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MiFID II

Pre- and post-trade transparency

Key Points

- The existing MiFID I transparency regime, which only relates to shares admitted to trading on regulated markets, will be extended to encompass other equity-like and non-equity instruments
- It will also be expanded to cover instruments traded or advertised through MTFs and 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

2016

Transparency in 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 regulated markets ("**RMs**") and multilateral trading facilities ("**MTFs**"), plus a new category of trading venues classified as organised trading facilities ("**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 will be contained in Level 2 legislation comprised of a combination of:

- delegated acts which will be drafted by the European Commission on the basis of the ESMA Technical Advice,[1] and
- regulatory technical standards ("**RTS**"), drafts of which have been developed by ESMA and are appended to the ESMA Consultation Paper[2] and the ESMA Final Report[3].

ESMA also issued an Addendum Consultation Paper on 18 February 2015.[4] 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.[5]

The ESMA Consultation Paper and ESMA Final Report explain the rationale for the approaches proposed in the draft RTS[6]. The ESMA Technical Advice to the Commission sets out ESMA's views in relation to various topics on which the Commission has been empowered to adopt delegated acts.

MiFID II also introduces a mandatory position reporting regime which aims to ensure transparency in relation to commodity derivatives and emissions allowances.[7]

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

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

[2] ESMA, Consultation Paper, 19 December 2014 (ESMA/2014/1570).

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

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

[5] ESMA, Final Report, 28 September 2015, chapter 2.2.

[6] ESMA, Consultation Paper, 19 December 2014; ESMA, Final Report, 28 September 2015.

[7] Please see Hogan Lovells' separate note on Commodity derivatives.

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.

The ESMA Final Report contains final draft RTS setting out the details of the pre-trade information to be made public in respect of equities and equity-like interests and non-equities.[8]

Waivers

National competent authorities ("**NCAs**") will continue to be able to waive pre-trade transparency obligations subject to certain criteria (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. Following feedback received during consultations, ESMA proposes to differentiate between different asset classes of equity-like assets in terms of the metric used to establish whether transactions are large in scale. For instance, for shares, depositary receipts and certificates this will be based on Average Daily Turnover ("**ADT**"), whereas there will be a single class for exchange traded funds ("**ETFs**") regardless of their underlying or their liquidity.

A reference price waiver and negotiated price waiver will continue to be available for equities, and will also be available for equity-like instruments. 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.

The ESMA Final Report contains final draft RTS which elaborate upon key concepts and terminology in relation to the transparency requirements and clarify the different types of waivers and the detailed reporting requirements for the purpose of the volume cap mechanism.[9]

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.

ESMA's final draft RTS set out the proposed methodology for calculating size-specific-to-the-instrument ("**SSTI**") and Large-In-Scale ("**LIS**") thresholds for non-equity instruments. That methodology takes a granular approach which differentiates between various asset classes, sub-asset classes and sub-classes. For bonds, liquidity will be calibrated on an instrument-by-instrument basis ("**IBIA**"). ESMA proposes a periodic assessment of liquidity based on specified criteria for most types of bonds. For illiquid instruments, pre-determined thresholds will be applied instead. [10]

Where a waiver has been granted in respect of non-equity instruments, trading venue operators are still

[8] ESMA, Regulatory technical and implementing standards: Annex I MiFID II/MiFIR, 28 September 2015.

[9] See draft RTS 1, 2 and 3 in ESMA, Regulatory technical and implementing standards: Annex I MiFID II/MiFIR, 28 September 2015

[10] See draft RTS 2 in ESMA, Regulatory technical and implementing standards: Annex I MiFID II/MiFIR, 28 September 2015

required to publish at least indicative pre-trade bid and offer prices continuously during trading hours. 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.

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.

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. ESMA has proposed that the maximum permissible delay for publication should ultimately be reduced to one minute in respect of equities and equity-like instruments [11] and five minutes for non-equities[12].

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.[13]

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 addition al measures during the period of deferral, such as requesting publication of limited details or of details of several transactions in aggregated form.

The ESMA Final Report 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.

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 opinion as to whether the proposed action is justified.

