CITADEL

March 8, 2016

MiFID Coordination
Markets Policy and International Division
Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

By email: cp15-43@fca.org.uk

Re: CP15/43: Markets in Financial Instruments Directive II Implementation - Consultation Paper I

Dear Sirs,

Citadel LLC[1] appreciates the opportunity to provide comments to the Financial Conduct Authority ("FCA") regarding "CP15/43: Markets in Financial Instruments Directive II Implementation - Consultation Paper I".[2]

Please feel free to call the undersigned at +44 20 7645 9700 with any questions regarding these comments.

Respectfully,

/s/ Eva Sanchez

General Counsel, Citadel Europe

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[1] Citadel is a global financial firm built around world-class talent, sound risk management, and innovative market-leading technology. For more than a quarter of a century, Citadel's hedge funds and capital markets platforms have delivered meaningful and measurable results to top-tier investors and clients around the world. Citadel operates in all major asset classes and financial markets, with offices in the world's leading financial centers, including Chicago, New York, San Francisco, Boston, London, Hong Kong, and Shanghai.

[2] Available at: http://www.fca.org.uk/static/documents/consultation-papers/cp15-43.pdf.

Q4: Do you agree with our approach to implementing the MTF requirements in MAR 5? If not, please give reasons why.

We generally agree with the FCA's proposed approach to implementing the MTF requirements in MAR 5. However, we believe further clarity is needed regarding revised MAR 5.3.1 R(4), which requires an MTF to have non-discriminatory rules governing access to its facility. The non-discriminatory access requirement in revised MAR 5.3.1 R(4) tracks the language in Article 18(3) of MiFID II and its proper transposition, implementation and enforcement is fundamental to achieving an array of derivatives market reform objectives, including promoting competition, increasing transparency, fostering liquidity, creating a fair market, and facilitating access to best execution.

The UK Fair and Effective Markets Review ("FEMR") recognized the importance of properly applying and enforcing the non-discriminatory access requirement on regulated trading venues, stating that: "[a]s more of these venues move into the regulated space (as a result of MiFID2 and the Dodd-Frank Act), it will be important to ensure that regulatory requirements for non-discriminatory access are appropriately applied to ensure effective competition to these markets."[3] FEMR further recognized that the incumbent dealers may seek to create or perpetuate barriers to access as more of the derivatives market transitions to regulated venues: "[t]he emergence of such trading structures may challenge the informational advantages at the heart of the market-making model. And that could lead to responses by incumbent market makers which seek to restrict effective competition."[4]

Historically, a select group of incumbent dealers in the OTC derivatives markets have transacted with each other on exclusive "dealer-only" trading venues that deny access to other market participants. This denial of access achieves two objectives. First, it prevents end users from directly accessing the competitive pricing and liquidity found on the dealer-only trading venues and, instead, end users have to bilaterally source prices and liquidity from one of the incumbent dealers. Second, it makes it extremely difficult for new liquidity providers to compete with the incumbent dealers on *any* trading venue, as potential new entrants are blocked from accessing necessary pools of liquidity for pricing and hedging purposes.

Barriers to trading venue access come in many forms. For example, several MTFs registered with the FCA currently impose access restrictions for transacting in cleared OTC derivatives that we believe constitute prohibited discrimination when evaluated under the MiFID II framework. These include (a) requiring direct clearing membership at a CCP in order to join the MTF, (b) providing or supporting mechanisms that allow MTF participants to selectively "turn-off", or otherwise restrict trading with, certain other participants (i.e. "enablement" or "credit control" mechanisms), and (c) requiring bilateral documentation between MTF participants in order to trade cleared OTC derivatives.

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[3] *See* the UK FEMR (made up of HM Treasury, the Bank of England and the Financial Conduct Authority) Final Report in June 2015 on wholesale Fixed Income, Currency and Commodities markets ("**FEMR Report**") at page 34, available at: http://www.bankofengland.co.uk/markets/Documents/femrjun15.pdf.

[4] *Id.*

The incumbent dealers have sought to justify access restrictions such as these by pointing to the need to manage counterparty credit risk to their executing counterparties. However, with a cleared OTC derivative, each executing counterparty only has exposure to the CCP, and does not have any bilateral counterparty credit exposure to the other executing counterparty. As a result, with respect to cleared OTC derivatives, there is no legitimate justification for an MTF to limit its participants to self-clearing members or to support mechanisms that allow MTF participants to selectively "turn-off" and refuse to trade with certain other participants. Instead, a market participant should be able to join an MTF, and transact in cleared OTC derivatives with *all of the other MTF participants*, provided the market participant either (a) is a self-clearing member or (b) has a clearing arrangement in place with a clearing member. Satisfying either of these requirements demonstrates that the market participant has sufficient resources to transact in cleared OTC derivatives on the MTF.

