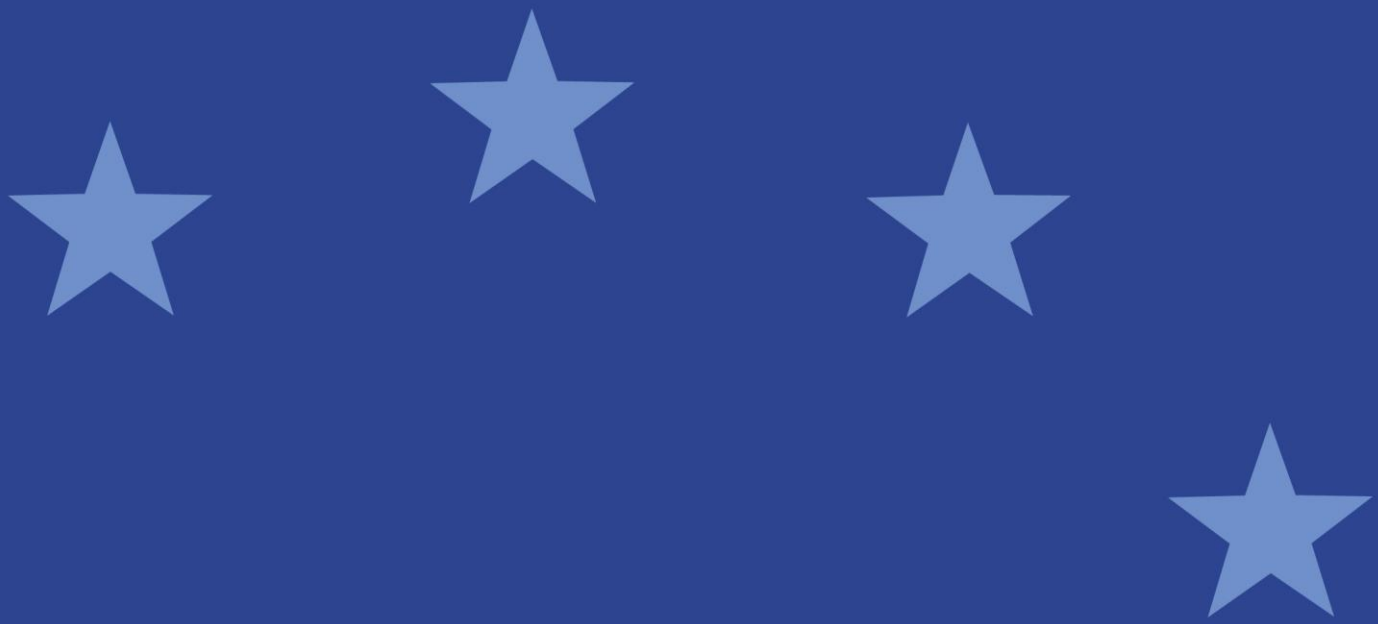
esma European Securities and Markets Authority

Questions and Answers

On MiFID II and MiFIR market structures topics



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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
HFT	High Frequency Trading
ITS 19	Commission Implementing Regulation (EU) 2016/824 on the content and format of the description of the functioning of multilateral trading facilities and organised trading facilities and the notification to the ESMA according to MiFID II
MAR	Market Abuse Regulation
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
OTF	Organised Trading Facility
Q&A	Question and answer
RTS	Regulatory Technical Standards
RTS 6	Commission Delegated Regulation (EU) 2017/589 specifying the organisational requirements of investment firms engaged in algorithmic trading
RTS 8	Commission Delegated Regulation (EU) 2017/578 specifying the requirements on market making agreements and schemes
RTS 9	Commission Delegated Regulation (EU) 2017/566 on the ratio of unexecuted orders to transactions in order to prevent disorderly trading conditions

RTS 10	Commission Delegated Regulation (EU) 2017/573 on requirements to ensure fair and non-discriminatory co-location services and fee structures
RTS 11	Commission Delegated Regulation (EU) 2017/588 on the tick size regime for shares, depositary receipts and exchange-traded funds
RTS 14	Commission Delegated Regulation (EU) 2017/572 on the specification of the offering of pre-and post-trade data and the level of disaggregation of data
RTS 15	Commission Delegated Regulation (EU) 2017/581 on clearing access in respect of trading venues and central counterparties
RTS 22	Commission Delegated Regulation (EU) 2017/590 on the reporting of transactions to competent authorities
RTS 24	Commission Delegated Regulation (EU) 2017/580 on the maintenance of relevant data relating to orders in financial instruments
RTS 25	Commission Delegated Regulation (EU) 2017/574 on the level of accuracy of business clocks
RTS 26	Commission Delegated Regulation (EU) 2017/582 specifying the obligation to clear derivatives traded on regulated markets and timing of acceptance for clearing
SI	Systematic internaliser
STOR	Suspicious Transaction or Order Report

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	2	Requests for disaggregated data	RTS 14	18/11/2016
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12	Definition of DEA	Article 20 of Commission Delegated Regulation (EU) 2017/565	03/04/2017
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20	Exercise of discretion	Article 20(6) of MiFID II	03/04/2017
21	Exercise of discretion	Article 20(6) of MiFID II	03/04/2017
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1 Introduction

Background

The final legislative texts of Directive 2014/65/EU[1] (MiFID II) and Regulation (EU) No 600/2014[2] (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[3] and two Commission Delegated Regulations[4] [5], 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

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[6].

[1] 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.
[2] 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.
[3] Commission Delegated Directive (EU) 2017/593 of 7 April 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 (OJ L 87, 31.3.2017, p. 500–517).
[4] Commission Delegated Regulation (EU) 2017/565 of 25 April 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 (OJ L 87, 31.3.2017, p. 1–83).
[5] Commission Delegated Regulation (EU) 2017/567 of 18 May 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 (OJ L 87, 31.3.2017, p. 90–116).
[6] 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 (OJ L 331, 15.12.2010, p. 84).

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.

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[7] 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

[7] Commission Delegated Regulation (EU) 2017/572 of 2 June 2016 supplementing Regulation (EU) No 600/2014 of the European Parliament and of the Council with regard to regulatory technical standards on the specification of the offering of pre-and post-trade data and the level of disaggregation of data (OJ L 87, 31.3.2017, p. 142–144).

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[8], including where the issuer is incorporated in a third country.

[8] 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: 05/12/2019]

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) 2017/565[9], 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

[9] Commission Delegated Regulation (EU) 2017/565 of 25 April 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 (OJ L 87, 31.3.2017, p. 1–83).

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.

Question 5 [Last update: 03/04/2017]

How should the identification and authorisation take place for those firms applying a High-Frequency Trading (HFT) technique?

Answer 5

The mechanics of identifying whether a firm is deemed to be applying a HFT technique are detailed in Article 19 of Commission Delegated Regulation (EU) 2017/565. Firms should review their trading activities at least on a monthly basis to self-assess whether an authorisation requirement has been triggered over the course of the period in question. Upon request, trading venues must provide their members, participants or clients with an estimate of the average number of messages per second two weeks after the end of each calendar month. For this purpose, trading venues should only include messages generated by algorithmic trading activity as identified by the member, participant or client.

However, the onus remains on firms to ensure that the estimates provided by the trading venues accurately reflect their actual trading activity (and in particular that it only takes into account proprietary algorithmic trading activity on liquid instruments excluding, in the case of DEA providers, messages sent by DEA clients using the firm's code).

Where a firm engages in HFT (as described above) and is not authorised as an investment firm under MiFID II, the firm is required to immediately seek authorisation as required under Article 2(1)(d)(iii) of MiFID II.

ESMA reminds that any firm engaged in algorithmic trading (including HFT) has to notify this circumstance to the national competent authority of its home Member State and to the national competent authorities of the trading venues at which it engages in algorithmic trading as member or participant.

Question 6 [Last update: 03/04/2017]

Can DEA users be identified as applying a HFT technique?

Answer 6

Yes. As clarified under Recital 20 of Commission Delegated Regulation (EU) 2017/565, DEA users may be classified as HFTs if they meet the conditions set out under Article 4(1)(40) of MiFID II and Article 19 Commission Delegated Regulation (EU) 2017/565.

In order to assess whether a DEA user meets the applicable message thresholds, firms accessing trading venues through DEA may contact their DEA provider which is obliged to record the data relating to the orders submitted, including modifications and cancellations under Article 21(5) of RTS 6[10].

However, the onus remains on investment firms to ensure that the estimates provided by the DEA providers accurately reflect their actual trading activity (and in particular that it only takes into account proprietary trading activity on liquid instruments excluding, in the case of DEA users sub-delegating the DEA provider's code, messages sent by their own DEA clients).

Question 7 [Last update: 03/04/2017]

When would an investment firm using only algorithms which draw human traders' attention to trading opportunities qualify as engaged in algorithmic trading?

Answer 7

The use of algorithms which only serve to inform a trader of a particular investment opportunity is not considered as algorithmic trading, provided that the execution is not algorithmic.

Question 8 [Last update: 03/04/2017]

Does the MiFID II obligation relating to algorithmic trading apply to electronic OTC trading? Are algorithms that provide quotes/orders to customers subject to the requirements set out in MiFID II?

Answer 8

[10] Commission Delegated Regulation (EU) 2017/589 of 19 July 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the organisational requirements of investment firms engaged in algorithmic trading (OJ L 87, 31.3.2017, p. 417–448).

Article 17 of MiFID II covers the trading activity that takes place on a trading venue. Therefore, OTC trading activity, such as the generation of quotes sent bilaterally to clients is not covered by the provisions in Article 17 of MiFID II (and any further requirements thereof).

Question 9 [Last update: 03/04/2017]

Please explain what is meant by Article 17(3) of RTS 6 which requires investment firms to "reconcile" their own electronic logs with information about their outstanding orders and risk exposures as provided by the trading venues to which they send orders, their brokers or DEA providers, their clearing members or CCP, their data providers or other relevant business partners?

Answer 9

The goal of post-trade controls is mainly to enable firms engaged in algorithmic trading to undertake appropriate management of their market and credit risk. To that end, and in order to make sure that post-trade controls are based on reliable information, Article 17(3) of RTS 6 requires investment firms to reconcile their own electronic logs with information about their outstanding orders and risk exposures as provided by external parties. This should be understood as an obligation to compare the trading activity's reports generated by the investment firm itself with reports from other external sources. This should contribute in particular to:

a) Early detection of any discrepancy between the different data sources and mitigation of errors and malfunctions;

b) Accurate calculation of the firm's actual exposure (in particular, where it accesses different multiple trading systems and/or brokers) and the timely generation of adequate alerts before the position and loss limits set out by the firm have been breached.

