



European Securities and
Markets Authority

Final Report

Draft Regulatory and Implementing Technical Standards MiFID II/MiFIR





European Securities and
Markets Authority

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Acronyms and definitions used

ADT	Average daily turnover
ADNA	Average daily notional amount
AIFMD	Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers (AIFMs)
Aii	Alternative instrument identifier
ANNA	Association of national numbering agencies
APA	Approved publication arrangement
AVT	Average value of transactions
BIPM	Bureau International des Poids and Mesures
CDS	Credit default swap
CESR	Committee of European Securities Regulators
CCP	Central counterparty
CFD	Contract for difference
CFI	Classification of Financial Instruments
CFTC	U.S. Commodities Futures Trading Commission
COFIA	Classes of financial instrument approach
Commission	European Commission
CP	Consultation Paper (2014/1570) published by ESMA on 19 December 2015 and its addendum (2015/319) published on 18 February 2015
CRD IV	Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC

CRR	Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012
CSD	Central securities depository
CT	Consolidated tape
CTP	Consolidated tape provider
DEA	Direct electronic access
DMA	Direct market access
DP	Discussion Paper (2014/548) published on 22 May 2014
EBA	European Banking Authority
EC	European Commission
ECB	European Central Bank
EEA	European Economic Area
EEOTC	Economically equivalent OTC contracts
EFP	Exchange for physical
EIOPA	European Insurance and Occupational Pension Authority
EMIR	European Market Infrastructures Regulation – Regulation (EU) 648/2012 of the European Parliament and Council on OTC derivatives, central counterparties and trade repositories – also referred to as “the Regulation”
EOD	End of the day
ESMA	European Securities and Markets Authority
ESMA Regulation	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
ETCs	Exchange traded commodities

ETD	Exchange-traded derivative
ETF	Exchange-traded fund
ETNs	Exchange traded notes
EU	European Union
FC	Financial counterparty
FCD	Financial Collateral Directive – Directive 2002/47/EC of the European Parliament and the Council.
FESE	Federation of European securities exchanges
FIX	Financial information exchange
FIXML	Financial information exchange markup language
FpML	Financial products markup language
FRA	Forward rate agreement
FSB	Financial Stability Board
FX	Foreign exchange
HFT	High frequency trading
ISIN	International Securities Identification Number: a 12-character alpha-numerical code that uniquely identifies a security. It is defined by ISO code 6166
IBIA	Instrument by instrument approach
ICAAP	Internal Capital Adequacy Assessment Process
IOI	Indication of interest
IOSCO	International Organisation of Securities Commissions
IPO	Initial public offering
IRS	Interest rate swap
ISO	International Organization for Standardization
ITS	Implementing Technical Standards

LEI	Legal entity identifier
LIS	Large in scale
LOI	letters of intent
MAD	Directive 2014/57/EU of the European Parliament and of the Council of 16 April 2014 on criminal sanctions for market abuse
MAR	Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation).
MIC	Market identifier code
MiFID or MiFID I	Markets in Financial Instruments Directive – Directive 2004/39/EC of the European Parliament and the Council
MiFID II	Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU
MiFIR	Regulation (EU) No 600/2014 of the European Parliament and of the Council on markets in financial instruments and amending Regulation (EU) No 648/2012
MO	Market operator
MS	Member State
MTF	Multilateral trading facility
MTN	Medium-term note
NCA	National Competent Authority
NDA	Non-disclosure agreements
NDF	Non deliverable forward
NTW	Negotiated trade waiver
OIS	Overnight index swap
OJ	The Official Journal of the European Union
OMF	Order management facility

OTC	Over-the-counter
OTF	Organised trading facility
PPRB	Person with proprietary rights to a benchmark
Q&A	Questions and Answers
RDS	Reference data system
RFQ	Request for quote
RM	Regulated market
RPO	Recovery point objective
RPW	Reference price waiver
RTO	Recovery time objective
RTS	Regulatory Technical Standards
SA	Sponsored access
SFI	Structured finance instrument
SFP	Structured finance product
SI	Systematic internaliser
SME	Small and medium sized enterprise
SME-GM	Small and medium sized enterprise – growth market
SMS	Standard market size
SMSG	Securities and Markets Stakeholder Group
SSTI	Size specific to the instrument
SREP	Supervisory Review and Evaluation Process
STP	Straight through processing
TFEU	Treaty on the Functioning of the European Union
TR	Trade repository



TREM	Transaction reporting exchange mechanism
UPI	Universal product identifier
TV	Trading venue
UCITS	Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009, on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS)
UTC	Coordinated universal time
XBRL	Extensible business reporting language

1. EXECUTIVE SUMMARY

Reasons for publication

Directive 2014/65/EU and Regulation (EU) No 600/2014 (MiFID II and MiFIR) require ESMA to develop a multitude of Regulatory Technical Standards (RTS) and Implementing Technical Standards (ITS). The package of standards subject to this report was consulted upon in a Discussion Paper (DP) published in May 2014 and two Consultation Papers (CP) published in December 2014 and February 2015. With this report ESMA publishes its final proposals for a total of 28 draft technical standards.

Contents

This final report deals with technical standards from the areas of transparency (Standards 1-5), market microstructure (Standards 6-12), data publication and access (Standards 13-16), requirements applying on and to trading venues (Standards 17-19), commodity derivatives (Standards 20 and 21), market data reporting (Standards 22-25), post-trading (Standard 26) and investor protection (Standards 27 and 28). It describes the feedback received in the public consultations and the rationale behind ESMA's final proposals.

Annexed to this final report are the draft technical standards themselves (Annex I) and the ESMA cost-benefit-analysis (Annex II).

Next Steps

The final report has been submitted to the European Commission on 28 September 2015. The Commission has three months to decide whether to endorse the technical standards.

2. TRANSPARENCY

2.1. Transparency requirements in respect of shares, depositary receipts, exchange-traded funds, certificates and other similar financial instruments

2.1.1 Pre-trade transparency for trading venues

Background/Mandate

Article 4(6) of MiFIR

1. *ESMA shall develop draft regulatory technical standards specifying the following:*
 - (a) *the range of bid and offer prices or designated market-maker quotes, and the depth of trading interest at those prices, to be made public for each class of financial instrument concerned in accordance with Article 3(1), taking into account the necessary calibration for different types of trading systems as referred to in Article 3(2);*
 - (b) *most relevant market in terms of liquidity of a financial instrument in accordance with paragraph 1(a);*
 - (c) *specific characteristics of a negotiated transaction in relation to the different ways the member or participant of a trading venue can execute such a transaction;*
 - (d) *negotiated transactions that do not contribute to price formation which avail of the waiver provided for under paragraph 1(b)(iii);*
 - (e) *the size of orders that are large in scale and the type and the minimum size of orders held in an order management facility of a trading venue pending disclosure for which pre-trade disclosure may be waived under paragraph 1 for each class of financial instrument concerned;*

I. Pre-trade information to be made public by type of trading system

1. MiFID II provides for two types of trading venues for shares, depositary receipts, exchange traded funds (ETFs), certificates and other similar financial instruments: regulated markets and multilateral trading facilities (MTFs). Under current MiFID within each of those two categories of trading venues, different types of trading systems may be operated in order to bring together buying and selling trading interests, such as quote driven systems, continuous auction order book systems and periodic auction systems.

2. ESMA, consistently with current MiFID, is of the view that the type of trading system should be the starting point for determining the appropriate level of pre-trade transparency which must be made public. In that regard Article 3(2) of MiFIR requires that “*the transparency requirements referred to in paragraph 1 shall be calibrated for different types of trading systems including order-book, quote-driven, hybrid and periodic auction trading systems*”. As a consequence and in order to ensure uniform applicable conditions between trading venues, the same pre-trade transparency requirements, calibrated according to the type of trading system operated, should apply equally to regulated markets and MTFs.
3. MiFIR empowers ESMA to calibrate the proper pre-trade transparency regime by defining the range of bid and offer prices or designated market-maker quotes, and the depth of trading interest at those prices, to be made public for each class of financial instrument concerned.
4. In the CP and based on the assumption that equity-like products are traded principally through the same trading systems as shares, ESMA proposed to calibrate the content of the pre-trade transparency requirements based on an amended version of Table 1 in Annex II of Implementing Regulation (EC) No 1287/2006 (which only applies to shares admitted to trading on a regulated market) regardless of the type of equity financial instrument traded. Furthermore, ESMA proposed to include in the table a definition of request for quote (RFQ) systems together with the pre-trade transparency requirements applicable to those systems.

Analysis following feedback from stakeholders

5. The majority of responses supported the definition of RFQ systems and the corresponding pre-trade transparency requirements. Some respondents, which in principle agreed with the proposal, suggested that RFQ systems should not be permitted to bring together buying and selling interest for equities. Instead, they suggested that this trading system should be limited to equity-like instruments. The main concern was that RFQ systems for equities will have similar levels of transparency to systems operating under the pre-trade transparency waivers, but will not be regulated as such.
6. ESMA is of the view that RFQ systems will be subject to a prescribed level of pre-trade transparency under the draft RTS, as other trading systems were under Table 1 of Annex II of Implementing Regulation (EC) No 1287/2006 and will not be able to waive pre-trade transparency like systems operating under waiver programmes.
7. There was broad support for the pre-trade transparency requirements proposed for RFQ systems, albeit some respondents suggested that publishing quotes should not be part of the definition of the trading system; instead it should be part of the transparency requirements. ESMA agrees with the comments and has modified the definition of RFQ systems accordingly in Table 1 of Annex I of the draft RTS.

8. Some respondents were of the opinion that the proposed requirements would have a detrimental effect on the quality and quantity of the quotes provided on RFQ systems, and instead proposed a range of amendments to the pre-trade transparency requirements to make the requirement workable (i.e. publishing the average bids and offers and a volume band, and giving the system operator a window period to collect the quotes before making them available). ESMA is of the view that the proposed pre-trade transparency requirements for RFQ systems should be sufficiently flexible to allow for differences between trading protocols, and to maintain the actual level of liquidity.
9. A number of respondents did not agree with the definition of hybrid systems due to the lack of clarity about the type of systems that would be caught under this category. Given the constant evolution of markets, and consequently of trading systems, ESMA proposes to retain the hybrid systems definition so as to have a category for trading systems that may develop in the future.

Proposal

10. ESMA, in line with the CP, proposes to retain the amendment to the current Table 1 in Annex II of Implementing Regulation (EC) No 1287/2006 for the purpose of establishing the content of pre-trade information that trading venues shall make public depending on the type of trading system operated, extending the requirements to actionable indication of interests (IOIs) which are, according to Article 2(1)(33) of MiFIR, messages between members or participants of a trading venues containing all the necessary information to agree to a trade.
11. ESMA also proposes to retain the definition of RFQ systems as presented in the CP with one caveat, publishing quotes will be part of the requirements instead of part of the definition. Additionally, and in order to provide further flexibility and to avoid that members or participants who are providing their quotes to the requester first are put at a disadvantage, the final draft RTS allows for the publication of all submitted quotes in response to a RFQ at the same time, i.e. once all quotes have been provided and the moment they become executable, whereas in the CP ESMA proposed that those systems should disclose all executable bids and offers the moment they are received.

II. Most relevant market in terms of liquidity

12. Under MiFIR, systems operating a trading methodology where orders are matched on the basis of a price derived from another system (the so-called reference price) can operate under a pre-trade transparency waiver provided that certain conditions are met. Firstly, the reference price must be widely published and regarded by market participants as a reliable reference price. Secondly, the set of eligible prices for matching orders within the systems operated by the trading venue is limited to the mid-point within the current bid and offer price or where not available, the opening or the closing price of the relevant session. Finally, the reference price can only be sourced from the trading venue

where that financial instrument was first admitted to trading or the most relevant market in terms of liquidity.

13. MiFIR empowers ESMA to draft regulatory technical standards specifying the most relevant market in terms of liquidity for the purpose of the reference price waiver. In the CP, ESMA noted that the concept of the most relevant market in terms of liquidity is also relevant in the context of the obligation of investment firms to report transactions under Article 26 MiFIR. However, in the CP, ESMA emphasised the different purposes of the most relevant market in terms of liquidity for transaction reporting and for pre-trade transparency and proposed to adopt two different definitions. In the CP, ESMA proposed that the most relevant market in terms of liquidity for a financial instrument should be the trading venue with the highest level of liquidity for that financial instrument measured by the total value of transactions executed by the trading venue during the relevant calendar year. ESMA also proposed, in order to strike an appropriate compromise between accuracy and operational costs, that the determination of the most relevant market in terms of liquidity would occur on an annual basis.

Analysis following feedback from stakeholders

14. While the majority of respondents were in favour of having a methodology to determine the most relevant market in terms of liquidity based on the trading venue with the highest turnover, some respondents stated that the most relevant market in terms of liquidity should only be sourced from systems that provide continuous trading, excluding auctions and RFQ systems. It was also suggested that the calculation of turnover should include transactions executed under a pre-trade transparency waiver, especially transactions executed under an order management facility. With respect to the frequency, all respondents agreed with determining the most relevant market in terms of liquidity on an annual basis.
15. Finally, a few respondents expressed concerns about how to determine the most relevant market when ETFs are dually listed in different currencies. ESMA appreciates that there might be merit in treating ETFs listed in several currencies as different financial instruments as they may have different liquidity profiles. However, the mandate of ESMA is limited here to defining the most relevant market in terms of liquidity and does not include the definition of what constitute a financial instrument.

Proposal

16. ESMA proposes that the most relevant market in terms of liquidity for a share, depositary receipt, ETF, certificate and other similar financial instrument should be the trading venue with the highest turnover for that share, depositary receipt, ETF, certificate or other similar financial instrument and regardless of the trading system (e.g. continuous trading order book, RFQ systems, etc.) under which the trading venue operates. The calculations shall take into account all relevant trading sessions (i.e. continuous and auction trading) and shall exclude reference price and negotiated transactions as well as pre-trade LIS transactions (i.e. a transaction executed on the basis of at least one order

that has benefitted from a large in scale waiver and where the transaction's size is above the applicable large in scale threshold).

III. Negotiated transactions

17. A negotiated transaction is a transaction involving one or more members or participants of a trading venue who negotiate privately the terms of the transaction which is then reported under the rules of the trading venue. For example, two members or participants bilaterally agree the price and volume of a trade before transmitting it to the trading venue. In some circumstances, the trade could not be executed under the systems operated by the trading venue (e.g. a consolidated limit order book) because of special conditions or requirements attached to the trade (e.g. portfolio trades or contingent transactions like delta-neutral equity hedges of a derivative) or because the transaction does not constitute liquidity addressable by market participants other than the counterparties negotiating the transaction (e.g. a give-up or give-in). The trading venue to which the negotiated transaction is reported remains responsible for ensuring that the negotiated transaction meets the relevant conditions for the negotiated trade and all other applicable requirements.
18. MiFIR allows, under certain circumstances, pre-trade transparency obligations to be waived for systems that formalise negotiated transactions. In particular Article 4(1) of MiFIR specifies that:

Article 4, MiFIR

1. *Competent authorities shall be able to waive the obligation for market operators and investment firms operating a trading venue to make public the information referred to in Article 3(1) for:*

[...]

(b) systems that formalise negotiated transactions which are:

- (i) made within the current volume weighted spread reflected on the order book or the quotes of the market makers of the trading venue operating that system, subject to the conditions set out in Article 5;*
- (ii) in an illiquid share, depositary receipt, ETF, certificate or other similar financial instrument that does not fall within the meaning of a liquid market and are dealt within a percentage of a suitable reference price, being a percentage and a reference price set in advance by the system operator; or*
- (iii) subject to conditions other than the current market price of that financial instrument;*

19. Under MiFIR, negotiated transactions are subject to some restrictions on admissible execution prices depending on the type of the transaction and the characteristics of the financial instrument being traded.
20. Negotiated transactions which are subject to conditions other than the current market price can be executed at any price where otherwise permitted by the rules of the trading venue.
21. Negotiated transactions which are subject to the current market price must instead comply with price conditions depending on whether or not there is a liquid market for the instrument being traded:
 - i. for liquid financial instruments, negotiated transactions must be executed within the spread - negotiated transactions falling under this limb are subject to the double volume cap mechanism as described in the relevant section of this document.
 - ii. for illiquid financial instruments, negotiated transactions can be executed at any price falling within a certain percentage of a suitable reference price, provided both the reference price and the percentage are set in advance by the system operator. In ESMA's view, this implies that operators of trading venues should set the reference price and the percentage in an objective and clear manner having regard to the nature of the market in the financial instrument and its overarching obligation to maintain fair and orderly trading.
22. With respect to negotiated transactions, MiFIR empowers ESMA to draft RTS specifying (i) the characteristics of a negotiated transaction in relation to the different ways the member or participant of a trading venue can execute such a transaction and (ii) the negotiated transactions that do not contribute to price formation which avail the waiver provided for under Article 4(1)(b)(iii) of MiFIR.

Analysis following feedback from stakeholders

23. In the CP, ESMA clarified that negotiated transactions shall be executed under the rules of a trading venue and negotiated privately by members or participants of a trading venue and that negotiated trades shall not be restricted to transactions between members or participants dealing on own account but may involve a client or clients of the member or participants. For that reason, and consistently with the existing framework for negotiated transactions under the Implementing Regulation (EC) No 1287/2006, ESMA proposed that a member or participant of a trading venue can execute such a negotiated transaction by undertaking one of the following tasks:
 - i. dealing on own account with another member or participant who acts for the account of a client;
 - ii. dealing with another member or participant, where both are executing orders on own account;

- iii. acting for the account of both the buyer and seller;
 - iv. acting for the account of the buyer, where another member or participant acts for the account of the seller; and
 - v. trading for own account against a client order.
24. Respondents to the CP were in support of maintaining the current approach (i.e. the approach adopted under Article 19 of the Implementing Regulation (EC) No 1287/2006) with regard to the different ways a member or participant of a trading venue can execute a negotiated transaction. However, a number of respondents suggested including circumstances where an investment firm is dealing on own account with another member or participant on behalf of a client, and not just for the account of a client. ESMA agrees that this is a possible characteristic of a negotiated transaction and, in order to take this concern into account, has replaced the expression “acting for the account of a client” with “acting on behalf of a client,” which should encompass all possible circumstances.
25. With regard to the negotiated transactions that do not contribute to price formation, in the CP, ESMA proposed to include a transaction that:
- i. is executed in reference to a price that is calculated over multiple time instances according to a given benchmark, such as volume-weighted average price or time-weighted average price;
 - ii. is part of a portfolio trade that involves the execution of 10 or more financial instruments from the same client and at the same time and the components of the trade are meant to be executed only as a single lot;
 - iii. is a give-up or a give-in;
 - iv. is contingent on a derivative contract having the same underlying and where all the components of the trade are meant to be executed only as a single lot; or
 - v. is contingent on technical characteristics of the transaction which are unrelated to the current market valuation of that financial instrument.
26. A large number of respondents opposed having an exhaustive list of negotiated transactions as the evolution of market practices may result in new types of transactions which need to be accommodated by the negotiated trade waiver. ESMA acknowledges the need to cater for future market developments and has added a final item in the list to provide sufficient flexibility to include new types of transactions that may develop in the future whilst providing legal clarity and a harmonized regulatory framework.
27. Furthermore, some respondents suggested that the list of transactions under Article 2 (transactions not contributing to the price discovery process for the purpose of the trading obligation for shares) and Article 6 (negotiated transactions subject to conditions

other than the current market price) of the draft RTS should be closely aligned where possible on the basis that there is no reason to exclude transactions outside the scope of Article 23 of MiFIR from the possibility of being traded under the rules of a trading venue, and thereby subjecting them to more control and surveillance, through the negotiated trade waiver.

28. Most respondents were in favour of the inclusion of non-standard/special settlement trades to the list of transactions that do not contribute to the price formation process. However, after careful consideration, ESMA remains unconvinced that the arguments brought forward during the consultation constitute sufficient legitimate reasons to consider those transactions as not contributing to the price formation process. ESMA is also concerned about the potential risk of circumvention such an inclusion would represent and, hence, has decided not to add those types of transactions to its list.
29. Lastly, during the consultation, it was brought to ESMA attention that other types of transactions should benefit from the negotiated trade waiver and be excluded from the trading obligation:
 - i. transactions carried out by a CCP or trading venue as part of its default management processes, including liquidations of securities held originally as margin or transactions in instruments to close out the positions of defaulting members; and
 - ii. transactions carried out under the rules of a trading venue, CCP or Central securities depository (CSD) to effect buy-in of unsettled transactions.
30. ESMA recognises that there is some merit in including those types of transactions to the list of transactions not contributing to the price discovery process since they are usually taking place in emergency situations that may require to have access to all possible trading channels and to trade in a non-transparent manner. For this reasons, ESMA has decided to add those specific transactions to the lists of:
 - i. transactions not contributing to the price discovery process as specified for the purposes of the trading obligation; and,
 - ii. negotiated transactions subject to conditions other than the current market price.

Proposal

31. ESMA proposes to amend the specific characteristics of a negotiated transaction in relation to the different ways a member or participant of a trading venue can execute such transaction in order to include instances when an investment firm is dealing on behalf of a client.
32. With regard to the types of negotiated transactions that do not contribute to the price formation process, ESMA proposes an exhaustive list to have a clear regulatory

framework, with the last item providing some flexibility to include types of trades that may appear in the future. The proposed list includes a transaction that:

- i. is executed in reference to a price that is calculated over multiple time instances according to a given benchmark, including transactions executed by reference to a volume-weighted average price or a time-weighted average price;
- ii. is part of a portfolio trade;
- iii. is contingent on the purchase, sale, creation or redemption of a derivative contract or other financial instrument where all the components of the trade are meant to be executed only as a single lot such as exchanges for related positions;
- iv. is executed by a management company as defined in Article 2(1)(b) of Directive 2009/65/EC or an alternative investment fund manager as defined in Article 4(1)(b) of Directive 2011/61/EU of the European Parliament and of the Council which transfers the beneficial ownership of financial instruments from one collective investment undertaking to another and where no investment firm is a party to the transaction;
- v. is a give-up or a give-in transaction;
- vi. has as its purpose the transferring of financial instruments as collateral in bilateral transactions or in the context of central counterparty (CCP) margin or collateral requirements or as part of the default management process of a CCP;
- vii. results in the delivery of financial instruments in the context of the exercise of convertible bonds, options, covered warrants or other similar financial derivative;
- viii. is a securities financing transaction;
- ix. is carried out under the rules or procedures of a trading venue, a CCP or a central securities depository to effect buy-in of unsettled transactions in accordance with Regulation (EU) No 909/2014;
- x. any other transaction equivalent to those described in points (a) to (i) and which is contingent on technical characteristics which are unrelated to the current market valuation of the financial instrument traded.

IV. Order management facility waiver

33. The order management facility waiver refers to functionalities operated by trading venues where certain orders are exempted from pre-trade transparency pending their disclosure to the market (i.e. subject to being released to an order book prior execution). In absence of more specific requirements under MiFID I, CAs and ESMA have elaborated opinions aimed at ensuring supervisory convergence on the set of

functionalities deemed to be compliant with the waiver. In accordance with those opinions, contingent orders such as reserve or iceberg orders and stop orders are currently considered orders held on an order management facility compliant with MiFID I.

34. MiFIR empowers ESMA to draft RTS specifying the type and minimum size of orders held in an order management facility.

Analysis following feedback from stakeholders

35. The vast majority of respondents agreed with ESMA's definition of the key characteristics of orders held in an order management facility, and with the minimum sizes proposed.

Proposal

36. ESMA proposes to retain the proposed definition of the relevant characteristics of orders held in an order management facility and not to restrict it to reserve and stop orders. With regard to the minimum size, ESMA maintains the proposal set in the CP that for all orders held in an order management facility, including stop orders, the minimum size should be, at the point of entry of the order, the minimum tradable quantity established by the trading venue. For reserve orders, the minimum size should be, at the point of entry and following any amendment, not smaller than EUR 10,000.

V. Large in scale waiver

37. Under MiFID I, orders that are large in scale (LIS) can benefit from a waiver from pre-trade transparency. The waiver is designed to protect large orders from adverse market impact and to avoid abrupt price movements that can cause market distortions. MiFIR recognises that mandatory public display of large orders can increase execution costs to the detriment of market liquidity and end-investors.
38. MiFIR empowers ESMA to draft RTS to specify the size of orders that are LIS compared with normal market size for each class of shares, depositary receipts, ETFs, certificates and other similar financial instruments.
39. In the CP ESMA proposed to adopt for all equity and equity-like financial instruments an approach using the average daily turnover (ADT) as a proxy for liquidity and market impact and allowing, for each financial instrument, the calibration of orders which may be considered LIS compared to the normal market size on this basis.

Shares and depositary receipts

Analysis following feedback from stakeholders

40. With respect to shares and depositary receipts, ESMA maintained in the CP the proposal made in the DP published in May 2014 and proposed to use for both shares and depositary receipts the following ADT classes and corresponding thresholds:

Table 1: Shares and depositary receipts orders large in scale compared with normal market size (as proposed in the CP)

Average daily turnover (ADT) in EUR	ADT < 100 000	100 000 ≤ ADT < 500 000	500 000 ≤ ADT < 1 000 000	1 000 000 ≤ ADT < 5 000 000	5 000 000 ≤ ADT < 25 000 000	25 000 000 ≤ ADT < 50 000 000	50 000 000 ≤ ADT < 100 000 000	ADT ≥ 100 000 000
Minimum size of orders qualifying as large in scale compared with normal market size in EUR	30 000	60 000	100 000	200 000	300 000	400 000	500 000	650 000

41. In line with the responses received to the May 2014 DP¹, responses to the CP were split reasonably evenly between those supporting the ESMA proposal and those advocating a revision of the proposal.
42. The first group of respondents agreed that the ADT remains a valid measure which has worked in the past, is easy to calculate and well understood by market participants. They pointed out that, since building upon the existing regime, the proposal was also easy to implement for market participants who have already in place appropriate systems and procedures.
43. The second group of responses reiterated the arguments put forward in the responses to the DP against the use of the ADT which is viewed as a too simplistic measure of liquidity and market impact and proposed using different measures to substitute or to complement the ADT, such as the average value of transactions (AVT) or the depth of the order book. Some respondents also noted that the proposed yearly calculation fails to take into consideration the erratic variation of liquidity.
44. In concordance with the CP proposal, ESMA appreciates that approaches different from the proposed one based on the ADT are possible. However, it remains convinced that any approach has different pros and cons and that, for instance, the approaches based on order book data would be significantly more complex to use in practice. In ESMA's views, while the ADT may not provide the best metric on which to establish the LIS threshold in all circumstances, it is a reliable metric positively correlated with liquidity which, from an operational perspective, can be collected and processed in a relatively simple way. Therefore, ESMA considers that the rationale provided in the CP supporting

¹ ESMA/2014/548.

the use of ADT is still valid and has decided to maintain its initial proposal to use ADT as a proxy.

45. Similarly to the responses received to the DP, respondents expressed concerns about the proposed thresholds for each class of ADT and in particular for less liquid shares (which often are shares issued by small and medium enterprises). In their views, the proposed thresholds would fail to capture a sufficient proportion of the orders as LIS and would entail very high trading costs in particular for the smallest ADT class (according to some responses, transaction costs might reach up to 200 bps for the class below EUR 100,000). ESMA appreciates those concerns and agrees that it is important that LIS thresholds are appropriate and in particular for less liquid shares such as SME shares. ESMA notes that, in the CP's proposal, the greater level of granularity and the new ADT categories (and related thresholds) which have been added to the current MiFID I regime partially addressed those concerns. It is worth noting in this respect that under MiFID I the threshold for the shares with an ADT lower than EUR 100,000 (and up to EUR 500,000 EUR) is EUR 50,000 whereas under the proposed regime it was set at EUR 30,000.
46. However, ESMA appreciates that there is some merit in introducing further granularity into the system in order to better take into consideration the less liquid shares such as SME shares. Therefore, in its final table, ESMA has added a new ADT category for shares with an ADT of less than EUR 50,000 with a corresponding threshold of EUR 15,000. The thresholds for deferred publication have also been modified on that basis.
47. Finally, some respondents asked for further clarification with respect to the transactions that should be taken into consideration for the ADT calculations, supporting a broad approach in this respect, i.e. the inclusion of lit, dark and OTC transactions. ESMA confirms that the ADT calculations should include all transactions executed in the relevant financial instrument, regardless whether they are traded on- or off-venue.

Proposal

48. In respect of shares and depositary receipts, ESMA reiterates its proposal to use the ADT as the relevant metric to establish orders that are large in scale. However, the table presented in the CP has been slightly amended and a new ADT category for shares with an ADT below EUR 50,000 has been added.

Table 2: Shares and depositary receipts orders large in scale compared with normal market size (as proposed in the final draft RTS)

Average daily turnover (ADT) in EUR	ADT < 50 000	50 000 ≤ ADT < 100 000	100 000 ≤ ADT < 500 000	500 000 ≤ ADT < 1 000 000	1 000 000 ≤ ADT < 5 000 000	5 000 000 ≤ ADT < 25 000 000	25 000 000 ≤ ADT < 50 000 000	50 000 000 ≤ ADT < 100 000 000	ADT ≥ 100 000 000
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Minimum size of orders qualifying as large in scale compared with normal market size in EUR	15 000	30 000	60 000	100 000	200 000	300 000	400 000	500 000	650 000
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49. ESMA also proposes to maintain the current recalibration frequency where the ADT of each financial instrument is determined on an annual basis.

ETFs

50. The large in scale regime for ETFs proposed in the CP was similar to the one for shares and depositary receipts in that the LIS thresholds would increase with the ADT of the financial instrument. However, following feedback received to the DP, ESMA also sought views in the CP on an alternative option under which a single large in scale threshold (EUR 1,000,000) would apply to all ETFs regardless of their liquidity or the liquidity of their underlying.

Analysis following feedback from stakeholders

51. Similarly to the feedback received on the post-trade deferrals, respondents rejected almost unanimously an LIS regime based on ADT and agreed with the alternative option to adopt a single large in scale threshold for ETFs that will apply across the board. In line with the comments on the DP received in May 2014, respondents stressed the unsuitability of the ADT as a measure of liquidity and market impact for ETFs, arguing for instance that ADT would not capture the actual liquidity of ETFs where the creation/redemption mechanism inherent to ETFs allows liquidity providers to access additional, non-displayed liquidity. They also noted that an ADT-based approach could result in having two ETFs with the same underlying assets being treated differently.

52. With respect to the threshold to be set, the vast majority of respondents supported the EUR 1,000,000 threshold proposed by ESMA in the CP which is thus maintained as the final proposal.

53. It is worth noting that some respondents recommended ESMA to differentiate between ETFs for which the creation/redemption process occurs just after the closing auction and those for which the creation/redemption process occurs at least 3 hours after the closing auction (e.g. ETFs which have an underlying trading in a different time zone - e.g. European ETF on Malaysian stock). However, ESMA believes that such a differentiation would bring too much complexity into the system and thus maintains its proposal to adopt a single threshold for all ETFs.

Proposal

54. ESMA proposes to establish a single EUR 1,000,000 LIS threshold for all ETFs regardless of their underlying or their liquidity.

Certificates

Analysis following feedback from stakeholders

55. Certificates are defined by MiFIR as transferable securities which are negotiable on the capital market and which, in case of repayment of investment by the issuers, are ranked above shares but below unsecured bond instruments and other similar financial instruments. ESMA identified two types of financial instruments traded in the Union that would be considered certificates under the above definition: Spanish Participaciones Preferentes and German Genussscheine.

56. For the DP, ESMA collected data on the trading of those instruments and proposed two possible scenarios based on a different classification of the ADT but did not advance any proposal for LIS thresholds. Based on feedback to the DP, ESMA proposed in the CP to establish a very simple regime for LIS orders for certificates with only two ADT classes and LIS thresholds. As for the other instruments, ESMA proposed to determine the ADT of each instrument on an annual basis.

57. ESMA received limited feedback on certificates, probably related to the fact that those financial instruments are available in very few jurisdictions. Some respondents highlighted that where a certificate is economically equivalent to a share issued from the same issuer, the calibration of the classes and the LIS thresholds should follow those applicable to shares. On the contrary, where the certificate is a distinct instrument (i.e. with different payoffs from the shares issued by the same issuer), then the LIS threshold should be calibrated based on its own liquidity features.

58. During the consultation, ESMA also received feedback suggesting including additional instruments in this category and in particular Rabobank-certificates. As stated in the advice to the Commission with respect to liquidity thresholds for equity instruments, ESMA believes that those instruments should indeed fall into the certificate category.

Proposal

59. ESMA remains of the view that certificates have different payoffs from shares and are hence separate financial instruments which ought to be subject to a different transparency regime. ESMA has decided to maintain the table presented in the CP and which is reproduced below.

Table 3: Certificates orders large in scale compared with normal market size

Average daily turnover (ADT) in EUR	ADT < 50 000	ADT ≥ 50 000

Minimum size of orders qualifying as large in scale compared with normal market size in EUR	15 000	30 000
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Stubs

Analysis following feedback from stakeholders

60. A stub usually refers to the remainder of an order (i.e. a limit order that is not immediately executed under prevailing market conditions) that was LIS at the time it was submitted to a trading venue and that was partially executed. Following partial execution, the order may fall below the relevant LIS threshold. In such circumstances it is not clear whether the LIS waiver continues to apply to the stub and, hence, whether the order has to be made transparent if and when remaining on the order book.
61. In the DP, ESMA evaluated the pros and cons of requiring stubs to meet the relevant LIS threshold following partial execution to continue to be eligible to the LIS waiver. On the one hand, ESMA considered that allowing stubs to remain protected under the LIS waiver would result in a more consistent treatment of the whole order, greater protection for large orders and greater incentive to execute transaction on order books and ultimately in better quality of execution. On the other hand, requiring stubs to be made transparent when falling below the relevant threshold was considered as conducive to greater transparency and consistent with an approach where similar sized orders are, *ceteris paribus*, subject to equivalent transparency requirements. As a compromise, ESMA's proposal in the DP was to require stubs to be made transparent only when, following partial execution, the size of the stub would fall below 75% of the relevant LIS threshold.
62. Overall, respondents to the DP did not support ESMA's proposal to make stub orders transparent when falling below a certain level below the LIS threshold and supported an approach where stubs would remain protected under the LIS waiver. The main reasons were that the proposed approach would hinder investors' ability to execute large orders through order books by revealing sensitive information to the market and would be too complex and difficult to implement and, hence, would be disproportionate to the marginal benefits.
63. ESMA therefore proposed in the CP to clarify that LIS orders may remain protected under the LIS waiver regime even when, following partial execution, they fall below the relevant LIS threshold provided that the price or other relevant conditions for execution are not amended following execution.
64. The majority of the respondents agreed with the new proposal. A few respondents were in favour of having stubs transparent. However, ESMA remains of the view that subjecting stubs to transparency is difficult to implement and the costs of such an approach would be disproportionate to the benefits.

Proposal



65. ESMA has therefore retained the approach proposed in the CP.

2.1.2 Pre-trade transparency for investment firms in respect of equity and equity-like financial instruments

Background/Mandate

Article 14(7) of MiFIR

7. *In order to ensure the efficient valuation of shares, depositary receipts, ETFs, certificates and other similar financial instruments and maximise the possibility of investment firms to obtain the best deal for their clients, ESMA shall develop draft regulatory technical standards to specify further the arrangements for the publication of a firm quote as referred to in paragraph 1, the determination of whether prices reflect prevailing market conditions as referred to in paragraph 3, and of the standard market size as referred to in paragraphs 2 and 4.*

I. Arrangements for the publication of a firm quote

66. SIs are required to publish firm quotes in respect of equity and equity-like instruments traded on a trading venue for which there is a liquid market, when dealing below standard market size (SMS). MiFIR already specifies or delegates through implementing measures various aspects of the obligation to make those quotes public. Those aspects include, among other things, the means by which a quote is made public such as the facilities of any regulated market that has admitted the financial instrument to trading, an approved publication arrangement (APA) or through proprietary arrangements.

Analysis following feedback from stakeholders

67. The vast majority of respondents agreed with ESMA's proposal to require SIs to adopt arrangements for the publication which ensure that the information is sufficiently reliable and free of errors, that the information is capable of being consolidated with other similar data from other sources and that it is made available to market participants on a non-discriminatory basis. Additionally, there was broad support for requiring SIs to make public the time quotes are entered or updated, supporting the two objectives of this provision:

- i. A timestamp assigned by the SI might help to ensure its quotes are firm and reliable by improving the audit chain of the publication to the benefit of market participants. It aims at avoiding potential disputes that may arise when a quote is changed close to the time a client order is entered and when, due to this change the client order fails to match the new systematic internaliser's quote. The risk is particularly serious when SIs use a website (which is allowed as a proprietary arrangement according to

Article 17(3)a of MiFIR) as the publication of quotes may suffer from the website page slowing down and displaying outdated quotes.

- ii. Moreover, the inclusion of the timestamp in the pre-trade information published by the SI is a key information for the client to better analyse ex-post the quality of prices quoted by SIs, and in particular to assess with accuracy the responsiveness of the SI and the validity periods of quotes. Without a timestamp assigned by the SI itself, market participants would need to rely on the information potentially provided by data vendors, the timestamps of which would be less accurate, especially when quotes are published through a website as pointed out by some respondents to the question on access to the quotes of SIs.

Proposal

68. Given the broad support from the respondents, ESMA is maintaining the proposal to adopt arrangements for the publication which ensure that the information is sufficiently reliable and free of errors, that the information is capable of being consolidated with other similar data from other sources and that it is made available to market participants on a non-discriminatory basis. Moreover, SIs will be required to timestamp their quotes.

II. Quotes reflecting prevailing market conditions

69. Under Article 14(3) of MiFIR the prices published by SIs in accordance with Article 14(1) of MiFIR must reflect the '*prevailing market conditions*' for each financial instrument for which the investment firm is a SI. However, Article 15(2) of MiFIR permits SIs '*in justified cases*' to execute orders at a better price than those quoted at the time of reception of the order, '*provided that this price falls within a public range close to market conditions*'.

Analysis following feedback from stakeholders

70. Most respondents agreed to maintain the existing definition of prevailing market condition of Article 24 of the Implementing Regulation (EC) No 1287/2006, according to which a quote or quotes reflect prevailing market conditions when they are close in price to comparable quotes for the same share on other trading venues. However, some respondents expressed concerns that SIs are not required to meet tick size requirements, which can create regulatory arbitrage. ESMA notes that although it appreciates the concern, it has no empowerment under Level 1 to mitigate this risk.
71. Other comments received by ESMA considered that the definition was too vague and thus subject to diverging interpretations. ESMA appreciates the concern and shares the view that a more specific provision will provide more legal certainty and facilitate harmonised application across the Union. To this end, ESMA has slightly modified its original proposal so as to provide further clarity by specifying the benchmark (most relevant market) and other elements of the comparability (time and the size elements) rather than simply referring to "other trading venues".

Proposal

72. ESMA has slightly amended the definition proposed in the CP. Under this revised provision, a price reflects prevailing market conditions if it is close in price to quotes of equivalent sizes for the same financial instrument on the most relevant market in terms of liquidity for that financial instrument at the time of publication.

III. Standard market size

73. A key aspect of the SI regime is the concept of the SMS. MiFIR requires SIs to comply with pre-trade transparency requirements when dealing in sizes up to the SMS and to make public quotes - a firm bid and a firm offer – for sizes of at least 10% of the SMS for the share, depositary receipt, ETF or certificate for which they are SIs.

74. Article 14(4) of MiFIR requires shares, depositary receipts, ETFs and certificates to be grouped together in classes on the basis of the arithmetic average value of the orders executed in the market for that financial instrument. The SMS must be of a size representative of the arithmetic average value of the orders executed in the market for the financial instruments included in each class.

Analysis following feedback from stakeholders

75. On the basis of the responses to the DP and with the objective of maintaining and enhancing transparency, ESMA proposed in the CP to establish equivalent classes by AVT for financial instruments with an AVT larger than €20,000. The SMS for the class with an AVT between 0 and €20,000 would be €10,000, the SMS for the next class (€20,000 - €40,000) would be €30,000 and so forth. ESMA also favoured a recalculation of the AVT for each financial instrument on an annual basis. In other words, ESMA proposed to amend the SMS under current MiFID I and to group the two smallest classes into a single class for shares with an AVT between zero and €20,000 and set a SMS of €10,000.

76. To recall, this corresponded to the second of the three options presented by ESMA in its DP, which were;

- i. Option 1: maintain the existing classes while lowering the SMS for the smallest class by AVT from €7,500 to €5,000;
- ii. Option 2: group the two smallest classes into a single class for shares with an AVT between zero and €20,000 and set an SMS of €10,000; or
- iii. Option 3: maintain the current classes and SMSs for each class as under Table 3 of Annex II of the Implementing Regulation (EC) No 1287/2006 (status quo option).

77. A slight majority of respondents disagreed with the ESMA proposal. However, within those respondents, half of them advocated for lower SMS whereas the other half was on

the contrary in favour of a more stringent regime. The arguments put forward included the following:

- i. Those supporting lower SMSs stressed that, as showed in the DP, around 95% of all trades have a volume of up to EUR 10,000. The introduction of a class with an AVT of up to EUR 20,000 and an SMS of EUR 10,000 as proposed by ESMA would hence result in almost every trade falling below the SMS. Whilst this would lead to increased transparency this must be, in the respondents' view, weighed against the protection of SIs against unreasonable risks. For them, the right equilibrium cannot be achieved if nearly all trades are below the SMS.

In this regard, ESMA would like to stress that, as already highlighted in the DP, it is vital to further reinforce the objective of increased transparency for SIs through well-targeted implementing measures. However, ESMA is unconvinced that the reduction in the average size of transaction necessarily reflects greater market risk for SIs.

- ii. Those supporting higher SMS thresholds stressed in particular that it is crucial to avoid creating significantly less rigorous transparency regime for SIs compared to the one generally enforced by trading venues in respect to market makers. Some suggested an alignment of the quantitative thresholds between SIs (SMS thresholds) and trading venues (LIS threshold). In their view, the methodology for the calculation should be changed, with ADT also applied to the SI instead of AVT. For them, the weakness of the AVT approach is simply that as liquidity increases for a specific share, the average size of transaction usually tends to decrease, resulting in lower SMS threshold for that share above which one can trade in the dark, which is completely counter-intuitive.

ESMA notes that MiFIR defines how the SMS should be calculated for shares and equity-like instruments and that that size shall reflect the average size of transaction for each class of financial instruments.

78. More generally, ESMA appreciates the concern raised by certain respondents with regard to the unintended consequences that a significant misalignment of the respective transparency regimes for trading venues and SIs could have. Respondents noted in this respect that SIs do not truly contribute to price formation. Due to the volume caps that will apply to dark trading on trading venues and to the trading obligation for shares, SIs might become an increasingly attractive option for accommodating current trading activity. In order to address such a development, which would go against the Level 1 framework objective to foster transparency, a key point for regulators and policymakers should be to ensure the bilateral nature of SI activity.
79. According to those respondents, some recitals in MiFID II/MiFIR may be used by market participants to argue that riskless counterparty trading can be undertaken by SIs, thus providing an alternative home for current OTC broker crossing business. Such a development, combined with the relatively light transparency regime applied to SIs (especially when compared to functionally equivalent market makers on multilateral

trading venues) together with their new ability to provide price improvement under MIFID II, would effectively see the re-introduction of an organised trading facility (OTF) category within the equity space. This is because, if ultimately allowed for the SI, riskless principal trading would de facto enable the matching of two client orders by interposing the SI own account between them for a fraction of time, i.e. taking very limited market/counterparty risk.

80. ESMA believes that this would indeed go against the political, technical and legal agreement underpinning the Level 1 text. It is worth noting that ESMA has acknowledged this is an issue and raised it in its December 2014 Technical Advice to the Commission but ESMA cannot provide further clarity in the final draft RTS as it has no relevant empowerment to do so.

Proposal

81. After careful consideration, ESMA has decided to maintain the proposal presented in the CP which represents the best possible compromise between those requesting more stringent thresholds and those advocating for a more accommodating regime for SIs. The proposal is summarised in the table below.

Table 4: Standard market size

Average value of transactions (AVT) in EUR	AVT < 20 000	20 000 ≤ AVT < 40 000	40 000 ≤ AVT < 60 000	60 000 ≤ AVT < 80 000	80 000 ≤ AVT < 100 000	100 000 ≤ AVT < 120 000	120 000 ≤ AVT < 140 000	Etc.
Standard market size	10 000	30 000	50 000	70 000	90 000	110 000	130 000	Etc.

82. In order to ensure consistent implementation in the Union, the methodology to be used for calculating the average value of transactions has been specified in the final draft RTS which also clarifies that calculations should take into consideration all transactions executed in the Union whether executed on or outside a trading venue excluding reference price, negotiated and post-trade LIS transactions. In that context, post-trade LIS transactions are transactions for which deferred publication is permitted or, in other words, the smallest threshold for each ADT class set out in table 4 of Annex II of the final draft RTS.

2.1.3 Trading obligation for shares

I. Transaction in shares that do not contribute to the price discovery process

Background/Mandate

Article 23(3) of MiFIR

3. ESMA shall develop draft regulatory technical standards to specify the particular characteristics of those transactions in shares that do not contribute to the price discovery process as referred to in paragraph 1, taking into consideration cases such as:

- (a) non-addressable liquidity transactions; or
- (b) where the exchange of such financial instruments is determined by factors other than the current market valuation of the financial instrument.

ESMA shall submit those draft regulatory technical standards to the Commission by 3 July 2015.

Power is delegated to the Commission to adopt the regulatory technical standards referred to in the first subparagraph in accordance with Articles 10 to 14 of Regulation (EU) No 1095/2010.

83. In the DP, ESMA consulted on the interpretation of the first exemption from the trading obligation (non-systematic, ad-hoc, irregular and infrequent), on the content of the proposed list of types of transactions not contributing to the price formation process and on whether the list should be exhaustive as well as whether benchmark and portfolio trades should be considered as transactions determined by factors other than the current market valuation of the financial instrument.
84. Many respondents generally agreed with ESMA that the exemption under Article 23 of MiFIR requires greater clarity as its application raises a number of relevant issues for a variety of market participants including investment firms and institutional investors such as asset managers.
85. In the DP, amongst the topics that would benefit from further clarity, the following issues were mentioned: (i) the link with the concept of frequent and substantial activity under the SI definition, (ii) the treatment of riskless principal transactions and (iii) the arrangements to allocate shares to final investors or other specific types of transactions or distribution procedures.

86. Lastly, most of respondents disagreed with ESMA's proposal to establish an exhaustive list. However ESMA remains in favour of maintaining an exhaustive list since this will deliver a clearer and more harmonised regulatory framework in the Union.

Analysis following feedback from stakeholders

87. In the CP, ESMA requested views on the proposed list of transactions not contributing to the price discovery process and, again, about its exhaustive character. A majority of respondents supported the proposal but some of them asked for clarifications or provided some drafting suggestions.
88. Responses received indicate that there are still certain areas apart from the ones highlighted in the DP where further guidance would be necessary. However, ESMA notes that this is mainly due to the limitation of the mandate to determine transactions not contributing to the price formation process. Various stakeholders requested more clarity about concepts that are out of the scope of the ESMA mandate. Nevertheless, should this be necessary, ESMA may consider developing further guidance in order to provide market stakeholders with more clarity and assist CAs in their supervisory duties.
89. In order to ensure consistent interpretations, ESMA has also adopted an approach where the list of transactions not contributing to the price discovery process has been established based on the attributes of the transactions rather than using market terminology (e.g. benchmark transaction). However, a number of respondents repeatedly requested clarification about whether exchange for physical transactions (EFPs) or exchanges for depositary receipts were included, about inter funds transfers or the treatment of non-segregated collateral. ESMA has taken into consideration those comments and has proposed an improved drafting accordingly.
90. A significant number of respondents pointed out the need for alignment of the different type of transactions that do not contribute to the price formation process under the different mandates such as the technical advice to the Commission on the definition of SI, the negotiated trade waiver and the trading obligation for shares. ESMA acknowledges the need for consistency and has aligned the definitions to the extent possible.
91. Views were divided about the exhaustive character of the list of transactions. The supportive respondents expressed a concern of a possible circumvention whereas those in favour of a non-exhaustive list claimed for the need of adding new types of transactions which might appear depending on market evolution. It should be noted that they did not provide any concrete example in this regard though. Taking into account all these elements and the ultimate regulatory goal, ESMA maintains the current proposal with some amendments aiming at mitigating the concerns and providing additional clarity.
92. In particular, it is worth noting that, as opposed to the list of negotiated transactions that do not contribute to the price formation, ESMA has decided here not to add an item that

provides a certain degree of flexibility and facilitate the inclusion of the potential new types of transactions that may develop in the future. With regard to the trading obligation, the exemption is indeed automatic and does not require any prior authorisation whereas in the case of negotiated transactions the granting of the exemption is subject to a assessment process through ESMA. There is hence some benefit in implementing the trading obligation exemption more narrowly.

Proposal

93. With regard to the particular characteristics of those transactions in shares that do not contribute to the price discovery process, ESMA proposes the following types of transactions to be included:

- i. the transaction is executed by reference to a price that is calculated over multiple time instances according to a given benchmark, including transactions executed by reference to a volume-weighted average price or a time-weighted average price;
- ii. the transaction is part of a portfolio trade which includes five or more different shares;
- iii. the transaction is contingent on the purchase, sale, creation or redemption of a derivative contract or other financial instrument where all the components of the trade are to be executed only as a single lot such as exchanges for related positions;
- iv. the transaction is executed by a management company as defined in Article 2(1)(b) of Directive 2009/65/EC or an alternative investment fund manager as defined in Article 4(1)(b) of Directive 2011/61/EU which transfers the beneficial ownership of shares from one collective investment undertaking to another and where no investment firm is a party to the transaction;
- v. the transaction is a give-up or a give-in transaction;
- vi. the transaction has as its purpose the transferring of shares as collateral in bilateral transactions or in the context of CCP margin or collateral requirements or as part of the default management process of a CCP;
- vii. the transaction results in the delivery of shares in the context of the exercise of convertible bonds, options, covered warrants or other similar derivatives;
- viii. the transaction is a securities financing transaction;
- ix. the transaction is carried out under the rules or procedures of a trading venue, a CCP or a central securities depository to effect a buy-in of unsettled transactions in accordance with Regulation (EU) No 909/2014 of the European Parliament and of the Council.

2.1.4 Post-trade transparency for trading venues and investment firms

Background/Mandate

Article 7(2) of MiFIR

2. ESMA shall develop draft regulatory technical standards to specify the following in such a way as to enable the publication of information required under Article 64 of Directive 2014/65/EU:

- (a) the details of transactions that investment firms, including systematic internalisers and market operators and investment firms operating a trading venue shall make available to the public for each class of financial instrument concerned in accordance with Article 6(1), as published under Article 6(1) and Article 20, distinguishing between those determined by factors linked primarily to the valuation of the financial instruments and those determined by other factors;
- (b) the time limit that would be deemed in compliance with the obligation to publish as close to real time as possible including when trades are executed outside ordinary trading hours.
- (c) the conditions for authorising investment firms, including systematic internalisers and market operators and investment firms operating a trading venue to provide for deferred publication of the details of transactions for each class of financial instruments concerned in accordance with paragraph 1 of this Article and with Article 20(1);
- (d) the criteria to be applied when deciding the transactions for which, due to their size or the type, including liquidity profile of the share, depositary receipt, ETF, certificate or other similar financial instrument involved, deferred publication is allowed for each class of financial instrument concerned.

Article 20(3), MiFIR

3. ESMA shall develop draft regulatory technical standards to specify the following:

- (a) identifiers for the different types of transactions published under this Article, distinguishing between those determined by factors linked primarily to the valuation of the financial instruments and those determined by other factors;
- (b) the application of the obligation under paragraph 1 to transactions involving the use of those financial instruments for collateral, lending or other purposes where the exchange of financial instruments is determined by factors other than the current market valuation of the financial instrument;

(c) the party to a transaction that has to make the transaction public in accordance with paragraph 1 if both parties to the transaction are investment firms.

94. ESMA is required to draft RTS implementing the new post-trade transparency regime for equity and equity-like instruments. Those measures include the content and timing of the information to be made public, the identifiers for different types of transactions, the criteria and conditions for the deferred publication of transactions and, for OTC transactions, the application of post-trade transparency obligations in respect of transactions involving the use of equity and equity-like instruments for collateral, lending or other purposes where the exchange of financial instruments is determined by factors other than the current market valuation of the financial instrument.

I. Content of the information to be made public

Analysis following feedback from stakeholders

95. In the CP, ESMA was of the view that the content of the information currently required to be published for shares admitted to trading on a regulated market was still valid and applicable to all equity and equity-like instruments. The information that ESMA proposed to be made public in respect of transactions in shares, depositary receipts, ETFs, certificates and other similar financial instruments included the date and time of the transaction, the instrument identifier, the price and price notation, the quantity and the venue identifier.

96. Respondents were mostly in favour of maintaining the current regime for shares and to extending it to all equity and equity-like instruments. In the CP, many respondents reiterated their support to the Market Model Typology developed by a number of market participants, including trading venues, aiming at improving the standardisation and content of post-trade information in Europe. ESMA agrees that the Market Model Typology is a valuable initiative, and it has considered the various flags proposed in the context of the identifiers for on-venue and OTC transactions. However, ESMA has to develop a flag regime that meets the specific requirements of MiFIR.

97. A few respondents were worried that the information under MiFIR post-trade transparency may be inconsistent with EMIR requirements. Considering EMIR and MiFIR have quite a different scope of application, ESMA believes the risk of inconsistency between the two sets of obligations, especially for equities, is rather limited.

98. A larger number of respondents supported the addition of a trade identifier code which would help following the execution chain, some stressing that a trade identifier code would support the uniqueness of trade identification. ESMA is of the opinion that a unique trade identifier would be valuable information to be added to the information to be published post-trade. Additionally, respondents largely supported the inclusion of the date and time of publication among the required fields.

99. Finally, based on the consultation feedback, ESMA believes it is necessary to publish post-trade the venue of publication in order to identify the trading venue, APA or consolidated tape provider (CTP) publishing the transaction.

Proposal

100. ESMA, in line with the CP, proposes to require investment firms and trading venues to publish the following information in respect of transactions executed by them or under their rules:

- i. Trading date and time;
- ii. Instrument identification code;
- iii. Unit price;
- iv. Price currency;
- v. Quantity;
- vi. Venue of execution;
- vii. OTC trading;
- viii. Publication date and time;
- ix. Venue of Publication;
- x. Transaction identification code.

101. In order to ensure that the information to be made available to the public for the purpose of post-trade transparency is operational and meaningful for the interested stakeholders, a common format for provision of such information needs to be defined. Additionally, due to the fact that trading venues which are subset of entities subject to post-trade transparency requirements are obliged at the same time to report financial instrument reference data as per RTS 23, and an overlap exists between the data to be provided under both requirements, alignment of the formats for relevant data has been considered reasonable and beneficial.

102. The formats to be applied for the post-trade reports are therefore consistent with the ISO 20022, which has been chosen as most suitable for the purpose of reference data reporting under MiFIR Art. 27. ISO 20022 is a standardisation methodology which sets out guidelines, principles and formats that should be followed in the development of a common formal notation to describe financial processes.

103. The alignment with the formats used for reference data (and thus, with ISO 20022 methodology) concerns only the way the information is represented, for example the

same codes are used to represent the same values. It does not affect the data requirements themselves nor the means of their collection or publishing (for example, no specific technical format, like XML, is required for the publication of data). In practical terms, it means that the additional burden resulting from the alignment is limited to the transformation of the data so that they are represented in a standard way, thus it can be considered marginal.

II. Identifiers

104. The main purpose of identifiers is to complement the information content of post-trade reports by disclosing the technical characteristics of a transaction or the particular circumstances under which a transaction has occurred (such as a transaction executed under a pre-trade transparency waiver or which is subject to conditions other than the current market price). Identifiers hence improve price formation in the market and support achieving and monitoring best execution.
105. Under current MiFID trading venues and investment firms are already required to make public additional information in the form of flags when a transaction is determined by factors other than the current market price, in the case of negotiated transactions and following any amendment of previously disclosed information.

Analysis following feedback from stakeholders

106. In the CP, ESMA proposed a list of flags on the basis of the DP and the previous work done by the Committee of European Securities Regulators (CESR) in its technical advice to the Commission on post-trade transparency standards (CESR/10-882). ESMA suggested enhancing this list to take into consideration the new transparency requirements imposed by MiFID II and in particular the implementation of the volume cap mechanism under Article 5 of MiFIR and the trading obligation for shares under Article 23 of MiFIR.
107. ESMA received a large number of responses which were generally supportive of the greater granularity proposed by ESMA.
108. A number of respondents pointed out the possible inconsistency or overlap between “G” and “T” flags which both relate to non-price forming trades. ESMA appreciates that the distinction between the two flags was not sufficiently clear and needs to be further clarified. Confusion is in particular due to the fact that several provisions in the RTS relate to similar concepts:
- i. Transactions not contributing to the price discovery process and which are not covered by the trading obligation for investment firms as set out under Article 23;
 - ii. Transactions where the exchange of financial instruments is determined by factors other than the current market valuation of the financial instrument and which are

excluded from the post-trade reporting obligations when traded OTC (Article 20(3)(b) of MiFIR); and

- iii. Negotiated transactions which are subject to conditions other than the current market price (Article 4(1)(b)(iii) of MiFIR).