MiFID II's straight-through-processing requirements also eliminate pretexts for access restrictions such as those cited above by ensuring all MTF participants transacting in cleared OTC derivatives benefit from a robust execution-to-clearing workflow without incurring bilateral counterparty credit risk. Before permitting the execution of a cleared OTC derivative, an MTF must facilitate pre-trade credit checks against the clearing member limits of each counterparty in order to ensure available capacity. Executed transactions are then promptly submitted to, and accepted or rejected by, the CCP as quickly as technologically practicable using automated systems. Finally, in the extraordinarily rare event that a transaction is rejected by the CCP, counterparties are permitted to resubmit the trade to resolve technical or clerical errors and, in the event the rejection cannot be resolved, the MTF shall either void the transaction (for electronic trades) or provide rules that govern its resolution (for voice trades). In either case, the straight-through-processing requirements in RTS 26 do not envision any form of bilateral trading documentation, such as a "breakage agreement", existing between the executing counterparties on an MTF for cleared OTC derivatives.

In the absence of further clarity from either ESMA, the European Commission or the FCA on the implementation of the requirement for an MTF to have non-discriminatory rules governing access to its facility, we are concerned that MTFs will not remove the access restrictions that are in place today. This proved to be the case with respect to the implementation of the parallel requirement in the U.S. for a swap execution facility ("SEF") to offer impartial access to its facility. Notwithstanding the clear statutory language, market participants experienced difficulties in accessing SEFs and the Commodity Futures Trading Commission ("CFTC") was forced to publish additional guidance on impartial access after SEFs were already in operation.[5] This guidance prohibited the same access restrictions described above that are currently being used by MTFs, as well as additional methods of discrimination, such as (a) requiring minimum transaction volumes or capital levels that only a small number of market participants can satisfy, (b) requiring members to act as either liquidity providers or liquidity takers, but not permitting them to act in both capacities, and (c) not allowing certain participants to fully interact on the available trading systems, including by being able to both send and respond to request-for-quotes ("RFQs").

[5] *See* Staff Guidance on Swap Execution Facilities Impartial Access (November 14, 2013), available at http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/dmostaffguidance111413.pdf.

Consistent implementation and enforcement of non-discriminatory access to regulated trading venues is critical to promoting competition, increasing liquidity, creating a fair market, and facilitating access to best execution. Ensuring all qualified market participants have the ability to access the available trading venues:

- Promotes competition by lowering barriers to entry for new liquidity providers and by providing market participants with the freedom to execute with any other eligible counterparty;
- Increases liquidity by allowing new liquidity providers to enter the market and by allowing all market participants to act as both price makers and price takers;
- Creates a fair market by removing anti-competitive barriers to access and information asymmetries; and
- Facilitates access to best execution by ensuring that buy-side market participants can both view and access the widest array of pricing sources and liquidity pools.

We urge the FCA to provide clarity that unwarranted access restrictions intended to restrict competition will be considered discriminatory under the MiFID II framework in advance of the effective date of the new regime.

Q5: Do you agree with our proposals on how to implement OTF rules in MAR 5A? If not, please give reasons why.

For the same reasons stated in our response to Question 4, we believe further clarity is needed regarding MAR 5A.4.1 R(6), which requires an OTF to have non-discriminatory rules governing access to its facility. Please see our response to Question 4 for more detail, as the response applies equally to OTFs as it does to MTFs. It is worth noting that FEMR also emphasized the need to strictly apply the non-discriminatory access requirement to OTFs:

> "it is important to ensure that access to these markets is appropriate, and free from artificial barriers. Access criteria should only exclude participants where absolutely necessary to ensure the effective functioning of the market. Open access requirements should help to remove unnecessary barriers, and support moves to more all-to-all trading [. . .] If the move to OTFs is to be successful in broadening access within FICC markets, it will be necessary for supervisors to monitor OTFs actively to ensure that venues do not introduce or maintain access criteria that serve to exclude market participants unnecessarily."[6]

We also recommend that the FCA provide additional clarity around the use of discretion by an OTF. First, in order to comply with the requirement to have transparent rules and procedures for fair and orderly trading (pursuant to Article 18(1) of MiFID II and MAR 5A.4.1 R(1)), an OTF must be required to clearly disclose to its participants (a) how the facility exercises discretion and

[6] *See* the FEMR Report at page 29.