Question 10 [Last update: 03/04/2017]

Are firms required to store market data in order to fulfil the requirements contained in Article 13(7) of RTS 6 regarding the replay functionality of surveillance systems?

Answer 10

Under Article 13(1) of RTS 6, investment firms engaged in algorithmic trading are obliged to have in place monitoring systems capable of generating operable alerts to indicate potential market abuse. To that end, firms have to take into account not only their own message, order flow and transaction records but also information from other sources (trading venues, brokers, clearing members, CCPs, data providers, relevant business partners and so forth) which

constitute not only the input used to generate messages but also the context of the trading activity.

Under Article 13 of RTS 6 there is no obligation to store internally all the information from other sources as long as it is possible to retrieve that information to operate the replay function.

Those operable alerts may lead to the submission to the national competent authority of a Suspicious Transaction or Order Report (STOR) under the Market Abuse Regulation (MAR)[11]. In particular, Article 5(3) of Commission Delegated Regulation (EU) 2016/957[12] prescribes that the information submitted as part of a STOR has to be based on facts and analysis, taking into account all information available to them. Additionally, there is an obligation to maintain for a period of five years the information documenting the analysis carried out with regard to orders and transactions that could constitute market abuse which have been examined and the reasons for submitting or not submitting a STOR. That information shall be provided to the competent authority upon request (Article 3(8) of Commission Delegated Regulation (EU) 2016/957).

Question 11 [Last update: 03/04/2017]

Article 20 of Commission Delegated Regulation (EU) 2017/565 further clarifies the definition of direct electronic access as per Article 4(1)(41) of MiFID II by stating that persons shall be considered not capable of electronically transmitting orders relating to a financial instrument directly to a trading venue in accordance with Article 4(1)(41) of MiFID II where that person cannot exercise discretion regarding the exact fraction of a second of order entry and the lifetime of the order within that timeframe. What does "exercise discretion regarding the exact fraction of a second" mean?

Answer 11

One of the benefits of accessing a trading venue by DEA is in the ability of the firm submitting the order to exercise greater control over the timing of order submission. The use of DEA without passing through appropriate control filters of the provider of DEA and those of the trading venue, is not permitted under MiFID II. Such filters add minimal, but a finite amount of delay to the order reaching the matching engine of the trading venue and as such some may preclude the possibility of a firm submitting such an order to exercise discretion regarding the exact fraction of a second.

However, the phrase in question should be construed as whether the DEA user in question is able to exercise discretion regarding the exact fraction of a second in sending an order, not

[11] Regulation (EU) 596/2014 f the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC (OJ L 173, 12.6.2014, p. 1–61)

[12] Commission Delegated Regulation (EU) 2016/957 of 9 March 2016 supplementing Regulation (EU) No 596/2014 of the European Parliament and of the Council with regard to regulatory technical standards for the appropriate arrangements, systems and procedures as well as notification templates to be used for preventing, detecting and reporting abusive practices or suspicious orders or transactions (OJ L 160, 17.6.2016, p. 1–14).

the exact timing of an order reaching the matching engine. This is a natural interpretation given that current network routing technology cannot provide certainty for a message to reach its destination with the precision of “exact fraction of a second”.

Question 12 [Last update: 31/05/2017]

What is meant by “continuous” assessment and monitoring of market and credit risk in Article 17(2) of RTS 6 which relates to investment firms’ post trade controls?

Answer 12

Article 17(2) of RTS 6 includes as part of the post-trade controls that investment firms engaged in algorithmic trading must have in place the ‘continuous assessment and monitoring of market and credit risk of the investment firm in terms of effective exposure’.

Since there is no requirement to operate this continuous assessment in real-time on an ongoing basis, intraday and/or end of day checks as appropriate can be carried out at entity level. However, it is noted that the investment firm must have the capability to calculate in real time if necessary and on the basis of the information that it has: a) its outstanding exposure; b) the outstanding exposure of each of its traders and c) the outstanding exposure of clients (Article 17(3) RTS 6).

ESMA notes that for that purpose, the reconciliation of the firm’s own records with those provided by trading venues, clearing members, central counterparties, brokers, DEA providers or any other business partners must be made in real time when those counterparties provide the information in real time.

Question 13 [Last update: 07/07/2017]

Does the format established for the record-keeping obligations of HFT firms established in RTS 6 apply to their non-algorithmic trading desks?

Answer 13

In addition to the general obligation of investment firms to maintain records of all orders and transactions in financial instruments under Article 25 of MiFIR, Article 17(2) of MiFID II establishes the obligation of investment firms engaged in HFT “to store in an approved form accurate and time sequenced records of all its placed orders, including cancellations of orders, executed orders and quotations on trading venues”.

For investment firms simultaneously engaging in HFT and non-HFT activities there are two formats that have to be considered:

- The format established in Annex 2 of RTS 6 has to be used to record the messaging activity related to activity using HFT technique. ESMA considers that 'activity using HFT technique' only includes the algorithmic proprietary trading activity of the firm on a trading venue with respect to any liquid instruments (see Article 19 of Commission Delegated Regulation (EU) 2017/565).

  With respect of the timestamping of those records (see fields 23 and 24 of table 3 of Annex II of RTS 6), the activity using HFT technique has to be timestamped within 1 microsecond or better (Table 2 of Annex to RTS 25, to which RTS 6 cross-refers).

- Non-HFT activity has to be recorded under the format established by Commission Delegated Regulation (EU) 2017/565. However, nothing prevents these investment firms from using Annex 2 of RTS 6 to record their non-HFT trading activity if their NCA so agrees.

  ESMA reminds that all other non-HFT algorithmic trading activity should be timestamped in one millisecond or better as provided for under 'any other trading activity' as specified in Table 2 of the Annex of RTS 25, to which Commission Delegated Regulation (EU) 2017/565 cross-refers.

Question 14 [Last update: 07/07/2017]

Article 2(2) of Commission Delegated Regulation (EU) 2017/582 (RTS 26) requires trading venues to provide tools to ensure pre-execution screening on an order-by-order basis by each clearing member of the limits set and maintained by that clearing member for its client pursuant to RTS 6. Which specific provision of RTS 6 is the reference to limits in Article 2(2) of RTS 26 referring to?

Answer 14

The reference made to RTS 6 in Article 2(2) of RTS 26 is referring to Article 26 of RTS 6.

Question 15 [Last update: 07/07/2017]

Article 2(1) of RTS 26 provides an exemption from pre-trade, order-by-order checking for on-venue traded cleared derivatives if certain conditions are met. When this exemption applies to clearing members, does it also exempt clearing members from the requirement under Article 26(2) of RTS 6 to have "appropriate pre-trade and post-trade procedures for managing the risk of breaches of position limits"?

Answer 15

General clearing members and trading venues are not required to subject client orders for cleared derivative transactions on a trading venue to the relevant pre-trade checks required

under RTS 26 where the conditions set out in Article 2(1) of RTS 26 are met. However, pursuant to Article 26(2) of RTS 6, they should have other pre-trade procedures to manage the risk of breaches of position limits by their clients, by way of appropriate margining practice and other means.

Question 16 [Last update: 07/07/2017]

Does the 'kill functionality' require having to integrate different systems in-house using a software approach so that a single button can cancel all orders in all asset classes for all house trading and client trading?

Answer 16

The requirement for an investment firm to have a kill functionality pursuant to Article 12 of RTS 6 obliges the firm to have the ability as an emergency measure to immediately pull any or all outstanding orders from any or all trading venues. ESMA considers that effective kill functionality is essential for ensuring adequate risk management and safeguarding of the orderly functioning of the market, given the risks to which algorithmic trading firms are exposed, in particular in situations where an algorithm is not behaving as expected.

In practical terms, this does not create an obligation for all systems connecting the firm to different trading venues to be implemented through a single unified piece of software, in particular when the investment firm comprises different trading systems. The functionality can comprise both procedures and switches that should be adjusted to the characteristics of the systems operated by the investment firm. For instance, when there is a unified system, a button could be set at the highest level of the system, with adequate and gradual procedures so as to limit risks of disorderly markets conditions. In any case, a single decision of the investment firm should be able to result in an immediate withdrawal of all orders or any subset of them.

Question 17 [Last update: 07/07/2017]

Under Article 3(2)(a) of Commission Delegated Regulation (EU) 2017/580 (RTS 24), there is a requirement to flag orders submitted to a trading venue "as part of a market making strategy pursuant to Articles 17 and 48 of [MiFID II]". Should a firm start flagging orders when it decides to submit orders with a view to make markets in a particular instrument, or only when it concludes a formal agreement with the trading venue subsequent to triggering such an obligation under Article 1 of Commission Delegated Regulation (EU) 2017/578 (RTS 8)?

Answer 17

The primary purpose of flagging as required under Article 3(2)(a) of RTS 24 is to enable efficient detection of market manipulation by distinguishing the order flow from an investment

firm based on pre-determined terms established by the issuer or the trading venue from the order flow of the investment firm acting at its own discretion (see Recital 6 of RTS 24).

ESMA therefore expects that only those orders submitted to a trading venue as part of a market making strategy subsequent to the conclusion of a market making agreement with the relevant trading venue should be flagged as such in field 8 as designated in Table 2 of the Annex of RTS 24. The same applies to field 3 of Table 3 of Annex II of RTS 6.

Question 18 [Last update: 07/07/2017]

Could trading venues set out different OTRs for different types of market participants (e.g. firms engaged in a market making scheme)?

Answer 18

As clarified by Recital 3 of Commission Delegated Regulation (EU) 2017/566 (RTS 9) trading venues may set the maximum ratio of unexecuted orders to transactions at the level they consider appropriate to prevent excessive volatility in the financial instrument concerned.

Nothing prevents trading venues from setting the limits on the basis of the different categories of market participants that operate in their systems. In particular, trading venues may determine a specific limit ratio for members or participants subject to market making obligations under a written agreement (Article 17(2) of MiFID II) or a market making scheme (Article 48(2)(b) of MiFID II).

The ratio limiting the number of unexecuted orders to transactions should be set in compliance with the objective of Article 48 of MiFID II and supported by statistical analysis of the activity of the different categories of members or participants and the liquidity of the instruments in which they operate.

Question 19 [Last update: 07/07/2017]

In terms of the Order to Trade Ratio (OTR), how should a trading venue tackle cases where a market participant has executed no trades after the submission of a high number of orders?

Answer 19

RTS 9 describes the methodology to calculate the actual OTR incurred by each member or participant of a trading venue using a fraction. In case there have been no trades, a strict application of the proposed methodology is not possible since one cannot divide by zero.

ESMA is of the view that trading venues should consider that the maximum OTR has been breached if the orders submitted without executing one single transaction surpassed the maximum authorised number of orders that can be sent for one transaction being executed.