109. Although the three lists above are referring to similar transactions, they do not cover the exact same range of transactions. Hence, in ESMA's view, it remains appropriate to affect a specific flag to each of those types of transactions. This should allow the market stakeholders to be adequately informed about the nature of a published transaction and should ensure accurate monitoring and supervision of the practical implementation of those provisions.

110. Other respondents were concerned that introducing an identifier for orders that are LIS for the purpose of the pre-trade transparency waiver under Article 4(1)(c) of MiFIR would expose them to the rest of the market (e.g. in case of partial execution) and discourage the execution of large orders through central order books. ESMA appreciates the concern raised and the flag on pre-trade LIS waiver has been deleted.

111. However, identifying non pre-trade transparent transactions remains necessary for ESMA's monitoring role (Article 52 of MiFIR) and for transparency calculations. Trading venues should therefore keep record of information about the transaction executed on their venue regardless of whether the information has been subject to a specific post-trade flagging or not.

112. There was some opposition to the inclusion of an algorithmic trading flag. Nevertheless, the need to include such identifier derives from Article 65(1)(h) of MiFID II where CTPs are required, where applicable, to collect and consolidate information about the fact that a computer algorithm was responsible for the investment firm decision and execution of the transaction. As consequence, ESMA maintains its proposal.

Proposal

113. ESMA has reviewed the list of identifiers following responses to the CP and is proposing to require the following flags to be included in post-trade reports:

- i. Benchmark transactions;
- ii. Agency cross transactions;
- iii. Non-price forming transactions which are excluded from the post-trade reporting obligations when traded OTC;
- iv. Transaction not contributing to the price discovery process for the purposes of Article 23 of Regulation (EU) No 600/2014 and as set out in Article 2

- v. Special dividend transactions;
 - vi. Post-trade large in scale transactions;
 - vii. Reference price transactions;
 - viii. Negotiated transactions in liquid financial instruments;
 - ix. Negotiated transactions in illiquid financial instruments;
 - x. Negotiated transactions subject to conditions other than the current market price;
 - xi. Algorithmic transactions;
 - xii. Transactions above the SMS;
 - xiii. Transactions in illiquid instruments;
 - xiv. Transactions which have received price improvement;
 - xv. Cancellations;
 - xvi. Amendments;
 - xvii. Duplicative trade reports.
114. With regard to flags, it should also be stressed that the flags to be used have been modified in order to comply with ISO 20022 standard (please see the section above on the content of the information to be made public). In practice, this means that the flags are now composed of 4 letters instead of one as initially proposed in the CP.

III. Timing

115. MiFIR empowers ESMA to establish draft RTS on the time limits that would be in compliance with the obligation to publish the details of a transaction as close to real time as possible, including when a transaction is executed outside normal trading hours.
116. Under MiFID I, post-trade information relating to transactions taking place on trading venues and within normal trading hours must be reported as close to real time as possible and in any case within three minutes of the relevant transaction. When a transaction occurs under the rules of a trading venue but outside normal trading hours (e.g. a negotiated transaction executed outside the systems operated by the trading venue to bring together buying and selling trading interest) the publication requirement is deemed to be complied with when the transaction is made public before the opening of the next trading day of the trading venue on which the transaction takes place (e.g. a trade occurring late in the evening must be published before the beginning of the trading day the following day). For transactions executed outside a trading venue (including

those executed under the systems of a SI) the time limits are set in respect of the trading day of the most relevant market in terms of liquidity or during the investment firm's normal trading hours.

117. In the CP, ESMA consulted on the definition of normal trading hours and on the maximum permissible delay of the publication of executed transactions. In line with the DP and with the previous CESR technical advice to the Commission on equity markets (CESR/10-208), ESMA proposed that, in order to improve the quality of post-trade information and the overall market transparency, the maximum permissible delay should be shortened to one minute after the relevant transaction for equity and equity-like instruments. Finally ESMA also consulted on whether different delays should be permissible depending on the type transaction.

Analysis following feedback from stakeholders

118. Respondents expressed support for ESMA's proposal to consider that the market opening hours as published by the market operator should be considered as normal trading hours. However, a number of market participants had different views in respect of whether the ordinary hours shall include the opening and closing auctions which, in most markets and for most securities, set the start and the end of the trading day. ESMA is of the view that periodic auctions are systems that significantly contribute to the price discovery process (as market participants are able to execute larger than average transactions at a price which is generally considered reliable). For that reason, ESMA considers it important that normal trading hours for a trading venue include the phases during which an instrument is in a periodic auction in order to allow market participants to execute transactions with as much information set on recently executed transactions as possible.
119. In respect of the maximum permissible delay, ESMA received mixed views on the shortening from three minutes to one minute. Some participants expressed the view that the one minute delay is challenging for non-electronic transactions (for manual transactions or transaction made over the phone). A few respondents considered that one minute delay was still too long.
120. ESMA appreciates that a maximum of one minute delay may be challenging under the technical arrangements currently adopted by certain market participants. However, the aim of the MiFID review is to improve those arrangements and set more rigorous transparency requirement for the benefit of the quality of the price formation process.
121. Finally, some respondents considered that a longer delay should be envisaged for portfolio transactions. One respondent also believed that ETFs should be granted a longer delay based on the fact that trading of these instruments is largely manual. Nevertheless, ESMA is of the view that there is no reason to have different maximum permissible delays for different classes of equity-like instruments. Besides, ESMA believes that the drafting of Article 17 of the draft RTS (CP version) on transparency requirements in respect of shares, depositary receipts, exchange-traded funds,

certificates already covered the specific case of post-trade transparency for portfolio transactions.

Proposal

122. On the basis of the strong support to the proposed definition of ‘normal trading hours’, ESMA suggests to maintain this definition. In order to respond to the MiFID II objective to increase market transparency and without any strong case against its initial proposal, ESMA suggests maintaining its proposal to shorten to one minute the maximum permissible delay to publish transaction details.

IV. Securities financing transactions and other transactions determined by factors other than the current market valuation of the financial instrument

123. Article 20(3)(b) of MiFIR empowers ESMA to develop draft RTS in respect of post-trade disclosure of OTC transactions involving the use of financial instruments for collateral, lending or other purposes where the exchange of financial instruments is determined by factors other than the current market valuation of the financial instrument.
124. ESMA notes that a similar empowerment exists under Article 28 of current MiFID. On the basis of that empowerment Article 5 of the Implementing Regulation (EC) No 1287/2006 does not consider transactions, for the purpose of the transparency regime, securities financing transaction, the exercise of options or of covered warrants and primary market transactions.
125. However, as mentioned above, ESMA notes that the empowerment under Article 20(3)(b) concerns OTC transactions only and that the level 1 text does not provide a similar empowerment for on-venue trades which, therefore, will have to comply with the general post-trade transparency obligations.

Analysis following feedback from stakeholders

126. In the CP, ESMA consulted on whether specific flags for securities financing transactions and other types of transactions determined by factors other than the current market valuation of the financial instrument would be necessary. A significant number of respondents were of the view that securities financing transactions should not be considered as reportable transactions as the publication of those transactions would not contribute to the price discovery process while the administrative burden and costs for market parties would be substantial. ESMA also proposed to exclude from transparency obligations transfers of financial instruments as segregated collateral as they are non-price forming transactions. However, quite a number of respondents explained that there was no reason to restrict this exemption only to segregated collateral.

127. Finally, according to one respondent transactions executed by trading venues and CCPs pursuant to buy-in rules should be treated as non-price forming trades for the purpose of post trade transparency. As explained above, ESMA has decided to include those types of transactions to the list of transactions not contributing to the price discovery process as specified for the purposes of the trading obligation and to the list of negotiated transactions subject to conditions other than the current market price. While ESMA consider that there is merit in excluding those transactions from the trading obligation and, where traded on-venue, to allow them to be eligible to the negotiated trade waiver as per Article 4(1)(b)(iii) of MiFIR, ESMA remains unconvinced that those transactions should be exempted from post-trade transparency when traded OTC. On the contrary, ESMA believes that the same post-trade transparency regime should apply regardless of whether the buy-in transaction is executed on-venue (under the negotiated trade waiver) or outside the rules of a trading venue.

Proposal

128. ESMA agrees that certain OTC non price forming transactions should not be considered as reportable trades for the purpose of the post-trade transparency regime. Consistently with current MiFID, ESMA proposes to establish a list of types of transactions determined by factors other than the current market valuation of the financial instrument to which Article 20 of MiFIR would not apply. The list includes:

- i. excluded transactions for the purpose of Article 26 of Regulation (EU) No 600/2014 as specified in RTS 22 on obligation to report transactions;
- ii. transactions executed by a management company as defined in Article 2(1)(b) of Directive 2009/65/EC or an alternative investment fund manager as defined in Article 4(1)(b) of Directive 2011/61/EU which transfers the beneficial ownership of financial instruments from one collective investment undertaking to another and where no investment firm is a party to the transaction;
- iii. give-ups and give-ins; and
- iv. transfers of financial instruments as collateral in bilateral transactions or in the context of a CCP margin and collateral requirements or as part of the default management process of a CCP.

V. Large in scale thresholds – shares and depositary receipts

129. Under current MiFID, as specified in the MiFID Implementing Regulation (Implementing Regulation (EC) No 1287/2006), LIS thresholds for deferred post-trade transparency are determined on the basis of the ADT of the share and the length of the deferral. The minimum qualifying size for an LIS transaction increases with the liquidity (using ADT as a proxy) of the share and the length of the deferral.

Analysis following feedback from stakeholders

130. In the DP already, and consistently with the recalibration of the liquidity classes in the context of the pre-trade waiver for LIS orders, ESMA had proposed a new table with 8 liquidity classes and, for each class, three thresholds increasing with the length of the deferral (60 minutes, 120 minutes and end of day (EOD)) applying to both, shares and depositary receipts. The table proposed by ESMA in the CP is reproduced below for information purposes.

Table 5: Post-trade LIS thresholds for shares and depositary receipts (as proposed in the CP)

Average daily turnover (ADT) in EUR	Minimum qualifying size of transaction for permitted delay in EUR	Timing of publication after the transaction
> 100m	10,000,000	60 minutes
	20,000,000	120 minutes
	35,000,000	EOD
50m – 100m	7,000,000	60 minutes
	15,000,000	120 minutes
	25,000,000	EOD
25m – 50m	5,000,000	60 minutes
	10,000,000	120 minutes
	12,000,000	EOD
5m – 25m	2,500,000	60 minutes
	4,000,000	120 minutes
	5,000,000	EOD
1m – 5m	450,000	60 minutes
	750,000	120 minutes
	1,000,000	EOD
500,000 – 1m	75,000	60 minutes
	150,000	120 minutes
	225,000	EOD
100,000 – 500,000	30,000	60 minutes
	80,000	120 minutes
	120,000	EOD
< 100 k	15,000	60 minutes
	30,000	120 minutes
	50,000	EOD

131. Many respondents criticised that implementing this table would have a negative impact on liquidity, pricing, volatility of and investment in SME stocks, in particular. They also pointed out that the LIS threshold represents a much higher percentage of the ADT

for transactions in less liquid shares than for transactions in more liquid ones. Respondents representing small issuers stressed that some stocks are so illiquid that an EOD deferral may turn out to be meaningless, market makers becoming cautious or ultimately stopping performing market making in highly illiquid stocks altogether. Respondents concluded that the ESMA proposal would not be aligned with the Capital Markets Union focus on promoting access of SMEs to capital markets.

132. Some respondents offered specific proposals to address this issue, including allowing more generous deferral periods for illiquid stocks (up to EOD +5), creating a specific class for highly illiquid stocks or linking the size of eligible trades to a percentage of ADT.
133. ESMA is aware of the goals of the Capital Markets Union and does not intend to make it more difficult capital market funding for SMEs. At the same time, ESMA also has to consider that a huge proportion, in terms of number of instruments, of shares traded on EU trading venues are concentrated in the lower liquidity bands of the table. MiFID II intends to introduce meaningful transparency for those shares and this objective would be challenged if deferrals of EOD + 5 were to be implemented.
134. Therefore, ESMA opted for a compromise solution whereby a new class for highly illiquid stock and depositary receipts (below EUR 50,000) is created with a lower LIS threshold and also grants an EOD + 1 deferral for the largest transactions in that new liquidity band.
135. ESMA clarified in the CP that an EOD means that market participants would have to publish the transaction (i) after the closing auction of the same trading day, if the transaction was concluded more than two hours away from the end of the trading day or (ii) before the start of the following trading day, if the transaction was concluded within the last two hours of the same trading day.
136. While a number of respondents were in favour of this solution, other respondents considered this as too onerous and ultimately as damaging liquidity, particularly in the already lower liquid bands. These respondents advocated maintaining the delays foreseen in the MiFID I Level 2 Implementing Regulation or at least allowing for a deferral until noon on the next trading day.
137. ESMA decided as a compromise to slightly amend its proposal and indeed allow for the largest transactions in each liquidity band to be published at noon local time on the following trading day at the latest.

Proposal

138. In respect of shares, ESMA retains the proposal to increase the number of liquidity bands and, thus, to align pre-trade and post-trade regimes in this regard so as to simplify implementation for investment firms and trading venues.

139. However, in response to the feedback received to the CP, ESMA introduces a new liquidity band of below EUR 50,000 where large trades can be granted a delay of publication of EOD + 1. ESMA therefore proposes to establish the thresholds and corresponding delays as specified in the table below:

Table 6: Deferred publication thresholds and delays for shares and depositary receipts (as included in the final draft RTS)

Average daily turnover (ADT) in EUR	Minimum qualifying size of transaction for permitted delay in EUR	Timing of publication after the transaction
> 100m	10,000,000	60 minutes
	20,000,000	120 minutes
	35,000,000	EOD
50m – 100m	7,000,000	60 minutes
	15,000,000	120 minutes
	25,000,000	EOD
25m – 50m	5,000,000	60 minutes
	10,000,000	120 minutes
	12,000,000	EOD
5m – 25m	2,500,000	60 minutes
	4,000,000	120 minutes
	5,000,000	EOD
1m – 5m	450,000	60 minutes
	750,000	120 minutes
	1,000,000	EOD
500,000 – 1m	75,000	60 minutes
	150,000	120 minutes
	225,000	EOD
100,000 – 500,000	30,000	60 minutes
	80,000	120 minutes
	120,000	EOD
50,000 – 100,000	15,000	60 minutes
	30,000	120 minutes
	50,000	EOD
< 50,000	7,500	60 minutes
	15,000	120 minutes
	25,000	EOD + 1

140. In detail, therefore the following regime would apply to shares and depositary receipts:

- i. Transactions eligible to a 60 or 120 minute delay in accordance with the above table have to be published respectively within 60 or 120 minutes after the transaction.
- ii. The largest transactions in each liquidity band (those eligible for an end of day publication) also have to be published as close to real as possible after the end of the closing auction if concluded earlier than 120 minutes before the end of the present trading day. If they are concluded within 120 minutes from the end of the trading day, they shall be published by 12.00 local time of the next trading day at the latest.
- iii. The largest transactions (greater than EUR 25,000) in the liquidity band below EUR 50,000 ADT have to be published after the end of the closing auction of the following trading day, regardless of the time when they were executed during the present trading day.

VI. Large in scale thresholds – ETFs

Analysis following feedback from stakeholders

141. In the CP, ESMA proposed two alternative options for establishing the LIS thresholds for ETFs.
142. The first option was based on using the ADT of the actual ETF for setting the LIS thresholds while applying the same set of liquidity bands for post-trade deferrals as those ESMA had proposed for pre-trade waivers.
143. The second option ESMA had published for consultation in reaction to feedback received to the DP was to establish a simple regime where the minimum LIS qualifying size for all ETFs, regardless of their liquidity, is set at EUR 5,000,000 and where the publication for any trade beyond that threshold should occur at the end of the trading day.
144. Respondents almost unanimously rejected the first option based on the ADT of the ETFs themselves arguing that the liquidity of an ETF depends on the liquidity of the underlying and that setting the thresholds based on the ADT of the ETFs themselves may install different thresholds for ETFs of identical liquidity and as a consequence may create incentives for an inefficient capital allocation.
145. The large majority of respondents preferred the creation of a simple and transparent regime where all ETFs are treated equally by either establishing a single monetary threshold triggering a uniform deferral for all or by imposing a two-step monetary threshold system where exceeding the first threshold triggers a shorter delay while exceeding the second threshold a longer one. A minority of respondents also favoured a simple regime but wanted to link the length of the deferral period to the point in time when the creation and redemption process of each specific ETF occurs.

146. A large group of respondents including a broad range of different market participants proposed a system where all transactions up to a size of EUR 10,000,000 would be made transparent in real-time, transactions of a size between EUR 10,000,000 and EUR 50,000,000 would benefit from a deferred publication of 60 minutes while transactions in a size exceeding EUR 50,000,000 would be published at the end of the trading day.
147. Taking into account the specificities of the ETF market and the importance of post-trade transparency, in particular, in a market environment where a large proportion of trading is conducted OTC, ESMA has decided to adopt the system as proposed by this group of respondents.
148. ESMA considers that an ambitious post-trade transparency regime for ETFs would contribute to creating a level-playing field between on-venue and OTC trading of ETFs in the Union, would stimulate competition and overall improve the price discovery system and the quality of execution for the end-investor.

Proposal

149. ESMA therefore proposes the following regime:

Table 7: Deferred publication thresholds and delays for ETFs (as included in the final draft RTS)

Minimum qualifying size of transaction for permitted delay in EUR	Timing of publication after the transaction
10 000 000	60 minutes
50 000 000	End of the day

VII. Large in scale thresholds – Certificates

Analysis following feedback from stakeholders

150. In the CP, ESMA proposed to establish two classes of liquidity: ADT above and below EUR 50.000 with time deferrals of 120 minutes or EOD depending on the size of the transaction within each liquidity class. Few stakeholders commented on the proposal and there was no significant opposition to this proposal. ESMA clarifies that the authorisation of deferred publication is at the discretion of the CA.

Proposal

151. ESMA proposes to establish two classes of liquidity, ADT above and below EUR 50 000 with deferrals of 120 minutes till end of the trading day according to the following table. These LIS thresholds would also apply to “other similar financial instruments”.

Table 8: Deferred publication thresholds and delays for certificates and other similar financial instruments (as included in the final draft RTS)

Average daily turnover (ADT) in EUR	Minimum qualifying size of transaction for permitted delay in EUR	Timing of publication after the transaction
ADT < 50 000	15 000	120 minutes
	30 000	End of the day
ADT ≥ 50 000	30 000	120 minutes
	60 000	End of the day

2.2. Transparency requirements in respect of bonds, structured finance products, emission allowances and derivatives

2.2.1 Liquidity and pre-trade and post-trade transparency for non-equity instruments

I. Feedback to the CP and revised proposal applicable across all asset classes

Background/Mandate

Articles 9(5)(c), (d), and (e) of MiFIR

5. *ESMA shall develop draft regulatory technical standards to specify the following:*

[...]

- (c) the size of orders that are large in scale and the type and the minimum size of orders held in an order management facility pending disclosure for which pre-trade disclosure may be waived under paragraph 1 for each class of financial instrument concerned;*
- (d) the size specific to the financial instrument referred to in paragraph 1(b) and the definition of re-request-for-quote and voice trading systems for which pre-trade disclosure may be waived under paragraph 1;*
- (e) the financial instruments or the classes of financial instruments for which there is not a liquid market where pre-trade disclosure may be waived under paragraph 1.*

Articles 11(4)(c) of MiFIR

4. *ESMA shall develop draft regulatory technical standards to specify the following in such a way as to enable the publication of information required under Article 64 of Directive 2014/65/EU:*

[...]

- (c) the conditions for authorising investment firms, including systematic internalisers, and market operators and investment firms operating a trading venue, to provide for deferred publication of the details of transactions for each class of financial instrument concerned in accordance with paragraph 1 of this Article and with Article 21(4);*

ESMA shall submit those draft regulatory technical standards to the Commission by 3 July 2015. Power is delegated to the Commission to adopt the regulatory technical standards referred to in the first subparagraph in accordance with Articles 10 to 14 of Regulation

(EU) No 1095/2010.

1. This section summarises ESMA's proposal for the liquidity assessment of non-equity instruments and the setting of thresholds for waivers from pre-trade transparency and deferrals from post-trade transparency presented in the December CP. It presents general feedback applicable across all asset classes received to the CP and describes the revised general approach set out in the draft RTS for the liquidity assessment, the thresholds for waivers from pre-trade transparency and the deferrals from post-trade transparency applicable to all non-equity instruments. Asset-class specific feedback, as well as, an explanation of the revised approach to reflect the specific market structure of the various asset classes are presented in sections A to K of this chapter.
2. MiFIR introduces transparency requirements for bonds, structured finance products, emission allowances and derivatives (including securitised derivatives) with powers for CAs under Article 9(1) of MiFIR to waive the obligation for market operators and investment firms operating a trading venue to make public pre-trade information for:
 - i. orders that are large in scale compared with normal market size;
 - ii. orders held in an order management facility of the trading venue pending disclosure;
 - iii. 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 and takes into account whether the relevant market participants are retail or wholesale investors; and
 - iv. derivatives which are not subject to the trading obligation and other financial instruments for which there is not a liquid market.
3. Similarly, on the post-trade side CAs may, under Article 11(1) of MiFIR, authorise market operators and investment firms to provide for deferred publication in respect of transactions that are:
 - i. large in scale compared with the normal market size for the financial instrument or for the class of financial instruments;
 - ii. related to financial instruments or to the related class of financial instruments for which there is not a liquid market; and
 - iii. above a size specific to that financial instrument or that class of financial instruments traded on a trading venue, which would expose liquidity providers to undue risk and takes into account whether the relevant market participants are retail or wholesale investors.

Liquidity

CP proposal

4. The concept of a liquid market for non-equity instruments is defined in Article 2(1)(17)(a) of MiFIR. On the basis of this definition and the mandates to define the classes of non-equity financial instruments for which a waiver/deferral may be granted because there is not a liquid market for them, ESMA is required to specify the non-equity financial instruments or classes of financial instruments for which there is not a liquid market.
5. In the CP ESMA proposed to use COFIA as the basis for determining the liquidity of all non-equity financial instruments. The proposed approach provided for the segmentation of non-equity financial instruments into specific sub-classes defined on the basis of a set of criteria (e.g. maturity, currency, underlying instrument, etc.) taking into account the specificities of the various asset classes. On this basis, sub-classes (and all the instruments belonging to those sub-classes) were deemed to be liquid or illiquid on the basis of the liquidity criteria listed under Article 2(1)(17)(a) and as further described in the December CP. Any newly issued instrument would have been classified as liquid if it belonged to one of the pre-defined liquid classes and as illiquid otherwise.
6. The assessment of the different non-equity instruments was carried out on data samples from trade repositories and trading venues for securitised derivatives, derivatives and emission allowances and from transaction reporting data for bonds and structured finance products (SFPs).
7. Under the proposal in the CP, classes deemed to be liquid would have been established until the RTS was reviewed.

Feedback from stakeholders

8. Overall, most respondents expressed strong concerns about the static nature of ESMA's approach and the level of the liquidity thresholds used to identify liquid classes. Most stakeholders recommended instead a methodology based on a periodic assessment of liquidity to reflect the episodic trading patterns of many non-equity instruments.
9. With regard to the liquidity thresholds, most stakeholders considered that ESMA had set the levels too low to adequately separate liquid classes from illiquid classes. There were also some concerns that not all liquidity criteria set out in Article 2(1)(17)(a) were applied (e.g. the presence of market makers was only considered for securitised derivatives). As a solution to address both those shortcomings, respondents recommended ESMA set more stringent liquidity thresholds.

Derivatives

10. A number of concerns applicable only to the liquidity assessment for derivatives were raised.

11. Firstly, most responses expressed strong reservations about the data used for the liquidity assessments, in particular for those assessments based on data from trade repositories (TRs). Overall, stakeholders considered that the data collection period of three months was too short and recommended the use of a data sample covering at least one year. Respondents raised concerns about the quality of TR data in general, stressing that reporting and data quality is, to date, very low and that reported data is not granular enough. While respondents appreciated that ESMA had cleaned the data before performing the calculations the resulting dataset was not considered to be of sufficient quality for the purpose of the analysis. Regarding trading venues' data which was used for ETDs, the general view was that it covered too few trading venues and that the sample size should be increased to cover both more EU trading venues as well as trading venues from third countries.
12. Secondly, stakeholders considered that the level of granularity for constructing the classes was insufficient to build homogeneous classes and recommended ESMA to further develop the taxonomy more in line with market practice. Some classes were considered too broad (e.g. the contract for difference (CFD) definition considered to include equity swaps), insufficiently precise, or not in line with market practice (e.g. spread bets for FX derivatives). This lack of granularity results, in the stakeholders' view, in inconsistent classes which are, at times, too heterogeneous. Respondents recommended using a more granular COFIA, which takes into account more asset-class specific criteria (e.g. underlying for single name credit default swaps (CDS) and options/futures on stocks) for the definition of classes, and equivalent liquidity thresholds where classes are broken down to an equivalent level of granularity. Furthermore, responses highlighted some missing classes (e.g. new categories of commodities that are financial instruments under the new MiFID II/MiFIR regime).
13. Thirdly, many respondents considered that the consequence of deficiencies in data quality and the lack of granularity resulted in significant misclassifications of illiquid classes as liquid and vice versa (although to a lower degree).
14. Finally, many respondents were concerned that the liquidity assessment did not distinguish between exchange traded derivatives (ETDs) and OTC derivatives which would result in market distortions. In particular, stakeholders were concerned that for some asset classes (e.g. equity derivatives) only data from trading venues had been taken into consideration and OTC trades not considered.
15. Further details pertinent to a specific derivative asset class are provided in the dedicated section of each asset class.

Bonds and structured finance products

16. Overall, feedback on the proposal for bonds and structured finance instruments was split into two groups. While some supported the proposed COFIA, mainly from the buy-side and exchanges, many respondents, mainly from the sell-side, asked ESMA to reconsider using IBIA. It should also be noted that most respondents in favour of COFIA considered

necessary to accompany this approach with a recalibration of the LIS and SSTI thresholds to address the problem of wrongly qualified bonds. Sections A and B of this chapter summarise in more detail the feedback for bonds and structured finance products.

Securitised derivatives

17. Overall, responses supported ESMA's approach to declare all securitised derivatives as liquid. The feedback for securitised derivatives is summarised in section C.

Emission allowances

18. ESMA received only very limited feedback for emission allowances. The feedback for emission allowances is summarised in section K.

Proposal

19. ESMA proposes to use a revised and more granular COFIA as the basis for determining the liquidity of all classes of non-equity financial instruments. For bonds IBIA will be used.

Derivatives and emission allowances

20. For derivatives and emission allowances, the changes ESMA has made are described in the following paragraphs.
21. A periodic (yearly) liquidity assessment has been introduced which will allow the regular reassessment of liquidity. In consequence, the draft RTS does not set out anymore the classes that have a liquid market or do not have a liquid market. The revised draft RTS provides instead for (1) a detailed taxonomy in the annex, including the segmentation criteria for defining the classes and their related granularity for the liquidity assessment (2) the quantitative liquidity criteria and related thresholds and/or the qualitative criteria to be used for the liquidity assessment. As suggested by respondents to the CP, the revised proposal provides for a greater level of granularity, which will result in more homogeneous classes. To address possible market distortions stemming from the inconsistent treatment of OTC derivatives compared to ETDs, ESMA categorises these instruments in the same class, where appropriate.
22. To appropriately reflect the very diverse characteristics of the various non-equity instruments, ESMA distinguishes in the draft RTS between three levels of granularity for classifying non-equity instruments (in order of increasing granularity): asset class, sub-asset class and sub-class. The liquidity assessment is carried out on the highest level of granularity. While this is in most cases the sub-class level, it has to be noted that not all non-equity instruments require the use of the highest level of granularity and in some cases granularity at the sub-asset class is sufficient (e.g. emission allowances) Table 9

provides an illustration of the various levels using the example of interest rate derivatives.

Table 9: Example of the level of granularity applied – interest rate derivatives

Level of granularity	Type of instrument
Asset class	Interest rate derivatives
Sub-asset class	Bond futures
Sub-class	Bond future whose underlying bond is of a specific issuer with a specific term and whose time to maturity (of the future) is within a specific time-to-maturity bucket

23. Annex III of the draft RTS specifies the segmentation criteria for constructing the various sub-asset classes and sub-classes and defines the level of granularity to be used for the liquidity assessment.
24. Concerning, the criteria against which to assess liquidity, ESMA maintained its approach to use the same assessment based on two liquidity criteria as in the CP, i.e. average daily notional amount and average daily number of trades. To better reflect the specific market structure of derivatives covered, ESMA introduces in some cases additional criteria (e.g. distinguishing between on-the-run and off-the-run status for credit derivatives).
25. Finally, ESMA increased the liquidity thresholds against which the liquidity of a sub-asset class or a sub-class will be assessed. To the extent possible, ESMA proposes the use of equivalent thresholds for equivalent sub-asset classes or sub-classes to avoid market distortions and to take into account that derivatives may have comparable economic terms but are transacted in different forms (e.g. EUA- emission allowance and CER- emission allowances).
26. ESMA considers that those changes, taken together, ensure a more accurate determination of the liquidity. It is expected that fewer instruments will be considered liquid due to the more granular definition of sub(-asset)classes and the increased liquidity thresholds.
27. Last but not least, ESMA provides for an alternative methodology with respect to the one described above for certain sub-asset classes and for the asset class of foreign exchange derivatives. Table 10 below provides a summary of the methodology applied to each sub-asset class. However, further details are provided in the dedicated section of each asset class (sections D to K). Last but not least, details on transitioning into the new regime are provided in section III of chapter 2.2.3.

Bonds and structured finance products

28. In light of the feedback ESMA suggests to apply IBIA for bonds. For SFPs ESMA has reviewed the proposal and suggests a two-step assessment based on two tests of the liquidity of these instruments which build on one another and will ensure that SFPs will be subject to an appropriate transparency regime should the overall market for these instruments become more liquid again. The proposal for bonds and structured finance products is summarised in sections A and B.

Securitised derivatives

29. ESMA has maintained the main elements of its proposal for securitised derivatives. More details are presented in section C.

Table 10: Methodology for assessing liquidity applied to each sub-asset class

LIQUIDITY ASSESSMENT								
	IBIA		2-TESTS APPROACH		COFA			
	BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)		ASSET CLASS ASSESSMENT - BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	IBIA - BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	BASED ON QUANTITATIVE (QT) AND QUALITATIVE (QL) LIQUIDITY CRITERIA	BASED ON QUALITATIVE LIQUIDITY CRITERIA (QL)	STATIC
	QT#1 - average daily turnover (ADT) QT#2 - average daily number of trades QT#3 - percentage of days traded	QT#1 - average daily turnover (ADT) QT#2 - average daily number of trades	QT#1 - average daily notional amount (ADNA) QT#2 - average daily number of trades QT#3 - percentage of days traded	QT#1 - average daily notional amount (ADNA) QT#2 - average daily number of trades	QT#1 - average daily notional amount (ADNA) QT#2 - average daily number of trades	QT#1 - average daily notional amount (ADNA) QT#2 - average daily number of trades QL#3 as described in the section above	Qualitative liquidity criteria as described in the section above	
BONDS								
Sovereign Bonds	x							
Other Public Bonds	x							
Convertible Bonds	x							
Covered Bonds	x							
Corporate Bonds	x							
ETCs		x						
ETNs		x						

LIQUIDITY ASSESSMENT								
	IBIA		2-TESTS APPROACH		COFA			
	BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)		ASSET CLASS ASSESSMENT - BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	IBIA -BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	BASED ON QUANTITATIVE (QT) AND QUALITATIVE (QL) LIQUIDITY CRITERIA	BASED ON QUALITATIVE LIQUIDITY CRITERIA (QL)	STATIC
	<i>QT#1 - average daily turnover (ADT)</i> <i>QT#2 - average daily number of trades</i> <i>QT#3 - percentage of days traded</i>	<i>QT#1 - average daily turnover (ADT)</i> <i>QT#2 - average daily number of trades</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i> <i>QT#3 - percentage of days traded</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i> <i>QL#3 as described in the section above</i>	<i>Qualitative liquidity criteria as described in the section above</i>	
BONDS								
Other Bonds								all illiquid
SFPs								
				x				
EMISSION ALLOWANCES								
European Union Allowances (EUA)					x			
European Union Aviation Allowances (EUAA)					x			

LIQUIDITY ASSESSMENT								
	IBIA		2-TESTS APPROACH		COFA			
	BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)		ASSET CLASS ASSESSMENT - BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	IBIA -BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	BASED ON QUANTITATIVE (QT) AND QUALITATIVE (QL) LIQUIDITY CRITERIA	BASED ON QUALITATIVE LIQUIDITY CRITERIA (QL)	STATIC
	<i>QT#1 - average daily turnover (ADT)</i> <i>QT#2 - average daily number of trades</i> <i>QT#3 - percentage of days traded</i>	<i>QT#1 - average daily turnover (ADT)</i> <i>QT#2 - average daily number of trades</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i> <i>QT#3 - percentage of days traded</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i> <i>QL#3 as described in the section above</i>	<i>Qualitative liquidity criteria as described in the section above</i>	
EMISSION ALLOWANCES								
Certified Emission Reductions (CER)					x			
Emission Reduction Units (ERU)					x			
Other Emission Allowances								all illiquid
SECURITISED DERIVATIVES								
								all liquid

LIQUIDITY ASSESSMENT								
	IBIA		2-TESTS APPROACH		COFA			
	BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)		ASSET CLASS ASSESSMENT - BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	IBIA -BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	BASED ON QUANTITATIVE (QT) AND QUALITATIVE (QL) LIQUIDITY CRITERIA	BASED ON QUALITATIVE LIQUIDITY CRITERIA (QL)	STATIC
	QT#1 - average daily turnover (ADT) QT#2 - average daily number of trades QT#3 - percentage of days traded	QT#1 - average daily turnover (ADT) QT#2 - average daily number of trades	QT#1 - average daily notional amount (ADNA) QT#2 - average daily number of trades QT#3 - percentage of days traded	QT#1 - average daily notional amount (ADNA) QT#2 - average daily number of trades	QT#1 - average daily notional amount (ADNA) QT#2 - average daily number of trades	QT#1 - average daily notional amount (ADNA) QT#2 - average daily number of trades QL#3 as described in the section above	Qualitative liquidity criteria as described in the section above	
C10 DERIVATIVES								
Freight derivatives					x			
Other C10 derivative								all illiquid
EMISSION ALLOWANCE DERIVATIVES								
Emission Allowance Derivatives - (EUA)					x			
Emission Allowance Derivatives - (EUAA)					x			

LIQUIDITY ASSESSMENT								
	IBIA		2-TESTS APPROACH		COFA			
	BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)		ASSET CLASS ASSESSMENT - BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	IBIA -BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	BASED ON QUANTITATIVE (QT) AND QUALITATIVE (QL) LIQUIDITY CRITERIA	BASED ON QUALITATIVE LIQUIDITY CRITERIA (QL)	STATIC
	<i>QT#1 - average daily turnover (ADT)</i> <i>QT#2 - average daily number of trades</i> <i>QT#3 - percentage of days traded</i>	<i>QT#1 - average daily turnover (ADT)</i> <i>QT#2 - average daily number of trades</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i> <i>QT#3 - percentage of days traded</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i> <i>QL#3 as described in the section above</i>	<i>Qualitative liquidity criteria as described in the section above</i>	
EMISSION ALLOWANCE DERIVATIVES								
Emission Allowance Derivatives - (CER)					x			
Emission Allowance Derivatives - (ERU)					x			
Other Emission Allowance Derivatives								all illiquid

LIQUIDITY ASSESSMENT								
	IBIA		2-TESTS APPROACH		COFA			
	BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)		ASSET CLASS ASSESSMENT - BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	IBIA -BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	BASED ON QUANTITATIVE (QT) AND QUALITATIVE (QL) LIQUIDITY CRITERIA	BASED ON QUALITATIVE LIQUIDITY CRITERIA (QL)	STATIC
	QT#1 - average daily turnover (ADT) QT#2 - average daily number of trades QT#3 - percentage of days traded	QT#1 - average daily turnover (ADT) QT#2 - average daily number of trades	QT#1 - average daily notional amount (ADNA) QT#2 - average daily number of trades QT#3 - percentage of days traded	QT#1 - average daily notional amount (ADNA) QT#2 - average daily number of trades	QT#1 - average daily notional amount (ADNA) QT#2 - average daily number of trades	QT#1 - average daily notional amount (ADNA) QT#2 - average daily number of trades QL#3 as described in the section above	Qualitative liquidity criteria as described in the section above	
INTEREST RATE DERIVATIVES								
Bond futures/forwards						x		
Bond options					x			
IR futures and FRA						x		
IR options					x			
Swaptions					x			
Fixed-to-Float 'multi currency swaps' and Futures/Forwards on Fixed-to-Float 'multi currency swaps'					x			

LIQUIDITY ASSESSMENT								
	IBIA		2-TESTS APPROACH		COFA			
	BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)		ASSET CLASS ASSESSMENT - BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	IBIA -BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	BASED ON QUANTITATIVE (QT) AND QUALITATIVE (QL) LIQUIDITY CRITERIA	BASED ON QUALITATIVE LIQUIDITY CRITERIA (QL)	STATIC
INTEREST RATE DERIVATIVES								
Float-to-Float 'multi currency swaps' and Futures/Forwards on Float-to-Float 'multi currency swaps'					x			
Fixed-to-Fixed 'multi currency swaps' and Futures/Forwards on Fixed-to-Fixed 'multi currency swaps'					x			
Overnight Index Swap (OIS) 'multi currency swaps' and Futures/Forwards on Overnight Index Swap (OIS) 'multi currency swaps'					x			

LIQUIDITY ASSESSMENT								
	IBIA		2-TESTS APPROACH		COFA			
	BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)		ASSET CLASS ASSESSMENT - BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	IBIA -BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	BASED ON QUANTITATIVE (QT) AND QUALITATIVE (QL) LIQUIDITY CRITERIA	BASED ON QUALITATIVE LIQUIDITY CRITERIA (QL)	STATIC
INTEREST RATE DERIVATIVES								
Inflation 'multi currency swaps' and Futures/Forwards on Inflation 'multi currency swaps'					x			
Fixed-to-Float 'single currency swaps' and Futures/Forwards on Fixed-to-Float 'single currency swaps'					x			
Float-to-Float 'single currency swaps' and Futures/Forwards on Float-to-Float 'single currency swaps'					x			

LIQUIDITY ASSESSMENT								
	IBIA		2-TESTS APPROACH		COFA			
	BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)		ASSET CLASS ASSESSMENT - BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	IBIA -BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	BASED ON QUANTITATIVE (QT) AND QUALITATIVE (QL) LIQUIDITY CRITERIA	BASED ON QUALITATIVE LIQUIDITY CRITERIA (QL)	STATIC
INTEREST RATE DERIVATIVES								
Fixed-to-Fixed 'single currency swaps' and Futures/Forwards on Fixed-to-Fixed 'single currency swaps'					x			
Overnight Index Swap (OIS) 'single currency swaps' and Futures/Forwards on Overnight Index Swap (OIS) 'single currency swaps'					x			
Inflation 'single currency swaps' and Futures/Forwards on Inflation 'single currency swaps'					x			

LIQUIDITY ASSESSMENT

	IBIA		2-TESTS APPROACH		COFA			
	BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)		ASSET CLASS ASSESSMENT - BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	IBIA -BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	BASED ON QUANTITATIVE (QT) AND QUALITATIVE (QL) LIQUIDITY CRITERIA	BASED ON QUALITATIVE LIQUIDITY CRITERIA (QL)	STATIC
	<i>QT#1 - average daily turnover (ADT)</i> <i>QT#2 - average daily number of trades</i> <i>QT#3 - percentage of days traded</i>	<i>QT#1 - average daily turnover (ADT)</i> <i>QT#2 - average daily number of trades</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i> <i>QT#3 - percentage of days traded</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i> <i>QL#3 as described in the section above</i>	<i>Qualitative liquidity criteria as described in the section above</i>	
INTEREST RATE DERIVATIVES								
Other Interest Rate Derivatives								all illiquid
EQUITY DERIVATIVES								
Index options								all liquid
Index futures/forwards								all liquid
Stock options								all liquid

LIQUIDITY ASSESSMENT

	IBIA		2-TESTS APPROACH		COFA			
	BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)		ASSET CLASS ASSESSMENT - BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	IBIA -BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	BASED ON QUANTITATIVE (QT) AND QUALITATIVE (QL) LIQUIDITY CRITERIA	BASED ON QUALITATIVE LIQUIDITY CRITERIA (QL)	STATIC
	<i>QT#1 - average daily turnover (ADT)</i> <i>QT#2 - average daily number of trades</i> <i>QT#3 - percentage of days traded</i>	<i>QT#1 - average daily turnover (ADT)</i> <i>QT#2 - average daily number of trades</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i> <i>QT#3 - percentage of days traded</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i> <i>QL#3 as described in the section above</i>	<i>Qualitative liquidity criteria as described in the section above</i>	
EQUITY DERIVATIVES								
Stock futures/forwards								all liquid
Stock dividend options								all liquid
Stock dividend futures/forwards								all liquid
Dividend index options								all liquid
Dividend index futures/forwards								all liquid

LIQUIDITY ASSESSMENT								
	IBIA		2-TESTS APPROACH		COFA			
	BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)		ASSET CLASS ASSESSMENT - BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	IBIA -BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	BASED ON QUANTITATIVE (QT) AND QUALITATIVE (QL) LIQUIDITY CRITERIA	BASED ON QUALITATIVE LIQUIDITY CRITERIA (QL)	STATIC
	QT#1 - average daily turnover (ADT) QT#2 - average daily number of trades QT#3 - percentage of days traded	QT#1 - average daily turnover (ADT) QT#2 - average daily number of trades	QT#1 - average daily notional amount (ADNA) QT#2 - average daily number of trades QT#3 - percentage of days traded	QT#1 - average daily notional amount (ADNA) QT#2 - average daily number of trades	QT#1 - average daily notional amount (ADNA) QT#2 - average daily number of trades	QT#1 - average daily notional amount (ADNA) QT#2 - average daily number of trades QL#3 as described in the section above	Qualitative liquidity criteria as described in the section above	
EQUITY DERIVATIVES								
Volatility index options								all liquid
Volatility index futures/forwards								all liquid
ETF options								all liquid
ETF futures/forwards								all liquid
Swaps					x			

LIQUIDITY ASSESSMENT								
	IBIA		2-TESTS APPROACH		COFA			
	BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)		ASSET CLASS ASSESSMENT - BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	IBIA -BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	BASED ON QUANTITATIVE (QT) AND QUALITATIVE (QL) LIQUIDITY CRITERIA	BASED ON QUALITATIVE LIQUIDITY CRITERIA (QL)	STATIC
	<i>QT#1 - average daily turnover (ADT)</i> <i>QT#2 - average daily number of trades</i> <i>QT#3 - percentage of days traded</i>	<i>QT#1 - average daily turnover (ADT)</i> <i>QT#2 - average daily number of trades</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i> <i>QT#3 - percentage of days traded</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i> <i>QL#3 as described in the section above</i>	<i>Qualitative liquidity criteria as described in the section above</i>	
EQUITY DERIVATIVES								
Portfolio Swaps					x			
Other equity derivatives								all illiquid
COMMODITY DERIVATIVES								
Metal commodity futures/forwards					x			
Metal commodity options					x			

LIQUIDITY ASSESSMENT								
	IBIA		2-TESTS APPROACH		COFA			
	BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)		ASSET CLASS ASSESSMENT - BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	IBIA -BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	BASED ON QUANTITATIVE (QT) AND QUALITATIVE (QL) LIQUIDITY CRITERIA	BASED ON QUALITATIVE LIQUIDITY CRITERIA (QL)	STATIC
	<i>QT#1 - average daily turnover (ADT)</i> <i>QT#2 - average daily number of trades</i> <i>QT#3 - percentage of days traded</i>	<i>QT#1 - average daily turnover (ADT)</i> <i>QT#2 - average daily number of trades</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i> <i>QT#3 - percentage of days traded</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i> <i>QL#3 as described in the section above</i>	<i>Qualitative liquidity criteria as described in the section above</i>	
COMMODITY DERIVATIVES								
Metal commodity swaps					x			
Energy commodity futures/forwards					x			
Energy commodity options					x			
Energy commodity swaps					x			

LIQUIDITY ASSESSMENT								
	IBIA		2-TESTS APPROACH		COFA			
	BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)		ASSET CLASS ASSESSMENT - BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	IBIA -BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	BASED ON QUANTITATIVE (QT) AND QUALITATIVE (QL) LIQUIDITY CRITERIA	BASED ON QUALITATIVE LIQUIDITY CRITERIA (QL)	STATIC
	<i>QT#1 - average daily turnover (ADT)</i> <i>QT#2 - average daily number of trades</i> <i>QT#3 - percentage of days traded</i>	<i>QT#1 - average daily turnover (ADT)</i> <i>QT#2 - average daily number of trades</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i> <i>QT#3 - percentage of days traded</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i> <i>QL#3 as described in the section above</i>	<i>Qualitative liquidity criteria as described in the section above</i>	
COMMODITY DERIVATIVES								
Agricultural commodity futures/forwards					x			
Agricultural commodity options					x			
Agricultural commodity swaps					x			
Other commodity derivatives								all illiquid

LIQUIDITY ASSESSMENT								
	IBIA		2-TESTS APPROACH		COFA			
	BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)		ASSET CLASS ASSESSMENT - BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	IBIA -BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	BASED ON QUANTITATIVE (QT) AND QUALITATIVE (QL) LIQUIDITY CRITERIA	BASED ON QUALITATIVE LIQUIDITY CRITERIA (QL)	STATIC
	<i>QT#1 - average daily turnover (ADT)</i> <i>QT#2 - average daily number of trades</i> <i>QT#3 - percentage of days traded</i>	<i>QT#1 - average daily turnover (ADT)</i> <i>QT#2 - average daily number of trades</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i> <i>QT#3 - percentage of days traded</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i> <i>QL#3 as described in the section above</i>	<i>Qualitative liquidity criteria as described in the section above</i>	
FX DERIVATIVES								
Non-deliverable forward (NDF)								all illiquid
Deliverable forward (DF)								all illiquid
Non-Deliverable FX options (NDO)								all illiquid
Deliverable FX options (DO)								all illiquid

LIQUIDITY ASSESSMENT

	IBIA		2-TESTS APPROACH		COFA			
	BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)		ASSET CLASS ASSESSMENT - BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	IBIA -BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	BASED ON QUANTITATIVE (QT) AND QUALITATIVE (QL) LIQUIDITY CRITERIA	BASED ON QUALITATIVE LIQUIDITY CRITERIA (QL)	STATIC
	<i>QT#1 - average daily turnover (ADT)</i> <i>QT#2 - average daily number of trades</i> <i>QT#3 - percentage of days traded</i>	<i>QT#1 - average daily turnover (ADT)</i> <i>QT#2 - average daily number of trades</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i> <i>QT#3 - percentage of days traded</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i> <i>QL#3 as described in the section above</i>	<i>Qualitative liquidity criteria as described in the section above</i>	
FX DERIVATIVES								
Non-Deliverable FX swaps (NDS)								all illiquid
Deliverable FX swaps (DS)								all illiquid
FX futures								all illiquid
Other Foreign Exchange Derivatives								all illiquid

LIQUIDITY ASSESSMENT								
	IBIA		2-TESTS APPROACH		COFA			
	BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)		ASSET CLASS ASSESSMENT - BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	IBIA -BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	BASED ON QUANTITATIVE (QT) AND QUALITATIVE (QL) LIQUIDITY CRITERIA	BASED ON QUALITATIVE LIQUIDITY CRITERIA (QL)	STATIC
	<i>QT#1 - average daily turnover (ADT)</i> <i>QT#2 - average daily number of trades</i> <i>QT#3 - percentage of days traded</i>	<i>QT#1 - average daily turnover (ADT)</i> <i>QT#2 - average daily number of trades</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i> <i>QT#3 - percentage of days traded</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i> <i>QL#3 as described in the section above</i>	<i>Qualitative liquidity criteria as described in the section above</i>	
CREDIT DERIVATIVES								
Index credit default swap (CDS)						x		
Single name credit default swap (CDS)					x			
CDS index options							x	
Single name CDS options							x	

LIQUIDITY ASSESSMENT								
	IBIA		2-TESTS APPROACH		COFA			
	BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)		ASSET CLASS ASSESSMENT - BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	IBIA -BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	BASED ON QUANTITATIVE (QT) AND QUALITATIVE (QL) LIQUIDITY CRITERIA	BASED ON QUALITATIVE LIQUIDITY CRITERIA (QL)	STATIC
	<i>QT#1 - average daily turnover (ADT)</i> <i>QT#2 - average daily number of trades</i> <i>QT#3 - percentage of days traded</i>	<i>QT#1 - average daily turnover (ADT)</i> <i>QT#2 - average daily number of trades</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i> <i>QT#3 - percentage of days traded</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i> <i>QL#3 as described in the section above</i>	<i>Qualitative liquidity criteria as described in the section above</i>	
CREDIT DERIVATIVES								
Other credit derivatives								all illiquid
CFDs								
Currency CFDs					x			
Commodity CFDs					x			

LIQUIDITY ASSESSMENT								
	IBIA		2-TESTS APPROACH		COFA			
	BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)		ASSET CLASS ASSESSMENT - BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	IBIA -BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	BASED ON QUANTITATIVE (QT) AND QUALITATIVE (QL) LIQUIDITY CRITERIA	BASED ON QUALITATIVE LIQUIDITY CRITERIA (QL)	STATIC
	<i>QT#1 - average daily turnover (ADT)</i> <i>QT#2 - average daily number of trades</i> <i>QT#3 - percentage of days traded</i>	<i>QT#1 - average daily turnover (ADT)</i> <i>QT#2 - average daily number of trades</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i> <i>QT#3 - percentage of days traded</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i> <i>QL#3 as described in the section above</i>	<i>Qualitative liquidity criteria as described in the section above</i>	
CFDs								
Equity CFDs							x	
Bond CFDs							x	
CFDs on future/forward on an equity							x	
CFDs on option on an equity							x	

LIQUIDITY ASSESSMENT								
	IBIA		2-TESTS APPROACH		COFA			
	BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)		ASSET CLASS ASSESSMENT - BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	IBIA -BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	BASED ON QUANTITATIVE LIQUIDITY CRITERIA (QT)	BASED ON QUANTITATIVE (QT) AND QUALITATIVE (QL) LIQUIDITY CRITERIA	BASED ON QUALITATIVE LIQUIDITY CRITERIA (QL)	STATIC
	<i>QT#1 - average daily turnover (ADT)</i> <i>QT#2 - average daily number of trades</i> <i>QT#3 - percentage of days traded</i>	<i>QT#1 - average daily turnover (ADT)</i> <i>QT#2 - average daily number of trades</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i> <i>QT#3 - percentage of days traded</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i>	<i>QT#1 - average daily notional amount (ADNA)</i> <i>QT#2 - average daily number of trades</i> <i>QL#3 as described in the section above</i>	<i>Qualitative liquidity criteria as described in the section above</i>	
CFDs								
Other CFDs								all illiquid

Deferral period and pre-trade and post-trade transparency thresholds

CP proposal

30. ESMA proposed in the CP the following approach:

- i. to set the deferral period which competent authorities may authorise for transactions that are large in scale, transactions above the size specific to the instrument if carried out on own account other than matched principal, and transactions in illiquid instruments, at 48 hours;
- ii. to set identical large in scale and size specific thresholds for both pre-trade and post-trade purposes;
- iii. to determine the large in scale threshold for each asset class defined in accordance with the COFIA approach;
- iv. to set the size specific to the instrument threshold equal to 50% of the large in scale threshold. Indicative prices which are close to the price of the trading interests to be published when using the waiver should be calculated and displayed by the operator of the trading venue in a transparent fashion; and
- v. to set large in scale and size specific thresholds according to the volume measure included in Annex II, Table 3 of the draft RTS in the December CP.

31. In addition, ESMA proposed two options in the CP with regard to setting the large in scale and size specific to the instrument thresholds:

Option 1

32. A static determination of the LIS and SSTI thresholds as the greater of a pre-determined floor based on expert judgement and a threshold meeting the policy objective to capture at least 90% of the trades below the large in scale threshold for both liquid and illiquid classes².

33. Under this option, concrete thresholds would be specified in the RTS and, thus, a revision of the thresholds would have implied a revision of the RTS itself.

Option 2

² In order to set the threshold of illiquid classes for interest rate derivatives traded OTC, for which trade repositories data was used, a 70% coverage ratio was applied instead of 90%. For more details on the methodology and results refer to the section "Interest rate derivatives – Pilot exercise on setting the large in scale thresholds" in the December CP. Furthermore, for ETD contracts, i.e. bond futures and interest rate futures, the related thresholds were calculated on the whole distribution of trades related to both sub-classes. The same applied to bond options and interest rate options. Moreover, for equity derivatives only the thresholds for index options and futures and for stock options and futures are based on the 90% coverage ratio in terms of number of trades, while those for the other classes were derived from those 4 values. Finally, the thresholds set for emission allowances were set on the basis of the average amount of tons of carbon dioxide traded and not according to any the policy of objective to capture x% of the trading volume.

34. The second option provided for a more dynamic regime. Under this proposal, the thresholds defined under option 1 would have been applied only for the year 2017 and, from 2018 onwards, the thresholds would have been recalculated on a yearly basis according to a pre-determined methodology: the LIS thresholds would have been set for each sub-class as the greater of:
- i. the threshold determined so that at least 90% of the trades would lie below the threshold (**criterion 1**);
 - ii. the threshold determined so that at least 70% of the total volume traded for that sub-class would lie below the threshold (**criterion 2**) or;
 - iii. the threshold floor determined for the class as provided in Annex III, Table 47 of draft RTS³ as published in the December CP.
35. ESMA expressed in the CP a preference for option 2.

Analysis following feedback from stakeholders and proposal

Alignment of pre-trade and post-trade thresholds

36. Most stakeholders did not agree with ESMA's proposal to align thresholds for pre-trade and post-trade purposes, supporting differentiated thresholds, and in particular lower pre-trade thresholds. While some stakeholders supported using the same pre-trade and post-trade thresholds, this support was in most cases qualified on the basis that pre-trade and post-trade transparency thresholds should be lowered overall and that if thresholds were not lowered, they would prefer at least that pre-trade thresholds were lower than post-trade thresholds.
37. In light of comments received, ESMA has revisited its proposal so that the pre-trade thresholds for LIS and SSTI are set at a lower level than the post-trade thresholds for LIS and SSTI. The methodology for determining the SSTI and LIS thresholds is described in the following paragraphs.

LIS and SSTI thresholds

38. Many respondents expressed concerns about the LIS and SSTI thresholds proposed in the CP, arguing that:
- i. the thresholds were generally too high, especially for pre-trade transparency and for trading in illiquid instruments;

³ In other words, the thresholds floors would represent the minimum applicable thresholds, replicating to a large extent the thresholds applicable for 2017.

- ii. the calculation of the SSTI as 50% of LIS was inappropriate, did not sufficiently reflect the mandate given in Level 1 and resulted in too high thresholds with sometimes a too small percentage of trades between the LIS and the corresponding SSTI threshold; and
 - iii. the use of threshold floors and volume measures to calculate the transparency thresholds was not appropriate, provided unpredictable and biased outcomes and could result in unintended consequences.
39. Respondents made various and wide-ranging proposals for determining the SSTI, ranging from setting the SSTI as a percentage of the LIS (e.g. from 5-10% to 95% as requested by various trading venues) to setting the SSTI based on a percentile as it was the case for the LIS threshold in relation to the trades covered (e.g. the median of the distribution of trades).

Derivatives (excluding equity derivatives) and emission allowances

40. Following feedback to the consultation, ESMA has revisited its proposal and suggests for emission allowances and all derivatives with the exception of equity derivatives the approach described below.
- i. For **sub-asset classes or sub-classes with a liquid market** ESMA suggests to determine the pre-trade and post-trade thresholds on a yearly basis according to the following methodology:
 - a. **Pre-trade SSTI**: The higher of the 60th trade percentile or the threshold floor
 - b. **Pre-trade LIS**: The higher of the 70th trade percentile or the threshold floor.
 - c. **Post-trade SSTI**: The higher of the 80th trade percentile, the 60th volume percentile⁴ or the threshold floor.
 - d. **Post-trade LIS**: The higher of the 90th trade percentile, the 70th volume percentile or the threshold floor.

In all cases, the volume percentile for determining the LIS and SSTI thresholds is applied only if the trade size related to the LIS volume percentile is not higher than the 97.5th trade percentile, in this case the trade percentile should then prevail.

Last but not least, whenever a statistically sufficient number of trades, set to 1000, is not available for the calculations of the percentiles the threshold floors should apply.

⁴ The volume percentile is not used for emission allowances and emission allowance derivatives for which only the trade percentile and the threshold floor are applied.