(b) how any use of discretion operates in a manner that is consistent with fair and orderly trading and best execution obligations. Areas that require clear disclosure to OTF participants include: (i) how RFQ recipients are selected by OTF employees for non-directed RFQs, (ii) how bids/offers are matched in any voice or voice-hybrid protocols (including voice or voice-hybrid order books), (iii) how bids/offers provided by voice or voice-hybrid protocols are notified to other OTF participants and (iv) how bids/offers provided by voice or voice-hybrid protocols interact with the OTF's electronic systems (including whether voice bids/offers are displayed on the OTF's electronic systems and whether they are matched with bids/offers already displayed on the OTF's electronic systems).

Second, we urge the FCA to clarify that an OTF's ability to use discretion does not override or otherwise diminish the separate requirement for an OTF to provide non-discriminatory access to its facility. Article 20(6) of MiFID II sets out the *only* permissible uses of discretion by an OTF, which are (a) whether to place or retract an order on the OTF and (b) whether to match a specific client order with other orders available on the OTF at a given time. Neither of these permissible uses of discretion involve the provision of access to the OTF. Furthermore, there is no suggestion that an OTF can engage in discrimination against specific market participants even when exercising discretion. To the contrary, Article 20(6) of MiFID II specifically states that the obligation for an OTF to exercise discretion is without prejudice to Article 18, which contains the non-discriminatory access requirement. Recital 14 of MiFID II is also consistent, clarifying that although the requirement for an OTF to consider its client obligations when exercising discretion, such as following client instructions and ensuring best execution, may lead the OTF to restrict access through system rules such as setting a minimum latency, any such system rules must be non-discriminatory in nature. We urge the FCA to ensure clarity is provided to market participants regarding the use of discretion by an OTF in advance of the effective date of the new regime.

Q8: Do you agree that we should use our power to grant waivers from pre-trade transparency in bonds, structured finance products, derivatives and emission allowances in relation to:

- **orders that are large in scale**
- **orders held in an order management facility pending disclosure**
- **actionable indications of interest in request-for-quote and voice trading systems, and**
- **derivatives that are not subject to the trading obligation under article 28 of MiFIR, and other financial instruments for which there is not a liquid market?**

If not, please give reasons why.

With respect to the granting of waivers from pre-trade transparency requirements, we urge the FCA to conduct regular assessments of the waiver regime to ensure the MiFID II objectives of promoting competition, increasing transparency, and creating a fair market are being achieved. Pre-trade transparency is an important element of the MiFID II framework, designed to increase price competition and help market participants achieve best execution. Pre-trade transparency also reduces information asymmetries that have hindered the ability of new liquidity providers to compete with the incumbent dealers.

We also recommend that the FCA further consider whether the two new types of waivers introduced by MiFID II are appropriate for cleared OTC derivatives. The first of these waivers applies to actionable indications of interest in RFQ and voice trading systems that are above the "size specific to the instrument" ("SSTI"). Experience with derivatives subject to the U.S. clearing and trading reforms demonstrates that, even after two years of mandatory SEF trading, the vast majority of dealer-to-customer transactions are executed via RFQ systems and voice trading continues to account for a significant percentage of the inter-dealer market. As a result, we expect that the application of this waiver will be significant in determining the overall scope of cleared OTC derivatives that are subject to pre-trade transparency requirements.

The SSTI threshold proposed by ESMA is generally set at the notional value of the trade in the 60th percentile (by trade count) of the overall set of transactions executed in the relevant sub-class of instruments. To qualify for the waiver, a transaction must be of a size equal to or greater than the SSTI threshold. While this waiver was designed to limit the exposure of liquidity providers to undue risk, we note that it will likely result in a significant percentage of the overall volume in highly liquid cleared OTC derivatives being exempt from pre-trade transparency requirements.

To illustrate this point, we conducted an analysis of the publicly available transaction data for USD interest rate swaps executed during the month of February 2016. Our analysis suggests that, using ESMA's methodology, the SSTI threshold for a 5 Year USD interest rate swap would be approximately $60 million notional, while the threshold for a 10 Year USD interest rate swap would be approximately $40 million notional. Both of these figures are below the standard size commonly quoted in the market for these instruments, suggesting that the waiver will not be limited to larger size trades that may present unique risks to liquidity providers. By contrast, the current CFTC block size (similar to the large in scale ("LIS") concept under MiFID II) is $240 million notional for a 5 Year USD interest rate swap and $170 million notional for a 10 Year USD interest rate swap.[7] Importantly, these block thresholds were set by the CFTC so that *50% of the aggregate volume* (by notional) in transactions executed in the relevant sub-class of instruments would be above the threshold.[8] The significant difference between those block thresholds and our estimates for the SSTI thresholds indicates that *far more than 50% of the aggregate volume* (by notional) in these highly liquid cleared OTC derivatives would likely be eligible for a pre-trade transparency waiver when transacted on an RFQ or voice trading system.

