



European Securities and
Markets Authority

Response Form to the Consultation Paper

MiFIR report on Systematic Internalisers in non-equity instruments



Responding to this paper

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

- respond to the question stated;
- indicate the specific question to which the comment relates;
- contain a clear rationale; and
- describe any alternatives ESMA should consider.

ESMA will consider all comments received by **18 March 2020**.

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

Instructions

In order to facilitate analysis of responses to the Consultation Paper, respondents are requested to follow the below steps when preparing and submitting their response:

1. Insert your responses to the questions in the Consultation Paper in the present response form.
2. Please do not remove tags of the type <ESMA_QUESTION_SINE_1>. Your response to each question has to be framed by the two tags corresponding to the question.
3. If you do not wish to respond to a given question, please do not delete it but simply leave the text "TYPE YOUR TEXT HERE" between the tags.
4. When you have drafted your response, name your response form according to the following convention: ESMA_SINE_nameofrespondent_RESPONSEFORM. For example, for a respondent named ABCD, the response form would be entitled ESMA_SINE_ABCD_RESPONSEFORM.

5. Upload the form containing your responses, in Word format, to ESMA's website (www.esma.europa.eu under the heading "Your input – Open Consultations" → "Consultation on MiFIR report on Systematic Internalisers in non-equity instruments").

Publication of responses

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

Data protection

Information on data protection can be found at www.esma.europa.eu under the heading [Legal Notice](#).

Who should read this paper

This paper is of interest mainly to systematic internalisers active in non-equity instruments as well as clients of such systematic internalisers, and any associations representing their interest.

General information about respondent

Name of the company / organisation	Deutsche Börse Group
Activity	Regulated markets/Exchanges/Trading Systems
Are you representing an association?	<input type="checkbox"/>
Country/Region	Germany

Introduction

Please make your introductory comments below, if any

<ESMA_COMMENT_CP_SINE_1>

Deutsche Börse Group (DBG) appreciates the opportunity to respond to ESMA's consultation on its MiFIR report on Systematic Internalisers in non-equity instruments. In general, DBG welcomes ESMA's proposals to make the transparency regime for SIs more efficient. Any changes to the quoting and disclosure requirements should cater for a level playing field compared to the transparency provided by multilateral venues.

DBG sees an unlevel playing field between SIs and multilateral venues in terms of transparency requirements. We agree with ESMA's findings that trading in the non-equity space is still opaque and there was no increase in transparency triggered by MiFID II compared to MiFID I. This is particular the case for SI trading where there is seemingly no pre- and post-trade transparency available, especially to the detriment of retail investors.

ESMA rightly concludes that below the SSTI thresholds, there is no significant quoting or trading by SIs. Against this background it is counterintuitive that SSTI thresholds applicable to SIs are below LIS thresholds applicable to regulated exchanges. LIS thresholds imply ESMA's understanding that below a certain notional/ number of contracts trading volumes can be and hence must be absorbed by orderbooks, to maximize the level of transparency, the number of market players competing for these trading volumes and ultimately the quality of prices and liquidity available to end customers.

While we do not question the merit of SIs forming part of the EU financial market's landscape, to create a level playing field across all types of execution venues, we strongly recommend closing the gap between SSTI thresholds and LIS thresholds for derivatives, effectively

allowing trading in sizes below LIS/SSTI on regulated markets, MTFs and OTFs only. Turning these different types of thresholds into only one threshold applicable across all execution venues in these instruments, permits quasi- or de-facto-bilateral trading only for trade sizes that cannot be absorbed by public orderbooks.

For bonds the LIS threshold may be too high to require all trading below LIS to happen on a RM, MTF or OTF. Therefore, we recommend for the special case of bonds to require trading of sizes at or below 100.000 EUR to be executed on a transparent trading venue. The threshold of 100.000 EUR is used by the prospectus regulation to ease the requirements for issuers of bonds for the publication of a prospectus. Furthermore, pursuant to RTS 2 trades below 100.000 EUR are not relevant for the consideration of the liquidity of a bond. Therefore, this threshold is suited to delineate lit trading from dark trading and to bring more liquidity onto orderbooks on transparent markets (Q6).

Further, we strongly disagree with ESMA's proposal to simplify the requirements in relation to SI quotes in liquid non-equity instruments. A quote against which only a subset of a SI's clients is entitled to trade decreases transparency and liquidity available to the overall market. A quote provided to one client, without the requirement to allow other clients to participate in the execution at this price is bilateral trading and must be avoided below LIS thresholds (Q8).

