

The European Securities and Markets Authority (ESMA)
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1 August 2014

Dear Sirs,

ESMA Discussion Paper – MiFID II/MiFIR

Introduction

We are the Quoted Companies Alliance, the independent membership organisation that champions the interests of small to mid-size quoted companies. Their individual market capitalisations tend to be below £500m.

The Quoted Companies Alliance is a founder member of **EuropeanIssuers**, which represents over 9,000 quoted companies in fourteen European countries.

The Quoted Companies Alliance Secondary Markets Expert Group has examined your proposals and advised on this response. A list of members of the Expert Group is at Appendix A.

Response

We welcome the opportunity to respond to this consultation. We have focused our response to the discussion paper on the questions related to best execution (publication of data related to the quality of execution by trading venues for each financial instrument traded), pre- and post-trade transparency and tick sizes.

Responses to specific questions

2.3. Best execution - publication of data related to the quality of execution by trading venues for each financial instrument traded

Q8: Do you agree data should be provided by all the execution venues as set out in footnote 24? If not, please state why not.

We do not agree with the proposed approach. We disagree with market makers being categorised as execution venues, and we specifically object in relation to equity markets.

The level I text recognises different market structures and obligations, and specifically the ‘trading obligation’ (article 27 (3)), which establishes that trading in equities should be performed by Trading Venues subject to strict rules regarding conduct and price formation and which should not be disregarded. ‘Trading venues’ is a defined term and does not include market makers.

The Quoted Companies Alliance is the independent membership organisation that champions the interests of small to mid-size quoted companies.

However, contrary to the Level 1 text, the proposals set out in the Discussion Paper imply that the market maker is performing some of the functions of a venue; we fundamentally disagree. We believe that the Discussion Paper should not have disregarded the differentiation between markets with and without trading obligations, as to do so goes against what was defined the Level 1 text and also gives way to important material consequences.

Indeed, the equity market makers are a participant on a trading venue. This means that equity market makers are subject to market making agreements and rules (such as the obligation to be present for a minimum percentage of the trading day), and that the obligation to report reflects upon the Trading Venues on which they are participants.

Consequentially, the definition as is in the Discussion Paper would mean duplication of effort in collation and publication of data and may cause market makers to incur increased costs with no added liquidity or perceived benefits.

This situation would ultimately be harmful to small and mid-size quoted companies, as the costs incurred could be sufficient to make equity market makers withdraw from the market. While many large cap securities enjoy highly liquid markets and are able to be traded through an order book mechanism, the market in small and mid-size quoted companies relies heavily on the significant capital commitment from liquidity providers, such as equity market makers on quote driven platforms.

We believe that this definition goes beyond ESMA's mandate and is contrary to the definition in Level 1. We urge ESMA to follow the Commission's recommendations and not impose restrictions to equity market makers.

Q9: If you think that the different types of venues should not publish exactly the same data, please specify how the data should be adapted in each case, and the reasons for each ad-justment.

Please refer to our response to Q8.

We welcome relevant data being produced so as to encourage competition, but measures should be appropriately calibrated for the market type. We are concerned that the quote driven markets have been neglected from ESMA's analysis. Quote driven markets are a model used extensively for the trading of less liquid, small and mid-size quoted company securities and one of the trading models recognised by MiFIR (recital 7).

Q10: Should the data publication obligation apply to every financial instrument traded on the execution venue? Alternatively, should there be a minimum threshold of activity and, if so, how should it be defined (for example, frequency of trades, number of trades, turnover etc.)?

Please refer to our response to Q8.

We believe that a minimum threshold of activity could create a cliff-edge, which means that the marginal cost of crossing that cliff-edge would be sufficient to discourage trading, especially for smaller specialist participants. This could be harmful for liquidity, especially for small and mid-size quoted companies.

Q12: Please provide an estimate of the cost of the necessary IT development for the production and the publication of such reporting.