- ii. For **sub-asset classes or sub-classes that do not have a liquid market** ESMA proposed to set fixed threshold values which are set at the same level as the respective threshold floor of liquid classes within the same asset class. This approach caters for the difficulty to determine meaningful thresholds for classes that are not liquid and where only very few trades (and of a very variable volumes) may take place.
41. ESMA is aware that many respondents raised concerns about the use of threshold floors. Nevertheless ESMA considered those floors necessary to avoid that transparency for instruments traded already on exchanges does not decrease after the introduction of the new transparency regime. The objective of MiFIR/MiFID II is to increase transparency and it would appear counterintuitive if the new regime resulted in a less transparent regime for exchange traded instruments or potentially trigger a race to the bottom. However, ESMA recalibrated the threshold floors proposed and considered the specific market structure of the respective asset class when setting them. Furthermore, to avoid distortions within one asset class, the same threshold floors per asset class are proposed⁵, for respectively the pre-trade and post-trade SSTI and LIS.
42. The draft RTS provide instructions which transactions should be taken into account for determining the SSTI and LIS thresholds. The baseline is that thresholds should be calculated at the sub-class level and include all transaction executed in financial instruments belonging to that sub-class. In some cases, where the taxonomy does not provide for a sub-class (e.g. emission allowances and emission allowance derivatives) the calculations will be calculated at the sub-asset-class level.
43. A detailed overview of the approach per asset class is provided in table 11, further details on the methodology applicable to each asset class are included in the relevant section of the asset class (sections D to K).
44. Respondents did broadly agree, however, that the LIS and SSTI thresholds should be set according to the proposed volume measure (e.g. notional amount in EUR of traded contracts for derivatives) presented in the CP. For some classes, e.g. commodity derivatives, some respondents were however suggesting using a different volume measure, such as lots. ESMA has not amended its proposal but allows trading venues to convert such thresholds in lots and maintain those sizes fixed over the year.
45. Taken together these changes allow for a more accurate determination of the transparency thresholds, taking into account the specific market structures and the needs to protect liquidity providers from undue risk (pre-trade SSTI).

Bonds and structured finance products

⁵ With the exception of emission allowances, emission allowance derivatives and interest rate derivatives.

46. ESMA proposes to calculate the SSTI and LIS thresholds in line with the revised dynamic approach for determining the transparency thresholds. In particular, for liquid and illiquid bonds the SSTI and LIS thresholds will be calculated in relation to percentiles in terms of trade count. A similar approach is proposed for SFPs, with the difference that threshold floors are used in addition for liquid SFPs and fixed value thresholds are used for illiquid SFPs. The proposal for bonds and structured finance products is summarised in sections A and B respectively.

Securitised derivatives

47. ESMA proposed to define static SSTI and LIS thresholds for securitised derivatives. The proposal for securitised derivatives is summarised in section C

Equity derivatives

48. ESMA revised its approach for equity derivatives and proposes an approach similar to the one applicable to shares for liquid classes, i.e. the applicable SSTI and LIS thresholds will be calibrated in relation to the average daily notional amount. The analysis of the feedback and the proposal for equity derivatives is summarised in section G.

Table 11: Overview of methodology to set the pre-trade and post-trade SSTI and LIS

	Pre-trade						Post-trade							
	SSTI			LIS			SSTI				LIS			
	Trade - percentile	Threshold floor	Threshold value	Trade - percentile	Threshold floor	Threshold value	Trade - percentile	Volume - percentile	Threshold floor	Threshold value	Trade - percentile	Volume - percentile	Threshold floor	Threshold value
BONDS														
ETCs - liquid	-	-	EUR 1,000,000	-	-	EUR 1,000,000	-	-	-	EUR 50,000,000	-	-	-	EUR 50,000,000
ETCs - illiquid	-	-	EUR 900,000	-	-	EUR 900,000	-	-	-	EUR 45,000,000	-	-	-	EUR 45,000,000
ETNs - liquid	-	-	EUR 1,000,000	-	-	EUR 1,000,000	-	-	-	EUR 50,000,000	-	-	-	EUR 50,000,000
ETNs - illiquid	-	-	EUR 900,000	-	-	EUR 900,000	-	-	-	EUR 45,000,000	-	-	-	EUR 45,000,000
Covered bonds	40	-	-	70	-	-	80	-	-	-	90	-	-	-
For all other bond types	60	-	-	70	-	-	80	-	-	-	90	-	-	-

	Pre-trade						Post-trade							
	SSTI			LIS			SSTI				LIS			
	Trade - percentile	Threshold floor	Threshold value	Trade - percentile	Threshold floor	Threshold value	Trade - percentile	Volume - percentile	Threshold floor	Threshold value	Trade - percentile	Volume - percentile	Threshold floor	Threshold value
SFPs														
Test-1 (SFPs - asset class assessment) and Test-2 (financial instrument assessment) both passed	60	-	EUR 100,000	70	-	EUR 250,000	80	-	-	EUR 500,000	90	-	-	EUR 1,000,000
Test-1 (SFPs - asset class assessment) passed but Test-2 (financial instrument assessment) not passed	-	-	EUR 100,000	-	-	EUR 250,000	-	-	-	EUR 500,000	-	-	-	EUR 1,000,000
Test-1 (SFPs - asset class assessment) not passed	-	-	EUR 100,000	-	-	EUR 250,000	-	-	-	EUR 500,000	-	-	-	EUR 1,000,000

	Pre-trade						Post-trade							
	SSTI			LIS			SSTI				LIS			
	Trade - percentile	Threshold floor	Threshold value	Trade - percentile	Threshold floor	Threshold value	Trade - percentile	Volume - percentile	Threshold floor	Threshold value	Trade - percentile	Volume - percentile	Threshold floor	Threshold value
EMISSION ALLOWANCES														
For European Union Allowances (EUA)														
Liquid sub-asset classes	60	40,000 tons of Carbon Dioxide	-	70	50,000 tons of Carbon Dioxide	-	80	-	90,000 tons of Carbon Dioxide	-	90	-	100,000 tons of Carbon Dioxide	-
Illiquid sub-asset classes	-	-	40,000 tons of Carbon Dioxide	-	-	50,000 tons of Carbon Dioxide	-	-	-	90,000 tons of Carbon Dioxide	-	-	-	100,000 tons of Carbon Dioxide
For emission allowances other than EUA														
Liquid sub-asset classes	60	20,000 tons of Carbon Dioxide	-	70	25,000 tons of Carbon Dioxide	-	80	-	40,000 tons of Carbon Dioxide	-	90	-	50,000 tons of Carbon Dioxide	-
Illiquid sub-asset classes	-	-	20,000 tons of Carbon Dioxide	-	-	25,000 tons of Carbon Dioxide	-	-	-	40,000 tons of Carbon Dioxide	-	-	-	50,000 tons of Carbon Dioxide
EMISSION ALLOWANCE DERIVATIVES														
For European Union Allowances (EUA)														
Liquid sub-asset classes	60	40,000 tons of Carbon Dioxide	-	70	50,000 tons of Carbon Dioxide	-	80	-	90,000 tons of Carbon Dioxide	-	90	-	100,000 tons of Carbon Dioxide	-
Illiquid sub-asset classes	-	-	40,000 tons of Carbon Dioxide	-	-	50,000 tons of Carbon Dioxide	-	-	-	90,000 tons of Carbon Dioxide	-	-	-	100,000 tons of Carbon Dioxide

	Pre-trade						Post-trade							
	SSTI			LIS			SSTI				LIS			
	Trade - percentile	Threshold floor	Threshold value	Trade - percentile	Threshold floor	Threshold value	Trade - percentile	Volume - percentile	Threshold floor	Threshold value	Trade - percentile	Volume - percentile	Threshold floor	Threshold value
EMISSION ALLOWANCE DERIVATIVES														
For emission allowances other than EUA														
Liquid sub-asset classes	60	20,000 tons of Carbon Dioxide	-	70	25,000 tons of Carbon Dioxide	-	80	-	40,000 tons of Carbon Dioxide	-	90	-	50,000 tons of Carbon Dioxide	-
Illiquid sub-asset classes	-	-	20,000 tons of Carbon Dioxide	-	-	25,000 tons of Carbon Dioxide	-	-	-	40,000 tons of Carbon Dioxide	-	-	-	50,000 tons of Carbon Dioxide
C10 DERIVATIVES														
Liquid sub-asset classes	60	EUR 25,000	-	70	EUR 50,000	-	80	60	EUR 75,000	-	90	70	EUR 100,000	-
Illiquid sub-asset classes	-	-	EUR 25,000	-	-	EUR 50,000	-	-	-	EUR 75,000	-	-	-	EUR 100,000
INTEREST RATE DERIVATIVES														
Bond futures/forwards, bond options liquid sub-classes	60	EUR 4,000,000	-	70	EUR 5,000,000	-	80	60	EUR 20,000,000	-	90	70	EUR 25,000,000	-
Bond futures/forwards, bond options illiquid sub-classes	-	-	EUR 4,000,000	-	-	EUR 5,000,000	-	-	-	EUR 20,000,000	-	-	-	EUR 25,000,000

	Pre-trade						Post-trade							
	SSTI			LIS			SSTI				LIS			
	Trade - percentile	Threshold floor	Threshold value	Trade - percentile	Threshold floor	Threshold value	Trade - percentile	Volume - percentile	Threshold floor	Threshold value	Trade - percentile	Volume - percentile	Threshold floor	Threshold value
INTEREST RATE DERIVATIVES														
IR futures and FRA, IR options liquid sub-classes	60	EUR 5,000,000	-	70	EUR 10,000,000	-	80	60	EUR 20,000,000	-	90	70	EUR 25,000,000	-
IR futures and FRA, IR options illiquid sub-classes	-	-	EUR 5,000,000	-	-	EUR 10,000,000	-	-	-	EUR 20,000,000	-	-	-	EUR 25,000,000
Liquid sub-classes for all other IR sub-asset classes	60	EUR 4,000,000	-	70	EUR 5,000,000	-	80	60	EUR 9,000,000	-	90	70	EUR 10,000,000	-
Illiquid sub-classes for all other IR sub-asset classes	-	-	EUR 4,000,000	-	-	EUR 5,000,000	-	-	-	EUR 9,000,000	-	-	-	EUR 10,000,000
EQUITY DERIVATIVES														
A different methodology applies to liquid sub-classes. For each sub-asset class ADNA bands are defined and for each band a threshold value is specified. Refer to the relevant section for further details.														
Illiquid sub-classes of swaps and portfolio swaps	-	-	EUR 20,000	-	-	EUR 25,000	-	-	-	EUR 100,000	-	-	-	EUR 150,000

	Pre-trade						Post-trade							
	SSTI			LIS			SSTI				LIS			
	Trade - percentile	Threshold floor	Threshold value	Trade - percentile	Threshold floor	Threshold value	Trade - percentile	Volume - percentile	Threshold floor	Threshold value	Trade - percentile	Volume - percentile	Threshold floor	Threshold value
COMMODITY DERIVATIVES														
Liquid sub-asset classes	60	EUR 250,000	-	70	EUR 500,000	-	80	60	EUR 750,000	-	90	70	EUR 1,000,000	-
Illiquid sub-asset classes	-	-	EUR 250,000	-	-	EUR 500,000	-	-	-	EUR 750,000	-	-	-	EUR 1,000,000
FX DERIVATIVES														
	-	-	EUR 4,000,000	-	-	EUR 5,000,000	-	-	-	EUR 20,000,000	-	-	-	EUR 25,000,000
CREDIT DERIVATIVES														
Liquid sub-asset classes	60	EUR 2,500,000	-	70	EUR 5,000,000	-	80	60	EUR 7,500,000	-	90	70	EUR 10,000,000	-
Illiquid sub-asset classes	-	-	EUR 2,500,000	-	-	EUR 5,000,000	-	-	-	EUR 7,500,000	-	-	-	EUR 10,000,000
CFDs														
Liquid sub-asset classes	60	EUR 50,000	-	70	EUR 60,000	-	80	60	EUR 90,000	-	90	70	EUR 100,000	-
Illiquid sub-asset classes	-	-	EUR 50,000	-	-	EUR 60,000	-	-	-	EUR 90,000	-	-	-	EUR 100,000

Dynamic calculation

49. Respondents supported the dynamic methodology ESMA suggested for calculating the SSTI and the LIS thresholds stressing that this would allow to capture future changes in the market structure. ESMA therefore proposes in the draft RTS to determine thresholds periodically as of the application of MiFID II. More detailed feedback on the methodology for determining the thresholds see paragraphs 40 to 48, details on the implementation of the new regime is provided in section 2.2.3.

Deferral period

50. The large majority of stakeholders across all asset classes were against the introduction of a deferral period of 48h and recommended instead to reference the deferral period to business days, e.g. T+2 business days, as this would simplify the operational burden of the requirement and ensure that transactions that occur close to the end of trading before a weekend or bank holiday are treated in the same manner as transactions under ordinary conditions.
51. Views on the appropriate length of the deferral period were split. Responses from the sell-side and the buy-side were in favour of extending the deferral period, in particular for trades in illiquid instruments that are large in scale, to up to 12 weeks, in order to avoid in effect unmasking the identity of the firm taking on risk in thin markets. Exchanges, on the other hand, were generally in favour of shortening deferral periods to end of day or to a maximum of 24h and stressed that currently most on-venue trades are published immediately and that block sizes on exchanges are significantly higher than the LIS thresholds proposed by ESMA.
52. In light of the feedback, ESMA has revisited its proposal and amended the deferral period to two trading days after the transaction has taken place ('T+2') as recommended in the feedback to the CP. However, given the split of views at opposite ends of the spectrum, and bearing in mind the possibility of supplementary deferrals granted at the discretion of CAs, as well as the need to avoid excessive complexity, ESMA has decided not to further adjust deferrals for different types of transactions but to set a T+2 deferral period across the board.
53. Some respondents raised concerns that the current drafting 'of no longer than 48 hours' would be ambiguous and could be understood as allowing CAs to grant shorter deferral periods (e.g. 24h), thereby leading to a patchwork of applicable deferral periods across the EU. ESMA would like to clarify that CAs may only grant a deferral period of 2 business days following the transaction with no discretion to shorten the deferral period.
54. The asset class specific elements are presented on a per asset class basis in the following sections.

II. Asset class specific analysis

A. Bonds

Liquidity

Summary of key proposals in the CP

55. For the purpose of determining liquid classes of bonds and SFPs, ESMA collected information from transaction reporting from 25 CAs for the period 1 June 2013 - 31 May 2014. ESMA included in the analysis 54,395 bonds, out of which 49% did not trade over the period.
56. Taking into account the responses from the DP, ESMA calibrated the COFIA aiming at optimising the number of bonds and SFPs correctly classified when using the following liquidity thresholds (hereinafter liquidity criteria):
 - i. 400 trades a year;
 - ii. 200 trading days a year; and
 - iii. an average notional amount traded of €100,000 per day.
57. These liquidity criteria were tested at ISIN level to build the basis for grouping instruments into liquidity classes.
58. Different explanatory variables were examined to analyse the predicting power on liquidity: issuance size, time to maturity, currency, instrument type and issuer type (financial vs. non-financial). Some of them had a relatively low predicting power on liquidity so the level of granularity was decided on the basis of the simplest classes with better predicting power.
59. The empirical exercise demonstrated that there was a clear relationship between liquidity and issuance size (the bigger the issuance size, the more liquid is the bond). Based on that, ESMA designed the classes optimising the issuance size for a given combination of instrument type and issuer type, under the objective of classifying correctly, according to the liquidity criteria, the majority of instruments belonging to a liquid or illiquid class.
60. In the CP ESMA proposed the segmentation below:

Table 12: Bonds and SFPs

BOND TYPE	DEBT SENIORITY	ISSUER SUB-TYPE	ISSUANCE SIZE*	Liquidity Test: 200 days traded, 400 trades and €100,000 nominal amount a year
European Sovereign Bond			greater or equal to 2,000,000,000	Liquid
Non-European Sovereign Bond			greater or equal to 2,000,000,000	Liquid
Other European Public Bond			greater or equal to 1,000,000,000	Liquid
Convertible Bond		Financial	greater or equal to 750,000,000	Liquid
Covered Bond			greater or equal to 750,000,000	Liquid
Corporate Bond	Senior	Financial	greater or equal to 500,000,000	Liquid
Corporate Bond	Senior	Non-financial	greater or equal to 750,000,000	Liquid
Corporate Bond	Subordinated	Financial	greater or equal to 500,000,000	Liquid
Corporate Bond	Subordinated	Non-financial	greater or equal to 500,000,000	Liquid
Convertible Bond		Non-financial		Illiquid
SFPs				Illiquid
Others				Illiquid

Analysis following feedback from stakeholders on CP proposals

61. Respondents to the CP expressed different views about the liquidity criteria. Some of them supported ESMA's proposal while others considered that the thresholds were too low and should be increased, hence being more demanding to be considered liquid.
62. Concerning the general approach to use COFIA, some respondents, mainly from the sell-side, asked ESMA to reconsider IBIA.
63. However other respondents supported the use of the COFIA and made some comments to increase the accuracy of the model.
64. Most of the respondents agreed that issue size is a good indicator to determine liquidity, while stressing that it is not the only driver. They proposed to consider other variables in order to find the appropriate granularity for COFIA, such as spreads, number of market participants, rating, placement of the issue, market structure, etc.
65. Respondents agreed that the proposed classes needed recalibration, specially increasing issue size thresholds. While some respondents preferred more granularity including adding further variables as mentioned above, others preferred fewer classes but adjusted issuance sizes. Those who supported the simplification of the classes did not see the need to divide corporate bonds by issuer type (financial vs. non-financial) and by seniority (senior vs. subordinated).
66. Most stakeholders claimed that most fixed income products were mainly liquid after issuance and rather illiquid afterwards.
67. In the CP ESMA also consulted on the definitions of the classes of bonds to be included in the draft RTS. ESMA received some feedback that the category of corporate bonds did not include the "Societas europaea" and that it was not clear to which bond type the category 'other non-European public bond belonged'.

ESMA's proposal for draft final RTS

68. Having carefully reconsidered the pros and cons of IBIA versus COFIA, including the arguments put forth by different groups of stakeholders, ESMA proposes to use IBIA for the liquidity assessment of bonds for a number of reasons:
- i. in consideration of the high number of false positives, i.e. bonds classified as liquid on the basis of the issuance size but not according to the trading activity presented by COFIA, ESMA attempted to refine the system in order to improve its accuracy. In particular, in comparison with COFIA proposed in the December CP, the number of classes was reduced by not taking into consideration debt seniority (senior vs subordinated) and issuer sub-type (financial vs non-financial). Furthermore, time from issuance was included as parameter (2 weeks for corporate bonds and 3 months for all the other bond types). Last but not least, the issuance sizes were reduced for the period close to issuance). However, the accuracy of the model showed only marginal improvements. In particular, the percentage of false positives decreased from 56.51% to 50.76% amongst all instruments at the expense of a slight increase of false negatives from 1.77% to 2.58% (the low percentage of false negatives is not surprising as the large majority of instruments is illiquid and will always be correctly classified). For more details on the accuracy of IBIA please refer to the cost-benefit analysis section;
 - ii. IBIA has no false positives/false negatives at the time of calculation, but can be inaccurate between calculation dates. When looking back, at the end of each quarter, some bonds that were classified as illiquid in the previous quarter may have actually traded above the liquidity thresholds and vice-versa. This relates to the fact that the past is not always a good indicator of the future, which is also true in the case of COFIA where any bond correctly classified as liquid also not necessarily remains liquid in the future. However, in the case of IBIA these misclassifications due to a change in the liquidity status of the bond (from liquid to illiquid or vice-versa) are corrected from one quarter to the other by means of the periodic liquidity reassessment. For more details on the accuracy of IBIA please refer to the cost-benefit analysis section;
 - iii. considering that the performance of the calculations for LIS and SSTI requires the collection of trading activity data and that such data will be collected on a daily basis, the incremental costs of implementing IBIA are marginal in comparison to a more correct classification of bonds.
69. In conclusion, IBIA is considered to strike the right balance among flexibility, stability and operational manageability.
70. Consequently, it is proposed that the liquidity of each bond is re-assessed at the end of every quarter on the basis of the following parameters and taking as observation period the last quarter;
- i. average daily nominal amount, which should be at least EUR 100,000;

- ii. average daily number of trades, which should be at least 2;
 - iii. minimum number of days traded which should correspond to at least 80% of the trading sessions available.
71. Furthermore, newly issued instruments are deemed to be liquid according to their issuance size. A bond is considered to be liquid until application of the first assessment based on the trading activity recorded over a quarter. In particular, for bonds issued during the first two months of a quarter the classification of liquidity based on the issuance size will last until the publication of the results of the calculations at the end of that calendar quarter. On the other hand, for bonds issued during the last month of a quarter the classification of liquidity based on the issuance size will last until the publication of the results of the calculations at the end of the next calendar quarter. The applicable issuance size for each bond type is the one provided below:

Bond Type	Time from issuance	Issuance size
Sovereign Bond	< 3 months	smaller than € 1,000,000,000
	≥ 3 months	smaller than € 2,000,000,000
Other Public Bond	< 3 months	smaller than € 500,000,000
	≥ 3 months	smaller than € 1,000,000,000
Convertible Bond	< 3 months	smaller than € 500,000,000
	≥ 3 months	smaller than € 1,250,000,000
Covered Bond	< 3 months	smaller than € 500,000,000
	≥ 3 months	smaller than € 1,250,000,000
Corporate Bond	< 2 weeks	smaller than € 500,000,000
	≥ 2 weeks	smaller than € 1,000,000,000

Pre-trade and post-trade LIS and SSTI

Analysis following feedback from stakeholders on CP proposals and proposal for draft final RTS

72. Regarding bonds, market participants argued against the use of the percentage of volume as a measure to determine LIS thresholds. They were concerned that the threshold would dramatically increase when the 70% methodology kicks in. According to some respondents' calculations if the LIS were set at 70% of nominal value traded, 99% of the trades will be below the threshold.
73. ESMA understands that the proposed methodology could be biased by a few extremely huge transactions that could represent a significant percentage of the total volume although representing just a small proportion of transactions, and hence recognizes the risk of adding the percentage of volume as a measure for setting the thresholds.
74. There was also criticism to the removal of trades below €100.000 from the calculation of the thresholds. However, in contrast to the volume measure, the calculation of LIS or

SSTI based on number of trades can be biased by a huge amount of retail transactions in small sizes, but representing a small proportion of the market volume. According to Directive 2010/73/EU the distinction between retail and professional investors in terms of investor capacity is set at a denomination per unit of at least €100.000.

75. ESMA considers that a minimum level of transparency needs to be guaranteed, in particular for retail investors, and that it is therefore necessary to exclude those transactions from the calculation of LIS and SSTI thresholds.
76. The majority of respondents were against the use of the proposed floors saying that the value of recalculation of the thresholds is questionable since it does not permit a lowering of the thresholds if the evolution of the market justifies it.
77. ESMA recognises the difficulty in setting appropriate thresholds that will not damage the dynamic determination of thresholds and acknowledges that excluding trades below €100.000 from the calculation is already establishing an implicit floor protecting the minimum level of transparency required for retail investors. For that reason ESMA has revised its proposal so that no additional floors are considered for liquid bonds.
78. Some respondents pointed out that covered bonds in the form of mortgage bonds are very important for the functioning of the housing markets. In these markets, market makers put their own capital at risk acting as intermediaries between institutional investors who only want to trade in big blocks and the homeowners who need to finance their houses and trade in retail sizes. It would imply an undue risk for these market makers, if they were forced to quote at sizes above the average price for houses and apartments. This could motivate them to leave this market altogether – with serious detrimental consequences for the ordinary mortgage borrowers.
79. Noticing that mortgage bonds are the most liquid type of covered bonds and that they serve a real economic purpose (financing a home for ordinary individuals), ESMA agrees that the function of this market should be protected by allowing a pre-trade transparency waiver for the mentioned liquidity providers above a transaction size which is reflective of the average price of a home and set to a lower trade percentile (40%) with respect to the other bond types.
80. Last but not least, the classes of European and non-European bonds for sovereign and public bonds were merged to ensure consistent treatment across sovereign and public bonds respectively.

Exchange traded commodities (ETCs) and Exchanges traded notes (ETNs)

81. In the December CP ESMA categorised ETCs and ETNs as securitised derivatives which were as a whole considered to be a liquid class.
82. However, a number of respondents raised concerns about the treatment of ETCs and ETNs and suggested to apply to those instruments the same transparency regime as for

ETFs arguing that those instruments change largely the same characteristics and that a different transparency regime might lead to market distortions. ESMA agrees that ideally ETCs, ETNs and ETFs should be covered under the same transparency regime given their similarities.

83. After further analysis ESMA concluded that the definition for ETFs in MiFID II applies only to fund structures and is therefore not applicable for ETCs and ETNs. However, in order to ensure a harmonised treatment of instruments sharing the same characteristics and taking into account the features of fixed income products of ETCs and ETNs, ESMA proposes to categorise those instruments as types of bonds and to apply a similar transparency regime for ETCs and ETNs as for ETFs.
84. Liquidity will be assessed on an instrument level as for ETFs and on the basis of the thresholds for 2 liquidity criteria, namely the ADT and average number of trades.
85. Again, similarly to ETFs, fixed values are set as pre-trade and post-trade LIS and SSTI thresholds. Furthermore, the SSTI threshold is set equal to the LIS as to have a unique threshold, again in line with ETFs. Last but not least, in line with the general approach, the pre-trade thresholds are set at lower values than post-trade thresholds.

B. Structured Finance Products

Analysis following feedback from stakeholders

86. For the CP the liquidity of SFPs was analysed on the basis of the same liquidity criteria as for bonds, i.e. at least 400 trades a year, traded on at least 200 days a year and a minimum nominal amount traded per day of € 100,000. Since the analysis revealed that on this basis 99.69% of SFPs would have been illiquid, ESMA proposed to classify the whole asset class as illiquid.
87. While many respondents agreed to this proposal, some responses pointed to the need of better distinguishing between different types of SFPs, since some instruments (e.g. certain Residential Mortgage Bonds) may be liquid. A number of respondents also pointed to the possibility that, in light with current policies to revive securitisation markets, SFPs might become sufficiently liquid in future.
88. ESMA agrees that the market for SFPs may become more liquid if attempts to revive securitisation markets are successful. Furthermore, ESMA considers that going forward the capital markets union (CMU) might also improve the liquidity of SFPs and that it might be contradictory for the success of both initiatives to introduce a static liquidity approach for SFPs, which would classify those instruments as illiquid irrespective of possible developments in the near future.

Proposal

89. In order to strike the right balance between the current situation where SFPs are illiquid and providing for sufficient flexibility to accommodate future market developments, ESMA revised its proposal and suggests a two-step liquidity assessment.
90. In a first test, the liquidity of the asset class as a whole would be assessed using the following quantitative liquidity criteria on a cumulative basis:
 - i. Average daily notional amount of at least € 300,000,000; and
 - ii. Average daily number of trades of at least 500.
91. If these criteria are not met, all SFPs will be considered as not having a liquid market. However, should the SFP class as a whole meet these criteria, a second liquidity test on an instrument basis would be undertaken. Every single SFP would be assessed against the following quantitative liquidity criteria on a cumulative basis:
 - i. Average daily notional amount of at least € 100,000;
 - ii. Average daily number of trades of at least 2; and
 - iii. Traded on at least 80% of trading days over the period considered.

92. Depending on the results of the tests, ESMA proposes the following methodology for determining the SSTI and LIS thresholds (pre-trade and post-trade):

- i. Scenario#1: the first test is not passed all SFPs are considered not having a liquid market, then fixed threshold values for all SFPs apply;
- ii. Scenario#2: the first test is passed but the second is not, those SFPs are considered not having a liquid market, then the same fixed threshold values provided in scenario#1 apply to those SFPs;
- iii. Scenario#3: the first and the second tests are both passed, those SFPs are considered having a liquid market, then the thresholds are determined as the greater of the trade size related to the trade percentiles and the threshold floors

Table 13: SSTI and LIS thresholds for SFPs having a liquid market – Scenario #3

SSTI pre-trade		LIS pre-trade		SSTI post-trade		LIS post-trade	
Trade percentile	Floor threshold						
60	EUR 100,000	70	EUR 250,000	80	EUR 500,000	90	EUR 1 million

Table 14: SSTI and LIS thresholds for SFPs not having a liquid market– Scenario #1 and Scenario #2

SSTI pre-trade	LIS pre-trade	SSTI post-trade	LIS post-trade
EUR 100,000	EUR 250,000	EUR 500,000	EUR 1 million

C. Securitised Derivatives

Summary of key proposals in the CP

93. In the CP ESMA analysed a dataset collected from 9 trading venues for the period of 1 June 2013 – 31 May 2014 covering 3,427,815 securitised derivatives of a wide range of product types. ESMA proposed that all securitised derivatives should be qualified as liquid. The majority of instruments were investment certificates, plain vanilla covered warrants and leverage certificates. The remaining 0.03% instruments included in the data set included exotic covered warrants, exchange-traded-commodities, exchange-traded notes, negotiable rights, structured medium-term-notes and other warrants.
94. Roughly 94% of the whole sample traded very little or not at all during the one year period covered. Furthermore, for approximately 98% of the whole sample at least one market maker was available. However, those instruments admitted to trading without the presence of a market maker constituted 71% of trades and 61% of volume traded of the whole sample and on average they traded more than twice a day (2.17 times) with an average volume of €6,843 traded per day.
95. Since either a market maker was available for the instruments covered or they met the liquidity thresholds. ESMA suggested in the CP that all securities derivatives should be liquid.
96. For the LIS and SSTI thresholds ESMA proposed to use the same threshold values for pre-trade and post-trade transparency purposes and suggested to set the SSTI at 50% of the LIS.

Analysis following feedback from stakeholders and proposal

97. The responses were split with regards to the liquidity assessment. On one side respondents agreed with the proposal to qualify all securitised derivatives as liquid, highlighting the retail focused nature of the market for securitised derivatives. On the other side respondents were of the opinion that the presence of a market maker is not a sufficient proxy for liquidity and proposed a liquidity assessment that is based on a more granular approach.
98. The majority of respondents supported the proposed definition of securitised derivatives. Some respondents proposed a clearer delineation between securitised derivatives on one hand and bonds, structured finance products and derivatives on the other hand. Some respondents argued that there is a risk that different trading venues and investment firms would treat structured debt securities with an embedded derivative differently for transparency purposes
99. ESMA therefore maintains its approach that all securitised derivatives should be qualified as liquid.

100. ESMA revised the thresholds for pre-trade and post-trade SSTI. In line with the overall changed approach, the new SSTI and LIS thresholds for pre-trade purposes are lower than the ones for post-trade purposes. Given the large amounts of retail market participants in this market, ESMA proposes to keep low and fixed thresholds, ranging from € 50,000 (pre-trade SSTI) to € 100,000 (post-trade LIS).

Table 15: SSTI and LIS thresholds for securitised derivatives

SSTI pre-trade	LIS pre-trade	SSTI post-trade	LIS post-trade
EUR 50,000	EUR 60,000	EUR 90,000	EUR 100,000

101. Finally, ETCs and ETNs are now categorised as bonds, for further details on ESMA proposal, see section A.

D. Interest Rate Derivatives

Summary of key proposals in December CP

102. In determining the thresholds for interest rate derivatives, ESMA undertook two data collection exercises, one from trading venues and one from TRs. The determination of liquidity distinguished between exchange traded derivatives (ETDs) and OTC derivatives.
103. For sub-asset classes of ETDs ESMA set the liquidity thresholds at an average trade per day of 1 or more and an average notional amount per day of EUR 5 million or more.
104. To determine whether an OTC interest rate derivative sub-class was liquid or illiquid, ESMA applied a two-step methodology. Firstly, ESMA applied quantitative liquidity thresholds at the sub-asset class level and secondly, for those sub-asset classes considered liquid based on these liquidity thresholds, ESMA further segmented each sub-asset class into sub-classes using a set of qualitative criteria, namely tenor, underlying and currency/ currency pair. Each sub-class was then re-assessed on the basis of quantitative thresholds, i.e. the average number of trades per day and notional amount per day, specified on a sub-asset class level.
105. For those sub-classes of financial instruments which were deemed to have a liquid market, ESMA asked stakeholders whether it should include sub-classes where the tenor is over the period specified for the related sub-class or include only sub-classes whose tenor is not a broken date (whether the tenor is a broken date was calculated as the difference between the maturity date and execution date with a tolerance of +/- 5 days).

Analysis following feedback from stakeholders

106. Overall, respondents did not agree with the thresholds ESMA set for determining whether a sub-class was liquid or not. Respondents considered the liquidity thresholds as too low and required for some sub-asset classes, particularly for swaptions and inflation rate single currency swaps, more granularity. Responses also queried the accuracy of the data, e.g. noting that Bunds less than 3 months to maturity were not identified as liquid and were considered to have a much lower volume than Gilts although Bunds are the EU's most liquid bond futures.
107. Concerns were raised that ESMA's taxonomy did not clearly distinguish between ETDs and OTC traded interest rate derivatives and that sub-classes were not consistently broken down to an equivalent level of granularity. There was also widespread criticism of ESMA's proposal not to reassess the sub-classes periodically.
108. A number of respondents provided detail regarding the liquidity status they would expect to see for specific sub-asset classes. For example, stakeholders expected liquidity to be concentrated in tenors less than three months for bond futures. A couple of

respondents noted that interest rate futures are similar to FRAs but that both sub-asset classes have been calibrated at a different level of granularity. Some stakeholders argued that for swaptions, the categories should be set at a more granular level using the tenor of the option and of the underlying as otherwise the swaption could be liquid although the underlying could be illiquid. Other comments related to the fact that some classes deemed liquid by ESMA, such as inflation single currency swaps and float to float multi-currency swaps should be illiquid

109. With respect to the two options for tenors, there was a slight preference for excluding broken dates and in particular, respondents noted option 2 was important for the trading obligation and would align the EU trading obligation to the approach in the US as the made available to trade (MAT) swaps are limited to benchmark tenors.

Proposal in final draft RTS

110. The liquid and illiquid sub classes for interest rate derivatives are constructed in line with the general approach described in the introductory section of this chapter. In response to the feedback received, IR futures and FRAs now form one sub-asset class. The sub-asset classes (e.g. bond futures, swaptions etc.) are further segmented into more granular sub-classes by reference to the criteria specified in Annex III of the final draft RTS, for example time to maturity. The criteria vary slightly from sub-asset class to sub-asset class. For example, sub-classes for bond futures are determined based on specified time to maturity buckets, the issuer of the underlying and the term of the underlying deliverable bond, whereas a fixed to float multi-currency swap sub-class is determined based on time to maturity bucket and the notional currency pair. An annual liquidity assessment will be undertaken for each sub-class.

111. With regard to the liquidity thresholds, the minimum average daily notional amount ranges between EUR 5 million and EUR 500 million and the minimum average number of trades per day is 10 for all sub-classes. The below table shows the quantitative liquidity thresholds for liquidity.

Table 16: Quantitative liquidity thresholds interest rate derivatives sub-asset classes

Sub-asset class	Average daily notional	Average number of trades
Bond Futures/Forwards	EUR 5 million	10
Bond Options	EUR 5 million	10
IR Futures and FRAs	EUR 500 million	10
IR Options		
Swaptions		

Fixed to float swaps and Futures /Forwards on fixed to float swaps (multi and single currency)	EUR 50 million	10
Float to float swaps and Futures /Forwards on float to float swaps (multi and single currency)		
Fixed to fixed swaps and Futures /Forwards on fixed to fixed swaps (multi and single currency)		
OIS swaps and Futures /Forwards on OIS swaps (multi and single currency)		
Inflation swaps and Futures /Forwards on inflation swaps (multi and single currency)		

112. Other interest rate derivatives not belonging to one of the defined sub-asset classes are considered to be illiquid. An annual liquidity assessment will be undertaken for each sub-class.
113. The SSTI and LIS thresholds for interest rate derivatives are calibrated in line with the general approach described in the introductory section of this chapter. The pre-trade transparency thresholds are set at a lower level than the post-trade transparency thresholds. For liquid sub-classes, the pre-trade transparency thresholds are set as the greater of a pre-determined floor and a trade percentile, and the post-trade transparency thresholds are set as the greater of a pre-determined floor, a trade percentile and a volume percentile if the volume percentile for the LIS threshold is not higher than the 97.5th percentile, in that case the trade percentile should prevail for both the LIS and SSTI.
114. For illiquid sub-classes, the thresholds are the same as the pre-determined threshold floors used for the liquid calculations. The thresholds floors are calibrated across the different sub-asset classes as to take into account the current block trade sizes applied on venues. The thresholds floors are summarised in the two tables below.

Table 17: SSTI and LIS thresholds for sub-classes having a liquid market

Sub-asset class	SSTI pre trade		LIS pre trade		SSTI post trade			LIS post trade		
	Trade percentile	Floor threshold	Trade percentile	Floor threshold	Trade percentile	Volume percentile	Floor threshold	Trade percentile	Volume percentile	Floor threshold
Bond Futures/Forwards	60	EUR 4 million	70	EUR 5 million	80	60	EUR 20 million	90	70	EUR 25 million
Bond Options										
IR Futures and FRAs		EUR 5 million		EUR 10 million			EUR 20 million			EUR 25 million
IR Options										
Swaptions										
Fixed to float swaps and Futures /Forwards on fixed to float swaps (multi and single currency)										
Float to float swaps and Futures /Forwards on float to float swaps (multi and single currency)										
Fixed to fixed swaps and Futures /Forwards on fixed to fixed swaps (multi and single currency)		EUR 4 million		EUR 5 million			EUR 9 million			EUR 10 million
OIS swaps and Futures /Forwards on OIS swaps (multi and single currency)										
Inflation swaps and Futures /Forwards on inflation swaps (multi and single currency)										

Table 18: SSTI and LIS thresholds for sub-classes not having a liquid market

Sub-asset class	SSTI pre trade	LIS pre trade	SSTI post trade	LIS post trade
Bond Futures/Forwards	EUR 4 million	EUR 5 million	EUR 20 million	EUR 25 million
Bond Options				
IR Futures and FRAs	EUR 5 million	EUR 10 million	EUR 20 million	EUR 25 million
IR Options				
Swaptions				
Fixed to float swaps and Futures /Forwards on fixed to float swaps (multi and single)	EUR 4 million	EUR 5 million	EUR 9 million	EUR 10 million

currency)				
Float to float swaps and Futures /Forwards on float to float swaps (multi and single currency)				
Fixed to fixed swaps and Futures /Forwards on fixed to fixed swaps (multi and single currency)				
OIS swaps and Futures /Forwards on OIS swaps (multi and single currency)				
Inflation swaps and Futures /Forwards on inflation swaps (multi and single currency)				

E. Foreign Exchange (FX) Derivatives

Summary of key proposals in December CP

115. In determining the liquidity thresholds for FX derivatives, ESMA collected data from TRs. ESMA divided FX derivatives into six sub-asset classes and applied a two-step methodology. Firstly, ESMA applied quantitative liquidity thresholds at the sub-asset class level and secondly, for sub-asset classes considered liquid based on these liquidity thresholds, ESMA further segmented each sub-asset class into sub-classes using a set of qualitative criteria, namely tenor and underlying currency pair. After segmentation the liquidity of each sub-class was re-assessed on the basis of quantitative thresholds, i.e. the average number of trades per day and notional amount per day, specified on a sub-asset class level.

Analysis following feedback from stakeholders

116. Respondents raised significant concerns over the accuracy of the data used for the analysis in the paper and consequently disagreed with ESMA's proposals on what is a liquid market. The majority did, however, agree with the qualitative criteria ESMA proposed to further segment the sub-asset classes but suggested distinguishing swaps and options between deliverable and non-deliverable as in the case of forwards.

Proposal in final draft RTS

117. Considering that the data available did not allow for a comprehensive and undistorted analysis of the entire market of foreign exchange derivatives Annex III of the final draft RTS includes a proposal with regard to only the qualitative liquidity criteria to be considered for the segmentation of the sub-asset classes but not the thresholds of the quantitative liquidity criteria necessary to perform the liquidity assessment and determine the sub-classes having a liquid market. As a result, ESMA proposes to deem the whole class of foreign exchange derivatives as illiquid until better data is available which would then trigger a revision of the RTS.

118. The qualitative criteria proposed are the same for each FX sub-asset class and are (1) underlying currency pair and (2) time to maturity bucket, which are further subdivided into 3 maturity buckets up to one year and yearly buckets from one year onwards.

119. Since the whole class of foreign exchange derivatives is deemed illiquid, in line with the general approach described in section "Feedback to the CP and revised proposal applicable across all asset classes" above, the pre-trade and post-trade SSTI and LIS thresholds are set as fixed values, with the pre-trade thresholds set at a lower level than the post-trade ones, as provided in the table below.

Table 19: SSTI and LIS thresholds for all sub-classes

SSTI pre-trade	LIS pre-trade	SSTI post-trade	LIS post-trade
EUR 4 million	EUR 5 million	EUR 20 million	EUR 25 million

F. Credit Derivatives

Summary of key proposals in December CP

120. ESMA undertook an analysis of credit derivatives based on trade repositories (TRs) data over the period 1 March 2014 – 31 May 2014.

121. Five different sub-asset classes were identified, two of which resulted to be illiquid as a whole, namely bespoke basket CDS and options on single name CDS. The remaining three sub-asset classes, namely CDS indices, single name CDS and options on a CDS index were further segmented into sub-classes and a certain number of those resulted to be liquid because they met the liquidity thresholds for the average daily notional amount and the average daily number of trades. In the table 20 below a summary of the liquidity criteria used to further segment the sub-asset classes and the liquidity thresholds applied.

Table 20: Summary of liquidity criteria and thresholds

CDS	Criterion to define sub-classes #1	Criterion to define sub-classes #2	Criterion to define sub-classes #3	Criterion to define sub-classes #4	Total num of sub-classes	Num of liquid sub-classes	Trades per day threshold	Notional per day (m EUR) threshold	% of trades captured	% of notional amount captured
Index	Tenor	Notional Currency	Underlying Index Name	On/Off-the-run status	53	25	1.0	10	98%	98%
Single Name	Tenor	Notional Currency	Underlying Issuer type		42	18	2.0	100	97%	98%
CDS Options	Criterion to define sub-classes #1	Criterion to define sub-classes #2	Criterion to define sub-classes #3	Criterion to define sub-classes #4	Total num of sub-classes	Num of liquid sub-classes	Trades per day threshold	Notional per day (m EUR) threshold	% of trades captured	% of notional amount captured
Index	Tenor	Notional Currency	Underlying Index Name	On/Off-the-run status	28	10	2.0	100	94%	98%

122. Furthermore, as far as single name CDS are concerned ESMA presented 2 options:

- i. In Option A ESMA described that the classes of single name CDS included in Annex III, Section 7 of draft RTS 9 (as published in CP in February 2015) would have been deemed to be liquid. ESMA emphasised itself that this approach suffered from a lack of granularity as it considered single name CDS sub-classes liquid regardless of the specific underlying due to a lack of granularity of TR data.
- ii. As Option B, ESMA proposed that a single name CDS would have been considered to belong to a 'single name CDS liquid class' only if besides being characterised by the combination of underlying issuer type, tenor, currency in which the notional amount of the contract is denominated as specified in each row of Table 62 in Annex III, Section 7 of draft RTS 9 (as published in CP in February 2015), the reference entity/obligation was included in a liquid CDS index as provided in Table 60 in Annex III, Section 7 of draft RTS 9 (as published in CP in February 2015). As a result, only those corporates and sovereign entities which are included in a liquid CDS index were deemed to be liquid.

Analysis following feedback from stakeholders

123. In respect of the general methodology applied, respondents criticised that the observation period of the data sample utilised by ESMA is too short and stems from a period just after the time when EMIR trade reporting was applied in practice.
124. Respondents also considered that the number and type of market participants and the size of spreads should have also been taken into account as criteria for applying the liquidity test but at the same time appreciated the practical difficulties in doing this. As a consequence, they consider that ESMA should compensate by applying higher thresholds for number and size of trades.
125. Other overarching comments from respondents were that ESMA should define the tenor in line with the market convention and that the standard market day count convention should be used. Many respondents asked ESMA to implement regular reviews of the liquidity thresholds set in order to take advantage of having better data available in the future.
126. ESMA appreciates the concerns expressed by respondents that ideally calculations should be performed on the basis of a larger and more mature dataset. ESMA did adjust its parameters for assessing liquidity to address some of the identified shortcomings. In particular, applying the methodology-based approach also to credit derivatives will ensure that liquidity assessments are carried out on a periodic basis and in line with market developments.
127. ESMA also points out again that for legal reasons it cannot build a review clause directly into the Level 2 technical standard. However, ESMA will monitor the application of this standard and is ready to review the parameters set for credit derivatives and to propose an amended version in the future should this prove necessary.

Single name CDS

128. Respondents by a large majority agreed with ESMA's assessment of option A and considered this option as not granular enough and in consequence lacking precision.
129. A majority of respondents also discarded Option B as not granular enough as it would still create too many false positives because liquid indices would also have many constituents which are illiquid if traded in their own right. A number of market participants agreed to this Option based on specific adjustments to achieve a greater degree of granularity. Suggestions to that end included, integrating single name corporate CDSs only if they are part of a liquid investment grade index and using only the most recent series of index CDSs as a reference point.
130. The main proposal to improve Option B was to assess the liquidity of single name CDS by also taking into consideration the underlying reference entity, in addition to the characteristics already applied by ESMA.

131. ESMA considers that this is indeed the solution for single name CDSs that would correctly classify single name CDSs as liquid and would address the difficulties of finding an adequate proxy (such as being a constituent of a liquid index). However, at this point in time ESMA does not possess a granular enough dataset to apply this approach.
132. Therefore, ESMA does undertake to add a new requirement to trade repository data identifying single name CDSs by the underlying reference entity (by country code for sovereigns and by LEI for corporates) as part of its work of amending the relevant EMIR Level 2 Regulation. ESMA expects this requirement to be in place by 2016.
133. Respondents to the consultation considered that ESMA did not take the irregular trading patterns of this market into account to a sufficient extent.
134. While some respondents considered that only the on-the-run five year single name CDS series should be qualified as liquid, others had specific proposals of how the liquidity thresholds should be set. For trades per day, respondents came back with concrete proposals ranging from five to fifteen trades a day. Notional amount traded should be set at €10 million per day if applied at the reference entity level in the view of a number of stakeholders.
135. ESMA took these proposals into account when adjusting its methodology as described below.

CDS index

136. In general, respondents agreed with the criteria considered to define the sub-classes and also with the list of indices which qualified as liquid. However, they raised two concerns: (i) only indices with a 5-year tenor should be deemed liquid, and (ii) the definition of an on-the-run index should be aligned to that generally accepted by market practice.
137. Finally, respondents also stated that the thresholds used to assess liquidity were too low and suggested to raise them to a range of 9-15 trades per day and 500m notional per day.
138. ESMA took these proposals into account when adjusting its methodology as described below.

CDS Index Options

139. Respondents to the consultation considered that the thresholds used to assess liquidity were too low and suggested to raise them to 15 trades per day and 500m notional per day. Others claimed that there is no liquidity for contracts other than 5 year on-the-run index as underlying.

140. Furthermore respondents also alleged that the level of granularity used was not sufficient and recommended to consider the following parameters: (i) the expiry of the option (ii) the distance of the option strike from the index price.

141. ESMA took these proposals into account when adjusting its methodology as described below.

CDS bespoke basket and Single name CDS Options

142. Respondents to the consultation agreed with ESMA’s proposal which qualified this class as illiquid. However, in order to take into account market developments and to ensure consistency with the other credit derivatives sub-asset classes ESMA moves, for single name CDS options, to a methodology-based approach while keeping the CDS bespoke basket sub-asset class as illiquid.

Proposal

143. ESMA proposes to use the COFIA approach as the basis for the determination of the liquidity of all the various non-equity financial instruments.

144. The liquid and illiquid sub-classes for the sub-asset classes of index CDS and single name CDS are constructed in line with the general approach described in section ” Feedback to the CP and revised proposal applicable across all asset classes” above. The sub-asset classes are further segmented into sub-classes by reference to criteria specified in Annex III of the final draft RTS which are as follows:

- i. for index CDS: the underlying index; the notional currency and the time to maturity bucket of the CDS. However, meeting the liquidity criteria is not sufficient to be considered liquid, an additional criteria has to be taken into account, i.e. ‘the on-the-run status’ of the index. In order to take into account the drop in liquidity after the roll, i.e. the change in the composition of the index, the CDS index meeting the liquidity criteria will be considered liquid only when on-the-run and for the first 30 days of its off-the-run status;
- ii. for single name CDS: the underlying type, the underlying reference entity, the notional currency and the time to maturity bucket of the CDS;

145. The criteria and thresholds used to assess liquidity are summarised in the table below

Table 21: SSTI and LIS thresholds for liquid sub-classes

Sub asset class	Average daily notional	Average number of trades
Index credit default swap (CDS)	EUR 200 million	10

Single name credit default swap (CDS)	EUR 10 million	10
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146. In line with the feedback received, the average daily number of trades has been increased. Furthermore, given the higher granularity of the single name CDS currently proposed the average daily notional has been decreased from EUR 100m to EUR 10m.
147. As far as the sub-asset class of bespoke basket CDS is concerned, considering the custom-made nature of the underlying and the feedback received to the consultation, it would still be qualified as illiquid and belong to the sub-asset class of “other credit derivatives”.
148. In order not to apply different transparency regimes to the derivative contract and to the related underlying, a methodology has been defined in order to assess liquidity for options on CDS indices and single name CDS. More specifically, since liquidity is concentrated in short term maturities, only options with a time to maturity up to 6 months whose underlying is a liquid CDS index or a liquid single name CDS will be considered liquid.
149. All other credit derivatives are considered to be illiquid.
150. The SSTI and LIS thresholds for credit derivatives are constructed in line with the general approach described in section “Feedback to the CP and revised proposal applicable across all asset classes” above. The pre-trade transparency thresholds are set at a lower level than the post trade transparency thresholds. For liquid sub-classes, the pre-trade transparency thresholds are set as the greater of a pre-determined floor and a trade percentile, and the post-trade transparency thresholds are set as the greater of a pre-determined floor, a trade percentile and a volume percentile if the volume percentile for the LIS threshold is not higher than the 97.5th percentile, in that case the trade percentile should prevail for both the LIS and SSTI.
151. For illiquid sub-classes, the thresholds are the same as the threshold floors used for the liquid sub-classes. The thresholds are the same for all credit derivative sub-classes, summarised in the two tables below:

Table 22: SSTI and LIS thresholds for sub-classes having a liquid market

SSTI pre-trade		LIS pre-trade		SSTI post-trade			LIS post-trade		
Trade percentile	Floor threshold	Trade percentile	Floor threshold	Trade percentile	Volume percentile	Floor threshold	Trade percentile	Volume percentile	Floor threshold
60	EUR 2.5 million	70	EUR 5 million	80	60	EUR 7.5 million	90	70	EUR 10 million

Table 23: SSTI and LIS thresholds for sub-classes not having a liquid market

SSTI pre-trade	LIS pre-trade	SSTI post-trade	LIS post-trade
EUR 2.5 million	EUR 5 million	EUR 7.5 million	EUR 10 million

G. Equity Derivatives

Analysis following feedback from stakeholders

152. ESMA proposed two options with regard to liquid classes for equity derivatives.
153. Option 1 relied on the results from the analysis presented in the CP from which it was evident that contracts with a time to maturity up to 3 months represent the majority of the overall trading for a sub-class. Option 1 qualified the following contract types with a time to maturity up to 6 months (in order to take into account the rolling between the front maturity into the next) as liquid:
- i. Index options (options on a specific index composed of shares);
 - ii. Stock options (options on a specific share);
 - iii. Options on a basket or portfolio of shares;
 - iv. Dividend index options (options on an index composed of the dividends of shares);
 - v. Options on other underlying values (i.e. volatility index or ETFs);
 - vi. Stock dividend options (options on the dividend from a specific share);
 - vii. Index futures (futures on a specific index composed of shares);
 - viii. Stock futures (futures on a specific share);
 - ix. Futures on a basket or portfolio of shares;
 - x. Dividend index futures (futures on an index composed of the dividends of shares);
 - xi. Futures on other underlying values (i.e. volatility index or ETFs);
 - xii. Stock dividend futures (futures on the dividend from a specific share).
154. ESMA also proposed Option 2 that extended MiFIR pre-trade and post-trade transparency obligations to all equity derivatives instruments available for trading on a trading venue irrespectively of the time to maturity.
155. Respondents were evenly split between Option 1 and Option 2. However, the majority of respondents, regardless whether they were in favour of Option 1 or Option 2, would like to see more granularity, either in the proposed list of contract types or as regards time to maturity.

156. Some respondents stated that Option 1 as well Option 2 should be modified in such a way that most classes are deemed illiquid and a few are considered liquid (namely futures on stock indices, options on stock indices and stock options).
157. A few respondents would like to define liquidity not only on the basis of maturity but also with a reference to the underlying instrument while a few other respondents would like to have (a minimum amount of) open interest as an additional criterion for a contract being liquid. Other respondents stated that only index futures and options can be regarded as liquid, provided that there are at least two market makers.
158. A few respondents argued that Option 1 is only supported by ESMA's data set because OTC trading is not taken into account and Option 2 is contradictory to the argument that most trading is within a maturity up to three months.
159. Several respondents argued that the imposition of mandatory transparency on less-liquid equity derivative contracts would prevent the emergence of alternative trading models.
160. Several respondents stated that ESMA needs to distinguish between exchange-traded equity derivatives and OTC equity derivatives in its definitions, whereby also a distinction between 'standard series' and 'flexible' or 'tailor-made series' is advocated. Respondents considered that from the definitions it is not clear whether or not OTC derivatives are included or excluded.
161. A few respondents suggest that there should be a definition for "option" so that only the standard options (European, American, call, put) are covered and not exotic options.
162. As an alternative to ESMA's proposal to define a liquid market for equity derivatives respondents to the CP provided an array of parameters, like reference to the liquidity of the underlying instrument(s), the use of open interest, the (average daily) turnover (whether expressed in notional value, in number of transactions or expressed in number of traded contracts), the number of market makers or whether an option contract is in or out of the money.
163. In addition to the contract types listed in the CP several respondents propose to include a definition for a volatility index and that the volatility indices and ETFs should be split into separate categories. Also several respondents propose to include an 'all other equity derivatives' category. This category would capture all derivatives that either (i) do not fall within one of the other classes, or (ii) that have multiple underlyings, such that they can fall in multiple classes.
164. As regards the setting of the LIS and SSTI thresholds several respondents expressed concerns that the proposed thresholds were too static.
165. One respondent provided an alternative to the LIS and SSTI thresholds proposed by ESMA. The system was designed to have several liquidity bands per sub-asset class

based on the average daily notional amount and the LIS and SSTI thresholds correlated to such liquidity measure. As a consequence, financial instruments within the same category that experience a low average daily notional amount relative to other financial instruments within that sub-asset class benefit from a lower LIS and SSTI threshold.

166. Furthermore, a handful of respondents proposed to set the LIS and SSTI thresholds in local currency rather than Euros as they stated that the need to apply a currency conversion results in an additional layer of complexity, and would result in inflexibility as exchange rates move.

Proposal

167. ESMA proposes to maintain current market practice namely to maintain pre-trade and post-trade transparency currently available for a wide range of instruments, expiration dates and strike prices for the following sub-asset classes of equity derivatives: stock index options, stock index futures/forwards, stock options, stock futures/forwards, stock dividend options, stock dividend futures/forwards, dividend index options, dividend index futures/forwards, volatility index options, volatility index futures/forwards, ETFs options and ETFs futures/forwards. Curtailing the transparency obligations to a limited category of exchange traded equity derivatives contracts denies that these financial instruments already are characterised by high pre-trade and post-trade transparency, by providing price, size and depth towards the market, and close to real time trade reporting. As a consequence, ESMA maintains Option 2 and its approach that the majority of equity derivatives should be qualified as liquid as expressed in Annex III of the final draft RTS.
168. ESMA brings to mind that the obligations related to pre-trade transparency are addressed to venue operators and SIs only. Investment firms concluding OTC transactions (not in the capacity of being a SI) do not have a pre-trade transparency obligation.
169. As regards determining whether an equity derivative contract is liquid on the basis of the maturity of the contract, the outstanding amount of open interest, or whether an option contract is in or out of the money, ESMA is of the view that these parameters for liquidity represent a significant technical and operational issue for trading venues in setting up their trading systems, since each contract will be required to change their qualification of being liquid or illiquid depending on the daily changes in open interest, the remaining time towards expiry of the contract or changes in the price of the underlying instrument. Apart from operational challenges applying these parameters would introduce uncertainty for market participants in their price discovery process.
170. ESMA agrees with the recommendation to include separate categories for options and futures on volatility indices and ETFs. In addition, an 'other equity derivatives' category is defined with the aim to better distinguish liquid from non-liquid sub-asset classes of equity derivatives.

