MiFID II

Pre- and post-trade transparency

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Key Points

- The existing MiFID I transparency regime, which only relates to shares admitted to trading on regulated markets ("**RMs**"), will be extended to encompass other equity-like and non-equity instruments.
- It will also be expanded to cover instruments traded or advertised through multilateral trading facilities ("**MTFs**") and organised trading facilities ("**OTFs**") (regardless of whether they are admitted to trading on regulated markets).
- Existing waivers for equities will be retained and extended to equity-like instruments
- The new volume cap mechanism will limit the number of trades in equities or equity-like instruments which can take place under waivers.
- There will be new waiver provisions specific to non-equities.
- Expanded pre- and post-trade transparency obligations for systematic internalisers.

This briefing note sets out the pre- and post-trade transparency regime under MiFID II. MiFID II also introduces a mandatory position reporting regime which aims to ensure transparency in relation to commodity derivatives and emissions allowances. This is covered in our separate briefing note on Commodity Derivatives.

Transparency under MiFID II

Extension of the transparency regime to equity-like and non-equity instruments (including derivatives) and to instruments advertised or traded on MTFs and OTFs

The MiFID II regime substantially expands the pre-trade and post-trade transparency regime for financial instruments traded in the European Union. The MiFID I transparency requirements are limited to equities admitted to trading on regulated markets. MiFID II extends the scope of the transparency framework to cover an expanded range of financial instruments. This includes not only shares but also depositary receipts, exchange traded funds, certificates and similar instruments ("**equity-like instruments**"), as well as bonds, structured finance products, emission allowances and traded derivatives ("**non-equity instruments**").

MiFID II also covers an expanded range of trading venues – the MiFID I venues, namely RMs and MTFs, plus a new category of trading venues classified as OTFs. MiFID II aims to push more trading onto these venues. Under MiFID II an expanded set of pre-and post-trade transparency obligations will also be imposed on systematic internalisers ("**SIs**") and other investment firms trading in over-the-counter ("**OTC**") financial instruments.

MiFIR contains separate transparency rules for trading venues for equities and equity-like instruments and for non-equity instruments, but the two sets of rules are similar in many respects. A separate set of transparency obligations apply to SIs and firms trading OTC.

The detailed requirements of the new transparency regime are contained in the following Level 2 legislation and regulatory technical standards ("**RTS**"):

- the MiFID II Delegated Regulation;[1]
- RTS 1;[2]

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[1] Commission Delegated Regulation 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 ("**MiFID II Delegated Regulation**")

[2] Commission Delegated Regulation of 14 July 2016 supplementing Regulation (EU) No 600/2014 of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards on transparency requirements for trading venues and investment firms in respect of shares, depositary receipts, exchange-traded funds, certificates and other similar financial instruments and on transaction execution obligations in respect of certain shares on a trading venue or by a systematic internaliser ("**RTS 1**").

- RTS 2;[3] and
- RTS 14.[4]

This Level 2 legislation has been developed following (in the case of the MiFID II Delegated Regulation) ESMA Technical Advice,[5] and (in the case of the various RTS) an earlier ESMA Consultation Paper[6] and Final Report.[7]

ESMA also issued an Addendum Consultation Paper on 18 February 2015.[8] This interim consultation covered further issues in relation to transparency for the following asset classes:

- foreign exchange derivatives;
- credit derivatives;
- other derivatives; and
- contracts for difference.

The results of this consultation were incorporated into ESMA's final draft RTS in September 2015.

Pre-trade transparency

Operators of trading venues will be required to make public current bid and offer prices and the depth of trading interests at those prices which are advertised through their systems for equities and equity-like interests and for non-equity instruments. This requirement also applies to actionable indication of interests. However, the pre-trade transparency requirements will not apply to derivative transactions of non-financial counterparties which are objectively measurable as reducing risks directly relating to those parties' commercial or treasury financing activities (or those of their corporate groups).

