Reply form for the Consultation Paper on the Algorithim Trading

18 December 2020 | ESMA70-156-4086

Responding to this paper

ESMA invites comments on all matters in this consultation paper and in particular on the specific questions summarised in Annex I. Comments are most helpful if they:

- respond to the question stated;
- indicate the specific question to which the comment relates;
- contain a clear rationale; and
- describe any alternatives ESMA should consider.

ESMA will consider all comments received by **12/03/2021.**

All contributions should be submitted online at www.esma.europa.eu under the heading 'Your input - Consultations'.

Instructions

In order to facilitate analysis of responses to the Consultation Paper, respondents are requested to follow the below steps when preparing and submitting their response:

1. Insert your responses to the questions in the Consultation Paper in the present response form.

2. Please do not remove tags of the type <ESMA_QUESTION_ALGO_1>. Your response to each question has to be framed by the two tags corresponding to the question.

3. If you do not wish to respond to a given question, please do not delete it but simply leave the text "TYPE YOUR TEXT HERE" between the tags.

4. When you have drafted your response, name your response form according to the following convention: ESMA_ALGO_nameofrespondent_RESPONSEFORM. For example, for a respondent named ABCD, the response form would be entitled ESMA_FOTF_ABCD_RESPONSEFORM.

5. Upload the form containing your responses, in Word format, to ESMA's website (www.esma.europa.eu under the heading "Your input – Open consultations" → "Consultation on Algorithmic Trading").

Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publically disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESMA's rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESMA's Board of Appeal and the European Ombudsman.

Data protection

Information on data protection can be found at www.esma.europa.eu under the heading Legal Notice.

Who should read this paper

This document will be of interest to (i) alternative investment fund managers, UCITS management companies, EUSEF managers and/or EuVECA managers and their trade associations, (ii) distributors of UCITS, alternative investment funds, EuSEFs and EuVECAs, as well as (iii) institutional and retail investors investing into UCITS, alternative investment funds, EuSEFs and/or EuVECAs and their associations..

General information about respondent

Name of the company / organisation	Finance Denmark
Activity	Investment Services
Are you representing an association?	☒
Country/Region	Denmark

Introduction

Please make your introductory comments below, if any

<ESMA_COMMENT_ALGO_1>

Finance Denmark[1] welcomes the opportunity to respond to the ESMA consultation regarding MiFIDII/MiFIR review report on Algorithmic Trading with a deadline on 12 March 2021.

General remarks
Generally, algorithmic trading has facilitated the possibilities for more efficient trading and execution quality. However, in particular high-frequency trading (HFT), which is a sub-set of algorithmic trading, has also been a facilitator in changing the market structure from a wholesale market framework benefitting the institutional segments with high quality execution in the formal markets and low market impact to a much more retail oriented market which is good in supporting smaller size orders with efficient execution. However, it is rather poor in facilitating high quality execution of large size orders in CLOBs due to relatively low average order sizes and "noise interference" from certain market players. This increases market impact and consequently, also the execution costs for investors.

One of the consequences of the changed market structure is the increasing importance of other execution venues, which can provide efficient execution of competitive terms and conditions. This should not be considered as a problem as the various execution venues are a part of the liberalization following MiFID I and II. Rather, it should be considered as materialization of the political wishes to introduce competitive execution venues which are able to provide more choices to investors to the benefit of the real economy.

It is an ascertainment of fact that the market development has an exclusionary effect and has fostered a much more complex regime – both regulatory and it-wise, forcing investment firms continuously to (re)invest in IT to stay relevant for clients and upscaling on the regulatory

[1] Finance Denmark is a business association for banks, mortgage institutions, asset management, securities trading and investment funds in Denmark. EU Transparency Register – registration number 20705158207-35.

side to ensure proper compliance. All in all – it requires a certain size to stay in business to be able to access all relevant marketplaces, to have the right technology in place and continuously to maintain and develop this. In short, to stay in business is associated with substantial costs and certainly favours bigger players. If the intention to extend the scope of algorithmic trading to SI trading as suggested in Q9 is pursued, this development will be accelerated. In this context, we do not understand what should be included and why? There is no explanation from ESMA in the consultation and we wonder how quotes from SIs to their clients can create a source of risk? The reason behind the regulation of algorithmic trading is first and foremost to avoid incidents like the Nasdaq flash crash in 2010 as also described in our response to Q3 and not to provide additional regulation on SIs providing quotes to their clients. Quotes are not orders which automatically end in trades. Quotes are prices which must be accepted. Please beware that in the Nordics and in particular in Denmark, SIs are mainly used to provide two-side quotes to retail clients in smaller sizes.

