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Additional Information

Level 1 Regulation
Markets in Financial Instruments Directive II (MiFID II) Directive 2014/65/EU- Secondary Markets

Topic
Ancillary activity

Subject Matter
Criteria privileged transactions exemption

Question
What are the criteria that liquidity provision contracts need to meet in order to qualify for the privileged transactions exemption under Article 2(4) of MiFID II?

ESMA Answer

23-09-2022

Original language

[ESMA70-87294901-36 Commodity derivatives, Ancillary activitiy, Q&A 8]

Article 2(4) fourth paragraph, letter (c) of MiFID II permits a number of transaction types to be classified as “privileged transactions” and thus to be set aside for the purposes of the ancillary activity calculations. Those transaction types include “transactions in commodity derivatives and emission allowances or derivatives thereof entered into to fulfil obligations to provide liquidity on a trading venue, where such obligations are required by regulatory authorities in accordance with Union law or with national laws, regulations and administrative provisions, or by trading venues”. Therefore, Article 2(4)(c) of MiFID II establishes two alternatives of liquidity provision programmes that can be exempt from the ancillary activity calculations, one being based on requirements by regulatory authorities and the other based on requirements imposed by trading venues. Under both alternatives it is only the transactions carried out under the liquidity programme that are exempt but not the liquidity provider as a person.

When elaborating the Level 2 rules, ESMA offered one example of the circumstances in which transactions undertaken in order to fulfil liquidity obligations would be privileged, i.e. the market making requirements established by the UK energy regulator, OFGEM, which oblige large electricity suppliers to post the prices at which they buy and sell wholesale electricity on power trading platforms up to two years in advance and to trade at those prices. This is an example of an obligation required by a regulatory authority in line with applicable national rules which satisfies the conditions imposed by the first alternative described in Article 2(4)(c) of MiFID II.

Article 2(4)(c) of MiFID II uses the term “obligations to provide liquidity” as opposed to the related term market maker which is used in Article 2(1)(j)(i) of MiFID II to determine the scope of the ancillary activity exemption and which is defined in Article 4(1)(7) of MiFID II.

As a consequence, a liquidity provider under Article 2(4)(c) of MiFID II in addition to providing liquidity on a continuous basis and being willing to deal on own account against its proprietary capital has to be under genuine obligations to carry out transactions. Such obligations have to be specified in advance by the trading venue and have to be the subject of an enforceable agreement between the trading venue and the liquidity provider. The obligations a trading venue requires liquidity providers to fulfil have to be transparent to other market participants and be applied in a non-discriminatory manner.

The obligations of any liquidity provider have to go clearly beyond the activities of any ordinary market participant providing liquidity in a more general sense by simply trading on the market. The obligations should contain elements such as or comparable to quoting requirements with a maximum spread, a minimum volume, a minimum quote duration and, depending on the trading model, a maximum response time to provide quotes and a minimum participation rate. Only transactions executed under these obligations should be considered as privileged transactions.