Pre-trade transparency requirements are to be calibrated for different types of trading systems including order-book, quote-driven, hybrid, periodic auction trading systems, and – for non-equity instruments – voice trading systems.[9]

The following RTS set out the details of the pre-trade information to be made public in respect of equities and equity-like interests and non-equities:

- RTS 1 (in respect of equities and equity-like interests); and
- RTS 2 (in respect of non-equities).

Waivers

Equities and equity-like instruments

National competent authorities ("**NCAs**") will continue to be able to waive pre-trade transparency obligations in respect of certain systems and orders (for instance, for orders that are large in scale compared with normal market size). Where NCAs wish to grant a waiver of the pre-trade transparency requirements, they must notify other NCAs and ESMA no less than four months before the waiver is intended to take effect. ESMA will then issue a non-binding opinion on the compliance of the waiver with MiFIR requirements. ESMA will monitor and report annually to the Commission on the application of waivers.[10]

RTS 1 provides further detail on when a NCA can waive pre-trade transparency obligations and the

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3 Commission Delegated Regulation of 14 July 2016 supplementing Regulation (EU) No 600/2014 of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards on transparency requirements for trading venues and investment firms in respect of bonds, structured finance products, emission allowances and derivatives ("**RTS 2**").

4 Commission Delegated Regulation 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 ("**RTS 14**")

5 ESMA, Final Report: Technical Advice to the Commission on MiFID II and MiFIR, 19 December 2014 (ESMA/2014/1569) (the "**Technical Advice**").

6 ESMA, Consultation Paper, 19 December 2014 (ESMA/2014/1570).

7 ESMA, Final Report: Draft Regulatory and Implementing Technical Standards MiFID II/MiFIR (the "**Final Report**"), 28 September 2015 (ESMA/2015/1464).

8 ESMA, Addendum Consultation Paper: MiFID II/MiFIR, 18 February 2015 (ESMA/2015/319).

9 See Articles 3 and 8 of MiFIR.

10 See Article 4, MiFIR.

requirements that must be met. The relevant articles are Articles 3 to 8 of RTS 1. For example, Article 7 contains the rules regarding the size of orders that are large in scale. The rules differentiate between different asset classes of equity-like assets in terms of the metric used to establish whether transactions are large in scale. For shares, depositary receipts and certificates this will be based on Average Daily Turnover ("**ADT**") with a different threshold applicable for different ADT figures, whereas there is a single threshold for exchange traded funds ("**ETFs**").

A reference price waiver and negotiated price waiver will continue to be available for equities, and will also be available for equity-like instruments.[11] However these waivers will be subject to a "volume cap mechanism", limiting the amount of trading that can take place under waivers. In particular the volume of trading in any share or equity-like instrument that can be carried out under the reference price waiver and the negotiated price waiver will be capped at:

- 4% per trading venue; and
- 8% in aggregate across the EU.[12]

Non-equity instruments

NCAs may waive the pre-trade transparency obligations for non-equity instruments in relation to:

- orders that are large in scale compared with normal market size and orders held in an order management facility of the trading venue pending disclosure;
- actionable indications of interest in request-for-quote and voice trading systems that are above a size specific to the financial instrument which would expose liquidity providers to undue risk (taking into account whether the market participants are retail or wholesale investors); and
- derivatives which are not required to be traded on RMs, MTFs or OTFs for which there is not a liquid market.[13]

RTS 2 sets out specific pre-trade transparency requirements relating to non-equity instruments, including in particular, a proposed methodology for calculating size-specific-to-the-instrument ("**SSTI**") and Large-In-Scale ("**LIS**") thresholds for non-equity instruments.[14]

That methodology takes a granular approach which differentiates between various asset classes, sub-asset classes and sub-classes. Depending on the asset type, the methodology refers either to:

- (generally for liquid assets) the greater of: (a) the trade size below which lies the percentage of the transactions corresponding to certain trade percentiles set out in the rules, and (b) a threshold set out in the annexes of RTS 2; or
- (generally for illiquid assets) a specified threshold set out in the annexes of RTS 2.

