones.**

As expressed already in 2014, we consider that relying on the volume of trading on ETF in Europe is irrelevant, as we consider that the figures registered by stock exchanges are not sufficient as market makers are frequently publishing only a fraction of their capabilities.

We also insist on the fact that the major liquidity of the ETFs is coming only from the basket of underlying assets' liquidity.

The most appropriate view of liquidity should therefore be based upon the underlying securities held by the ETF.

Due to the open-ended nature of ETFs this liquidity can be accessed through the Subscription and Redemption process, adding to the intrinsic liquidity of the ETF.

Implementation of the regime is not consistent for ETFs and varies from one exchange to another. It is also applicable to some, but not all i.e. systematic internalisers (SIs) vs. non-SI. And even where ETFs can use the upper end of the liquidity bands, we still end up with tick sizes >2bps in some instances, which is too large for some very liquid and heavily traded products.

For efficient ETF markets in liquid instruments a tick size should be closer to 1bp and no more than 1.5bps. Therefore, ETFs should have their own liquidity bands completely, or further liquidity bands should be created to capture the dynamic trading element of ETFs.

To do so, the liquidity thresholds proposed for ETFs would benefit from integrating criteria that take into account the liquidity of the underlying basket. While this might be difficult to implement for some exposures (notably in the Fixed Income space), we suggest below a possible way to measure liquidity for equity baskets:

ETFs	**Free Float (Number of units issued for trading)**	**Average daily number of transactions**	**Average daily turnover**
	100	20	500,000

Or (for Equity ETFs)

Underlying basket of stocks for Equity ETFs	**Free Float**	**Average daily number of transactions**	**Average daily turnover**
	EUR 100,000,000	250	EUR 1,000,000

With
Free Float = $\sum_{i=1}^{n} w_i \, ff_i$ where w_i is the weight of stock i in the underlying basket and ff_i is the Free Float of stock i
ADNT = $\sum_{i=1}^{n} w_i \, ADNT_i$ where w_i is the weight of stock i in the underlying basket and $ADNT_i$ is the Average daily number of transactions of stock i
ADV = $\sum_{i=1}^{n} w_i \, ADV_i$ where w_i is the weight of stock i in the underlying basket and ADV_i is the Average daily turnover of stock i

8. **CBA: Is there any specific provision in the draft RTS that you would expect to be a source of significant concerns or cost? If so, please elaborate**

We believe that the tick size regime for SIs remains insufficiently defined.

From of our concern and, we understand, one concern of the legislators and regulators, the regime defined for SIs was their ability to quote at any tick size, potentially having an unfair competitive advantage over exchanges. However, according to the views of our members and the figures collected from some brokers; around 80 % of transactions on SIs are traded at-tick, with a further about 10% quoted at a tenth of a tick. Therefore we consider that the potential competition with exchanges seems slightly exaggerated. We have also seen clearer reporting of the tape going from Q1 to Q2, with fewer distinct combination of condition codes, and the dropping of the Negotiated tag.

We see the objective of the definition of a tick size regime as a way to ensure that orderly and transparent trading takes place on trading venues through promoting the effective formation of prices on a displayed order book. It also helps to maintain a reasonable depth of liquidity whilst allowing spreads to fluctuate.

Therefore, we consider that the tick size regime is relevant for order book driven markets which are pre-trade transparent, and for alternative trading mechanisms that are comparable to such order book driven markets (e.g. accessed by market participants alongside - or as an alternative to - pre-trade transparent order books in the course of executing).

In that perspective, we wish to raise ESMA attention on an issue coming from the intention of Members of the Committee on Economic and Monetary Affairs (ECON) of the European Parliament to create a level playing field between SIs and trading venues. We consider that this would place artificial constraints on actual price formation and market transparency.

In line with our long standing position on the critical need to preserve liquidity for the execution and settlement of large transaction, we believe that ESMA should consider the following elements:

- Competition issue
  Trading venues may still conclude transactions at the midpoint, also for large negotiated trades.
  If SIs were subject to the tick size regime when dealing in sizes above SMS, SIs would
  - have a disadvantage vis-à-vis trading venues; and
  - would deprive investors from access to important sources of liquidity
- It is also essential that institutional investors seeking execution of large orders can do so at the midpoint of the Bid-Ask spread. The midpoint is understood and accepted globally as a fair execution price, and European markets would be materially harmed (and out of step with global markets) should the ability to execute at the midpoint be constrained.
- Price formation
  The application of the tick size regime on SI for trades above SMS may reduce the functioning of price formation for large transaction.
  This would introduce a bias against between investors depending on how rounding rules would be applied.
- Market stability
  Institutional investors investing for instance in an index that the fund tracks do not want causing the risk of a movement on that market.
  To protect that price market stability, institutional investors will mandate their broker, in its capacity as an SI, to start buying up that stock incrementally, tracking available liquidity at the average price at any given point in time and over a certain period.
  Since this reflects an average price of available liquidity, it will in most cases not be at a round tick.
  However, this would no longer be possible if tick size rules were to be applied to SIs.

Therefore, we consider that

- this matter should not be dealt with in the context of MiFIR and should rather be addressed in the context of the European Commission's proposal for a regulation of the European Parliament and of the Council on the prudential requirements of investment firms and amending Regulations (EU) No 575/2013, (EU) No 600/2014 and (EU) No 1093/2010 (COM(2017)0790 – C8-0453/2017 – 2017/0359 (COD)); and
- The tick size regime should apply to quotes pursuant to Article 14 of MiFIR; and
- ESMA must maintain in its regime the possibility to cross prices at mid-market prices across multiple venues and multiple venues type.

Consequently, we urge ESMA to engage also in a constructive dialogue with the ECON at an early stage to ensure legal consistency and insists on the fact that prices published by SIs should reflect prevailing market conditions as expressed in ESMA's regulatory technical standards 1 (RTS 1).

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Brussels, 7 September 2018
[18-4052]