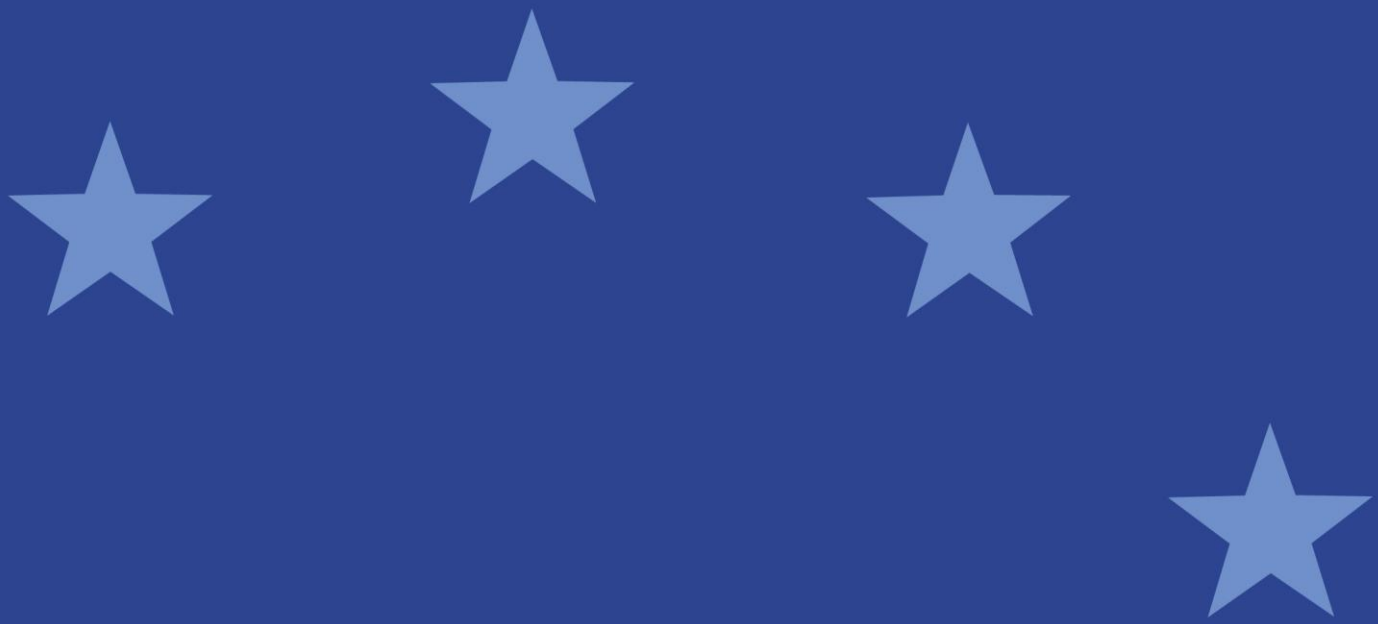
esma European Securities and Markets Authority

Questions and Answers

On MiFID II and MiFIR market structures topics



31 January 2017 | ESMA70-872942901-38

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Acronyms and definitions used

ADNT	Average Daily Number of Transactions
AOR	Automated Order Router
DEA	Direct Electronic Access
ESMA	The European Markets and Securities Authority
MiFID I	Markets in Financial Instruments Directive – Directive 2004/39/EC of the European Parliament and of the Council
MiFID II	Markets in Financial Instruments Directive (recast) – Directive 2014/65/EU of the European Parliament and of the Council
MiFIR	Markets in Financial Instruments Regulation – Regulation 600/2014 of the European Parliament and of the Council
NCA	National Competent Authority
Q&A	Question and answer
RTS	Regulatory Technical Standards