For instance if the maximum OTR set by the trading is 10, members or participants should not sent more than 10 orders without executing one transaction.

Question 20 [Last update: 07/07/2017]

Article 1(2)(d) of RTS 8 establishes that quotes shall be deemed to have competitive prices where they are posted at or within the maximum bid-ask range set by the trading venue. Does this mean that trading venues have to have published maximum bid-ask ranges for all instruments traded on their venues or only for the instruments on which they have a market making scheme in place?

Answer 20

There are two different obligations when an investment firm is pursuing a market making strategy in trading venues allowing or enabling algorithmic trading through their systems:

a) There is a generic obligation, not restricted to specific financial instruments, for trading venues to sign written market making agreements with all investment firms pursuing a market making strategy on their systems (Article 48(2) and Article 17(3) and (4) of MiFID II) when the circumstances described in Article 1(2) of RTS 8 are met; and

b) Trading venues must have market making schemes in place only with respect to the instruments listed in Article 5 of RTS 8.

In order for investment firms to assess whether they are posting competitive prices on a trading venue and may therefore potentially qualify as engaging into a market making strategy, and have to enter into a market making agreement, trading venues enabling or allowing algorithmic trading through their systems must make public a maximum bid-ask range for each financial instrument they made available for trading.

ESMA notes that trading venues may group financial instruments when setting the maximum bid-ask spread for these purposes.

Question 21 [Last update: 07/07/2017]

Under which circumstances a trading venue may cancel, vary or correct a transaction?

Answer 21

Trading venues enabling or allowing algorithmic trading through their systems shall be able to cancel or revoke transactions in case of malfunctioning of the trading venue's mechanisms to manage volatility or of the trading system in the context of disorderly trading conditions, according to Article 18 of RTS 7.

However, Article 47(1)(d) of MiFID II also establishes the general organisational requirement for all trading venues "to have transparent and non-discriminatory rules and procedures that provide for fair and orderly trading and establish objective criteria for the efficient execution of orders". Therefore, the rulebook of a trading venue may foresee other exceptional situations in which transactions might be cancelled provided that those situations are transparent and non-discriminatory.

Question 22 [Last update: 03/10/2017]

Are the suitability checks and controls a DEA provider should perform on clients using the service also applicable in case of clients that are not investment firms authorised in the EU? Where a DEA client extends its access to its own clients, is the DEA provider responsible for the conduct of these sub-delegated clients?

Answer 22

Yes, the obligations that fall on a DEA provider as per Article 17(5) of MiFID II and as specified in RTS 6 apply regardless whether the client is an authorised EU investment firms or not. In particular, the DEA provider retains responsibility for all clients accessing an EU trading venue through its DEA, including the sub-delegated DEA clients, in relation to the requirements of Article 17(5) of MiFID II as well as provisions of Articles 19 to 23 of RTS 6.

In order to fulfil its responsibility, the DEA provider must have access to information on its DEA clients, irrespective of DEA clients' jurisdiction or their authorisation status. A DEA provider may not provide services to its clients, including sub-delegated clients, unless all information can be made available to the Competent Authority of the trading venue for its supervisory and enforcement purposes.

The DEA provider should also clarify in the binding written agreement that the DEA service will be suspended or withdrawn from the client if the provider is not satisfied that continued access would be consistent with its rules and procedures for fair and orderly trading and market integrity - this includes a situation where the client fails to supply a reasonable explanation for a suspicious trading pattern or inappropriate trading behaviour that may involve market abuse.

Where a DEA sub-delegation is allowed, the DEA provider should require its DEA clients to have a provision to enable the DEA provider to have access to information on their sub-delegated clients' trading activities for the express purpose of enabling the DEA provider to provide information to the Competent Authority of the trading venue.

Furthermore, trading venues must observe Article 22(3) of RTS 7 when permitting sponsored access, and where appropriate DMA, to their members and participants. TVs should clearly state in their rules the circumstance in which the TV suspends or terminates the provision of DEA, for example, where the conduct of a DEA client is reasonably suspected to be abusive.

Question 24 **[Last update: 15/11/2017]**

Can DEA clients accessing an EU trading venue through sub-delegated DEA benefit from the exemption offered under Article 2(1)(d) of MiFID II?

Answer 24

Article 2(1)(d) of MiFID II exempts persons dealing on own account in financial instruments from the requirement to be authorised as a MiFID investment firm. However, it also lists a set of circumstances where such an exemption does not apply, including where such persons have DEA to a trading venue.

Article 4(1)(41) of MiFID II defines DEA as "an arrangement where a member or participant or client of a trading venue permits a person to use its trading code so the person can electronically transmit orders relating to a financial instrument directly to the trading venue". A person who directly interacts with the member to obtain the use of the trading code will be the person granted permission under an arrangement. The DEA provider has direct knowledge of that person's use and must be taken to allow it; such a person (Tier 1 DEA client) therefore should be understood to have DEA to a trading venue.

However, in some cases a DEA provider may allow a DEA user to sub-delegate the access rights onto a third entity (Tier 2 DEA client). Unlike a Tier 1 DEA client who directly interacts with the member to obtain the use of the trading code, a Tier 2 DEA client would, in most cases, not technically be in possession of the trading code of a DEA provider. The trading code is not passed down to the ultimate users of DEA, but only appended to the order message by the DEA provider before being submitted to the trading venue. Therefore, ESMA does not consider such Tier 2 DEA clients as having DEA for the purposes of Article 2(1)(d) of MiFID II.

ESMA notes that any risks posed by Tier 2 DEA clients are indirectly regulated through the provisions of Article 17(5) of MiFID II as well as Articles 22 and 23 of RTS 6.

In addition, Article 21(4) of RTS 6 requires the DEA providers to 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.

Question 25 **[Last update: 15/11/2017]**

Does a firm need to be authorised as an investment firm under MiFID II to provide DEA to an EU trading venue?

Answer 25

Yes, Article 48(7) of MiFID II provides that trading venues should only permit a member or participant to provide DEA "if they are investment firms authorised under [MiFID II] or credit institution authorised under Directive 2013/36/EU". Therefore, non-EU firms (including non-EU firms licensed in an equivalent jurisdiction) or EU firms without a MiFID II licence are not

allowed to provide DEA to their clients. This applies regardless of where the clients using the DEA service are located.

Question 26 [Last update: 04/10/2018]

Article 6 of RTS 8 requires trading venues to set the incentives and the requirements that must be met by investment firms in order to access those incentives under stressed market conditions, taking into account the additional risks. What are the types of incentives to be provided under stressed market conditions by the trading venues to comply with this requirement?

Answer 26

RTS 8 sets forth an obligation for trading venues to provide incentives to market makers "effectively contributing to liquidity provision under stressed market conditions" (Recital 8 of RTS 8). To this end, the market making schemes should "clearly indicate the conditions for accessing incentives and should take into account the effective contribution to the liquidity in the trading venue measured in terms of presence, size and spread by the participants in the schemes" (Recital 9 of RTS 8).

On the basis of the individual trading system, trading venues still have the ability to adjust their scheme of incentives, which may well be of a "monetary" or "non-monetary" nature as long as they effectively support trading and provision of liquidity to the market on a regular and predictable basis and in particular when it is the most volatile.

In particular, trading venues should not induce market makers to leave an already depleted market or to privilege normal market conditions over stressed ones. This means that those schemes where an incentive is given to all market makers regardless of whether they effectively meet the requirements in terms of presence, size and spread set by the trading venues under stressed market conditions would not comply with RTS 8 obligations.

Similarly, trading venues can impose different market making quoting obligations during normal and stressed markets, provided that they should always be bound by Article 2(1)(b) of RTS 8. In this regard, relaxation of market making obligations should not be construed as an incentive.

Question 27 [Last update: 04/10/2018]

In the context of RTS 9, which is the order-counting methodology for bulk quotes?

Answer 27

A bulk quote is a bundle of multiple quotes, possibly on several financial instruments. As per Article 3 of RTS 9, where the methodology for counting orders for a specific order type is not

detailed, the trading venue “shall count the messages in accordance with the general system behind the methodology outlined and on the basis of the most similar order type appearing in the Annex”. According to the methodology in RTS 9, calculations should be performed at the level of each financial instrument and, furthermore, the Annex specifies that each quote should be counted as two orders (one for the buy side and one for the sell side). Accordingly, each order/quote sent within a bulk quote, should be treated individually and be counted as specified in the Annex of RTS 9.

Question 28 [Last update: 04/10/2018]

Do the provisions of Article 17(6) of MiFID II and of Chapter IV of RTS 6 apply to all general clearing members or only to those clearing members having algorithmic traders as clients?

Answer 28

Article 17(6) of MiFID II targets investment firms acting as general clearing members, without mentioning algorithmic trading nor restricting the scope to those clearing members having algorithmic traders as clients. Therefore, Article 17(6) should be interpreted as applying to all firms acting as general clearing members, regardless of the nature of their clients. Analogously, the provisions in Chapter IV of RTS 6 are drafted without any reference to algorithmic trading and should apply to all general clearing members. This reading is reinforced by Recital 1 of RTS 6, which defines the scope of RTS 6 differentiating on the one hand “Investment firms engaged in algorithmic trading” and, on the other hand, those “providing direct electronic access or acting as general clearing members”.

The title of Article 17 and RTS 6 should not be interpreted as narrowing the scope of the provisions in question, but rather suggesting that the issues addressed are more prominent with respect to algorithmic trading.

Question 29 [Last update: 14/11/2018]

Does the requirement imposed on market markers to post simultaneous two-way quotes of comparable size restrict the ability of market makers to voluntarily post additional liquidity on either side of the order book?

Answer 29

No, it is not the intention of RTS 8 to prevent market makers that have live two-way quotes from adding further liquidity in the order book on a voluntary basis. Market Makers are therefore free to discretionarily post additional quotes on either side of order book in addition to the “simultaneous two-way quotes of comparable size and competitive price” imposed by Article 2(1)(b) of RTS 8. Only quotes that are posted to fulfil the obligations imposed by the market

making agreement should be flagged as such in field 8 of Table 2 of the Annex of RTS 24 and field 3 of Table 3 of Annex II of RTS 6.

Question 30 [Last update: 01/02/2019]

How should the tests to identify high frequency trading techniques, described in Article 19 of CDR 2017/565, be undertaken?

Answer 30

Article 19 of Commission Delegated Regulation (EU) 2017/565 states the requirements for a trading technique to be deemed as high frequency algorithmic trading. Regarding the indicators in Articles 19(1)(a) & (b) firms should assess each instrument based on the relevant trading hours of that instrument for Article 19(1)(a), and sum those calculated indicators for all relevant instruments traded on a trading venue together for Article 19(1)(b). Regarding the applicability established in Article 19(2) firms should apply these calculations to liquid instruments according to the relevant ESMA publications at the time of calculation.