We are concerned about the many attempts to make it more/too complicated to act as an SI. The ESMA question on excluding SIs as eligible execution venues for the STO was one example[2]. The exchanges proposal to limit the SIs to trade above LIS only is another example. The ESMA proposal to broaden the definition and scope of multilateral trading in the OTF consultation[3] is a third example. The ESMA proposal to include SI into the scope of algo trading in this consultation is a fourth example. We see these proposals as attempts to limit the competition. Competition in the execution space was introduced with MiFIDI with the delinking between listing and trading and the introduction of SIs and MTFs as new, formal execution venues.[4] The development was partly continued with MiFIDII/MiFIR with the introduction of OTFs. If the conditions for acting as an SI de facto becomes so restrictive that it may be considered as a prohibition, we face a de facto concentration rule and thereby monopoly like conditions. The only change is now that the exchanges are for profit and are not utilities as before. This is not a development in line with the internal market and is neither to the benefit of the investors nor the companies.

Finance Denmark does not see a problem with an increasing role of Sis, provided that the SIs business model complies with the requirements in MiFIDII/MiFIR. In case there may be concerns for SIs that do not comply with the existing regulatory requirements, Finance Denmark suggests focusing on enforcing the rules rather than limiting the competition in general. Finance Denmark has previously provided suggestions to strengthen the description of the compliant SI activity and include this in level 2 regulation (rather than in Q&As)[5]. This is also elaborated in Finance Denmark's responses to the ESMA consultation on transparency for equities and the European Commission consultation on the MiFIDII/MiFIR Review for further input.6
<ESMA_COMMENT_ALGO_1>

[2] https://www.esma.europa.eu/sites/default/files/library/cp_review_report_transparency_equity_dvc_tos.pdf, page 96-97
[3] https://www.esma.europa.eu/press-news/esma-news/esma-consults-otf-regime
[4] See also https://icsa.global/sites/default/files/Global%20Memo%20on%20Market%20Data%20Costs%20-%20June%202020%20.pdf for a description of the development from a global perspective.
[5] The essence of this paper was in the Finance Denmark response to the ESMA consultation on transparency in the equity markets and was elaborated in connection with the European Commission consultation on the MiFIDII/MiFIR Review in May 2020: https://finansdanmark.dk/media/40705/proposals-to-questions-in-the-ec-consultation-finance-denmark-position-paper.pdf
[6] https://finansdanmark.dk/media/40665/finance-denmark-response-to-esma-consultation-on-equity-transparency.pdf and https://finansdanmark.dk/media/40706/finance-denmark-response-to-european-commission-consultation-on-mifidiimifir-review.pdf

Questions

Q1 : What is your overall assessment of the MiFID II framework for algorithmic trading, HFT and DEA?

<ESMA_QUESTION_ALGO_1>
As Finance Denmark certainly agrees with the need for adequate control of algorithmic trading, HFT and DEA, Finance Denmark assesses certain part of the present MiFIDII framework for algorithmic trading, HFT and DEA as too comprehensive and complex. For example, experience has shown that the regime appears to be too broad in the definition of HFT strategies and too strict for the simpler algorithms which do not speculate in market movements. Another example is the sub-delegation for DMA access, where the requirements are too demanding. A third example is the self-assessment, which is overly complicated. Furthermore, if the proposal to extend the scope to SI trading – the regime becomes even more unnecessarily complex. We will elaborate on these examples below.

Rather, we strongly urge a revision of the framework to ensure an appropriate regulatory coverage which is calibrated from a more risk-based approach than today, for example meaning that advanced algorithms which speculate in market movements are riskier than market making strategies which ensure updated prices and quotes and should be treated as such from a regulatory perspective. This would lead to a more sensible approach implying strengthening in some areas and easing in others.
<ESMA_QUESTION_ALGO_1>

Q2 : In your views, are there risks other than the one mentioned in MiFID II or impacts on market structure developments due to market electronification/ algorithmic trading that would deserve further regulatory attention? Please elaborate.

<ESMA_QUESTION_ALGO_2>
Finance Denmark agrees with the description of the potential risks. In this context, it is important to stress that the risks are concentrated on the trading venues and not OTC as also referred to by ESMA; "..trading technology also gives rise to a number of potential risks such as an increased risk of the overloading of the systems of trading venues due to large volume of orders, risks of algorithmic trading generating duplicative or erroneous orders or otherwise malfunctioning in a way that may create a disorderly market, risk of overreaction to market events exacerbating volatility and risk of market abuse behaviours…"

<ESMA_QUESTION_ALGO_2>

Q3 : Do you consider that the potential risks attached to algorithmic trading should also be given consideration in other trading areas? Please elaborate.

<ESMA_QUESTION_ALGO_3>
No. The focus should be concentrated on algorithmic trading in relation to trading venues as this is where the multilateral interaction is and thereby where the risk of an automatic chain reaction leading to incidents like the Nasdaq Flash Crash in 2010 may appear if not handled properly.
<ESMA_QUESTION_ALGO_3>

Q4 : Do you agree with this analysis? If not, please explain why.