As regards transparency requirements for SI's in non-liquid instruments, DBG supports ESMA's proposed option 2 and hence a Level 1 change in Art. 18.2 MiFIR to include all instruments in a proportionate manner into the transparency regime for which there is a liquid market (Q9).

As regards the arrangements for publishing quotes, we recommend that the formats to disclose quotes should be the same for all types of execution venues in order to ensure a level playing field between all types of execution venues (Q10).

On ESMA's question regarding the analysis of derivatives data and the relation with the SSTI threshold, we recommend considering the fundamental logic behind the definition of SSTI thresholds and the overall impact these thresholds have on the wider market rather than focusing on specific numeric thresholds. We therefore argue to change the underlying methodology for SSTI thresholds, and make them identical to LIS thresholds (Q12)

Finally, we concur with ESMA's analysis and FESE observations that there are gaps in the application and enforcement of the SI legal framework to the detriment of transparent trading. ESMA should review how SIs operate by looking more deeply into the transactions they conclude and report with a view to enforce existing rules.

- Address inconsistent and unclear flagging of SI trades, e.g. by a broader implementation of the Market Model Typology (MMT) which currently ensures consistency of exchange data, to increase supervisory control of SI activity.
- Monitor riskless principal trading to ensure that SIs truly provide bilateral trading and do not engage in multilateral matching arrangements without being subject to corresponding requirements, as some investment firms seem to have developed models by which third party firms can provide liquidity to SI clients.

- Create a level playing field in the registration process of SIs and trading venues as regards the description of the business model and how regulatory compliance is maintained.

<ESMA_COMMENT_CP_SINE_1>

Questions

- Q1** : Do you consider that there is a need to clarify what a “firm quote” is? If so, in your view, what are the characteristics to be met by such quote?

<ESMA_QUESTION_CP_SINE_1>

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<ESMA_QUESTION_CP_SINE_1>

- Q2** : (For SI clients) As a SI client, do you have easy access to the quotes published, i.e. can you potentially trade against those quotes when you are not the requestor? Do you happen to trade against SIs quotes when you are not the initial requestor? How often? If it varies across asset classes, please explain.

<ESMA_QUESTION_CP_SINE_2>

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<ESMA_QUESTION_CP_SINE_2>

- Q3** : What is your overall assessment of the pre-trade transparency provided by SIs in liquid non-equity instruments? Do you have any suggestion to amend the existing pre-trade transparency obligations? If so, please explain which ones and why.

<ESMA_QUESTION_CP_SINE_3>

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<ESMA_QUESTION_CP_SINE_3>

- Q4** : (For SI clients) do you have access to quotes in illiquid instruments? If so, how often do you request access to those quotes? What is your assessment of the pre-trade transparency provided by SIs in illiquid instruments?

<ESMA_QUESTION_CP_SINE_4>

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<ESMA_QUESTION_CP_SINE_4>

- Q5** : (For SIs) Do you disclose quotes in illiquid instruments to clients upon request or do you operate under a pre-trade transparency waiver? In the former case, how often are you requested to disclose quotes (rarely, often, very often)? Does it vary across instruments / asset classes?

<ESMA_QUESTION_CP_SINE_5>

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<ESMA_QUESTION_CP_SINE_5>

Q6 : Do you consider that there is an unlevel playing field between SIs and multilateral trading venues active in non-equity instruments, in particular with respect to pre-trade transparency? If so, please explain why and suggest potential remedies.

<ESMA_QUESTION_CP_SINE_6>

DBG sees an unlevel playing field between SIs and multilateral venues active in non-equity instruments, in particular as regards pre-trade transparency. For example, regarding bonds and securitized derivatives, trading is still opaque and there was no increase in transparency triggered by MiFID II compared to MiFID I. This is particular the case for SI trading where there is seemingly no pre- and post-trade transparency available, especially to the detriment of retail investors. Transparency is established by SIs via proprietary means, via their websites, via ECN-like networks or has not to be established at all (for illiquid bonds). In a fragmented market structure with 166 SI's in bonds and 45 SI's in securitized derivatives.

While SIs are regulated under MiFID II as execution venues providing bilateral trading, they provide less transparency for non-equity instruments than on-exchange trading. While it is true that SIs have to disclose their identity when quotes are made public and have to put their own capital at risk, it is questionable whether trading on an SI instead of trading on a regulated exchange benefits the overall financial market.