The ESMA Final Report contains final draft RTS specifying the information to be made public in respect of equities and equity-like instruments[14] and non-equity instruments,[15] 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

[11] 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. Final draft RTS 1 in ESMA, Regulatory technical and implementing standards: Annex I MiFID II/MiFIR, 28 September 2015 proposes that, during trading hours post-trade information must be made available within one minute (and otherwise before the opening of the next trading day).

[12] ESMA proposes a fifteen minute limit on a transitional basis , with the five minute limit to take effect from 1 January 2020.

[13] Final draft RTS (1 and 2) in ESMA, Regulatory technical and implementing standards: Annex I MiFID II/MiFIR, 28 September 2015 propose detailed provisions and thresholds by which to determine whether an order is to be considered large in scale compared with normal market size.

[14] See draft RTS 1 in ESMA, Regulatory technical and implementing standards: Annex I MiFID II/MiFIR, 28 September 2015.

[15] See draft RTS 2 in ESMA, Regulatory technical and implementing standards: Annex I MiFID II/MiFIR, 28 September 2015.

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. The information must be available free of charge 15 minutes after publication (reducing to 5 minutes from 2020)[16].

Final draft RTS set out in the ESMA Final Report expand upon the requirements for the provision of data, including the details to be made public, the appropriate flags to be used, the timelines for publication and the party responsible for publication in respect of transactions between two investment firms.[17] The Commission is also required to adopt delegated acts clarifying what constitutes a "reasonable commercial basis".

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.[18] 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 transparency rules, but it is not intended that other firms will be caught when trading OTC.[19]

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.

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.

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

[16] See draft RTS 2 in ESMA, Regulatory technical and implementing standards: Annex I MiFID II/MiFIR, 28 September 2015.

[17] See draft RTS 2 in ESMA, Regulatory technical and implementing standards: Annex I MiFID II/MiFIR, 28 September 2015.

[18] 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.

[19] MiFIR, recital 22.

- in respect of orders that are subject to conditions other than the current market price.

Equities and equity-like instruments are to be grouped in classes[20] 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.

The ESMA Final Report 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.[21]

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.[22]

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

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.

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.

The ESMA Final Report contained final draft RTS specifying:

- identifiers for the different types of transactions published;
- 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

[20] 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. Draft RTS set out criteria for establishing the most relevant market in terms of liquidity for the purpose of the reference price waiver.

[21] See draft RTS 1 in ESMA, Regulatory technical and implementing standards: Annex I MiFID II/MiFIR, 28 September 2015.

[22] 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).

- 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. Most of their provisions are currently stated to come into effect in member states from 3 January 2017, with Member states having until July 2016 to transpose the MiFID II Directive into national law.

However, it is now expected that the implementation of MiFID II will be delayed until January 2018. It is not yet clear precisely how those delays will be enacted, but it seems likely that they will have knock-on effects on the timing of phased implementation arrangements, including those described below.

ESMA submitted draft technical standards to the Commission on 28 September 2015. In principle, the Commission has had three months to consider whether to endorse the technical standards (i.e. by 28 December 2015). However, in the context of ongoing uncertainty regarding the legislative timetable, the Commission has not met this deadline.

The European Commission is also drafting delegated acts on the basis of the Technical Advice received from ESMA in December 2014.

All of the draft RTS proposed in the ESMA Final Report in relation to transparency also currently state that they are to be applicable from 3 January 2017. Certain provisions within the draft RTS, however, are intended to apply differently at different times. For example:

- draft RTS 1 and 2 contain provisional provisions which apply immediately upon the RTS coming into force and which provide for phased implementation of certain requirements;
- draft RTS 2 contains certain provisions relating to the methodology for performing transparency calculations which will not become effective until 1 January 2018; and
- post-trade information for non-equities must be made available as close to real time as possible and in any case within 15 minutes after the execution of the relevant transaction from 3 January 2017 until 1 January 2020. After 1 January 2020 this limit will be reduced to 5 minutes.[23]

[23] Please note that these timings are as stated in the current draft RTS, but they are likely to change in light of the overall delays to MiFID II implementation.

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