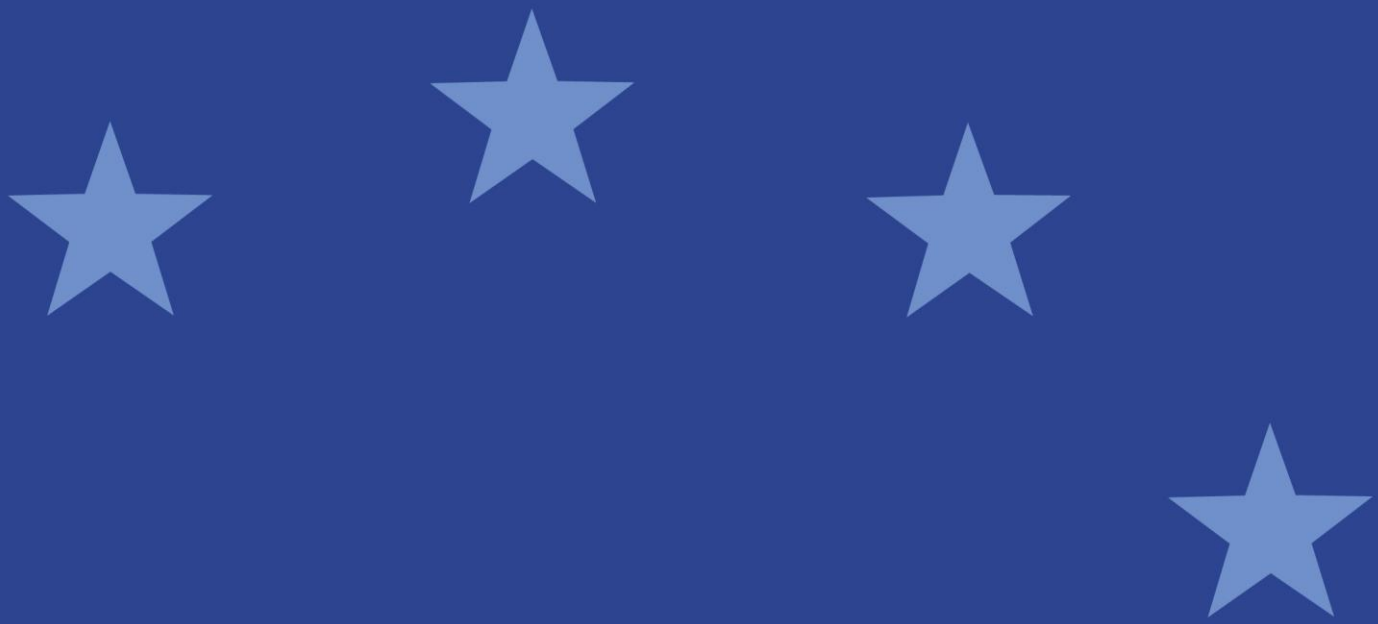
esma European Securities and Markets Authority

Questions and Answers

On MiFID II and MiFIR market structures topics



31 May 2017 | ESMA70-872942901-38

Table of Contents

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
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 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 22	Commission Delegated Regulation (EU) 2017/590 on the reporting of transactions to competent authorities

SI	Systematic internaliser
STOR	Suspicious Transaction or Order Report

Table of questions

		Topic of the Question	Level 1/Level 2 issue	Last Updated
Data disaggregation	1	Level at which disaggregation is required	Article 12 of MiFIR and RTS 14	18/11/2016
	2	Requests for disaggregated data	RTS 14	18/11/2016
	3	Country of issue	RTS 14	18/11/2016
Direct Electronic Access (DEA) and algorithmic trading	1	Treatment of simple algorithms	Article 18 of the Commission Delegated Regulation (EU) 2017/565	19/12/2016
	2	Transmission of orders and algorithmic trading	Article 18 of the Commission Delegated Regulation (EU) 2017/565	19/12/2016
	3	Automated Order Router (AOR)	Article 18 of the Commission Delegated Regulation (EU) 2017/565	19/12/2016
	4	Reference to “market markers” under Article 2(1)(d) of MiFID II	Article 2(1)(d) of MiFID II	31/01/2017
	5	Identification and authorisation of HFT	Article 19 of the Commission Delegated Regulation (EU) 2017/565 and Article 2(1)(d) of MiFID II	03/04/2017
	6	Identification and authorisation of HFT	Article 19 of the Commission Delegated Regulation (EU) 2017/565	03/04/2017
	7	DEA users and HFT	Article 19 of the Commission Delegated	03/04/2017

			Regulation (EU) 2017/565	
	8	Identification of algorithmic trading activities	Article 18 of the Commission Delegated Regulation (EU) 2017/565 and Article 4(1)(39) of MiFID II	03/04/2017
	9	Algorithmic trading and OTC activities	Article 17 of MiFID II	03/04/2017
	10	Reconciliation of logs	Article 17(3) of RTS 6	03/04/2017
	11	Storage of order and transaction data	Article 13(7) of RTS 6	03/04/2017
	12	Definition of DEA	Article 20 of Commission Delegated Regulation (EU) 2017/565	03/04/2017
	13	Meaning of “continuous assessment and monitoring of market and credit risk” in Article 17(2) of RTS 6	Article 17(2) of RTS 6	31/05/2017
Tick size regime	1	Relevant National Competent Authority (NCA) responsible for calculating and publishing the average daily number of transactions (ADNT)	RTS 11	18/11/2016
	2	Corporate actions	RTS 11	18/11/2016
	3	Determination of the applicable tick size for instruments listed in non-EU countries	RTS 11	18/11/2016
	4	Application of the tick size for instruments trading in different currencies	RTS 11	18/11/2016
	5	Ad hoc changes of the applicable tick sizes	RTS 11	18/11/2016
	6	Tick size regime and pre-trade transparency waivers	RTS 11	19/12/2016

