ESMA opinion on trading venue perimeter

ECB FX Contact Group
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  • What is a multilateral system?
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Background – Why did we publish this opinion?

- **MiFID II review reports**
  ESMA committed to publish an opinion clarifying the definition of multilateral system.
  Guidance on the trading venue perimeter.

- **Objective of the opinion**
  Clarify when certain systems qualify as multilateral and should seek authorisation as a trading venue.
  Contribute to the consistency of supervisory practices and to consistent approaches throughout the Union.
ESMA opinion

• All multilateral systems need to be authorised as trading venues.
• Multilateral system “means any system or facility in which multiple third-party buying and selling trading interests in financial instruments are able to interact in the system”

It is a system

There are multiple third-party buying and selling interests

Those trading interests need to be able to interact

Financial instruments
What is a system?

• Set of rules that governs how third-party trading interests interact.
• Rules must contain elements that concern the matching, arranging and/or negotiation of trading interests.
• Contractual arrangements or standard procedures that shape and facilitate the interaction of third-party trading interests.
Multiple third-party trading interests

• Persons other than the system operator, that are brought together in a transaction.
• ‘Multiple’ refers to the system allowing various trading interests to interact in the same system or facility.
Interaction between trading interests

• Display of different trading interests not enough to be multilateral.

• Users need to be able to react to those trading interests – exchange information concerning those trading interests and match, arrange and/or negotiate essential terms of a transaction.

• Multilateral system definition does not require the legal conclusion of a contract.

• General advertising / aggregation of trading interests should not qualify as multilateral systems.
Financial instruments

- In scope of multilateral system are only those instruments specified in SECTION C of Annex I of MiFID II.
- FX DERIVATIVES included (C4)
Specific cases

• Technology providers (incl. bulleting boards and EMS)
  - Third party interaction
• Request-for-quote systems (RFQ)
  - Single dealer platform (SI vs trading venue)
• Pre-arranged transactions
Implications of the ESMA opinion

• Enhance supervisory convergence in the Union.
• Firms should assess their systems against the opinion and reflect whether they are operating under the appropriate authorisation.
• Ensure that firms operating a trading venue without the proper authorisation swiftly apply for authorisation.
• Opinion will require some firms that operate trading venues to be authorised as such.
Hedging exemption

- Some non-financial (corporate) companies currently use trading systems for their hedging activity.
- Corporate companies may be considered as members and participants of trading venues – authorisation as investment firms.
- Hedging exemption: authorisation not required if trading activity for hedging purposes.
- Risk that one single transaction which may not qualify as “hedging” would require investment firm authorisation.
- Disproportionate to require authorisation based on a single transaction.
- ESMA to work on additional guidance.
Any questions?

Potential questions for discussion:

• Do you see any impact of the opinion on FX markets?
• What to you see as the key challenges for the FX market?
ESMA opinion on trading venue perimeter

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AGENDA

› Regulatory complexity
› Regulatory evolution – a view
› Focus on Europe – ESMA paper
A map of burgeoning regulatory and logistical complexity

In 2003 wholesale FX firms mostly operated globally from their home state. In 2023 it looks like this, ...

- **USA**
  - Dodd Frank / CEA
  - SEF – No trading mandate
  - Forwards & Swaps exempt

- **EUROPE**
  - MiFID / MiFIR
  - National Laws
  - MTF / RTO – no trading mandates
  - Spot regulated in Germany

- **UK**
  - MiFID / FSMA
  - MTF / arranging Spot unregulated

- **SWITZERLAND**
  - SEF / MTF recognised as foreign trading venue

- **INDIA**
  - Full onshore operations required – localised focus

- **AFRICA**
  - Currently no specific requirements – but certain countries e.g., Brazil under observation

- **LATAM**
  - Currently no specific requirements – but certain countries e.g., Brazil under observation

- **SINGAPORE**
  - Local RMO’s
  - But will grant overseas authorisation

- **CHINA**
  - No CNY;
  - No interbank;
  - Must enter a JV

- **UAE**
  - Similar regulatory framework to UK

- **HONG KONG**
  - Money Broker approval – local staff and rep offices

- **JAPAN**
  - Has not yet implemented G20 commitments for wholesale FX

- **KOREA**
  - Authorisation only granted to local firms

- **TAIWAN**
  - No onshore business

- **MALAYSIA**
  - Onshore money broker + electronic trading platform

- **INDONESIA**
  - Authorisation with Joint Venture requirement, introduced 2022

- **AUSTRALIA**
  - Local offices – but like Canada authorizes home state venues

Equivalence – but often ineffective due to reporting restrictions and other concerns
Regulatory evolution today, as we perceived it

Regulatory evolution has many components: OTC vs. MTF; regulatory fragmentation & de-globalization

Where we came from…

- Regulatory evolution over last years
  - Introduction of SEFs and MTFs
  - Equivalence concept introduced
  - Regulated OTC market
    - Under RTO / Arranging
- Compliant MDPs providing safe, integrated & regulated venues on a global scale
- SDPs also covered by global regulations
- Transparency and compliance improved

…where we stand today…

- SEF and MTF regimes exist
- OTC markets significant
- ESMA increases guidance to NCAs
- Brexit impact finally being felt
- Costs escalating for all involved across different regulatory set ups – venues, LPs, Clients etc.
- Equivalence patchy
- MTF perimeter currently porous
- Regulatory fragmentation and de-globalization trends accelerating
  - E.g., UK, India,…
  - Split liquidity

… now what’s the future?

- Trend of global regulatory fragmentation and de-globalization to continue?
  - High negative impact on established Global FX market
  - Liquidity fragmentation
  - Equivalence will not be delivered
  - Inefficient localization of markets
  - Different legal structures
  - Costs escalate, netting-, credit- transparency – decreased execution efficiency / prices, …
- Hurdle to new entrants huge, reducing choice and innovation
Focus on Europe: ESMA push to bring FX OTC on MTF

ESMA Report on Trading Venue Perimeter (Feb 2023) – areas for discussion

Push for EU unification on MTFs ...  
- ESMAs view on market development and dynamics
  - Report providing guidance on delineation of bi- and multilateral sphere; leaving room for interpretation (to be filled by NCAs);
  - Further guidance on service of ‘receipt and transmission of orders (RTO)’ to be provided by ESMA at a later stage, leaving perimeter porous
  - ESMA guidance to be pushed by consistent enforcement and monitoring by NCAs; regulatory arbitrage and FX markets returning OTC/off-shore to be avoided
- International coordination? FX markets are global – e.g., UK developments: FCA has consulted on trading venue perimeter as part of WMR

... driving need for clarifications on status!
- Corporates
  - Strong concern from 360T Client Base about impact of changes
  - Accessing MTFs without IF status
- Cross EU-UK border impact on credit and netting
  - Fund Managers accessing both EU and UK Market Making entities
- Urgent need for proper equivalency solutions to ensure functioning global FX market
  - EU LPs to UK MTFs and vice versa
- Timeline for implementation by NCAs
  - Years?
Thank you.