WMBA

The Function of an Organised Trading Facility

1. Definition of admission to trading needs to focus on market participants

The Wholesale Market Brokers' Association (WMBA) and the London Energy Brokers' Association (LEBA) consider that the suggested definition of 'admission to trading' is problematic by virtue of its product centric standpoint. Whilst equity markets have a single product and Regulated Markets list relatively few products compared to the number of participating counterparties, the derivatives markets are characterised by fewer major participants but an infinite variety of products. Indeed OTC Fixed Income markets for investment products are also characterised by a multitude of products relative to the number of participants and these products are often very rarely traded in the secondary markets.

The definition centres on the concept of 'allowing' a financial instrument to be traded, 'on its systems', which implies that a financial instrument is traded on a system (i.e. an exchange look-a-like) rather than through a system and may not necessarily accurately capture the non-discriminatory, impartial and open access gateways which have globally evolved to enable the best practice execution method per OTC product (which may often involve broker discretion and may be effectively an electronically referenced open-outcry).

This implies that an Interdealer Broker (IDB) will have to have some formalised procedures for 'allowing' financial instruments to be traded on its systems, maintain lists of instruments allowed and make them public. This should not prove difficult in their operation of MTFs as they should already have this hard wired into their trading procedures as products traded; however for all execution methods employed by IDBs it is the wholesale participants that are formalised and the products are described by these clients.

Therefore, to begin the enlargement process of the initial MiFID by adopting a product centric definition may only serve to obfuscate and create unintended consequences. THE WMBA believe that it would serve the legislation better to define the participants who are admitted to trading under MiFID categorisation rather than failing to attempt to capture an almost infinite spectrum of products.

Moreover, the concept of a "*Market Operator/Investment Firm*" who may be in control of the RM, MTF or OTF is misleading in the context of bilateral trades which are "arranged" by an IDB; where effectively it is the counterparties who are defining these terms. Therefore either a separate or bespoke review of the listed equities MiFID regime would be more appropriate. Consequently the jurisdiction of derivatives under MiFID2 needs to be defined in terms of the market participants.

2. Legislation requires a broad definition of 'Organised Trading Facility'

The WMBA is in agreement with the definition of an OTF as laid down in paragraph 2.2 of the Consultation Paper on MiFID. The WMBA are appreciative that the Commission has taken CESR advice to create the OTF category and further to widely utilise the term Organised Trading Venue to include all organised venues. Both of these categories were encouraged in our response to the CESR consultation process as it admits the vast majority of the OTC transactions entered into by our wholesale client base on the basis of their Professional and Eligible counterparty status.

We would however caution about the pre-trade transparency requirements in 2.23 since it is the nature of wholesale OTC and derivatives markets to trade in a non-frequent and non-continuous manner. We would also emphasise the potential dangers of aggregating the activities of IDBs and other platforms that match multiple bids and offers and which do not involve principal positioning, with SI's and similar single bank platforms where the capital treatment of the operator falls into an entirely different regulatory category.

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The WMBA is in general agreement with the requirements for OTFs (2.2.1 a) to h) in the MiFID consultation document), but urges that these should be supervised within the existing requirements for firms regulated on a Limited Activity basis. The Association believes that the definition of an OTF should be kept broad and that flexibility of currently liquid models should not be lost. OTFs should however, be restricted to facilities and systems operated by firms regulated by a Competent Authority and which are notifiable to ESMA.

3. Current definition of Investment Service under MiFID is sufficient

The current definition of Investment Service under Annex I, Section A of Directive 2004/39/EC is sufficient as it is to capture the operation of OTFs on the basis that this definition is currently acceptable for firms who are operating MTFs. Accordingly, the passporting rules as they currently apply to activities covered by the existing definition of an Investment Service should therefore, by default, apply to operators of OTFs.
There is no logic for including an Investment Service into the new framework of MiFID if it cannot be passported across Europe. Such action is against MiFID's underlying principles of promoting its single market objectives and through greater competition drive down costs and deliver better (and level) services.

4. Discretion in arranging a transaction - it is unnecessary and unworkable to mandate the conversion of an OTF to an MTF beyond a certain threshold

The flexibility envisaged by the definition of an OTF, regulated by ESMA and appropriate national authorities means that regulation mandating a conversion into an MTF appears unnecessary and counter-productive. In contrast to the terms defining an MTF, we understand that an IDB as an operator of an OTF is deploying a degree of discretion in order to discover matching pools of liquidity, in order to translate the economic terms of derivatives into contractual terms (for example option deltas into strike prices), and to match the credit requirements of counterparties to a transaction (such as the collateral required, credit rating or specifying the clearing pool).