<ESMA_QUESTION_ALGO_4>
Yes. Finance Denmark agrees.
<ESMA_QUESTION_ALGO_4>

Q5 : Did you encounter any specific issue with the definition of HFT? Do you consider that the definition should be amended? Do you have any suggestion to replace the high message intraday rates with other criteria or amend the thresholds currently set in Level 2? Please elaborate and provide data supporting your response where available.

<ESMA_QUESTION_ALGO_5>
Finance Denmark is of the view that it is appropriate to revise the definition of HFT as the level of intraday messages may be too low thereby captures ordinary market making activities. It should be considered whether market making activities in own instruments should be exempted from the definition of HFT.
<ESMA_QUESTION_ALGO_5>

Q6 : Based on your experience, is sub-delegation of DMA access a frequent practice? In which circumstances? Which benefits does it provide to the DEA user and to the sub-delegatees? Are you aware of sub delegation arrangements in the context of Sponsored access? If so, please elaborate.

<ESMA_QUESTION_ALGO_6>
No. According to the members of Finance Denmark, sub-delegation is not a frequent practice in the Nordics due to the comprehensive due diligence requirements which are considered prohibitive to enter into such practice. For example, a DEA provider that allows a DEA client to provide its DEA access to its own clients ('sub-delegation') shall be able to identify the different order flows from the beneficiaries of such sub-delegation without being required to know the identity of the beneficiaries of such arrangement. This identification requirement is not realistic to comply with.
<ESMA_QUESTION_ALGO_6>

Q7 : (for DEA Tier 1clients) Do you sub-delegate direct electronic access? If so, are your Tier 2 clients typically regulated entities/investment firms? Are they EU-based or third country based?

<ESMA_QUESTION_ALGO_7>
Finance Denmark does not respond to this question.
<ESMA_QUESTION_ALGO_7>

Q8 : Do you agree with this analysis? If not, please explain why. Do you consider that further clarification is needed in this area? If so, what would you suggest?

<ESMA_QUESTION_ALGO_8>
Finance Denmark agrees. It is crucial to keep this approach in order to ensure proper engagement and continuous development of the investment culture to the benefit of the real economy.

<ESMA_QUESTION_ALGO_8>

Q9 : Do you agree with ESMA's proposal? If so, do you consider that the requirements considered above relevant? Should there be additional ones? If you disagree with ESMA's proposal, please explain why.

<ESMA_QUESTION_ALGO_9>
No. Finance Denmark strongly disagrees as also noted initially under "General comments" as we do not recognize the problem and we kindly ask ESMA to elaborate as the rationale behind the proposal as described on page 29 (no 59-61) seems vague and unclear: "the use of more and more sophisticated technology by market participants…there could be merit in extending the definition of algorithmic trading in financial instruments OTC…..This would ensure that the quotes displayed, streamed, or sent to counterparties or clients by SIs are not a source of risk for the SI itself and a source of confusion, disruption and potential chain reaction in the market." Furthermore, there are not specifications in the consultation paper of which types of SI flows ESMA considers to be in scope (specific trading scenarios). Therefore, it is difficult to assess the rationale behind the suggestion.

The reason behind the regulation of algorithmic trading is first and foremost to avoid incidents like the Nasdaq flash crash in 2010 as also described in our response to Q3 and not to provide additional regulation on SI providing quotes to their clients. Quotes are not orders which automatically end in trades. Quotes are prices which must be accepted by the client. The quotes made by SIs are of risk to the SI itself and not a source of risk to the financial system.

SIs' in equities are required to continuously provide two-side quotes to its clients (in smaller sizes) and for non-equities the SI faces more limited requirements to provide quotes.

It seems hard to understand why there is a focus on these SI flows. They do not differ from other OTC flows and it is hard to understand why such flows may need to be treated in the same way as algo-flows on trading venues and we urge ESMA to elaborate on the concerns as these seem unclear and unjustified.

Most of the requirements in Article 17 of MiFID II (and as a consequence, in RTS 6 and 8) apply rightly and solely to investment firms connected to a trading venue, i.e. not trading OTC:

- Article 17.2: obligation to notify to the NCA of the jurisdiction where the investment firm engages in algorithmic trading as a member or participant of a trading venue;
- Article 17.3 and 4: market making strategies, agreements and schemes apply only to firms which are members or participants of one or more trading venues;
- Article 17.5: direct electronic access can only be provided to a trading venue.

The text of Article 17.1 of MiFID II suggests that it also refers only to on-venue trading: "Such a firm shall also have in place effective systems and risk controls to ensure that the trading systems cannot be used for any purpose that is contrary (…) to the rules of the trading venue to which it is connected". Finally, this interpretation is also supported by Article 1(5) of MiFID II that extends the requirements in Article 17 to: "members or participants of regulated markets and MTFs which are not required to be authorised under Article 2.1 (a), (e), (i) and (j) of MiFID II."