Table of questions

		Topic of the Question	Level 1/Level 2 issue	Last Updated
Data disaggregation	1	Level at which disaggregation is required	Article 12 of MiFIR and RTS 14[1]	18/11/2016
	2	Requests for disaggregated data	RTS 14	18/11/2016
	3	Country of issue	RTS 14	18/11/2016
Direct Electronic Access (DEA) and algorithmic trading	1	Treatment of simple algorithms	Article 18 of the Commission Delegated Regulation (EU) No XXX/2016	19/12/2016
	2	Transmission of orders and algorithmic trading	Article 18 of the Commission Delegated Regulation (EU) No XXX/2016	19/12/2016
	3	Automated Order Router (AOR)	Article 18 of the Commission Delegated Regulation (EU) No XXX/2016	19/12/2016
	4	Reference to "market markers" under Article 2(1)(d) of MiFID II	Article 2(1)(d) of MiFID II	31/01/2017
Tick size regime	1	Relevant National Competent Authority (NCA) responsible for calculating and publishing the average daily number of transactions (ADNT)	RTS 11	18/11/2016
	2	Corporate actions	RTS 11	18/11/2016
	3	Determination of the applicable tick size for instruments listed in non-EU countries	RTS 11	18/11/2016
	4	Application of the tick size for instruments trading in different currencies	RTS 11	18/11/2016

[1] Please note that, for ease of reference, RTS have been numbered in this document in accordance with the numbering used in the package sent by ESMA to the Commission in September 2015 (ESMA/2015/1464). Readers are nevertheless invited to consult the Commission and European Parliament websites for updated versions of those RTS.

	5	Ad hoc changes of the applicable tick sizes	RTS 11	18/11/2016
	6	Tick size regime and pre-trade transparency waivers	RTS 11	19/12/2016
	7	Orders remaining on the order book at the moment the tick size increases	RTS 11	19/12/2016
Multilateral systems	1	Can an MTF operator be a member/participant of its own MTF	Article 19 of MiFID II	31/01/2017
	2	Compliance with co-location provisions under RTS 10 in case of outsourced co-location service	RTS 10	31/01/2017

1 Introduction

Background

The final legislative texts of Directive 2014/65/EU[2] (MiFID II) and Regulation (EU) No 600/2014[3] (MiFIR) were approved by the European Parliament on 15 April 2014 and by the European Council on 13 May 2014. The two texts were published in the Official Journal on 12 June 2014 and entered into force on the twentieth day following this publication – i.e. 2 July 2014.

Many of the obligations under MiFID II and MiFIR were further specified in the Commission Delegated Directive[4] and two Commission Delegated Regulations[5] [6], as well as regulatory and implementing technical standards developed by the European Securities and Markets Authority (ESMA).

MiFID II and MiFIR, together with the Commission delegated acts as well as regulatory and implementing technical standards will be applicable from 3 January 2018.

Purpose

The purpose of this document is to promote common supervisory approaches and practices in the application of MiFID II and MiFIR in relation to market structures topics. It provides responses to questions posed by the general public, market participants and competent authorities in relation to the practical application of MiFID II and MiFIR.

The content of this document is aimed at competent authorities and firms by providing clarity on the application of the MiFID II and MiFIR requirements.

The content of this document is not exhaustive and it does not constitute new policy.

Status

[2] Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU.
[3] Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) N0 648/2012.
[4] Commission Delegated Directive of 7.4.2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to safeguarding of financial instruments and funds belonging to clients, product governance obligations and the rules applicable to the provision or reception of fees, commissions or any monetary or non-monetary benefits. The Commission Delegated Directive was published on 7 April 2016 and no objection has been expressed by the European Parliament or the Council on the MiFID II Delegate Directive and Delegated Regulation within the period set in Article 89 of MiFID II.
[5] Commission Delegated Regulation of 25.4.2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive. The Commission Delegated Regulation was published on 25 April 2016 and no objection has been expressed by the European Parliament or the Council on the MiFID II Delegate Directive and Delegated Regulation within the period set in Article 89 of MiFID II.
[6] Commission Delegated Regulation of 18.5.2016 supplementing Regulation (EU) No 600/2014 of the European Parliament and of the Council with regard to definitions, transparency, portfolio compression and supervisory measures on product intervention and positions. The Commission Delegated Regulation was published on 18 May 2016 and no objection has been expressed by the European Parliament or the Council on the MiFID II Delegate Directive and Delegated Regulation within the period set in Article 50 of MiFIR.

