

**ESMA CONSULTATION PAPER  
ON THE FUNCTIONING OF ORGANISED TRADING  
FACILITIES (OTF)**

**AMAFI contribution**

**Association française des marchés financiers (AMAFI)** is the trade organisation working at national, European and international levels to represent financial market participants in France. It acts on behalf of credit institutions, investment firms and trading and post-trade infrastructures, regardless of where they operate or where their clients or counterparties are located. AMAFI's members operate for their own account or for clients in different segments, particularly organised and over-the-counter markets for equities, fixed-income products and derivatives, including commodities.

AMAFI welcomes the opportunity to respond to this consultation paper (hereafter the CP). As a matter of fact, the regulation of OTFs is a key concern for AMAFI, considering the 5 OTF arrangements identified in ESMA's consultation paper are AMAFI members. In a post-Brexit context, French OTFs may have a prominent position in the EU27 landscape.

Before answering the specific questions raised in the CP, AMAFI would like to highlight the following general comments.

## GENERAL COMMENTS

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In preamble, AMAFI notes that some data and chart include the UK volumes while others do not which makes it difficult to interpret the figures. Furthermore, AMAFI would like to stress that Brexit will change the trading landscape in the EU. This is why AMAFI considers that any major reform of the organisation of the markets in Europe should not be undertaken until it is possible to observe how the market is being distorted as a result of Brexit, and how activity is localised between the UK and the EU-27, particularly for products that are not subject to a trading obligation.

The OTF regime was newly introduced by MiFID II. Two years following its implementation, it is clear that the main French interdealers brokers act as OTF operators of multilateral trading systems for non-equity instruments. In the following AMAFI highlights the main teachings that can be drawn:

- AMAFI believes that ESMA should prioritize the uniform application of the supervisory perimeter to platforms that are functioning as multilateral systems but for various reasons have not yet been authorized as trading venues. It is important that such platforms are mandated to seek authorization, since their unsupervised status leads to the accumulation of risks. It also leads to an unlevel playing field with those platforms that are correctly regulated as venues. To the extent that being unsupervised allows platforms to operate at a lower cost base than regulated venues (they have no compliance costs) this encourages clients to move away from regulated entities and subsequently encourages regulated entities to become unregulated. **As such AMAFI embraces ESMA's proposals for a consistent application of the supervisory perimeter across the EU.**
- Pre-arranging transactions (under a 'reception & transmission of orders' license); is and should remain a separate licensable activity. ESMA Q&A 11, MIFID II/R transparency topics correctly addresses this. Ultimately, such transactions may be submitted to an authorised trading venue, all under the rules of the trading venue. Problems arise when firms that engage in multilateral activity are not regulated as either pre-arranger nor venue and ESMA should address this problem by bringing these firms into the supervisory scope. The distinction itself should remain, and firms that pre-arrange should be regulated as such and not as venues.

## ANSWERS

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**Q1: What are your views about the current OTFs landscape in the EU? What is your initial assessment of the efficiency and usefulness of the OTF regime so far?**

AMAFI notes that some data and chart include the UK volumes while others do not which makes it difficult to interpret the figures.

The creation of the OTF usefully and efficiently widened the regulatory scope of MiFID, while recognizing the specificities of voice and hybrid electronic/voice execution models. OTFs are key venues in both the interdealer and dealer-to-client market. In the interdealer market, the expertise and network of brokers allows dealers to offload risk at lower transaction costs. In the dealer-to-client markets (and particularly in France), OTFs help investors execute often complex transactions in an 'agency' capacity.

**Q2: Trading in OTFs has been fairly stable and concentrated in certain type of instruments throughout the application of MiFID II. How would you explain those findings? What in your view incentivizes market participants to trade on OTFs? How do you see the OTF landscape evolving in the near future?**

As stated above, and with regard to the French market, the larger investment firms were the first captured by the OTF regime, and were also pressured by their clients to seek authorisation to operate an OTF, mainly for considerations related to post-trade transparency requirements.

The sector's stable market share demonstrates that, despite the rise of e-trading, the human factor remains key; particularly for large and complex transactions. Nevertheless, the role of technology within the OTF (in a hybrid between human and electronic trading system components) is likely to increase. This is, for example, apparent in the success of volume matching; which is an electronic auction where the broker can propose a mid price.