It is worth noting that changes were made to the draft form of RTS 2 released in September 2015 following arguments raised by the Commission in a letter to ESMA on 20 April 2016. These changes relate to assessing whether there is a liquid market for these instruments, and the calculation of the SSTI thresholds.

Where a waiver has been granted in respect of non-equity instruments, trading venue operators are still required to publish at least indicative pre-trade bid and offer prices continuously during trading hours.[15] NCAs may withdraw the waiver if they observe that it is being used in a way that deviates from its original purpose or being used to circumvent MiFIR requirements.[16]

11 Article 4, MiFIR.
12 Article 5, MiFIR.
13 Article 9, MiFIR.
14 See Articles 3, 5 and 13 of RTS 2.
15 Article 8(4), MiFIR.
16 Article 9(3), MiFIR.

NCAs may also suspend pre-trade transparency obligations in relation to non-equity instruments where the liquidity of that class of instrument falls below a specified threshold. That threshold is to be based on objective criteria specific to the market for the instrument concerned.[17]

RTS 2 contains detailed rules regarding when such suspension can be exercised for liquid and non-liquid instruments.[18]

Revised post-trade transparency regime (including equity-like and non-equity instruments)

Post-trade transparency

The post-trade transparency regime has been extended to include non-equity and equity-like instruments and instruments traded on MTFs and OTFs. MiFID II retains the requirement for operators of trading venues to make public the price, volume and time of transactions as close to real-time as is technically possible.[19]

RTS have been released which contain detailed requirements on post-trade transparency.[20] For example, these rules indicate that the maximum permissible delay for publication should ultimately be reduced to one minute in respect of equities and equity-like instruments [21] and five minutes for non-equities[22].

Deferral

NCAs will continue to be permitted to authorise the deferred publication of post-trade information based on the size or type of the transaction, although such arrangements must be clearly disclosed to market participants and to the public. In particular, deferral may be authorised where transactions are large in scale compared with the normal market for that instrument or class of instrument.[23]

For non-equities, deferred publication may also be authorised for illiquid financial instruments and transactions above a specified size threshold that would expose liquidity providers to undue risk. NCAs may also take a range of additional measures during the period of deferral, such as requesting publication of limited details or of details of several transactions in aggregated form.[24] RTS 2 clarifies the treatment of "**package transactions"** consisting of several contingent components. Where at least one component of the package is above the relevant LIS or SSTI thresholds, or deemed illiquid, a deferral from post-trade transparency requirements may be granted. A further RTS is under preparation by ESMA in relation to the methodology for assessing the liquidity of package orders for these purposes.[25]

Suspension

NCAs may also temporarily suspend the post-trade transparency obligations for a non-equity instrument where the liquidity of that class of instrument falls below the relevant threshold. Temporary suspensions are valid for an initial period not exceeding three months from the date of publication on the website of the relevant NCA, but may be renewed by up to three months at a time if the grounds for the suspension persist. NCAs must notify ESMA before making or renewing a suspension and ESMA will issue an

17 Article 9(4), MiFIR.
18 See Articles 16 and 13 of RTS 2.
19 Articles 6 and 10 of MiFIR.
20 See RTS 2 for non-equity instruments, and RTS 1 for equity and equity-like instruments.
21 Under MiFID I, post-trade information must be reported as close to real time as possible and in any case within three minutes of the relevant transaction. RTS 1 makes clear that, during trading hours post-trade information must be made available within one minute (and otherwise before the opening of the next trading day).
22 RTS 2 indicates that it will be a time limit of fifteen minutes on a transitional basis for the first three years of application, and a five minute limit thereafter.