171. ESMA agrees that a single LIS threshold per sub-asset class of equity derivatives as proposed in the CP denies the various degrees of liquidity within the respective category of contract types and therefore decided to build upon the alternative proposal provided by one of the respondents to the CP.
172. Therefore, ESMA proposes a methodology for equity derivatives that uses the average daily notional amount (ADNA) in terms of notional size as main criterion for classifying sub-classes into liquidity bands, and also as the key component for calculating applicable SSTI and LIS thresholds.
173. According to this methodology trading venue operators and SIs and investment firms concluding transactions OTC can determine per financial instrument in which liquidity band the contract fits, based on the ADNA for that specific instrument. Whereby the trading venue operator and SI has the discretion to impose higher block sizes than the proposed thresholds.
174. For non-Euro denominated contracts ESMA is of the view that the LIS and SSTI thresholds (that are expressed in Euro) should be converted by applying the relevant European Central Bank Euro foreign exchange reference rate as at 31 December of the preceding calendar year. However, trading venues may convert the threshold sizes into lots as defined in advance.
175. For instruments with a relatively low ADNA, a pre-trade SSTI threshold of € 20.000 is set, with the aim of catering for the development of new instruments falling in the respective sub-class regardless whether these are traded on-exchange, via RFQ or voice trading, or OTC.
176. The applicable pre-trade SSTI thresholds are set at roughly 95%⁶ of the corresponding LIS threshold with the aim of providing for similar transparency across traditional trading systems and RFQ and voice trading systems.
177. Depending on the type of equity derivative instrument post-trade LIS and SSTI thresholds are set 10 or 5 times higher compared to pre-trade LIS and SSTI thresholds. This reflects current practice on European trading venues.
178. The liquid and illiquid sub-classes for equity swaps and portfolio swaps, typical OTC traded contracts, are constructed in line with the general approach described in section "Feedback to the CP and revised proposal applicable across all asset classes" above. The sub-asset classes are further segmented into sub-classes by reference to criteria specified in Annex III of the final draft RTS. The criteria are the same for both swaps and portfolio swaps, i.e. (1) underlying type (2) specific underlying (3) parameter and (4) time to maturity bucket.
179. An annual liquidity assessment will be undertaken for each sub-class.

⁶ The percentage depends on the rounding of the figures

180. The below table shows the quantitative liquidity thresholds for swaps and portfolio swaps which, given the increased granularity of the class, have been reduced.

Table 24: Quantitative liquidity thresholds equity derivatives sub-classes

Sub-asset class	Average daily notional	Average number of trades
Swaps	EUR 50 million	15
Portfolio Swaps		

181. Other equity derivatives not belonging to one of the defined sub-asset classes are considered not to have a liquid market.

182. The SSTI and LIS thresholds for equity swaps and portfolio swaps, are structured on liquidity bands based on the ADNA as for the other equity derivatives sub-asset classes.

183. For illiquid sub-classes, fixed thresholds are pre-determined as provided in the table below.

Table 25: SSTI and LIS thresholds for sub-classes not having a liquid market

SSTI pre-trade	LIS pre-trade	SSTI post-trade	LIS post-trade
EUR 20,000	EUR 25,000	EUR 100,000	EUR 150,000

H. Commodity derivatives

CP proposal

184. For the CP ESMA analysed data from 5-7 trading venues for the period ranging from 1 June 2013 to 31 May 2014 and distinguishing between three asset classes: metals, energy and agricultural. For each of these sub-asset classes ESMA identified the sub-classes for which there was a liquid market. For the liquidity assessment the same liquidity criteria were applied for all three asset classes, namely:

- i. Average daily notional amount = EUR 100,000; and
- ii. Average daily number of trades = 1

185. However, the qualitative criteria applied to segment them were different.

Analysis following feedback from stakeholders

186. Most respondents did not agree with the definition of liquidity, although they supported COFIA. Most comments are already reflected in the introductory section “Feedback to the CP and revised proposal applicable across all asset classes” above and therefore not repeated in this section. Concerning commodity derivative specific comments some respondents noted that the data set used in the analysis was too narrow and that it did not accurately represent liquidity in the commodity markets. Respondents stated that the data set should include at least three years of data from both EU and non-EU trading venues, and that open interest should be used instead of transaction data. Another concern raised with COFIA was the treatment of new financial products that may develop in the future.

187. Many respondents proposed to make a distinction between precious and base metals and to use commodity units instead of notional amount for the liquidity assessment. Some respondents noted that if ESMA is to continue using notional amounts, it should express the threshold only in the currency in which commodity contracts are traded. Some respondents included a harmonised table illustrating the proposal listed above.

188. The feedback on the pre-trade and post-trade LIS and SSTI thresholds is summarised in the introductory section “Feedback to the CP and revised proposal applicable across all asset classes” above.

Proposal

189. Taking into account the suggestions included in the responses, ESMA proposes to use COFIA as the basis for the determination of the liquidity of all the various non-equity financial instruments. Furthermore, ESMA proposes to divide the sub-asset classes by underlying commodity, notional currency (being defined as the currency in which the notional amount of the derivative contract is denominated), and time to maturity. ESMA

proposes to make a distinction for base and precious metals as suggested by the respondents in regards to time to maturity. Furthermore, ESMA proposes to take into account the load type and the deliver/cash settlement location for energy derivatives and to include settlement type in the determination of the sub-asset classes for commodity swaps.

Table 26: Quantitative liquidity thresholds commodity derivatives sub classes

Sub-asset class	Average daily notional	Average number of trades
Metal commodity futures/ forwards	EUR 10 million	10
Metal commodity options		
Metal commodity swaps		
Energy commodity futures/forwards		
Energy commodity options		
Energy commodity swaps		
Agricultural commodity futures/ forwards		
Agricultural commodity options		
Agricultural commodity swaps		

190. In light of the feedback received and reflecting the general changed framework, ESMA proposes to calculate annually the pre-trade and post-trade thresholds for LIS and SSTI on basis of the methodology set out in Article 13 and Annex III of draft RTS 2 and as illustrated in table 11. The pre-trade transparency thresholds are set at a lower level than the post trade transparency thresholds. For liquid sub-classes, the pre-trade transparency thresholds are set as the greater of a pre-determined floor and a trade percentile, and the post-trade transparency thresholds are set as the greater of a pre-determined floor, a trade percentile and a volume percentile if the volume percentile for the LIS threshold is not higher than the 97.5th percentile, in that case the trade percentile should prevail for both the LIS and SSTI.

191. For illiquid sub-classes, the thresholds are the same as the threshold floors used for the liquid sub-classes. The thresholds are the same for all commodity derivative sub-classes, as summarised in the tables below:

Table 27: SSTI and LIS thresholds for sub-classes having a liquid market

SSTI pre-trade		LIS pre-trade		SSTI post-trade			LIS post-trade		
Trade percentile	Floor threshold	Trade percentile	Floor threshold	Trade percentile	Volume percentile	Floor threshold	Trade percentile	Volume percentile	Floor threshold
60	EUR 250,000	70	EUR 500,000	80	60	EUR 750,000	90	70	EUR 1 million

Table 28: SSTI and LIS thresholds for sub-classes not having a liquid market

SSTI pre-trade	LIS pre-trade	SSTI post-trade	LIS post-trade
EUR 250,000	EUR 500,000	EUR 750,000	EUR 1 million

I. Exotic Derivatives (including C10 derivatives and emission allowance derivatives)

CP proposal

192. In the Addendum CP published in February 2015, ESMA presented an analysis of the residual class of derivatives, called other or exotic derivatives, and which corresponds to derivatives on emission allowances and the derivatives defined under Section C(10) of Annex I of MiFID II, i.e. freight derivatives, weather derivatives and other C10 derivatives.
193. All exotic derivatives were considered to be illiquid on the basis of a liquidity test applied at the sub-asset class level (e.g. weather derivatives) based on the following liquidity thresholds applied on a cumulative basis:
- i. average notional amount per day greater or equal to €500 m;
 - ii. number of days traded greater or equal to 80% of the available trading days in the period;
 - iii. average number of trades per day greater or equal to 100.
194. With respect to the LIS and SSTI thresholds, ESMA proposed in the Addendum CP for the purpose of setting the LIS and SSTI thresholds two alternatives:
- i. Alternative A: to divide the exotic derivatives class into 4 sub-classes on the basis of the type of underlying (i.e. freight, emission, weather and other derivatives); or
 - ii. Alternative B: to use more granular sub-classes dividing the exotic derivative category on the basis of not only the type of underlying but also the contract type (i.e. futures (FU), options (OP), forwards (FW) and swaps (SW) and others (OT)).

Analysis following feedback from stakeholders

195. In the responses received to the Addendum CP, most respondents agreed with ESMA's proposal to consider illiquid freight derivatives, weather derivatives and other exotic derivatives. However, for emission derivatives, whereas the majority deemed that those derivatives should be treated as illiquid as proposed by ESMA, some respondents noted that emission derivatives are currently traded on venues in pre-trade and post-trade transparent manner and that classifying those products as illiquid would reduce the existing transparency in these markets.
196. Respondents stressed that liquidity parameters and thresholds should not be on the notional traded but that the quantity traded should rather be monitored looking at the relevant number of units or lots traded (e.g. metric tonnes of cargo, tonnes of CO₂, etc).

197. With respect to the liquidity thresholds, respondents also pointed out that the ones used for other derivatives differed significantly from the ones used from assessing the liquidity of other asset classes (e.g. commodity derivatives, emission allowances). In their view, those classes should have been treated more consistently.
198. Lastly, in the respondents' view, the liquidity assessment should be more granular taking into account criteria such as the tenor and the open interest. For emission allowance derivatives, most respondents suggested to replicate the emission allowance segmentation - i.e. European Union Allowances (EUA), Certified Emission Reductions (CER), European Union Aviation Allowance (EUAA), and Emission Reducing Units (ERU).
199. ESMA appreciates the comments made with respect to exotic derivatives and has tried to take them into consideration when establishing the new dynamic liquidity regime by introducing more granularity and more consistency between the different classes. Furthermore, ESMA decided to align the liquidity assessment for derivatives on emission allowances to that of emission allowances on the basis of the average daily number of tons of carbon dioxide traded and average daily number of trades.
200. However, ESMA decided to maintain the liquidity assessment based on trading volume in terms of average daily notional amount traded for the other sub-asset classes in order to allow consistency between them and proper calibration of the thresholds using the data currently available.
201. As far as the LIS and SSTI thresholds are concerned, the vast majority of respondents supported more granularity when setting the thresholds. In this respect, alternative B had the support of the respondents. However, some stressed that the type of contract might not always be the most relevant criteria and recommend rather other criteria such as emission allowance types (i.e. EUA, CER, EUAA, and ERU) or tenor.
202. With respect to the methodology to determine the LIS and SSTI thresholds, ESMA received a few responses highlighting that the notional traded is inappropriate as it is subject to price fluctuations and recommend rather capturing volumes through more relevant metrics such as tonnes of CO₂, etc.
203. ESMA believes that the new approach proposed to determine the LIS and SSTI thresholds for pre-trade and post-trade transparency purposes should address most of comments received since it will be based on more granular classes and calculated on a yearly basis. The differentiation of pre-trade and post-trade thresholds should also mitigate to a certain extent the concerns raised by a couple of respondents with respect to the level of thresholds as presented in the Addendum CP.

Proposal

204. To improve the readability of the draft RTS, ESMA decided to disentangle the asset class of exotic derivatives into two classes: derivatives on emission allowances and C10 derivatives.

Derivatives on emission allowances

205. The liquid and illiquid sub-asset classes for emission allowance derivatives are constructed in line with the general approach described in section “Feedback to the CP and revised proposal applicable across all asset classes” above. The asset class is further segmented into sub-asset classes by reference to the criterion specified in Annex III of the final draft RTS which is, as it is the case for emission allowances, the type of underlying emission allowances.

206. Contracts not belonging to one of the defined sub-asset classes are considered to be illiquid.

207. An annual liquidity assessment will be undertaken for each sub-asset class.

208. The below table shows the quantitative liquidity thresholds for each sub-asset class of emission allowance derivatives.

Table 29: Quantitative liquidity thresholds emission allowance derivatives sub-asset classes

Sub-asset class	Average daily notional amount	Average number of trades
EUA	150,000 tons of Carbon Dioxide	5
EUAA		
CER		
ERU		

209. The LIS and SSTI thresholds for emission allowance derivatives are constructed in line with the general approach described in section “Feedback to the CP and revised proposal applicable across all asset classes” above. The pre-trade transparency thresholds are set at a lower level than the post-trade transparency thresholds. However, as in the case of emission allowances, for liquid sub-asset classes, the pre-trade and post-trade transparency thresholds are set as the greater of a pre-determined floor and a trade percentile.

210. For illiquid sub-asset classes, the thresholds are the same as the pre-determined threshold floors used for the liquid calculations. The thresholds are summarised in the table below.

211. Last but not least, trading venues may convert the threshold sizes into lots as defined in advance.

Table 30: SSTI and LIS thresholds for sub-asset classes having a liquid market

Emission allowance type	SSTI pre trade		LIS pre trade		SSTI post trade		LIS post trade	
	Trade percentile	Floor threshold						
EUA	60	40,000 tons of Carbon Dioxide	70	50,000 tons of Carbon Dioxide	80	90,000 tons of Carbon Dioxide	90	100,000 tons of Carbon Dioxide
other than EUA	60	20,000 tons of Carbon Dioxide	70	25,000 tons of Carbon Dioxide	80	40,000 tons of Carbon Dioxide	90	50,000 tons of Carbon Dioxide

Table 31: SSTI and LIS thresholds for sub-asset classes not having a liquid market

Emission allowance type	SSTI pre trade	LIS pre trade	SSTI post trade	LIS post trade
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EUA	40,000 tons of Carbon Dioxide	50,000 tons of Carbon Dioxide	90,000 tons of Carbon Dioxide	100,000 tons of Carbon Dioxide
Other than EUA	20,000 tons of Carbon Dioxide	25,000 tons of Carbon Dioxide	40,000 tons of Carbon Dioxide	50,000 tons of Carbon Dioxide

C10 Derivatives

212. The asset class of C10 derivatives is divided into freight derivatives and other C10 derivatives including weather derivatives, inflation derivatives and derivatives linked to official economic statistics.
213. The liquid and illiquid sub-classes for freight derivatives are constructed in line with the general approach described in section "Feedback to the CP and revised proposal applicable across all asset classes" above and the sub-classes are defined by means of the criteria specified in Annex III of the final draft RTS, which include the contract type and the characteristics defining the underlying freight contract.
214. An annual liquidity assessment will be undertaken for freight derivatives and the below table shows the quantitative liquidity thresholds, in line with all the other commodity derivative sub-asset classes, to be used.

Table 32: Quantitative liquidity thresholds freight derivative sub-asset classes

Sub-asset class	Average daily notional amount	Average number of trades
Freight derivatives	EUR 10 million	10

215. All other contracts belong to the other C10 sub-asset class and are considered to be illiquid.
216. The LIS and SSTI thresholds for C10 derivatives are constructed in line with the general approach described in section "Feedback to the CP and revised proposal applicable across all asset classes" above. The pre-trade transparency thresholds are set at a lower level than the post-trade transparency thresholds. For liquid sub-classes, the pre-trade transparency thresholds are set as the greater of a pre-determined floor and a trade percentile, and the post-trade transparency thresholds are set as the greater of a pre-determined floor, a trade percentile and a volume percentile if the volume percentile for the LIS threshold is not higher than the 97.5th percentile, in that case the trade percentile should prevail for both the LIS and SSTI.
217. For illiquid sub-asset classes, the thresholds are the same as the pre-determined threshold floors used for the liquid calculations. The thresholds are summarised in the table below.

218. Last but not least, trading venues may convert the threshold sizes into lots as defined in advance.

Table 33: SSTI and LIS thresholds for sub-classes having a liquid market

SSTI pre-trade		LIS pre-trade		SSTI post-trade			LIS post-trade		
Trade percentile	Floor threshold	Trade percentile	Floor threshold	Trade percentile	Volume percentile	Floor threshold	Trade percentile	Volume percentile	Floor threshold
60	EUR 25,000	70	EUR 50,000	80	60	EUR 75,000	90	70	EUR 100,000

Table 34: SSTI and LIS thresholds for sub-classes not having a liquid market

SSTI pre-trade	LIS pre-trade	SSTI post-trade	LIS post-trade
EUR 25,000	EUR 50,000	EUR 75,000	EUR 100,000

J. Contracts for Difference

Summary of key proposals in February addendum CP

219. In respect of CFDs on equities ESMA proposed to define as liquid any CFD where the underlying is a share for which there is a liquid market as determined in accordance with article 2(1)(17)(b) of Regulation 600/2014.
220. ESMA was not in a position to establish the liquidity of CFDs with other sub-classes of equity as underlyings such as CFDs on ETFs or depositary receipts. On that basis ESMA was seeking stakeholders' views in the addendum CP on a proposal for extending the same approach taken on CFDs on shares to CFDs on ETFs and depositary receipts, i.e. determine as liquid all CFDs based on an equity or equity-like instrument for which there is a liquid market in accordance with article 2(1)(17)(b) of Regulation 600/2014.
221. As far as CFDs on currencies are concerned, ESMA proposed in the CP that a number of classes set out in Annex III, Section 9 of the draft RTS 9 in the addendum CP were liquid.

Analysis following feedback from stakeholders

222. Most respondents agreed with ESMA's approach to deem any CFD based on an underlying liquid share as liquid.
223. The feedback for CFDs on currency was very limited; the few respondents who commented agreed with ESMA's proposal.
224. In general, the majority of respondents agreed with the criteria proposed to define classes and sub-classes, the parameters proposed in the addendum CP, and with extending the approach to CFDs with other equity and equity-like instruments as underlyings. Overall, respondents considered that the definition of CFDs was too broad, and could unintentionally capture some type of equity swaps.
225. Most respondents agreed with the proposed LIS threshold; however, one respondent stated that beyond 2018, it should be lowered to the 50th percentile of transactions. In regard to the system and frequency of the recalculation of the thresholds, there were mixed views, with a small majority supporting recalibration on a dynamic basis.

Proposal

226. ESMA proposes to divide the classes of CFDs into equity, bond, futures/forwards on equity, option on equity, commodity, currency and a further class for other CFDs.
227. Sub-classes of CFDs on equity, bonds, futures/forwards on equity and options on equity will be deemed liquid if the underlying equity, bond, future/forward on equity or

option on equity is considered to have a liquid market, in accordance with article 2(1)(17)(b) of Regulation 600/2014.

228. For CFDs on currency and commodities the sub-classes will be defined by the underlying currency pair and commodity. Both CFDs on currency and on commodity will be deemed liquid if the average daily notional is at least EUR 50 million and the average daily number of trades is at least 100.
229. All other exotic derivatives which do not belong to any of the determined sub-asset classes are considered to be illiquid.
230. An annual liquidity assessment will be undertaken for each sub-class.
231. The SSTI and LIS thresholds for CFDs are constructed in line with the general approach described in section "Feedback to the CP and revised proposal applicable across all asset classes" above. The pre-trade transparency thresholds are set at a lower level than the post-trade transparency thresholds. For liquid sub-classes, the pre-trade transparency thresholds are set as the greater of a pre-determined floor and a trade percentile, and the post-trade transparency thresholds are set as the greater of a pre-determined floor, a trade percentile and a volume percentile if the volume percentile for the LIS threshold is not higher than the 97.5th percentile, in that case the trade percentile should prevail for both the LIS and SSTI.
232. For illiquid sub-classes, the thresholds are the same as the pre-determined threshold floors used for the liquid calculations. The thresholds are summarised in the table below.

Table 35: SSTI and LIS thresholds for sub-classes having a liquid market

SSTI pre-trade		LIS pre-trade		SSTI post-trade			LIS post-trade		
Trade percentile	Floor threshold	Trade percentile	Floor threshold	Trade percentile	Volume percentile	Floor threshold	Trade percentile	Volume percentile	Floor threshold
60	EUR 50,000	70	EUR 60,000	80	60	EUR 90,000	90	70	EUR 100,000

Table 36: SSTI and LIS thresholds for sub classes not having a liquid market

SSTI pre-trade	LIS pre-trade	SSTI post-trade	LIS post-trade
EUR 50,000	EUR 60,000	EUR 90,000	EUR 100,000

K. Emission Allowances

CP proposal

233. To assess the liquidity of emission allowances, ESMA analysed a dataset collected from 3 trading venues for the period of 1 June 2013 – 31 May 2014. In total, the dataset included 1,142 instruments covering 4 types of emission allowances, with the majority accounting for either EUA or CER. An average of 5 trades per day and 150,000 tons of carbon dioxide per day, representing roughly €750,000, was considered as sufficient trading activity to qualify this class as liquid.
234. On that basis, ESMA proposed to consider only the class of EUA contracts as liquid and all other classes as illiquid.

Analysis following feedback from stakeholders and proposal

235. ESMA received only very limited feedback to this question and the majority of responses received were rather focussing on derivatives on emission allowances than on emission allowances.
236. Some responses considered the proposed liquidity thresholds identifying liquid sub-classes as too low and recommended increasing the thresholds. However, since ESMA received no guidance or evidence as to the appropriate level of the thresholds, ESMA did not change the thresholds used. Concerning the question whether identified sub-classes were correctly classified, there was limited feedback considering the categorisation of entire asset classes as illiquid as overly simplistic, which could lead to a reduction of existing transparency. While ESMA agrees that a reduction of transparency would not be desirable, ESMA was, given the lack of indication on how to improve the classification of emission allowances, not in a position to refine the categorisation of liquid vs. illiquid classes. Furthermore, ESMA would like to point out that CAs may decide not to grant waivers and/or deferrals, in particular in cases where this would diminish current levels of transparency.
237. In light of the feedback received and reflecting the general changed framework, ESMA proposes that the liquidity assessment per emission allowances class (EUA, CER, EUAA, ERU and others) should be carried out on an annual basis against the following liquidity thresholds: an average of 5 trades per day and 150,000 tonnes of carbon dioxide per day.
238. ESMA received only very limited feedback on the level of pre-trade and post-trade thresholds for emission allowances and, in addition, as mentioned above most of the feedback was rather related to derivatives on emission allowances. Points raised included concerns that the proposed thresholds would lead to a lower transparency for emission allowances compared to the situation today, the recommendation to set the thresholds based on order level data and to use an alternative volume measure for setting the thresholds (without however providing an alternative volume measure).

239. In light of the feedback received and reflecting the general changed framework, ESMA proposes to calculate annually the pre-trade and post-trade thresholds for LIS and SSTI on basis of the methodology set out in Article 13 and Annex III of draft RTS 2.

240. The SSTI and LIS thresholds for emission allowances are constructed in line with the general approach described in section "Feedback to the CP and revised proposal applicable across all asset classes" above. The pre-trade transparency thresholds are set at a lower level than the post-trade transparency thresholds. For liquid sub-asset classes, the pre-trade transparency and post-trade transparency thresholds are set as the greater of a pre-determined floor and a trade percentile.

241. For illiquid sub-asset classes, the thresholds are the same as the pre-determined threshold floors used for the liquid calculations. The thresholds are summarised in the tables below.

Table 37: SSTI and LIS thresholds for sub-asset classes having a liquid market

Emission allowance type	SSTI pre trade		LIS pre trade		SSTI post trade		LIS post trade	
	Trade percentile	Floor threshold						
EUA	60	40,000 tons of Carbon Dioxide	70	50,000 tons of Carbon Dioxide	80	90,000 tons of Carbon Dioxide	90	100,000 tons of Carbon Dioxide
other than EUA	60	20,000 tons of Carbon Dioxide	70	25,000 tons of Carbon Dioxide	80	40,000 tons of Carbon Dioxide	90	50,000 tons of Carbon Dioxide

Table 38: SSTI and LIS thresholds for sub-asset classes not having a liquid market

Emission allowance type	SSTI pre trade	LIS pre trade	SSTI post trade	LIS post trade
EUA	40,000 tons of Carbon Dioxide	50,000 tons of Carbon Dioxide	90,000 tons of Carbon Dioxide	100,000 tons of Carbon Dioxide
Other than EUA	20,000 tons of Carbon Dioxide	25,000 tons of Carbon Dioxide	40,000 tons of Carbon Dioxide	50,000 tons of Carbon Dioxide

2.2.2 Elements common to all asset classes: analysis and approach

I. Trading Models

Background/Mandate

Article 9(5) of MiFIR

5. *ESMA shall develop draft regulatory technical standards to specify the following:*

[...]

(b) the range of bid and offer prices or quotes and the depth of trading interests at those prices, or indicative pre-trade bid and offer prices which are close to the price of the trading interest, to be made public for each class of financial instrument concerned in accordance with Article 8(1) and (4), taking into account the necessary calibration for different types of trading systems as referred to in Article 8(2);

242. MiFID II provides for three types of trading venues for bonds, structured finance products, emission allowances and derivatives: regulated markets, MTFs and OTFs. Within each of these trading venues different types of trading systems may be operated in order to bring together buying and selling trading interests. Article 8(2) of MiFIR requires the calibration of the transparency requirements for different types of trading systems, including order-book, quote-driven, periodic auction trading, request-for-quote (RFQ), voice and hybrid trading systems. In order to ensure uniform applicable conditions for trading venues, the same pre-trade transparency requirements, defined at trading system level, would then apply equally to regulated markets, MTFs and OTFs to the extent that the trading systems can be operated in line with the definition of the trading venues under MiFIR⁷.

243. Article 9(5)(b) of MiFIR empowers ESMA to specify the pre-trade transparency obligations by defining the range of bid and offer prices or quotes and the depth of trading interests at those prices, or indicative pre-trade bid and offer prices which are close to the price of the trading interest, to be made public for each class of financial instrument concerned taking into account the different types of trading systems.

244. In calibrating the requirements for different trading systems, the definitions of RFQ systems and voice trading systems are key in determining the minimum amount of pre-trade information they must offer. These definitions are also relevant for determining when pre-trade transparency obligations can be waived for orders above a size specific

⁷ Recital 16 of MiFIR

to the instrument. Article 9(1)(b) of MiFIR states that CAs can authorise waivers to pre-trade transparency requirements for actionable indications of interest in request-for-quote and voice trading systems that are above a size specific to the instrument.

245. In the CP ESMA proposed to use the approach for calibrating the content of the pre-trade transparency requirements for shares according to Table 1 in Annex II of MiFID Regulation 1287/2006 for all types of non-equity financial instruments traded as a basis, and to add the commonly used trading systems for non-equities: RFQ and voice systems.

246. On the basis that feedback to the DP broadly supported the proposed definition for voice trading, ESMA retained the definition proposed in the DP. In light of feedback to the CP ESMA proposed to amend the RFQ definition on which it consulted. Regarding the definition of RFQ system ESMA proposes to amend the definition to incorporate the exclusivity feature of RFQ systems, i.e. to elucidate that the requesting party to which the quote is disclosed is the only counterparty entitled to trade against it.

Analysis following feedback from stakeholders

247. The majority of responses opposed the proposal regarding the definition of RFQ systems on the basis that it would have a negative impact on market liquidity and the quality of price settings. Market participants were concerned that the proposal to publish the individual responses to a RFQ would create disincentives for dealers to quote since competitive dealers might adapt their quotes in light of already published quotes ('first mover disadvantage') and could result in a 'winner's curse' where the market moves against the dealer which wins the business.

248. Various proposals were made to introduce a regime for RFQ systems that mitigates these concerns, ranging from clarifying that RFQ systems would be allowed to publish submitted quotes in response to a RFQ at the same time, i.e. once all quotes have been provided and the moment they become executable to publishing average or composite prices.

249. ESMA carefully reviewed these proposals, in particular the extent to which those would address the two concerns raised above, and their compatibility with the MiFIR requirements. ESMA considers that the proposed definition of an RFQ system allowed for publishing all quotes submitted at the same time, but has further clarified this in a recital to provide market participants with legal certainty. Concerning the proposal to provide pre-trade transparency on basis of average prices, ESMA decided not to include it in its revised proposal for two reasons. Firstly, publishing average prices falls short of providing pre-trade transparency as defined in MiFIR, which requires trading venues to make public the current bid and offer prices and the depth of trading interest at those prices which are advertised through their systems (Article 8(1) of MiFIR). Secondly, it would grant RFQ systems a preferential treatment which discriminates against other trading systems. ESMA therefore maintained the proposal to disclose all quotes provided in request for a quote.

250. Some respondents suggested adding ‘all-to-all’ trading systems, i.e. trading systems that allow to source liquidity from all other system participants (investors and dealers), to the types of trading systems. ESMA acknowledges that this type of trading system could gain in importance in the future, but considers that it is already covered by the ‘hybrid system’.

Proposal

251. ESMA largely maintained its proposal in the CP and clarified in a recital that RFQ systems may publish submitted quotes in response to a RFQ at the same time.

II. SSTI – Indicative prices

252. When the actionable indication of interest is above the SSTI threshold, market operators and investments firms operating a trading venue under an RFQ or voice trading system are required in accordance with Article 8(4) of MiFIR to make public at least indicative pre-trade bid and offer prices which are close to the price of the trading interest advertised through their system. In the CP ESMA proposed that the indicative prices which are close to the price of the trading interests should be calculated and displayed by the operator of the trading venue in a transparent fashion. The composition and calculation of these indicative prices should be based on a clear and comprehensive methodology that is made transparent to the public beforehand and laid down in the rules of the trading venue.

Analysis following feedback from stakeholders

253. Views from market participants were split. About half of the respondents supported ESMA's proposal stressing that a flexible approach provided the needed flexibility for a provision applicable to a broad area of non-equity instruments and considering that it would allow for strengthened competition between trading venues. On the other hand, the other half of the respondents disagreed with the approach, in particular for derivatives, and recommended to define a clear methodology to be used. Different proposals for the methodology to be applied were made, ranging from using the best available indicative bid and offer to simple average or volume weighted average price. A number of respondents also requested clarification whether indicative prices should be published continuously.

Proposal

254. The final draft RTS specify the valid methodologies to be used when publishing indicative prices while allowing trading venues to choose the methodology that they consider most appropriate. ESMA believes that this approach has the advantage of providing market participants with more clarity on the kind of methodology to be used for publishing indicative prices, while still providing for the flexibility needed to cater for the heterogeneous nature of non-equity instruments covered by the provision. Furthermore, ESMA clarifies that indicative prices should be updated.

III. Order management facility waiver

255. Under MiFIR the order management facility waiver is introduced for non-equities. ESMA is of the opinion that the proposed approach for applying the order management facility waiver for equities would be appropriate to use for non-equities.
256. The order management facility waiver refers to functionalities operated by trading venues where certain orders may waive pre-trade transparency pending their disclosure to the market (i.e. subject to being released to an order book prior to execution). With regard to the practice developed under MiFID I contingent orders such as reserve or iceberg orders and stop orders are considered orders held on an order management facility deemed compliant with MiFID I.
257. MiFIR empowers ESMA to draft RTS specifying the type and minimum size of orders held in an order management facility.
258. In the CP, and in line with the proposal for order management facilities for shares and equity-like instruments, ESMA proposed to define the key characteristics of orders held in an order management facility without narrowly prescribing specific characteristics of those orders. In relation to the minimum size ESMA proposed that for all orders held in an order management facility, with the exception of reserve orders, the minimum size should be, at the point of entry of the order, the minimum tradable quantity established by the trading venue. For reserve orders the minimum size shall be not smaller than €10,000.

Analysis following feedback from stakeholders

259. Most respondents agreed with ESMA's proposal. Some limited feedback highlighted that the suggested minimum sizes were too low, in particular for exchange trade equity derivatives, and might lead to reduced transparency if applied.

Proposal

260. In view of the strong support, ESMA maintained its approach.

IV. Content and timing of post-trade transparency requirements

Background/Mandate

Article 11(4) of MiFIR

4. *ESMA shall develop draft regulatory technical standards to specify the following in such a way as to enable the publication of information required under Article 64 of Directive 2014/65/EU:*
- (a) the details of transactions that investment firms, including systematic internalisers, and market operators and investment firms operating a trading venue shall make available to the public for each class of financial instrument concerned in accordance with Article 10(1), including identifiers for the different types of transactions published under Article 10(1) and Article 21(1), distinguishing between those determined by factors linked primarily to the valuation of the financial instruments and those determined by other factors;*
 - (b) the time limit that would be deemed in compliance with the obligation to publish as close to real time as possible including when trades are executed outside ordinary trading hours;*

[...]

Article 21(5) of MiFIR

5. *ESMA shall develop draft regulatory technical standards in such a way as to enable the publication of information required under Article 64 of Directive 2014/65/EU to specify the following:*
- (a) the identifiers for the different types of transactions published in accordance with this Article, distinguishing between those determined by factors linked primarily to the valuation of the financial instruments and those determined by other factors;*
 - (b) the application of the obligation under paragraph 1 to transactions involving the use of those financial instruments for collateral, lending or other purposes where the exchange of financial instruments is determined by factors other than the current market valuation of the financial instrument;*

[...]

261. Article 10(1) of MiFIR asks market operators and investment firms operating a trading venue to make public the price, volume and time of transactions executed in non-equity

instruments which are traded on a trading venue. The post-trade transparency requirements have been extended, by Article 21(1) of MiFIR, to investment firms, including SIs, which, either on own account or on behalf of clients, conclude transactions outside trading venues (RMs, MTFs and OTFs) in non-equity financial instruments falling under the scope of the transparency regime.

262. Articles 11(4) and 21(5) of MiFIR require ESMA to develop draft RTS specifying information and details to be made public under the new post-trade transparency regime for bonds, structured finance products, emission allowances and derivatives, as well as the timing of publication.
263. The list of flags in the CP (Annex II, Table 2 of the draft RTS) proposed the substitution of the pre-trade LIS flag with a post-trade LIS flag and the addition of some additional flags: a non-price forming flag and flags for transactions for which the deferred publication of information follow the supplementary deferrals granted by CAs (in accordance with Article 10 of the draft RTS)⁸. Furthermore, the CP consulted on the detail of transactions to be made available to the public (Table 1 of Annex II of the draft RTS) and asked whether an additional field for the date and time of publication of a transaction should be added.
264. ESMA proposed to set the maximum time limit for publishing post-trade information in compliance with the requirement to publish as close to real time as possible to a maximum delay of 5 minutes. . To allow market participants to adapt to the new regime, ESMA provided for a less strict requirement of 15 minutes for the first 3 years of application. ESMA notes that the maximum permissible delay should only be used for market participants who for technical reasons cannot achieve real-time publication as promptly as in a fully automated process.

Analysis following feedback from stakeholders and proposal

265. Views from respondents on whether to add the date and time of publication were split. However, those opposing this provision did not provide reasons why this field should not be added, and ESMA, together with a significant part of respondents, considers that this information would be valuable both for market participants as well as for CAs. Therefore, the data and time of publication has been added to the details of a transaction to be made public. However, it has to be noted that for OTC transactions the field will have to be filled in by APAs and not by investment firms. The majority of respondents were not in favour of adding other fields to Annex II, Table 1.
266. ESMA did not introduce further new fields. However, the fields previously included and related to the price and quantity of the transaction have been disentangled to take into account the different characteristics of non-equity financial instruments, e.g.

⁸ For more details on the rationale for the list of flags proposed please see section 3.7 in the CP.

commodity derivatives, and as to ensure a consistent application of the information related to the quantity and notional/nominal value of the transaction.

267. As concerns the flags for post-trade transparency the changes that were introduced following feedback from respondents to the consultation are the deletion of the “technical trades” flag - as those transactions were already covered under the category of the non-price forming trades - and the deletion of the “algorithmic trades” flag. Since there is no legal obligation to include an “algorithmic trading flag” for non-equity instruments – contrary to the requirement for CTPs for equity instrument to flag algorithmic transactions, the latter information was deleted, since most respondents considered it not as providing useful information.
268. In line with the special treatment to which certain package transactions, including exchange for physicals (EFP) are entitled to (see below section VIII of chapter 2.2.2) ESMA considered relevant to include a “package transaction” flag and an “exchange for physicals” flag, so as to provide post-trade information on component transactions the reported prices of which would otherwise give misleading information.
269. Last but not least, the flags to be used in the case of transactions executed under the discretionary deferral regime are maintained. However, for each scenario specific flags have to be used so as to identify the transaction at both points in time, i.e. when limited and full transparency to the reporting is applied.
270. The majority of respondents confirmed the proposal for the time limit for publishing post-trade information, and the approach to set more demanding time limits after 3 years of application. Some respondents would have preferred a more flexible regime, allowing for a review of the provision rather than an automatic reduction to 5 minutes after the 3-year period to ensure that the industry is ready for such a reduction. However, ESMA considers that this approach provides market participants with sufficient time to prepare for more demanding time limits while respecting the objective of MiFID to provide for post-trade transparency in real-time.
271. In order to ensure that the information to be made available to the public for the purpose of post-trade transparency is operational and meaningful, a common format for provision of such information needs to be defined. Additionally, since trading venues are not only subject to post-trade transparency requirements, but also (at the same time) obliged to report financial instrument reference data as per the draft RTS 23, alignment of the formats for relevant data has been considered reasonable and beneficial in light of the overlap between the data to be provided under both requirements.
272. The formats to be applied for the post-trade reports are therefore consistent with the ISO 20022, which has been chosen as the most suitable for the purpose of reference data reporting under MiFIR Art. 27. ISO 20022 is a standardisation methodology which sets out guidelines, principles and formats that should be followed in the development of a common formal notation to describe financial processes.

273. The alignment with the formats used for reference data (and thus, with ISO 20022 methodology) concerns only the way the information is represented, for example the same codes are used to represent the same values. It does not affect the data requirements themselves or the means of their collection or publishing (for example, no specific technical format, like XML, is required for the publication of data). In practical terms it means that the additional burden resulting from the alignment is limited to the transformation of the data so that they are represented in a standard way, thus it can be considered marginal.

V. Application of post trade transparency regime to certain OTC transactions

274. Article 21(5) of MiFIR empowers ESMA to develop draft RTS to identify transactions involving the use of non-equity financial instruments for collateral, lending or other purposes where the exchange of such instruments is determined by factors other than their current market valuation.
275. ESMA notes that a similar, although broader, empowerment exists under Article 28 of MiFID I. On the basis of that empowerment, Article 5 of the Implementing Regulation 1287/2006 does not consider, for the purpose of the transparency regime, securities financing transactions, the exercise of options or of covered warrants and primary market transactions.
276. ESMA consulted on an exhaustive list of transactions for which the application to investment firms, including SIs, of the obligation to make public the volume and price of transactions and the time at which they were concluded is deemed not appropriate as those transactions are initiated on the basis of factors other than the current market valuation of the involved financial instruments. Within that list were included, *inter alia*, securities financing transactions and the exercise of options, covered warrants or convertible bonds. With particular regard to securities financing transactions the vast majority of respondents supported the inclusion as they noted that the reporting requirements are now being dealt with under a separate piece of draft Regulation on the Transparency of Securities Financing Transactions and that MiFIR should avoid duplicative or conflicting reporting requirements.
277. Some respondents stressed the need to exempt transactions that do not contribute to the current valuation of an instrument from post-trade transparency provisions also when executed on trading venues. ESMA notes that the empowerment in Article 21(5) only encompasses investment firms trading OTC, also in their activity as SIs, whereas it is not applicable to on venue trading. However, in order to be able to identify transactions taking place on trading venues and not contributing to the current valuation of the financial instrument, ESMA suggests introducing a flag for those transactions.
278. Primary markets transactions have not explicitly been mentioned as those are out of the scope of the transparency regime of MiFIR.
279. Furthermore, a few respondents outlined the need to exempt post-trade risk reduction service component transactions from the post-trade obligation. Portfolio compression trades are already exempt under the draft RTS, by way of reference to the list of transactions excluded from the scope of Article 26 of MiFIR under the relevant draft RTS. ESMA also notes that Recital 27 of MiFIR, provides that the obligation to conclude transactions in eligible derivatives on a trading venue should not apply to the components of non-price forming post-trade risk reduction services which reduce non-market risks in derivatives portfolios. Commission Delegated Regulation (EU) 149/2013

supplementing Regulation (EU) 648/2012 with regard to, inter alia, risk mitigation techniques for OTC derivatives contracts not cleared by a CCP, does only explicitly cater for portfolio compression. Therefore, for the sake of consistency, no other (non-defined) transactions have been considered for the purpose of setting an exemption from relevant transparency requirements.

VI. Identification of the investment firm making the transaction public

Background/Mandate/Empowerment

280. Investment firms and SIs (SI) trading OTC need to make public the price and volume of transactions with respect to instruments traded on a venue⁹ – Articles 20(1) and 21(1) of MiFIR. Publication occurs through an APA.

281. When a transaction involves two investment firms, it is necessary to determine which of the investment firms should report such a transaction, and ESMA is to specify which of the investment firms is responsible for ensuring publication.

Articles 20(3)(c) and 21(5)(c) of MiFIR:

ESMA shall develop draft regulatory technical standards to specify the following:

“(c) the party to a transaction that has to make the transaction public in accordance with Paragraph 1 if both parties to the transaction are investment firms;”

282. Currently Article 27(4) of the MiFID I Implementing Regulation states that:

“Where the transaction is executed outside the rules of a regulated market or an MTF, one of the following investment firms shall, by agreement between the parties, arrange to make the information public:

- a. the investment firm that sells the share concerned;
- b. the investment firm that acts on behalf of or arranges the transaction for the seller;
- c. the investment firm that acts on behalf of or arranges the transaction for the buyer;
- d. the investment firm that buys the share concerned.

In the absence of such an agreement, the information shall be made public by the investment firm determined by proceeding sequentially from point (a) to point (d) until the first point that applies to the case in question.

⁹ The duty to make sure a trade is published falls only on investment firms, including where applicable systematic internalisers.

The parties shall take all reasonable steps to ensure that the transaction is made public as a single transaction. For those purposes two matching trades entered at the same time and price with a single party interposed shall be considered to be a single transaction.”

283. In order to ensure a clear and enforceable regime ESMA proposed in the CP that the responsibility for publishing transactions should always fall on the seller. This proposal has furthermore the advantage of limiting the scope for regulatory arbitrage when granting investment firms the discretion of choosing which party is responsible for making a transaction public and thereby implicitly the discretion of choosing the applicable deferral regime (in particular for non-equities).

284. For transactions where only one of the investment firms party to the transaction is an SI in the given instrument and the SI is the buyer, ESMA proposed a different approach requiring the SI to always publish the transaction. ESMA opted for this approach since: firstly, there might be an expectation on the part of the SI's client that the SI will be responsible for reporting; and secondly, the trade report will need to have "SINT" entered in the venue of execution field. In the unlikely case where both parties to the transaction are SIs in the given instrument, the selling firm should report the transaction, following the usual principle of 'seller reports'.

Analysis and proposal following feedback from stakeholders

285. The large majority of respondents agreed with the proposal stressing that it provides legal clarity, avoids double reporting and contributes to improving the quality of the publication of OTC trades. However, a number of concerns and requests for clarifications were raised.

286. Some respondents asked for clarification that on-venue trades will be published by trading venues and that only trades concluded outside of trading venues should be published by APAs. ESMA agrees with this interpretation of the interaction between the post-trade transparency requirements for investment firms and trading venues in MiFIR, which is furthermore confirmed by recital 116 of MiFID II¹⁰.

287. A number of responses considered that the draft RTS needs to address the scenario that the seller is a third-country firm. However, ESMA considers Article 20(1) and 21(1) of MiFIR already sufficient clear in stating that the obligation to report the trade falls always on investment firms, thereby excluding third-country firms from a publication duty. Hence, if an investment firms concludes a transaction with a third-country firm, duty to make the transaction public would always fall on the investment firm, even if it is the buyer.

¹⁰ "The introduction of APAs should improve the quality of trade transparency information published in the OTC space and contribute significantly to ensuring that such data is published in a way facilitating its consolidation with data published by trading venues".

288. Some responses asked for guidance on the identification of the seller for transactions in derivatives, and in particular FX instruments. ESMA notes that the parties to an OTC derivative transaction have to establish who is the seller and who is the buyer for the purposes of reporting the transaction to a Trade Repository under EMIR¹¹ and therefore concludes that the participants in such a transaction will identify the seller. ESMA is currently reviewing Implementing Regulation (EU) No 148/2013 including to reflect the guidance currently provided in the Q&A guidance for EMIR. It is expected that the amended ITS will be adopted and applicable by the time of application of MiFID II.
289. A few respondents believed that the proposal is too complex, reverses current market practice and is difficult and costly to implement, in particular for smaller firms. ESMA considered the alternative proposals made in the responses but came to the conclusion that these were either more complex than ESMA's proposal or did not provide the clarification requested in the empowerment.
290. In light of the responses received ESMA maintains its proposal.

¹¹ The requirement is in item 13 of Table 1 of the Annex to Regulation (EU) No 148/2013 of 19 December 2012. ESMA has supplemented this with Q&A guidance, i.e., Questions and Answers: Implementation of Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories (EMIR), ESMA, 10 July 2014, <http://www.esma.europa.eu/system/files/2014-815.pdf>. See "TR Question 24".

VII. Discretionary deferral regime

Background/Mandate

Article 11(3) of MiFIR

3. *Competent authorities may, in conjunction with an authorisation of deferred publication:*

- (a) request the publication of limited details of a transaction or details of several transactions in an aggregated form, or a combination thereof, during the time period of deferral;*
- (b) allow the omission of the publication of the volume of an individual transaction during an extended time period of deferral;*
- (c) regarding non-equity instruments that are not sovereign debt, allow the publication of several transactions in an aggregated form during an extended time period of deferral;*
- (d) regarding sovereign debt instruments, allow the publication of several transactions in an aggregated form for an indefinite period of time.*

In relation to sovereign debt instruments, points (b) and (d) may be used either separately or consecutively whereby once the volume omission extended period lapses, the volumes could then be published in aggregated form.

In relation to all other financial instruments, when the deferral time period lapses, the outstanding details of the transaction and all the details of the transactions on an individual basis shall be published.

Article 11(4) of MiFIR

4. *ESMA shall develop draft regulatory technical standards to specify the following in such a way as to enable the publication of information required under Article 64 of Directive 2014/65/EU:*

[...]

- (d) the criteria to be applied when determining the size or type of a transaction for which deferred publication and publication of limited details of a transaction, or publication of details of several transactions in an aggregated form, or omission of the publication of the volume of a transaction with particular reference to allowing an extended length of time of deferral for certain financial instruments de-pending on their liquidity, is allowed under paragraph 3.*

291. According to Article 11(3) of MiFIR, CAs may, in conjunction with an authorisation of deferred publication, supplement the deferred publication regime with additional

features. Combined with the deferred publication regime, some of these features effectively provide additional transparency (e.g. publication of limited details during the time period of deferral) while most of them provide for longer deferrals or publication in an aggregated fashion.

292. Article 11(4)(d) of MiFIR requires ESMA to draft RTS specifying the criteria to be applied when determining the features described in Article 11(3) of MiFIR.

293. The option for CAs to grant an authorisation of deferred publication and the options to allow or request additional features listed in Article 11(3) of MiFIR means that there are effectively 3 different transparency regimes that may apply for transactions eligible for a deferral:

- i. Real-time transparency, if the CA does not permit deferred publication;
- ii. Deferred publication, if the CA permits deferred publication; and
- iii. Deferred publication with supplementary features (e.g. volume omission for an extended period of deferral), if the CA permits deferred publication in conjunction with any of the additional features listed in Article 11(3) of MiFIR.

Analysis following feedback from stakeholders

294. In the CP, ESMA proposed to set the length of the extended time period of deferral described in Articles 11(3)(b) and 11(3)(c) to 4 weeks.

295. With regard to the publication of transactions in an aggregated form, ESMA proposed:

- i. a daily aggregation of transactions during the 48h time period of deferral for Article 11(3)(a) MiFIR;
- ii. that transactions benefitting from an extended deferral should be aggregated by the respective trading venues and APAs over the course of one calendar week and would be published on the following Tuesday before 9.00 CET. Once the four week period lapses transactions should be published on an individual basis for Article 11(3)(c) of MiFIR;
- iii. that transactions benefitting from an extended deferral should be aggregated by the respective trading venues and APAs over the course of one calendar week and should be published on the following Tuesday before 9.00 CET for Article 11(3)(d) of MiFIR.

296. For sovereign debt instruments for which the options in Article 11(3)(b) and (d) MiFIR can be applied consecutively ESMA proposed that transactions are aggregated over the course of one calendar week and published on the Tuesday following the expiry of the

extended period of deferral of four weeks counting from the last day of the calendar week before 9.00 CET.

297. ESMA pointed out that the proposed rules for operationalising the supplementary deferral regime imply that transactions for which CAs are exercising the option under Article 11(3)(c) and (d) would benefit from slightly longer and varying periods of deferrals before aggregated data would be published and in the cases covered by Article 11(3)(c) to slightly varying extended periods of deferrals. However, ESMA considered its proposal as a pragmatic solution which avoids overburdening trading venues and APAs with potentially numerous aggregation periods that might lead to confusion in markets. Furthermore, ESMA considered that the proposal addressed concerns that too short periods for aggregating transactions might lead to situations where only very few transactions are aggregated thereby exposing risk positions to the public and impairing liquidity.
298. For the content of the aggregated data to be published, ESMA proposed including the weighted average price, the total volume traded and the total number of transactions. ESMA proposed that the data should only be aggregated at an instrument level and considered that Articles 11(3)(a), (b), (c) and (d) of MiFIR should not be used in combination, except in the case of sovereign debt where a combination of Articles 11(3)(b) and (d) of MiFIR is expressly permitted as per the Level 1 text.
299. The large majority of respondents did not comment on the ESMA proposals on how to draft the implementing measures, but rather expressed their concerns about the effects of the Level 1 text.
300. Respondents considered that Article 11(3) of MiFIR can create a highly fragmented environment in the EU which would cause an unlevelled playing field, distorted market conditions and cross-border issues where two counterparties in different jurisdictions may be subject to different regimes.
301. Respondents therefore urged ESMA to actively coordinate the national implementation of the supplementary deferral regime in order to ensure a harmonised deferral regime to the extent possible.
302. ESMA agrees with the concerns expressed, however they cannot be addressed at Level 2. While ESMA will encourage a harmonised implementation of the supplementary deferral regime, it has also has to acknowledge that the various options for CAs are enshrined in the Level 1 text and therefore can be exercised in different ways.
303. Regarding the actual Level 2 proposals, respondents overall agreed with how ESMA is envisaging operationalising the different options, notwithstanding a number of dissenting views.
304. For the extended period of deferral foreseen in Article 11(3)(b) and (d) of MiFIR, many investment firms advocated extending the deferral period from four to twelve

weeks for large trades, especially in illiquid instruments and for occasional very large or bespoke transactions, as 4 weeks were deemed insufficient to fully exit positions.

305. Many trading venues however asked for a reduction of the supplementary deferral period to 24 hours for exchange-trade derivatives, one or two weeks for fixed income instruments and 72 hours for all other instruments to avoid promoting regulatory arbitrage and in order not to undermine existing levels of transparency.

Proposal

306. ESMA has only made small technical adjustments to its proposal for the supplementary deferral regime in Article 11 of the draft RTS and kept the overall system proposed in the CP.

307. While ESMA appreciates that there may be merit in differentiating per asset class or per type or size of transaction, it also has to take into account that Article 11(3) of MiFIR already lays the foundation for a potentially highly fragmented transparency regime across the Union, as has also been recognised by many respondents.

308. Therefore, ESMA believes that the implementing measures should operationalise the supplementary deferral regime on Level 2 in a simple and unified way to the extent possible rather than making the system even more complex due to the many options that have to be taken into consideration.

309. ESMA also considers that the four week supplementary deferral period, that is the basis for implementing the volume-masking option in Article 11(3)(b) of MiFIR and the aggregate publication option in Article 11(3)(c) of MiFIR, does represent an adequate and workable compromise between the opposing views expressed by investment firms and trading venues.

Chart 1: General description of the supplementary deferral regime at the discretion of the CA (Part I)

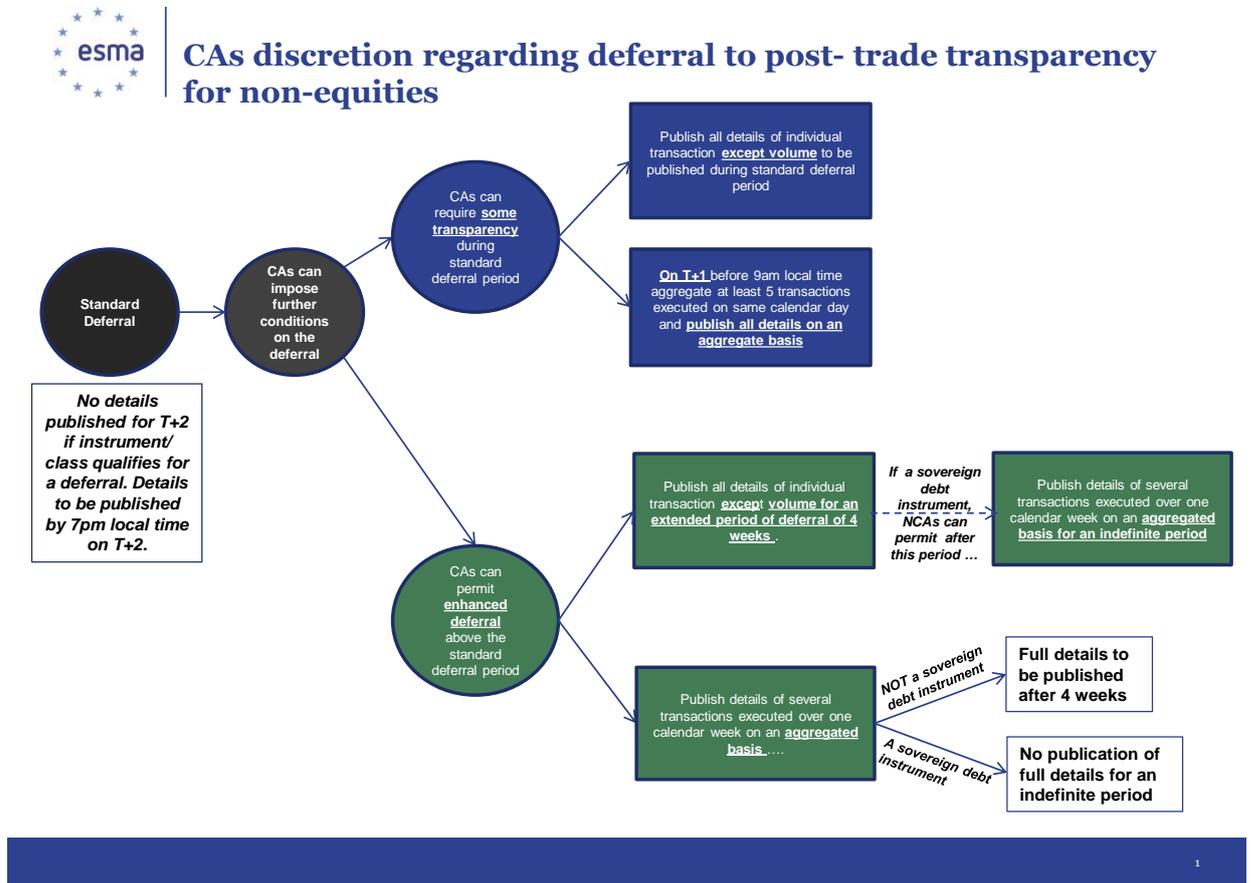


Table 39: General description of the supplementary deferral regime at the discretion of the CA (part II)

		Article 10(1)(a)(i) of the draft RTS	Article 10(1)(a)(ii) of the draft RTS	Article 10(1)(b) of the draft RTS	Article 10(1)(c) of the draft RTS (non-sovereign debt only)	Article 10(1)(d) of the draft RTS (sovereign debt only)	Article 10(1)(b) and (d) of the draft RTS applied consecutively (sovereign debt only)
Initial publication	Content	All details except the quantity using the flag "LMTF"	Aggregated publication of at least 5 transactions using the flag "DATF"	All details except the quantity using the flag "VOLO"	Aggregated publication of transactions executed over the course of one calendar week using the flag "FWAF"	Aggregated publication of transactions executed over the course of one calendar week using the flag "IDAF"	All details except the quantity using the flag "VOLW"
	Timing	As close to real time as possible	The next day before 09.00 am local time	As close to real time as possible	The following Tuesday before 09.00 am local time	The following Tuesday before 09.00 am local time	As close to real time as possible and
Second publication	Content	All details of the transaction and using the flag "FULF"	All individual transactions with all details using the flag "FULA"	All details of the transaction and using the flag "FULV"	All individual transactions with all details and using the flag "FULU"	-	Aggregated publication of transactions executed over the course of one calendar week using the flag "COAF"
	Timing	Before 7pm local time on the second day after initial publication	Before 7pm local time on the second day after initial publication	Before 9am local time four weeks after initial publication	Before 9am local time four weeks after initial publication	-	The following Tuesday before 09.00 am CET four weeks after the initial publication

VIII. Package transactions

310. A number of stakeholders stressed in their response to the CP the need to provide for a tailored transparency regime for package transactions, i.e. transactions comprising several linked and contingent components, aiming at allowing clients or investment firms to reduce transactions costs and manage execution risks. Those responses stressed the need to allow market participants to continue using package transactions once the new regime is in place.
311. ESMA agrees that it is important to provide more guidance on how the transparency requirements apply for package transactions and under which conditions those transactions may benefit from deferrals. However, it is important to stress the limited mandate given to ESMA in Level 1 for developing such a tailored regime. Some proposals brought forward by stakeholders, such as provisions covering pre-trade waivers for packages and/or the introduction of a negotiated transaction waiver for package transactions similar to the one used for equity instruments, cannot be introduced at Level 2 but would require changes to the text of MiFIR.
312. The draft RTS therefore does not include provisions on pre-trade transparency for packages. However, since ESMA shares the view that appropriate pre-trade transparency provisions for packages are needed, ESMA recommends an amendment of MiFIR, which would allow for a tailored treatment of packages also in the context of pre-trade transparency. Furthermore, ESMA intends to take the specificities of package transactions into account when developing the draft RTS on the trading obligation (see section 2.4 on trading obligation for derivatives).
313. ESMA considers it important to provide for a regime that appropriately treats the different types of package transactions. In ESMA's view, at least three different types of package transactions can be distinguished:
- i. Bespoke transactions that are largely carried out OTC and to which only post-trade transparency will be applied;
 - ii. Trading strategies such as swap butterflies (i.e. a package of three swaps of different tenors) or swap spreads traded on the same trading venue and which many trading venues already quote as a package; and
 - iii. Exchange for physicals (EFP) where a derivative position on one trading venue is entered into to offset a simultaneous transaction in a physical underlying on the physical market or another trading venue.
314. Given the limited empowerment and the diversity of packages to be covered, ESMA proposes in the revised draft RTS the following solution:

- i. Introduction of a definition for EFP and package transactions to provide legal certainty on the meaning of the term package transaction for the purpose of non-equity transparency.
- ii. Concerning post-trade transparency, the draft RTS clarifies that, in line with market practice, the individual components of a package shall be published. In case where one of the components is subject to a deferral, the information on all components shall only be published after the lapse of the deferral period to provide all components of the package with the necessary protection. Last but not least, ESMA proposes a flag to identify package transactions and a separate flag for EFP.
- iii. Deferrals: for the application of post-trade deferrals ESMA proposes in the draft RTS that deferrals may be granted where one component of a package transaction, including an EFP, is above the LIS or SSTI threshold or does not have a liquid market.