Question 31 [Last update: 05/12/2019]

To which types of trading systems does Commission Delegated Regulation (EU) 2017/584 RTS 7 apply? In particular, are trading venues without auto-matching trading systems or that explicitly prohibit algorithmic trading subject to the provisions of RTS 7?

Answer 31

Article 1 of RTS 7 limits the scope of application of RTS 7 to trading venues which "*allow or enable algorithmic trading*". Article 1(2) of RTS 7 defines those venues as trading venues "*where order submission and order matching is facilitated by electronic means*". The rationale is explained in Recital 3 which clarifies that "*risks arising from algorithmic trading can be present in any type of trading system that is supported by electronic means*".

ESMA further notes that Recital 5 of RTS 7 explicitly refers to request-for-quote systems, where transactions are usually not automatically executed based on pre-set parameters and logic (i.e. no auto-matching protocols), as being within the scope of the RTS. ESMA therefore consider that the absence of an auto-matching protocol should not exclude the trading venue operating such system from the scope of RTS 7.

Similarly, an explicit prohibition of algorithmic trading does not appear sufficient for the trading venue to be excluded from the scope of the RTS considering the definition of trading venues allowing or enabling algorithmic trading provided under Article 1(2).

Nevertheless, regarding the specific application of the provisions contained in RTS 7, Recital 5 clarifies that (i) "*some organisational requirements may not be appropriate for certain trading*

models although their trading systems could be supported to a certain extent by electronic means" and that (ii) "*the specific requirements to be set in relation to request-for-quote systems or hybrid systems should be considered according to the nature, scale and complexity of the algorithmic trading activity undertaken*". ESMA would for instance consider it unreasonable to require a trading venue that explicitly prohibits algorithmic trading to offer to its clients a simulation facility for testing algorithms in conditions that are as realistic as possible (Article 10(2) of RTS 7).

Lastly, Recital 3 clarifies that voice trading systems are excluded from the scope of RTS 7. It is however important to stress that trading venues operating such systems remain subject to the organisational requirements prescribed under Article 48(1) of MiFID II.

4 The tick size regime [Last update: 02/10/2019]

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[13].

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[14].

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.

[13] Commission Delegated Regulation (EU) 2017/590 of 28 July 2016 supplementing Regulation (EU) No 600/2014 of the European Parliament and of the Council with regard to regulatory technical standards for the reporting of transactions to competent authorities (OJ L 87, 31.3.2017, p. 449–478).
[14] Commission Delegated Regulation (EU) 2017/588 of 14 July 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards on the tick size regime for shares, depositary receipts and exchange-traded funds (OJ L 87, 31.3.2017, p. 411–416).

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: 18/12/2017]**

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, orders held in an order management system as well as LIS orders pegged to the mid-point in a lit order book (in practice those LIS orders can only be pegged to the mid-point where the spread consists of an even number of ticks).

However, 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.

Question 8 [Last update: 28/03/2018]

If the ADNT for an instrument is not available, which liquidity band should trading venues apply until the ADNT is published by NCA or ESMA? When can the trading venue proceed to adopt such a liquidity band?

Answer 8

In the event of the ADNT not being published by ESMA or, where applicable the NCA, all relevant trading venues would need to apply a harmonised default tick size pending such a publication to ensure a uniform tick size regime across the Union.

For an instrument that is admitted to trading or traded in the EU, where the applicable ADNT remains unavailable, trading venues should assign the highest liquidity band (i.e. liquidity band for instrument with an ADNT ≥ 9,000) to the instrument in question for the purpose of the tick size regime. This default regime should apply until the actual publication of the ADNT by ESMA or by the relevant NCAs. ADNTs published should apply the day after their publication.

Question 9 [Last update: 03/10/2017]

In case of a simultaneous dual listing, shall an NCA be appointed for the purpose of determining the estimated average daily number of shares and establishing the applicable tick size?

Answer 9

Yes, the ESMA website will always display one NCA as the NCA of the most relevant market in terms of liquidity as per Article 26 of MiFIR.

Question 10 [Last update: 15/11/2017]

Does the mandatory tick size regime apply to both orders and quotes?

Answer 10

Yes, the minimum tick size established under Article 49 of MiFID II and further specified in RTS 11 should apply to both orders and quotes. This regime is meant to create a level playing field between the different trading venues and the reference to “orders” in Article 2 of RTS 11 should not be interpreted as restricting the application of the tick size regime to only certain types of trading systems but, on the contrary, should be understood in the broadest sense.

Question 11 [Last update: 02/10/2019] *Update*

Are periodic auctions systems subject to the tick size regime?

Answer 11

Yes, periodic auction trading systems are subject to the tick size regime defined under Article 49 of MiFID II and further specified under CDR (EU) 2017/588. Therefore, market operators and investment firms operating such trading systems need to ensure that orders are submitted and that transactions are executed at a price that is in line with the mandatory tick size regime. For periodic auction systems that do not benefit from a reference price waiver, this prohibits the execution of transactions at a price that corresponds to the mid-point in cases where the spread consists of an uneven number of ticks.

5 Multilateral and bilateral systems [Last update: 05/12/2019]

5.1 General

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[15] 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.

Question 3 [Last update: 07/07/2017]

Article 18(3) of MiFID II requires that investment firms and market operators operating an MTF or OTF establish, publish and maintain and implement transparent and non-discriminatory rules, based on objective criteria, governing access to its facility. A similar requirement is applied to regulated markets through Article 53(1) of MiFID II. What sort of behaviour or restrictions should be considered as non-objective, or discriminatory?

Answer 3

One of the benefits of more on-venue, pre-trade transparent trading is to broaden access to liquidity for market participants. In order for these benefits to be fully realised, it is important

[15] Commission Delegated Regulation (EU) 2017/573 of 6 June 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards on requirements to ensure fair and non-discriminatory co-location services and fee structures (OJ L 87, 31.3.2017, p. 145–147).

that trading venues do not have restrictive criteria governing their access, which place unreasonable restraints on certain market participants' access to particular liquidity pools.

In particular, ESMA does not consider the following arrangements to be in compliance with Articles 18(3) and 53(1) of MiFID II. This is not, however, an exhaustive list of arrangements which are non-objective and discriminatory.

a) Trading venues should not require members or participants to be direct clearing members of a CCP.

Given the protections afforded to non-clearing members under MiFIR and EMIR, as well as the rules on straight through processing (STP), a trading venue should not require all its members or participants to be direct clearing members of a CCP. Trading venues may however require members or participants to enter into, and maintain, an agreement with a clearing member as a condition for access when trading is centrally cleared.

b) For financial instruments that are centrally cleared, trading venues should not allow members or participants to require other members or participants to be enabled before they are allowed to trade with each other.

There are legitimate checks that a trading venue might carry out before allowing a member or participant on to their venue. For example, in markets for non-centrally cleared financial instruments trading venues may wish to carry out credit checks, or ensure that a member or participant has appropriate capital to support the positions it intends to take on the trading venue. In a non-centrally cleared derivatives market, there may be a need for bilateral master netting agreements to be in place between participants before the trading venue can allow their trading interests to interact. Trading venues will also need to be comfortable that potential participants are meeting the regulatory requirements to be a member of a trading venue such as having appropriate systems and controls to ensure fair and orderly trading.

However, in centrally cleared markets, enablement mechanisms whereby existing members or participants of a trading venue can decide whether their trading interests may interact with a new participant's trading interest are considered discriminatory and an attempt to limit competition. Enablement mechanisms also reduce the transparency around the liquidity available on different trading venues.

c) Trading venues should not require minimum trading activity.

Trading venues should not require minimum trading activity to become a member or participant of a trading venue, as this could restrict the access to the trading venue to large members or participants.

d) Trading venues should not impose restrictions on the number of participants that a participant can interact with.

In a request for quote (RFQ) protocol, a trading venue should not impose limits on the number of participants that a firm can request a quote from. Whilst a firm requesting a quote may, in

compliance with Article 28 of MiFID II, want to limit the number of participants it requests quotes from in order to minimise the risk of unduly exposing its trading interest, which could result in it obtaining a worse price, this should not be mandated by the trading venue. For instance, where a smaller firm is requesting a quote to execute a low volume trade, it might be less concerned about the risks of exposing its trading interest, and so happier to request quotes from a larger number of market makers or liquidity providers.

Limiting the number of participants a firm can request quotes from risks restricting the ability of market participants to access liquidity pools, and only sending requests to traditionally larger dealers who they assume might have larger inventories. This simultaneously restricts the ability of the requestor to access the best pool of liquidity and reduces the likelihood of a smaller dealer receiving requests, despite it having a strong trading interest.

Question 4 [Last update: 07/07/2017]

Can a person that is not authorised as an investment firm but meets the requirements of Article 53(3) of MiFID II be a member or participant of a regulated market or an MTF?

Answer 4

Yes. Article 53(3) of MiFID II provides that an entity that is not an investment firm or a credit institution can be a member of a regulated market under certain conditions, this rule being extended to MTFs by Article 19(2) of MiFID II.

ESMA considers that this provision should be read in conjunction with the requirements of Article 2(1). Under this provision, a person falling under any of the categories listed in Article 2(1) would not have to be authorised as an investment firm.

However, pursuant to Article 2(1)(d) (ii) of MiFID II, when a person dealing on own account in financial instruments other than commodity derivatives or emission allowances or derivatives thereof and not providing any other investment services or performing any other investment activities in such instruments is also a member of or a participant in a regulated market or an MTF, it falls under the scope of MiFID II, and should accordingly be authorised as an investment firm unless:

- it is exempted under points (a), (i) and (j); or
- it is a non-financial entity which executes transactions on a trading venue which are objectively measurable as reducing risks directly relating to the commercial activity or treasury financing activity of that non-financial entity or its group.

As a consequence, the reference in Article 53(3) to persons other than investment firms and credit institutions only relates to entities that are exempted from authorisation under Article 2(1), such as insurance companies or collective investment undertakings, as long as their own regulatory framework permits them to do so.

This Q&A does not address the issue of non-EEA firms being a member or participant of an EEA trading venue.

Question 5 [Last update: 15/11/2017]

Does a client relationship exist between two counterparties that trade on a trading venue?

Answer 5

No, there is no new client relationship between two counterparties to a trade that takes place on a trading venue, including when the trading venue operates on a request for quote basis.

Question 6 [Last update: 28/03/2018]

Can a trading venue control access to the fee and other information required to be published by Article 4 of RTS 10?