23 See Articles 7 and 11, MiFIR. RTS 1 and 2 propose detailed provisions and thresholds by which to determine whether an order is to be considered large in scale compared with normal market size.
24 Article 11, MiFIR.
25 ESMA, *Consultation Paper: Draft RTS on package orders for which there is a liquid market* (ESMA/2016/1562) (10 November 2016).

opinion as to whether the proposed action is justified. [26]

RTS have been released specifying the information to be made public in respect of equities and equity-like instruments[27] and non-equity instruments,[28] along with further details further details for the scope and timing of post-trade transparency obligations and the specific conditions for deferral in respect of different financial instruments.

Publication of trade data

Operators of trading venues must make pre-trade and post-trade transparency data available to the public separately and on a reasonable commercial basis, and must ensure non-discriminatory access.[29] The information must be available free of charge 15 minutes after publication (reducing to 5 minutes from 2021).[30]

RTS 14 expands upon the requirements for the provision of data, in particular the way in which the data should be disaggregated. The Commission is also required to adopt delegated acts clarifying what constitutes a "reasonable commercial basis".[31]

Expanded transparency obligations for systematic internalisers and firms trading OTC

Under the revised definition in MiFID II a "systematic internaliser" means an investment firm which, on an organised, frequent systematic and substantial basis, deals on own account when executing client orders outside a regulated market, an MTF or an OTF without operating a multilateral system.[32] Firms which meet this definition must notify their NCA, and the NCA will communicate this to ESMA. ESMA will publish a list of all EU SIs on its website. As under MiFID I, systematic internalisers will be subject to pre-trade and post-trade transparency rules, but it is not intended that other firms will be caught when trading OTC.

Where SIs are required to make firm quotes public, this is to be done in a manner which is easily accessible to other market participants on a reasonable commercial basis. SIs may update their quotes at any time, and may also withdraw them under exceptional market conditions.

Pre-trade transparency for SIs – equities and equity-like instruments

SIs will be required to make public firm quotes for transactions up to a standard market size in respect of traded equities and equity-like instruments, provided that there is a liquid market in the relevant instrument. Where there is not a liquid market, SIs will only be required to disclose quotes to their clients upon request. The transparency requirements for SIs only apply to when they deal in sizes up to a standard market size and not when they deal in larger sizes.

SIs will be allowed to decide the clients to whom they give access to their quotes on the basis of their commercial policy, provided they do so in an objective non-discriminatory way. In order to limit their risk exposure, SIs are entitled to impose limits on the number of transactions with a single client which they undertake to enter at the published conditions. They may also limit the total number of simultaneous transactions from different clients where the number and/or volume of orders sought considerably exceeds the norm. [33]

26 Article 11 MiFIR.
27 See RTS 1.
28 See RTS 2.
29 See Articles 12 and 13, MiFIR.
30 Article 7, RTS 2.
31 See Articles 84 to 89 of the MiFID II Delegated Regulation for the meaning of this term in the context of reporting services providers, although the explanatory memorandum notes that these rules are also applicable to investment firms and market operators.

32 ESMA has produced additional technical advice identifying criteria to be applied in order to determine whether a firm shall be treated as a systematic internaliser in respect of certain financial instruments. See technical advice set out in section 3 of ESMA, Technical Advice, 19 December 2014.
33 Article 17, MiFIR.

SIs will also be able to decide the size or sizes at which they will quote. The minimum quote size for equities and equity-like instruments will be at least 10% of the standard market size of the relevant instrument. Quotes must include a firm bid and offer price or prices for a size which could be up to a standard market size for the class to which the instrument belongs. These prices must be regularly updated to reflect prevailing market conditions for the instrument in question.[34]

Quotes must be made public on a regular and continuous basis during normal trading hours in a manner easily accessible to other market participants and on a reasonable commercial basis. Subject to complying with their best execution obligation, SIs must execute the orders they receive from clients for equities and equity-like instruments at the quoted prices at the time of receiving the order. However, they may execute at a better price in justified cases, provided that the price falls within a public range close to market conditions. Orders from professional clients, however, may be executed at prices different from those quoted in the following cases:

- where execution in several securities is part of a single transaction; or
- in respect of orders that are subject to conditions other than the current market price.[35]

Equities and equity-like instruments are to be grouped in classes[36] on the basis of the average value of orders executed in the market for that instrument. The average value of orders executed within each class will be established as the "standard market size" for that class. The market for each instrument will be comprised of all orders executed in the EU for that instrument, excluding those that are large in scale compared to normal market size.

