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European Securities and Markets Authority
103 rue de Grenelle
75007 Paris
France

Re: Consultation paper – Amendments to Commission Delegated Regulation (EU) 2017/587 (RTS 1) on Markets in Financial Instruments

Dear Sir/Madam,

CFA Institute appreciates the opportunity to comment on ESMA's consultation paper on amendments to RTS 1 of the Markets in Financial Instruments Regulation intended to clarify the tick size regime to be used by Systematic Internalisers (SIs) when quoting prices.

CFA Institute is the global association of investment professionals that sets the standard for professional excellence and credentials. The organization is a champion for ethical behaviour in investment markets and a respected source of knowledge in the global financial community. The end goal: to create an environment where investors' interests come first, markets function at their best, and economies grow. CFA Institute has more than 140,000 members in 150 countries and territories, including 133,000 Chartered Financial Analyst® charterholders, and 147 member societies.

Specific Comments

Q1: Do you agree with ESMA's proposal to clarify that SIs' quotes would only reflect prevailing market conditions where the price levels could be traded on a trading venue at the time of publication?

CFA Institute is supportive of ESMA's efforts to promote a level playing field on EU capital markets. At issue is whether the introduction of the Systematic Internaliser (SI) regime in MiFID II / MiIFIR causes a potential competitive advantage for SIs relative to other trading venues (e.g. MTFs).

Under MiFID II / MiFIR, the SI regime requires SIs to be pre-trade transparent when dealing in shares and equity-like instruments up to standard market size in liquid markets (as defined in the legislation). To this end, Article 10 of RTS 1 provides the conditions under which an SI is considered to be quoting prices that reflect prevailing market conditions:

> *"…where they are close in price, at the time of publication, to quotes of equivalent sizes for the same financial instrument on the most relevfant market in terms of liquidity…"*

ESMA notes that the additional flexibility provided to SIs, particularly the possibility to quote in smaller price increments than those allowed on trading venues, could allow SIs to provide only nominal price improvement to attract execution away from trading venues.

This nominal price improvement phenomenon has been observed in the United States, and we have previously commented about the issues involved[1,2]. The key concern observed in the US is that nominal price improvement (in the form of sub-penny executions, i.e. executions in price increments smaller than the minimum price variation permitted on exchanges) allows internaliers to syphon-off desirable order flow (typically, uninformed retail orders) away from trading venues onto their own platforms, leaving so-called 'toxic' or less desirable (de-facto more informed) order flow to regulated trading venues. This, in turn, can hamper the market quality of those trading venues, since investors are fearful of the higher proportion of relatively more informed, or 'toxic', order flow remaining on those venues. This could lead to inferior market quality or disincentivise displayed liquidity provision as described by ESMA in paragraph 10.

We therefore welcome ESMA's attention to this issue and wish to make two points in response to this consultation. First, we support the effort to limit the ability of SIs to quote in different price increments than available on exchanges and provide nominal price improvement for the sole purpose of exploiting their competitive advantage of a more flexible tick size regime. However, we think ESMA's proposed addition to Article 10 of RTS 1 could be worded in a more direct manner following the language in paragraph 12 of the consultation. We believe the following change should be made in order to more directly address the issue at hand:

Current proposal: "*... and where the price levels could be traded on a trading venue at the time of publication.*"

CFA Institute proposal: "*…and where those quotes reflect the price increments applicable to EU trading venues trading the same instruments.*"

Second, we want to draw emphasis to paragraph 14 of the consultation, where ESMA reflects that price improvement on quoted prices would only be justified when they are meaningful and reflect the minimum applicable tick size. CFA Institute agrees that SIs should be allowed to offer price improvement in the form of more favourable exection prices compared with prevailing price quotations, as long as it is being done to provide investors with meaningfully better outcomes than otherwise available on exhanges. Price improvement provides benefits to investors but also creates opportunity costs for displayed liquidity providers on exchanges. ESMA's assertion that price improvement should reflect the minimum applicable tick size[3] would ensure a fair outcome taking into consideration the aforementioned costs and benefits for respective market participants.

We also wish to draw ESMA's attention to an academic study[4], sponsored by CFA Institute, published in 2014 that looks at the experience of Canadian and Australian 'trade-at' rules, which mandated meaningful price improvement (defined as one full tick, or half a tick for stocks priced less than $1) by internalizers. The study concludes that the interaction of the trade-at rules with minimum tick-size regulations produces mixed results with the proportion of dark trading falling, but spreads widening. The authors posit that the spread widening was caused by relatively large (and inflexible) tick sizes in those markets and propose a reduction of tick sizes across all trading venues to ameliorate this problem.

[1] https://blogs.cfainstitute.org/marketintegrity/2014/12/18/hft-price-improvement-adverse-selection-an-expensive-way-to-get-tighter-spreads/

[2] https://www.sec.gov/comments/265-29/26529-53.pdf

[3] The European tick size framework specifies different minimum tick sizes according to the liquidity of the stock. This allows for more granular tick sizes where appropriate and differs from the U.S. framework in which all stocks priced above $1 have a minimum tick of 1 cent.

[4] https://www.cfainstitute.org/ethics/Documents/Policy%20Brief_Trade-at%20Rules.pdf

These findings implicitly lend support to establishing more granular and liquidity-dependent tick sizes, as has been introduced under MiFID II / MiFIR.

Q2: Do you agree with the drafting amendment described above?

No comments.

Concluding Remarks

CFA Institute appreciates this opportunity to welcome and encourage ESMA's efforts in more fully addressing regulatory inconsistencies pertaining to market structure and the SI regime.These efforts should help ensure a level playing field for market participants, which we believe is the most direct way to promote market fairness, integrity, and investor protection. Please do not hesitate to contact us should you wish further elaboration of the points raised.

Yours faithfully,

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