

UK wholesale markets review update: CP 22/18 and the trading venue perimeter

Overview

On 22 September 2022, the Financial Conduct Authority (FCA) published its consultation paper (CP 22/18, the CP) which proposes new guidance on the trading venue perimeter. The CP follows on from the discussion on this as part of HM Treasury's Wholesale Market Review (WMR), which concluded that there is a need for greater clarity about what types of firms fall within scope of the definition of "multilateral trading facility" (MTF). This is particularly true in light of the spread of new technologies and systems that perform some of the functions conventionally associated with trading venues.¹

The definitions of MTF and "multilateral system" (which includes regulated markets and organised trading facilities, as well as MTFs), are derived from MiFID II legislation. Questions as to the application of these definitions to various systems and facilities have arisen on both sides of the Channel. Requests for clarity in this area have also been actioned by ESMA, which issued its own consultation in January 2022 and has now published the

Final Report on ESMA's Opinion on the Trading Venue Perimeter (the ESMA Final Report).

This briefing is limited to the content of the proposals in CP 22/18 and comparable elements of the ESMA Final Report. Other WMR proposals relating to trading venues are not covered below, but our earlier briefing on the broader WMR consultation can be found [here](#), and our briefing on the FSM Bill can be found [here](#).

1. This client briefing has been updated to reflect changes which came into force on 31 March 2023.

Summary of the UK proposal

The FCA proposes a new set of Q&A, to be inserted in the Perimeter Guidance Sourcebook in the FCA handbook. These new Q&A will cover the definition of multilateral system as well as specific trading venue perimeter topics, including voice broking, portfolio management internal matching, block trades, crowdfunding and bulletin boards.

The FCA is also proposing to disapply certain ESMA Q&A on MiFID II and MiFIR market structure topics that relate to the trading venue perimeter – questions 7, 10, 11 and 12 in section 5 of the ESMA Q&A. This is to ensure consistency across guidance which is relevant to UK firms, given that UK firms are still expected to have regard to EU non-legislative material.

At a high-level, the keynotes for the new guidance are:

- There are four elements of a multilateral system: trading system/facility characteristics; multiple third party buying/selling trading interests; interaction of trading interests in the system; trading interests in respect of MiFID instruments.
- The question of whether or not a trading system of facility meets the definition of multilateral system will turn on the purpose for which it is used by the operator, and will be informed by any specific design features that indicate its intended use and function.

- The concept of multiple third party buying/selling trading interests is broad, as per UK MiFIR Recital 7 and so includes orders, quotes and indications of interest.
- Interaction of trading interests in the system is not restricted to execution and settlement – the interaction element can be satisfied where trading interests interacting with a view to counterparties agreeing the contractual terms of a trade.
- Arranging trades over the telephone (voice broking) may be part of a multilateral system by being the only method for bringing about transactions. However, generally, voice broking is part of a multilateral system when operating in conjunction with other modes of execution.
- Portfolio managers carrying out internal matching will not fall within the definition of multilateral system.
- A system operated for the sole purpose of blocking trades onto a trading venue ‘consistent with the intentions of the parties to the underlying transactions to trade on a trading venue’ would not amount to a multilateral system.
- There is no specific carve out for crowd-funding platforms and bulletin boards, but such platforms or facilities would need to be assessed against the four elements of the multilateral system definition.

- For crowd-funding platforms, provided they only operate in the primary markets, this should not fall within scope because there would be no interaction of trading interests (the FCA draws a distinction between ‘funding interests’ and trading interests which is helpful).
- For bulletin boards, these types of systems are capable of falling outside the definition of multilateral system as long as they do not: match trading interests within the system; allow users to respond within the system to other users’ including by communicating in relation to, negotiating or accepting essential terms of a transaction; or committing to or entering into contracts for the sale and purchase of contracts in the system.

The proposals also include an update to the definition of service company,² so that it no longer refers to the pre-MiFID terminology of intermediate customers and market counterparties (now professional clients and eligible counterparties). This change came into force on 31 March 2023.

2. A service company is a firm, in summary, whose regulatory licence is strictly limited and only allows it to make arrangements with a view to transactions in investments for professional and eligible counterparty clients.

European developments

Before the FCA issued the CP, ESMA had published its own consultation on the trading venue perimeter. As with the FCA's consultation, the purpose of ESMA's paper was to provide guidance on when systems should be considered as multilateral and seek authorisation as trading venues, in the form of a legal opinion on multilateral systems and the trading venue perimeter. Accordingly, much of the content of the ESMA consultation overlaps with the FCA's proposals and questions.

On 2 February 2023, ESMA published its Final Report together with the finalised Opinion, and in a number of ways its approach is broadly comparable to the CP. Points of similarity include the following.

- Both look at the definition of multilateral system in the same way, by breaking it down into four key elements, and making similar comments in regard to each of these.
- While the ESMA Final Report namechecks execution management systems (EMS), order management systems (OMS) and request for quote (RFQ) systems specifically, the overarching approach of the regulators is generally the same when it comes to determining whether a technology-based solution could be a multilateral system. That is, in essence, a system which is purely for communication purposes and/or does not allow multiple third-party buying and selling trading interests in financial instruments would not be a multilateral system – but a case-by-case analysis should be applied, looking at all the features of the system and the intention of the users and operators.
- Both the CP and the ESMA Final Report consider the pre-arranged transactions that are blocked onto trading venues would not trigger a requirement at the level of the arranging firm for authorisation as a trading venue.
- The CP and the ESMA Final Report both consider that the criteria for the definition of multilateral system can be met without there being actual execution within the system. Both the FCA and ESMA consider that the 'interaction' element of the definition can be satisfied by systems which enable users to react to trading interests and match, arrange and/or negotiate essential terms of the transaction with a view to concluding the transaction.



Market response

While there has been market enthusiasm for guidance in this area, there is a sense that the FCA's proposals could go further when it comes to categorising different types of technologies. In addition, the FCA still takes a broad approach when discussing the difference between what is 'interaction' and what is not, for the purpose of applying the four-element definition on a case-by-case basis.

In this vein, responses to both to the CP and to the ESMA proposals indicate that there is still a grey area around the interpretation of recital 7 of MiFIR/UK MiFIR, and the reference to sets of rules which comprise a system or facility capable of being deemed a 'multilateral system'. Some market participants would prefer a crystal clear distinction drawn between rules that govern the negotiation and execution process, in contrast with technical system rules (including those that only operate to digitise transactions which would otherwise be carried out bilaterally).

While the ESMA Final Report did confirm that technical standard messaging and protocols would not be a 'set of rules' for this purpose, it did not go so far as to confirm that non-contractual rules would be incapable of meeting the criteria. It will be interesting to see whether the FCA would be comfortable in being more specific on these areas, to provide more comfort and clarity on the UK side.

The FCA is due to finalise the guidance and publish a policy statement in Q2 2023.