The question and answer (Q&A) mechanism is a practical convergence tool used to promote common supervisory approaches and practices under Article 29(2) of the ESMA Regulation[7].

Due to the nature of Q&As, formal consultation on the draft answers is considered unnecessary. However, even if Q&As are not formally consulted on, ESMA may check them with representatives of ESMA's Securities and Markets Stakeholder Group, the relevant Standing Committees' Consultative Working Group or, where specific expertise is needed, with other external parties.

ESMA will periodically review these Q&As on a regular basis to update them where required and to identify if, in a certain area, there is a need to convert some of the material into ESMA Guidelines and recommendations. In such cases, the procedures foreseen under Article 16 of the ESMA Regulation will be followed.

The Q&As in this document cover only activities of EU investment firms in the EU, unless specifically mentioned otherwise. Third country related issues, and in particular the treatment of non-EU branches of EU investment firms, will be addressed in a dedicated third country section.

Questions and answers

This document is intended to be continually edited and updated as and when new questions are received. The date on which each section was last amended is included for ease of reference.

[7] Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC Regulation, 15.12.2010, L331/84.

2 Data disaggregation [Last update: 18/11/2016]

Question 1 [Last update: 18/11/2016]

Will disaggregation be required at the level of the market operator or at the level of each trading venue?

Answer 1

Disaggregation is required at the level of each trading venue for which the market operator or investment firm operating a trading venue has received a specific authorisation under MiFID II.

Question 2 [Last update: 18/11/2016]

Article 1 of RTS 14[8] states that market operators and investment firms operating a trading venue shall provide disaggregated data "on request". Who would be entitled to make such requests? What constitutes a request in this context? How quickly do market operators and investment firms operating a trading venue need to respond to a request for unbundled data?

Answer 2

MiFIR requires the relevant data to be made available "to the public" in disaggregated form on reasonable commercial terms. As such, any individual or entity (whether or not a user of the trading venue) could make a request for disaggregated data and the market operator or investment firm operating a trading venue has to provide the commercial terms to acquire the disaggregated data.

As part of those commercial terms and to effectively provide access to the arrangements employed for making public the information referred to in Articles 3, 4 and 6 to 11 of MiFIR, the market operator or investment firm operating a trading venue may impose non-discriminatory technical requirements on clients.

The request for disaggregated data could be in any format provided it clearly expresses a request for the disaggregated data. For the avoidance of doubt, market operators and investment firms operating a trading venue do not need to make disaggregated data available unless they have received a request to do so.

Market operators and investment firms operating a trading venue should respond to requests for disaggregated data as quickly as practicable. The response should not be slower than to a

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request for non-disaggregated data. Market operators and investment firms operating a trading venue should reply to requests falling in the same category within the same time frame.

Question 3 [Last update: 18/11/2016]

Article 1(1)(b) of RTS 14 requires disaggregation by country of issue for shares. How should "country of issue" be interpreted? Is this also required for non-EU countries?

Answer 3

Country of issue should be interpreted as the home Member State of the issuer, as defined in Article 2(1)(i) of the Transparency Directive[9], including where the issuer is incorporated in a third country.

[9] Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC.

3 Direct Electronic Access (DEA) and algorithmic trading [Last update: 31/01/2017]

Question 1 **[Last update: 19/12/2016]**

Does a simple algorithm qualify as algorithmic trading?

Answer 1

Yes. The fact that a person or firm undertakes trading activity by means of an algorithm which includes a small number of processes (e.g. makes quotes that replicate the prices made by a trading venue) does not disqualify the firm running such algorithm from being engaged in algorithmic trading.

Question 2 **[Last update: 19/12/2016]**

If an investment firm (firm A) merely transmits a client's order for execution to another investment firm (firm B) who uses algorithmic trading, is investment firm A engaged in algorithmic trading?

Answer 2

No. The transmission of an order for execution to another investment firm without performing any algorithmic trading activity is not algorithmic trading.

Question 3 **[Last update: 19/12/2016]**

Can a functionality be considered as an Automated Order Router (AOR) if it submits the same order to several trading venues? Would that qualify as algorithmic trading?