In this respect, the main bulk of the obligations in RTS 6 apply only to firms that are members or participants of a trading venue:

- Article 3.1(d) [staff with knowledge of the requirements imposed by the relevant trading venues];
- Article 5.4(c) and 5.5 [testing scenarios]
- Article 6 [conformance testing]
- Article 12 [kill functionality]
- Article 15 [pre-trade controls]
- Article 16 [real-time monitoring]
- Chapter III [DEA]

<ESMA_QUESTION_ALGO_9>

Q10 : Do you agree with ESMA's proposals above? Please elaborate.

<ESMA_QUESTION_ALGO_10>
Yes, Finance Denmark agrees.
<ESMA_QUESTION_ALGO_10>

Q11 : Do you agree with ESMA's proposal? Please elaborate.

<ESMA_QUESTION_ALGO_11>
Question 11 is missing.
<ESMA_QUESTION_ALGO_11>

Q12 : Do you see merit in ESMA developing a template for notifications to NCAs under Articles 17(2) and 17(5) of MiFID II? If not, please justify your position.

<ESMA_QUESTION_ALGO_12>
Finance Denmark agrees.
<ESMA_QUESTION_ALGO_12>

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Q13 : Do you agree that it would be useful to clarify that notifications should be done 'without undue delay'?

<ESMA_QUESTION_ALGO_13>
Finance Denmark agrees.
<ESMA_QUESTION_ALGO_13>

Q14 : Do you agree with ESMA's approach for the exchange of information between NCAs? If not, please justify your position.

<ESMA_QUESTION_ALGO_14>
Finance Denmark agrees.
<ESMA_QUESTION_ALGO_14>

Q15 : What is your view on clarifying the definition of algorithmic trading? If you deem it beneficial to refine the definition and account for further types of algorithms or algorithmic trading strategies, please provide your suggestion as well as underlying rationale.

<ESMA_QUESTION_ALGO_15>
The definition should reflect a more risk-based approach as described in our response to Q1 and to consider whether the definition of HFT should exclude market making in own products.

<ESMA_QUESTION_ALGO_15>

Q16 : Do you think there should be specific requirements for different type of algorithms or algorithmic trading strategies in RTS 6? Please explain.

<ESMA_QUESTION_ALGO_16>
Please see our response to Q15.
<ESMA_QUESTION_ALGO_16>

Q17 : What is your experience with testing environments? Are they used frequently? If not, why? Do you see a need for any improvements?

<ESMA_QUESTION_ALGO_17>
Finance Denmark is of the opinion that it is in general too complicated to use an external test environment since it is often not possible to ensure adequate control of the test scenarios. Our members often perform tests based on simulation in their own test systems where it is easier to configure the scenarios which unfold themselves during behavioral tests. External test systems are primarily used for conformance testing and to some extent for stress testing.
<ESMA_QUESTION_ALGO_17>

Q18 : Do you agree that the definition of "disorderly trading conditions" should be clarified? If yes, how would you define such trading conditions?

<ESMA_QUESTION_ALGO_18>
Finance Denmark supports ESMAs proposal to clarify the definition of "disorderly trading conditions". In this context we urge ESMA to take into account the individual trading venues' speed bumps and kill switches. By doing so, the scope for disorderly trading conditions is adapted to include only behavior that is not already prevented by existing control.

<ESMA_QUESTION_ALGO_18>

Q19 : Do you agree that ESMA should provide additional guidance on the expectations concerning the checks and testing to be done, in particular for testing on disorderly trading conditions?

<ESMA_QUESTION_ALGO_19>
Finance Denmark agrees.
<ESMA_QUESTION_ALGO_19>

Q20 : Would you agree that it could be beneficial if ESMA develops a prescribed format for the self-assessment foreseen in Article 9 of RTS 6?

<ESMA_QUESTION_ALGO_20>
Finance Denmark agrees.
<ESMA_QUESTION_ALGO_20>

Q21 : Do you agree with the changes proposed to the self-assessment of Article 9 of RTS 6?

<ESMA_QUESTION_ALGO_21>
Finance Denmark agrees.
<ESMA_QUESTION_ALGO_21>

Q22 : Would you propose any other targeted legislative amendments to RTS 6? Please include a detailed explanation of the proposed amendment and of the underlying issue that this amendment would aim to tackle.

<ESMA_QUESTION_ALGO_22>
Finance Denmark does not respond to this question.
<ESMA_QUESTION_ALGO_22>

Q23 : Do you agree with ESMA's proposal to harmonize and create a clear structure for the performance of the self-assessment?

<ESMA_QUESTION_ALGO_23>
Finance Denmark does not respond to this question.
<ESMA_QUESTION_ALGO_23>

Q24 : Do you agree with limiting the self-assessment to every two years and to require trading venues to share it with their relevant NCA?