IX. Temporary suspension of transparency requirements

Background/Mandate

Article 9(4) of MiFIR

4. *The competent authority responsible for supervising one or more trading venues on which a class of bond, structured finance product, emission allowance or derivative is traded may, where the liquidity of that class of financial instrument falls below a specified threshold, temporarily suspend the obligations referred to in Article 8. The specified threshold shall be defined based on the basis of objective criteria specific to the market for the financial instrument concerned. Notification of such temporary suspension shall be published on the website of the relevant competent authority.*

The temporary suspension shall be valid for an initial period not exceeding three months from the date of its publication on the website of the relevant competent authority. Such a suspension may be renewed for further periods not exceeding three months at a time if the grounds for the temporary suspension continue to be applicable. Where the temporary suspension is not renewed after that three-month period, it shall automatically lapse.

Before suspending or renewing the temporary suspension under this paragraph of the obligations referred to in Article 8, the relevant competent authority shall notify ESMA of its intention and provide an explanation. ESMA shall issue an opinion to the competent authority as soon as practicable on whether in its view the suspension or the renewal of the temporary suspension is justified in accordance with the first and second subparagraphs.

Article 11(2) of MiFIR

2. *The competent authority responsible for supervising one or more trading venues on which a class of bond, structured finance product, emission allowance or derivative is traded may, where the liquidity of that class of financial instrument falls below the threshold determined in accordance with the methodology as referred to in Article 9(5)(a), temporarily suspend the obligations referred to in Article 10. That threshold shall be defined based on objective criteria specific to the market for the financial instrument concerned. Such temporary suspension shall be published on the website of the relevant competent authority.*

The temporary suspension shall be valid for an initial period not exceeding three months from the date of its publication on the website of the relevant competent authority. Such a suspension may be renewed for further periods not exceeding three months at a time if the grounds for the temporary suspension continue to be applicable. Where the temporary

suspension is not renewed after that three-month period, it shall automatically lapse.

Before suspending or renewing the temporary suspension of the obligations referred to in Article 10, the relevant competent authority shall notify ESMA of its intention and provide an explanation. ESMA shall issue an opinion to the competent authority as soon as practicable on whether in its view the suspension or the renewal of the temporary suspension is justified in accordance with the first and second subparagraphs.

Article 9(5)(a) of MiFIR

5. *ESMA shall develop draft regulatory technical standards to specify the following:*

(a) *the parameters and methods for calculating the threshold of liquidity referred to in paragraph 4 in relation to the financial instrument. The parameters and methods for Member States to calculate the threshold shall be set in such a way that when the threshold is reached, it represents a significant decline in liquidity across all venues within the Union for the financial instrument concerned based on the criteria used under Article 2(1)(17);*

315. Articles 9(4) and 11(2) of MiFIR allow CAs to temporarily suspend pre-trade and post-trade transparency requirements for trading venues and investment firms when the liquidity of a class of financial instrument falls below a specified threshold. Article 9(5) requires ESMA to specify in draft RTS the parameters and methods for calculating the threshold on the basis of objective criteria specific to the market for the financial instrument concerned and in such a way that it represents a significant decline in the liquidity within a class of bond, structured finance product, emission allowance or derivative across all venues within the Union based on the criteria used under Article 2(1)(17)(a) of MiFIR.

316. While there is some overlap between the “liquid” market and the “liquidity threshold” to be specified under Article 9(5)(a) of MiFIR, the two provisions have different rationales and produce different effects. The “liquid market” provision deals with more structural aspects of liquidity and follows the standard procedure for granting a waiver or deferral of transparency requirements, whereas the “liquidity threshold” is meant to address an unexpected drop in liquidity allowing a CA to immediately suspend all transparency obligations for a limited period of time. ESMA’s understanding of the rationale for this provision is that temporarily removing transparency requirements in markets suffering from a temporary lack of liquidity can contribute to restoring liquidity.

317. In the DP ESMA suggested that the power to suspend transparency obligations should be used only in exceptional market circumstances and that the threshold should be set at a sufficiently low level in order to avoid unnecessary fluctuations in transparency requirements and maintain a level playing field across the Union and also including a qualitative assessment.

318. In light of the feedback to the DP and being mindful of the scope of MiFIR and that the temporary suspension should only be applied in extraordinary circumstances, ESMA further developed its proposal and suggested in the CP that the liquidity suspension could be triggered following a drop in liquidity during the last 30 days compared to the average monthly volume for the preceding 12 full calendar months:

- i. by 60% for instruments or classes of financial instruments which have a liquid market.
- ii. by 80% for instruments or classes of financial instruments which do not have a liquid market.

Analysis following feedback from stakeholders

319. The majority of respondents disagreed with the ESMA proposal and considered it unworkable from a general perspective. In particular, two issues were raised: Firstly, market participants considered that the period for assessing a significant drop in liquidity of 30 days was too long and would not allow CAs to react in a timely manner to changing market conditions, in particular in stressed market conditions. Secondly, the assessment on the basis of COFIA classes was considered as too broad since they do not represent the liquidity of one financial instrument and classes were not considered to be homogeneous enough.

320. Responses suggested addressing these deficiencies by adding a non-exhaustive list of market events which could trigger a temporary suspension, take into consideration more granular classes and shorten the look-back period from 30 days to 20 or 7 days.

321. In addition, some respondents also noted that suspending transparency without suspending the trading obligation might put market participants in a difficult position by being obliged to trade on-venue on the basis of little or no market data.

322. ESMA recognises that the conditions for triggering the temporary suspension are very restrictive, but considers that those reflect co-legislators' intention to provide competent authorities with an instrument to only address extraordinary circumstances, while providing overall for a stable environment and avoiding unnecessary fluctuations in transparency requirements. Furthermore, the more granular calibration of classes of instruments for the liquidity assessment will also be mirrored in the assessment for the temporary suspension, allowing to better take developments at instrument level into account. ESMA has clarified in the draft RTS that the assessment should be carried out at the same level of the class of instruments as for determining the liquidity of a class of instruments.

Proposal

323. ESMA maintains its approach to set different thresholds for financial instruments for which there is a liquid market and financial instruments for which there is not a liquid market, including the consideration of qualitative criteria. In light of feedback received, the draft RTS clarifies that the significant drop in liquidity should be measured at the same level of the class of instruments as used for the determination of the liquid market.

X. Exemptions from transparency requirements in respect of transactions executed by a member of the ESCB

Background/Mandate

Article 1 of MiFIR

[...]

6. *Articles 8, 10, 18 and 21 shall not apply to regulated markets, market operators and investment firms in respect of a transaction where the counterparty is a member of the European System of Central Banks (ESCB) and where that transaction is entered into in performance of monetary, foreign exchange and financial stability policy which that member of the ESCB is legally empowered to pursue and where that member has given prior notification to its counterparty that the transaction is exempt.*

7. *Paragraph 6 shall not apply in respect of transactions entered into by any member of the ESCB in performance of their investment operations.*

8. *ESMA shall, in close cooperation with the ESCB, develop draft regulatory technical standards to specify the monetary foreign exchange and financial stability policy operations and the types of transactions to which paragraphs 6 and 7 apply.*

ESMA shall submit those draft regulatory technical standards to the Commission by 3 July 2015.

Power is delegated to the Commission to adopt the regulatory technical standards referred to in the first subparagraph in accordance with the procedure laid down in Articles 10 to 14 of Regulation (EU) No 1095/2010.

324. Article 1(6) of MiFIR exempts regulated markets, market operators and investment firms from transparency requirements in respect of transactions in non-equity instruments where the counterparty is a member of the European System of Central Banks (ESCB) and where a transaction is carried out for the purpose of monetary, foreign exchange and financial stability policy.

325. MiFIR empowers ESMA to develop, in close collaboration with the ESCB, draft RTS specifying the monetary, foreign exchange and financial stability policy operations and other tasks in the public interest of each member of the ESCB and the type of transactions to which the exemption applies.

326. MiFIR also empowers the Commission to adopt delegated acts to extend the scope of the exemption from transparency requirements in relation of transactions carried out by

central banks that are not members of the ESCB. ESMA stands ready to provide technical advice to the Commission on the extension of the exemption to other central banks.

327. ESMA's proposal for draft RTS in the CP clarified the operations and types of transactions for which the exemption from pre-trade and post-trade transparency in Article 1(6) of MiFIR apply. The proposal defined monetary, foreign exchange and financial stability policy operations in relation to the legal acts or statutes laying down the duties and powers of members of the ESCB. The proposal clarified the types of investment operations for which the exemption under Article 1(6) does not apply which includes those where the member of the ESCB acts in its capacity as administrator of a pension scheme.

Analysis following feedback from stakeholders

328. The vast majority of respondents agreed with the proposal, requesting that it is made clear in the draft RTS that the member of the ESCB is responsible for notifying when the transaction is being carried out for the purpose of monetary, foreign exchange and financial stability policy. Trading venues, in contrast, opposed the proposal, noting that the exemption would require them to adapt their systems to allow the members of the ESCB to make such a notification, translating into increased costs. Trading venues also stated that the exemption should not apply to anonymous order books.

Proposal

329. ESMA maintains its proposal of the operations and types of transactions for which the exemption from pre-trade and post-trade transparency in article 1(6) of MiFIR apply, and continues to be of the view that the requirement to provide prior notification rests only on the member of the ESCB in the form of legal documentation or contractual or regulatory arrangements. In the context of certain trading systems such as anonymous electronic order books, prior notification shall be provided by the member of the ESCB to the operator of the trading venue rather than to the counterparty. ESMA clarifies that the notification given by the member of the ESCB when trading in an anonymous order book exempts the system from producing a transaction report, which includes both legs of the trade.

2.2.3 Implementing the new non-equities liquidity and transparency regime

I. Data collection, calculations and publication

Annual determination of liquid classes and of the LIS and SSTI thresholds

330. The CP included only some basic provisions on the methodology to be applied for the purpose of determining the LIS and SSTI thresholds. However, in light of the revised approach requiring periodic calculation, ESMA has further developed the methodology in the draft RTS to provide certainty on the treatment of different asset classes, to ensure that all classes and sub(-asset) classes of instruments are included and that calculations are carried out consistently.
331. The revised approach requires the yearly determination of the financial instruments or classes of instruments (not) having a liquid market and the thresholds to determine the LIS and SSTI on the basis of the distribution of trades of each sub(asset)-class as presented in section "Feedback to the CP and revised proposal applicable across all asset classes" above and asset class by asset class in sections A to K above and set out in Annex III of the draft RTS.
332. However, the Regulation requires trading venues, APAs and CTPs to submit data related to the trading activity on a daily basis. Considering the broad scope of financial instruments covered and the large amount of data to be processed, daily submission enables CAs to more accurately process files of manageable sizes and ensures an efficient and timely management of the data submission, data quality check and data processing. Furthermore, collecting data on a daily basis also simplifies the data provision obligation on trading venues, APAs and CTPs by alleviating them from the burden of calculating the number of trading days in the cases where that quantitative liquidity criterion is applicable, and of aggregating data for the same financial instrument across different time maturity buckets in the cases where the time to maturity has to be considered. Centralising that calculation also ensures a consistent use of the criteria across financial instruments and trading venues.
333. The following paragraphs present the different steps of the data collection, calculation and publication.
334. **Step 1:** CA collect on a daily basis the data on the trading activity over the period from 1 January to 31 December for the purpose of the liquidity assessment and the determination of the SSTI/LIS thresholds except for the liquidity assessment bonds which shall be performed at the end of each quarter.

335. **Step 2:** The collected data, where expressed in monetary value and not denominated in Euro is converted into EUR (applicable currency) using the ECB foreign exchange rate reference data.
336. **Step 3:** Determination of the liquid market for the various sub(-asset) classes. Five cases can be distinguished:
- i. For securitised derivatives, foreign exchange derivatives and some sub-asset classes of equity derivatives, Annex III of the draft RTS already pre-determines whether those classes (not) have a liquid market. For those cases no calculations are needed.
 - ii. For bonds (including ETCs and ETNs), interest rate derivatives, commodity derivatives, C10 derivatives, emission allowances, emission allowance derivatives, some sub-asset classes of equity derivatives (swaps, portfolio swaps), credit derivatives as well as some sub-asset classes of CFDs (currency and commodity CFDs), Annex III defines quantitative liquidity criteria and thresholds against which the liquidity assessment should be performed.
 - iii. For some credit derivatives (CDS index options and single name options) and CFDs not covered under (ii) the liquidity assessment shall be determined on basis of the so-called qualitative liquidity criteria. In particular, the liquidity assessment will be based on the underlying, i.e. where the underlying is liquid, the derivative contract will be, subject to further conditions set out in Annex III, categorised as liquid.
 - iv. For SFPs a two-test procedure is provided: the first test is performed at the class level, in other words the trading executed in all SFPs is measured against quantitative liquidity criteria and thresholds. If the first test is not passed all SFPs are deemed illiquid, otherwise the second test has to be performed. The second test is performed on an instrument by instrument basis and aims at selecting as liquid only those SFPs that recorded a certain trading activity over the period by applying quantitative liquidity criteria and thresholds.
 - v. All sub-asset classes that do not belong to any of the defined sub-asset class of the respective asset class will be considered as not having a liquid market and no calculations are needed.
337. **Step 4:** Determination of the SSTI/LIS-thresholds
- i. The data collected on a daily basis, as mentioned above, is used for the determination of the SSTI/LIS thresholds. In particular, for each instrument data related to the number of transactions and related volume executed (using the measure of volume set out in Table 4 of Annex II fo the final draft RTS) in pre-

defined transaction-size bins¹² defined on the basis of the rounding rule provided in Article 13 of the final draft RTS¹³ is collected.

- ii. For a given sub(-asset) class, the data received for all days and all instruments it will be summed as to have, for each transaction-size bin, the number of transactions of that size range executed during the year and the total volume represented by those transactions.
- iii. The cumulative distribution function will be computed by cumulating the number of transactions and the total volume of the transactions over the transaction-size bins.
- iv. The upper bound of the bin so that the X% percentile lies within the bin will be determined as the X% trade-percentile (or volume-percentile).

338. **Step 5:** Determination of the SSTI/LIS-thresholds according to one of the following methodologies:

- i. For bonds applying the trade percentiles set out in table 2.3 of Annex III.
- ii. For ETCs and ETNs, securitised derivatives, foreign exchange derivatives, all SFPs when the first test for the purpose of the liquidity assessment is not passed, for those SFPs considered not to have a liquid market where the first is passed and sub(-asset) classes of all derivatives (except equity derivatives), emission allowances and CFDs not having a liquid market the threshold values set out in the respective tables of Annex III of the final draft RTS
- iii. For those SFPs considered to have a liquid market, i.e. when the both tests are passed I and all sub(-asset) classes of derivatives (except equity derivatives and foreign exchange derivatives), emission allowances and CFDs having a liquid market if they recorded more than 1,000 transactions¹⁴, the greater of:
 - a. the trade size below which lies the percentage of transactions corresponding to a certain trade percentile;
 - b. (only for the determination of the post-trade LIS/SSTI thresholds except for emission allowances and emission allowance derivatives) the trade size below which lies the percentage of volume corresponding to a certain volume percentile as long as the volume percentile for the LIS threshold is not higher

¹² For bonds, transactions < EUR 100,000 will not be considered for the calculations

¹³ Transactions size bins are defined as follows:

- | | |
|--|--|
| - EUR 100,000 steps until EUR1 million | 0-EUR 100,000; EUR 100,000- EUR 200,000, etc. |
| - EUR 500,000 steps until EUR10 million | EUR1 million-EUR1.5 million, EUR1.5 million-EUR 2 million, etc. |
| - EUR 5million steps until EUR100 million | EUR5 million-EUR10 million, EUR10 million-EUR 15 million, etc. |
| - EUR 25million steps above EUR100 million | EUR100million-EUR125 million, EUR125 million-EUR 150 million, etc. |

¹⁴ For sub(-asset)classes with less than 1,000 trades the threshold floors shall apply.

than the 97.5th percentile, in that case the trade percentile should prevail for both the LIS and SSTI; and

c. the threshold floor.

iv. For equity derivatives the threshold values should be set in relation to the average daily notional amount (ADNA) according to table 6.2 in Annex III of the final draft RTS.

339. **Step 6:** Round the resulting value of classes covered under (ii) and (iii) of step 5 using the following methodology:

Trade value (TV) in EUR	Rounding up to the next...(in EUR)
TV < 1,000,000	100,000
1,000,000 ≤ TV < 10,000,000	500,000
10,000,000 ≤ TV < 100,000,000	5,000,000
TV 100,000,000 ≥	25,000,000

340. **Step 7:** Publication of results of the liquidity test and of the LIS/SSTI thresholds by the first day of May each year.

341. **Step 8:** Application of the results of the publication one month following its publication, i.e. on the first day of June for a 12-month period.

II. Reference data, treatment of newly issued instruments and instruments traded for the first time

Reference data

342. In order to ensure that data on financial instruments traded is provided on a sufficiently granular basis to assign the financial instruments to the respective sub(-asset)classes and to carry out the transparency calculations, Article 13 of the final draft RTS requires trading venues to submit to competent authorities the necessary details included in Annex IV (e.g. for interest rate derivatives information on the underlying type and the maturity date) whenever an instrument is admitted to trading or first traded and any time the information provided are subject to change. Such details are additional to the reference data that trading venues have to provide under Article 27 of MiFIR.

Treatment of instruments admitted to trading or traded for the first time on a trading venue

343. Under the proposed COFIA approach newly issued instruments or derivatives traded for the first time on a trading venue will, in general automatically, fall into one of the existing sub-classes and hence the liquidity classification and transparency thresholds applicable to this specific sub-class will be applied.

344. However, given the dynamic market environment, it cannot be excluded that financial instruments not covered by any sub-class as defined in Annex III of the draft RTS may be admitted to trading or traded for the first time. To ensure that in such a situation, the transparency regime can be applied, the draft RTS clarifies that those instruments will be treated as instruments not having a liquid market and the liquidity threshold values applicable to instruments of the same sub-asset class that do not have a liquid market will apply.

345. In light of the impact of such a new non-defined sub-class, it may be necessary to amend in the medium term the RTS to ensure a comprehensive approach.

III. Transition

346. To provide for a smooth transition into the new system and to ensure that all results of the transparency calculation are published sufficiently ahead of the first application on 3 January 2017, the draft RTS includes transitional provisions. On basis of a reference period of 6 months (1 July 2015 - 31 December 2015), all calculations specified in Article 13 and described in sections I and II of chapter 2.2.3 will be carried out and published by 3 July 2016. Publication half a year ahead of the application of the new transparency regime will ensure that markets are informed timely of which financial instruments and/or classes of financial instruments are considered to have a liquid market and on the applicable transparency thresholds.
347. However, for bonds (except ETCs and ETNs) the observation period used for the transitional period will be the quarter ranging from 1 August 2016 to 31 October 2016 and the results will be published by 1 December 2016.
348. Data will be collected from trading venues for exchange traded products and from trade repositories for other financial instruments. However, for bonds (except ETCs and ETNs) transaction reporting will be used.

2.3. Double volume cap mechanism and the provision of information for the purposes of transparency and other calculations

2.3.1 Double volume cap mechanism

Background/Mandate

Article 5 of MiFIR

1. *In order to ensure that the use of the waivers provided for in Article 4(1)(a) and 4(1)(b)(i) does not unduly harm price formation, trading under those waivers is restricted as follows:*

- (a) the percentage of trading in a financial instrument carried out on a trading venue under those waivers shall be limited to 4% of the total volume of trading in that financial instrument on all trading venues across the Union over the previous 12 months.*
- (b) overall EU trading in a financial instrument carried out under those waivers shall be limited to 8% of the total volume of trading in that financial instrument on all trading venues across the Union over the previous 12 months.*

That volume cap mechanism shall not apply to negotiated transactions which are in a share, depositary receipt, ETF, certificate or other similar financial instrument for which there is not a liquid market as determined in accordance with Article 2(1)(17)(b) and are dealt within a percentage of a suitable reference price as referred to in Article 4(1)(b)(ii), or to negotiated transactions that are subject to conditions other than the current market price of that financial instrument as referred to in Art 4(1)(b)(iii).

[...]

4. *ESMA shall publish within five working days of the end of each calendar month, the total volume of Union trading per financial instrument in the previous 12 months, the percentage of trading in a financial instrument carried out across the Union under those waivers and on each trading venue in the previous 12 months, and the methodology that is used to derive those percentages.*

5. *In the event that the report as referred to paragraph 4 identifies any trading venue where trading in any financial instrument carried out under the waivers has exceeded 3.75% of the total trading in the Union in that financial instrument, based on the previous 12 months trading, ESMA shall publish an additional report within 5 working days of the 15th day of the calendar month in which the report referred to in paragraph 4 is published. That report shall contain the information specified in paragraph 4 in respect of those financial instruments*

where 3.75% has been exceeded.

6. *In the event that the report referred to paragraph 4 identifies that overall EU trading in any financial instrument carried out under the waivers has exceeded 7.75% of the total EU trading in the financial instrument, based on the previous 12 months trading, ESMA shall publish an additional report within five working days of the 15th on the day of the calendar month in which the report referred to in paragraph 4 is published. That report shall contain the information specified in paragraph 4 in respect of those financial instruments where 7.75% has been exceeded.*

[...]

9. *ESMA shall develop draft regulatory technical standards to specify the method, including the flagging of transactions, by which it collates, calculates and publishes the transaction data, as outlined in paragraph 4, in order to provide an accurate measurement of the total volume of trading per financial instrument and the percentages of trading that use those waivers across the Union and per trading venue.*

1. In order to ensure that the use of waivers from pre-trade transparency does not unduly harm price formation, MiFIR introduces in Article 5 a mechanism that caps the amount of trading carried out under:
 - i. systems matching orders based on a trading methodology by which the price is determined in accordance with a reference price; and
 - ii. negotiated transactions in liquid instruments carried out under limb (i) of Article 4(1)(b) of MiFIR.
2. This double volume cap mechanism is to be implemented and supervised on the basis of ESMA publications regarding the volume of trading under the waivers and an empowerment for technical standards enabling CAs to obtain the data for making such publications.
3. The volume cap applies on an instrument by instrument basis. Two situations can be distinguished. In the first case, the first volume cap is calculated on a trading venue by trading venue basis and is set at the level of 4% of the overall amount of trading across all trading venues in the EU. That means that the volume of trading on any trading venue using the reference price waiver and/or the first limb of the negotiated trade waiver should not exceed the 4% threshold. As an example, a trading venue would be in breach of the 4% threshold when the amount of trading carried out under the reference price waiver and the relevant negotiated trade waiver is 2% and 3% respectively. If the 4% cap is breached by a trading venue in a particular financial instrument, the CA that has authorised the use of these waivers shall suspend within 2 working days their use for that trading venue for that particular financial instrument for a period of 6 months.

4. In the second case, the volume cap is calculated across all trading venues operating under one or both of the relevant waivers and is set at the level of 8% of the overall amount of trading across all trading venues in the EU. That means that the total volume of trading on all trading venues using the reference price waiver and/or the first limb of the negotiated trade waiver should not exceed the 8% threshold. As an example the 8% threshold would be considered to be breached when the amount of trading in the EU carried out under the reference price waiver and the relevant negotiated trade waiver is 4% and 5% respectively. If the 8% cap is breached, all CAs shall within 2 working days suspend the use of those waivers across all trading venues in the EU for a period of 6 months.
5. Both volume caps are measured against a rolling 12 month period with monthly updates published by ESMA as well as updates published twice a month in certain circumstances.
6. In order to effect such publications of actual volume traded within waiver facilities, ESMA is empowered to draft RTS specifying the methods by which ESMA can collate the necessary information, calculate the actual volumes traded and publish the information.

Analysis following feedback from stakeholders

Volume traded via waiver facilities

7. ESMA is aware of the sensitivity of the double volume cap calculations and the potential commercial consequences for venues, issuers and other market participants alike of the publication of incorrect information which would then lead to the suspension of the use of one waiver or of all waivers across the EU for one particular financial instrument. In the CP, ESMA proposed to use two different channels for collecting data:
 - i. First source of data - Collation of the volume of trading from trading venues: One way envisaged to collect the entire volume of on-venue trading consists in requesting all trading venues to submit volumes traded on their systems over the relevant 12 months period to their CA.
 - ii. Second source of data - Collation of volumes from CTPs: ESMA also considered that trading volumes could be retrieved from the CTPs. ESMA considered this source particularly helpful for checking the validity and completeness of data submitted by trading venues.
8. In the responses received to the CP, some respondents questioned the fact that ESMA was expecting to receive data from these two different sources (i.e. trading venues and CTPs). In their view, this would represent an unnecessary burden and, hence, they recommended using only one source of data. They added that, given that uncertainty remains on whether or not there will be CTPs in the future, TVs should be used as the unique source of data. On the other hand, other respondents welcomed the ESMA

proposal in this respect highlighting the extreme sensitivity of the DVC publications and they deemed crucial to have the possibility to cross check data if necessary.

Frequency of the calculations and publications

9. According to Article 5(4) of MiFIR, “ESMA shall publish within five working days of the end of each calendar month, the total volume of Union trading per financial instrument in the previous 12 months, the percentage of trading in a financial instrument carried out across the Union under those waiver and on each trading venue in the previous 12 months, and the methodology that is used to derive those percentages”. Article 5(2) and 5(3) stipulate that, in case of breach of one of two thresholds, the competent authority will have two days after this publication by ESMA to suspend the use of the waiver concerned. Therefore, and given the limited timeframe granted to CAs to react and in order to ensure timely publication, ESMA suggested in the CP that the use of waivers should be monitored on a more frequent basis and proposed to request data and perform the calculations twice a month.
10. ESMA proposed in the CP to receive data twice a month for two reasons:
 - i. to minimise the impact of potential data errors; if data is requested twice a month, data errors can be corrected as soon as they are detected. This is important as ESMA only has five days for error checking and publication from the reception of end of month information, as foreseen in Article 5(4) of MiFIR;
 - ii. to be prepared from the outset for the publication of information twice a month which is required in cases where the thresholds of 3.75% per trading venue or 7.75% overall are reached (Article 5(5) and (6) of MiFIR).
11. No comments were received against collecting data twice a month, hence the proposal to do so is maintained. However, respondents wondered whether the mid-month data were to be published on a systematic basis. As mentioned in the CP, updates will only be published once a month as prescribed by Level 1 text or twice a month in the cases described in Article 5(5) and (6) of MiFIR.
12. In the CP, ESMA also suggested, in order to simplify the periodic submission of data, that trading volumes should be requested not for the previous 12 months but only for the last 15 days (or 13, 14, 15 or 16 days in the second half of the month, depending on the calendar month). The volumes would then be aggregated with the data collected previously from which the trading volume for the first 15 days (or again 13, 14, 15 or 16 as the case may be) of the rolling calendar year would be removed. As an example, on 1 March 2017, trading venues would be requested to submit data for the period from 16 February 2017 to 28 February 2017 (end of the month). Volumes collected would then be added to the calculation sample from which volumes for the period from 16 February 2016 to 29 February 2016 (end of the month) would have been removed. No specific comments have been received in this respect and, thus, the proposal is maintained.

13. Trading venues will be required to send all data required on the first and sixteenth day of each calendar month by 13.00 CET to their respective CA. All such dates are subject to adjustments if they fall on a public holiday or a non-trading day according to the trading venue's home country calendar. In this case, it was proposed that data should be reported on the following working day before the opening of the markets. However, in some of the responses received, respondents asked ESMA to extend the submission in those cases to the following working day by 13.00 CET. Although ESMA noted that a non-working day for a trading venue might always correspond to a non-working day for ESMA (and hence the delay for the general publication of the volumes on the ESMA website would necessarily be delayed), ESMA also appreciates the benefit of having consistent timing for the delivery of the data. Hence, the draft RTS has been modified to accommodate the comments received in this respect.
14. It is worth stressing that ESMA has maintained the possibility to submit ad-hoc requests to trading venues and CTPs. Thus, trading venues and CTPs should have systems and IT infrastructures in place to submit, by close of business on the next working day following the request, data for the last 12 months aggregated over different time horizons (e.g. last 12 months aggregation, monthly aggregation over the last year, etc.). As mentioned above, this data could for instance be used in case errors are detected in the main data sample.

Calculation of actual volumes by ESMA

15. Some responses received during the consultation questioned the use of "value" thresholds (i.e. number of units traded multiplied by price) and recommend using rather "volume" thresholds (i.e. considering only the number of units traded). Should the "value" threshold be maintained, respondents asked for having further clarity on the exchange rate to be used. With respect to the converted data, one respondent stressed that, in his view, converted data might introduce distortion in the calculation with the possibility that one of the thresholds is breached just because of currency swings.
16. With respect to the use of "volume" thresholds rather than "value" thresholds, ESMA disagrees with the responses received. In its view, the price remains an essential element that should be taken into consideration in order to adequately monitor the volume of trading undertaken under the waivers and the economic impact this has on financial markets. ESMA also notes that the proposed use of "volume" thresholds would not allow taking adequately into account potential increases or decreases of the number of outstanding shares for a specific financial instrument (e.g. in case of splits or reverse splits).
17. With respect to the conversion of data into euros, ESMA appreciates the concern that conversion might introduce distortion in the calculations and agrees that it would more appropriate to convert volumes only where necessary. Therefore, with respect to financial instruments which are traded in only one single currency across the Union, the volumes to be used for the calculations and to be published will not be converted.

However, for financial instruments traded in more than one currency across the Union, it is necessary to convert the volumes executed in different currencies into one common currency so as to enable the computation of those volumes and make the required calculations. In those cases, the volumes will be converted into euro using average exchange rates calculated on the basis of the euro foreign exchange reference rates as published daily by the European Central Bank on its website over the collection period.

18. It is also worth stressing that trading venues will not be responsible for the conversion of the volumes. Leaving to trading venues the responsibility of the conversion might otherwise lead to divergent application between venues and would introduce additional operational risks and possible errors. Hence, ESMA has revised its proposal in this respect: data will be reported to CAs and ESMA using the transaction original currency and the conversion into euros will be managed, where necessary, centrally by ESMA.
19. Last but not least, some respondents also asked ESMA to clarify whether transactions executed on the basis of orders benefitting from the pre-trade large in scale (LIS) waiver should be included in the calculations. In ESMA's view, this should only be the case for a transaction executed on the basis of two orders benefitting from the large in scale waiver, where such waiver has been granted by the CA.

Data with respect to financial instruments for which there is less than 12 months of data available

20. It is worth clarifying that ESMA also expects to receive data for instruments for which there is less than 12 months of data available. This could concern notably instruments newly admitted to trading or instruments traded for the first time on a venue. More generally, trading volumes have to be reported for equity and equity-like financial instruments regardless of whether they have been traded continuously over the previous 12 months or only during a limited time over that period.

Consolidation of volumes by ESMA

21. With regard to the consolidation and calculation of the relevant data for the operation of the volume cap, ESMA remains minded to establish technical arrangements seeking to ensure that the data is consolidated on a timely basis and that proper procedures for the identification and correction of errors are in place.
22. To ensure a timely publication of data each month ESMA intends to develop templates in a format allowing for a seamless aggregation of volumes across venues which must be completed by stakeholders. In order to ensure sufficient harmonisation in this respect, ESMA has deemed appropriate to already include some specifications on the data to be submitted in Annex of the RTS.
23. In particular, ESMA notes that the identifiers currently used by trading venues for diverse purposes do not always provide the sufficient level of granularity required for performing

the DVC calculations. In particular, ESMA has observed that in some cases, where for instance a regulated market and a MTF are operated by the same entity, they might be using the same identifier (MIC code) which is not appropriate in the context of the DVC calculations.

24. As indicated in a recital, for the purpose of the double volume cap mechanism, trading venues and CTPs should ensure that the entity on which the transaction was executed is identified with sufficient granularity so as to allow ESMA to perform all calculations set out under MiFIR. In particular, the trading venue identifier used should be unique and not shared with any other trading venue operated by the same market operator or otherwise. Trading venue identifiers should allow ESMA to distinguish in an unequivocal manner all trading venues for which the market operator has received a specific authorisation under MiFID II.

Suspension and resumption of the waiver

25. Some respondents asked for further clarification on how the suspension and resumption of the waiver will operate in practice and in particular on how to achieve sufficient coordination. ESMA appreciates the concerns expressed in this respect and agrees that some clarification could be provided. However, it also notes that those questions concern more specifically the level 1 text and are outside the mandate conferred to ESMA with respect to the Technical Standards on the double volume cap mechanism.
26. Some responses suggested that in case of suspension of the use of the waiver for six-months, the aggregated volumes of the two waivers should be reset automatically to zero rather than include the six months prior to the suspension in a rolling 12 month calculation claiming that, otherwise, the same trades could result in two consecutive suspensions. ESMA does not agree with this interpretation and considers that the last 12 months of data should always be taken into consideration, as prescribed by the level 1 text and regardless of whether a suspension has already occurred or not. In ESMA's view, the same trades could indeed result in two separate suspensions should the volumes of trading under the waiver(s) for the last 12 months still be above the thresholds set out by Article 5 of MiFIR. However, it should be stressed that a suspension would prevent the use of waivers for 6 months and that the volume of trading under the waivers taken into account for the calculation should, hence, be lower in relative terms after the end of the suspension period (considering that lit trading should continue in the meanwhile).

Implementation of the DVC provisions and 2016 data

27. Article 5(8) of MiFIR stipulates that *“the period for the publication of trading data by ESMA, and for which trading in a financial instrument under those waivers is to be monitored shall start on 3 January 2016. Without prejudice to Article 4(5), competent authorities shall be empowered to suspend the use of those waiver from the date of application of this Regulation [i.e. 3 January 2017] and thereafter on monthly basis”*. On

this basis, trading venues will have to submit their first report to their respective CA by 3 January 2017. This report will include trading data for the previous 12 months (i.e. from 3 January 2016 to 31 December 2016) and will be published by ESMA within five working days. The data to be submitted in this respect should be granular enough so as to allow ESMA to collate data to be received in line with the methodology described in the paragraphs above. In other words, the aggregated data to be submitted will need to be split into 24 distinct periods as follows: from 3 January 2016 to 15 January 2016; from 16 January 2016 to 31 January 2016, etc.

28. MiFID II / MiFIR, including the waiver regime, will only be applied as of 3 January 2017. It has to be noted that the waivers under MiFIR are not identical to the ones under MiFID. This applies in particular to the negotiated trades waiver which has been further refined in MiFIR compared to MiFID I. However, in ESMA's view, this should not prevent trading venues from submitting the first reports based on the new waiver regime. ESMA takes this view for two reasons. First, the volumes of trading executed under the reference price and negotiated transaction waivers can be inferred from the equivalent waivers existing under MiFID I and specified in Article 18(1) of the Commission Regulation (EC) No 1287/2006 (MiFID I Implementing Regulation). In order to fit the MiFID II definition of the reference price and of the negotiated transaction waivers, those volumes will however need to be adjusted, in particular by excluding negotiated transactions in illiquid instruments from the volume of transactions under the negotiated transactions waiver. Transactions executed on the basis of orders that would have benefitted from the large in scale waiver if executed after 3 January 2017 will also have to be excluded from the reference price and negotiated transaction volumes. Second, MiFID II/MiFIR entered into force in July 2014, thereby providing trading venues with sufficient lead time to implement the new waiver regime and to be able to perform the necessary adjustments.
29. Several respondents raised concerns about the implementation of the DVC mechanism and in particular the collection of data for the year 2016 described above. ESMA is fully aware that smooth implementation of the RTS requires adequate coordination with trading venues well before the entry into force of the DVC provisions. ESMA is already working on the operational implementation of those technical standards and should contact the relevant parties in due course.

Proposal

Volume traded via waiver facilities

30. ESMA proposes to use trading venues as the primary source of data for performing all the necessary calculations for the purpose of the DVC mechanism. ESMA agrees that a second source of data is not needed in all circumstances and that it might not be necessary to request data from CTPs on a systematic basis. However, ESMA still believes that in some cases (e.g. partial or non-delivery of the data, doubts with regard to the quality and accurateness of the data, etc.) a second source of data should be

available. The possibility of requesting data to CTPs on ad hoc basis has therefore been maintained in the RTS.

Frequency of the calculations and publications

31. Although some adjustments were made with respect to the exact time by which the data should be submitted by trading venues, ESMA has maintained the general procedure described in the CP and will request data from trading venues and perform the calculations twice a month. Updates will however still be published monthly as prescribed by Level 1 text or twice a month in the cases described in Article 5(5) and (6) of MiFIR.

Calculation of actual volumes by ESMA

32. ESMA has maintained its initial proposal to use “value” thresholds (i.e. number of units traded multiplied by price) and rather than “volume” thresholds (i.e. considering only the number of units traded). However, ESMA has revised its proposal with respect to the conversion of data:
 - i. volumes will only be converted into euro for financial instruments traded in more than one currency across the Union; and
 - ii. data will be submitted to CAs and ESMA in the original currency of the transaction and the conversion into EUR will be managed centrally by ESMA.
33. ESMA has also clarified in a recital how to treat transactions executed on the basis of orders benefitting from the large in scale (LIS) waiver for the purpose of the DVC calculations. Only transactions executed on the basis of two orders benefitting from the large in scale waiver should be excluded.

Consolidation of volumes by ESMA

34. In order to ensure sufficient harmonisation of the data submitted and facilitate the consolidation of volumes submitted by different trading venues, ESMA included some specifications on the data to be submitted in the Annex of the draft RTS.

Suspension and resumption of the waiver

35. ESMA has not considered appropriate to modify or further specify its proposal with respect to the suspension and resumption of the waiver and the proposal is maintained in this regard.

Implementation of the DVC provisions and 2016 data

36. ESMA is mindful of the challenges arising from the implementation of the DVC mechanism and will liaise with trading venues to ensure smooth implementation of the

provisions contained in the RTS and in particular with respect to the collection of data for 2016.

2.3.2 Article 22, MiFIR: Providing information for the purposes of transparency and other calculations

Background/Mandate

Article 22(4) of MiFIR

4. *ESMA shall develop draft regulatory technical standards to specify the content and frequency of data requests and the formats and the timeframe in which trading venues, APAs and CTPs shall respond to such requests in accordance with paragraph 1 and the type of data that must be stored and the minimum period of time trading venues, APAs and CTPs shall store data in order to be able to respond to such requests in accordance with paragraph 2.*

37. MiFIR requires competent authorities and ESMA to perform a significant number of calculations in order to determine whether financial instruments are liquid and the level at which various thresholds (e.g. the ones for the large in scale waiver and the deferred publication regime) are set for such instruments. More specifically, these calculations are for the following purposes:

- i. determining whether equity, equity-like and non-equity financial instruments have a liquid market;
- ii. setting the thresholds for pre-trade transparency waivers for equity, equity-like and non-equity financial instruments;
- iii. setting the thresholds for post-trade transparency deferrals for equity, equity-like and non-equity financial instruments;
- iv. determining whether an investment firm is a SI;
- v. setting the SMS applicable to SIs dealing in equity and equity-like instruments, and the size specific to the instrument applicable to SIs dealing in non-equity instruments; and
- vi. determining whether derivatives are sufficiently liquid for the purposes of implementing the trading obligation for derivatives.

38. Under Article 22(4), ESMA is empowered to further specify:

- i. the content, frequency and formats of such requests;

- ii. the timeframe within which trading venues, APAs and CTPs must respond to such requests; and
- iii. the rules applying to the storage of data by trading venues, APAs and CTPs.

Analysis following feedback from stakeholders

Content of data requests

39. In the CP, ESMA noted that the content of data requests under Article 22 of MiFIR will depend, to a large extent, on the methodologies ESMA will set for determining the various thresholds. Therefore this section must be read in the context of ESMA's proposals on how to determine the diverse thresholds for the pre-trade and post-trade transparency requirements for equity, equity-like and non-equity instruments.
40. In addition, ESMA stressed that the Level 1 text already imposes a number of specific parameters. For instance, Article 2(1)(17)(a) already stipulates criteria to be used when assessing the liquidity of non-equity financial instruments for transparency purposes and, hence, data requests to trading venues, APAs and CTPs should entail parameters like the number of transactions in instruments over a specified period of time, the volume executed, the number and type of market participants active and the size of spreads. Similar criteria also apply to the determination of whether an instrument is sufficiently liquid for the purposes of the trading obligation for derivatives.
41. No specific comments were received with respect to the general approach suggested by ESMA in the CP in which it proposed to cross refer to the calculation and methodologies set out in the relevant RTSs (i.e. RTSs on transparency requirements for equity, equity-like and non-equity instruments, trading obligation, etc.) and, therefore, the RTS has been maintained in this respect.

Frequency of data requests and timeframe to respond to data requests

42. In the CP, ESMA stressed that carrying out the calculations for determining the requirements for pre-trade and post-trade transparency and the trading obligation regimes implies both periodic and ad hoc requests from CAs. In ESMA's view, the calculations to be carried out for determining the various transparency requirements listed under Article 22(1) MiFIR cannot all be performed on a periodic basis and, thus, ESMA also foresees the need for ad-hoc requests. This concerns, for instance, future recalculations of the thresholds to adapt potential market changes, re-setting of the liquidity categories, production of reports as required under Article 4(4) of MiFIR, etc.
43. With regard to the timeframe to respond to the data requests, ESMA considered in the CP that four weeks should be an appropriate timeframe to respond to ad hoc data requests and that, for periodic requests, information should be provided at the pre-set dates without any additional delay permitted.

44. Many respondents stressed that they should be able to cope with the response time set out under Article 3 of the draft RTS (CP version) on the double volume cap mechanism and the provision of information for the purposes of transparency and other calculations only in case of the use of standardised templates. ESMA agrees that the timeframe to respond to data requests very much depends on the level of automation and standardisation reached in the data request processes.
45. In this respect, it is worth stressing that, given the very large amount of data which will need to be collected and the broad scope of financial instruments to be covered, this is indeed ESMA's intention to set up robust and automatized procedures for the collection of the data. In this context, ESMA has revised its initial proposal with respect to the frequency for the collection data. Except for the double volume cap calculations, it appears indeed appropriate to collect data daily from trading venues, APAs and CTPs to allow competent authorities to process smaller files and ensure an efficient and timely management of data submission, data quality check and data processing. Given the important amount of data to be collected, it also appears more appropriate to collect data in an aggregated form where possible. Daily collection will hence alleviate the burden such aggregation for submitting entities especially since certain calculations implies aggregating data for the same financial instrument across different time maturity buckets.

Formats of data requests

46. As already stated in the DP and CP, it is ESMA's intention to develop, in coordination with the stakeholders concerned, standardised templates setting out pre-determined content and format specifications in order to minimise the IT investment costs for trading venues, APAs and CTPs and to allow automating, to the extent possible, the submission of data.
47. As advised by the respondents, ESMA will try to the extent possible to leverage on templates already developed in the context of EMIR as well as existing industry standards so as to avoid unnecessary implementing costs for the industry.
48. As mentioned in the CP, such templates must be sufficiently adaptable so that they can incorporate any changes considered necessary at a later stage in a pragmatic fashion. Therefore ESMA has not integrated, but for the double volume cap, any templates into the technical standards given that any change to technical standards requires a significant period of time.

Type of Data to be Stored and minimum period for storage

49. Trading venues, APAs and CTPs are requested to store data that is comprehensive and allow competent authorities and ESMA to perform accurately the calculations as required in the RTSs establishing the MiFID II / MiFIR requirements in terms of transparency such as the RTSs on:

- i. Transparency for equity and equity-like instruments;
 - ii. Transparency for non-equity instruments;
 - iii. Liquid Market for equity and equity-like;
 - iv. Definition of SI; and
 - v. Trading obligation for derivatives.
50. It worth noting that while the required information should usually be included in the post-trade transaction reports, it might be necessary for trading venues, APAs and CTPs, in some cases, to store and provide additional information to CAs and ESMA. In particular, information on transactions executed on the basis of orders benefitting from the pre-trade large in scale waiver might need to be submitted as for instance in the context on the calculations for the DVC mechanism.
51. In terms of minimum period for storage, ESMA has revised its original proposal. The two years periods initially proposed in the CP does not appear to be sufficient to manage all the transparency calculations and, where necessary, perform ad hoc requests and calculations.
52. For instance, for equity and equity-like instruments, calculations have to be performed by 1 March each year on the basis of data from the previous calendar year and the results of those calculations will apply for a year starting 1 April following that publication. This means that, for example, the first round of calculations will be based on data for the period between 1 January 2017 and 31 December 2017 and will apply from 1 April 2018 until 1 April 2019. It is crucial for competent authorities that the submitting entities store the data that has served for the calculations at least until the end of the period of application. Hence, in this example, data from January 2017 should be stored at least until 1 April 2019 – i.e. more than 2 years.
53. Nevertheless, ESMA remains of the view that it is not necessary I to align the minimum period of storage for the purposes of Article 22 with the record keeping rules under Article 25 of MiFIR which provide for investment firms and require trading venues, APAs and CTPs to store data for five years. A period of three years is deemed sufficient to manage all the transparency calculations and, where necessary, perform ad hoc requests and calculations.

Proposal

54. Following the comments received by ESMA, the general approach developed in the draft RTS on the double volume cap mechanism and the provision of information for the purposes of transparency and other calculations annexed to the CP has been maintained except for two changes which have been introduced for practical reasons:

- i. The daily collection of data (except for double volume cap mechanism); and
 - ii. A minimum period for storage of three instead of two as consulted on.
55. It should be noted that the draft RTS on the double volume cap mechanism and the provision of information for the purposes of transparency and other calculations establishes only the abstract principles for providing information necessary for the purpose of the transparency calculations. These principles are further developed in the draft RTS on equity and non-equity transparency which specify the content and frequency of data requests.
56. Lastly, ESMA takes note of the stakeholders call for developing standardised templates as early as possible so as to ensure smooth implementation of the provisions contained in this RTS.

2.4. Criteria for determining whether derivatives should be subject to the trading obligation (Article 32(6) of MiFIR)

Background/Mandate

Article 32(6) of MiFIR – Criteria for determining whether derivatives should be subject to the trading obligation

[...]

ESMA shall develop draft regulatory technical standards to specify the criteria referred to in paragraph 2(b):

Article 32(1) – (3)

1. *ESMA shall develop draft regulatory technical standards to specify the following:*

- (a) *Which of the class of derivatives declared subject to the clearing obligation in accordance with Article 5(2) and (4) of Regulation (EU) No 648/2012 or a relevant subset thereof shall be traded on the venues referred to in Article 28(1) of this Regulation;*
- (b) *The date or dates from which the trading obligation takes effect, including any phase-in and the categories of counterparties to which the obligation applies where such phase-in and such categories of counterparties have been provided for in regulatory technical standards in accordance with Article 5(2)(b) of Regulation (EU) No 648/2012.*

ESMA shall submit those draft regulatory technical standards to the Commission within six months after the adoption of the regulatory technical standards in accordance with Article 5(2) Regulation (EU) No 648/2012 by the Commission.

Before submitting the draft regulatory technical standards to the Commission for adoption, ESMA shall conduct a public consultation and, where appropriate, may consult third-country competent authorities.

2. *In order for the trading obligation to take effect:*

- (a) *The class of derivatives pursuant to paragraph 1(a) or a relevant subset thereof must be admitted to trading or traded on at least one trading venue as referred to in Article 28(1); and*
- (b) *There must be sufficient third-party buying and selling interest in the class of derivatives or a relevant subset thereof so that such a class of derivatives is considered sufficiently*

liquid to trade only on the venues referred to in Article 28(1).

3. *In developing the draft regulatory technical standards referred to paragraph 1, ESMA shall consider the class of derivatives or a relevant subset thereof as sufficiently liquid pursuant to the following criteria:*

- (a) The average frequency and size of trades over a range of market conditions, having regard to the nature and lifecycle of products within the class of derivatives;*
- (b) The number and type of active market participants including the ratio of market participants to products/contracts traded in a given product market;*
- (c) The average of the size of the spreads.*

In preparing those draft regulatory technical standards, ESMA shall take into consideration the anticipated impact that trading obligation might have on the liquidity of a class of derivatives or a relevant subset thereof and the commercial activities of end users which are not financial entities.

ESMA shall determine whether the class of derivatives or relevant subset is only sufficiently liquid in transactions below a certain size.

4. *ESMA shall, on its own initiative, in accordance with the criteria set out in paragraph 2 and after conducting a public consultation, identify and notify to the Commission the classes of derivatives or individual derivative contracts that should be subject to the obligation to trade on the venues referred to in Article 28(1), but for which no CCP has yet received authorisation under Article 14 or 15 of Regulation (EU) No 648/2012 or which is not admitted to trading or traded on a trading venue referred to in Article 28(1).*

Following the notification by ESMA referred to in the first subparagraph, the Commission may publish a call for development of proposals for the trading of those derivatives on the venues referred to in Article 28(1).

5. *ESMA shall in accordance with paragraph 1, submit to the Commission draft regulatory technical standards to amend, suspend or revoke existing regulatory technical standards whenever there is a material change in the criteria set out in paragraph 2. Before doing so, ESMA may, where appropriate, consult the competent authorities of third countries.*

The trading obligation procedure

1. The application of the trading obligation is defined by Article 32 MiFIR which outlines the process for deciding which derivatives should be declared subject to mandatory trading. Once a class of derivatives has been mandated as subject to the clearing obligation under EMIR, ESMA must determine whether those derivatives (or a subset of them) should be subject to the trading obligation, meaning they can only be traded on an RM,

MTF, OTF or a third country trading venue deemed to be equivalent by the Commission. In summary, whether or not a class of derivatives subject to the clearing obligation should also be made subject to the trading obligation will be determined by two main factors:

- i. The venue test: the class of derivatives must be admitted to trading or traded on at least one admissible trading venue; and
 - ii. The liquidity test: whether the derivatives are 'sufficiently liquid' and there is sufficient third party and selling interest.
2. Article 32 of MiFIR provides three empowerments for ESMA for drafting RTS in relation to derivatives subject to the trading obligation.
3. Under Article 32(1) of MiFIR, every time a class of derivatives (or subset) is declared subject to the clearing obligation under EMIR, ESMA has 6 months to prepare, consult on, and present to the Commission a draft RTS stating whether those derivatives should also be made subject to the trading obligation and if so, when. In preparing these RTS, ESMA must consider, under Article 32(3), a list of criteria when making a determination regarding whether the class of derivatives (or subset) is "sufficiently liquid" to be subject to the trading obligation. In summary, these are: the average frequency and size of trades, the number and type of active market participants, the average size of spreads, the anticipated impact of the trading obligation on liquidity and the size of the transactions to which it should apply.
4. Under Article 32(5) of MiFIR ESMA must submit to the Commission a draft RTS to "amend, suspend or revoke" an existing RTS (created under empowerment Article 32(1) described in the paragraph above) whenever there is a material change in the criteria set out in Article 32(2). The criteria under Article 32(2) are: (a) the derivatives are admitted to trading or traded on at least one trading venue; and, (b) there is sufficient third-party buying and selling interest in the derivatives so that it can be considered sufficiently liquid to trade only on trading venues.
5. Article 32(6) of MiFIR empowers ESMA to draft RTS to specify the criterion under Article 32(2)(b): that there is sufficient third-party buying and selling interest in the class of derivatives (or subset) so that such a class of derivatives (or subset) is considered "sufficiently liquid" to trade on trading venues only. This is also one of the criteria, as noted in the paragraph above, which ESMA must take into account when deciding whether to amend, suspend or revoke an existing RTS created under empowerment Article 32(1).
6. ESMA is of the view that the empowerment under Article 32(2)(b) should be read broadly and in conjunction with the criteria set out under Article 32(3)(a),(b) and (c), given the link with determining what is "sufficiently liquid".

7. ESMA notes that Article 32(3) also requires it to take into consideration the anticipated impact of the trading obligation on liquidity and the commercial activities of end users which are not financial entities, and the size of the transactions to which it should apply in determining whether a specific class or subset of derivatives should be subject to the trading obligation. Given the more subjective nature of these criteria, in that they do not provide objective measurements regarding whether a class of derivatives or subset is sufficiently liquid, ESMA has not included specific Level 2 rules on these criteria since the draft RTS only specifies the general approach ESMA will adopt in determining whether a class of derivatives or subset is sufficiently liquid. However, ESMA will address these criteria in the draft RTS prepared regarding whether a specific class of derivatives or subset should be subject to the trading obligation.
8. As ESMA noted in its DP, the definition of the liquidity test for the trading obligation is very similar to the definition of 'liquid market' for non-equities under Article 2(1)(17)(a), which ESMA must also further specify. The definition of the liquidity test for the trading obligation differs in the following:
 - i. Article 32(3)(a) refers to trades instead of transactions (however it is assumed the terms are used interchangeably);
 - ii. Article 32(3)(b) refers to the number and type of active market participants, "including the ratio of market participants to products/contracts traded in a given product market" rather than "including the ratio of market participants to traded instruments in a particular product"; and
 - iii. When referring to the use of spreads, Article 32(3)(c) does not qualify the criterion with 'when available'.
9. The trading obligation assessment is triggered when a class of derivatives has been mandated as subject to the clearing obligation under EMIR. In determining whether the clearing obligation should apply, ESMA must perform a liquidity assessment as specified under Article 5(4)(b) of EMIR and further elaborated at level 2 under Article 7(2) of Commission Delegated Regulation 149/2013:

Article 7(2), EMIR Commission Delegated Regulation 149/2013

1. *In relation to the volume and liquidity of the relevant class of OTC derivative contracts, ESMA shall take into consideration:*

- (a) *Whether the margins or financial requirements of the CCP would be proportionate to the risk that the clearing obligation intends to mitigate;*
- (b) *The stability of the market size and depth in respect of the product over time;*

(c) *The likelihood that market dispersion would remain sufficient in the event of the default of the clearing member;*

(d) *The number and value of the transactions.*

10. As discussed in its CP, ESMA has concluded that complete alignment with the EMIR liquidity test is neither desirable nor feasible because the clearing and the trading obligation serve different regulatory purposes. In addition, the factors of the liquidity test prescribed in Article 32(3) of MiFIR only partially match those in the EMIR framework so that the MiFIR liquidity test which incorporates factors such as the number and type of market participants and the size of spreads will always have to be operated in a different fashion from the EMIR one.

Analysis following feedback from stakeholders

11. In its CP, ESMA asked for comments on its proposals regarding how to interpret the different components of the definition of 'liquid market' in relation to the trading obligation.

12. ESMA proposed to align the criteria under the definition of 'liquid market' for non-equities under Article 2(1)(17)(a) with the trading obligation criteria although the thresholds would not necessarily be the same. In addition, given the different purposes of the two assessments, ESMA proposed building sufficient flexibility into its draft RTS so that approaches to assessing the criteria, which may subsequently prove to be valid, are not excluded. In brief, it proposed that:

- i. **Average frequency of transactions:** ESMA noted its preferred approach for calculating this criterion would be to set thresholds for both a minimum number of trades per day and a minimum number of days on which trading took place, over a specified period of time (the 'assessment reference period'). However, it would not exclude the use of alternative approaches for calculating this criterion.
- ii. **Average size of transactions:** ESMA noted its preferred approach for calculating this criterion would be the division of notional size by number of trading days during the specified period. However, it would not exclude the use of other options, e.g. calculation of notional size divided by number of trades.
- iii. **Assessment reference period:** ESMA proposed that as the assessment reference period may need to vary depending on the class of derivatives or subset, it would not introduce hard timeframes within its draft.
- iv. **Number and type of active market participants:** ESMA proposed it would assess this criterion by giving consideration to the number of members or participants of a trading venue involved in at least one transaction in a given market or where any

member or participant of a trading venue has a contractual arrangement to provide liquidity in a financial instrument at least on one trading venue.

