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EXTENSION OF THE TICK SIZE REGIME TO SYSTEMATIC INTERNALISERS (SIs)

Summary of Euronext Position

It is acceptable for large-in-scale (LIS) trades executed on SIs and Trading Venues, and trades that are non-price forming, to be exempt from the tick size regime.

A. A level playing field should exist between trading venues and SIs. Euronext supports extending the tick size regime to SIs up to LIS, recognising the fact that over applying the tick size regime may raise issues in respect of above LIS transactions. Above LIS, if SIs are exempted from applying tick sizes, then so should Trading Venues.

B. In addition, MiFID II recognises that non-price forming trades (regardless of the size) may be exempted from tick sizes because they are not subject to the shares trading obligation. As such, these trades are still allowed for OTC execution and not subject to any tick size requirement when executed OTC.

INTRODUCTION

1. Policymakers' attention is currently focused on the non-application of the tick size regime to SIs and the implications of this exemption for the effectiveness of EU public equities markets. This concern has been translated into a proposed amendment from the European Parliament to extend the tick size regime to SIs in the context of the Investment Firm Reform (IFR). With the Council having recently adopted its position on the IFR proposals, Euronext believes it is timely to consider some issues of relevance to the ongoing trialogue discussions.

2. Many data sources report that SI volumes have grown from below 1% to over 20% of pan-European equities trading[1]. At first glance this appears to be a major shift in market structure, but it is important to take a closer look. The SI category contains two very distinct types of platform.

3. The first category is composed of new independent liquidity centres, operated by proprietary trading firms (sometimes referred to as electronic liquidity providers, or 'ELPs'). According to the latest official data (published quarterly under RTS 27), 'ELP' SIs executed €1.1bn average daily volume on European securities in September 2018. This represented 5% of overall SI reported activity. Various non-public proprietary data sources indicate that this proportion had doubled by Q1 2019.

4. The second category is made up of SIs operated by banks. These volumes are a reclassification of business previously done within banks' own OTC processes and make up the majority of reported SI activity. Within this category, a further distinction can be made between 'price forming' and 'non-price forming' transactions. Note that a portion of non-price forming transactions are reported through bank SIs. Non-price forming transactions are not subject to the trading mandate and can be exempted from any tick size regime if they occur OTC. Addressable liquidity is not limited to the new ELP SIs:

<table>
<tr><th></th><th>Operated by</th><th>Liquidity</th></tr>
<tr><td rowspan="2">SI</td><td>ELPs (new liquidity centres)</td><td>Addressable liquidity</td></tr>
<tr><td>Banks (recategorisation of OTC processes)</td><td rowspan="2">Non-addressable liquidity</td></tr>
<tr><td colspan="2">OTC</td></tr>
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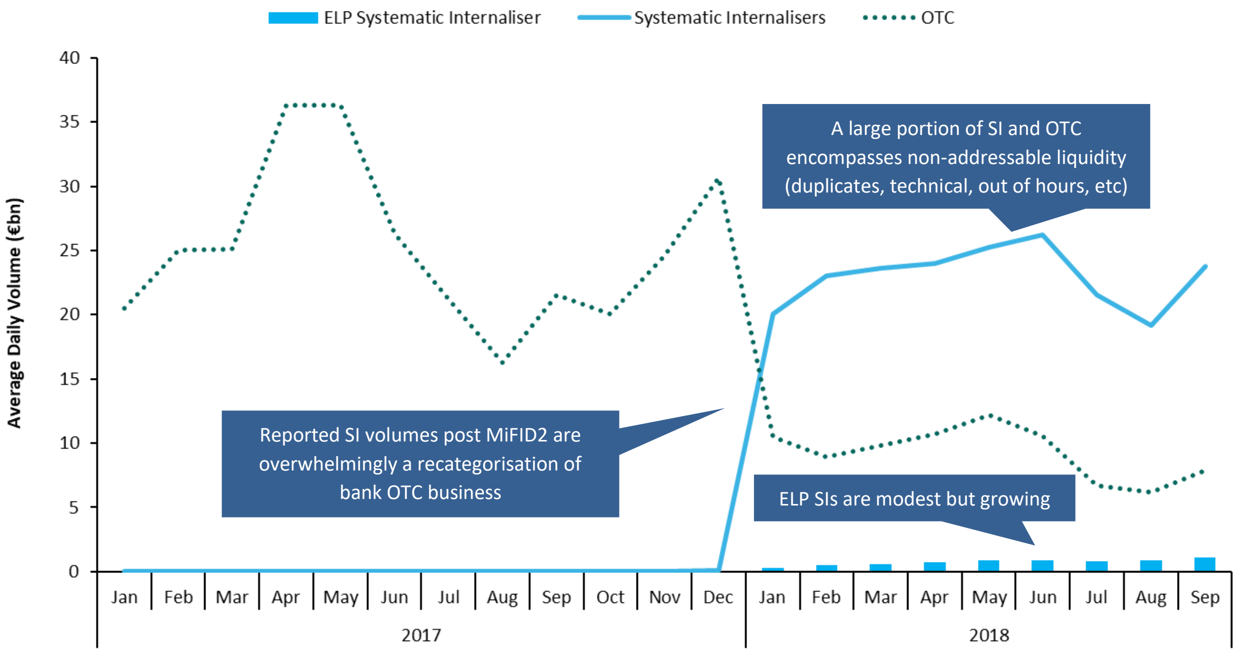
5. No formal data are published to measure and break down addressable and non-addressable liquidity under the SI reported volumes. Furthermore, there are well known reporting issues with SI and OTC volumes, with the inclusion of duplicate reports, technical trades, outside hours transactions. In the chart below, we can consider the volumes of ELP SIs to be accurate thanks to the RTS27 reports, but the overall SI number is probably over-inflated due to the inclusion of non-addressable liquidity.