<ESMA_QUESTION_ALGO_24>
Finance Denmark has not a strong view, but questions why exchanges only have to do this every second year whilst investment firms need to do it every year.
<ESMA_QUESTION_ALGO_24>

Q25 : Do you agree with ESMA's analysis about the overlapping requirements between RTS 6 and 7? Are those overlaps considered beneficial, should they be removed or are there any gaps? Are there any further points that should be clarified?

<ESMA_QUESTION_ALGO_25>
Finance Denmark agrees.
<ESMA_QUESTION_ALGO_25>

Q26 : What is your view with regards to the testing of algorithms requirements? Do you agree that more robust testing scenarios should be set?

<ESMA_QUESTION_ALGO_26>
Finance Denmark is of the opinion that RTS 7 should be more specific in the requirements to the trading venues test systems including the type of scenarios which should be tested to ensure adequate, comprehensive and homogeneous testing. We propose that it should be a requirement for trading venues to prepare concrete test scenarios which must be conducted before deployment. For example, it should be a requirement that the algorithms correctly interact with circuit breakers or similar controls for the purpose of preventing disorderly trading.
<ESMA_QUESTION_ALGO_26>

Q27 : Are the testing environments available for the testing of algorithms appropriate for this purpose?

<ESMA_QUESTION_ALGO_27>
No. Please see our response to Q17 and Q26.
<ESMA_QUESTION_ALGO_27>

Q28 : Do you agree with ESMA's analysis that the circuit breaker mechanism achieved its objective to avoid significant disruptions to the orderliness of trading?

<ESMA_QUESTION_ALGO_28>
Finance Denmark agrees.
<ESMA_QUESTION_ALGO_28>

Q29 : Do you agree that the requirements under Article 48(5) of MiFID II complemented by RTS 7 and the guidelines on the calibration of circuit breakers and publication of trading halts under MiFID II remain appropriate? If not, what regulatory changes do you deem necessary?

<ESMA_QUESTION_ALGO_29>
Finance Denmark does not respond to this question.
<ESMA_QUESTION_ALGO_29>

Q30 : Do you agree that the co-location services and fees structures are fair and non-discriminatory? Please elaborate.

<ESMA_QUESTION_ALGO_30>
No, we believe for example that fee structures which promote non-genuine orders should be prohibited. An example is maker-taker fee.
<ESMA_QUESTION_ALGO_30>

Q31 : Do you think that the disclosures under RTS 10 made by the trading venues are sufficient or should they be harmonized among the different entities? Please explain.

<ESMA_QUESTION_ALGO_31>
In general, the pricelists are long and complex. It should be considered to provide standards for pricelists and to require the publication of historical price lists as well (minimum from the past 5 years). Additionally, it should be considered to require publication of pricelists based on multiyear comparisons.

<ESMA_QUESTION_ALGO_31>

Q32 : Do you agree with ESMA's proposal to set out the maximum OTR ratio, calibrated per asset class?

<ESMA_QUESTION_ALGO_32>
Finance Denmark agrees.
<ESMA_QUESTION_ALGO_32>

Q33 Q33: Do you agree that the maximum limits are not frequently exceeded? Please explain any potential underlying issues in this respect that should be recognised.

<ESMA_QUESTION_ALGO_33>
Finance Denmark does not agree. As the trading venues face competition in the execution space (in contrast to the market data space, which is subject to monopoly), the trading venues are compelled to ensure as appealing execution conditions as possible in order to attract liquidity i.e. by offering artificially low execution fees and by cross substituting these initiatives via the stable and increasing revenue from market data. Thereby, there is no incentive for the trading venues to unilaterally impose any kind of restrictions on the execution conditions. The reasoning is that unilateral restrictions/increased costs will imply that their clients face higher execution costs compared to other trading venues' clients thereby giving other trading venues a competitive advantage to attract liquidity. This is why there is a "race to the bottom" illustrated by a reluctance to impose/introduce a fine when OTR ratios are exceeded, a reluctance to set "low" OTR ratios, no wish to introduce higher tick sizes than "minimum tick sizes" by any venue in instruments subject to competition in trading, an incentive to set trading fees which attract as many orders as possible whether it is based on genuine orders or not and so forth. In short, any restrictions must be set centrally – else it will not work and/or creates an unlevel playing field.
<ESMA_QUESTION_ALGO_33>

Q34 : Do you agree with the consequences as described of exceeding the maximum limits or should there be a more convergent approach? Please provide any comment or suggestion regarding the procedures in place by trading venues in case of a member exceeding the prescribed limit.

<ESMA_QUESTION_ALGO_34>

Further to our response to Q33 above, we see a need for a convergent approach in order to ensure uniform limits across venues and to ensure proper actions (a fine) by all venues when the limits are exceeded.
<ESMA_QUESTION_ALGO_34>

Q35 : Do you agree with the need to improve the notification process in case of IT incidents and system outages? Beyond the notification process between NCAs and ESMA, which improvements could be done regarding communication of incidents to the public?