**Q3: Do you concur with ESMA's clarifications above regarding the application of Article 1(7) and Article 4(19) of MiFID II? If yes, do you agree with the ESMA proposed amendment of Level 1? Which other amendment of the Level 1 text would you consider to be necessary?**

AMAFI agrees with ESMA's clarifications regarding the application of Article 1(7) and Article 4(19) and agrees with the proposed amendments of Level 1 seeking to increase certainty and increase regulatory convergence.

**Q4: Do you agree with ESMA's two-step approach? If not, which alternative should ESMA consider?**

AMAFI agrees with ESMA's two-step approach. That being said, AMAFI considers that ESMA, before providing any guidance, may wish to consider further consulting with the main trade associations representing OTF operators such as AMAFI, so that these can help with practical examples and advise. From that perspective ESMA may wish to express its interpretation in a RTS rather than in an Opinion, which would formalize the consultation process and as such could provide more direction to regulators.

**Q5: Do you agree with ESMA's proposal not to amend the OTF authorisation regime and not to exempt smaller entities? If not, based on which criteria should those smaller entities potentially subject to an OTF exemption be identified?**

AMAFI agrees that the OTF authorisation regime should not be amended to exempt smaller entities, and that such a step would unlevel the playing field. As per our response to question 3, AMAFI believes that the current regime should be amended in order to capture more entities (small or large) which are currently operating multilateral systems but as of yet remain unregulated and unsupervised.

**Q6: Which provisions applicable to OTFs are particularly burdensome to apply for less sophisticated firms? Which Level 1 or Level 2 amendments would alleviate this regulatory burden without jeopardising the level playing field between OTFs and the convergent application of MiFID II/MiFIR rules in the EU?**

Venue authorisation rules improve investor protection and market transparency. If certain requirements are unnecessary in light of these policy objectives, any relief should apply to the market as a whole and not single out a specific subgroup. Otherwise, risk will concentrate in parts of the market that are outside of the supervisory perimeter.

In light of this, we support measures that would reduce the burden of producing Best Execution reports for all supervised entities.

**Q7: Do you consider that ESMA should publish further guidance on the difference between the operation of an OTF, or other multilateral systems, and other investment services (primarily Reception and Transmission of Orders and Execution of orders on behalf of clients)? If yes, what elements should be considered to differentiate between the operation of multilateral systems and these other investment services?**

The distinction between venue operation and other investment services is well recognized and does not require further guidance. AMAFI members often act in both capacities. They not only operate venues, but they also arrange trading interests outside of a trading venue (under their 'reception & transmission of orders' permit) for the purpose of submitting concluded trades to a trading venue. This logically follows from ESMA's position that there should be a single trading venue for the execution of a trade.

It would be unhelpful to treat the activity of the broker, taking place outside of a venue but with the aim of transmitting matched interests to that trading venue, as part of the trading systems of the venue. There would be a proliferation of venues that would only exist to send trades to other venues for execution. What is key is that the relevant trade is ultimately executed on or under the rules of the venue

**Q8: Do you consider that there are networks of SIs currently operating in such a way that it would in your view qualify as a multilateral system? Please give concrete examples.**

AMAFI fully agrees with ESMA's statement that the clarifications included in the Q&As are sufficiently clear to distinguish where the trading activity of an SI is purely bilateral and which arrangements should be considered as multilateral activity. It is a matter of supervisory guidance. AMAFI is not aware of any networks of SIs currently operating in a way that would qualify as a multilateral system.

**Q9: Do you agree that the line differentiating bilateral and multilateral trading in the context of SIs is sufficiently clear? Do you think there should be a Level 1 amendment?**

AMAFI agrees that the line differentiating bilateral and multilateral trading in the context of SIs is sufficiently clear.

**Q10: What are the main characteristics of software providers and how to categorise them? Amongst these business models of software providers, which are those that in your view constitute a multilateral system and should be authorised as such?**

From a general perspective, AMAFI considers that if some software providers are operating *de facto* multilateral trading systems, they should seek authorisation under MiFID II, to ensure a level playing field with entities authorised to operate multilateral trading systems.

According to our members, several software providers fall under this category.

AMAFI would propose activity-based regulation which does not regulate software providers based on how they characterise themselves, but rather on what activities they undertake. As such, there are providers that engage in multilateral activity (and therefore should be regulated as venues) and those that do not. In order to determine whether they fall in the first or the second category, it is helpful to distinguish between two types of software companies: those that provide distributed trading mechanisms and those that provide insourced trading mechanisms

#### Distributed Trading Mechanisms

There are technology providers that make available to their client's technology that enables trading interests entered by each client to be made visible to and actionable by other clients.