Evolution of SI and OTC reported volumes, with ELP SI volumes broken out



In this paper, we make use of some helpful distinctions made by AFME, CBOE and LSEG (hereafter, 'the organisations') in their Joint Paper[2] last autumn: execution up to LIS; technical non-price forming trades and execution in above-LIS sizes.

EXECUTION UP TO LARGE-IN-SCALE (LIS)

6. Euronext notes that the organisations' paper establishes a point of consensus on the extension of the tick size regime to SIs in respect of execution up to LIS. This is important to ensure that order driven markets and SIs (up to LIS) that are comparable, and in competition with each other, are subject to the same regime.

[2] https://www.afme.eu/globalassets/downloads/briefing-notes/2017/afme-eqt-cboe-lse-paper-application-of-the-tick-size- regime.pdf

7. In extending the scope of the tick size regime, and in relation to execution up to LIS, it is important that it be applied to SIs in respect of quotes, price improvement on quotes and execution prices. When dealing with their clients, SIs have the ability to improve their price compared to their public quote, which is a common feature in bilateral trading. Therefore, the tick size regime should apply not only to quotes, but to price improvement and execution prices as well. An amendment limited to quotes would be ineffective, since SIs would retain the capacity to execute at prices outside of the tick size regime.

> ***Euronext Position***
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> Euronext supports the proposals to apply the tick size regime up to LIS, provided that quotes, price improvement AND trades are covered by the amendments.

TECHNICAL NON-PRICE FORMING TRADES

8. The organisations proposed to exempt non-price forming trades from the application of any tick size regime on SIs via reference to the exhaustive list of transactions subject to conditions other than the current market price under RTS 1.

9. However, the list of transactions subject to conditions other than the current market price is identical to the list of transactions which are **exempted from the share trading obligation** on the grounds that they are not contributing to the price discovery process. As such, these 'technical' trades, including volume-weighted average price (VWAP) transactions, are still allowed for OTC execution and not subject to any tick size requirement when executed OTC.

10. It would be helpful to understand, therefore, why investment firms are choosing to execute these trades on SIs instead of OTC given that the latter is not, nor will be, subject to any tick size requirement.

> ***Euronext Position***
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> Euronext is of the view that further clarification would be required from investment firms should policymakers wish to consider exempting technical non-price forming trades on SIs from the tick size regime. In particular, further clarity as to the reasons why the SI is being used for these trades when OTC is still an option as provided for by the framework would assist policymakers in their assessment. The current FIX work to clarify to addressable versus non-addressable liquidity should also be included in this assessment.

EXECUTION IN ABOVE LIS SIZES

11. Euronext recognises the fact that over applying the tick size regime may raise issues in respect of **above LIS transactions**. In particular, it is clear that SIs' ability to execute LIS trades on a sub-tick basis can provide meaningful price improvement for clients trading in large sizes. This may bring benefits to end investors and does not raise the same issues which are in evidence for trading below LIS where sub-tick trading does not always deliver meaningful price improvement.

12. **However, it is important that a level playing field is respected between SIs and trading venues in this respect**, given that trading venues are subject to the tick size regime in all sizes.

> ***Euronext Position***
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> Changes in tick size application above LIS should be introduced in a coordinated manner to ensure that a level playing field is introduced from the outset. If SIs are exempt above LIS, then trading tenues should be given the same flexibility.