- v. Average size of spreads: ESMA proposed to use the average size of weighted spreads over different periods of time, the size of spreads at different points in time, and use proxies where information on spreads cannot be obtained.
 - vi. Decision mechanism for assessing liquidity criteria: ESMA noted it may not always give equal weight to each criterion when determining whether a class or sub-class should be subject to the trading obligation, but rather it can judge each case separately.
13. Overall, respondents broadly agreed with ESMA's proposals on how it specified the different elements of the liquidity assessment, largely because it provided flexibility. Some respondents highlighted that although products may be traded infrequently in certain markets, there may still be a liquid market in terms of readily available buyers and sellers and market makers. Others noted that the number of market makers and other market participants should not be limited to where liquidity is provided under a specific written agreement as this is not common in the swaps market.
 14. Views on what the size of the spread indicates continued to diverge: some respondents consider a lack of spreads indicate there is insufficient liquidity whereas others note spreads may tighten once trading is moved on to trading venues. However, most respondents acknowledged the difficulty in obtaining this data and views were split between either agreeing with ESMA in using a proxy, or suggesting ESMA ignore this criterion. Given the average size of spreads is a criterion listed in MiFID II, ESMA cannot ignore it and therefore retains its proposal to use proxies.
 15. The majority of respondents argued that a class of derivatives or subset thereof should be considered for the trading obligation only if it is deemed liquid for transparency purposes and considered that the trading obligation thresholds should be higher than those set for transparency, although some respondents did propose the thresholds be set at the same level. Some respondents also noted that the trading obligation assessment may need to be done at a more granular level than the sub-classes proposed in the CP. ESMA has decided to maintain flexibility in its draft RTS so that although it will take the assessment undertaken for transparency into consideration when making a trading obligation determination, to promote consistency of treatment of instruments, derivatives deemed to have a liquid market for transparency purposes will not be deemed automatically to be sufficiently liquid for the trading obligation and the thresholds may differ, taking into account the different purposes of the two assessments.
 16. Article 32(3) states that in developing RTS to specify whether specific derivatives should be subject to the trading obligation, "ESMA shall determine whether the class of derivatives or relevant subset thereof is only sufficiently liquid in transactions below a certain size". Most respondents used the consultation as an opportunity to state that the

LIS thresholds under the transparency regime should be the same under the trading obligation i.e. if a trade is above the LIS size, it would not be subject to the trading obligation in addition to not being subject to transparency requirements. ESMA notes this point and will consult on the precise size when it prepares RTS specific to a class of derivatives under empowerment Article 32(1) of MiFIR. In this draft RTS under empowerment Article 32(6), ESMA states that it will analyse the data collected to identify whether liquidity is concentrated at certain sizes above which there may be insufficient liquidity to apply the trading obligation.

17. A large number of respondents voiced the importance of ESMA clarifying how (preferably by exclusion) package transactions would be treated under the trading obligation and highlighted that this has been an issue in the US where the CFTC (Commodities Futures Trading Commission) had to issue relief of implementation on SEFs. ESMA has therefore included a recital identifying that where package transactions are used to manage risks and improve the resiliency of financial markets, it may be desirable to permit the execution of these transactions on a bilateral basis, outside a trading venue, although they may include one or more derivatives subject to the trading obligation. In preparing the RTS specific to a class of derivatives (under empowerment Article 32(1)) ESMA will consult on the use of package transactions and their treatment, taking into account the characteristics of the class under consideration.
18. Some trading venues raised concerns that there could be a loophole because the clearing obligation is not applied automatically to OTC equity derivative contracts equivalent to standardised exchange-traded equity derivatives. Consequently, there is a concern that participants may create look-alike contracts to circumvent the trading obligation. However, Article 33(4) of MiFIR provides for ESMA to identify and notify to the Commission, on its own initiative, classes of derivatives or individual derivatives which should be subject to the trading obligation although no CCP may be authorised to clear them or they are not yet traded on a trading venue. ESMA would consider using this empowerment where economically equivalent OTC contracts are being created to circumvent the trading obligation, and notes that Article 28(2) MiFIR requires it to monitor activity in derivatives not subject to the trading obligation “to identify cases where a particular class of contracts may pose systemic risk and to prevent regulatory arbitrage between derivative transactions subject to the trading obligation and derivative transactions which are not subject to the trading obligation”. Equally, should trading move from trading venues to economically equivalent OTC contracts, such a class of OTC derivatives may later become subject to the clearing obligation under EMIR.
19. Some trading venue also noted that the absence of a trading obligation for ETDs traded on Regulated Markets (due to EMIR not applying to instruments traded on Regulated Markets) coupled with the lack of a waiver for negotiated transactions could move trading away from trading venues which would be contrary to the objectives of the trading obligations. ESMA agrees that MiFID II does not provide a mechanism to apply the trading obligation to ETDs on Regulated Markets: the empowerment under Article

32(1) is contingent on the derivatives first being made subject to the clearing obligation under EMIR, which does not apply to Regulated Markets, and ESMA's own initiative empowerment under Article 32(4) is to be used for derivatives:

- i. Which should be subject to the trading obligation but where no such CCP has yet been authorised to clear them under EMIR; or
 - ii. Which are not yet traded on any trading venue.
20. Neither scenario will apply to ETDs traded on Regulated Markets. However, being the overall objective of MiFID II to bring greater transparency to the non-equity markets, ESMA considers that the risk of ETD trading moving off venue because there will no longer be a negotiated trade waiver is mitigated by the transparency requirements and quantitative thresholds which will apply to the new SI regime.
21. Some respondents noted the necessity of CAs being able to quickly de-list a derivative from the trading obligation if it is no longer liquid and voiced concern that there is no corresponding 'temporary suspension' empowerment for CAs in relation to the trading obligation compared to under the transparency requirements. ESMA is aware of this issue, but as there is an absence of a mechanism in MiFID II and MiFIR to invoke a temporary suspension of the trading obligation except in exceptional circumstances, this means ESMA cannot introduce such a provision in its draft RTS.

2.5. Criteria for determining whether derivatives have a direct, substantial and foreseeable effect within the EU (Article 28(5) of MiFIR)

Background/Mandate

Article 28(5) of MiFIR – Criteria for determining whether derivatives have a direct, substantial and foreseeable effect within the EU

In order to ensure consistent application of this Article, ESMA shall develop draft regulatory technical standards to specify the types of contracts referred to in paragraph 2 which have a direct, substantial and foreseeable effect within the Union and the cases where the trading obligation is necessary or appropriate to prevent the evasion of any provision of this Regulation.

ESMA shall submit those draft regulatory technical standards to the Commission by 3 July 2015.

1. The last paragraph of Article 28(5) MiFIR prescribes that “where possible and appropriate, the regulatory technical standards referred to in this paragraph shall be identical to those adopted under Article 4(4) of Regulation (EU) No 648/2012”.
2. The Commission published on the 21 March 2014 the Delegated Regulation (EU) No 285/2014, of the 13th February supplementing Regulation (EU) No 648/2012 on direct, substantial and foreseeable effect of contracts within the Union and to prevent the evasion of rules and obligations (Regulation 285/2014).
3. The CP proposed a framework closely linked to Regulation 285/2014 for the purposes of the trading obligation for derivatives, based on the following key elements:
 - i. Considering as contracts with a direct, substantial and foreseeable effect within the Union:
 - a. Contracts entered into by a third country entity which has a guarantee from an EU financial counterparty would be subject to the clearing obligation if they were established in the EU.
 - b. Contracts entered into between two European branches of non-EU financial counterparties.
 - ii. An indicative set of criteria to measure the substance or effect on the Union of trading which would normally be subject to the trading obligation but escapes it by

virtue of a unique business arrangement, considering mainly as such those designed for the purpose of avoiding the trading obligation.

Analysis following feedback from stakeholders

4. Respondents broadly supported the proposed approach, after determining that alignment with EMIR would be the simplest and least costly approach. Approximately half of respondents argued that it is not appropriate for the trading obligation to apply to third country firms' trades where the clearing obligation under EMIR does not apply to the relevant transactions by virtue of an equivalence assessment under Article 13 of EMIR. These respondents expressed concern that the EU would, in such circumstances, impose an obligation on two counterparties to trade an instrument on an EU trading venue despite the fact that neither counterparty would be based in the EU and thus the relevant transaction would be exempted from the EU clearing obligation. As a solution, they suggested the draft RTS specify the criteria will not have been met if the clearing obligation does not apply to the transaction as a result of the application of Article 13 of EMIR.
5. ESMA notes that some respondents made these comments in response to the discussion paper published in May 2014. ESMA has given the matter further thought but continues to conclude that a class of derivatives that has been exempt from the clearing obligation, in accordance Article 13 of EMIR, should still be subject to the trading obligation in cases where it had a direct, substantial and foreseeable effect within the Union unless an implementing act of equivalence under Article 33(3) of MiFIR has been adopted. In this regard, ESMA would point out that whilst Article 28(5) of MiFIR refers to capturing contracts under the EU trading obligation that would otherwise be out of scope, the trading obligation may in some cases be applicable even where there is no clearing obligation in place, pursuant to Article 32(4) of MiFIR. Furthermore, since the determinations of equivalence by the Commission under Article 33(2) of MiFIR and Article 13(2) of EMIR are to be carried out on the basis of different criteria, counterparties fulfilling the clearing obligation under EMIR cannot a priori be said to fulfil the trading obligation under MiFIR. ESMA does, however, recognise the potential for difficulties, as expressed by respondents, and that it is desirable for equivalent assessments of third country jurisdictions to look at both the clearing and trading obligation regimes at the same time where possible.
6. ESMA also sought comments regarding whether there was a need to expand the scope of the EMIR RTS, which refers only to EU branches of third country financial counterparties and to EU branches of third country non-financial counterparties. Most respondents did not consider there was a need to extend the scope and thus ESMA has decided to keep the scope of these RTS aligned with those under EMIR.

3. MICROSTRUCTURAL ISSUES

3.1. Organisational requirements for investment firms engaged in algorithmic trading, providing direct electronic access and acting as general clearing members

Background/Mandate

Article 17(7)(a) of MiFID II

7. ESMA shall develop draft regulatory technical standards to specify the following:

- (a) The details of organisational requirements laid down in paragraphs 1 to 6 to be imposed on investment firms providing different investment services and/or activities and ancillary services or combinations thereof, whereby the specifications in relation to the organisational requirements laid down in paragraph 5 shall set out specific requirements for direct market access and for sponsored access in such a way as to ensure that the controls applied to sponsored access are at least equivalent to those applied to direct market access.*

Analysis following feedback from stakeholders

General

1. ESMA proposed twelve definitions in the draft RTS. In general, stakeholders welcomed the definition of 'investment firm' in the draft RTS. However this definition has been removed to avoid confusion with the Level 1 definition of 'investment firm' as per Article 4(1)(1) of MiFID II. The definition in the draft RTS was intended to clarify that the Regulation only applies to those firms engaged in algorithmic trading. ESMA has now clarified this point on the scope of the Regulation in the title and recitals.
2. One respondent recommended clarifying that the RTS is applicable to Direct Electronic Access (DEA) clients only when they are engaged in algorithmic trading. ESMA does not necessarily disagree with that statement, however it is noted that the requirements set out in the Regulation affect DEA providers. The obligations imposed on DEA providers (directly or through sub-delegation) are applicable regardless of the type of trading (algorithmic or non-algorithmic) that their DEA clients undertake. ESMA has clarified in a Recital that investment firms must fulfil the requirements of the RTS if they provide DEA. In this regard, provisions concerning DEA should take into account the definition of DEA as adopted by the European Commission, based on the technical advice provided by ESMA.

3. One respondent suggested excluding RFQ systems from the scope since only quotes themselves are in the scope of algorithmic trading, which have limited or no human interaction. However, Article 17 of MiFID II sets out the scope of this Regulation where it refers to 'investment firms engaged in algorithmic trading' without further reference to the specific types of trading systems.
4. It was pointed out that there were different definitions of "disorderly trading conditions" in the draft regulations on the organisational requirements for investment firms and for trading venues. To avoid unnecessary confusion, ESMA has deleted the definitions of "stressed market conditions" and "disorderly trading conditions" from this Regulation. However, it should be noted that the draft RTS 8 on market making agreements and market making schemes still makes reference to those concepts.
5. In terms of organisation of the RTS, ESMA has eliminated the standalone article for definitions and specified each concept in the relevant articles.

Governance

6. In the draft RTS, ESMA had proposed the segregation of trading functions, middle office and back office functions. According to one respondent, smaller firms would be required to hire additional personnel in order to fulfil the requirements of the draft RTS. ESMA has revised the text to require only that different functions should be involved in the governance of algorithmic trading systems.
7. ESMA has also revised the text of the draft RTS to clarify that the references in the governance process refer to those elements that are specific to the investment firm's algorithmic trading system, rather than the general requirements that are covered under Article 16 of MiFID II.
8. Mindful of the need to cover a broad spectrum of firms, including smaller firms, ESMA has allowed for the compliance function to operate the kill functionality itself.
9. ESMA has deleted the references to the specific types of training needed to gain the relevant competencies and knowledge regarding algorithmic trading, a new provision focuses rather on the competencies and knowledge themselves leaving more flexibility to investment firms to achieve that outcome.
10. ESMA proposed organisational requirements for IT outsourcing and IT procurement. Some stakeholders recommended narrowing down the scope to 'material' software and hardware. However, ESMA decided not to differentiate between material and non-material outsourcing or procurement since minor components of an IT system may have an important impact on the entire system. These respondents requested for the rights to audit the outsourced activity only being applicable to new contracts. On this point, the Regulation no longer includes a reference to audit functions. However, ESMA reminds

that Article 16(5) of MiFID II and any delegated regulation thereof are also applicable to investment firms engaged in algorithmic trading.

11. Two respondents expressly opposed setting any requirements regarding the content of the commercial agreements between investment firms and their vendors. These respondents considered that investment firms would incur a significant cost by requesting vendors to comply with the proposed requirements given the absence of any regulatory requirements on these vendors. In their opinion, it was the investment firms' responsibility to ensure that sufficient documentation existed concerning any outsourced or procured hardware and software. Furthermore, they proposed that ESMA defined the terms "outsource" and "procure" to clarify the scope and application of these provisions.
12. In this regard, ESMA notes that the requirements regarding outsourcing are general organisational requirements, per Article 16 of MiFID II. A recital has been added to the Regulation to clarify that the requirements stemming from Article 17 of MiFID II should be applied in conjunction with the whole regulatory framework.

Testing of trading systems and algorithms

13. Respondents accepted most of ESMA's proposals for the testing of trading algorithms and trading systems. They suggested amending some of the obligations so as to ensure their appropriateness and practical applicability. ESMA has duly considered these comments, and has made several changes to the relevant articles.
14. In particular, several respondents pointed out their concern that pure investment decision algorithms, which do not make any order execution decisions, may inadvertently be captured by the RTS as originally drafted. In this regard, ESMA has now clarified that pure investment decision algorithms that are executed by non-automated means are out of scope of the algorithm testing requirements contained in the Regulation. Further, several of the proposed articles in relation to testing have been moved to provide greater clarity.
15. Respondents generally agreed with the proposed obligations in relation to testing governance and general considerations, which in the draft RTS were partially captured under the headings "general" and "initial testing". ESMA has revised such obligations to align those requirements with the draft RTS on the organisational requirements for trading venues enabling algorithmic trading through their systems (RTS 7). Therefore, investment firms are expected to undertake testing to ensure that the algorithmic trading system or algorithm behaves as designed, complies with the investment firm's regulatory obligations, is conformant to the trading venue's rules and systems and does not contribute to disorderly trading conditions, including behaviour under stressed market conditions. Following the input from respondents, ESMA has clarified in the Regulation that the record keeping requirements regarding the sign-off process for making changes to proprietary software is limited to material changes only.

16. One stakeholder group proposed that testing to prevent contributing to disorderly trading conditions should include requirements to ensure that algorithms do not create stressed market conditions. As indicated above, the definitions of “stressed market conditions” and “disorderly trading conditions” have been deleted from this Regulation. However, ESMA wishes to clarify that one of the elements to be tested is the ability of the trading system, algorithm or strategy “to work effectively in stressed market conditions, and where necessary under those conditions, allow the trading system or algorithm to be switched off”. Therefore, where an algorithm is creating stress in the market it should be possible to manage that situation, including by switching off the algorithm.
17. Respondents pointed out to ESMA that a physical segregation of production and test environments should not be a disproportionately burdensome requirement. In this regard, ESMA has now clarified that it expects testing environments to be merely segregated from the production environment without requiring for duplicative physical systems or infrastructures.
18. ESMA’s draft proposal regarding non-live trading environments was viewed critically by most respondents, in particular because they considered that an exclusive reliance on non-live test environments provided by trading venues would inappropriately limit firms’ testing options, while also creating quality and cost concerns. ESMA has consequently reviewed its approach regarding non-live testing requirements for investment firms in conjunction with the test environment obligations for trading venues. The approach taken in this Regulation is as follows: as with the other testing requirements, the non-live testing obligations do not cover algorithms that only make investment decisions without execution decisions. Further, the Regulation allows firms the option of using a non-live testing environment that is appropriate to the type of testing being performed, i.e., a firm’s own testing environment, or a third-party test environment (provided by a trading venue, DEA providers, or vendor).
19. Regarding conformance testing, the respondents generally agreed with the draft obligations, but several considered that improvements could be made to more precisely define the scope of the conformance testing obligations. Based on the feedback received, ESMA has made several adaptations in the Regulation: as elsewhere in the area of testing, pure decision making algorithms are carved out from the obligations given that such algorithms should not interact with the trading systems. Also, the Regulation clarifies that, depending on the precise nature of their access arrangements, firms should undertake conformance testing with either the trading venue (for trading venue members and sponsored access (SA) clients) or with the direct market access (DMA) provider (for DMA clients). Further, it is clarified that subsequent conformance testing is only necessary in case of material or substantial changes to the trading systems or access facilities involved.
20. Regarding the controlled deployment of algorithms, a number of respondents asked ESMA to grant firms more flexibility as to whether, and the extent to which, the relevant

parameters should be restricted. Additionally, several respondents were materially concerned with the proposed obligation, arguing that it would unduly prevent them from carrying out their activities, notably portfolio optimisation, market making, and hedging. ESMA has duly considered the comments received, but remains of the opinion that in view of the risks for the orderly functioning of the market from firms insufficiently controlling the deployment of algorithms in the production environment, it would be inappropriate to allow firms to exercise such discretions. Therefore, ESMA has not materially changed its approach in the Regulation compared to the draft RTS. It should be noted, however, that the general carve out of pure decision making algorithms from the testing obligations in the Regulation also extends to this area, which should allay respondents' concerns regarding portfolio optimisation.

21. Regarding the annual review and validation of systems, respondents generally agreed with ESMA's proposal. However, they made several suggestions, which ESMA has adopted after due consideration. In particular, it is now clarified that the annual review and validation should consider a firm's relevant business continuity arrangements, and that validation report should be audited by an internal audit function where such function exists. The audit function may be carried out by staff in the investment firm who is independent of the risk control function that prepared the report, such as compliance staff or by an external firm. Further, the drafting of the article has been made more concise on the basis of several of the suggestions by respondents.
22. Regarding stress testing, many respondents were concerned by certain elements of the proposed obligations in the draft RTS. ESMA has made several changes in this regard, in particular by clarifying that any stress tests should be undertaken in such a way that they do not affect the production environment, and by limiting the number of mandatory test scenarios to two (i.e., high message and trade volume tests) only.
23. A group of market participants noted that the annual stress testing should not be based on the number of algorithms running simultaneously but on the volume of messages managed by the system. ESMA agrees with that approach and has revised the text accordingly.
24. Regarding change management, respondents agreed with ESMA's proposal, but considered that the requirements should apply only to material changes. Also it was suggested that part of the obligations that ESMA had proposed could be better placed elsewhere (in the general obligations regarding testing). After due consideration, ESMA has adopted these suggestions, and has changed the relevant articles.
25. One respondent commented that on Article 15 of the draft RTS ("Ad hoc" change management), not all changes to an algorithm should require senior management sign-offs, but rather sign-off at an appropriate level. Assuming that a proper governance arrangement is in place within the firm, investment firms should have the discretion as to whether there was a need for senior management sign-off on any ad hoc changes to a production system. ESMA has revised the text accordingly, requiring that material

changes to the production environment should be subject to a review by a responsible party as designated by the senior management of the investment firm.

Business continuity arrangements

26. ESMA's proposal in the CP reflected the arguments made in the consultation paper for the 2012 ESMA Guidelines¹⁵ adding a minimum range of disruptive scenarios related to the operation of trading systems that should be considered by investment firms.
27. Respondents unanimously rejected the list of disruptive scenarios that ESMA had proposed. A significant majority of the respondents explicitly stated that the list was too prescriptive for an efficient regulatory outcome to be achieved. Many added that the Regulation should be seeking to codify the 2012 ESMA Guidelines which took into account the nature, scale and complexity of the firm's business. Respondents felt that this was not achieved in the draft RTS proposed in the CP.
28. Respondents considered that such a list should not be a list of minimum requirements, but a non-exhaustive list where the firms can choose the requirements that fit their circumstances. Furthermore, one respondent noted that simulating the loss of staff or human error as stipulated in the list of disruptive scenarios are extremely difficult to undertake, and considered unlikely to add any value.
29. A sizable minority of the respondents noted that "disorderly markets" were perceived differently by investment firms and trading venues. For investment firms, this was seen as a particular market event, whereas for trading venues, this was more about IT or operational issues rather than market conditions. Therefore respondents suggested that ESMA clarifies which perspective should be adopted, so as to enable all participants to prepare their business continuity arrangements appropriately.
30. On ESMA's proposed requirement for investment firms to trade all existing orders manually in the event of a disruptive event, a significant majority of respondents noted that this would be impractical and may compromise the firm's ability to act in the best interest of its clients. In such circumstances, having the option to either trade, cancel or re-route would be preferable. To resolve this issue many respondents suggested substituting the term "trade" with "manage".
31. Additionally, one stakeholder pointed out the need to distinguish between algorithms that were used for making investment decisions and those used for trading decisions. Although the requirement for business continuity arrangements to set out trading (or managing) of the outstanding orders following a disruptive event would be relevant for execution algorithms, imposing the same requirement on investment decision algorithms was unwarranted as it may be better to simply disable that algorithm than to require

¹⁵ ESMA's Guidelines on Systems and controls in an automated trading environment for trading platforms, investment firms and competent authorities

resumption of trading using such an algorithm. These respondents called for investment firms to have the discretion to identify the relevant algorithms for which such a requirement should be applied.

32. Based on the input from stakeholders, ESMA has decided not to include a list of disruptive scenarios that were viewed as being too prescriptive, but instead to require firms to have business continuity arrangements that are appropriate to the nature, scale and complexity of their business.
33. Furthermore, in view of the comments made regarding the appropriateness of requiring all investment firms to arrange for the resumption of trading, a provision was added so that a business continuity arrangement may include a scenario for an orderly wind down of operations for firms that are not engaged in activities that would create risks market disruption following their sudden withdrawal from the market. In this regard, the requirement to maintain duplicate hardware components to permit continuous operations in case of a failover was dropped from the list of arrangements to be included in the business continuity arrangement.
34. With regard to assessing the relevance and adequacy of the existing business continuity arrangements, an assessment is to be undertaken on an annual basis, as proposed in the CP.

Pre-trade and post-trade controls

35. ESMA proposed a framework of six mandatory pre-trade controls. Stakeholders highlighted that the controls were too detailed and preferred the approach of the 2012 ESMA Guidelines because too detailed requirements might become outdated in the future. Moreover, the detailed requirements on pre-trade controls raised several questions concerning their operationalisation. Some respondents commented that some requirements were not workable for all businesses.
36. ESMA streamlined the framework in this Regulation, with only four mandatory pre-trade controls applicable for trading in all instruments. In addition, the text was clarified to indicate that investment firms should apply automation execution throttles to limit the number of times a strategy was applied only where appropriate to the specific trading venue, strategy and product.
37. ESMA has added a requirement to ensure that the calculations supporting each pre-trade control take into account all orders sent to a trading venue.
38. ESMA proposed that monitoring of order flows should take place in real-time with a time delay of no more than five seconds. Stakeholders stressed that real time monitoring was too excessive, and “timely controls” (or “as near to real time as is practical”) would be more adequate. ESMA still considers a five-second period for the generation of an alert

as adequate if an investment firm is engaged in algorithmic trading. However, it does not imply that the resolution of such an alert should take place within five seconds.

39. ESMA proposed that monitoring staff should have the authority to take remedial action. Respondents questioned whether the monitoring staff should take remedial action or just ensure that action is taken. ESMA has clarified that monitoring staff, in analogy to compliance staff, should monitor the order flow and initiate remedial action. Hence monitoring staff is not required to solve the problem itself. Additionally, ESMA has clarified that real-time monitoring should be undertaken by the trader in charge of the algorithm and also by a risk function that is independent from that trader, to ensure an appropriate segregation between the trading desk and supporting functions.
40. ESMA proposed to have in place pre-trade controls at investment firms and trading venues. Some respondents questioned the necessity for such redundancy, and recommended keeping the approach taken in the 2012 ESMA Guidelines. Other respondents stated that whilst trading venues should always be “the last line” of defence, the redundant nature of such controls were appropriate. ESMA believes that at least two lines of defence are appropriate in this complex business and thus continues to require pre-trade controls conducted by both investment firms and trading venues.
41. ESMA proposed to require investment firms to use drop copies for reconciliation as soon as possible. Although many respondents agreed to that proposal, they also recommended requiring trading venues to provide for drop copies, and introduce requirements to improve availability of drop copies since their quality varies. One respondent acknowledged the importance of drop copies but did not believe that drop copies could ensure accurate and consistent information. Whilst ESMA does not require trading venues to offer drop copies, it expects investment firms to use them if they are available.
42. One group of stakeholders expressed concerns about the requirement to provide alerts on a real-time basis when the volatility interruption mechanisms of a trading venue have been triggered by an algorithm or DEA order. ESMA remains of the view that investment firms should have the means to identify DEA clients or algorithms that might contribute to the creation of disorderly trading conditions, for a specific assessment of their performance and timely reaction when needed.
43. One response requested clarification on the authorisations that trading venues should grant to monitoring staff of investment firms. ESMA has revised the text to clarify that relevant competent authorities, trading venues and where applicable DEA providers should have access to the investment firm’s monitoring staff.
44. One respondent noted that it was not clear whether the “kill functionality” which is embedded in a trading venue’s system was expected to also be used by investment firms for their use, or it was just for the trading venue’s exclusive use. ESMA notes that this Regulation and the Regulation on the organisational requirements for trading venues

enabling or allowing algorithmic trading through their systems (RTS 7) set out two different obligations: trading venues should operate their own “kill functionality” on pre-determined cases. Separately, investment firms must have the ability to cancel unexecuted orders as stipulated in Article 12 of this Regulation. These Regulations neither oblige trading venues to provide access to their “kill functionality” for use by investment firms (unless where the member or SA client is technically unable to delete its own orders) nor ban it, in the context of the requirements for IT outsourcing and procuring.

Market impact assessment

45. Virtually all respondents rejected the suggestion to consider mandating firms to apply a market impact assessment as a pre-trade control. Respondents considered that a market impact assessment control would have very limited added value, while causing significant operational and cost concerns. Also, respondents considered that such a control would be redundant with well-calibrated “fat finger” controls. For this reason, ESMA has not pursued the market impact assessment control any further. However, ESMA would like to stress in this regard the importance for firms to appropriately calibrate their other pre-trade controls for varying price and liquidity levels and scenarios.

Monitoring for the prevention and identification of potential market abuse

46. In the Discussion Paper, respondents expressed cost concerns regarding a requirement for undertaking automated monitoring of algorithmic trading activities and argued that the decision to automate market surveillance alerts should be at the discretion of the firm. However, given the large amount of data that needs to be analysed, as well as the complexity of algorithmically generated trading patterns, ESMA considered that the nature of algorithmic trading activity is such that applying non-automated (i.e. manual) surveillance filters would be insufficient for identifying potential instances of market manipulation. ESMA therefore considered that a requirement for implementation of an automated alert system to identify potential market manipulation should be applicable for all investment firms undertaking algorithmic trading activities. In the CP, ESMA clarified that such a system should be able to at least analyse in an automated way the indicators of manipulative behaviour as specified by Annex 1.A of Regulation 2014/596/EU on market abuse (MAR).
47. However, ESMA recognised that a proportionality principle should be observed in implementing automated alerts for the identification of other forms of market abuse, such as insider dealing, unlawful disclosure of insider information, and market manipulation by way of employing a fictitious device or any other form of deception or contrivance. ESMA considered that, based on a rigorous risk assessment, firms may decide not to automate the alerts for the latter mentioned types of market abuse, for instance because the firm does not have any clients, or because the firm is certain that the trading activity they allow to take place via their systems cannot be used for these forms of market abuse.

48. In the CP, ESMA sought to clarify that the requirements regarding market surveillance and the use of automated alerts would not presuppose a requirement to contract with a third party provider. ESMA considered that investment firms were free to develop their own automated surveillance alerts, as long as these were fit for purpose.
49. With respect to monitoring for the prevention and identification of potential market abuse, the majority of the responses disagreed with the proposal either partially or completely. Many of these respondents supported ESMA's intention behind the proposal, but noted that the MAD/MAR regime was sufficient for this purpose. In their view, to include the proposed requirement in MiFID/R Level 2 would have been duplicative or would introduce regulatory ambiguity or interpretative slippage. Many of these stakeholders requested removing this reference from the Regulation, and proposed that algorithmic trading should be included in the Regulation developing Article 16 of MAR.
50. A significant number of responses considered that cross-asset class and cross-market surveillance presents a number of challenges from a technological perspective particularly in the case of monitoring the activity of the clients. One respondent considered that simpler controls that are easier to implement, would be more effective; and that most, if not all, instances of market abuse would be flagged by monitoring single markets and single products on a simultaneous basis.
51. ESMA has revised the text of this Article to avoid overlaps with the Regulation in development of Article 16 of the MAR. On that basis, the surveillance of non-algorithmic trading activity and the effective reporting of algorithmic and non-algorithmic suspicious transaction orders or reports falls under the 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.
52. On the contrary, the surveillance of algorithmic trading activity is regulated by Article 13 of the final draft RTS. As a consequence, the content of this Article has been revised to clarify that where an investment firm is engaged in algorithmic trading, its surveillance systems must be automated in all cases. However, the final draft RTS still recognises that the alerts generation may need manual intervention, for which there should be an extended deadline. It has also been clarified that the reports generated by this surveillance activity must be adequately reviewed by the compliance staff to determine whether a suspicious transaction or order report is required to be generated.

Security and limits to access

53. ESMA proposed to require penetration tests and vulnerability scans of an investment firm's systems to be undertaken at least on a semi-annual basis. The respondents recommended using penetration tests only for connections which are open to attack from external parties and suggested that undertaking such tests semi-annually was too frequent. It is worth noting that ESMA does not impose specific details on how to

conduct these tests. Moreover, based on the feedback received, ESMA has aligned the frequency of these tests with other requirements in the Regulation by requiring these tests to be undertaken on an annual basis.

Direct Electronic Access

54. In the DP, ESMA proposed to include know-your-client and anti-money-laundering requirements within the due diligence assessment of DEA clients. One concern of stakeholders was the existence of an overlap with the Anti Money Laundering Directive (Directive 2005/60/EC on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing). ESMA has considered this issue, and clarified in a Recital that such requirements should be met without prejudice to other regulatory requirements such as the Anti-Money Laundering Directive.
55. One market participant noted that the storage of alerts generated by SA clients would not be possible, as SA providers do not hold such data. ESMA notes that the Directive does not allow for the controls applied to SA to be less stringent than those applied to direct market access. The same respondent also sought clarity as to how long such data needs be held in case of direct market access clients, suggesting three months. ESMA notes that this requirement should be read jointly with the general record keeping requirements in Article 16(6) and (7) of MiFID II where the records must be kept for a minimum period of five years.

General Clearing Members

56. ESMA proposed to require firms acting as general clearing members to monitor their client's exposure in real time, and to perform non-discriminatory reviews of their clients' performance. Respondents stated that intra-day risk management (ideally near to as real time as practical) would be more appropriate. Following such comments, ESMA has revised the text to clarify that clearing firms should monitor their clients' positions as close to real time as possible.
57. A number of market participants requested ESMA to consider requiring CCPs to apply limits to clearing members such that their clients' exposures to clearing members were automatically managed. They also proposed setting limits at a clearing level to control trading activities. This group also suggested broadening the scope of the requirement proposed by ESMA to notify the competent authority upon a breach of electronic security, to cover any major incidents affecting critical systems of a trading system. ESMA notes that the scope of the mandate in Article 17 of MiFID II does not include CCPs.

Content and Format of Order Records

58. While confirming the approach presented in the DP, the CP specifies in detail the order data and information that each and every investment firm engaged in a high frequency

algorithmic trading technique has to maintain under Article 17 of MiFID II. The CP further provides for the precise standard and format under which the order data and information have to be kept. In doing so, the CP distinguishes between on the one hand, the data and information pertaining to orders received from the client or orders initiated internally, and on the other hand, those pertaining to orders being executed or leaving the investment firm. The CP finally confirms that the record-keeping period is five years.

59. The respondents to the CP (including trade associations, trading venues and investment firms) all agreed that the order data and information provided in the CP for the purposes of the record-keeping obligations of investment firms engaged in a high frequency trading technique were complete and did not need to be supplemented with any additional elements. The different fields of order information and data provided in the Regulatory Technical Standard (RTS) have therefore been maintained.
60. A few respondents nonetheless asked for some clarification in relation to the client identification and trader identification fields. To this end, the description of these fields has been further specified in consistency with the corresponding fields provided under the transaction reporting requirements pursuant to Article 26 of MiFIR. Moreover, the table of fields has been slightly reorganized in order to improve its readability.
61. With regard to the timestamping of orders, a majority of respondents questioned the nanosecond granularity (through the cross-reference to the draft RTS on clock synchronization) arguing that such a granularity was not technically feasible and was irrelevant business wise. On the other hand, these respondents indicated supporting the microsecond granularity. ESMA recognizes that a nanosecond granularity would raise technical feasibility issues as pointed out by the respondents. Moreover, there is no evidence that such a granularity would greatly improve the quality of order data and facilitate their assessment by CAs. ESMA further highlights that the nanosecond granularity was only provided via a cross-reference to the draft RTS on clock synchronization which has since been amended to reflect the comments received to the CP. In particular, an amendment to this draft RTS has consisted in providing for different timestamps granularity (i.e., second, millisecond, microsecond) according to the type of trading activity of investment firms and removing the nanosecond granularity. This amendment should address the concerns raised by the respondents.
62. The majority of stakeholders further supported the proposal providing for a five-year record-keeping period. Several respondents highlighted that this was consistent with national law which already provides for record-keeping obligations and in some instances, even requires a longer period. Only two respondents indicated not agreeing with the record-keeping obligations provided in the CP arguing that these obligations were disproportionate notably as regards the amount of data to be kept by venue operators. In consideration of the comments received, the record-keeping period provided in the RTS has remained unchanged.

63. Clarification was also requested by a respondent as regards the precise moment at which the five-year record-keeping period commences. For the purpose of efficiency and simplicity, the RTS has been amended to expressly specify that the starting point of the record-keeping period is the date of the order submission to a trading venue or to another investment firm for execution.
64. It was further proposed by one respondent that ESMA reconsiders the applicability of the provision after one year of implementation with a view to potentially reducing the amount of order data and information to be maintained. This proposal may not be supported as such a review is not provided under MiFID II.

3.2. Organisational requirements of regulated markets, multilateral trading facilities and organised trading facilities enabling or allowing algorithmic trading through their systems

Background/Mandate

Article 48 (12), MiFID II

12. *ESMA shall develop draft regulatory technical standards further specifying:*

(a) *the requirements to ensure trading systems of regulated markets are resilient and have adequate capacity;*

[...]

(c) *the controls concerning direct electronic access in such a way as to ensure that the controls applied to sponsored access are at least equivalent to those applied to direct market access;*

[...]

(g) *the requirements to ensure appropriate testing of algorithms so as to ensure that trading systems including high-frequency trading systems cannot create or contribute to disorderly trading conditions on the market.*

1. Article 48 of MiFID II requires a regulated market:

- i. to have in place effective systems, procedures and arrangements to ensure its trading systems are resilient, to have sufficient capacity to deal with peak order and message volumes, to be able to ensure orderly trading under conditions of severe market stress and to be fully tested to ensure such conditions are met and to have arrangements to ensure continuity of its services if there is any failure of its trading systems;
- ii. to have in place effective systems, procedures and arrangements to reject orders that exceed pre-determined volume and price thresholds or are clearly erroneous;
- iii. to be able to temporarily halt or constrain trading if there is a significant price movement in a financial instrument on that market or a related market during a short period and, in exceptional cases, to be able to cancel, vary or correct any transaction. Regulated markets are required to ensure that the parameters for halting trading are appropriately calibrated in a way which takes into account the liquidity of different asset classes and sub-classes, the nature of the market model

and types of users and is sufficient to avoid significant disruptions to the orderliness of trading;

- iv. to have in place effective systems, procedures and arrangements, including requiring members or participants to carry out appropriate testing of algorithms and providing environments to facilitate such testing to ensure that trading systems cannot create or contribute to disorderly trading conditions on the market and to manage any disorderly trading conditions which do arise from such trading systems;
 - v. to set and apply appropriate criteria regarding the suitability of persons to whom direct electronic access may be provided. Member States shall also require that the regulated market set appropriate standards regarding risk controls and thresholds on trading through such access and is able to distinguish and if necessary to stop orders or trading by a person using direct electronic access separately from other orders or trading by the member or participant. The regulated market shall have arrangements in place to suspend or terminate the provision of direct electronic access by a member or participant to a client in the case of non-compliance;
 - vi. to be able to identify, by means of flagging from members or participants, orders generated by algorithmic trading, the different algorithms used for the creation of orders and the relevant persons initiating those orders. That information shall be available to competent authorities upon request
2. Article 18(5) of MiFID II requires investment firms and market operators operating an MTF or OTF to comply with Articles 48 and have in place all the necessary effective systems, procedures and arrangements to do so.

Analysis following feedback from stakeholders

Scope and definitions

3. ESMA's proposal in relation to the organisational requirements for trading venues captured by the scope of Article 48 of MiFID II aims at setting the minimum requirements that all trading venues should meet in relation to their trading systems linked to algorithmic trading. In this regard, some respondents to the CP recommended that rules and requirements should apply only to trading venues' specific systems and/or segments which enable algorithmic trading, taking into account the fact that trading venues can have different systems and market models in place. Some respondents also questioned the use of the wording "allowing algorithmic trading", suggesting a cross reference to the definition of algorithmic trading under Article 4 of MiFID II and an explicit exemption for voice, hybrid, quote-driven or RFQ trading systems.
4. ESMA has revised its original proposal to clarify that any regulated market, MTF or OTF where algorithmic trading may take place should be subject to the RTS. Therefore,

where a venue has different trading segments and some of them do not enable algorithmic trading, the Technical standards should not apply to those segments.

5. Additionally, ESMA wishes to clarify that the fact that trading systems are supported by electronic means does not necessarily mean that the whole set of technical standards is applicable to them as long as it is not possible to carry out algorithmic activity through those trading systems. This is particularly the case with respect to RFQ or hybrid systems. In the case of voice trading systems where transactions between members are arranged through voice negotiation, the core activity is not algorithmic by nature and therefore, they should not be covered by the Technical standards.
6. Some respondents to the CP questioned the definitions of “stressed market conditions” and “disorderly trading conditions”. In particular, a number of them referred to the sentence “including cases where orders are not resting for sufficient time to be executed” in the definition of disorderly trading conditions, as being ambiguous, detrimental to a competitive market and to some extent envisaging a minimum resting time for orders. Another respondent considered necessary to link the existence of disorderly trading conditions to extraordinary price movements unrelated to price sensitive information. Other respondents regarded the ‘disorderly trading conditions’ to exist when the pricing mechanism of the market becomes unreliable because of a delay or interruption in the order book. These respondents considered that the requirements linked to such conditions were not applicable for RFQ systems. One respondent also requested exemptions from these requirements where a trading venue only allows for limited algorithmic trading.
7. Following the responses from the CP, ESMA decided to delete the definitions of “stressed market conditions” and “disorderly trading conditions” from the draft RTS. However, it is noted that the draft RTS on market making agreements and market making schemes (RTS 8) make reference to those concepts.
8. On the “kill functionality”, although the respondents agreed with the definition proposed by ESMA, some stakeholders suggested that clearing houses should be able to request trading venues to invoke the “kill functionality” where appropriate. According to these respondents, such ability should be within the clearing houses’ responsibility in monitoring intraday position limits whereby the suspension of trading activity on trading venues is invoked where the limits are breached. ESMA wishes to clarify that the draft RTS describe the minimum set of requirements that must be met by trading venues that allow algorithmic trading. However, nothing in the draft RTS prevent trading venues from adopting additional mechanisms to protect their markets as appropriate.
9. Some respondents required further clarification on the definition of “real time” to reflect the fact that trading venues are required to operate systems which trigger alerts on a real-time basis, but the investigation and resulting assessment by trading venues takes place ex-post. ESMA clarifies that the trading system infrastructure should be able to automatically generate alerts within five seconds of the relevant event but that the

reaction to such alerts is not expected within such timeframe, given the eventual need for human intervention.

General organisational requirements for trading venues

Proportionality principle

10. ESMA proposed that trading venues should assess their compliance with Article 48 of MiFID II at least once a year, taking into account the nature, scale and complexity of their business. In undertaking this self-assessment, ESMA proposed that trading venues should take into account at least the elements contained in a non-exhaustive list annexed to the final draft RTS.
11. One respondent proposed deleting some of the references from the non-exhaustive list of factors to be considered for the purpose of the application of the proportionality principle. Other respondents expressed concerns on the proportionality principle itself since, in their opinion, the draft RTS should ensure that all trading venues are covered by exactly the same requirements. ESMA highlights that the purpose of RTS according to Article 10 of Regulation (EU) No 1095/2010 (ESMA Regulation) is to ensure consistent harmonisation and a level playing field but it is also necessary to recognise the wide range of trading models and market participants operating in Europe.
12. Therefore ESMA has maintained the principle that trading venues are required to assess, before the deployment of any new trading system and subsequently at least on an annual basis, the compliance of their systems with Article 48 of MiFID II. For this purpose, trading venues should use at least the non-exhaustive list of elements as mentioned above. The record of their self-assessment should be kept by trading venues for five years and submitted to their competent authorities only when requested.

Governance and staffing

13. ESMA consulted twice on a set of governance, outsourcing and staffing requirements based on its Guidelines on systems and controls in an automated trading environment for trading platforms, investment firms and competent authorities published in 2012.
14. ESMA received comments seeking clarity on the expectation of ESMA concerning the role of the compliance function within a trading venue, and whether the department responsible for the development of the internal policies and procedures should be distinct from the department responsible for the on-going compliance function. ESMA remains agnostic with respect to the organisational set up of a trading venue's compliance function. ESMA expects all trading venues to ensure that these functions are in place and that there is an adequate segregation of functions to ensure effective supervision of the venue's compliance with their legal and regulatory obligations regardless of their circumstances. ESMA has also acknowledged that in some trading venues the compliance function may also be in charge of operating the kill functionality.

Outsourcing

15. ESMA consulted on a proposal about outsourcing arrangements of the operational function of trading venues based on Article 14 of Directive 2006/73/EC.
16. The comments received by ESMA noted that the reporting requirements included in the proposal would imply a significant overhead both for trading venues and competent authorities. ESMA has therefore revised its original proposal to clarify that trading venues are obliged to notify only in specific circumstances.
17. Other respondents noted that some trading venues are operated and governed by legal entities other than the legal owner of the systems, arrangements that have been endorsed by competent authorities. ESMA has further clarified the scope of the outsourcing requirements covered by the draft RTS, which corresponds to the operational functions in relation to the systems allowing or enabling algorithmic trading.
18. Some respondents sought clarification on the exact meaning of the term “critical operational functions”. ESMA has revised the text to identify which operational functions are considered critical.
19. Some respondents considered that requests for information should be processed either via the trading venue or via the competent authority of the service provider, still enabling the competent authority of the trading venue to receive the information it needs, on the basis that both the trading venue and the service provider are authorised within the EU. The same comments were made with respect to auditors’ access. The text has been redrafted to clarify these points.
20. Regarding the authorization for outsourcing of critical functions, some respondents considered that trading venues should be required to provide notification with relevant information but that explicit authorisation should not be required: the competent authority should have the right to object to it when not in compliance with the technical standards. In addition, some respondents felt that the obligation to report the intention to outsource was not reasonable and might create significant costs. To clarify its expectations, ESMA amended the text to distinguish ‘ex ante’ notification of relevant outsourcing arrangements from ‘ex post’ notification for any other outsourcing agreement affecting the systems allowing or enabling algorithmic trading.
21. ESMA reiterates that the provisions in relation to outsourcing should be read in conjunction with IOSCO Principles on Outsourcing by Markets published in July 2009.

Capacity and resilience of trading venues

Due diligence for members or participants of trading venues

22. ESMA proposed that a trading venue which permits algorithmic trading through its systems should perform an adequate due diligence to ensure that all members or participants meet certain pre-defined parameters. In addition, appropriateness of such parameters should be reviewed periodically by trading venues. To enable this, ESMA included a list of elements to be taken into account by the trading venue when performing due diligence.
23. Responses to the CP focused on two elements: firstly, as some of the elements listed for assessment in the due diligence (experience of staff in key positions within the members; responsible managers for the operation of the trading system; testing of algorithms; business continuity and disaster recovery procedures; outsourcing policy of the member) were covered by the draft RTS on organisational requirements for investment firms, trading venues' due diligence would duplicate the supervision made by CAs. ESMA has therefore revised the list of requirements while maintaining the requirement relating to staff in key positions within the members as this obligation should be read in the context of Article 53(2)(c) of MiFID II whereby trading venues shall specify the professional standards imposed on the staff of the investment firms or credit institutions that are operating on the market. Secondly, the concern expressed by respondents concerning the obligation of trading venues to revise the due diligence already made for all their members annually. The final draft RTS have been revised to clarify that trading venues are not obliged to revise the due diligence for all of their members on an annual basis.

Testing the capacity of members or participants to access trading systems

24. ESMA described in its CP three different sets of obligations on trading venues with respect to testing to reduce the possibility of threats to their capacity and resilience: the obligation of trading venues to test their own systems, the obligation to impose a conformance testing on their members, participants or clients and the minimum requirements for the testing environment provided by the trading venues to prevent disorderly trading conditions.
25. Only one respondent addressed the testing by the trading venue of its own systems, positing that the ultimate responsibility in relation to disorderly trading conditions rests with the members, participants or clients of a trading venue. ESMA wishes to clarify that this obligation prevents the deployment of systems without sufficient testing that, by themselves, might create disorderly trading conditions regardless of the operation of other market participants.
26. Regarding conformance testing, ESMA's proposal required a functional test and a technical test to ensure that the basic interaction between the member, participant or client and the trading venue conformed to the venue's specifications.
27. Some respondents suggested limiting the scope of conformance testing to those algorithms or systems that interact directly with the trading venue's infrastructure (mostly

smart order routers and gateways) and that may have a direct interaction with the trading venue's logic (in certain cases, scheduling algorithms). However, based on the evidence provided, it was not possible to differentiate in a way that would be applicable across various asset classes (for instance, according to these respondents there are cases where conformance testing and testing against disorderly trading conditions would be applicable to smart order routers and other cases in which it would not) and the final draft RTS does not differ significantly from the original text. Nevertheless, ESMA has specified in Recital (5) of the draft RTS that the specific organisational requirements for trading venues should be determined following a self-assessment that includes as well the testing requirements. For these purposes, Recitals (3) and (4) of the draft RTS 6 on the organisational requirements for investment firms engaged in algorithmic trading, which differentiate between investment decision algorithms and order execution algorithms, are also relevant.

28. Additionally, some respondents were concerned with the scope of instruments to be tested, signalling that the focus should be on groups of instruments rather than having the whole list of instruments tested, due to the cost of maintaining a full correspondence between a live and non-live environment. ESMA has addressed this concern and the text now reflects that trading venues should have available a list of instruments which is representative of those available in a live environment.
29. A number of respondents proposed for the conformance testing requirement to apply only when 'material' changes are made to an algorithm. Other respondents requested clarification of what should be considered as 'material' for these purposes. ESMA has revised the original text to acknowledge that not all types of updates in a trading venue's functionality may trigger a requirement for conformance testing. However, on the basis of the evidence gathered it was not possible to provide definitive guidance on identifying 'material' changes. ESMA has also revised the text to clarify that there are two main types of events that would require a new conformance test: setting up or introducing material changes in the access to a trading venue or a substantial update of the member's system, algorithm or strategy.
30. A number of respondents noted that the obligation to test on one trading venue should only apply to those algorithms or strategies effectively deployed in that venue. ESMA agrees with that interpretation.
31. Throughout the consultative process, ESMA identified the minimum characteristics that a conformance testing environment should have:
 - i. be accessible in equivalent conditions to the rest of trading venue's testing service;
 - ii. have a list of financial instruments available for testing representative of the ones available in the live environment;

- iii. be available during general market hours or on a pre-scheduled periodic basis if outside market hours. However, the text has been revised to highlight that trading venues should ensure separation between a testing and a production environment;
 - iv. be supported by knowledgeable staff; and
 - v. provide a report with the outcome of the testing exclusively to the actual or prospective member.
32. These elements of a conformance testing environment have not been revised respondents provided no comments on them.

Testing the member's algorithms to avoid disorderly trading conditions

33. The purpose testing for disorderly trading conditions is to recreate real market conditions to ensure the well-functioning of algorithms under changing circumstances.
34. ESMA's preliminary view was that, without prejudice of the ability of investment firms to test their algorithms through alternative means, investment firms should use the testing facilities provided by trading venues in which they planned to operate as part of the regular procedure before accessing a trading venue.
35. ESMA was of the opinion that the scenarios selected by trading venues should be appropriate to the nature and scale of the trading activity that takes place on them. They should be comprehensive in terms of functionalities, protocols and structure and should be as close as to real market conditions as possible, including disorderly market conditions. The facilities offered by trading venues for these purposes should also permit testing a range of scenarios the users consider suitable to their activity.
36. The main criticism received by ESMA was the difficulty to reproduce real market conditions in a non-live environment, where the simultaneous interaction with other relevant market players is a prerequisite. These respondents viewed such technical limitations significant enough to render such an exercise ineffectual as designing scenarios as close to market situations as possible would be fundamentally unachievable, and therefore not useful in attempting to avoid a black swan scenario as envisaged. Additionally, some respondents suggested the use of fictional test 'symbols' to undertake testing where different algorithms may interact with each other in a live trading environment to be sufficient in meeting such an objective.
37. In light of the responses received, ESMA considers that trading venues may fulfil the obligation to offer environments for use by their members, participants or users to test their algorithms against disorderly trading conditions either by providing access to a facility simulating their markets or by providing a dedicated fictional symbol for testing purposes. ESMA has also noted the concern raised by one respondent in relation to the potential risks to trading venues' system capacity and resiliency arising from an

excessive use of fictional testing symbols by clarifying that testing process should be subject to a fair usage policy and also that strict separation from the production environment should be maintained.

38. The second main element pointed out in the responses was the excessive burden created with the imposition of testing algorithms in all trading venues where they are active. ESMA remains of the view that testing against disorderly trading conditions should be undertaken prior to the deployment or substantial update of an algorithm in a venue. However, nothing prevents several trading venues from developing joint testing environments that can be used for all of them when their market microstructures are sufficiently homogeneous.
39. Some respondents proposed limiting the scope of this type of testing to those algorithms or infrastructures that may create disorderly trading conditions due to their interaction with other market participants (mainly scheduling algorithms and smart order routers) since only those elements which interact directly with market infrastructure or other participants should be subject to the tests. ESMA wishes to reiterate the points made in paragraph 27 above.
40. A significant number of respondents raised concerns on the proposal to place testing obligations on trading venues as this would obfuscate the responsibility of investment firms and create an impossible task for trading venues, as they would be unable to guarantee that a firm would not create or contribute to disorderly trading conditions. ESMA agrees with these views and has revised its approach on the obligations to test investment firm's algorithms: trading venues should only require their members or participants to certify that the algorithm has been subjected to testing obligations. However, trading venues are not obliged to validate the outcome of those tests. The responsibility for the adequate testing against disorderly trading conditions remains with the investment firm. ESMA reminds that these provisions should be read jointly with Articles 5 to 8 of the draft RTS 6 on the organisational requirements of investment firms engaged in algorithmic trading.

Trading venue's capacity

41. ESMA proposed requiring trading venues' trading systems to have sufficient capacity to accommodate at least twice the highest number of messages per second and per value ever recorded on any given day. In the original proposal, if the historical peak of messages had been overridden the capacity was considered as no longer sufficient, forcing the trading venue to take measures to expand its capacity. ESMA did not consider it appropriate to set a fixed period for trading venues to remedy the situation but indicated that the design of the trading system should permit installing new capacity "within a reasonable timeframe if necessary". ESMA's proposal permitted trading venues not to increase their capacity in justified cases upon providing their CAs with reasons for not doing that. The proposal also required trading venues to allow for scalability of the

performance of their systems in response to increased message flow which may otherwise threaten their operation.

42. The responses to the CP addressed several points in this respect which are described below.
43. Some respondents requested ESMA to clarify the definition of a 'message' in this context. ESMA has modified the text to clarify that 'messages' should be construed broadly, by including any input or output messaging consuming the trading venue's capacity. This implies that quotes, indications of interest or trade confirmations should be considered within the scope of this obligation.
44. One respondent recommended specifying that capacity should refer to the market segment in which the instrument is traded. ESMA has maintained the original proposal on this point since capacity should be viewed in terms of system usage of the trading systems where algorithmic trading may take place, not in terms of market segments. Where a trading venue has several market segments, capacity should be measured on a per segment basis only where each market segment is served by different systems.
45. Some respondents highlighted the inconsistency between the record-keeping obligations imposed on trading venues (five years) and the historical peak to be considered for these purposes (the all-time high). The text has been amended to require such obligations taking into account the previous five-year period.
46. One respondent sought further clarity on ESMA's expectation with regards to the sequence of events for the trading venue following the breach of a historical peak. The sequence of events should be: 1) breaching of the historical peak; 2) assessment to be undertaken within a reasonable timeframe by the trading venue's senior management as to whether an expansion of their system capacity is deemed necessary; and 3) immediately inform the competent authority of the decision made, including the schedule for the implementation of the capacity increase where appropriate, and the reasons supporting that decision.
47. An alternative proposal for setting the minimum capacity requirements was made by a number of respondents, based on the average performance or the continuous load of a trading system rather than the historical peak. Other respondents proposed that the system should merely have controls in place to manage degradation in system performance once the number of messages has reached twice the historical peak. ESMA highlights that the draft RTS prescribes the absolute minimum that should be met by all trading venues to prevent market disruptions. In this respect, ESMA reiterates the arguments put forward in its Discussion Paper on this issue¹⁶. In particular, ESMA reminds that in general, standard market practice is significantly more rigorous than the

¹⁶ http://www.esma.europa.eu/system/files/2014-548_discussion_paper_mifid-mifir.pdf; pages 245 and 246.

minimum standard proposed by ESMA. Since the specific capacity of each trading system should be determined according to the “nature, scale and complexity” of the venue’s business, ESMA does not expect the current standards to be reduced in any case.

48. Finally, the obligation of senior management to revise whether that capacity remains appropriate has not changed and is triggered by a new historical peak of messages. The capacity of a trading system has to be expanded following the identification of system failures, outages or errors in matching transactions.

On-going monitoring and periodic review of the performance and capacity of the trading systems

49. ESMA’s proposal was that, on an ongoing basis, trading systems should be well adapted to the business which takes place through them and are robust enough to ensure continuity and consistency of performance. To this end, ESMA considered that trading venues should be able to demonstrate at all times to CAs continuous real-time monitoring of the performance and degree of usage of the elements of their trading systems in relation to a number of parameters.
50. ESMA received three comments on the ongoing monitoring of performance and capacity of trading systems. One market participant considered that such monitoring depends upon the clear definition of the relevant baselines. ESMA agrees with this position, but considers that trading venues should set out such baselines. Other respondents considered that the monitoring obligation should not be conducted at all times. ESMA disagrees with this approach and has maintained the original approach. In this regard, ESMA wishes to stress that the infrastructure should be able to generate alerts within five seconds of the event, but the remedial processes do not need to take place in that timeframe as human involvement may be required.
51. Regarding the stress tests to be performed under the periodic review of the systems, the baseline has been aligned with the record-keeping obligations of trading venues: the highest number of messages managed by the system during the previous five years instead of the historical peak of messages. Following the indications provided by one respondent, the ability of trading venues to determine which members should participate in those stress tests has been substituted by simulation of the members’ activity.

Means to ensure resilience of trading venues

Business continuity

52. ESMA’s proposal in this area focused on the requirement for a business continuity plan and effective business continuity arrangements to ensure a timely resumption of trading, targeting a recovery time objective (RTO) of no more than two hours and a recovery point objective (RPO) close to zero. The business continuity plan should be supported

by an impact assessment, and subject to periodic revision and testing to ensure that the plan remains appropriate.

53. The feedback received from market participants addressed different points described below.
54. Some market participants considered that an RTO of two hours would be too demanding. Placing the trading venues on equal footing with more systemically relevant infrastructures, such as CCPs would create unnecessary pressure for the venues. In this respect, ESMA notes that different words are used in the draft RTS and Article 17 of Commission Delegated Regulation (EU) No 153/2013. Whereas Article 15 of the draft RTS refers to ensuring timely resumption of trading by “*targeting* a recovery time no later than two hours”, Article 17 of Commission Delegated Regulation (EU) No 153/2013 establishes that “the maximum recovery time for the CCP’s critical functions to be included in the business continuity policy shall not be higher than two hours”. These differences are in acknowledgement of the fact that in exceptional circumstances, the resumption of trading may take longer than two hours.
55. Other respondents requested ESMA to clarify the concept of RPO. This is a reference to the maximum tolerable amount of data that may be lost from an IT perspective that occurs as a result of a major incident and is directly linked to the minimum frequency of backups that trading venues must carry out. Therefore, this requirement obliges trading venues to back up the relevant data as frequently as possible.
56. One respondent noted that the list of disruptive events should be reduced to the effective impacts that any disruptive incidents might have: loss of staff, loss of facilities or loss of technology. ESMA agrees with this point and has revised the text accordingly.
57. One respondent considered too onerous the obligation for the Board of Directors or any competent management body to approve every amendment to the Business Continuity Plan. ESMA has revised the text, assigning much of the responsibilities with respect of the Business Continuity Plan to the senior management. However, if a deficiency in the Business Continuity Plan is detected in the course of a periodic impact assessment and the trading venue decides not to address it, then that decision should be endorsed by senior management.
58. One respondent remarked that obliging trading venues to have arrangements to ensure timely resumption of trading would not be sufficient. This respondent considered necessary that members or participants of trading venues should be required to maintain, in addition to the connection to the trading venue’s production datacentre, connection to the trading venue’s disaster recovery facility. ESMA has addressed this issue in Article 18(2) of the Draft RTS 6 on the organisational requirements of investment firms engaged in algorithmic trading, where investment firms must have in place arrangements that are bespoke to each of the venues that they access.

