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Additional Information

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

Topic
Multilateral and bilateral systems

Subject Matter
Organized Trading facilities OTFs

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

ESMA Answer

03-04-2017

Original language

[ESMA 70-872942901-38 MiFID II MiFIR market structures Q&A, Q&A 5.21]

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

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

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