	7	Orders remaining on the order book at the moment the tick size increases	RTS 11	19/12/2016
Multilateral & bilateral systems	1	Can an MTF operator be a member/participant of its own MTF	Article 19 of MiFID II	31/01/2017
	2	Compliance with co-location provisions under RTS 10 in case of outsourced co-location service	RTS 10	31/01/2017
	3	Characteristics of OTFs	Article 4(1)(23) of MiFID II	03/04/2017
	4	OTFs and voice trading	Article 4(1)(23) of MiFID II	03/04/2017
	5	Distinction between OTFs and MTFs	Articles 4(1)(22) &(23), 19 and 20 of MiFID II	03/04/2017
	6	Allowed activities for OTFs: concept of liquid sovereign debt	Article 20(3) of MiFID II	03/04/2017
	7	Allowed activities for OTFs: carrying out market making on an independent basis	Article 20(5) of MiFID II	03/04/2017
	8	Operation of an OTF and a SI	Article 20(4) of MiFID II	03/04/2017
	9	Operation of an OTF and a SI	Article 20(4) of MiFID II	03/04/2017
	10	Connexion of an OTF to other liquidity pools	Article 20(4) of MiFID II	03/04/2017
	11	Operation of an OTF and best execution	Article 20(8) of MiFID II	03/04/2017
	12	Exercise of discretion	Article 20(6) of MiFID II	03/04/2017
	13	Exercise of discretion	Article 20(6) of MiFID II	03/04/2017
	14	Exercise of discretion	Article 20(6) of MiFID II	03/04/2017
	15	SI and matched principal trading	Commission Delegated Regulation (EU) 2017/565	03/04/2017

	16	Providing matched principal trading on an occasional basis	Commission Delegated Regulation (EU) 2017/565	03/04/2017

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: 31/05/2017]

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

Does a simple algorithm qualify as algorithmic trading?

Answer 1

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

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

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

Answer 2

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

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

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

Answer 3

According to Recital 22 of Commission Delegated Regulation (EU) 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]

Given that the identification of HFT technique takes into account the previous twelve months of trading and that trading venues are only obliged to provide the data under Article 19 of Commission Delegated Regulation (EU) 2017/565 *as of 3 January 2018, when the actual identification as high-frequency traders is expected to take place?*

Answer 6

Trading venues are only required by Article 19(5) of Commission Delegated Regulation (EU) 2017/565 to provide estimates of the average of messages per second as of 3 January 2018. As a consequence, over 2018 trading venues have to provide the estimates corresponding to the trading activity of their members/participants from 3 January 2018 onwards. Trading venues may only be able to provide those estimates taking into account the previous twelve months of trading activity in the second week of February 2019. Provided that their 2017 records allow them so, trading venues may provide estimates taking into account the previous twelve months before that date.

As of 3 January 2018, persons engaged in algorithmic trading are responsible for their own self-assessment to determine whether their trading activity meets the characteristics of HFT as set out under Article 4(1)(40) of MiFID II and Article 19 of Commission Delegated Regulation (EU) 2017/565. If it is the case, they should proceed immediately as described in Answer 5. ESMA notes in this respect that the information provided by trading venues are only estimates that need to be refined according to each person's own records of the messages sent.

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

Can DEA users be identified as applying a HFT technique?

Answer 7

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].

[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).

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 8 [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 8

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 9 [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 9

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 10 [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 10

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 11 [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 11

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

[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).

competent authority upon request (Article 3(8) of Commission Delegated Regulation (EU) 2016/957).

Question 12 [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 12

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 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 13 [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 13

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.

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

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

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

Answer 1

The relevant NCA responsible calculating and publishing the ADNT should be the competent authority identified as the NCA of most relevant market in terms for the purposes of transaction reporting. In the case of multi-listed instruments, the criteria and procedure to be used for determining which NCA should be the relevant NCA are specified under Article 16 of RTS 22[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 3 **[Last update: 18/11/2016]**

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

Answer 3

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

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

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

Answer 4

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

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

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

Answer 5

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

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

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

Answer 6

Article 49 of MiFID II requires trading venues to adopt minimum tick sizes in relation to equity and certain equity-like instruments. RTS 11 specifies the minimum tick size regime which applies to those instruments depending on their liquidity and price level. As the aim of the minimum tick size regime is to ensure the orderly functioning of the market, its application extends to all orders submitted to trading venues. The application of the tick size regime would include, for example, limit orders resting on an order book, including orders held in an order management system as per Article 4(1)(d) of MiFIR.

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

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

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

Answer 7

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

5 Multilateral and bilateral systems [Last update: 03/04/2017]

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.

5.2 Organised Trading Facilities (OTFs)

Question 3 [Last update: 03/04/2017]

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

Answer 3

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)

[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).

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 4 [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 4

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 5 [Last update: 03/04/2017]

What distinguishes an OTF from an MTF?

Answer 5

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 6 [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 6

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 7 [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 7

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 8 [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 8

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 9 [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 9

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

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

Answer 10

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 11 **[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 11

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 12 [Last update: 03/04/2017]

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

Answer 12

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.

a) 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.

b) 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 13 [Last update: 03/04/2017]

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

Answer 13

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 14 [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 14

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.

5.3 Systematic internalisers and riskless transactions

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

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 15

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

   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 16 **[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 16

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.