Answer 6

Article 4 of RTS 10 requires trading venues (regulated markets, MTFs and OTFs) to publish the objective criteria for the establishment of their fees and fee structures and other conditions provided for in Article 3, together with execution fees, ancillary fees, rebates, incentives and disincentives in one comprehensive and publicly accessible document on their website.

ESMA is of the view that the Article requires the information specified to be contained in a single document and available to any member of the public with no further dependence on action by the firm operating the venue. That is, the document should be immediately downloadable.

Attempts to control public access, for example, by requiring an email to be sent requesting the document or an online form to be completed, would be considered not to meet the requirement.

Question 7 [Last update: 04/10/2018]

Can a trading venue use its trading systems and platforms to arrange transactions that are then reported and ultimately executed on another trading venue?

Answer 7

No, the fundamental characteristic of a trading venue is to execute transactions.

As defined under Article 4(1)(21), (22) and (23) of MiFID II, trading venues under all its possible forms as regulated market, multilateral trading facility and organised trading facility are

multilateral systems “which bring together multiple third-party buying and selling interests in financial instruments […] in a way that results in a contract”. Therefore, a trading venue should not be allowed to arrange transactions without formalising the execution of those transactions under its rules and systems. ESMA has also already clarified that a transaction cannot be concluded on more than one trading venue at the same time.

However, where a trading venue is operated by an investment firm, ESMA considers that these investment firms can arrange transactions as a provider of investment services listed under points (1), (2) or (3) in section A of Annex I of MiFID II, should the investment firm be authorised for the provision of such investment services. This is without prejudice to the guidance provided by ESMA in Q&A10 of section 5.2 clarifying the characteristics of an OTF and, more generally, what constitutes a multilateral activity and should be authorised as such.

Question 8 [Last update: 04/10/2018]

Can a market operator or an investment firm operating an MTF apply for a single segment of the MTF to be registered as an SME growth market?

Answer 8

The operator of an MTF can apply for a segment of the MTF to be registered as an SME growth market when the requirements and criteria set out in Article 33 of MiFID II and Articles 77 and 78 of the Commission Delegated Regulation 2017/565 are met in respect of that segment. A specific segment registered as an SME growth market should be considered in isolation to other segments within the MTF. Other segments which are not specifically registered as an SME GM, cannot benefit from the SME growth market regime. For this purpose the following conditions should apply:

- An SME growth market segment is clearly separated from the other market segments operated by the MTF operator. Clear separation implies at least a different name, rulebook, marketing strategy, and publicity as well as the allocation of the dedicated “Segment MIC” to the SME GM segment.

- Trades made on a specific SME growth market segment should be clearly distinguished from other market activity within the other segments of the MTF.

Furthermore, on demand of the competent authority and with the aim of avoiding circumvention of the definition of an SME growth market, the MTF should provide a comprehensive list of the instruments listed on an SME growth market segment and provide any further requested information on the operation of the SME growth market segment.

Question 9 [Last update: 04/10/2018]

Would any payment received from a trading venue in respect of market making activity or liquidity provision require the conclusion of a market making agreement?

Answer 9

No. The purpose of the requirement in Article 48 is to ensure that any party receiving financial incentives, such as rebates, to provide liquidity on a trading venue is subject to appropriate market making obligations, but these need not always take the form of a market making agreement as specified in RTS 8.

A "rebate" in this context should be read to include negative fees or direct payments to the provider of liquidity as well as to refunds or discounts on fees due from the provider of liquidity to the trading venue. It follows from this interpretation that "maker/taker schemes", whereby financial incentives are provided to market participants to conclude trades by posting passive orders, are not only allowed for firms required to enter into in a market making agreement in accordance with Article 17(4) of MiFID II but also for other market makers covered by Article 4(1)(7) of MiFID II provided that these are subject to the appropriate market making obligations.

Question 9a [Last update: 05/12/2019]

Can member preferencing functionalities be used to formalise pre-arranged transactions?

Answer 9a

MiFID II requires trading venues to use transparent rules and procedures providing for fair and orderly trading and to establish objective criteria for the efficient execution of orders (Articles 19(1) and 47(1)(d) of MiFID II). ESMA considers that trading venues may implement/offer member preferencing functionalities in the trading system they operate as long as those functionalities comply with the MiFID II requirements and in particular are transparent and available to all members or participants.

However, ESMA also considers that member preferencing functionalities cannot be used to formalise pre-arranged transactions. Trading venues should monitor the use of member preferencing on any type of trading system and establish arrangements and procedures to detect attempts to use member preferencing functionalities to formalise privately negotiated trades. Should trading venues detect such use of member preferencing functionalities, they should have appropriate means in place to ensure that those trading patterns are discontinued.

ESMA reminds market participants that pre-arranged transactions may only be formalised on a trading venue when that trading venue benefits from an appropriate pre-trade transparency waiver.

5.2 Organised Trading Facilities (OTFs)

Question 10 [Last update: 03/04/2017]

What are the characteristics of an OTF? When is the authorisation for the operation of an OTF required?

Answer 10

An OTF is a multilateral system, i.e. "a system or facility in which multiple third-party buying and selling interests in financial instruments are able to interact in the system" (Article 4(1)(19) of MIFID II). The OTF definition supplements this overarching definition by further establishing that only buying and selling interests in bonds, structured finance products, emission allowances and derivatives may interact on an OTF in a way that results in a contract and that the execution of orders must be carried out on a discretionary basis.

In addition, two types of systems operated by an OTF are identified in Article 20(6) of MiFID II: (i) systems that cross client orders (without prejudice to the restrictions placed on matched principal trading) and (ii) systems that arrange transactions in non-equities where the operator of the OTF may facilitate negotiations between clients so as to bring together two or more potentially compatible trading interests in a transaction.

Under Section A(8) of Annex I of MiFID II, the operation of an OTF is an investment activity that requires prior authorisation.

ESMA is of the view that an entity should seek authorisation to operate an OTF where the three following conditions are met: a) trading is conducted on a multilateral basis, b) the trading arrangements in place have the characteristics of a system, and c) the execution of the orders takes place on a discretionary basis through the systems or under the rules of the system.

a) Trading is conducted on a multilateral basis: Interaction with a view to trading in a financial instrument is conducted in such a way that a trading interest in the system can potentially interact with other opposite trading interests. As OTFs are required to "have at least three materially active members or users, each having the opportunity to interact with all the others in respect to price formation" (Article18(7) of MiFID II), an OTF user's trading interests can potentially interact with those of at least two other users. On OTFs, the interaction of user trading interest can take place in different ways, including through matched-principal trading or market-making, within the limits set out in Article 20(2) and 20(5).

b) The trading arrangements in place have the characteristics of a system: MiFIDII/MiFIR is technology neutral and accommodates a variety of "systems". A system would be easily identified when embedded in an automated system. This would cover a situation where, for instance, the arrangements in place consist of the automated crossing of client trading interests, subject to the exercise of discretion on an OTF. However, other

non-automated systems or repeatable arrangements that achieve a similar outcome as a computerised system, including for instance where a firm would reach out to other clients to find a potential match when receiving an initial buying or selling interest, would also be characterised as a system.

Where a firm would, by coincidence and accidentally, receive matching buying and selling interests, and decide to execute those orders internally, such unpredictable circumstances would not qualify as the operation of a system.

c) The execution of the transaction is taking place on the system or under the rules of the system. The execution of the orders would be considered to be taking place under the rules of the system including where, once the trade price, volume and terms have been agreed through a firm, the counterparties' names are disclosed, the firm steps away from the transaction and the transaction is then legally formalised between the counterparties outside a trading venue.

If an investment firm arranges a transaction between two clients and the clients decide to formalise the trade on a regulated market or an MTF, the transaction would not be considered as taking place under the rules of the system because a transaction cannot be concluded on more than one venue.

ESMA notes that if an investment firm were to arrange transactions on one system and provide for the execution of the transactions on another system for avoidance purposes, the disconnection between arranging and executing would not waive the obligation for the investment firm operating those systems to seek authorisation as an OTF operator.

ESMA highlights that OTFs are only one of the three categories of multilateral trading systems foreseen by MiFID II. Market participants operating a platform that meets the characteristics of a multilateral trading facility should therefore exercise judgment to assess, based on their business model, whether they need to seek authorisation for the operation of a multilateral trading facility (MTF), an OTF or, potentially of a regulated market. See also Question 5 on the differences between an MTF and an OTF and Questions 14 and 15 on systematic internalisers (SIs) and riskless transactions.

Question 11 [Last update: 03/04/2017]

Does the concept of OTF apply to voice trading and, if yes, when an investment firm executing transactions through voice negotiation should be considered as falling under the definition of OTF?

Answer 11

Yes. MiFID II is technology neutral and the OTF definition includes voice trading in the same way as the definition of regulated markets and MTFs include voice trading systems. An

investment firm executing transactions through voice negotiation would be considered as falling under the definition of an OTF where the arrangements in place would meet the conditions set out in Answer 3.

Question 12 [Last update: 03/04/2017]

What distinguishes an OTF from an MTF?

Answer 12

MTFs and OTFs both are multilateral trading systems that can be operated by an investment firm or a market operator. However, compared to MTFs, OTFs have a number of key distinct features:

a) OTFs may only trade in bonds, structured finance products, derivatives and emission allowance (non-equity instruments);

b) There are less stringent limitations to the type of activities that the operator of the OTF may undertake both in relation to matched principal trading and trading on own account. Additional restrictions apply as an OTF and a SI cannot be operated by the same legal entity;

c) As opposed to regulated markets and MTFs governed by non-discretionary rules, the OTF operator must exercise discretion either when deciding to place or retract an order on the OTF and/or when deciding not to match potential matching orders available in the system;

d) As opposed to regulated markets and MTFs that have members or participants, OTFs have clients. As a consequence, transactions concluded on OTFs have to comply with client facing rules, including best execution rules, regardless whether the OTF is operated by an investment firms or a market operator; and

e) Wholesale energy products that must be physically settled (C6 REMIT) do not qualify as financial instruments when traded on an OTF.

Question 13 [Last update: 03/04/2017]

The operator of an OTF may engage in dealing on own account other than matched-principal trading only with regard to sovereign debt instruments that do not have a liquid market. (Article 20(3) of MiFID II. How should the liquidity of sovereign debt instruments be assessed?

Answer 13

ESMA notes that RTS 2 sets out how to determine whether a financial instrument has a liquid market.

Although RTS 2 was developed for the sole purpose of further specifying the MiFIR pre-trade and post-trade transparency obligations for trading venues and investment firms, ESMA considers that the methodology and criteria set out in RTS 2 for assessing whether a sovereign bond has a liquid market are also relevant, and should serve as a reference, for the purpose of Article 20(3) of MiFID II.