On regulated exchanges, while anonymously, liquidity is disclosed to and available to all members of the exchange. Furthermore, information is made available to the public as well. The regulator has appreciated that (only) above certain thresholds, i.e. LIS thresholds, the risk of potentially detrimental prices and potential front-running or market manipulation outweighs the maximum level of pre-trade transparency provided by regulated exchanges.

While SIs disclose their identity, they are only required to disclose and offer liquidity to a much smaller sub-set of market participants than regulated exchanges, differentiating between their own customers.

At least in theory, an unlimited number of derivatives by different issuers can be issued for the same underlying. As such, even if it is not ETDs that are tradable on an SI, derivatives trading volumes on SIs compete with derivatives trading volumes on regulated exchanges, whenever they concern the same or similar underlyings. The degree of competition between the respective products depends on the relevant product structures and the degree of correlation between the relevant underlyings.

It is commonly understood that publicly available orderbooks of regulated exchanges maximize transparency and hence benefits for overall financial markets. Therefore, orderbook trading at regulated exchanges should be encouraged by financial regulation wherever possible.

Against this background it is counterintuitive that SSTI thresholds applicable to SIs are below LIS thresholds applicable to regulated exchanges. LIS thresholds imply ESMA's understanding that below a certain size/notional/ number of contracts trading volumes can be and hence must be absorbed by orderbooks, to maximize the level of transparency, the number of market players competing for these trading volumes and ultimately the quality of prices and liquidity available to end customers.

Allowing SSTI thresholds to be below LIS thresholds implies that even though certain trade sizes could be absorbed by publicly available orderbooks, liquidity of orderbooks is compromised and threatened to be fragmented by trading these trade sizes on SIs instead.

The argument that the disclosed identity of the SI provides a higher level of transparency than trading in a regulated exchange's orderbook does not hold true for centrally cleared products, as for these products the identity of each trades' counterparty, namely the CCP, is also known to all market participants before any trade is executed.

The argument that SIs have to hold their own capital against trades executed on the SI, does not benefit the SI's customers other than by implicitly decreasing their SI's counterparty credit risk towards them. However, considering the stringent prudential framework applicable to all EU CCPs, it can be assumed that a centrally cleared trade bears lower counterparty credit risk than a trade executed on an SI, all other things equal.

While we do not question the merit of SIs forming part of the EU financial market's landscape, to create a level playing field across all types of execution venues, we strongly recommend closing the gap between SSTI thresholds and LIS thresholds. Turning these different types of thresholds into only one threshold applicable across all execution venues, permits quasi- or de-facto-bilateral trading only for trade sizes that cannot be absorbed by public orderbooks. Requiring trading of sizes below LIS on transparent RMs, MTFs and OTFs only would significantly reduce market fragmentation, aggregate liquidity and increase pre- and post-trade transparency in particular for retail investors.

For bonds the LIS threshold may be too high to require all trading below LIS to happen on a RM, MTF or OTF. Therefore, we recommend for the special case of bonds to require trading of sizes at or below 100.000 EUR to be executed on a transparent trading venue. The threshold of 100.000 EUR is used by the prospectus regulation to ease the requirements for issuers of bonds for the publication of a prospectus. Furthermore, pursuant to RTS 2 trades below 100.000 EUR are not relevant for the consideration of the liquidity of a bond. Therefore, this threshold is suited to delineate lit trading from dark trading and to bring more liquidity onto orderbooks on transparent markets.

<ESMA_QUESTION_CP_SINE_6>

Q7 : (for SIs who are also providing liquidity on trading venues): What are the key factors that determine whether quote requesters (your clients) want to receive the quote through the facilities of a trading venue or through your own bilateral trading facilities?

<ESMA_QUESTION_CP_SINE_7>

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<ESMA_QUESTION_CP_SINE_7>

Q8 : What is your view on the proposal to simplify the requirements in relation to SI quotes in liquid non-equity instruments under Article 16(6) and 18(7)?

<ESMA_QUESTION_CP_SINE_8>

We strongly disagree with the proposal. The difference between a market participant providing a quote in a public orderbook and an SI providing a quote to a customer, is that the first does

not discriminate against potential market participants who can make use of the offered liquidity. A quote in an orderbook displays the total size available for any participant of the exchange to trade against at this price. A quote that can be traded against by all clients of an SI, follows the same logic. A quote against which only a subset of a SI's clients is entitled to trade (because only this subset is shown the quote) decreases transparency and liquidity available to the overall market. A quote provided to one client, without the requirement to allow other clients to participate in the execution at this price is bilateral trading and must be avoided below LIS thresholds. Transparency available to the public would foster competition in the same way as in the case of fully transparency provided by exchanges in the equity markets.