<ESMA_QUESTION_ALGO_35>
Finance Denmark agrees.
<ESMA_QUESTION_ALGO_35>

Q36 : Do you believe any initiative should be put forward to ensure there is more continuity on trading in case of an outage on the main market, e.g. by requiring algo traders to use more than one reference data point?

<ESMA_QUESTION_ALGO_36>
Finance Denmark agrees. In order to ensure a continuous reference data point, it should be required for algo trades to use more than one reference data point.
<ESMA_QUESTION_ALGO_36>

Q37 : Do you agree with the view that the tick size regime had overall a positive effect on market depth and transaction costs?

<ESMA_QUESTION_ALGO_37>
No. Finance Denmark does not agree that the tick size regime had an overall positive effect on market depth and transaction costs as the tick size table does not properly take into account the differences in the various market structures in EU, whereby the tick sizes are too low in some markets/segments/shares and too high in others.

The previous LIBA-FESE tables enabled implementation of different and supportive tick size tables in contrast to the present ESMA tick size table in RTS 11 which does not adequately take different liquidity structures into account. In the Nordics, we are generally faced with too low tick sizes which compromises the depth in the CLOB. We are aware that the table contains "minimum tick sizes". But as underlined in our response to Q33, competition within the execution space does not support a wider tick size due the "race to the bottom" to attract liquidity as we have seen before the implementation of the LIBA-FESE tick size tables in 2009 due to fragmentation of trading. To our knowledge, no one moves above the specified levels for exactly that reason.

When tick sizes are reduced below a certain level, the incentive for traders to quote is reduced causing decreasing depth in the order book. While the change in tick size might improve the liquidity for small size orders, institutional traders are worse off. They must bear an increase in trading costs following the decline in depth throughout the entire order book (direct market impact). Another market impact is the so-called adverse selection which measures the probability and the level of a price move after a trade. To our knowledge, this cost is rarely, if ever, taken into consideration even though the likelihood of adverse selection has increased considerably for shares which have faced lower tick sizes.

To compensate, larger orders will increasingly be executed outside the lit order books in case tick sizes are too low or too high. Additionally, larger orders may also be sliced into smaller orders, which increases the overall execution costs.

This development is exactly what has been observed with the increasing usage of dark trading, SI trading and execution in the (closing) auctions.

Finance Denmark's members assess that challenges with market impact are becoming significant for orders exceeding EUR 100.000. For orders in small cap and even mid cap – the size is expected to be smaller.

During MiFID1 – we faced an actual "tick size war" between trading platforms which reduced tick sizes to attract (low quality) liquidity from each other. This led to an industry-led creation of the so-called FESE-LIBA tick size tables to harmonize the tick size regime across Europe. One of the good things about these tables was that these took into account various degrees of liquidity in each share in a much better way than the present "one-size-fits-all" regime in RTS 11.

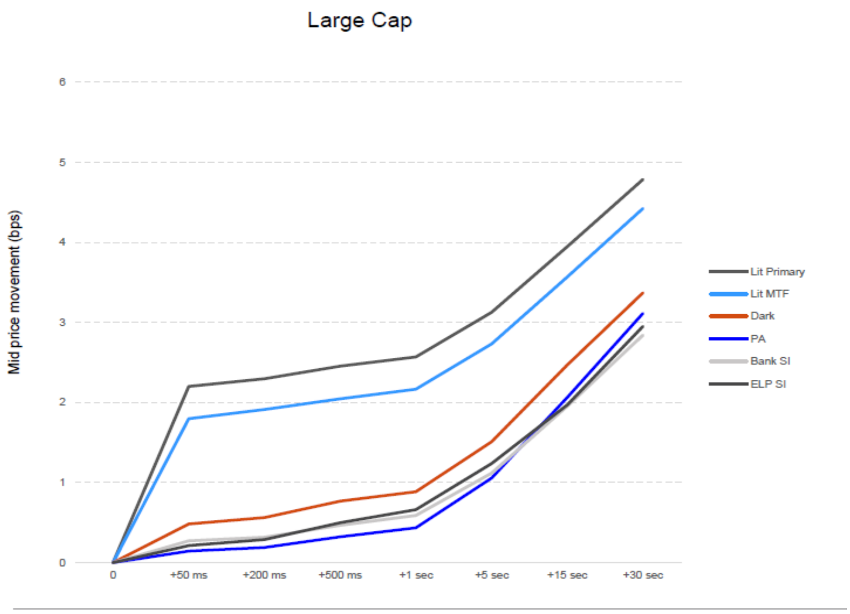
Actually, the AMF study based on Euronext7 data apparently supports this approach. Looking at pages 4 and 5 in the study, it illustrates a significant change – and mostly an increase - in tick sizes on Euronext compared to the previous FESE-LIBA tables. We are also aware of the recent study by the Danish FSA[8] which suffers from the similar shortcoming as the AMF study. For smaller orders (below around EUR 100.000), the market impact has not increased. But above, our experience is that the cost has increased. Please also beware that the AMF study only includes the blue chips shares and both studies only investigate trading on the primary exchanges.