As a result, we are concerned that the SSTI waiver may be used for standard size transactions that do not pose any unique risks to liquidity providers. At a minimum, we urge the FCA to conduct a data driven analysis of how many transactions in cleared OTC derivatives would be expected to be eligible for this waiver and reconsider its availability to the extent too many transactions in these highly liquid instruments would be exempted. We also recommend the FCA closely monitor any permitted use of this waiver for cleared OTC derivatives and its impact on market transparency and competition.

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[7] Procedures to Establish Appropriate Minimum Block Sizes for Large Notional Off-Facility Swaps and Block Trades; Final Rule, 78 Fed. Reg. 32866 (May 31, 2013) at 32942, available at: http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2013-12133a.pdf.

[8] *Id.*

The second new waiver applies to "derivatives that are not subject to the trading obligation under MiFIR Article 28 and other financial instruments for which there is not a liquid market." With respect to the application of this waiver to derivatives, it appears the FCA is adopting the more practical interpretation developed by ESMA in its draft RTS 2. This approach limits the waiver to derivatives that are subject to the clearing obligation but excluded from the trading obligation by an ESMA determination.[9] While this interpretation prevents the waiver from being used to exempt liquid derivatives not yet subject to mandatory clearing from pre-trade transparency requirements, it does create a new exemption for derivatives that have already been determined to be sufficiently liquid to be subject to mandatory clearing under EMIR.[10]

As a result, the proposed interpretation of this waiver increases the importance of ensuring cleared instruments are not inappropriately exempted from the trading obligation. Once a derivative becomes subject to mandatory clearing, it appears the choices are to either: (a) apply the trading obligation to such derivative, or (b) exclude such derivative from *both* the trading obligation and pre-trade transparency requirements. We are concerned that the broad nature of this waiver has the potential to undermine the pre-trade transparency regime for cleared OTC derivatives and believe the FCA should reconsider its availability for these instruments. To the extent this waiver is permitted by the FCA for cleared OTC derivatives, we recommend the FCA closely monitor its application and seek to ensure it is taken into account as part of trading obligation determinations made by ESMA.

Q12: Do you agree that we should authorise operators of trading venues and investment firms to provide for deferred publication in relation to transactions that are:

- **large in scale**
- **in financial instruments for which there is not a liquid market**
- **above the size specific to the instrument, and**
- **packages**

If yes, do you agree that we should set up the process for the use of guidance in the Handbook for the application of deferrals?

If not, please give reasons why.

We are extremely concerned about the potential use of post-trade transparency deferrals for cleared OTC derivatives. Under the current proposal, a significant percentage of transactions in these highly liquid instruments will be eligible for a public reporting deferral of at least two days. This approach contrasts sharply with U.S. requirements, where all cleared OTC derivatives under the CFTC regime are subject to *real-time* public reporting, with a maximum delay of 15 minutes for block trades either executed on venue or bilaterally off-venue by a dealer.[11]

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[9] *See* Recital 7 of RTS 2, ESMA Regulatory technical and implementing standards- Annex I (Sept. 28, 2015), available at: https://www.esma.europa.eu/sites/default/files/library/2015/11/2015-esma-1464_annex_i_-_draft_rts_and_its_on_mifid_ii_and_mifir.pdf.

[10] *See, e.g.,* Recital 21 of Regulation No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories.

[11] Real-Time Public Reporting of Swap Transaction Data, 77 Fed. Reg. 1182 (Jan. 9, 2012) at 1217-18, available at: http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2011-33173a.pdf. Meanwhile, cleared

Real-time public reporting fosters competition and improves pricing and liquidity by providing market participants with transparency into trading activity across the market. This reduces information asymmetries and allows end users to better negotiate pricing and demand accountability from their liquidity providers when assessing best execution. The removal of information asymmetries also enables new liquidity providers to enter the market and compete with the incumbent dealers, enhancing liquidity and lowering costs for investors. Without the benefit of real-time publicly available information about executed transactions, it is extremely difficult for new liquidity providers to overcome the incumbents' access to private information about customer inquiries and executed transactions.