As we are not a participant, we cannot provide an estimation regarding costs. However, it is our view that the specificities of the reporting have not been put forward in sufficient detail to facilitate the estimation of such costs by participants. We believe that more detail is required and that the reporting should be appropriate for all market models.

Q16: Do you consider that this requirement will generate any additional cost? If yes, could you specify in which areas and provide an estimation of these costs?

While we are not a participant, we believe that additional costs will be generated. We are concerned that if these additional costs are disproportionate then they will harm liquidity (especially in small and mid-size quoted companies) as some participants may be forced to withdraw from the market.

Q21: What would be the most appropriate way to measure the speed of execution in order to get useful data?

When considering the quality of execution, we believe that speed of execution only becomes a relevant factor where liquidity is adequate to satisfy trading. We would therefore suggest speed is only a priority in the most liquid markets.

In the segments in which our members, small and mid-size quoted companies, are traded, liquidity is limited. In this circumstance, we would argue that speed is a secondary consideration after likelihood of execution. A focus on speed could therefore have a detrimental effect on overall execution quality.

Q24: Are there any adjustments that need to be made to the above execution quality metrics to accommodate different market microstructures?

We are concerned that the US model proposed by ESMA assumes that markets take the form of order book trading mechanisms. This is certainly not the case in the EU (as ESMA has identified in MiFID that four different market structure types exist in the EU).

As stated in our response to Q9, we are concerned that the proposal has disregarded quote driven markets, which are a model used extensively for the trading of less liquid, small and mid-size quoted company securities and one of the trading models recognised by MiFIR (recital 7). Therefore, we believe that the model needs to be designed to capture all trading mechanisms, and allow identification of where liquidity is adequate to ensure the best execution quality for the instrument.

2.4. Best execution - publication of data by investment firms

Q29: Do you agree that in order to allow clients to evaluate the quality of a firm's execution, any proposed standards should oblige the firm to give an appropriate picture of the venues and the different ways they execute an order?

Please see our response to Q8.

Where equity market makers are required to individually produce data, we find that this could be distracting and confusing and would unnecessarily duplicate data, thus increasing costs for the market makers. Any unnecessary cost friction in the secondary market can reduce liquidity and widen spreads, thus reducing the attractiveness of the secondary market. Without an efficient, functional and attractive

secondary market, there will be no primary market investment. Therefore, we believe this could be detrimental to small and mid-size quoted companies' ability to raise finance.

Q30: Do you agree that when systematic internalisers, market makers, OTC negotiation or dealing on own account represent one of the five most important ways for the firm to execute clients' orders, they should be incorporated in the reporting obligations under Article 27(6) of MiFID II?

Please see our response to Q8.

We agree. As per our earlier responses, it is the venue that should be included, not the participant on a venue.

3. Transparency

3.1. Pre-trade transparency - Equities

Q50: Do you think there is merit in creating a new ADT class of 0 to €100,000 with an adequate new large in scale threshold and a new ADT class of €100,000 to €500,000? At what level should the thresholds be set? Please provide reasons for your answer.

We believe that there is a significant flaw in the calculations of the ADT groups. ESMA has used the ESMA MiFID database, which only includes shares admitted to trading on a regulated market. Therefore, ESMA's calculations have disregarded a significant number of small and mid-size quoted company shares throughout Europe which are admitted to trading on a MTF.

Analysis that we have seen shows that, as of May 2014, there were 5,917 shares admitted to a regulated market in UK, which is an equivalent sample used by ESMA to calculate the proposed ADT groups. During that same period, there were 2,299 shares admitted to MTF markets in the UK. On the basis of these figures, 28% of the affected instruments have been excluded from ESMA's calculation of the ADT groups.

The result is that ESMA's analysis is skewed toward the more liquid shares and potentially to the detriment of less liquid shares of small and mid-size quoted companies. This has the perverse effect of potentially granting greater protection to liquid shares (that do not need it).