Prevention of disorderly trading conditions

59. Following on from the comments received from the Discussion Paper, in the CP, ESMA reviewed the definitions of ‘stressed market conditions’ and ‘disorderly trading conditions’ and proposed a revised set of arrangements that trading venues should have to prevent disorderly trading. Such arrangements were referring to limits per participant on the number of orders sent per second (throttle limits) to prevent flooding of the order book, mechanisms to manage volatility, pre- and post-trade controls, ability to obtain information from any member/participant or user to monitor compliance with the rules and procedures of the trading venue, suspension of access of a member or participant to the market, cancellation and amendment of orders under a set of predefined set of circumstances, cancellation and amendment of transactions and the ability to balance order entrance between different gateways.
60. In its CP, trading venues were required to:
- i. ensure that appropriate mechanisms to halt trading were in place in all phases of trading (i.e. from opening to close of trading);
 - ii. perform an in-depth assessment to evaluate the potential risks, pros and cons to investors and the market arising from different approaches to trading halts, taking into account a number of elements (such as the specific trading model, the trading profile of the financial instrument, the volatility history of financial instruments that are considered to have similar characteristics);
 - iii. ensure that appropriate mechanisms and arrangements were in place for initial and periodic testing of the mechanisms to halt or constrain trading as well as to allocate specific and adequate IT and human resources to deal with the design, maintenance and monitoring of the effectiveness of the mechanisms implemented;
 - iv. continuously monitor the adequacy of the thresholds in light of the observed volatility to ensure that they are in line with market developments;
 - v. disclose on their website the relevant information relating to the basis for halting or constraining trading and the rules and protocols under which they are implemented in order to provide market participants with sufficient predictability and certainty.
61. The definition of ‘disorderly trading conditions’ raised the attention of several market participants, as discussed above.
62. Regarding the impact that these requirements may have on different trading models, ESMA has added a recital clarifying that the analysis of the ‘nature, scale and complexity’ of the business is particularly relevant for RFQ and hybrid trading systems, whereby some of the requirements included in the draft RTS may not be appropriate.

63. One respondent noted that not all trading venues have an architecture based on different gateways. The text has been adapted to reflect this situation.
64. Regarding the obligation of trading venues to be aware of significant price movements in other venues of an instrument traded on them, the same respondent noted that that requirement would not be workable in the context of derivatives. Other respondents requested that trading venues and CAs agree on the price movement that would trigger the notification requirement under Article 20(2). Noting this, these requirements have been deleted.
65. Several market participants questioned the ability of CCPs to request the cancellation of orders or transactions. The text has been revised to clarify that the only individuals qualified to request the cancellation of pending orders are the member or the SA client who submitted the orders. The final version of the draft RTS also indicates that the cancellation of trades can only take place in the case of a malfunction of the trading venue's mechanisms to manage volatility or of the trading system.
66. A number of respondents noted that correcting transactions ex-post would not be possible for trading venues, as they are not in the position to know the true value of an instrument. The draft RTS have been amended to reflect this point.
67. The proposal to include as part of the throttling arrangements the penalties to be imposed in case of inadequate behaviour from one member was criticized. Despite this specific provision being deleted from the draft RTS, nothing prevents trading venues from imposing such penalties under the 'measures to be adopted following a throttling event'.
68. Article 20(6) of the draft RTS established the obligation of trading venues to document and report to the competent authority the rules and parameters of the mechanisms used to manage volatility. One participant requested limiting such reporting obligations to 'material changes'. The draft RTS have been amended to clarify the requirement, however, ESMA notes that the requirement for trading venues to report to their authorities the parameters of halting trading and any material changes to those parameters is stipulated in Article 48(5) of the Directive.
69. Article 20(3) of the draft RTS required trading venues to consider historical volatility of the financial instruments with similar characteristics in their calibration of their mechanism to manage volatility. One respondent noted that such information may not be available. ESMA acknowledges such possibility but notes that they would still be liable to have mechanisms to manage volatility that are 'appropriate' to their trading systems, per Article 19(1). Although the Article 20(3) of the draft RTS has now been deleted, this will be addressed in the ESMA Guidelines on the calibration of trading halts provided in accordance with Article 48(13) of the MiFID II.

70. One respondent noted that post-trade controls were employed by investment firms for risk management purposes and the trading venues typically did not operate controls that would prevent a member or participant from trading when a pre-set threshold has been breached. ESMA has revised the wording to allow trading venues flexibility to establish separate post-trade controls which they deem appropriate on the basis of a risk assessment of their members' activity.
71. One respondent requested limiting the requirement to disclose the policies concerning trading venue's mechanisms to manage volatility to its members. However, ESMA has maintained the original approach of requiring public disclosure, but clarified that such obligation need not be as granular as, for example, to disclose the specific number of orders per second on pre-defined time intervals for throttling arrangements and the specific parameters of their mechanisms to manage volatility, given the obvious risk of such information being misused.

Pre-trade and post-trade controls

72. ESMA proposed that trading venues should ensure that their members or participants operated the pre-trade controls specified in the draft RTS 6 on organisational requirements of investment firms engaged in algorithmic trading.
73. Additionally, the draft RTS established that trading venues should operate price collars, maximum order value and maximum order volume controls.
74. Some respondents noted that the requirement to have pre-trade controls as included in the draft RTS 6 on organisational requirements of investment firms engaged in algorithmic trading should be monitored by the competent authorities, not by trading venues. ESMA agrees with this and has amended the text accordingly.
75. Several respondents contested the requirement whereby pre-trade controls should ensure that 'order submission is entirely stopped once a limit is breached'. These respondents agreed that trading venues should have such ability but this should in their view not be required in all instances. In their view, such an action would affect the firm's ability to deliver best execution for its clients as further orders, even on different instruments, would be prevented from entering the order book. ESMA agrees with this point and has revised the draft RTS accordingly.
76. A number of respondents requested clarification on the requirement where order price collars should operate on both an order-by-order basis and over a specified period of time. In particular, the reference to a 'specified period of time' seemed problematic for some. One market participant considered that 'specified period of time' should be the period defined by a trading venue in which an incoming order or a trade is taken as reference price accordingly with current market practice. ESMA agrees with such a view, but upon reviewing its relevance to the draft RTS, it has deleted the reference.

77. The obligation to operate simultaneously the three pre-trade controls proposed by ESMA raised some concerns from one market participant. This respondent noted that not all of them might be appropriate for all types of trading, taking into account that some illiquid instruments may suffer abrupt price movements from one trade to the next. For some of these instruments it would be more appropriate to constrain trading by passing to a volatility auction. ESMA clarifies that the obligation to have in place arrangements to reject an order which exceeds certain volume and price thresholds or is clearly erroneous is stipulated in Article 48(4) of the Directive. Additionally, the obligation to have mechanisms to halt or constrain trading appears also in Article 48(5). Trading venues should set appropriate thresholds to make those different arrangements operate jointly.

Direct electronic access

78. ESMA proposed in the CP a provision on Direct Electronic Access (DEA) which covered the following main obligations: i) trading venues should specify the framework to provide DEA by their members, participants or clients; ii) SA should be subject to the specific authorisation by the trading venue; and iii) trading venues should require specific monitoring requirements to their members, participants or clients with respect to the order flow generated by firms using DEA.

79. Two respondents agreed with ESMA that the responsibility of trading venues regarding DEA should be limited to setting the framework. ESMA wishes to clarify that the proposal sets out the minimum standards to be met by trading venues in this respect. However, where a trading venue considers it necessary to establish a stricter approach on the provision of DMA or SA, for instance by approving on a case by case basis DMA clients, nothing in the draft RTS prevents it from doing so as long as the provisions of the draft RTS are adhered to.

80. The feedback received pointed out to uncertainty regarding the definition of DEA which determines which firms will be in scope. In this particular regard, the reading of DEA provisions should be informed by the works undertaken by the Commission on the definition of DEA based on the technical advice provided by ESMA.

81. Another source of uncertainty was the relationship between the obligations set out in the draft RTS on organisation requirement for trading venues and the draft RTS on the organisational requirements of investment firms engaged in algorithmic trading. In particular, a number of respondents had objected to trading venues being able to impose different frameworks and subsequent requirements relating to DEA. To address this problem, a suggestion was made for the obligations on DEA to be exclusively covered through the latter draft RTS on organisational requirements for investment firms.

82. ESMA agrees with the point made and has revised the approach, avoiding the potential overlap between those draft RTS. Therefore, the requirements as set out in the draft RTS on the organisational requirements of investment firms engaged in algorithmic

trading are considered as a minimum. Trading venues may only introduce in their rules and conditions the technical specifications to provide DEA according to their own microstructure but without deviations from the minimum requirements.

83. Two respondents objected to the role that trading venues would have on the authorisation of each SA client subsequent to the due diligence performed by the DEA provider. ESMA has decided to maintain the obligation for the trading venue to authorise the provision of SA on a case-by-case basis, given the higher risk of the trading flow under SA which does not flow through a DMA provider's trading systems. In this regard, trading venues are required to ensure that the prospective SA client has at least the same pre-trade risk limits and controls as the prospective DMA clients, and that the SA provider is the only one with the capability to set or modify the parameters or limits of the pre-trade and post-trade controls of their SA clients.
84. One respondent disagreed with the obligation of SA providers to set the parameters of the post-trade controls of their SA clients. ESMA has maintained that obligation in the final draft RTS and instead revised Article 20(3) of the draft RTS 6 on organisational requirements of investment firms engaged in algorithmic trading to clarify that DEA providers should apply pre-trade and post-trade controls on the order flow of each of their clients as well as real-time monitoring and market surveillance controls in accordance with Articles 13, 15, 16 and 17 of those standards.
85. Some responses noted that information regarding the disciplinary history of the prospective client may not always be available in the due diligence process. ESMA has reflected this point in the draft RTS 6 on the organisational requirements of investment firms engaged in algorithmic trading by requiring a DEA provider to only check publicly available sources as part of its due diligence process.
86. Some stakeholders sought clarification on the proposed provision regarding the ability to stop the order flow of DEA clients to be applied only to the order flow of a particular DEA client and not to the DEA order flow as a whole. To this end, ESMA has revised the draft RTS 6 on Organisational Requirements for Investment Firms engaged in Algorithmic Trading to reflect this. One respondent noted that such a requirement would be impossible to implement without the attribution of a specific DEA client ID. ESMA agrees with this point which is covered by the draft RTS on the organisational requirements of investment firms engaged in algorithmic trading.
87. One respondent noted that any infringement of MiFID II, MiFIR, MAR or the trading venue's internal rules would automatically lead to the cancellation of the SA provision, regardless of the nature and the magnitude of such an infringement. ESMA has revised the text taking this into account.

Security

88. ESMA's proposal on this topic focused on the following main elements:

- i. trading venues should have procedures and arrangements for physical and electronic security designed to protect their systems from misuse or unauthorised access and to ensure the integrity of the data that passes through their systems, including arrangements that prevent or mitigate the risks of attacks against their information systems;
 - ii. trading venues should set up and maintain measures and arrangements to promptly identify and manage the risks related to any access to its trading system;
 - iii. trading venues should inform the competent authority of any breaches to their physical and electronic security measures. An incident report should be promptly submitted to the competent authority indicating the nature of the incident, the measures taken in response to the emergency situation and the initiatives taken to avoid similar incidents recurring in the future.
89. ESMA did not receive feedback on this topic. Therefore the draft RTS remains in line with the original proposal.

3.3. Market making, market making agreements and market making schemes

Background/Mandate

Article 17(7) of MiFID II

7. *ESMA shall develop draft regulatory technical standards to specify the following:*

[...]

- (b) The circumstances in which an investment firm would be obliged to enter into the market making agreement referred to in point (b) of paragraph 3 and the content of such agreements, including the proportion of the trading venue's trading hours laid down in paragraph 3;*
- (c) The situations constituting exceptional circumstances referred to in paragraph 3, including circumstances of extreme volatility, political and macroeconomic issues, system and operational matters, and circumstances which contradict the investment firm's ability to maintain prudent risk management practices as laid down in paragraph 1;*

Article 48(12), MiFID II

12. *ESMA shall develop draft regulatory technical standards further specifying:*

[...]

- (f) The requirements to ensure that market making schemes are fair and non-discriminatory and to establish minimum market making obligations that regulated markets must provide for when designing a market making scheme and the conditions under which the requirement to have in place a market making scheme is not appropriate, taking into account the nature and scale of the trading on that regulated market, including whether the regulated market allows for or enables algorithmic trading to take place through its systems;*

1. Articles 17 and 48 of MiFID II introduce requirements on investment firms pursuing what is defined as a “Market Making Strategy” and trading venues where market making activities are undertaken using an algorithmic trading technique. As stated in Recitals (62) and (113) of MiFID II, there are two main goals of MiFID II in this respect. Firstly, the introduction of an element of predictability to the apparent liquidity in the order book by introducing contractual obligations for firms performing certain types of strategies. Secondly, as advanced technologies may bring new risks to the market, MiFID II aims to

maintain market participants' ability to transfer risks efficiently during stressed market conditions.

2. MiFID II introduces a number of concepts to promote orderly and efficient functioning of markets in the current market environment in relation to firms pursuing market making strategies and trading venues.
3. Article 17(3) of MiFID II determines that “an investment firm that engages in algorithmic trading to pursue a market making strategy shall, taking into account the liquidity, scale and nature of the specific market and the characteristics of the instrument traded:
 - i. carry out this market making continuously during a specified proportion of the trading venue's trading hours, except under exceptional circumstances, with the result of providing liquidity on a regular and predictable basis to the trading venue;
 - ii. enter into a binding written agreement with the trading venue which shall at least specify the obligations of the investment firm in accordance with point (a); and
 - iii. have in place effective systems and controls to ensure that it fulfils its obligations under the agreement referred to in point (b) at all times”.
4. According to Article 17(4) of MiFID II, “an investment firm that engages in algorithmic trading shall be considered to be pursuing a market making strategy when, as a member or participant of one or more trading venues, its strategy, when dealing on own account, involves posting firm, simultaneous two-way quotes of comparable size and at competitive prices relating to one or more financial instruments on a single trading venue or across different trading venues, with the result of providing liquidity on a regular and frequent basis to the overall market”.
5. Further, Article 48(2) of MiFID II states that “Member States shall require a regulated market to have in place:
 - i. written agreements with all investment firms pursuing a market making strategy on the regulated market;
 - ii. schemes to ensure that a sufficient number of investment firms participate in such agreements which require them to post firm quotes at competitive prices with the result of providing liquidity to the market on a regular and predictable basis, where such a requirement is appropriate to the nature and scale of the trading on that regulated market.”
6. The written agreement between the trading venue and the investment firm pursuing a market making strategy is required to at least specify:

- i. the obligations of the investment firm in relation to the provision of liquidity and where applicable, any other obligation arising from participation in the scheme referred to in paragraph 2(b) of Article 48 of MiFID II;
 - ii. any incentives in terms of rebates or otherwise offered by the regulated market to an investment firm so as to provide liquidity to the market on a regular and predictable basis and, where applicable, any other rights accruing to the investment firm as a result of participation in the scheme referred to in paragraph 2(b) of Article 48 of MiFID II.
7. The regulated markets are required to monitor and enforce compliance by investment firms with the requirements of such binding written agreements. The regulated markets are required to inform their competent authority about the content of the binding written agreement and, upon request, provide to the CA all additional information necessary to enable the CA to monitor itself the compliance by the regulated market with the requirements of Article 48(3) of MiFID II.
8. Article 18(5) extends the obligations of Articles 48 and 49 to MTF and OTF.

Analysis following feedback from stakeholders

9. The main elements of the ESMA proposal as published in the CP were the following:
 - i. an investment firm would be considered as pursuing a market making strategy, and therefore, should to sign a market making agreement when posting firm, simultaneous two-way quotes of comparable size and at competitive prices in at least one financial instrument on a single trading venue for no less than 30% of the daily trading hours during one trading day;
 - ii. the minimum obligations to be specified in such a market making agreement included the obligation to post firm, simultaneous two-way quotes of comparable size and competitive prices for no less than 50% of the daily trading hours;
 - iii. only trading venues or market segments where algorithmic trading could take place were subject to the obligation to have a market making scheme in place;
 - iv. a exhaustive list of exceptional circumstances where the provision of liquidity on a regular and predictable basis would not be required;
 - v. the draft RTS prohibited the setting of a maximum number of investment firms taking part in a market making scheme, but acknowledged the ability for trading venues to limit the incentives to be provided only to those firms which perform better;
 - vi. access to incentives was expected to be proportional to the effective contribution to the liquidity in the market, as measured in terms of presence, size and spread;

- vii. an obligation to incentivise the presence of firms engaged in a market making agreement during stressed market conditions; and
 - viii. an obligation for trading venues to make publicly available the terms and conditions of the market making scheme.
10. Responses received to the CP raised a number of concerns about the ESMA proposal which are summarised below.

General concerns

11. Firstly, some respondents raised concerns about the scope of the proposed regime which would apply to:
- i. all asset classes, regardless of the liquidity profile of the instrument;
 - ii. all trading venues, regardless of the trading system they operate (e.g. RFQ); and,
 - iii. all investment firms, irrespective of whether the quotes posted are provided at the request of a client or in a genuinely proprietary capacity.

Specific comments made on the definitions

12. With regard to the definitions proposed by ESMA, respondents made the following comments:
- i. the definition of “trading venue allowing or enabling algorithmic trading through its systems” was perceived to be too broad and would potentially include almost all the trading venues in the Union.
 - ii. the draft RTS would benefit from greater clarity on terms such as market hours, trading hours, normal trading hours and daily trading hours.
 - iii. some respondents said that the proposed definition of ‘simultaneous’ as orders being ‘entered into the order book within one second of the other,’ would not reflect the market practice and would be open to gaming and misapplication. Some exchanges also voiced concerns that it might be challenging for a venue to monitor whether two-way-quotes were entered at the same time.
 - iv. some respondents also stressed that the proposed definition of ‘comparable size’ added the risk of false measurement and misclassification of market participants’ trading activity as a market strategy. In their view, the comparable size requirement should be equal to, or superior to, a minimum size set by the venue.
 - v. many respondents were of the opinion that the definition of ‘competitive prices’ should reflect the maximum bid-ask spreads set by a trading venue for market

making in a given instrument. In the view of these market participants, this approach would be consistent with the Short Selling Regulation (Regulation (EU) No 236/2012).

- vi. many respondents considered that the definition of stressed market situations which included “situations where a significant change in the number of messages being sent to and received from, the systems of a trading venue” was not appropriate. Those situations might, in their view, materialise without stressed conditions. For instance, significant changes in number of messages and transactions would be natural in equity derivatives markets as a result of volatility changes, macro and corporate news, specific situations such as roll weeks, etc.
13. In ESMA’s view, the revised RTS addresses most of these concerns presented by the respondents. In particular, ESMA has moved the definitions to the relevant provisions and where necessary, clarified them so as to provide stakeholders with greater clarity and address the concern raised about practical implementation.
 14. In particular, the references to the time periods on which a market making strategy should be observed or monitored have been aligned. ESMA has maintained the identification of ‘comparable’ quotes between the quotes posted on both sides permitting a maximum divergence of 50%. In ESMA’s view, the proposal made by market participants would not fulfil the Level 1 requirement that the size of quotes is ‘comparable’. ESMA agrees with the point made regarding ‘competitive’ prices and has revised the text accordingly. Finally, on the identification of ‘stressed market conditions’, ESMA agrees that these conditions relate to changes in prices and volumes but the situations of stress may vary a lot among trading venues and types of instruments traded. Therefore, it has revised the text leaving to trading venues the obligation to identify the specific parameters of stressed market conditions in terms of significant short-term changes of price and volume.

Identification of market making strategies

15. Most respondents were of the opinion that trading venues should not be responsible for detecting market making strategies. ESMA agrees that it is the investment firm’s duty to notify the venue if it intends to pursue this type of strategy. However, if a venue identifies such strategy without prior notification, it has to contact that investment firm to sign a market making agreement as prescribed by Article 48(2)(a) of MiFID II. Where the investment firm does not agree to sign the agreement or to disable that strategy, the trading venue may report an infringement of Article 17(3) of MiFID II to its CA. ESMA appreciates that the provisions would benefit from further clarifications in that respect. However, it notes that those elements are not covered by ESMA’s Level 1 mandate and hence the final draft RTS remains silent on those points.

Circumstances in which an investment firm will be obliged to enter into a market making agreement

16. The vast majority of the respondents disagreed with ESMA's proposal, i.e. that investment firms pursuing a market making strategy in at least one financial instrument during 30% of the daily trading hours during one trading day should sign a market making agreement with the trading venue. In this respect, respondents raised concerns about both the 30% threshold and the proposed observation period (one single trading day).
17. In their view, both the threshold of 30% and the short observation period of one day would likely lead to erroneously capturing firms that rarely trade on a particular market but which have, for various reasons (e.g. market turmoil, necessity to liquidate a position, etc.), a high presence on a particular day. It would also be possible, for instance, that a firm liquidating its position provides quotes for more than 30% of the trading hours on a single day in at least one instrument. Such an activity should not accidentally trigger a substantive commercial obligation.
18. It is worth noting that the 30% threshold proposed in the CP relates to two-way quotes which should be of comparable sizes and posted simultaneously. Hence in ESMA's view it is unlikely that this requirement would capture investment firms liquidating a position in one specific instrument. However, ESMA recognises that the proposed threshold and in particular the short observation period associated with it could lead to investment firms being captured without pursuing genuine market making strategies. ESMA has therefore decided to revise its proposal.
19. Various alternative thresholds and observation periods were suggested by the respondents. With regard to the specific threshold, most of the respondents favoured a 50% threshold instead of 30% in the observation period. As far as the observation period is concerned, a large majority of respondents suggested an observation period of at least one month as evidence of undertaking such an activity on a regular basis. They also stressed that the trading hours of trading venues in Europe vary between one and 24 hours' continuous trading and that it was important for the new regime to accommodate all situations.
20. In line with these responses, ESMA has modified its initial provision. In the final draft RTS, investment firms are now obliged to enter into a market making agreement when posting firm, simultaneous two-way quotes of comparable size and at competitive prices in at least one financial instrument on a single trading venue for at least 50% of the daily trading hours of continuous trading at the respective trading venue, excluding opening and closing auctions, and for half of the trading days over a one month period.
21. Respondents also pointed out that the regime proposed in the CP could have unintended consequences on the liquidity of European markets. In their view, there was a risk that investment firms would try to avoid being captured and undertake less "firm, simultaneous two-way quotes of comparable size and at competitive prices" on the trading venues and more trading through SIs. To mitigate such concerns, ESMA has

raised the proportion of the time that a market making strategy has to be operative to trigger the obligation to sign a market making agreement.

22. Other respondents highlighted the excessive administrative burden on the trading venues and firms in requiring them to conclude market making agreements even though many firms may not be genuine market makers. In this respect, some respondents suggested that it would be better to base the market making requirements on the deliberate intention of a firm to be a market maker, and that no firm should be forced to enter into market making agreement. ESMA believes that this approach suggested by the respondents would not be compliant with the requirements of Article 17(3) of MiFID II.
23. Lastly, it was mentioned that a DEA provider should not be obliged to sign a market making agreement due to the activity of a DEA client. ESMA wishes to clarify that under Article 17(4) of MiFID II, a market making strategy takes place when an investment firm is dealing on own account “as a member or participant”. Therefore, a DEA provider should not be liable for the trading activities of its DEA clients under this provision since in this specific case it would not be dealing on own account as specified under Level 1.

Market making agreement

24. With respect to the market making agreements, respondents asked for clarification on:
 - i. the point in time when the market making agreement should be signed and come into force suggesting a term of one month, as the one for SIs, for the signing of the contract after the conditions are met; and,
 - ii. how a firm could exit from market making obligations once the parameters were met and for how long (a day, a week, a month, etc) would a firm meeting the thresholds on one day remain under the market making obligation.
25. ESMA appreciates that the provisions would benefit from further clarifications in that respect. However, it notes that those elements are not covered by ESMA’s Level 1 mandate and hence the RTS remains silent on those points.
26. Respondents also sought clarity on whether a separate market making agreement should be signed for each financial instrument. In ESMA’s view, the market making agreement should be limited to those instruments in which the investment firm is pursuing a market making strategy. However, nothing prevents, where appropriate, a trading venue and an investment firm, to cover more than one financial instrument under the same agreement.
27. With regard to the minimum threshold of 50% presence time for those market makers having signed a market making agreement, the main points raised in the responses are:

- i. Respondents generally considered this minimum threshold would be workable if an application across all market sectors is intended. However, for ESMA, this should only apply to the trading venue the investment firm has signed the agreement with. It is worth noting that in the revised RTS, the threshold is now consistent with the threshold used to determine when a firm is obliged to enter into a market making agreement.
- ii. Some respondents considered that the minimum threshold of 50% fails to take into consideration the different trading models, the different asset classes, financial instruments and market environments. ESMA appreciates that there would be some merit in further calibrating the minimum threshold for each specific asset class but notes that this would on the other hand create extra complexity and burden for the stakeholders. Thus, it was decided to maintain a single threshold which will apply across the board.
- iii. Some respondents welcomed the suggested 50% minimum presence for market makers only during 'normal trading conditions' but were of the opinion that the level is not attainable during periods of stressed market conditions. ESMA understands the concern but notes that the provision of liquidity is particularly relevant in periods of stress. It should also be noted that Article 17(3)(a) of MiFID II stipulates that an investment firm under a market making agreement should "carry out this market making continuously during a specified proportion of the trading venue's trading hours, except under exceptional circumstances" without making any reference to stressed market conditions. The proposal included in the CP was therefore maintained in this regard.
- iv. Many respondents considered it necessary to clarify more precisely the consequence of breaching this obligation. One respondent also asked for a clarification on how the proposed 50% will be monitored. In this respect, ESMA notes that under the second paragraph of Article 48(3) of MiFID II, trading venues are required to monitor and enforce compliance by investment firms with the terms of the agreement signed. In addition, the obligation for investment firms to sign a market making agreement and consequently provide liquidity during a significant proportion of the daily trading hours is also clearly stipulated under Article 17(3)(a). Therefore, Competent Authorities have the power to enforce this requirement under Article 69 of MiFID II.

Exceptional circumstances

28. Some respondents considered that it should not be up to the trading venue to declare 'exceptional circumstances'. In their view, an investment firm is best placed to determine whether it is able to continue pursuing a market making strategy in 'exceptional circumstances' and would in such instances inform the trading venue and be able to immediately suspend its market making agreement. On the contrary, other respondents felt that only trading venues should be allowed to determine exceptional circumstances.

ESMA appreciates the arguments raised but remains of the view that, in order to achieve harmonised application of the provision, trading venues should be responsible for identifying the occurrence of exceptional circumstances.

29. With regard to the list itself, most respondents disagreed with ESMA setting a hard-coded list of exceptional circumstances and recommended rather establishing a non-exhaustive list. ESMA believes that it is crucial, in order to achieve harmonised implementation of those standards, to clearly delineate the list of events and circumstances which should be included and thus has maintained an exhaustive list in the final version of the draft RTS.
30. Some respondents made some suggestions about the list, recommending in particular adding the following items:
 - i. Pre-planned information events (e.g. corporate action announcements); ESMA disagrees with this suggestion as it considers that exceptional circumstances cannot, by their very nature, include any regular or pre-planned information events that may affect the fair value of a financial instrument. The RTS provides more clarity in this regard.
 - ii. Internal IT disruptions of the investment firm; ESMA has revised the text to identify the exceptional IT circumstances that may impede performing this activity; and
 - iii. The situation when a market maker has a conflict of interest due to insider knowledge of a possible merger/acquisition of the entity. ESMA considers that under those circumstances an investment firm should have in place a conflict of interest policy as prescribed by Article 16(3) of MiFID II.
31. Lastly, some respondents did not want the public disclosure of exceptional circumstances as it could increase the market distortion and monitoring this disclosure would be “operationally onerous”. ESMA does not consider that the determination of exceptional circumstance should have such a detrimental impact on markets. On the other hand, ESMA considers that it is crucial for the trading venues to communicate this information to all its members and participants in order to ensure a level playing field between them. Thus, the original proposal has been maintained in this respect expect for the case where those exceptional circumstances are due an investment firm’s inability to maintain prudent risk management practices.

Conditions under which it is appropriate to have a market making scheme in place

32. Some respondents felt that insufficient guidance was given on the circumstances under which trading venues would be exempted from the requirement to introduce market-making schemes (‘nature and scale of trade’). In particular, some respondents considered that ESMA’s proposal did not sufficiently take into consideration situations where a trading venue designates a single market-maker per instrument who needs to

fulfil more obligations than normal market makers and who can directly influence the price determination process.

33. ESMA appreciates the comments made and has revised its proposal in this respect. In its revised proposal, ESMA has decided to limit the obligation to have a market making scheme in place to those situations and instruments where algorithmic trading entails a greater risk of overreaction to external events which can exacerbate market volatility. More specifically, under the new proposal, it is now only required to have such scheme in place (i) for trading venues operating a continuous auction trading order book trading system; and (ii) for specific liquid financial instruments, namely shares, equity index futures and options, exchange traded funds and ETFs futures and options. However, nothing prevents trading venues which are outside this scope from establishing a market making scheme at their own initiative.

Minimum market making obligations that trading venues must provide for when designing a market making scheme

34. Many respondents criticised that trading venues cannot and should not be required to 'compensate' a market maker for trading in an instrument under stressed market conditions (by providing incentives). In their view, trading venues should rather have discretion to determine the amount and format (fees or relaxed quoting requirements) of incentives. The respondents highlighted that it would be unrealistic in practice for trading venues to pay additional incentives for market makers who fulfil their obligations in tough times because of the extra costs for increased liquidity in such times which are necessarily paid by the venues. In this respect, it was also mentioned that the costs might be passed down the value chain.
35. ESMA understands the concerns but stresses that under Article 48(2)(b) of MiFID II it is stipulated that the objective of any such schemes is to bring "liquidity to the market on a regular and predictable basis". In ESMA's view, it is particularly important to have those schemes in place during stressed market conditions where liquidity is the most volatile and where it is appropriate to incentivise trading and provision of liquidity. However, trading venues still have the ability to adjust their scheme of incentive and, for instance, only reward the best performers as long as this is done in a non-discriminatory manner.

Fair and non-discriminatory market making schemes

36. Respondents provided in their answers some suggestions for changes to make market making schemes fair and non-discriminatory such as:
- i. Amendments to a market making scheme should be allowed with one month's notice rather than three months. ESMA agrees with the proposal and has amended the provision accordingly.

- ii. There should be a cap on incentives given to market makers. ESMA believes that this should be possible under the proposed regime as long as the conditions apply equally to all the members or participants of a trading venue.
- iii. There should not be an exemption from market making schemes for trading venues that do not permit algorithmic trading. ESMA disagrees with this approach. Recitals (59) to (65) frame the scope of the mandates under Articles 17 and 48 to algorithmic trading activity.
- iv. Market making fees and schemes should be publically available although one respondent specifically opposed the names of market makers to be publically disclosed. ESMA does not agree with this suggestion and remains convinced that there is some merit to disclose the individuals engaged in market making agreements to ensure fair and non-discriminatory treatment.
- v. Volume should be considered when determining incentives based on the quality of liquidity provided in a market making scheme. In ESMA's view, incentives should be granted in accordance with pre-set parameters that must be met in terms of presence, size and spread. Therefore volumes are captured by the provision.
- vi. Trading venues should have the ability to deregister market makers for not fulfilling obligations rather than providing "negative incentives". In the final RTS, the specific reference to negative incentives has been deleted. However, ESMA notes that trading venues are in charge of monitoring and enforcing compliance with the market making agreements under Article 48(3) of MiFID II. ESMA is also of the view that market makers that do not fulfil their obligations should not be able to access the incentives.

Proposal

37. In the light of the comments received, ESMA has re-considered its proposal presented in the CP. The main elements of the final draft RTS are:
- i. An investment firm is considered to be pursuing a market making strategy, and therefore should sign a market making agreement, if it is posting firm, simultaneous two-way quotes of comparable size and at competitive prices in at least one financial instrument on a single trading venue for at least 50% of the daily trading hours of continuous trading at the respective trading venue, excluding opening and closing auctions, and for half of the trading days over a one month period.
 - ii. The minimum obligations that a market making agreement must establish include an obligation to post firm, simultaneous two-way quotes of comparable size and competitive prices for no less than 50% of the daily trading hours, excluding opening and closing auctions.

- iii. The final draft RTS provides for a comprehensive list of circumstances which could constitute exceptional circumstances impeding the provision of liquidity on a regular and predictable basis. The standards also clarify the role of trading venues in the identification of those exceptional circumstances and, where necessary, the dissemination of this information to all their members or participants.
- iv. The final draft RTS restricts the obligation to have a market making scheme in place to (i) trading venues operating a continuous auction order book trading system; and (ii) specific liquid financial instruments, namely shares, equity index futures and options, exchange traded funds and ETFs futures and options.
- v. The obligation to incentivise the presence of firms engaged in a market making agreement in stressed market conditions has been maintained.
- vi. The requirements set to ensure that market making schemes are fair and non-discriminatory include the following provisions:
 - a. no limitation of the number of investment firms taking part in a market making scheme, but acknowledgement of the ability of trading venues to limit the access to the incentives to those which have a better performance;
 - b. access to incentives should be proportional to the effective contribution to the liquidity in the market measured in terms of presence, size and spread; and
 - c. obligation for trading venues to make publicly available the conditions of the market making scheme and the name of the firms that have signed a market making agreement under this scheme.

3.4. Ratio of unexecuted orders to transactions

Background/Mandate

Article 48, MiFID II

6. *Member States shall require a regulated market to have in place effective systems, procedures and arrangements, including requiring members or participants to carry out appropriate testing of algorithms and providing environments to facilitate such testing, to ensure that algorithmic trading systems cannot create or contribute to disorderly trading conditions on the market and to manage any disorderly trading conditions which do arise from such algorithmic trading systems, including systems to limit the ratio of unexecuted orders to transactions that may be entered into the system by a member or participant, to be able to slow down the flow of orders if there is a risk of its system capacity being reached and to limit and enforce the minimum tick size that may be executed on the market.*

[...]

12. *ESMA shall develop draft regulatory technical standards further specifying:*

[...]

(b) the ratio referred to in paragraph 6, taking into account factors such as the value of unexecuted orders in relation to the value of executed transactions;

1. Under Articles 48(6) and 18(5) of MiFID II, trading venues must have in place effective systems, procedures and arrangements to ensure algorithmic trading systems cannot create or contribute to disorderly trading conditions on their market and to manage any disorderly trading conditions arising from such algorithmic trading systems, including systems to limit the ratio of unexecuted orders to transactions that may be entered into the system by a member or participant. In order to meet this objective, ESMA is required to further specify the ratio of unexecuted orders to transactions (OTR) that may be submitted to a trading venue by a member or participant taking into account factors such as the value of unexecuted orders in relation to the value of executed transactions.
2. For the CP, ESMA revised its original proposal in line with the Commission specifications according to which this Regulation would only focus on the methodology to determine the OTR.

Analysis following feedback from stakeholders

3. ESMA published in its CP a proposal on the methodology to set out the ratio of unexecuted orders to transactions that may be submitted to a trading venue by a

member or participant taking into account factors such as the value of unexecuted orders in relation to the value of executed transactions.

4. While a number of market participants expressed a general support for ESMA's proposal, a lot of responses made specific objections with respect to the draft Regulation. The main issues that arose from the consultation are summarised below.
5. Regarding the scope of MiFID II mandate, some respondents considered that the mandate does not refer to the methodology for determining the maximum OTR (which should be set out by trading venues) but to the methodology for calculating the OTR of members or participants. ESMA agrees with this view and the draft Regulation has been amended accordingly.
6. For some respondents, the proposal did not sufficiently differentiate between the existing types of market participants. Those respondents further stated that trading venues should have the ability to change the maximum OTRs according to the type of market participant on the basis of the different impact that their activity might have and the roles they play on that venue. In particular, those respondents had the view that market makers should be explicitly exempted from these obligations. ESMA appreciates the comments made and agrees that in some cases certain participants should be subject to a specific maximum OTR in order to allow them to perform their obligations vis-à-vis the trading venue. However, it should be noted that ESMA's mandate is limited to specifying the methodology for calculating the OTR and not to determining the maximum OTR. Nevertheless, in ESMA's view, the trading venues should set a maximum OTR appropriate to their trading systems in order to reduce the risk of disorderly trading conditions.
7. With regard to the scope in terms of instruments, some responses noted that there was no value in setting a maximum OTR for certain categories of instruments such as interest rate swaps or bonds. ESMA has revised the draft RTS to clarify that only the calculation methodology of the OTR is set out and not the maximum allowable OTR.
8. On the methodology to set out the maximum OTR, some participants opposed this proposal as it was based on previous year's aggregated number of transactions, executions and volumes which may lead to an ever-decreasing OTR. Others noted the need for a "floor" to facilitate the activity of market makers in illiquid instruments and to capture those market participants that may effectively contribute to disorderly trading conditions, as opposed to small participants who may have a higher OTR, but their number of orders does not create any issue to the trading venue. As mentioned, the scope of the draft RTS is now limited to setting out the methodology to calculate the OTR effectively incurred by members or participants and not their maximum OTR.
9. A number of respondents proposed excluding from the calculations indicative orders/quotes as they are not considered as genuine orders but as an "invitatio ad offerendum" that would be followed by a binding quote by the interested party. ESMA

agrees that the references to orders and quotes refer to executable orders or quotes and their modification or cancellation.

10. ESMA also asked whether the definition of “order” was sufficiently precise. Whereas a significant number of stakeholders agreed with the proposal, some respondents proposed considering as “orders” only those messages that have the potential to create executions but not messages that are removing this potential so as not to include within the scope cancellations or any technical messages sent to the trading venue. In this respect, ESMA wishes to clarify that cancellations of orders are part of the calculations, with the exception of cancellations due to uncrossing in an auction, a loss of venue connectivity or the use of a kill functionality. The wording in the final draft has been amended accordingly.
11. Several market participants disagreed with using the reference period of one trading session to assess the OTR as in their view Article 48(6) addresses strategies with consistently high cancellation rates. ESMA disagrees with that view and considers that the monitoring obligation and the appropriate observation period to calculate the effective OTR of members and participants is one trading session. However, nothing prevents trading venues from using shorter timescales to calculate their OTR. ESMA also requested views on whether the monitoring of the OTR by trading venues should cover all trading phases or only continuous auction. There were opposing views on whether auctions should be considered in the calculations. Given that each trading venue may establish its own maximum OTR, auctions have been considered part of the trading session.
12. On the annual determination of the OTR, many respondents insisted on the need for trading venues to have sufficient leeway to react to changing market conditions. One respondent proposed to use as maximum OTR the highest OTR recorded during a five-year period. These concerns have been addressed by clarifying that the draft RTS does not refer to the determination of the maximum OTR.
13. ESMA also asked market participants about the counting methodology proposed. Despite a significant number of respondents supporting the proposal, some of them made technical comments regarding how some types of orders should be counted. The core argument of these respondents was that the counting methodology is dependent on the purpose of the Regulation: preventing disorderly trading conditions should lead to different counting methods than prevention of a critical system load. For example, some of the respondents argued that “penalising” order cancellations would actually increase the risk exposure of market makers. They disagreed with the proposal with respect to the ratio of the number of unexecuted orders (but not with the ratio of the volume of unexecuted orders).
14. ESMA considered such a view but decided to maintain the proposed counting methodology, not only because there is a link between a capacity overload of one trading venue and the risk of disorderly trading conditions but also because trading

venues have the ability to set out the maximum OTR at the level they deem appropriate. The counting methodology for the different order types is included in the Annex to the draft Regulation.

15. ESMA also consulted whether further clarification was necessary in relation to the calculation method in terms of volume. Most respondents did not consider it necessary.
16. A significant number of respondents made proposals to improve the Regulation with regards to the annual determination of the maximum OTR. However, ESMA was not able to act upon these proposals as they are outside of the scope of its mandate.
17. In light of the comments received and the revised scope of ESMA's mandate in this regard, the draft Regulation does not limit the obligation to calculate the OTR for any type of financial instrument but limits the scope to those trading systems where there is a higher risk of disorderly trading conditions due to excessive OTRs, i.e. electronic continuous auction order book, quote-driven, and hybrid trading models.
18. Whereas trading venues running these systems should calculate the OTR for their members or participants, it is clear that trading venues may set out the maximum OTR at the level they consider appropriate. As originally consulted, trading venues should calculate the OTR of their members or participants in terms of volume and in terms of number of orders. Accordingly, the breach of any of those OTRs by a member or participant should be considered as a breach of the OTR.
19. ESMA annexes a table with a list of order types and how they should be counted for these purposes. It is noted that in case a trading venue uses an order type that is not included in that list, the venue should count such an order in accordance with the counting methodology commonly accepted in the market taking into account how a similar order type in the Annex is counted.

3.5. Requirements to ensure co-location and fee structures are fair and non-discriminatory

3.5.1 Co-location

Background/Mandate

1. Article 48(8) of MiFID II mandates that regulated markets shall ensure that their rules on co-location are transparent, fair and non-discriminatory.
2. Article 48(12) of MiFID II requires ESMA to develop draft RTS to specify the requirements to ensure that co-location services are fair and non-discriminatory.

Article 48, MiFID II

[...]

8. *Member States shall require a regulated market to ensure that its rules on co-location services are transparent, fair and non-discriminatory.*

[...]

12. *ESMA shall develop draft regulatory technical standards further specifying (...) the requirements to ensure that co-location services and fee structures are fair and non-discriminatory and that fee structures do not create incentives for disorderly trading conditions or market abuse.*

ESMA shall submit those regulatory technical standards to the Commission by 3 July 2015.

Analysis following feedback from stakeholders

3. In the CP, ESMA maintained the general approach presented in the DP whereby co-location services were addressed through three different aspects: the level of access to such services, the pricing models used by the providers of such services and the technical support that the service providers should offer to their users.
4. Taking into consideration the feedback from the DP, the CP proposed that trading venues should not be forced to expand their capabilities indefinitely to meet the demand for the co-location service. Respondents to the CP supported this view and so this is reflected in the final draft RTS.
5. Respondents raised concerns regarding the scope of the draft RTS, in particular that they may not be able to control the service provided by a third party provider of co-

location to the trading venue, as they cannot control what is outside of their perimeter. One possible solution suggested was to add a clarification that trading venues have no control over their third party providers; another proposed solution was to add a clause that such third parties should adhere to the same requirements as the trading venues.

6. ESMA appreciates the concerns raised and understands that where services are contracted out to third parties, there may be an additional barrier to ensuring compliance with this Regulation. However, contracting out services to third parties does not absolve trading venues from remaining accountable for compliance with the draft RTS. In order to ensure a level playing field, trading venues must remain accountable even when they have contracted out the services. In such circumstances, the trading venue has the ability to contractually enforce compliance with the draft RTS through contractual means with the relevant third party.
7. Some respondents raised concerns about requiring trading venues to provide their users with the same cable lengths. They remarked that complying with such a requirement would impose significant cost and complexity for trading venues. In addition, even if the fibre cable is cut at the same physical length, it would still yield different fibre strand lengths due to how the fibre is twisted within the cable sheathing.
8. ESMA recognises that there may be technical reasons that would prevent the trading venues from providing cables of exactly the same length. As a general rule however, trading venues should provide access to their network under equivalent conditions for all users subscribing to the same co-location service. In this regard, ESMA has amended the draft RTS with respect to connections and latency monitoring to require that trading venues must take reasonable steps to monitor latency measurements and ensure non-discriminatory treatment of any of their users.
9. Some respondents were of the opinion that as the information concerning co-location services is commercially sensitive, access to this information should only be available upon request. However, other responses stressed that trading venues should be fully transparent about the co-location services they provide, and give details of the services' specifications that they offer, the criteria for accessing those services and the costs of the services, and that the information should be published to ensure that it is equally available to all interested parties.
10. Having taken into consideration these comments, ESMA decided to maintain the position that was stated in the CP, namely for the trading venues to publish their policies regarding co-location services on their website. ESMA remains convinced that a sufficient level of publicity is a prerequisite to fair and non-discriminatory co-location services.

Proposal

11. ESMA has re-considered its proposal in line with the comments received as presented in the final draft RTS in the Annex.

3.5.2 Fee structures

Background/Mandate

12. Article 48(9) of MiFID II requires that regulated markets shall ensure that their fee structures are transparent, fair, non-discriminatory and do not incentivise disorderly trading conditions or market abuse.
13. Article 48(12) of MiFID II requires ESMA to develop draft RTS specifying the requirements to ensure that fee structures are fair and non-discriminatory and do not create incentives for disorderly trading or market abuse.

Article 48, MiFID II

[...]

9. *Member States shall require that a regulated market ensure that its fee structures including execution fees, ancillary fees and any rebates are transparent, fair and non-discriminatory and that they do not create incentives to place, modify or cancel orders or to execute transactions in a way which contributes to disorderly trading conditions or market abuse.*

[...]

12. *ESMA shall develop draft regulatory technical standards further specifying:*

[...]

(d) the requirements to ensure that co-location services and fee structures are fair and non-discriminatory and that fee structures do not create incentives for disorderly trading conditions or market abuse;

ESMA shall submit those draft regulatory technical standards to the Commission by 3 July 2015.

Analysis following feedback from stakeholders

14. In the CP, respondents were asked whether:
 - i. they agreed with ESMA's proposal with respect to fee structures;
 - ii. they could provide further information on instances of improper trading occurring possibly as a result of a particular rebate structure encouraging such an activity;

- iii. there were any other types of incentive that should be covered in the draft RTS;
 - iv. they could provide further evidence about fee structures supporting an “early look”;
 - v. they could provide examples of fee structures that would support non-genuine orders, payment for privileged access to market data, or any other abusive behaviour;
 - vi. they consider that the proposed distinction made between volume discounts and cliff-edge fee structures were sufficiently clear.
15. Respondents generally agreed with the proposed approach of the draft RTS in the CP, however the responses raised some points for clarification addressed below:
- i. respondents asked ESMA to widen the proposed definition of ‘rebate’, as the way it was drafted in the CP restricted the use of rebates only to shares. It was suggested that the definition should apply to all financial instruments. ESMA agrees with the view that rebates should be allowed for all financial instruments, and in order to avoid creating confusion and restricting inappropriately the definition has been deleted.
 - ii. respondents raised the issue of making the fee structure publically available on the trading venue’s website. Some respondents stated that the fee structure should be publically available with sufficient granularity to allow market participants to be informed of the fees and the parameters, so that they are predictable and can easily be compared with that of other venues. Other respondents held the view that such information is commercially sensitive and that access to such information should be limited to existing and potential participants. Having considered these points of view, and the Level 1 text which requires for fee structures to be transparent and for participants and interested parties to be able to compare the fee structures across trading venues, ESMA decided to maintain that fee structures should be publically available on the website so that they are easily accessible by any prospective user.
 - iii. respondents raised the issue of trading venues charging investment firms for testing their algorithms. The draft RTS in the CP proposed that an algorithm testing facility to prevent disorderly trading conditions should be provided on an at-cost basis. Some respondents posited that the testing facility should be provided on a commercial basis given that MiFID II does not mandate ESMA to set the basis of the fees that may be charged and that the trading venue will need to pay significant costs for providing such a testing facility. Other respondents held the belief that the testing facility should be provided for free if possible, or else on an at-cost basis. Given that algorithm testing was to become mandatory on every trading venue on which the algorithm was used, they argued that if the trading venue were allowed to charge excessively, investment firms may become disincentivised from testing their algorithms thoroughly.

- iv. Following on from the responses regarding trading venues providing a testing facility to both the draft RTS on organisational requirements for investment firms engaged in algorithmic trading and the draft RTS on organisational requirements for trading venues, ESMA decided to change its approach on this issue. The new approach does not mandate that investment firms use the testing facilities of the trading venue to prevent disorderly trading conditions. It also offers choice of using 'test symbols' provided by the trading venue, and for investment firms to test algorithms in a third party facility provided that such tests are adequate for the purpose. On this basis, ESMA has removed the section on fees charged for algorithm testing against disorderly trading conditions.
16. Overall, only very few respondents disagreed with the direction of the proposed draft RTS taken in the CP claiming that it would contradict the principles of free market economy or because they were not supportive of trades being subsidised or of incentivising a fee structure that did not foster efficient transactions in general.
17. In the CP, ESMA also sought views on whether rebates could be set to encourage improper trading. Views expressed included the following:
 - i. the rebate itself would lead to improper trading if the member was motivated to route orders to a particular trading venue for the rebate, which it does not subsequently pass on to its client;
 - ii. if rebates were excessive to a degree that they generated profit without the need for spread capture, they would not be sustainable;
 - iii. rebate levels were unlikely to encourage improper trading, as implementing the basic principles (transparency, discrimination) should be sufficient;
 - iv. the parameters of fee structures, including rebates, were considered as a factor not significant enough to encourage a behaviour which may lead to disorderly trading conditions; and,
 - v. provided that there are no "cliff-edge" elements, no specific thresholds were thought to encourage improper trading.
18. Such comments provided ESMA with valuable insight, and ESMA took such views into account when revising the draft RTS.
19. Furthermore, in the CP a question was asked as to whether there were any other issues that should be included in the draft RTS. Although no specific information was provided on any particular incentives, respondents requested ESMA not to limit rebates, incentives and discounts to an exhaustive list. On this basis, ESMA decided not to highlight any particular incentives in the final draft RTS or to arbitrarily limit the rebates, incentives and discounts.

20. ESMA requested further information on fee structures that would support an “early look”. As none of the respondents provided further information on such a practice, ESMA decided not to take any specific action on this point.
21. ESMA asked for examples of fee structures that encouraged non-genuine orders, payments for privileged access to market data or any other type of abusive behaviour. Examples given by the respondents included the following:
 - i. market data policies where the direct members of a trading venue receive its data at a lower price, or for free, as compared to users of the competing trading venues;
 - ii. fees that were dependent on the latency of a real-time data feed;
 - iii. payment of a regular retainer fee;
 - iv. rebates on algorithmic and high frequency trading order flows;
 - v. fees that provide the participant with order data before its order enters the trading venue’s matching engine; and,
 - vi. thresholds on the amount of transactions/fees that would incentivise high frequency trading firms to exceed such thresholds by placing orders in small size, which in practice do not represent liquidity and vanish when market conditions deteriorate.
22. ESMA has carefully considered the above comments. ESMA does not share the view that the charging of data which varies between members and non-members is an example of abuse or privileged access to market data for a particular user group but considers that the pricing differentials between trading venues are due to commercial forces and competition. Regarding fees that were dependent on the latency of real-time feed, ESMA considers such practices permissible as long as no users were excluded from accessing low-latency feeds. Regarding retainer fees, ESMA considered that such fees in themselves did not support abusive behaviour. Regarding rebates given to algorithmic and high frequency flows, ESMA considers such practices not objectionable as long as they were based on non-discriminatory, measurable and objective parameters. ESMA considers that fees charged for providing order information before the participant’s order reaches the trading venue’s matching engine would be regarded as market abuse and therefore are not permitted.
23. The majority of respondents felt that the distinction between volume discounts and cliff-edge was clear. A few respondents suggested minor amendments. ESMA has considered the application of the term “cliff-edges” in the revised draft RTS, and made appropriate text changes. The majority of respondents agreed with the proposal to prohibit fee schemes that have a “cliff-edge” component, as they recognised that they may encourage improper trading activity. ESMA agreed that ‘cliff-edge’ fee structure should be banned whereby upon a member’s, participant's or client’s trading exceeding

a given threshold, all of its trades benefit from a lower fee for a set period, including trades which have been executed previously in addition to the trades executed subsequent to reaching the threshold. This has been expressly stated in the final draft RTS .

Proposal

24. ESMA has reconsidered its proposal in line with the comments received as presented in the draft RTS in the Annex.

3.6. Tick size regime for shares, depositary receipts and exchange traded funds

Background/Mandate

Article 49, MiFID II

1. *Member States shall require regulated markets to adopt tick size regimes in shares, depositary receipts, exchange-traded funds, certificates and other similar financial instruments and in any other financial instrument for which regulatory technical standards are developed in accordance with paragraph 4.*

2. *The tick size regimes referred to in paragraph 1 shall:*

(a) *be calibrated to reflect the liquidity profile of the financial instrument in different markets and the average bid-ask spread, taking into account the desirability of enabling reasonably stable prices without unduly constraining further narrowing of spreads;*

(b) *adapt the tick size for each financial instrument appropriately.*

3. *ESMA shall develop draft regulatory technical standards to specify minimum tick sizes or tick size regimes for specific shares, depositary receipts, exchange-traded funds, certificates, and other similar financial instruments where necessary to ensure the orderly functioning of markets, in accordance with the factors in paragraph 2 and the price, spreads and depth of liquidity of the financial instruments.*

ESMA shall submit those draft regulatory technical standards to the Commission by 3 July 2015.

4. *ESMA may develop draft regulatory technical standards to specify minimum tick sizes or tick size regimes for specific financial instruments other than those listed in paragraph 3 where necessary to ensure the orderly functioning of markets, in accordance with the factors in paragraph 2 and the price, spreads and depth of liquidity of the financial instruments.*

1. MiFID II provides for the harmonisation of tick size regimes with the aim of preventing any disorderly functioning of the financial markets in the EU.
2. In its CP, ESMA proposed a tick size regime incorporating the feedback received to its May 2014 DP. ESMA's proposal provided for a regime where tick sizes were determined taking into account both the liquidity of the financial instrument and the price of the submitted order. This approach did not prescribe for a specific tick size for each financial instrument (a per instrument approach would be too complex to implement and maintain as stressed by the respondents to the DP) but rather a tick size regime where the tick

size for financial instruments with similar liquidity is determined by the same price dependent tick size table.

Analysis following feedback from stakeholders

Scope of the proposed tick size regime

3. The vast majority of respondents agreed with the scope of the tick size regime as proposed in the CP. They notably agreed that non-equity financial instruments should not be included in the scope as there was no need to have such a regime for the purpose of the orderly functioning of the markets for these instruments. They added that it was premature at this stage to envisage a tick size regime for non-equity instruments and that the scope of the regime should be reviewed in a few years once there is sufficient experience on the subject.
4. Respondents further considered that the only equity-like financial instruments that should be subject to the tick size regime should be ETFs and depositary receipts.
5. A few respondents challenged the tick size regime proposed for ETFs arguing that it resulted in too wide tick sizes compared to those currently used on a number of trading venues in the Union, especially for ETFs having non-equities as underlying. Some respondents also considered that certificates should not be subject to the tick size regime in light of their liquidity, scale and nature.
6. Some other respondents suggested that the tick size regime for ETFs should also cover ETNs and ETCs. In this respect, it should be noted that ETNs and ETCs should be considered as debt instruments due to their legal structure and therefore they are included within the scope of the final draft RTS on tick size.
7. In light of the above comments and to address the concerns raised, ESMA has adapted the scope of the proposed tick size regime. In particular, it has excluded certificates from the scope given that their liquidity levels and trading characteristics do not warrant the inclusion in this tick size regime in order to prevent the occurrence of disorderly trading conditions.
8. ESMA has also slightly amended the tick size regime applicable to ETFs both in terms of scope and process. With regard to the scope, it is proposed that the tick size regime only applies to ETFs where the constituent underlying instruments are all subject to the tick size regime. Consequently, where one or more underlying components of an ETF are not subject to the tick size regime (e.g. a bond), the ETF itself is not required to comply with the regime. For ETFs that are subject to the tick size regime, a tick size should be applied which is equal to or greater than the tick size corresponding to the liquidity band of the tick size table with the highest average number of transactions per day and the price of the submitted order.