Question 14 [Last update: 03/04/2017]

On what basis can a third party investment firm carry out market making on an OTF on an independent basis (cf. Article 20(5) of MiFID II)?

Answer 14

As provided for by Article 20(5) of MiFID II, the operator of the OTF may engage another investment firm to carry out market making on the OTF on an independent basis. The independence test is met when the investment firm carrying out market making has no close links with the operator of the OTF as defined under Article 4(1)(35) of MiFID II.

ESMA recalls that, under Article 18(4) of MiFID II, an investment firm operating an OTF must have arrangements in place to clearly identify and manage the potential adverse consequence for the operation of the OTF and its users of any conflict of interest between the interest of the OTF, the investment firm operating the OTF and the sound functioning of the OTF. More generally, ESMA highlights that investment firms must maintain and operate effective organisational and administrative arrangements with a view to taking all reasonable steps to prevent conflicts of interest from adversely affecting the interests of clients.

Question 15 [Last update: 03/04/2017]

Can an SI and an OTF be operated by the same legal entity when they do not trade the same instruments or class of instruments (e.g. an SI in equities and an OTF in derivatives)?

Answer 15

No. ESMA is of the view that the very general wording of Article 20(4) of MiFID II introduces a blanket prohibition of the combination of the OTF and SI activities by the same legal entity across asset classes and instruments. This blanket prohibition also addresses circumstances under which an investment firm would be operating an OTF and an SI in different asset classes, while being potentially subject to similar conflicts of interests as the ones associated with being an OTF and an SI in the same asset class or instrument. This would be the case, for instance, with an investment firm operating an OTF in equity derivatives while being an SI in the underlying equities.

Question 16 **[Last update: 03/04/2017]**

Where an investment firm that is an SI has to set up a separate legal entity to operate an OTF (or vice-versa), can those two entities have shared resources?

Answer 16

Having two separate legal entities operating the OTF and the SI aims at ensuring that each venue is operated to the sole benefit of its respective clients and is not influenced in any way by the activity undertaken by the other venue.

To that end, ESMA is of the view that the two legal entities respectively operating the SI and the OTF should have arrangements in place that prevent information sharing on each other's relevant activities regarding the operation of the OTF and the SI. 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 in place to ensure that there is no information leakage across the SI and the OTF activities. Outsourcing from one legal entity to the other should only be considered where the arrangements in place meet a similar test.

The above is 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 17 **[Last update: 03/04/2017]**

Under which conditions can an OTF connect to other liquidity pools such as an SI or another OTF?

Answer 17

Article 20(4) of MiFID II limits the circumstances under which an OTF may connect with other liquidity pools by prohibiting orders placed in an OTF to interact with quotes or orders in a SI or with orders in other OTFs. Interaction would occur when buying and selling interests would comingle in the same liquidity pool. Accordingly, an SI quote may not be placed on an OTF. Nor can an order originating from another OTF.

ESMA highlights that a trading interest in an OTF may not be executed against an opposite order or quote on another execution venue. For a transaction to take place, the two opposite trading interests must be placed with the same execution venue. However, this does not prevent the investment firm or the market operator operating an OTF from retracting the order from the OTF and sending it to another OTF, to an SI, an MTF or a regulated market, where consistent with the investment firm's or the market operator's execution policy and exercise of discretion.

Question 18 **[Last update: 03/04/2017]**

When an investment firm operates an OTF, at which level should the best execution policy be set? At the level of the investment firm, at the level of the OTF or both? Would similar requirements apply to a market operator operating an OTF?

Answer 18

Where an investment firm operates an OTF, ESMA is of the view that the investment firm's best execution should cover how orders are executed both at the level of the investment firm and at the level of the OTF and, in particular, how discretion is exercised at each stage.

Firstly, an investment firm operating an OTF should, in the same way as other investment firms that execute client orders, have a firm-level execution policy setting out the various execution venues, including its own OTF, that it will be considering when receiving a client order and explain in which circumstances an execution venue would prevail over the others.

Secondly, the investment firm should have either a separate policy or an additional section in the firm-level execution policy governing how, when a client order is sent to the OTF, the best possible result for the client is achieved taking into account the trading interests in the system and the different execution mechanisms that may be available on the OTF, such as voice execution, electronic RFQ or order book.

As the exercise of discretion by the investment firm in its OTF operator capacity is to be in compliance with its execution policy, the document should also set out in details the area(s) in which the OTF operator intends to exercise discretion and the basis on which such discretion will be exercised (Article 20(6) of MiFID II).

Equivalent requirements apply to a market operator operating an OTF. In this regard, a market operator would need to have a best execution policy in place, setting out the conditions under which an order received by a client may be executed on its OTF, as described above.

Question 19 **[Last update: 03/04/2017]**

Does the exercise of any form of discretion mean that a venue is an OTF?

Answer 19

No. Article 20(6) of MiFID II sets out that "the market operator or the investment firm operating an OTF must exercise discretion only in either or both of the following circumstances:

a) When deciding to place or retract an order on the OTF they operate;

b) When deciding not to match a specific client order with other orders available in the systems at a given time, provided it is in compliance with specific instructions received from a client and with its obligations in accordance with article 27.

For the system that crosses client orders, the investment firm or the market operator operating the OTF may decide if, when, and how much of two or more orders it wants to match within the system. […] with regards to a system that arranges transactions in non-equities, the investment firm or market operator operating the OTF may facilitate negotiations between clients so as to bring together two or more potentially compatible trading interest in a transaction".

ESMA understands "execution on a discretionary basis" and "exercise of a discretion" as meaning that, in the circumstances foreseen in Article 20(6), the operator of the OTF has options to consider for the execution of a client's order and exercises a judgement as to the decision to make and the way forward.

As suggested by Article 20(6), ESMA is of the view that the exercise of discretion can usefully be split into a) order discretion and b) execution discretion.

c) Exercise of discretion at order level

When an investment firm or a market operator receives an order from a client, the "order discretion" refers to the judgement exercised by the OTF operator whether to place the order at all on the OTF, whether to place the whole order or just a portion of it on the OTF, and when to do so. This may be the case for instance where an investment firm would receive a buy order for a 500 lots and would decide to place an order for 200 lots only on the OTF, the remaining 300 lots being executed elsewhere.

Similarly, and as opposed to the operator of an MTF which may not withdraw an order from the MTF at its own initiative unless for fair and orderly market purposes, the operator of the OTF is expected to make a judgement as to whether and when an order should be retracted from the OTF.

This may be the case where, at a given point of time, the OTF operator considers that a more favourable outcome would be obtained by executing the order on another execution venue foreseen in the best execution policy. The OTF operator may also have placed the order on the OTF, sent it to another trading venue simultaneously, subsequently decided to have the order executed on the trading venue and retracted it from the OTF.

The exercise of order discretion would always have to comply with the OTF best execution policy and with client order handling rules. Where clients would be providing a specific instruction to the operator of the OTF, the OTF operator would not be considered as exercising order discretion when complying with that specific instruction.

d) Exercise of discretion at execution level

Under Article 20(6), the exercise of discretion at execution level has to be in compliance with client specific instructions and the best execution policy. ESMA is of the view that the mere implementation of client specific instructions or of best execution obligations would not be the exercise of discretion.

The operator of the OTF is expected to exercise a judgement as to if, when, and how much of two matching orders in the system should be matched. For instance, assuming a buy side order for 500 bonds and an opposite order of 200 bonds have been placed into the OTF, the operator of the OTF would exercise discretion when deciding whether the 500 buy side order should not be matched with the sell side order.

Finally, ESMA highlights that the exercise of discretion, be it "order discretion" or "execution discretion", should not be just a possibility foreseen in the rules of the OTF and in the best execution policy of the OTF operator. Discretion has to be actually implemented by the operator of the OTF as part of its ordinary course of business and should be a key part of its activities. It is not expected that any quantitative threshold would be set to assess the exercise of discretion. However, as provided for under Article 20(7) of MiFID II, at the time of authorisation or on ad-hoc basis, the market operator or the investment firm operating an OTF should be able to provide to its national competent authority a detailed description of how discretion will be exercised and in particular when an order may be retracted from the OTF and when and how two or more client orders will be matched in the OTF. ESMA also highlights that the OTF operator should be able to explain to its national competent authority the rationale underpinning the exercise of discretion, such as the set of reasons and the logical basis for not matching two opposite buying and selling interests. Random placing, retracting, matching or non-matching of orders on the OTF would not be considered as the exercise of discretion.

Likewise, the exercise of pre-trade controls by the operator of the OTF to ensure fair and orderly trading would not qualify as the exercise of discretion. Post-trade decisions, for example over where transactions are settled, are not relevant either for the purposes of these provisions. Similarly, the decision to enter into a client relationship in compliance with OTF rules on non-discriminatory access does not constitute discretion under Article 20(6).

Question 20 [Last update: 03/04/2017]

Does discretion have to be exercised on an order by order basis?

Answer 20

ESMA is of the view that discretion at order level (see Answer 12) does not have to be exercised order by order. As an example, the OTF operator may consider, at a given point in time that some or all orders of a specific size in a specific instrument should be retracted from the OTF as more favourable conditions are temporarily available elsewhere. However, the OTF operator must have the ability to exercise discretion at order level if circumstances so require, for instance in case of prior execution of an order on another trading venue.

Conversely, ESMA is of the view that, at execution level, discretion whether not to match two potential matching buying and selling interests can only be meaningfully exercised at order level.

Question 21 [Last update: 03/04/2017]

Does a fully automated system exclude the exercise of discretion and should therefore be automatically classified as an MTF?

Answer 21

No. MiFID II is 'technology neutral' and permits any trading protocol to be operated by an OTF, provided it is consistent with fair and orderly trading and the exercise of discretion.

ESMA is of the view that the exercise of discretion as to if and when to place or retract an order could possibly be automated through artificial intelligence and algorithms, without necessarily the exercise of human judgement on a case by case basis. Conversely, human intervention is not necessarily sufficient to prove the exercise of discretion. Human intervention that is not based on the exercise of human judgement (for instance, only consisting in the random placing or retracting or matching/non-matching of orders) would not be considered as the exercise of discretion.

When discretion is exercised at execution level, i.e. when deciding if, when or how much of two or more trading interests should (or should not) be matched, ESMA is of the view that the exercise of discretion would not preclude the use of automated systems, provided that certain conditions are met. In particular, the sophisticated algorithms supporting automated matching would need to anticipate the circumstances under which the orders would not be matched; they would also have the capacity to ensure that the decision to match (or not to match) two opposite trading interests is in compliance with the best execution policy or a client specific instruction. As one of the differentiating factors from execution algorithms operated by MTFs, the algorithms operated by the OTF would be expected to take into account external market factors or other external source of information to demonstrate the exercise of discretion.