Finance Denmark strongly recommends that the AMF study as well as the DK-FSA study should be replicated to other trading venues, as the conclusions are expected to substantiate our claim. We suggest not only an analysis of direct market impact when executing larger orders (for instance from EUR 100.000 and up), but also to include the effects of the adverse selection as this part is apparently not taken into account in any of the recent studies of the changed tick size tables.

As an example, please see figure 1 and 2 in which the adverse selection for Nordic shares (Q3 and Q4 2019) are illustrated when using different execution venues:

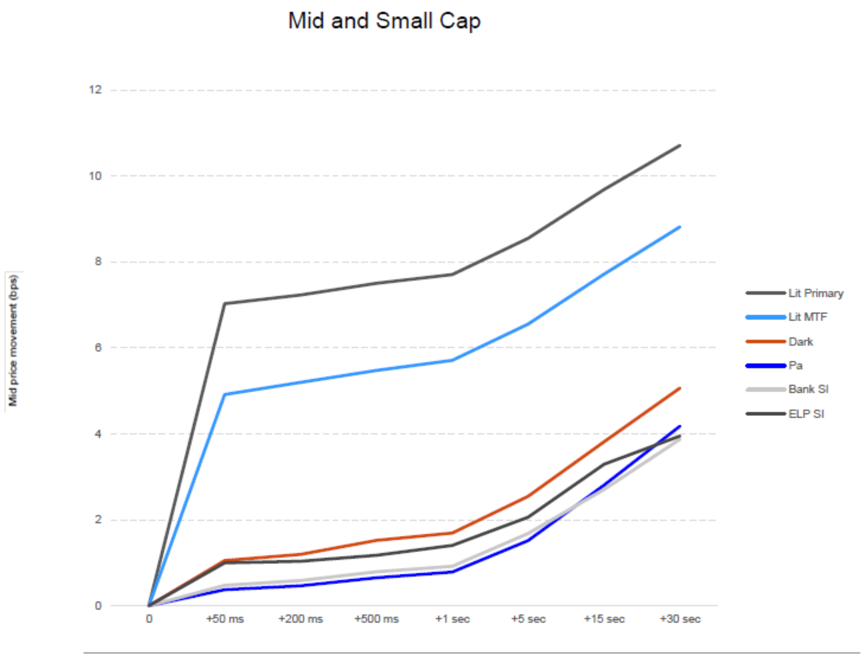
[7] https://www.amf-france.org/sites/default/files/contenu_simple/lettre_ou_cahier/risques_tendances/MiFID%20II%20Impact%20of%20the%20new%20tick%20size%20regime%20after%20several%20months%20of%20implementation.pdf
[8] https://www.finanstilsynet.dk/Nyheder-og-Presse/Pressemeddelelser/2020/EU_regler_Tick_sizes

Figure 1: Adverse selection, Large Cap, Q3 and Q4 2019



Source; Nordea

Figure 2. Adverse Selection, Mid and Small Cap, Q3 and Q2 2019



Source: Nordea

For example, when looking at figure 1, trading Nordic Large Cap shares in the Lit market at the primary exchange will imply a price impact with around 2.4 bps within 50 ms, whereas trading via e.g. an SI, the level is less than 0.5 bps. The price impact is significant larger in Mid- and Small cap as illustrated in figure 2, where the costs are around 7 bps in the Lit market, Primary exchange and still around 0.5 bps when trading via SI.
<ESMA_QUESTION_ALGO_37>

Q38 : Is there any further issue you would like to highlight regarding tick size regime?

<ESMA_QUESTION_ALGO_38>
Please see our input to Q37.
<ESMA_QUESTION_ALGO_38>

Q39 : Do You agree with the proposal not to amend the tick size regime for third country shares? Please explain.

<ESMA_QUESTION_ALGO_39>
Finance Denmark does not respond to this question.
<ESMA_QUESTION_ALGO_39>

Q40 : Do you agree with the proposal to widen the scope of the tick size regime to all ETFs? Would this pose challenges in your view? Please explain.

<ESMA_QUESTION_ALGO_40>
Finance Denmark does not agree as the present tick size table does not adequately take into account the different markets or liquidity structures as also stressed in our response to Q37. We are aware that the table is containing "minimum tick sizes". But due to the competition in the execution space, it will not be possible to enforce a wider tick size due the "race to the bottom" to attract liquidity as elaborated in our responses to Q33 and Q37.

Therefore, as the "one-size-fits-all" tick regime is inappropriate within shares, it should be expanded to include all ETFs before it is properly recalibrated.
<ESMA_QUESTION_ALGO_40>

Q41 : Do you agree with the proposal not to widen the scope of the tick size regime to non-equity instruments? Please explain.