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.

These arguments are irrelevant 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.

It should make no difference under MiFID II 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.

#### 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.

Their technology forms part of the broker's own system, which may be a combination of voice and electronic components. 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.

**Q11: Do you agree with the approach suggested by ESMA regarding software providers that pre-arranged transactions formalised on other authorised trading venues? Do you consider that this approach is sufficient to ensure a level playing field or do you think that ESMA should provide further clarifications or propose specific Level 1 amendments, and if so, which ones?**

Pre-arranging transactions (under a 'reception & transmission of orders' license); is and should remain a separate licensable activity whether provided by software companies or other firms. ESMA Q&A 11, MiFID II/R transparency topics correctly addresses this. Ultimately, such transactions may be submitted to an authorised trading venue, all under the rules of the trading venue. Problems arise when firms that engage in multilateral activity are not regulated as either pre-arranger nor venue and ESMA should address this problem by bringing these firms into the supervisory scope. The distinction itself should remain, and software firms that pre-arrange should be regulated as such and not as venues.

**Q12: Do you agree with the principles suggested by ESMA to identify a bulletin board? If not, please elaborate. Do you agree to amend Level 1 to include a definition of bulletin board?**

AMAFI agrees with ESMA's characterisation of bulletin boards according to Recital 8 of MiFIR and welcomes the proposed Level 1 amendment to include a definition of bulletin board.

**Q13: Are you aware of any facility operating as a bulletin board that would not comply with the principles identified above?**

AMAFI is not aware of such entities.

**Q14: Market participants that currently operate such systems are invited to share more detailed information on their crossing systems (scale of the activity, geographical coverage, instruments concerned, etc...), providing examples of such platforms and describing how much costs & fees are saved this way as opposed to executing the relevant transactions via brokers or trading venues.**

AMAFI is not in a position to answer this question.

**Q15: Do you consider that internal crossing systems allowing different fund managers within the same group to transact between themselves should be in scope of MiFID II or regarded as an investment management function covered under the AIFMD and UCITS? Please explain. In your view, should the regulatory treatment of these internal crossing system be clarified via a Level 1 change?**

AMAFI considers that internal crossing system operated by one or several fund manager(s) should be registered as OTF as long as it organizes the interaction “of multiple third-party buying and selling interests”.

**Q16: Do you agree with the interpretation provided by ESMA regarding how discretion should be applied and do you think the concept of discretion should be further clarified?**

AMAFI considers that there is no need to provide further clarification on the concept of discretion.

**Q17: For OTF operators: Do you apply discretion predominantly in placement of orders or in execution of orders? Does this depend on the type of trading system you operate? Please explain.**

In response to this question, AMAFI members operating an OTF stated that discretion in practice can equally apply to placement and execution, with the prevalence of each depending on the venue and its operating model.

**Q18: For OTF clients: Do you face any issue in the way OTF operators exercise discretion for order placement and order execution? If so, please explain. Does it appear to be used regularly in practice by OTF operators?**

AMAFI is not in a position to answer this question.

**Q19: Do you think ESMA should clarify any aspect in relation to MPT or that any specific measure in relation to MPT shall be recommended?**

We do not believe any clarification is needed.

**Q20: In your view what is the difference between MPT and riskless principal trading and should this difference be clarified in Level 1? In addition, what, in your view, incentivizes a firm to engage in MPT rather than in agency cross trades (i.e. trades where a broker arranges transactions between two of its clients but without interposing itself)?**

While the terms are mostly used interchangeably, it is our understanding that riskless principle is a US term, describing the situation in which a firm receives an order from a client to buy or sell a security and then sources the security or sells the security in the market as principal. Following that logic, MPT would be a subset of this category, in which a firm matches two client positions in different directions (buy and sell) and then interposes itself as the counterparty to each of the two legs.

Advantages of MPT include client anonymity and uniformity of credit risk to the client (no need for the client to consider the credit risk of each possible counterparty in the liquidity pool).

**Q21: Do you agree with ESMA's proposal to clarify that the prohibition of investment firms or market operators operating an MTF to execute client orders against proprietary capital or to engage in matched principal trading only applies to the MTF they operate, in line with the same wording as applicable to regulated markets?**

AMAFI fully agrees with ESMA proposal.