Therefore, we believe that ESMA should recalculate the data, including the securities of companies traded on MTFs, in order to determine whether the ADT groups are appropriately calibrated.

Q52: Do you think there is merit in creating a new ADT class for 'super-liquid' shares with an ADT in excess of €100m and a new class of €50m to €100m? At what level should the thresholds be set?

As mentioned in our response to Q50, we believe that ESMA's analysis of ADT groups is skewed towards the more liquid end of the market. Since ESMA is proposing the creation of a 'super-liquid' ADT class, we believe that there could be a case for a 'super-illiquid' ADT class of shares, which has largely been disregarded from ESMA's analysis.

Q53: What comments do you have in respect of the new large in scale transparency thresholds for shares proposed by ESMA?

We believe that the new large in scale transparency thresholds for shares proposed by ESMA, as set out in the table set out in paragraph 3.1.40, would have a distortive effect on trading. As mentioned in our

response to Q50, ESMA has not taken into account shares of companies on MTFs that should be in the equity consideration for the calculation of the ADT groups. The thresholds should be considered after adding in these shares to ESMA's calculation of the ADT groups.

3.2. Post-trade transparency - Equities

Q82: Do you agree with the definition of "normal trading hours" given above?

Yes, we agree with the definition.

Q83: Do you agree with the proposed shortening of the maximum permissible delay to 1 minute? Do you see any reason to have a different maximum permissible deferral of publication for any equity-like instrument? Please provide reasons for your answer

We generally support any proposal that will bring increased transparency to the secondary markets. We believe that the availability of appropriate information in the market benefits our small and mid-size quoted company members, as a viable and attractive secondary market will assist them in raising capital. It is on this basis that we support the proposal to reduce the deadline for reporting in real time from 3 minutes to 1 minute, as we have previously supported in our response to the Commission's consultation on the MiFID review in 2011.

Q85: Which of the two options do you prefer in relation to the deferral periods for large in scale transactions (or do you prefer another option that has not been proposed)? Please provide reasons for your answer

We believe that the liquidity of a security needs to be taken into consideration in terms of the deferral period for a large in scale transactions. As we have stated in our response to Q8, while many securities of large cap companies enjoy highly liquid markets and are able to be traded through an order book mechanism, the market in small and mid-size quoted companies relies heavily on the significant capital commitment from liquidity providers such as market makers, often through quote driven platforms. The willingness of the market maker to place capital at risk will rely on their ability to unwind that risk in a controlled manner, which may involve deferring the publication of large transactions of small and mid-size quoted company shares to manage the market impact.

Consequently, we believe that all of ESMA's options in relation to the deferral periods for large in scale transactions could lead to significant degradation of the market in small and mid-size quoted company securities, likely causing significant harm to the wider sector and market.

The loss of publication delays past the end of the trading day will dramatically reduce liquidity in shares on SME Growth Markets and also in shares of small and mid-size listed companies on regulated markets. Where larger trades do occur, the bid offer spread will be far larger to reflect the additional market risk faced by the market maker. This is therefore harmful to all market participants. If the market is seen to be less welcoming, it will become questionable how desirable it is to invest in small and mid-size quoted company securities. This should be avoided, as a degradation of the secondary markets will lead to an unhealthy primary market.

Equity growth markets are becoming increasingly the source of much needed funding for small and mid-size quoted companies, providing capital where the banking system has been unwilling or unable to assist.

Conversely, it is the smaller companies that provide the growth required for economic growth and job creation in the European Union.

We therefore believe that ESMA should reconsider the proposed approach for less liquid small and mid-size listed company securities on regulated markets and for all securities on SME Growth Markets. We believe that the retaining a more flexible deferral period for large in scale transactions of securities of small and mid-size companies on regulated markets and SME Growth Markets is essential to maintain liquidity and trading in these less liquid securities. We believe that it would be important to introduce an appropriately calibrated approach to ensure that small and mid-size quoted companies are able to raise finance and grow.