Question 22 [Last update: 03/10/2017]

Can an OTF offer trading in C(6) REMIT wholesale energy products only?

Answer 22

No. Under Article 4(1)(23) of MiFID II, an organised trading facility (OTF) is a multilateral trading system which organises the interaction of multiple third party buying and selling interests in bonds, structured finance products, emission allowances and derivatives, i.e. in financial instruments.

Accordingly, to be authorised as an OTF, a multilateral trading system must offer trading in the financial instruments listed above, without prejudice to the other requirements to be met for such authorisation.

However, a trading platform that is authorised as an OTF based on trading financial instruments can, in addition, offer trading in wholesale energy contracts that must be physically settled (“REMIT carve-out” contracts).

ESMA highlights that the OTF must ensure that genuine trading in financial instruments takes place on the OTF to be authorised, and retain authorisation, as an OTF, with appropriate staff, IT, financial and other resources being devoted to this activity. Trading in financial instruments should not be designed for the sole purpose of obtaining an OTF license and with the end-objective of trading REMIT carve-out contracts almost exclusively.

Question 23 [Last update: 03/10/2017]

When an OTF authorised to trade financial instruments also trades REMIT wholesale energy products, i.e. in non-financial instruments, what are the applicable MiFID II/MiFIR provisions?

Answer 23

MiFID II/MiFIR provisions apply to the operation of an OTF trading financial instruments.

Where a person seeks authorisation as an OTF and intends to offer trading in REMIT carve-out contracts as well, a detailed description of the REMIT carve-out trading activity should be included in the authorisation file so that the competent authority can understand and assess the potential impact of REMIT carve-out trading on the investment firm or market operator operating the OTF and on trading in financial instruments. The information to be provided is set out in ITS 19[16].

Where an investment firm or market operator operating an OTF has been authorised and intends to additionally offer trading in REMIT carve-out products, a detailed description of the REMIT carve-out trading activity should be provided to the competent authority in due course before the start of such trading activities.

The management body of the investment firm (or the market operator) operating the OTF is responsible for defining, approving and overseeing the organisation of the firm or market operator for the provision of investment services and activities, taking into account the nature, scale and complexity of its business and all the requirements the firm has to comply with. ESMA is of the view that the responsibilities of the management body extends to the non-financial instrument trading activity of the OTF as they may have an impact on the investment

[16] Commission Implementing Regulation (EU) 2016/824 of 25 May 2016 laying down implementing technical standards with regard to the content and format of the description of the functioning of multilateral trading facilities and organised trading facilities and the notification to the European Securities and Markets Authority according to Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments (OJ L 137, 26.5.2016, p. 10–16)

activities provided by the investment firm (or the market operator). This also applies to the management body's responsibilities governing the investment firm (or market operator)'s internal policy setting out, among other things, the activities, products and operations offered or provided in accordance with risk tolerance of the firm (or the market operator).

More generally, ESMA highlights that a market operator or an investment firm operating an OTF trading both financial instruments and REMIT carve-out products should identify, prevent or otherwise manage any potential adverse consequences that trading in REMIT carve-out products may have on trading in financial instruments and on its ability to meet its MiFIDII/MiFIR obligations on an on-going basis. Upon request, the operator of the OTF should be able to explain to the competent authority the procedures and arrangements put in place to that effect.

Question 24 [Last update: 03/10/2017]

How do the OTF best execution obligations apply when third-party brokers are clients of the OTF or when these brokers provide Direct Electronic Access (DEA) (see Article 4(1)(41) of MiFID II)?

Answer 24

When an investment firm or a market operator operating an OTF receives orders or indications of interest from a broker acting on behalf of its own clients, the operator of the OTF should be implementing its own best execution policy when executing the order from the broker orders as it owes its user clients (the broker) the duty of best execution. The broker should determine that the OTF it selects allows it to comply with its best execution obligations towards its own clients. To that end, the broker should conduct a performance assessment of the OTF including how discretion is exercised.

In the specific case of DEA to an OTF, the DEA order is entered in the OTF client's name (the broker) and the OTF operator should execute the DEA order as it would for any OTF client order. Alternatively, the operator of the OTF may decide not to permit DEA to its system.

ESMA notes that a DEA order could be considered as a client specific instruction to the broker providing the DEA arrangement to its clients.

Question 25 [Last update: 29/05/2018]

Can an OTF arrange or trade strategies including an equity leg?

Answer 25

Strategies that include futures contracts, the contingent trade of a basket of equities or delta one financial instruments can be arranged by an investment firm, as a provider of investment

services listed under points (1), (2) or (3) in section A of Annex I of MiFID II. This includes a strategy in which one party agrees to buy an equity and to execute a short derivative in the equity and the other party agrees to sell the equity and to execute the long derivative.

ESMA considers that an investment firm operating an OTF could arrange such strategies provided that the equity leg is not executed on the OTF system, since Article 4(1)(23) of MiFID II defines OTFs as multilateral systems where only non-equity instruments can be traded. This restriction also applies to strategies composed of a look-alike equity leg, including a forward trade.

In addition, for the purpose of market integrity, ESMA recalls that double counting should be avoided. Thus, an OTF should only provide transparency information, transaction and best execution reports for transactions that are concluded on its system and considered as taking place under the rules of its system. In case of a strategy composed of an equity leg concluded on another venue while the derivative is concluded on the OTF system, the OTF is subject to reporting requirements for the derivatives' leg.

5.3 Systematic internalisers

Question 26 [Last update: 28/03/2018]

Recital 19 of the Commission Delegated Regulation (EU) 2017/565 clarifies the conditions under which an SI may engage in matched principal trading to execute client orders. To what extent can SIs engage in other types of riskless back-to-back transactions?

Answer 26

Recital 19 of the Commission Delegated Regulation (EU) 2017/565 is not limited to internal matching of client orders through matched principal trading but more generally prevents SIs from operating any system that would "bring together third party buying and selling interests in functionally the same way as a trading venue". The prohibition for an SI to operate an internal matching system for matching client orders is just one example, as opposed to the unique circumstance, under which an SI would actually be operating functionally in the same way as a trading venue and would be required to seek authorisation as such.

Based on the SI definition provided in Article 4(1)(20) of MiFID II, ESMA understands that the trading activity of a SI is characterised by risk-facing transactions that impact the Profit and Loss account of the firm. By undertaking such risk-facing transactions, SIs are a valuable source of liquidity to market participants. In that regard, ESMA notes that the MiFIR pre-trade transparency provisions for SIs seek to avoid submitting SI to undue risks based on the assumption and understanding that SIs are indeed facing risks when trading.

In contrast to the above, ESMA is of the view that arrangements operated by an SI would be functionally similar to a trading venue where they meet the following criteria:

a) The arrangements would extend beyond a bilateral interaction between the SI and a client, with a view to ensuring that the SI de facto does not undertake risk-facing transactions. This would be the case, for instance, where an SI would have agreements with other liquidity providers so that the SI would do a riskless back-to back transaction with one of those liquidity providers whenever a transaction is executed with a client, or where it would only execute one transaction contingent on another one. A similar outcome would be reached from the reverse situation where one or more liquidity providers would be streaming quotes to an SI. The quotes would then be forwarded by the SI to its clients to be executed against, resulting again in no risk back-to-back transactions which could involve multiple parties. The concept of de facto riskless back-to-back transactions is not confined to pairs of transactions in the same financial instrument. Other arrangements, for example where one leg is a securities transaction and the other is a derivative which references that security, could also be deemed as having the objective or consequence of carrying out de facto riskless back-to-back transactions.

   By crossing client trading interests with other liquidity providers' quotes, via matched principal trading or another type of riskless back-to-back transaction, so that it is de facto not trading on risk, the SI would actually organise an interaction between its client orders on the one hand and the SI or other liquidity providers' quotes on the other hand. The SI would be bringing together multiple third party buying and selling trading interests in a way functionally similar to the operator of a trading venue.

b) The arrangements in place are used on a regular basis and qualify as a system or facility, as opposed to ad-hoc transactions. The existence of a system would be easily identified where, for instance, the arrangement in place would be underpinned by technological developments to increase speed and efficiency and legal agreements would be in place between the SI and liquidity providers. The operation of a system could also include circumstances where there is an understanding with third parties that trade by trade hedging will be available on a regular basis. ESMA recalls that MiFID II/MiFIR is technology neutral and applies to voice systems as well as to electronic and hybrid systems;

c) The transactions arising from bringing together multiple third party buying and selling interests are executed OTC, outside the rules of a trading venue.

ESMA highlights that the above does not prevent SIs from hedging the positions arising from the execution of client orders as long as it does not lead to the SI de facto executing non risk-facing transactions and bringing together multiple third party buying and selling interests. ESMA is of the view that an SI would not be bringing together multiple third party buying and selling interests as foreseen in Recital 19 where hedging transactions would be executed on a trading venue.

Question 27 [Last update: 03/04/2017]

Recital (19) of the Commission Delegated Regulation (EU) 2017/565 foresees that a SI can undertake matched principal trading provided it does so on an occasional, and not a regular, basis. How is "occasional basis" expected to be assessed?

Answer 27

As stated under Answer 15, ESMA is of the view that a SI activity is characterised by risk-facing transactions that impact the Profit and Loss account of the firm.

Where an SI would receive, and execute, two potentially matching buying and selling interests from clients as one matched principal trade or where it would try to find the buyer for a sell order (or the other way around) and execute the first leg contingent on the second leg, those transactions would not qualify as risk facing transactions. As such, they could only be executed by an SI on an occasional basis, as provided for by Recital (19) of the Commission Delegated Regulation (EU) 2017/565.

ESMA is of the view that an SI would not be undertaking matched principal trading on an occasional and non-regular basis if it meets any of the following criteria:

a) the investment firm operates one or more systems or arrangements, be they automated or not, intended to match opposite client orders. The investment firm may accidentally receive two opposite matching buying and selling interests and match them but it should not have systems in place aimed at increasing opportunities for client order matching;

b) when executing client orders, non-risk facing activities account for a recurrent or significant source of revenue for the investment firm's trading activity;

c) the investment firm markets, or otherwise promotes, its matched principal trading activities.

Question 28 [Last update: 07/07/2017]

Should a system providing quote streaming and order execution services to multiple SIs be authorised as a multilateral system?

Answer 28

Articles 14(1) and 18(1) of MIFIR require SIs to make public firm quotes, which may be published through an APA. Some prospective APAs propose setting up arrangements which, on top of their APA services, provide a suite of quote streaming and order execution services to SIs and their clients. Clients cannot interact with more than one SI via a single message but can send multiple messages to multiple SIs participating in the service provided.