For cleared OTC derivatives in particular, real-time public reporting also contributes to CCP resiliency by supporting robust valuation and margining methodologies. Real-time information regarding current trading activity can assist clearing members in providing accurate pricing submissions and CCPs in valuing positions, calculating margin and managing portfolio risk.

In light of the importance of real-time public reporting in achieving the MiFID II objectives of promoting competition, increasing transparency, and creating a fair market, we believe that a post-trade transparency deferral of two days should be limited to illiquid instruments that present specific risks to market participants. Experience with the *real-time* public reporting regime in the U.S. demonstrates that liquidity and pricing in cleared OTC derivatives has not been negatively impacted as a result; to the contrary, recent Bank of England research found that pricing and liquidity in standard interest rate swaps significantly improved following the implementation of the U.S. reforms.[12]

Prior to authorising the use of deferrals for cleared OTC derivatives, we recommend the FCA conduct a data driven analysis of how many transactions in these instruments would be expected to be eligible for each deferral. In addition, to the extent deferrals are permitted for cleared OTC derivatives, we urge the FCA to closely monitor the post-trade transparency regime and its impact on market transparency and competition. Particular attention should be paid to the two deferrals that are broadest in scope as currently proposed by ESMA: (a) transactions equal to or greater than the SSTI threshold and (b) package transactions.

The SSTI threshold proposed by ESMA for post-trade transparency deferrals is generally set at the greater of (a) the notional value of the trade in the 80th percentile of the overall set of transactions executed in the relevant sub-class of instruments and (b) the notional value calculated so that 60 percent of the aggregate volume in such set of transactions would be below the threshold. To qualify for the deferral, a transaction must be of a size equal to or greater than the SSTI threshold. The SSTI deferral was designed to lower execution costs for investors by protecting liquidity providers from undue risk, but may have the opposite effect for liquid cleared OTC

OTC derivatives executed off-venue and where neither party is a swap dealer or major swap participant under the CFTC regime benefit from a 1 hour delay (however, such transactions are very rare).

[12] *See* Staff Working Paper No. 580 "Centralized trading, transparency and interest rate swap market liquidity: evidence from the implementation of the Dodd-Frank Act", Bank of England (January 2016), available at: http://www.bankofengland.co.uk/research/Documents/workingpapers/2016/swp580.pdf.

derivatives given that it may encompass *40% of the aggregate volume* in these instruments and therefore impact market competition and pricing as a result.

The post-trade transparency deferral proposed by ESMA for package transactions would allow the entire package to benefit from a deferral as long as one leg of the package qualifies for a deferral on a standalone basis. We are concerned that this approach will result in a large number of liquid packages containing cleared OTC derivatives being eligible for a deferral. Cleared OTC derivatives are frequently transacted as part of a package, including (a) swap curves (2 interest rate swaps of different maturities), (b) swap butterflies (3 interest rate swaps of different maturities), (c) spread overs (an interest rate swap and a sovereign bond), and (d) invoice spreads (an interest rate swap and a future on a sovereign bond). Data now available from the cleared OTC derivatives market in the U.S. suggests that *more than 50%* of cleared spot starting USD interest rate swaps traded on venue are executed as part of a package.

Many of these packages containing cleared OTC derivatives are highly liquid and are already required to be traded on SEFs in the U.S. and are being traded on MTFs in Europe. In addition, packages have not been granted any specific exemptions from the U.S. public reporting regime and therefore the OTC derivative components of package transactions are being reported in *real-time*. As a result, broad deferrals from the MiFID II post-trade transparency requirements are inappropriate. We are concerned that a deferral based solely on the characteristics of one component of a package transaction, such as its size (e.g. whether it is above the SSTI threshold on a standalone basis), will result in too many packages being eligible for a deferral. The CFTC considered a similar issue when implementing the trading obligation in the U.S. and ultimately determined that a package transaction should only be eligible for the block transaction exemption (similar to the LIS concept under MiFID II) if *all* OTC derivative legs of a package exceed the relevant block threshold. At a minimum, we urge the FCA to collect data regarding the execution of package transactions in cleared OTC derivatives and the percentage of which would be eligible for the deferral proposed by ESMA.

Q13: Should we:

- **use our powers under article 11(3) of MiFIR further to calibrate post-trade deferrals in accordance with the above options**
- **require additional information to be made public during the deferral period?**

and/or, should we:

- **permit the omission of the volume, or the aggregation of information, for an extended time period of four weeks?**

If not, please give reasons why.