RTS 1 sets out final draft RTS further specifying the arrangements for the publication of a firm quote, the determination of whether prices reflect prevailing market conditions, and the standard market size.[37]

Pre-trade transparency for SIs and OTC traders – non-equities

SIs are only required to make firm quotes in respect of non-equity instruments public where:

- there is a liquid market;
- they are prompted for a quote by a client; and
- they agree to provide a quote.

Where there is not a liquid market, SIs are only required to disclose quotes to their clients upon request if they agree to provide a quote (subject to pre-trade transparency waivers).

SIs may decide the clients to whom they give access to their quotes for non-equities, provided they do so in an objective and non-discriminatory way and have clear standards in place to govern access. SIs are required to undertake to enter into transactions on the basis of these quotes with any client to whom they are made available, provided that the quoted size is at or below a certain size.[38]

SIs may also establish non-discriminatory and transparent limits on the number of transactions they undertake to enter into pursuant to any given quote.

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34 Article 14, MiFIR.
35 Article 15, MiFIR.
36 See Article 14, MiFIR. The NCA of the 'most relevant market' in terms of liquidity will determine the class to which an instrument belongs at least annually, on the basis of the arithmetic average value of the orders executed in the market in respect of that financial instrument. The NCA must make this information public to all market participants and communicate it to ESMA which will publish the information on its website. RTS 1 sets out criteria for establishing the most relevant market in terms of liquidity for the purpose of the reference price waiver.
37 See Articles 9 to 11 of RTS 1.
38 See Article 18, MiFIR. The relevant size threshold will be specified for each financial instrument to reflect the size, specific to the financial instrument, which would expose liquidity providers to undue risk (taking into account whether the market participants are retail or wholesale investors).

There is no obligation to publish a firm quote for non-equity instruments where they fall below the liquidity threshold at which NCAs are permitted to suspend the pre-trade transparency rules.

Post-trade transparency for SIs and firms trading OTC

SIs which conclude transactions in financial instruments traded on a trading venue – either on their own account or on behalf of clients – are required to publish the volume and price of those transactions and the time at which they were concluded through an authorised publication arrangement ("**APA**"). The information to be made public and the applicable time-limits for various financial instruments will be the same as for trades conducted on trading venues. For non-equity instruments, each individual transaction must be made public once through a single APA.[39]

Where NCAs have permitted deferrals in respect of trades conducted on trading venues (or additional requirements such as publication in limited or aggregated form, in the case of non-equities), those will also apply in respect of trades outside of trading venues.[40]

RTS 1 and 2 contain rules specifying:

- how post-trade transparency obligations are to be applied to transactions involving the use of financial instruments for collateral, lending or other purposes where the exchange is determined by factors other than the current market valuation; and
- that the selling party to the transaction is ordinarily responsible for making the transaction public where both parties are investment firms.

Timescales for implementation

The MiFID II Directive and MiFIR came into force on 3 July 2014, and most of their provisions will come into effect in member states from 3 January 2018. Member states have until 3 July 2017 to transpose the MiFID II Directive and the Delegated Directive into national law.

The RTS and the MiFID II Delegated Regulation will become effective from 3 January 2018. The RTS and the MiFID II Delegated Regulation are EU Regulations having direct effect in EU law and so do not need to be transposed into the national law of member states.

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[39] See Articles 20 to 21, MiFIR.
[40] Articles 20 and 21, MiFIR.

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