Article 4(19) of MiFID II defines a multilateral system as" […] any system or facility in which multiple third-party buying and selling trading interests in financial instruments are able to interact in the system". Article 1(7) of MiFID II requires all multilateral systems to operate as either a RM, an MTF or an OTF.

In line with the criteria set out in Q&A 3 on OTFs published on 3 April 2017 for identifying multilateral trading systems, ESMA notes that:

a) If a system allows multiple SIs to send quotes to multiple clients and allows clients to request execution against multiple SIs, then this meets the interaction test foreseen in Article 4(1)(19) even if there is no aggregation across individual SI quote streams;

b) The arrangements described above have the characteristics of a system as they are embedded in an automated facility; and,

c) Those arrangements are not limited to pooling potential buying and selling interests from SIs but also cater for the direct execution of the selected SI quotes. Genuine trade execution would be taking place on the system provided.

Accordingly, a system that provides quote streaming and order execution services for multiple SIs should be considered a multilateral system and would be required to seek authorisation as a regulated market, MTF or OTF in accordance with Article 1(7) of MiFID II.

ESMA reminds that if a firm were to arrange transactions on one system and provide for the execution of the transactions on another system, the disconnection between arranging and executing would not waive the obligation for the firm operating those systems to seek authorisation as a trading venue.

Question 29 [Last update: 03/10/2017]

Article 15(2) of MiFIR sets out that "in justified cases", systematic internalisers may execute orders at a better price than the quoted prices provided that the price falls within a public range close to market conditions. What are those justified cases?

Answer 29

Articles 14, 15, and 17 of MiFIR establish a comprehensive pre-trade transparency framework for systematic internalisers (SIs) in shares, depositary receipts, ETFs, certificates and other similar financial instruments. As set out in Article 17(3) of MiFIR, the implementing measures further aim at ensuring the efficient valuation of those instruments and maximising the possibility for investment firms to obtain the best deal for their clients.

Whilst Article 15(2) of MiFIR provides that in justified cases, systematic internalisers may execute orders at a better price than the quote published, ESMA considers that price improvements on those quotes are only justified where they would serve similar purposes as those referred on Article 17(3) of MiFIR.

ESMA notes that marginal price improvements on quoted prices would challenge the efficient valuation of equity instruments without bringing any real benefits to investors. As a consequence, and to ensure that price improvements do not undermine the efficient pricing of instruments traded, price improvements on quoted prices would only be justified when they are meaningful and reflect the minimum tick size applicable to the same financial instrument traded on a trading venue.

This is without prejudice to SIs' ability to quote any price level when dealing in sizes above standard market size.

Question 30 [Last update: 01/04/2019]

Can a EU branch of a third-country firm operate an SI?

Answer 30

MiFID II does not prohibit a branch, including the EU branch of a third-country firm, from operating as an SI in the EU. In this case the branch should fulfil all relevant MiFID II / MiFIR provisions and in particular the obligations attached to SI activity, i.e. Article 14 to 27 of MiFIR. The branch should also meet the criteria set out in the Q&A on 'centralised risk management within a group for the operation of an SI'.

However, as clarified under Article 47(3) of MiFIR, in the absence of an equivalence decision by the European Commission, branches can only operate as SIs in the Member State where they have been authorised. Those branches can therefore only actively serve clients that are located in this Member State.

A branch of a third-country firm is subject to the supervision of the competent authority in the Member State where the authorisation was granted, which is expected to use the supervisory powers under Article 69 of MiFID II, to ensure the compliance by the branch with the SI regime and the related obligations. In this respect, it is also recalled that article 70(2) of MiFID II also require Member States to "*ensure that where obligations apply to […] branches of third-country firms in the case of an infringement, sanctions and measures can be applied, subject to the conditions laid down in national law in areas not harmonised by this Directive, to the members of the investment firms' and market operators' management body, and any other natural or legal persons who, under national law, are responsible for an infringement*".

Question 31 [Last update: 01/04/2019]

How does the concept of "risk-facing activity" apply to an EU branch of a third-country firm that operates as an SI in the EU?

Answer 31

As clarified in Q&As above, ESMA is of the view that based on the SI definition provided in Article 4(1)(20) of MiFID II, the trading activity of a SI is characterised by risk-facing transactions that impact the Profit and Loss of the SI.

ESMA considers that the SI should carry out a degree of risk on an independent basis. Accordingly, ESMA is of the view that an EU branch of a third-country firm, in order to comply with the SI regime, should at least meet the following criteria:

- Risk management

The EU branch should not transfer the risk resulting from its SI activity through a de facto riskless back-to-back booking for hedging purposes whenever a transaction is executed with a client. Any transactions undertaken in an SI capacity should impact the Profit and Loss of the branch.

- Quote provision

The EU branch should have control over the provision of quotes. This would require the EU branch to have the ability to define its own pricing model through dedicated parameters, set its quotes, define its pricing model update and withdraw its quotes on an independent basis. The EU branch should also have traders located in the EU assigned to the SI activity and providing quotes to EU clients.

- Specific commercial policy

The EU branch should have documentation signed with its clients and a dedicated commercial policy with respect to its SI activity including a definition of the objective, non-discriminatory criteria governing access to its quotes.

- Reporting

The EU branch should have a dedicated MIC code for the purpose of the relevant reporting obligations (including those covered by Article 14(5) of RTS 22 and the Guidelines on transaction reporting section 5.14.4 and 5.17.3) to be done in its SI capacity.

6 Access to CCPs and trading venues [Last update: 02/04/2019]

Question 2 [Last update: 07/07/2017]

Is a CCP using an open offer trade acceptance model obliged to accept a request for access from a trading venue using a novation trade acceptance model?

Answer 2

Yes, a CCP using an open offer trade acceptance model that receives a request for access from a trading venue using a novation trade acceptance model should grant that access unless it can identify how precisely the simultaneous use of an open offer and a novation trade acceptance model would give rise to significant undue risks that cannot be managed.

Question 4 [Last update: 12/09/2017]

In which cases should a trading venue apply for an exemption foreseen in Articles 36(5) or Article 54(2) of MiFIR?

Answer 4

MiFIR provides for two transitory arrangements with respect to ETDs, in case the European Commission decides not to temporarily exclude ETDs from the scope of Articles 35 and 36 of MiFIR in accordance with Article 52(12) of MiFIR:

a) Article 54(2) of MiFIR allows for trading venues to apply to their NCAs for transitional arrangements on the basis of the risks that granting access to the venue on ETDs would pose to the orderly functioning of the relevant trading venue. Their NCA may exempt ETDs traded on that venue from the access provisions for only one transitional period of 30 months that cannot be prolonged. This provision applies to CCPs as well.

b) Article 36(5) of MiFIR specifies that trading venues offering trading in ETDs may opt out of the access provisions for a thirty-month period provided that their annual notional amount traded in ETDs falls below EUR 1,000,000 million. This transitory arrangement can be prolonged as long as the annual notional amount traded on that venue remains below the above-mentioned threshold all along the observation period, irrespective of any other consideration. ESMA is in charge of approving the opt-out based on the analysis of the annual notional amount traded.

Question 6 [Last update: 12/09/2017]

In case that a trading venue which opted-out the access provisions for ETDs under Article 36(5) MiFIR maintains close links with a CCP, is that CCP prevented from having access rights to venues trading any ETD?

Answer 6

CCPs with close links to trading venues that benefit from the exemption under Article 36(5) of MiFIR have their access rights restrained to exchange-traded derivatives 'within the relevant threshold'. The 'relevant threshold' refers to the notional amount traded in all ETDs concluded under the rules of that venue.

ESMA considers that this limitation applies to derivatives falling within the same asset class of the ETDs traded on that trading venue as described in Annex II of RTS 2, consistently with the notification requirements in Forms 3.2 and 4.2 in RTS 15.

Question 7 [Last update: 02/04/2019]

Can a third country trading venue request access to an EU CCP under Article 38 of MiFIR in the absence of an equivalence decision under Article 28(4) of MiFIR?

Answer 7

Article 38 of MiFIR governs third-country access requests relating to transferable securities, money market instruments and exchange-traded derivatives.

ESMA considers that an equivalence decision under Article 28(4) of MiFIR is only necessary if the third-country trading venue wishes to enter into an access arrangement with an EU CCP covering derivatives subject to the trading obligation to the extent that they are traded on a regulated market.

In the absence of an equivalence decision under Article 28(4) of MiFIR, third-country trading venues can enter into access arrangements (and maintain existing access arrangements) with EU CCPs for transferable securities, money market instruments and derivatives, to the extent that they are not subject to the trading obligation.

ESMA recalls that access requests covering derivatives traded on OTFs and MTFs are subject to the EMIR access provisions.

7 Application of MiFID II after 3 January 2018, including issues of 'late transposition' [Last update: 18/12/2017]

Question 1 [Last update: 18/12/2017]

Should authorisations as a regulated market granted under MiFID I still be valid after 3 January 2018?

Answer 1

Yes, the authorisations granted under MiFID I should continue to be valid after 3 January 2018. This applies also to the authorisations for market operators to operate an MTF. However, ESMA notes that competent authorities, as set out in Article 44 of MiFID II (and, already, Article 36 of MiFID I), should monitor that market operators comply at all times with the conditions for initial authorisation and therefore regularly review conditions for initial authorisation.

Question 2 [Last update: 18/12/2017]

Can regulated markets established in Member States that have not transposed MiFID II at the date of 3 January 2018, and that already have a valid authorisation, continue to provide appropriate arrangements in other EU Member States that facilitate access to and trading on those markets by remote members and participants after the entry into application of MiFID II?

Answer 2

Regulated markets established in Member States that have not transposed MiFID II by 3 January 2018 but that have already been authorised under MiFID I and have already provided appropriate arrangements that facilitate access to and trading on those markets by remote members and participants in other Member States, may continue to provide these arrangements in those Member States. The competent authorities of regulated markets that provide such arrangements on the territory of other Member States may be requested to reassure host Member States competent authorities that, pending transposition of MiFID II, they are applying the detailed operating conditions included in MiFID II.

Question 3 [Last update: 18/12/2017]

Can entities providing data reporting services established in a Member State that has not transposed MiFID II, provide data reporting services throughout the Union?

Answer 3

According to Article 60 of MiFID II authorisations for the provisions of data reporting services are valid for the entire Union and allow a data reporting services provider to provide the services, for which it has been authorised, throughout the Union. Therefore, only authorised entities in Member States that have transposed the relevant provisions of MiFID II can provide data reporting services throughout the Union.