Answer 3

According to Recital 22 of Commission Delegated Regulation (EU) No XXX/2016[10], an AOR is characterized by only determining the trading venue or trading venues to which the order has to be sent without changing any other parameter of the order (including modifying the size of the order by "slicing" it into "child" orders). In case the same unmodified order is sent to several trading venues to ensure execution and it is executed in one of these venues, the functionality

[10] Commission Delegated Regulation of 25.4.2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive.

can also cancel the unexecuted orders in the other venues without qualifying as algorithmic trading.

Question 4 [Last update: 31/01/2017]

Do the references to 'market makers' in MiFID II Article 2(1)(d)(i) and Article 2(1)(j) cover those market makers as defined under MiFID II Article 4(1)(7) or those firms engaged in a market making agreement according to Article 17(4) of MiFID II?

Answer 4

The reference to market makers' in MiFID II Article 2(1)(d)(i) and Article 2(1)(j) covers both firms engaged in a market making agreement according to Article 17(4) of MiFID II and other market makers covered by Article 4(1)(7) of MiFID II.

4 The tick size regime [Last update: 19/12/2016]

Question 1 [Last update: 18/11/2016]

Which National Competent Authority (NCA) should be responsible for calculating and publishing the average daily number of transactions (ADNT) and in particular in the case of multi-listed instruments?

Answer 1

The relevant NCA responsible calculating and publishing the ADNT should be the competent authority identified as the NCA of most relevant market in terms for the purposes of transaction reporting. In the case of multi-listed instruments, the criteria and procedure to be used for determining which NCA should be the relevant NCA are specified under Article 16 of RTS 22.

For new instruments, Article 16 of RTS 22 clarifies that the most relevant market for the financial instrument is the market of the Member State in which a request for admission to trading was first made or where the instrument was first traded. The NCA of this Member State will be responsible for publishing the estimates and preliminary calculations as per the procedure set out under Article 3(5) and (6) of RTS 11.

Where the relevant NCA has concluded an agreement with ESMA, the ADNT will be published centrally on the ESMA website. For other NCAs, the ADNT will be published on the ESMA website on a best-effort basis.

Question 2 [Last update: 18/11/2016]

Which types of corporate actions for an instrument may trigger a recalculation of ADNT?

Answer 2

Any corporate actions that the relevant NCA anticipates will lead to a material change in the average daily number of trades after the event may initiate the recalculation process per Article 4 of RTS 11. Normally such a circumstance may arise when the issuer plans to undertake, amongst other things, share buybacks or share issuance which will result in the instrument continuing to trade in a liquidity band that would not be optimal unless a recalculation is undertaken.

Question 3 [Last update: 18/11/2016]

Are non-EU instruments in scope and how the calculation of ADNT should be performed for those instruments?

Answer 3

Non-EU instruments are included in the scope of the Article 49 regime as soon as they are traded on a trading venue in the Union. The applicable liquidity band is determined by the relevant NCA taking into account the ADNT on the most relevant market in terms of liquidity according to Article 4 of RTS 1. Trading activity taking place outside of the Union should not be considered for these purposes.

Question 4 [Last update: 18/11/2016]

How is a liquidity band applied for instruments trading in different currencies across trading venues?

Answer 4

Once a particular liquidity band is assigned to an instrument, trading of that instrument will continue within that band until another liquidity band is assigned as a result of periodical or ad hoc review by the relevant NCA or ESMA. As set out in Recital 8 of RTS 11, the same liquidity band will be applied irrespective of the currency denomination used for the quotation of the financial instrument.

Question 5 [Last update: 18/11/2016]

Can a trading venue or NCA manually intervene to allow a smaller tick size if it can be shown that the mandated minimum tick size is adversely impacting liquidity?

Answer 5

No, except where there has been a corporate action event in which the NCA concerned will consider assigning a different liquidity band according to its estimate of the ADNT occurring in the most liquid venue following the said corporate action event.

Question 6 [Last update: 19/12/2016]

Does the minimum tick size regime under Article 49 of MiFID II apply to all orders for which a pre-trade transparency waiver can be granted in accordance with Article 4 of MiFIR?