Similar to an MTF, there is absolutely no discrimination between suitable counterparties. The WMBA would assume that authorised firms regulated under national authorities will be able to operate OTFs, which means that regulatory oversight of such entities should be satisfactory. An OTF would enable voice, hybrid/voice and electronic execution. Therefore the mandatory conversion into an MTF once an OTF has reached an asset specific threshold makes little sense and seems to provide no supervisory benefit.

It is difficult to understand what an asset specific threshold could be, as some OTFs may operate a number of different asset classes simultaneously to all global counterparties. Even within the same asset classes, instruments are likely to have very different ranges of liquidity. The liquidity volumes will often determine a customer's decision whether to trade electronically, by voice or hybrid. The share between these execution methods changes over time and one instrument that is very liquid at one time may not be at another time. This is particularly the case during periods of market stress, when inter-dealer electronic volumes tend to migrate to voice execution due to market volatility.
Accordingly it would be difficult to determine such a threshold. Furthermore once such a threshold is breached and an OTF did convert into an MTF, is it envisaged that if an MTF then dips back underneath the threshold it converts back in to an OTF? Such a scenario could cause some level of market chaos and mean that operating costs of the operators of an OTF become unmanageable. Furthermore our members' broker prices seamlessly across the globe, therefore any restrictions would need to be global in scope and recognition.
Finally requirements to report trades to trade repositories and/or regulators by market participants will provide market supervisors with sufficient trade transparency for voice trades without the need for any form of mandated conversion of OTFs into MTFs.

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5. All "*sufficiently liquid financial derivatives*" should be traded exclusively on RMs, MTFs or OTFs (subject to the final definition of an OTF)

THE WMBA members already successfully operate numerous MTFs for various derivative products. The migration of products onto these MTFs (regulated pure electronic and hybrid electronic trading platforms) has been evolutionary in response to the maturity and commoditisation of the derivative products in question.
If the objective of an OTF is to capture the entire universe of financial instruments matched by IDBs which are not transacted exclusively via an MTF, then the specification to liquid derivatives becomes confusing. Firstly derivative and cash products are separated without warrant. Secondly the inclusive nature of an OTF being defined as a "broad church" is undermined. Thirdly the term brings obfuscation with the "clearing eligible" categorisation in EMIR and the more generally unhelpful terminology of "Standardised Financial Instruments".
In respect of the above point, it is imperative that the Commission carefully considers the criteria for an instrument to be defined as a "liquid derivative". The establishment of a definition of "liquid derivative" which is too broad and not focused on the correct instruments is dangerous as the market liquidity of a derivative product can vary significantly, both globally and temporally (even intra-day), due to numerous market factors. We further have concerns with the additional requirements, such as continuous pre trade transparency as it might be implied from the Commission text.
We would argue that any new regulation for execution processes should continue to recognise and, therefore, continue to allow for "voice" interaction/execution in any definition of a Regulated Market, MTF, or Organised Trading Facility. This is important as the interaction of "voice" broking and "voice" sales expedites pricing/liquidity provision, which is a requirement for a market to operate efficiently during periods of stress. It is a dangerous precedent to imply that markets could be dictated to in terms of the methods by which they transact based on a "statistical analysis" basis as opposed to allowing markets to evolve naturally in the way they have done historically.

6. The definition and mandating of pre-trade transparency for OTFs is unnecessary and counter-productive

THE WMBA members understand that whilst broker screens and other electronic mediums offer the market participants a great deal of pre trade transparency, this varies greatly and proportionately across products and is differently accessible according to such things as the credit of the counterparties and the scale of the of the transaction.
We would therefore commend the Commission to only require fair and open access by all market participants to any firm pre-trade commitments which are currently being published.

7. The degree of post-trade transparency required to be made available by trade venues must be proportionate to preserving and enhancing market liquidity

THE WMBA is in agreement with the Commission that wholesale markets need to ensure that sufficient post-trade price transparency is made in a timely manner to ensure the integrity of the market access for all end users. We would further point out that our members aggregate and publish trade prices and volumes through the Association on a daily basis in a fully automated manner.
Both the Association and our members closely cooperate with relevant regulators and market supervisors to provide authorities with required trade reporting, and shall be compliant with the demands of trade repositories. Whilst the automated post-trade processes allows for a great deal of data collection and aggregation, the Association would urge the Commission to listen closely to both the advice from CESR and market participants whose risk positions and balance sheets, and therefore market liquidity, may be compromised by a non-proportionate requirement for public disclosure. In general the Association considered the metrics advanced by CESR to be broadly appropriate.

The Association would further emphasise that as arrangers of transactions, an IDB does not have access or knowledge of the underlying positions of executing counterparties. Therefore any obligations on the defined facilities to monitor position size would be unable to be fulfilled, and we would recommend these functions as the role of Trade Repositories and Clearing Houses.

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