As detailed in our response to Question 12, we do not support a two day public reporting deferral for cleared OTC derivatives. As such, we see no reason why these transactions should be eligible for additional deferrals, such as (a) omitting volume data for four weeks or (b) only publishing aggregate information on a weekly basis for four weeks. Omitting volume data or only publishing aggregate information will reduce transparency into trading activity in these liquid instruments, impacting price competition and the ability to assess best execution. Instead, to the extent the FCA determines to permit any post-trade transparency deferrals for cleared OTC derivatives, we strongly believe the FCA should require the publication of as much information as possible during the two day deferral period. The best available option under MiFIR Article 11(3) is requiring the publication of all transaction details except for volume, which will be published at the end of the deferral period.

We also believe this type of calibration must be centrally coordinated by the FCA, instead of allowing trading venues and investment firms the ability to select extended deferral periods on a transaction-by-transaction basis. Permitting this level of discretion by trading venues and investment firms risks having materially different deferral periods applied to the same type of transaction and may lead to a race to the bottom in terms of overall market transparency. Given the importance of post-trade transparency in achieving best execution for investors and enhancing liquidity and lowering costs through increased competition, the FCA must closely monitor the post-trade transparency deferral regime and have the ability to quickly implement changes that are uniformly applied across the market to the extent necessary to achieve the MiFID II objectives.

Q17: Do you agree with our proposal to add in the rules outlined above to our Handbook? If not, please give reasons why.

We support the proposal to include a section in the Handbook setting out the requirement for MTFs and OTFs to have transparent, fair and non-discriminatory fee structures (see MAR 5.3A.11 and MAR 5A.5.11). It is important that MTFs and OTFs are not permitted to circumvent the non-discriminatory access requirement through other methods, such as discriminatory fee arrangements. FEMR specifically mentioned this possibility, stating that "respondents described observing a number of techniques to limit access, including for example the use of high access fees to limit the access of the buy-side to inter-dealer broker platforms".[13]

As highlighted by ESMA in RTS 10, ensuring fair and non-discriminatory fee structures requires sufficient public transparency into execution fees, ancillary fees, rebates, incentives and disincentives. All of these fees, rebates and incentives are relevant in assessing the overall fee structure of the trading venue, and therefore should be specifically mentioned in MAR 5.3A.11 and MAR 5A.5.11 in order to maintain consistency with RTS 10. Currently, these sections of the Handbook only specifically mention "fees" and "rebates". In addition, it would be helpful to provide examples of common rebate and incentive programs that are included within these requirements, such as market making programs and revenue share agreements.

Q28: Do you agree with our interpretation of the definition of a multilateral system? If not, please give reasons why.

We agree with the FCA's interpretation of the definition of a multilateral system. Per Article 4(19) of MiFID II, a multilateral system is a system or facility in which multiple third-party buying and selling trading interests have the ability to interact. This includes systems that facilitate the execution process, including by enabling market participants to exchange information about firm

[13] *See* the FEMR Report at page 34.

orders or indications of interest or by providing market participants with notification or confirmation messages regarding the ability to interact. Furthermore, pursuant to Article 1(7) of MiFID II, all multilateral systems are required to operate as a RM, an MTF, or an OTF.

These provisions are important in ensuring firms and systems that facilitate multilateral execution in financial instruments are subject to appropriate regulatory oversight through registration as a regulated trading venue. The MiFID II definition of a multilateral system also levels the playing field for firms and systems that facilitate multilateral execution in non-equity instruments by ensuring that all of these various facilities are captured. These include (a) systems offering RFQ trading protocols that enable market participants to exchange information about indications of interest and (b) voice brokers that regularly facilitate execution between multiple third-party buying and selling trading interests.

By ensuring these various multilateral execution facilities for non-equity instruments must operate as a regulated trading venue pursuant to Article 1(7) of MiFID II, the definition of a multilateral system also supports the overall transparency regime. Many of the transparency requirements in MiFID II for non-equity instruments are based on whether the instrument is traded on a trading venue, and therefore excluding certain multilateral execution facilities from trading venue registration could significantly limit the overall scope of instruments subject to the transparency requirements. The OTF trading venue category was created specifically for the purpose of providing a more flexible registration category for firms and systems that facilitate multilateral execution in non-equity instruments but do not fit neatly into the RM or MTF categories. It is therefore important to ensure that multilateral execution facilities do not operate completely outside of the MiFID II framework for regulated trading venues.