Q86: Do you see merit in adding more ADT classes and adjusting the large in scale thresholds as proposed? Please provide alternatives if you disagree with ESMA's proposal

We understand the consideration given by ESMA to adding more ADT classes, and we would generally support a more granular and representative approach to setting ADT classes. However, we believe that the proposed thresholds are not appropriate for SME shares, as described in detail in response to Q87.

Q87: Do you consider the thresholds proposed as appropriate for SME shares?

No, we do not agree with the thresholds proposed as appropriate for SME shares.

In line with what we stated in our response on pre-trade transparency (equities) in Q50, we believe that there are flaws in the calculations of the ADT groups. ESMA's calculations have disregarded a significant number of small and mid-size quoted company shares traded on MTFs, which results in skewing ESMA's analysis to the detriment of less liquid shares.

Therefore, as mentioned in our response to Q50, we believe that ESMA should recalculate the data, including the securities of companies traded on MTFs, in order to determine whether the ADT groups are appropriately calibrated. It may be that ESMA should consider creating an ADT group for super-illiquid shares or adjusting the groups in the original proposal.

We note that the Central Securities Depositories Regulation (CSDr) recognises the need to calibrate the approach for settlement of less liquid securities. We strongly believe that ESMA should consider the same in its proposals on the ADT groups and the deferral periods for large in scale transactions.

Q89: Do you have any concerns regarding deferred publication occurring at the end of the trading day, during the closing auction period?

We believe that the proposed deferred publication occurring at the end of the trading day, during the closing auction period raises significant concerns, namely regarding the provision of liquidity and bid offer spreads for larger trades.

Publication prior to or during the auction period would remove the opportunity to use the auction as a means to unwind part of the client position. This increases the risk of exposure of the liquidity provider, leading to reductions in the liquidity offered and widening bid offer spreads for large trades to compensate for the added risk. This is detrimental to less liquid shares of small and mid-size quoted companies.

We believe that the deferred publication occurring at the end of the trading day should be made public after the auction close.

We would like to point out that adding the reference to the time as 15.00 can bring discrepancies and uncertainty to the functioning of the internal market since EU Member States are located in different time zones. We note that the Level 2 regulations or guidance should make reference to “x hours before the close of market trading” to avoid any inconsistencies across Member States.

4.8. Tick sizes (Article 48(6) and Article 49 of MiFID II)

Q330: Do you agree with the general approach ESMA has suggested?

We believe that there should be a minimum price differentiation, small enough to allow a competitor to top or beat that price. This should be inclusive of small and mid-size quoted company securities and we question whether ESMA has considered small and mid-size quoted companies in its analysis. There should be an economic difference that reflects the value of the stock, otherwise it becomes cheap to manipulate the market and can have real implications for smaller companies in terms of affecting their ability to raise finance and grow. We urge ESMA to consider small and mid-size quoted companies and the goals of the internal market for SMEs.

If you would like to discuss any of our responses in more detail, we would be happy to attend a meeting.

Yours faithfully,

A handwritten signature in blue ink, appearing to read 'TW', is positioned above the typed name of the signatory.

Tim Ward
Chief Executive

Quoted Companies Alliance Secondary Markets Expert Group

Simon Rafferty (Chairman)	Winterflood Securities Ltd
William Lynne/ Claire Noyce	Hybridan LLP
Andy Thompson	Wealth Management Association (WMA)
Paul Arathoon/ Andrew Collins/	
William Garner	Speechly Bircham LLP
Sunil Dhall	Peel Hunt LLP
Fraser Elms/ Katie Potts	Herald Investment Management Ltd
Richard Everett	Wragge Lawrence Graham & Co
Jon Gerty	Shore Capital Group Ltd
Mitchell Gibb	Peel Hunt LLP
Brian McDonnell	Olswang
Robert Scavera	Numis Securities Limited
James Stapleton	Winterflood Securities Ltd
Peter Swabey	ICSA
Mark Tubby	finnCap