<ESMA_QUESTION_ALGO_41>
Finance Denmark agrees that the tick size regime should not be extended to non-equity instruments.
<ESMA_QUESTION_ALGO_41>

Q42 : Do you agree with ESMA findings and assessment of the current MiFID II market making regime?

<ESMA_QUESTION_ALGO_42>
Finance Denmark agrees with ESMA's findings.
<ESMA_QUESTION_ALGO_42>

Q43 : What do you think of ESMA proposals and suggested amendments to RTS 8? In your view, what other aspects of the market making regime require to be amended and how?

<ESMA_QUESTION_ALGO_43>
Finance Denmark has no comments at this point in time.

<ESMA_QUESTION_ALGO_43>

Q44 : What are market participants views regarding the flexibility left in the MiFID II market making regime? Would you agree with ESMA further clarifying certain relevant concepts? If yes, which ones?

<ESMA_QUESTION_ALGO_44>
Finance Denmark has no comments at this point in time.
<ESMA_QUESTION_ALGO_44>

Q45 : Could you please describe how Primary Dealers agreements are designed (number of designated Primary Dealers, transparency about investment firms having signed such agreements, typical obligations contained, etc…). Do you consider that Primary Dealers should be exempted from the Article 1 of RTS 8? Do you consider that this can introduce a regulatory loophole?

<ESMA_QUESTION_ALGO_45>
A Primary Dealer agreement can be designed in many various ways, depending on the Issuer's requirement to the obligations that the Primary Dealer must fulfill, and as well set the terms for payment etcetera.

The agreement could include limits on the number of designated Primary Dealers, and an obligation can be that the Primary Dealer should deliver streaming quotes to a venue.

We are on neutral ground with regards to the question whether Primary Dealers should be exempted from entering into a Market Maker agreement with the venue (RTS 8, article 1), if the Primary Dealer has an obligation in the agreement to stream quotes to a venue.

We find it difficult to see any regulatory loophole if Primary Dealers are exempted but having in mind that a softer regulation and governance can be a risk to conduct.
<ESMA_QUESTION_ALGO_45>

Q46 : Do you think that venues which introduced asymmetric speedbumps provide enough information regarding the mechanism used? If not, what additional information would be useful to disclose to market participants?

<ESMA_QUESTION_ALGO_46>
Finance Denmark does not respond to this question.
<ESMA_QUESTION_ALGO_46>

Q47 : Reflecting on those mechanisms which allow liquidity providers to provide quotes that can be filled only against retail order flow, do you think that such mechanisms are beneficial in terms of market quality? Is there any specific aspect that you think should be further taken into account, also considering the type of instruments traded? Please specify the venue of reference and the type of arrangement discussed.

<ESMA_QUESTION_ALGO_47>
Finance Denmark does not respond to this question.

<ESMA_QUESTION_ALGO_47>

Q48 : Do you think that venues which introduce asymmetric speedbumps should set tighter market making requirements? Please explain why and how tight those new requirements should be.

<ESMA_QUESTION_ALGO_48>
Finance Denmark has no comments at this point in time.

<ESMA_QUESTION_ALGO_48>

Q49 : Do you agree on the conclusion that speedbumps might not be a well-suited arrangement for equity markets? If yes, do you think that such arrangements for equities should be prohibited in Level 1? Please explain.

<ESMA_QUESTION_ALGO_49>
Finance Denmark does not support a prohibition. Rather, there should be a requirement of transparency with detailed information of the speed bump.

<ESMA_QUESTION_ALGO_49>

Q50 : Do you think that the introduction and functioning of speedbumps should be further regulated? If yes, which specific requirements would you like to be included in EU legislation?

<ESMA_QUESTION_ALGO_50>
Finance Denmark supports transparency requirements in case speed bumps are introduced.

<ESMA_QUESTION_ALGO_50>

Q51 : Is there any specific issue you would like to highlight about speedbumps?

<ESMA_QUESTION_ALGO_51>
Finance Denmark has no specific issues at this point in time.

<ESMA_QUESTION_ALGO_51>

Q52 : What are your views on the relative timing of private fill confirmations and public trade messages? If you are a trading venue, please provide in your answer an explanation of the model you have in place.

<ESMA_QUESTION_ALGO_52>
Finance Denmark is of the firm opinion that a private fill confirmation is always more important than a public trade message.
<ESMA_QUESTION_ALGO_52>

Q53 : Do you consider information on the sequencing of these two feeds at trading venues to be easily available? If you are a trading venue, please provide a link to where this information can be found publicly.

<ESMA_QUESTION_ALGO_53>
The members of Finance Denmark do not find it easy to find information about the feeds.
<ESMA_QUESTION_ALGO_53>

Q54 : Do you think there should be any legislative amendments or policy measures in respect of these feed dynamics?

<ESMA_QUESTION_ALGO_54>
Finance Denmark has no proposals at this point in time.
<ESMA_QUESTION_ALGO_54>