<ESMA_QUESTION_CP_SINE_8>

Q9 : Do you consider that the requirements in relation to SI quotes in illiquid non-equity instruments (Article 18(2)) are appropriate? What is your preference between the options presented in paragraph 52 (please justify)?

<ESMA_QUESTION_CP_SINE_9>

DBG does not see any reason why transparency requirements for SI's in liquid instruments should not be extended to illiquid instruments incl. a fully fletched waiver process for SI's. In markets where bonds or securitized derivatives may only trade less often price information provided by pre-trade transparency would increase the quality of the price formation.

DBG agrees with ESMA's conclusion in the equity consultation paper that an extension of the transparency obligation for SI's to illiquid instruments would be an effective way to improve market transparency and level the playing field between on-venue and SI trading given that SI currently benefit from a competitive advantage as a considerable part of trading is still not subject to any pre-trade transparency requirements. This is even more the case for bonds and securitized derivatives where the main part of trading takes place in the dark between SIs and its clients. Furthermore, in such an opaque market it is unclear how best execution may be obtained.

Illiquid instruments are in scope for pre-trade transparency for all trading venues unless a waiver from pre-trade transparency is used. DBG supports the approach to remove the pre-trade transparency waivers (non-liquid waiver) except for LIS and OMF also for bonds and securitized derivatives. Consequently, DBG supports option 2 and hence a Level 1 change in article 18 (2) of MiFIR to include all instruments in a proportionate manner into the transparency regime for which there is a liquid market. DBG is not of the view that such new requirements would be overly burdensome for SIs. Rather, they would effectively foster lit trading and overall transparency for the benefit of more stable EU markets.

<ESMA_QUESTION_CP_SINE_9>

Q10 : What is your view on the recommendation to specify the arrangements for publishing quotes?

<ESMA_QUESTION_CP_SINE_10>

SI quotes (and prices) in bonds and securitized derivatives are mainly available using proprietary arrangements (if any) and websites of SIs. This conflicts with the aim to increase transparency in the traditionally opaque markets in these instruments. Therefore, DBG strongly supports ESMA's proposal to define the requirements to be met by SIs in non-equity

instruments for publishing their quotes and to extend the requirements set out in Article 13 of Commission Delegated Regulation (EU) No 2017/567 on obligations for systematic internalisers to make quotes easily accessible to SIs in non-equity instruments.

<ESMA_QUESTION_CP_SINE_10>

Q11 : Do you have any comment on the analysis of Bond data and the relation with the SSTI thresholds as presented above?

<ESMA_QUESTION_CP_SINE_11>

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<ESMA_QUESTION_CP_SINE_11>

Q12 : Do you have any comment on the analysis of derivatives data and the relation with the SSTI threshold as presented above?

<ESMA_QUESTION_CP_SINE_12>

We believe paragraph 89 to be of crucial importance for the response to this question. If SSTIs (at least for certain derivatives) happen to be currently set to values, which make it (close to) impossible to quote or trade below these thresholds, the results of the numeric analysis, while interesting, are flawed.

As such, and rather than focusing on specific numeric thresholds we recommend for ESMA to consider the fundamental logic behind the definition of SSTI thresholds and the overall impact these thresholds have on the wider market. As explained in more detail in our response to Q6, we strongly recommend changing the underlying methodology for SSTI thresholds, and make them identical to LIS thresholds.

<ESMA_QUESTION_CP_SINE_12>

Q13 : What is your view on the influence of the SSTI thresholds on the pre-trade transparency framework for SI active in non-equity instruments? Are there any changes to the legal framework that you would consider necessary in this respect?

<ESMA_QUESTION_CP_SINE_13>

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<ESMA_QUESTION_CP_SINE_13>

Q14 : What is your view on the best way for ESMA to fulfil the mandate related to whether quoted and traded prices reflect prevailing market conditions and in particular: (1) the source of data for the SI quotes/trades (RTS 27, APA); (2) the source of market data prices; and (3) the methodology to compare the two and formulate an assessment?

<ESMA_QUESTION_CP_SINE_14>

Non-equity markets are usually dealer-organized markets and as such rather opaque to the public including competitors. Market conditions in such markets could be referenced by comparing pre- and post-trade data across SIs at the same time (millisec). ESMA could therefore request data sets to be provided to ESMA for selected time slots on demand.

<ESMA_QUESTION_CP_SINE_14>