Answer 6

Article 49 of MiFID II requires trading venues to adopt minimum tick sizes in relation to equity and certain equity-like instruments. RTS 11 specifies the minimum tick size regime which applies to those instruments depending on their liquidity and price level. As the aim of the minimum tick size regime is to ensure the orderly functioning of the market, its application

extends to all orders submitted to trading venues. The application of the tick size regime would include, for example, limit orders resting on an order book, including orders held in an order management system as per Article 4(1)(d) of MiFIR.

However, since the tick size regime applies to orders and not to the execution price of transactions, it is therefore possible for a transaction to take place at a price between two ticks. This is the case if this price is derived from other prices that otherwise comply with the minimum tick size. For example, the minimum tick size regime would not apply to transactions executed in systems that match orders on the basis of a reference price as per Article 4(1)(a) of MiFIR, or to negotiated transactions as per Article 4(1)(b) of MiFIR.

Question 7 **[Last update: 19/12/2016]**

What happens to orders remaining on the order book at the moment the tick size increases?

Answer 7

Trading venues have discretion to set the rules covering the treatment of orders remaining on the book at the moment the minimum tick size increases, including whether or not such orders are to be cancelled or amended. Trading venues are responsible to disclose those rules appropriately. Trading venues must also observe the requirement to enforce the minimum tick size for orders submitted after that tick size comes into force.

5 Multilateral systems [Last update: 31/01/2017]

Question 1 [Last update: 31/01/2017]

Can an MTF operator be a member/participant of its own MTF?

Answer 1

Whether an MTF operator may become a member of its own MTF requires the application of two different MiFID II articles.

Article 19 of MiFID II does not prevent an investment firm operating an MTF to be a member of its own MTF. However, Article 19(5) prohibits investments firms and market operators operating an MTF to execute client orders against proprietary capital, or to engage in matched principal trading. As a consequence, the investment firm could only operate on its own MTF through pure agency trading.

Article 18(4) also requires the operator of an MTF to have arrangements to identify clearly and manage the potential adverse consequences for the operation of the MTF or for its members or participants, of any conflict of interests between the MTF, their owners or the investment firm and market operator operating an MTF and its sound functioning.

Appropriate management of conflict of interest is all the more important to ensure the effective implementation of Article 31 of MiFID II, which requires investment firms and market operators operating an MTF to monitor the compliance of its members and participants with the rules of the MTF and with other legal obligations.

Therefore, unless otherwise demonstrated by adequate and effective internal arrangements and procedures, ESMA is of the view that the potential conflicts of interest that may arise as a result of this would only be managed effectively by means of operating the MTF and the membership through different legal entities.

To ensure that having two separate legal entities serves a meaningful purpose, ESMA is of the view that the two investment firms should have arrangements in place that prevent information sharing on each other's activities. This would include for instance having distinct management and operational teams and physical separation of activities. Similarly, whereas some elements of the IT infrastructure could be shared, execution systems would be expected to be segregated and safeguards to be put in place to prevent information leakage across the two entities. Outsourcing from one legal entity to the other should only take place where the arrangements meet a similar test.

The arrangements described above shall be without prejudice to the ability of the MTF to monitor its participants for compliance with market rules and other legal obligations and also without prejudice to the MiFID II provisions on identification and management of conflicts of interest to be met by each of the two investment firms.

Question 2 [Last update: 31/01/2017]

Would a trading venue locating its electronic systems on a third party data centre be required to comply with the co-location provisions under RTS 10 even where the venue is not providing the co-location service?

Answer 2

The principle underpinning Article 1 of RTS 10 is to ensure that electronic access to trading venues is fair and based on objective and non-discriminatory criteria. A trading venue should seek to ensure that this principle is not violated even when the connectivity service is provided by a third-party to members, participants or a client of the trading venue.

Therefore, the trading venue should take all the necessary steps to ensure that the third party proximity hosting service provider offers a fair and non-discriminatory access to all members/participants/clients of the trading venue subscribing to such services. Such a requirement may include the conclusion or amendment of an agreement between the trading venue and the service provider so as to remain fully compliant with the provisions in RTS 10.