Implementation of the proposed tick size regime

9. With regard to the liquidity indicator to be used to determine the liquidity profile of financial instruments under the new tick size regime, ESMA asked in its CP whether the average number of transactions per day should be considered on the most relevant market in terms of liquidity or another market. There was no strong majority objecting to the determination of the average number of transactions per day on the most relevant market in terms of liquidity (as specified for the purpose of the reference price waiver in the draft RTS on transparency requirements in respect of equity and equity-like financial instruments). Some respondents who did not support the proposed liquidity proxy suggested instead to consider all transactions participating in the price formation process executed across all trading venues (or alternatively across trading venues with a relevant market share). Some respondents further suggested to take into account also trades executed off-venue (e.g. OTC transactions and transaction executed through an SI). Other respondents highlighted the importance of not taking into account auction data.
10. The various respondents supporting ESMA's approach argued that relying on the most liquid venue ("reference market") will "yield the most representative trading frequency measure" and allow consistency. ESMA has maintained its original approach.
11. In the CP, ESMA also asked whether the tick size proposal was sufficiently granular so as to take into account the case of very liquid but also poorly liquid stocks. Some respondents indicated that there were risks attached to the tick size proposal. In particular, it was argued that the most liquid liquidity band (i.e. for financial instruments with an average daily number of transactions higher than 15,000) was not suitable for all ETFs. It was also indicated that too large tick sizes could result in liquidity fleeing from lit order books to dark pools and SIs which are not subject to the common tick size regime, whereas too small tick sizes could be detrimental to liquidity by discouraging market makers from posting liquidity especially on less liquid stocks (e.g. many SME stocks). These respondents therefore insisted on the need to refine the liquidity bands of the tick size table taking those risks into account. They also stressed that the appropriateness of liquidity bands should be reassessed and, where necessary, recalibrated annually. ESMA has revised the tick size table to address these concerns.
12. In its CP, ESMA also proposed a particular regime for financial instruments for which the most relevant market operates a periodic auction trading system or fixing segment (application of the lowest liquidity band) and another particular regime for instruments newly admitted to trading (application of the liquidity band on the basis of an estimate of the trading activity). These two particular regimes were supported by most respondents on the ground that they were fair and appropriate. Respondents nonetheless suggested a few clarifications notably in relation to the definition of periodic auction trading system and the time schedule for the estimates to be made by the trading venues. ESMA has revised the draft RTS to clarify these elements.

13. ESMA further provided in its CP that trading venues could modify for a given instrument the applicable liquidity band where they considered a corporate action as significantly modifying that instrument's liquidity so that the tick size prescribed by the regime may no longer be appropriate. In order to address the risk of disorderly market conditions arising from a corporate action likely to result in the tick size to be unsuitable for a given instrument, respondents proposed that the trading venue would treat the financial instrument as if it was first admitted to trading. Most respondents supported ESMA's proposal on the ground that it was fair, reflective of the requirement resulting from a corporate action, practical and easy to implement. Respondents also suggested clarifying the concept of "corporate action" and the related time schedule and process. Some respondents requested that the list of corporate actions provided in ESMA's proposal be reworded in a non-exhaustive manner. In this regard, ESMA considers it more appropriate to list in the recital of the draft RTS the most common corporate actions as a non-exhaustive list in order not to exclude any specific corporate actions that have not been anticipated at this stage and so as to be future proof.
14. Most respondents added that for the tick size regime to be efficient, it needs to be complied with at all times. Allowing exemptions would inevitably lead to a less predictable and transparent regime and add complexity (notably as regards the definition of the exemption process).
15. Therefore to ensure the predictability of the regime, ESMA proposes to limit the exceptional conditions under which it could be derogated from the regime to corporate actions only. The main change with respect to the original ESMA suggestion is that the proposal from a trading venue regarding a corporate action should be endorsed by its CA.

Annual review and monitoring of the regime

16. The vast majority of respondents agreed that for the tick size regime to reach the objective of maintaining orderly market conditions, the liquidity bands have to be reviewed on a regular basis and at least annually (some suggesting a preliminary review after six months of implementation). Respondents further requested that the revision process be detailed notably in respect of the time schedule (from the commencement of the revision until the implementation of the revised table) and the procedures to be followed (e.g. communication channels).
17. With respect to the annual revision and adjustment of the liquidity bands where necessary, ESMA has examined this issue but neither the legal mandate provided to ESMA under Article 49 of MiFID II nor the regulatory tool used (i.e. RTS) allow such a provision.
18. However, some dynamic elements remain for the determination of the applicable tick size and this should partially address the concerns raised during the consultation. In particular, the liquidity band applicable to a financial instrument will be reassessed

annually allowing taking into consideration any potential change of the liquidity profile of an instrument. It is worth noting that the most relevant market in terms of liquidity will itself be re-determined annually.

19. Although it is not provided in the Regulation, nothing prevents ESMA and other competent authorities from monitoring the implementation of this tick size regime and recalibrating the tick size table through a revision of the RTS, if and when necessary.

Proposal

20. ESMA has decided to maintain the main features of the tick size regime described in the CP with some refinements so as to incorporate the respondents' feedback.
21. Thus, ESMA proposes to maintain the two-dimensional tick size table with one dimension reflecting the financial instrument's liquidity, expressed in terms of the average number of transactions per day on the most relevant market in terms of liquidity (as defined for the purpose of the reference price waiver), and with the other dimension being the price of the orders submitted. ESMA believes that the use of this two-dimensional table will allow the assignment of a tick size to each single financial instrument at any point in time, taking into consideration its liquidity and its price. Under the proposed approach, the tick size for a specific financial instrument evolves continuously with the price of the order relating to that financial instrument.
22. For the purpose of simplicity of implementation, ESMA further proposes to build the new tick size regime on the basis of the existing FESE table 2. However, whereas FESE Table 2 only has two price increments (1 and 5); ESMA has created its table with three tick size increments: 1, 2 and 5. In ESMA's table the smallest possible tick size is 0.0001. The final table is presented below (with explanations on the structure of the table and how it was built).
23. It is proposed to establish the common tick size regime provided under Article 49 of MiFID II on the basis of the tick size table presented below. ESMA highlights that this tick size table was built with a view to being simple to understand and implement while having a controlled impact to the extent possible.
24. ESMA has refined the tick size regime proposed in the CP with a view to addressing the concerns raised by respondents. The main adjustments made to the CP approach relate to the following:
 - i. The scope: the proposed tick size regime applies to shares, depositary receipts and certain ETFs only (please see below for ETFs). Certificates are no longer subject to the regime given their specific microstructural properties and the lack of evidence that a tick size regime would ensure the orderly functioning of markets for these instruments.

- ii. The liquidity bands: they have been adjusted to better reflect the liquidity profile of financial instruments. One additional liquidity class has been added to the tick size table providing more granularity and allowing further calibration with a view to:
 - a. avoiding an overall large decrease or increase in the tick sizes currently applicable on EU trading venues (this will be monitored on the basis of a relevant control group for assessing the actual impact of the new regime);
 - b. ensuring that there is a relevant cost to overbidding, to reduce excessive noise in the order book and to avoid discouraging market makers from posting liquidity; to that end, the tick size table was built such that the expected spread to tick ratio with the new regime would be smaller than 5 (ceiling) for most of the financial instruments;
 - c. avoiding increasing viscosity by constraining the spread which may lead to liquidity fleeing to dark order book or SIs; in this regard, the liquidity bands have been designed so as to maintain an expected spread to tick ratio greater than 1.3 (floor) for most of the financial instruments.
- iii. The regime for ETFs: In light of respondents' comment that the tick size regime was not suitable for all ETFs (notably those with underlying components trading with a very small tick size), the refined proposal excludes from the scope of the tick size regime those ETFs having at least one underlying component not subject to the regime. As a result, the proposed tick size regime will exclusively apply to ETFs with underlying components which are themselves subject to the regime.
- iv. In addition, to avoid constraining the spread which can be detrimental to their liquidity, ETFs which are subject to the tick size regime will be applied the tick sizes of the liquidity band corresponding to the highest average number of transactions per day.

Table 40: Tick size table as included in Annex of the final draft RTS

Price Ranges	Liquidity Bands					
	0 ≤ Average number of trades per day < 10	10 ≤ Average number of trades per day < 80	80 ≤ Average number of trades per day < 600	600 ≤ Average number of trades per day < 2000	2000 ≤ Average number of trades per day < 9000	9000 ≤ Average number of trades per day
0 ≤ price < 0.1	0.0005	0.0002	0.0001	0.0001	0.0001	0.0001
0.1 ≤ price < 0.2	0.001	0.0005	0.0002	0.0001	0.0001	0.0001
0.2 ≤ price < 0.5	0.002	0.001	0.0005	0.0002	0.0001	0.0001
0.5 ≤ price < 1	0.005	0.002	0.001	0.0005	0.0002	0.0001
1 ≤ price < 2	0.01	0.005	0.002	0.001	0.0005	0.0002
2 ≤ price < 5	0.02	0.01	0.005	0.002	0.001	0.0005
5 ≤ price < 10	0.05	0.02	0.01	0.005	0.002	0.001
10 ≤ price < 20	0.1	0.05	0.02	0.01	0.005	0.002
20 ≤ price < 50	0.2	0.1	0.05	0.02	0.01	0.005
50 ≤ price < 100	0.5	0.2	0.1	0.05	0.02	0.01
100 ≤ price < 200	1	0.5	0.2	0.1	0.05	0.02
200 ≤ price < 500	2	1	0.5	0.2	0.1	0.05
500 ≤ price < 1000	5	2	1	0.5	0.2	0.1
1000 ≤ price < 2000	10	5	2	1	0.5	0.2
2000 ≤ price < 5000	20	10	5	2	1	0.5
5000 ≤ price < 10000	50	20	10	5	2	1
10000 ≤ price < 20000	100	50	20	10	5	2
20000 ≤ price < 50000	200	100	50	20	10	5
50000 ≤ price	500	200	100	50	20	10
Structure of the tick size table	Reference class +3 tick increments	Reference class +2 tick increments	Reference class +1 tick increment	Reference class corresponding to FESE table 2 (with some adjustments)	Reference class -1 tick increment	Reference class -2 tick increments

- v. Finally, the proposal also includes a transitional provision to ensure that the regime will be effectively applicable from 3 January 2017.

3.7. Material markets in terms of liquidity relating to trading halt notifications

Background/Mandate

Article 48(5) of MiFID II

5. *Member States shall require a regulated market to be able to temporarily halt or constrain trading if there is a significant price movement in a financial instrument on that market or a related market during a short period and, in exceptional cases, to be able to cancel, vary or correct any transaction. Member States shall require a regulated market to ensure that the parameters for halting trading are appropriately calibrated in a way which takes into account the liquidity of different asset classes and sub-classes, the nature of the market model and types of users and is sufficient to avoid significant disruptions to the orderliness of trading.*

Member States shall ensure that a regulated market reports the parameters for halting trading and any material changes to those parameters to the competent authority in a consistent and comparable manner, and that the competent authority shall in turn report them to ESMA. Member States shall require that where a regulated market which is material in terms of liquidity in that financial instrument halts trading, in any Member State, that trading venue has the necessary systems and procedures in place to ensure that it will notify competent authorities in order for them to coordinate a market-wide response and determine whether it is appropriate to halt trading on other venues on which the financial instrument is traded until trading resumes on the original market.

Article 48(12)(e) of MiFID II

12. *ESMA shall develop draft regulatory technical standards further specifying:*

[...]

(e) The determination of where a regulated market is material in terms of liquidity in that instrument;

1. Article 48(5) of MiFID II imposes on regulated markets which are material in terms of liquidity in a given instrument the requirement to have the necessary systems and procedures in place to notify competent authorities of trading halts. This requirement is extended to MTFs and OTFs by virtue of Article 18(5) of MiFID II.

Analysis following feedback from stakeholders

2. In its CP, following the feedback received to the May 2014 Discussion Paper, ESMA proposed material markets in terms of liquidity in a financial instrument to be:
 - i. the trading venues where the financial instrument was first admitted to trading, including all the venues where the instrument was simultaneously admitted to trading in case of multiple listing; or,
 - ii. the most relevant markets in terms of liquidity for a financial instrument as verified during the preceding year.
3. Respondents to the CP asked ESMA to provide some clarifications on the scope of the Regulation and the provisions it contains. More specifically, some respondents sought clarification on whether the proposed definition applied only to regulated markets or also to MTFs and OTFs. In their view, the definition of material market in terms of liquidity should be workable and relevant for all types of markets. Other respondents recommended focusing only on the primary markets (which was viewed as the only venue having a natural relationship with the issuer) and to delete Article 1(2) of the draft RTS.
4. In ESMA's view, although Article 48 of MiFID II refers only to regulated markets, Article 18(5) specifies that "Member States shall require that investment firms and market operators operating an MTF or OTF comply with Articles 48 and 49 and have in place all the necessary effective systems, procedures and arrangements to do so" extending the requirements to other types of trading venues. The Level 1 text therefore does not restrict the requirement to inform the relevant competent authorities of a trading halt to regulated markets. Rather, for the purpose of Article 48(5) of MiFID II, all types of trading venues (RM, MTF or OTF) could be a material market in terms of liquidity for a given financial instrument. ESMA has therefore decided to maintain the two elements of its definition of market material in terms of liquidity.
5. With respect to the first part of the ESMA proposal, respondents had suggested to align with other RTSs using the same concept on the definition of "admission to trading". ESMA agrees that alignment in this respect would be beneficial but notes that the concept of admission to trading is established under Article 51 of MiFID II and further specified in the draft RTS on the admission of financial instruments on trading on regulated markets. This definition applies to all Level 2 measures and therefore there is, in ESMA's view, no need to further clarify the concept in this Regulation.
6. With respect to the second part of the ESMA proposal, some respondents had pointed out that this provision would not apply to non-equity instruments. For those, only the first paragraph would therefore be applicable. However, this first paragraph refers to the venue where the instrument was first admitted to trading while, the concept of "admitted to trading" does not apply to all derivatives. Also with regards to fixed income products, respondents noted that bonds are often listed on regulated markets but scarcely traded on these venues. They specified that for instruments that are exclusively traded on

MTFs or OTFs, the concept of admission to trading does not apply. In those cases, they highlighted that the draft RTS would not determine any material market in terms of liquidity.

7. A possible solution suggested by some respondents was to use a liquidity threshold to allow further markets to be captured. This liquidity threshold would consist of a determination of when the percentage of trading taking place in a given venue is sufficiently substantial so that the information regarding one trading halt should be “passed on” to other venues to prevent potentially systemic events. It could be set as a percentage of the total turnover for the financial instrument executed on a specific trading venue or, as proposed in other responses, it could take into consideration other criteria such as the number of participants, the volume traded or spreads.
8. ESMA appreciates the concerns raised and the potential solutions proposed especially with respect to non-equity financial instruments. ESMA acknowledges that under the proposal set out in the consultation, some financial instruments would not be captured by the definition and in particular non-equity financial instruments trading only on MTFs and OTFs and not admitted to trading on any venue. Therefore, ESMA has decided to revise its proposal and to extend the first part of the proposed definition to trading venues where a financial instrument was traded for the first time. This revised proposal should bring all financial instruments into the scope of the Regulation.
9. In ESMA’s view, setting out liquidity thresholds for the sole purpose of determining the material markets in terms of liquidity in Article 48(5) of MiFID II would add too much complexity to the system since this would necessitate each trading venue to calculate its relative market share in terms of turnover for each financial instrument traded on it. ESMA therefore chose to opt for a more cost effective solution and to leverage, where possible, on existing provisions and concepts such as the determination of the most relevant market in terms of liquidity for the purpose of the reference price waiver (Article 4 of MiFIR).

Proposal

10. ESMA proposes to amend its definition of the trading venues that should be considered as material markets in terms of liquidity in a financial instrument in order to include trading venues which are:
 - i. the most relevant market in terms of liquidity as defined for the purpose of the reference price waiver (for equity and equity-like instruments only); or,
 - ii. the regulated markets where the financial instrument was first admitted to trading, (including all the venues where the instrument was simultaneously admitted to trading in case of multiple listing) or, for financial instruments not admitted to trading on any venue, the trading venue where the financial instrument was traded for the first time (for non-equity financial instruments).

4. DATA PUBLICATION AND ACCESS

4.1. Authorisation, organisational requirements and the publication of transactions for data reporting service providers

Background/Mandate/Empowerment

Article 61(4) (a) and (b) of MiFID II

ESMA shall develop draft regulatory technical standards to determine:

- (a) the information to be provided to the competent authorities under paragraph 2, including the programme of operations;*
- (b) the information included in the notifications under Article 63(3)*

Article 64(8)(c) of MiFID II

ESMA shall develop draft regulatory technical standards specifying:

- (c) the concrete organisational requirements laid down in paragraphs 3, 4 and 5.*

Article 65(6) of MiFID II

ESMA shall develop draft regulatory technical standards to determine [...] additional services the CTP could perform which increase the efficiency of the market.

Article 65(8)(e) of MiFID II

ESMA shall develop draft regulatory technical standards specifying:

- (e) the concrete organisational requirements laid down in paragraphs 4 and 5.*

Article 66(5)(a) and (b) of MiFID II

ESMA shall develop draft regulatory technical standards specifying:

- (a) the means by which the ARM may comply with the information obligation referred to in paragraph 1; and*
- (b) the concrete organisational requirements laid down in paragraphs 2, 3 and 4.*

1. In the CP, ESMA proposed draft technical standards which would impose similar authorisation and organisational requirements on the three different types of data reporting services providers (DRSPs): Approved Reporting Mechanisms (ARMs), APAs and CTPs. This was on the basis that there are commonalities in the type of business being undertaken by DRSPs and therefore they should broadly be regulated under the same regulatory framework.
2. ESMA acknowledged however that slightly different requirements should apply depending on the specific type of DRSP service that was being provided as this may mean that some requirements may not apply or be relevant. ESMA also sought feedback on three specific topics related to DRSPs: periodic reconciliations, maximum recovery times and operational hours. In addition, ESMA requested general feedback on the other provisions of the draft regulatory technical standards.

4.1.2 Periodic reconciliations

CP Proposal

3. In the CP, ESMA proposed that an ARM would have to perform periodic reconciliations not only at the request of the CA of its home Member State but also at the request of any other CA to whom the ARM submitted reports. This was to acknowledge that CAs who receive data from an ARM also have an interest in the quality and completeness of that data.

Analysis following feedback from stakeholders and proposal

4. Overall the 27 respondents to the CP supported ESMA's proposal to allow the CA to whom the ARM submitted the transaction report to request that an ARM performs periodic reconciliations. Several respondents also indicated that they supported ESMA's proposal for reconciliations to be undertaken by APAs and CTPs.
5. Some concerns were raised about the extent to which DRSPs would be required to reconcile reports and a few respondents suggested that competent authorities should apply a standardised approach when making reconciliation requests to DRSPs.
6. Based on the feedback, ESMA believes that it is necessary to further clarify its intention in relation to its proposal:
 - i. In the case of ARMs, periodic reconciliations must be performed by the ARM at the request of its CA or any CA to which the ARM submits reports. The obligation has been phrased to be 'on request' because ESMA is aware that not all CAs provide data samples of transaction reports;
 - ii. In the case of APAs and CTPs, the obligation to reconcile exists, even if a specific request is not made by the CA. This is because unlike ARMs, the APA or CTP is

reconciling the information which it has published with the information which it has received. Therefore the APA or CTP does not need to rely on data samples from a third party and as a result, should always be in a position to reconcile the trade information.

7. Given this approach, ESMA does not believe that it is necessary to standardise requests by CAs as it does not believe that such standardisation is warranted. In the case of ARMs, it is not expected that CAs will make highly prescriptive requests about the specific data set that the ARM will reconcile, although it does not prevent a CA from doing so. In most cases, ESMA envisages that a CA may make a standing request to the ARM to periodically reconcile the transaction reports it handles. ESMA has also inserted a recital to state that the frequency and extent of those reconciliations should be proportionate to the volume of data handled by the ARM and the nature of the ARM's activities in relation to the processing of the transaction report.
8. One respondent was concerned that the term 'reconciliations' may unduly limit the ability of an ARM to implement other arrangements for detecting errors and omissions. ESMA is of the view that the draft RTS does not preclude an ARM from performing other checks of the data. However, ESMA believes that the ARM, should at a minimum, perform the reconciliations described in the regulatory technical standards as this provides a robust method for ensuring that the reports that it submits to the CA are complete and accurate.

4.1.3 Maximum recovery times

CP Proposal

9. ESMA requested feedback on its proposal to impose maximum recovery times on DRSPs in the event of a disruptive incident. The proposed maximum recovery periods were 6 hours for APAs and CTPs and by the close of the next working day for ARMs.

Analysis following feedback from stakeholders and proposal

10. There was strong disagreement amongst the 24 respondents in relation to ESMA's proposal to establish maximum recovery times for DRSPs.
11. The primary arguments against the proposal were that it would be too prescriptive and would not necessarily lead to a quicker resumption of business. Furthermore, respondents did not believe that it was achievable even with robust continuity plans. For example, respondents argued that it would be difficult to comply with the requirements in the case of a severe situation such as a natural disaster. The majority of respondents also believed that DRSPs would already have a commercial incentive to recover as quickly as possible.

12. In light of these concerns, ESMA has refined its proposal. Although the DRSP must still aim to be operational as soon as possible after a disruptive incident, ESMA does not intend to be overly prescriptive in setting a deadline for the resumption of business. Therefore, the requirements now refer to these periods as the ‘target’ maximum recovery times. ESMA believes that this strikes an appropriate balance because it means that DRSPs should establish arrangements to resume business as quickly as possible but also recognises that there may be extreme situations, such as force majeure where it is not feasible to expect a DRSP to recover within the set time limit.

4.1.4 Operational Hours

CP Proposal

13. ESMA’s original proposal in the CP was to allow DRSPs to be permitted to establish their own operational hours provided that the hours are pre-established and made public.

Analysis following feedback from stakeholders and proposal

14. In general, the 27 respondents to this question supported ESMA’s proposal. However, a small number of respondents disagreed with the proposal and an argument was made that APAs should be open 24 hours/7 days a week to ensure that there would always be an APA available to publish the trade.
15. Given the strong support for the proposal, ESMA maintains its proposal to not prescribe operational hours for DRSPs in the draft RTS. Giving DRSPs flexibility to determine their own operational hours will foster competition amongst DRSPs, with the possibility that some DRSPs may specialise in providing services during certain hours.

4.1.5 General comments

CP Proposal

16. In addition to the specific questions posed in the CP, ESMA requested general feedback on the other provisions of the draft DRSP regulatory technical standards.

Analysis following feedback from stakeholders and proposal

17. The majority of the 23 respondents agreed with the provisions of the draft RTS although a few respondents believed that the technical standards were too onerous. Respondents raised concerns focussing on a number of areas. For example, concerns were raised about the rationale for specifying a list of other services that a CTP can perform as well as the requirement to provide information on the remuneration of the management body and determination of fees charged by a DRSP.

18. The list of other services that a CTP can perform is required under Article 65 of the Directive. For this reason, ESMA has not made any changes to the technical standards but would like to clarify that this list does not compel a CTP to provide any of these other services. The list is also not intended to be exhaustive, meaning that it does not restrict the ability of a CTP to offer other services not listed. However, the CTP must ensure that this additional service does not interfere with the CTP's core function of consolidating and publishing trade information.
19. Several respondents also queried why CAs should be permitted to request information on the remuneration of the management body and the determination of fees charged by the DRSP. These respondents did not believe that it was justified and expressed doubts about why a CA would be involved in the determination of prices.
20. To clarify, this information will be useful to help CAs to determine whether the manner in which the DRSP remunerates its management body or sets its fee structure will give rise to any conflicts of interest with the DRSP's clients. This information is not intended to be used for regulating prices or remuneration, although ESMA notes that APAs and CTPs must charge clients on a reasonable commercial basis.
21. Other comments included a suggestion that APAs should provide information relating to submitted trades back to the submitter. ESMA agrees with this proposal and has inserted a provision requiring APAs to assign a transaction identification code to a trade report, notify the client of this identification code and refer to it in all subsequent communications with their client. This will allow APAs and their clients to more precisely identify the trade report and will facilitate traceability of the report.
22. On the issue of the security of the data handled by DRSPs, some respondents suggested that the technical standards should be expanded. It was suggested that in the event of a breach of the security of the data, DRSPs should not only provide an incident report to the CA but also to any clients of the DRSP. ESMA agrees with this proposal because clients which have been affected by a breach should be notified of the incident in case they need to take any steps to mitigate the effects of the breach.
23. In the draft RTS, ESMA had proposed some provisions regarding outsourcing. The effect of these provisions was to ensure that the DRSP would retain responsibility for any outsourced activities and to ensure that the DRSP's CA would still be able to obtain information about the outsourced activities.
24. There were mixed responses to the proposals. A few respondents commented that they would like the provisions to be strengthened to explicitly state that the DRSP must still comply with the technical standards in relation to the outsourced activities. On the other hand, some respondents raised concerns around the right of CAs to be able to access information from the third party service provider on the basis that this would be excessive and may potentially reduce the appetite for third party service providers to provide services.

25. On balance, ESMA believes that it should continue with its original proposal to introduce outsourcing rules. ESMA believes that a robust set of rules are needed to deal with outsourcing arrangements because on principle, there should be no difference in terms of regulatory treatment between when a DRSP carries out the activities itself compared to where it outsources those activities. In particular, the existence of an outsourcing arrangement should not inadvertently restrict the ability of the CA to supervise the DRSP. Obtaining information about how those activities are being carried out is fundamental to a CA's obligation to monitor that the DRSP is continuing to comply with the conditions of its initial authorisation. This information may be retrieved from the third party service provider directly or via the DRSP.

4.1.6 Publication chain

Scope of the consolidated tape for equity and equity-like instruments

Background/Mandate/Empowerment

Article 65(8)(c) of MiFID II

ESMA shall develop draft regulatory technical standards specifying:

(c) the financial instruments data of which must be provided in the data stream and for non-equity instruments the trading venues and APAs which need to be included.

26. ESMA proposed in the CP that a CTP should collect data from a new trading venue or a new APA as soon as possible and in any case no later than 3 months after the start of the APA's or trading venue's operations.

Analysis following feedback from stakeholders and proposal

27. Some respondents reiterated their doubts regarding the viability of a CTP given the requirement of a complete coverage in terms of sources.
28. With regard to the proposed grace period, potential clients of CTP services, including the buy side and the sell side communities, usually agreed with the 3-month timeline. Conversely, most exchanges, as mandatory contributors to the CTPs, considered the period as too demanding and recommended to extend the period to 6 to 12 months. Such a period was deemed to be more appropriate in particular for developing and testing the needed interface infrastructure.
29. In light of the responses received and given the relatively stringent requirement of the full coverage, ESMA proposes to extend the grace period from 3 to 6 months.

4.1.7 Technical arrangements facilitating the consolidation of information - Machine readability

Mandate/Empowerment/Background

Article 64 (6) of MiFID II

ESMA shall develop draft regulatory technical standards to determine [...] technical arrangements facilitating the consolidation of information as referred to in paragraph 1.

Article 65(6) of MiFID II

ESMA shall develop draft regulatory technical standards to determine [...] technical arrangements promoting an efficient and consistent dissemination of information in a way ensuring for it to be easily accessible and utilisable for market participants as referred to in paragraphs 1 and 2 [...].

30. In the CP, ESMA proposed requiring APAs and CTPs to disseminate data in a machine readable format in order to ensure “fast access to the information” and suggested, based on the feedback received to the DP a definition of machine readable format.

Analysis following feedback from stakeholders

31. Feedback of respondents was split. On the one hand, a number of respondents from various sectors including exchanges, data vendors, buy side and sell side members agreed with the definition. On the other hand, a number of respondents - mostly exchanges- were opposed to requiring free, open source and non-proprietary solutions as some current proprietary solutions, are neither free (but “cost-effective”) nor open source as they contain certain IP rights.
32. Respondents also raised objections against the 1-month notice period prior to any change in the instructions as to how to access and use the data, and suggested extending the period to 3 months as a general principle while providing for the possibility of a shorter notice in exceptional cases.
33. Some participants recommended explicitly ruling out websites as they are likely to hinder consolidation and requiring instead data feeds pushed by the source.

Proposal

34. ESMA finds it important to avoid format and protocol lock-in to which users might be tied to as it could be costly and compromise the provision of data on a reasonable commercial basis. Accordingly ESMA proposes to retain the principle of a free and non-proprietary format and protocol but has slightly amended the definition to take feedback of stakeholders into account. Furthermore, APAs and CTPs will be able to offer proprietary solutions in addition as long as other more standardized protocols that are free and non-proprietary are available. This approach is the current practice of some exchanges.
35. ESMA proposes to extend the notice period to 3 months for making public any changes to the instructions explaining how and where to access and use the data, while introducing the possibility that changes to the instructions take effect more quickly in urgent and justified cases.
36. While ESMA recognises the weakness of some current web-based solutions, ESMA has decided not to prescribe a specific technology as new developments in the future may overcome current constraints and has maintained a technology-neutral approach based on criteria of robustness and scalability which need to be met.

4.1.8 Consolidation of information specific to equities and equity-like instruments

Background/Mandate/Empowerment

Article 64(6) of MiFID II

ESMA shall develop draft regulatory technical standards specifying [...] technical arrangements promoting an efficient and consistent dissemination of information in a way ensuring for it to be easily accessible and utilisable for market participants as referred to in paragraphs 1 and 2 [...].

Article 65(8)(d) of MiFID II

ESMA shall develop draft regulatory technical standards specifying:

(d) other means to ensure that the data published by different CTPs is consistent and allows for comprehensive mapping and cross-referencing against similar data from other sources, and is capable of being aggregated at Union level.

37. ESMA has to ensure that CTPs consolidate and publish transactions without any duplication. Since Article 20(1) of MiFIR does not prevent an investment firm from

reporting the same trade to several APAs, the CTP may collect the same trade from several APAs and there is a risk that a single transaction might be duplicated in the tape.

38. ESMA therefore proposed in the CP that an APA publishes transactions reported by investment firms in a format that facilitates consolidation by including a reprint field which flags duplicative reports. ESMA considered that an APA can meet this requirement in two ways: (i) by requiring investment firms to report transactions exclusively to that APA; or (ii) by requiring the investment firm to use an identification mechanism which flags one report as the original one and all other reports of the same transaction as duplicates. This provision would allow a CTP to identify duplicates and keep them out of the published tape.

Analysis following feedback from stakeholders

39. The vast majority of respondents agreed with ESMA's approach. Some respondents questioned the possibility of investment firms publishing the same transaction through different APAs for equity instruments (unlike for non-equity instruments, where such an option is explicitly ruled out in MiFIR). Others recommended flagging either originals or duplicates in any case to limit administrative burden.
40. Some stakeholders asked for clarification whether an investment firm would need to publish all transactions, i.e. transactions in all equity instruments, via the same APA. The amended draft RTS clarifies that the requirement to make transactions public exclusively through one APA needs to be met on a per financial instrument basis.

Proposal

41. As Article 20 of MiFIR does not prevent investment firms from making a transaction public through several APAs for equity instruments, ESMA remains convinced that a rule for avoiding duplicative reporting for equity instruments is needed. ESMA considers that its proposal strikes the right balance between ensuring that duplicates can be ultimately avoided without restricting the freedom for Investment firms to choose how many APAs to report to. While the required flagging may create some administrative burden, these costs are limited and one-off. ESMA therefore maintains its approach.

4.1.9 Content of the information published by the equity CTP and the APA

Trade ID

Background/Mandate/Empowerment

Article 65(8)(a) and (b) of MiFID II *ESMA shall develop draft regulatory technical standards specifying:*

(a) the means by which the CTP may comply with the information obligation referred to in paragraphs 1 and 2;

(b) the content of information published under paragraphs 1 and 2;

Article 64(8)(a) and (b) of MiFID II

ESMA shall develop draft regulatory technical standards specifying:

(a) the means by which an APA may comply with the information obligation referred to in paragraph 1;

(b) the content of the information published under paragraph 1, including at least the information referred to in paragraph 2 in such a way as to enable the publication of information required under Article 64;

42. ESMA proposed in the CP the introduction of a trade ID assigned by the CTP which would allow market participants to refer to a specific trade in the consolidated tape.

Analysis following feedback from stakeholders

43. Respondents unanimously agreed that a trade ID would be a valuable element. However views were split on whether the trade ID should be assigned at the level of the CTP or rather at the level of the APA, trading venue or investment firm. While some respondents agreed with ESMA's proposal that the trade ID should be originated by the CTPs, most respondents suggested that APAs and trading venues should assign the trade ID which would then be used by the CTP. Respondents considered that this approach has the advantage of assigning the trade ID at the level of the venue that comes first in the publication chain and thereby reduces the possibility of errors. Furthermore, it would ensure that a trade ID is available in case no CTP emerges.

44. Some respondents recommended defining the format of the trade ID and so that trades can be unambiguously sequenced regardless of the level of granularity of the timestamp used.

Proposal

45. In light of the strong support for a trade ID assigned by APAs and trading venues rather than by CTPs, ESMA has amended its approach and proposes to require APAs and trading venues to assign a transaction identification code.

46. ESMA considers that imposing a specific format for the transaction identification code would be overly prescriptive, disproportionate in terms of costs and benefits and pre-empt initiatives for developing a unique transaction identification code in the future. Accordingly ESMA does not require the use of a unified transaction identification code across all APAs and trading venues but opts for a pragmatic approach requiring the use of a string of characters leaving much flexibility to APAs and trading venues when determining their own transaction identification code. This code in combination with the identification of the APA or trading venue publishing the trade and the time of publication will enable users to unambiguously refer to any trade published that day. To avoid duplications in requirements, the transaction identification code for trading venues is identical to the transaction identification code required for transaction reporting purposes.

4.1.10 Publication time for CTPs when trades take place on trading venues

47. APAs and CTPs are required to publish “the time the transaction was reported” in addition to the time of the transaction according to Articles 64(2)(d) and (e), 65(1)(d) and (e) and 65(2)(d) and (e) of MiFID II.
48. ESMA proposed in the CP that the “time the transaction was reported” should be understood as the time when the transaction was published by the APA or the trading venue since this gives market participants valuable information to better understand to which events the market actually reacted and when.

Analysis following feedback from stakeholders and proposal

49. A majority of respondents supported ESMA’s proposal for having a publication time assigned by the trading venue instead of the CTP when a trade takes place on a trading venue. This timestamp provided by the source of the publication corresponds to the time when market participants are first able to see the trade information released and is deemed as the most relevant. Only a few respondents wanted the CTP to originate the timestamp to allow for benchmarking across CTPs.
50. Some respondents argued against a publication time assigned by the trading venue, explaining that execution time was more important but without recommending or preferring a publication time allocated by the CTP either. The question as to whether or not trading venues should publish the publication time in addition to the execution time was specifically addressed in Q50 of the CP. Responses were largely supportive.
51. Given the majority of supportive responses, ESMA maintains its proposal.

4.1.11 Accuracy of the publication timestamp

CP Proposal

52. To ensure a reliable audit chain for trade information along the publication chain, ESMA proposed to require an APA to timestamp trade reports in terms of granularity, i.e. up to the millisecond for electronic systems and up to the second for other trades, and accuracy, i.e. timestamping should not diverge by more than one second or millisecond from the UTC.

Analysis following feedback from stakeholders and proposal

53. A significant number of respondents representing different sectors (mainly from the sell side and data vendors, but also including some exchanges) were in favour of ESMA's proposal. Some respondents suggested more accuracy in the maximum divergence with the time reference based on the capabilities of the originating trading system or service in line with the requirements on clock synchronisation for trading venues and their members or participants. Another group of respondents, composed largely of exchanges, recommended less accuracy, with a divergence up to one second also for trades taking place on electronic systems to avoid confusion with other trades (e.g. voice systems) and because transmission and processing will add latency to the primary source.
54. Given the split of responses, ESMA maintains the original requirement which appears to strike the right balance of granularity and accuracy. ESMA considers it essential to require sufficient granularity and accuracy to ensure meaningful and reliable timestamps

4.1.12 Identification of the source contributing to the CTP

CP Proposal

55. ESMA proposed to require for transparency purposes that the CTP should publish the identification of its source for each trade. For on-venue trades this should be the venue of execution, whereas for OTC trades or trades that took place on an SI, the identification of the venue and the identification of the source (i.e. the APA) will be different and will add meaningful information.

Analysis following feedback from stakeholders

56. Overall, the proposal gained large support with only very few respondents opposing the identification of the reporting source, stressing that it was confusing, could reveal sensitive information and could result in undesirable competitive behaviour.

57. Some responses suggested that the identifiers for APAs should be assigned and published by ESMA.

Proposal

58. Given the strong support, ESMA maintains its proposal. It should be recalled that the publication source is in any case public information and that the mechanism of deferred publication will further provide the necessary protection against undue market risk. ESMA is therefore not convinced of the arguments that such an approach could reveal sensitive information or result in undesirable competitive behaviour.

59. ESMA understands and shares the proposal that identifiers should be assigned to APAs, but is lacking the necessary legal mandate to require the use of such identifiers. However, in order to allow for a harmonised identification of APAs, ESMA will explore the possibility to have identifiers assigned in a similar way to MIC and to publish these identifiers on ESMA's website in the list of DRSPs. The code identifying the source contributing to the CTP will be referred to as 'Venue of publication'.

4.2. Data disaggregation

Background/Mandate/Empowerment

Article 12 of MiFIR

1. *Market operators and investment firms operating a trading venue shall make the information published in accordance with Articles 3, 4 and 6 to 11 available to the public by offering pre-trade and post-trade transparency data separately.*

2. *ESMA shall develop draft regulatory technical standards to specify the offering of pre-trade and post-trade transparency data, including the level of disaggregation of the data to be made available to the public as referred to in paragraph 1.*

ESMA shall submit those draft regulatory technical standards to the Commission by 3 July 2015.

CP proposal

1. The proposals contained in the CP were:
 - i. each venue must offer its pre- and post-trade data disaggregated by four asset classes;
 - ii. each venue must also disaggregate by further criteria, unless there is insufficient demand for such data streams. The criteria would be: country, currency, industry sector, membership of a major index, auctions vs. continuous trading, and different types of derivatives;
 - iii. if a venue decides that there is not sufficient demand to disaggregate by a particular criterion, it should state this alongside its price lists, and in response to any request for pricing information.

Analysis following feedback from stakeholders

2. The responses divided roughly equally into those who thought the proposals went too far and those who supported them or thought they should go further.
3. The opponents (mostly exchanges) included those who thought there should be no disaggregation, or that it should be by asset class only. Their arguments were that disaggregation would increase costs and complexity and create confusion. They argued very strongly that the lack of regulation of data vendors meant that disaggregation might not be carried through to end-users. ESMA recognises that there is a risk that disaggregation may not be fully passed through to end users. However, the scope of

MiFIR and the empowerment for ESMA is clear in requiring data disaggregation by trading venues.

4. Some of those who supported the proposals thought that they required the right amount of disaggregation, while others thought they should go further in different ways, e.g. more or all criteria should be mandatory; there should be disaggregation to the instrument level; or there should be a mechanism for challenging venues who claim that there is not sufficient demand.
5. Many responses from all categories of respondents considered the phrase “[In]sufficient demand” as too vague and asked for a definition.
6. Among other comments, a number identified the “membership of a major index” criterion as particularly problematic as this criterion was considered not specific enough and ESMA should therefore specify the “major indices”. Another concern pointed to the changing population of such a data feed (including reference and historic data) as each index is rebalanced.

Proposal

7. In the light of the comments on relying on the criterion “insufficient demand”, ESMA has decided to dispense with it and to make all disaggregation mandatory.
8. Pre-trade and post-trade data relating to all instruments will have to be disaggregated by the following criteria: asset class (separating equity from equity-like, and distinguishing fixed income, emission allowances and different types of derivatives), currency, scheduled daily auctions as opposed to continuous trading. In addition, shares and sovereign bonds will also be disaggregated by country of issue.
9. As the proposed requirements are mandatory, ESMA removed two criteria for which, on the basis of the responses, there was the least demand and which were criticised for being too costly or too vague: membership of a major index, and industrial sector. Furthermore, the draft RTS clarifies that a trading venue has to offer data on a reasonable commercial basis using any combination of the disaggregation criteria provided that it is requested at least by one market participant. Trading venues may, in addition, offer bundles of data.

4.3. Access in respect of central counterparties and trading venues

Introduction

1. Articles 35 and 36 of MiFIR require ESMA to develop draft RTS in relation to various issues covered in the following sections of this final report. As both trading venues and CCPs are regulated under Union law, that fact has to be taken into account when drafting implementing measures under the said MiFIR articles.
2. Therefore, this section takes the assumption that both entities are regulated and supervised (e.g. under EMIR, MAD/MAR and MiFID/MiFIR or, if not EU entities, under legislation recognised as equivalent by a decision prior to an access request being made – Article 25 of EMIR for CCPs, and Article 38 of MiFIR for trading venues) and does not question the proper enforcement of such regulations against the relevant entities.

4.3.1 Denial of access by a CCP or trading venue

Background/Mandate/Empowerment

Article 35(6)(a) of MiFIR

ESMA shall develop draft regulatory technical standards specifying:

the specific conditions under which an access request may be denied by a CCP, including:

- (a) the anticipated volume of transactions,*
- (b) the number and type of users,*
- (c) arrangements for managing operational risk and complexity, or*
- (d) other factors creating significant undue risks.*

Article 36(6)(a) of MiFIR

ESMA shall develop draft regulatory technical standards specifying:

the specific conditions under which an access request may be denied by a trading venue, including:

- (a) conditions based on the anticipated volume of transactions,*

- (b) *the number of users,*
- (c) *arrangements for managing operational risk and complexity, or*
- (d) *other factors creating significant undue risks.*

3. ESMA considers that access should be granted if after reasonable efforts to manage the risks arising from access no significant undue risks remain. The conditions for denying access and the conditions under which access is granted should be aimed at meeting these objectives.
4. With that in mind, differences in asset classes may be relevant and need, in some circumstances, to be taken into account. Having regard to the fact that managing risks in relation to derivatives is in most cases much more complex and challenging than in relation to securities, and to the differences between financial and non-financial derivatives and between physically and financially settled derivatives, ESMA expects the application of the draft RTS to reflect such differences.
5. As mentioned, the diverse nature of the different financial instruments concerned is reflected in the text of the proposed draft RTS and will, to a greater extent, be reflected through the practical application of the rules. The differences between the instruments will play a significant role in the moment of application of the rules, e.g. what constitutes a significant undue risk may differ when considering access (to CCPs or trading venues) in relation to, for example, blue chips or power derivatives.
6. Additionally, ESMA notes that although the legal text of the empowerments in both Articles 35 and 36 of MiFIR is very similar, in practice they impact CCPs and trading venues differently.

4.3.2 Conditions under which an access request may be denied by a CCP to a trading venue – Article 35(6)(a)

Anticipated volume of transactions

7. Article 35 of MiFIR recognises that by providing access to a trading venue, the volume of transactions cleared by a given CCP may substantially increase and is possible grounds for a CCP to deny access. It is therefore important for CCPs to consider their systems'

operational reliability and scalable capacity and, indeed, EMIR requires CCPs to have adequate scalability¹⁷.

8. In the DP and CP, ESMA consulted on whether Article 35 of MiFIR, envisages a situation in which the expected growth in volume arising from granting access is so substantial that it exceeds the capacity planning of the CCP (i.e. the design of the CCP's systems, including hardware and software, will not be able to cope with the anticipated volume of transactions) and how that situation could be addressed.
9. The majority of respondents agreed that exceeding the capacity of the CCP could be grounds to deny access. It is important to mention that the increase in the foreseeable flow would have to be so substantial that the CCP would not in due time be able to acquire the necessary dimension to cope with it, such that granting access would leave significant undue risks.
10. Furthermore, the majority of respondents advised against setting a precise threshold (e.g. foreseeable increase/current capacity), as it is not a continuous function of a CCP's clearing service to increase its systems scalable capacity and depending on the particular circumstances of a given CCP, coping with the same increase in transaction flow could imply significant investments or none at all.
11. ESMA is of the view that, taking into account the EMIR regulatory requirements on CCPs, to deny access CCPs will need to demonstrate what capacity they have installed, (in use and idle) as well as their ability to increase capacity, the foreseeable increase in flow and how the concrete increase in flow could not be manageable in a given timeframe, i.e., why and how the CCP would not be able to acquire the needed capacity, so that granting access would, therefore, leave a significant undue risk.
12. On the slightly different question of the determination of the anticipated volume of transactions respondents to the public consultations also mentioned that the foreseeable increase in flow should be assessed by looking at the business case on the basis of current and historical volumes of comparable data and a forecast on the share that is likely to migrate following the access agreement.
13. On the question of other risks related to the anticipated volume of transactions, respondents identified the need to cater for the costs of granting access, the time spent considering access requests and the relationship with clearing members. A significant number of respondents to the public consultations were more concerned by a request for access which would bring low volumes, as the CCP would incur costs and could not expect to recover them easily. Whilst this may be a legitimate concern, ESMA notes that

¹⁷ Pursuant to Article 26(9) EMIR, Article 9(1) of the Commission Delegated Regulation (EU) No 153/2013, of 19 December 2012 specifies that "The systems shall be designed to deal with the CCP's operational needs and the risks the CCP faces, be resilient, including in stressed market conditions, and be scalable, if necessary, to process additional information. The CCP shall provide for procedures and capacity planning as well as for sufficient redundant capacity (...)"

the risk the CCP would be incurring would be a financial one, i.e., eventually entering into a less profitable agreement. ESMA notes further that CCPs are able to recover some one-off and on-going costs stemming from access. Some respondents also mentioned the need for the access arrangement to encompass access to the exchange operated warehouse.

14. Notwithstanding the obvious interest of these aspects, ESMA notes that they cannot be catered for under Article 35(6)(a) of MiFIR. In the particular case of costs, ESMA is considering them under “other factors creating significant undue risk” but notes that it has otherwise only a considerably limited empowerment in Articles 35(6)(b) and 36(6)(b). Regarding the other issues there is no empowerment under which ESMA could act.

Number and type of users

15. Article 35 of MiFIR also considers the number and types of users as possible grounds for a CCP to deny access. By providing access to a trading venue, the number of users connected to the CCP may substantially increase. ESMA consulted on whether similar considerations to the ones under anticipated volume of transactions would be relevant in this remit.
16. Regarding the number of users, several respondents to the DP made the point that where users would demand individually segregated accounts (ISA) in accordance with Article 39 of EMIR this could cause problems for the CCP in terms of managing those accounts.
17. ESMA fails to understand how the CCP would not be able to manage an increase in the number of ISAs and still be in compliance with its requirements under EMIR.
18. The public consultations did not yield an identification of additional risks from the types of users accessing a CCP that could arise from an access arrangement.
19. With that in mind, ESMA keeps the approach proposed this far and does not consider types of users as grounds to deny access. Granting access to a trading venue does not, in itself, entail automatic membership of the CCP for market participants. The general legal framework applies and nothing suggests that CCPs should lower their membership eligibility criteria as a result of granting access.
20. For direct access CCPs must comply with Article 37 of EMIR, which allows for fair and open access to the extent that it does not expose the CCP to additional risks. Article 37 of EMIR also requires that CCP rules allow for relevant concentrations of risks relating to the provision of services to clients to be identified, monitored and managed.

Arrangements for managing operational risk and complexity

21. Having asked market participants how a CCP would establish that the anticipated operational risk would exceed its operational risk management design and what other risks should be considered in this respect, ESMA received very comprehensive and detailed lists of the possible relevant risks.
22. A significant number of respondents advocated for a more tightly drawn list of grounds to deny access, and others proposed a larger array of grounds and open-ended lists. Many of the arguments repeated those made in responses to the DP.
23. It should be once more noted that ESMA's empowerment relates to risks that simultaneously (i) are created by granting access, (ii) cannot be managed and (iii) pose significant undue risks to the CCP. When analysing the several types of operational risks listed by market participants, ESMA came to the conclusion that most of them are either already covered in ESMA's proposal (e.g. settlement arrangements), or would not pass the three criteria above. For example, it should be possible for a trading venue requesting access and for the CCP to work together to align their processes and manage the risks so that the request for access would not be denied on the grounds of incompatible business continuity plans or straight through processing (STP).
24. Accordingly, ESMA identified the following as relevant risks:
 - i. the incompatibility of CCP and trading venue IT systems such that the CCP cannot provide for connectivity between the systems; and
 - ii. the fact that the CCP does not have, nor is it able to get in due time, the necessary human resources with the necessary knowledge, skills and experience to perform its functions regarding the risks stemming from additional financial instruments where these differ from financial instruments already cleared by the CCP. Obviously, this could not be applicable when the request for access is for clearing instruments that the CCP is already clearing.
25. Special mention should be made of two categories of risks that were widely mentioned by respondents in the two rounds of consultation which ESMA did not acknowledge as relevant for denying access for different reasons. Those risks relate to the need for trading venues to fulfil position management control obligations under Article 57(8) of MiFID II, and the risks relating to the allegedly insufficient quality control of checks performed by the counterparty relating to its institution regarding money laundering, the financing of terrorism and other aspects.
26. ESMA acknowledges that both risks may be important, contesting however their ability to be the grounds on which access is denied. In the context of position management controls, as required under Article 57(8) of MiFID II, if a CCP nets commodity derivative contracts, then a trading venue's ability to fulfil its obligations regarding the application of position management controls will be highly dependent on collaboration with the CCP to obtain relevant information. ESMA considers that the CCP has to engage with each

trading venue in information sharing agreements to enable the latter to meet its regulatory obligations and the extra work involved in meeting the requirement to apply position management control cannot in itself be the basis for refusing access.

27. Regarding the alleged lower standard of quality control of checks performed by the counterparty to the access agreement, ESMA does not accept this as grounds to refuse access as the relevant quality controls are the ones stemming from existing legislation. Regarding these, both regulated entities are subject to supervision and CAs will supervise compliance with regulatory requirements. Furthermore, CAs have a specific role to play in terms of an access request that will be analysed below.
28. Having considered the proposals in the responses, ESMA clarified the drafting to better reflect the overarching principle that access should be granted unless despite best efforts to manage them access would lead to significant undue risk.

Other factors creating significant undue risks

Authorisation under EMIR

29. Risk management is an important function for CCPs. ESMA therefore believes that CCPs may deny access on grounds related to other factors that would lead to significant undue risk, for example, when access would prevent the CCP from being able to comply with relevant requirements it is subject to. Article 14(3) EMIR specifies that the authorisation of a CCP should specify the services or activities which the CCP is authorised to provide or perform, including the classes of financial instruments covered by such authorisation. Additionally, although there are a number of prudential requirements CCPs will have to ensure they comply with on an on-going basis¹⁸, CCP risk-management frameworks will vary depending on the services or activities, including the classes of financial instruments, which the CCP is authorised to provide or perform. Article 35(2) of MiFIR states that a trading venue requesting access to a CCP should specify to which types of financial instruments access is requested. In the CP, ESMA proposed that CCPs should request the necessary authorisation if receiving an access request concerning financial instruments for which it is currently not licensed.
30. Many respondents considered this proposal as too far-reaching. In light of responses to the CP the proposal has been revised so that a CCP should be able to deny access where it would not be able with reasonable efforts to launch a clearing service for the new instruments compliant with the requirements of EMIR. This way not only a full correspondence is ensured between the mandate to provide access and the necessary risk management CCPs have to perform under EMIR, but a better balance is struck

¹⁸ For example, and from an IT perspective, Article 26.6 EMIR requires CCPs to maintain “information technology systems adequate to deal with the complexity, variety and type of services and activities performed so as to ensure high standards of security and the integrity and confidentiality of the information maintained”.

between the MiFIR command to provide access and the legitimate position of someone who has to grant access.

Relevance of costs

31. Separately, CCPs may incur significant costs to facilitate access. Although Article 35 of MiFIR does not make any explicit reference to costs, ESMA's preliminary view was that where such costs would threaten the viability of the CCP as a standalone entity that would be considered a significant undue risk and can be used as grounds to deny access. This view was not challenged in the public consultation. Following responses to the consultations, ESMA has maintained the requirement in the draft RTS specifying that a CCP may deny access when access would threaten its ability to meet its minimum capital requirements under Article 16 of EMIR.
32. Due to the formulation of MiFIR, and responding to another proposal from stakeholders, ESMA believes that any further consideration of cost would not be in accordance with the decision by the co-legislators as it is the stated aim of Articles 35 and 36 of MiFIR to eliminate other restrictions on access than the ones based on significant undue risk.

Legal risks

Conflicts of law

33. In cross-border, as well as some national contexts, different bodies of law can apply to a single transaction, including to the parties to that transaction.
34. Most respondents to the DP broadly agreed with ESMA that conflicts of law could in certain circumstances lead to unmanageable significant undue risks. Therefore, ESMA proposed in the CP to encompass two situations of legal risks: the inability of a CCP to enforce its rules relating to close out netting and default procedures, and the inability to manage the risks arising from the simultaneous use of different trade acceptance models.
35. Most respondents broadly agreed that conflicts of law could in certain circumstances lead to unmanageable significant undue risks, while acknowledging at the same time that conflicts of law that could lead to refusing access would be rare within the EEA, quoting live examples of currently operational access agreements. There were, however, several respondents who stated that conflicts of law cannot be totally excluded within the EEA as some areas of law are not sufficiently harmonised. In this context insolvency law, which is covered in the paragraph above by reference to the enforceability of close-out netting, and indirect clearing were mentioned. ESMA does not rule out the possibility that conflicts of law could lead to a refusal, but expects the cases to be rare and has therefore maintained its proposal.

Incompatibility between CCP and trading venue rules

36. Following feedback to the DP, ESMA proposed in the CP an additional source of significant undue risk that could arise from granting access, i.e., the incompatibility of trading venue and CCP rules beyond remedial action. This approach has been maintained.
37. In fact, granting access needs to rely on the frictionless interplay of the two institutions, each of them performing their role. Should it not be possible to achieve this collaboration due to incompatibility in the respective rules that cannot be avoided, it is possible for a CCP to deny access.

4.3.3 Conditions under which an access request may be denied by a trading venue to a CCP – Article 36(6)(a) of MiFIR

38. Article 36 of MiFIR provides that a trading venue may be allowed to deny access to a CCP on the grounds of the anticipated volume of transactions, the number of users, arrangements for managing operational risk and complexity or other factors creating significant undue risks.

Conditions based on the anticipated volume of transactions and the number of users

39. ESMA asked for views of market participants on how the factors above could constitute grounds for denying access, being unclear on how to take account of them, because in terms of providing access they are less relevant for trading venues than they are for CCPs. The consultations failed to yield significant input in this regard. ESMA has not yet identified how granting access to a new CCP would impact a trading venue in such a way that it would have to deny access on reasonable risk grounds, i.e. it is not clear how granting access to a CCP would cause users of the trading venue to change their trading behaviour to the extent that it would put the trading venue at risk.
40. It is not obvious that the availability of more clearing options, i.e. granting access, would directly translate into more flow upstream in the trading venue. The responses to the consultation do not identify such a link. ESMA is therefore not acknowledging these situations as giving rise to significant undue risks that would justify denial of access by a trading venue.

Arrangements for managing operational risk and complexity

41. As for CCPs, ESMA considers that IT incompatibility could in certain circumstances impede granting access. The same considerations as above on CCPs apply mutatis mutandis.

Other factors creating significant undue risks

42. As above, trading venues may incur significant costs to facilitate access, and ESMA believes that where such costs would threaten the viability of the trading venue, as a standalone entity, that would be considered a significant undue risk and can be used as grounds to deny access. According to the results of the public consultations ESMA is enlarging its original proposal to also encompass denial of access when as a result of granting access a trading venue cannot meet its minimum capital requirements under Article 47(1)(f) of MiFID.
43. Also in parallel to ESMA's proposal on CCPs, and according to the received feedback, ESMA is acknowledging that incompatibility of trading venue and CCP rules beyond remedial action may be grounds for denying access.
44. Lastly in cross-border, as well as some national contexts, different bodies of law can apply to a single transaction, including to the parties to that transaction. ESMA believes that potential legal risks, including the compatibility of different legal regimes, are less relevant for trading venues than they are for CCPs. Having consulted on this aspect, respondents have not been able to identify situations beyond those identified above (incompatibility of rules) where granting access could increase such risks. ESMA therefore maintained the CP approach.

4.3.4 Conditions under which granting access will threaten the smooth and orderly functioning of the markets or would otherwise adversely affect systemic risk

Background/Mandate/Empowerment

Article 35(6)(c) and 36(6)(c) of MiFIR

ESMA shall develop draft regulatory technical standards to specify:

(c) the conditions under which granting access will threaten the smooth and orderly functioning of markets or would adversely affect systemic risk;

45. Articles 35(6)(c) and 36(6)(c) of MiFIR require ESMA to further specify the conditions under which granting access will threaten the smooth and orderly functioning of the markets or would adversely affect systemic risk.

Analysis following feedback from stakeholders and proposal

46. The CAs will assess whether granting access is likely to threaten the smooth and orderly functioning of the markets or adversely affect systemic risk. ESMA notes that MiFIR

requires CAs to make this assessment before any access arrangement has been agreed, and it will base its assessment on the conditions at the time and how it expects them to evolve. If things develop in an unexpected way and a CA at a later stage assesses that increased risks might threaten the smooth and orderly functioning of the markets or adversely affect systemic risk, it may take necessary action, which may result in requiring termination of the access arrangement.

47. Respondents mentioned in the two rounds of consultation the need to control all sorts of risk (which is already mandated by MiFIR/MiFID and EMIR requirements), concerns regarding outages due to the trading venue's unreliable service (this risk should be managed through the fact that trading venues will need to comply with various organisational requirements under MiFID II and where there is still a risk it is already covered by denial of access on the grounds of operational risk) and technology requirements related to front running of trades on different trading venues due to different latency times between each trading venue (an aspect that is not particular to access). Another respondent mentioned that access could impede innovation and competition; however, it would be impossible for a CA to make a judgement in this respect and about whether such a risk could threaten the smooth and orderly functioning of the markets or adversely affect systemic risk.
48. In the CP, ESMA proposed that a CA should deny access when:
 - i. the CCP or trading venue involved in the proposed access arrangements was not meeting its legal obligations or would be unlikely to meet its obligations as a consequence of entering an access agreement;
 - ii. granting access would create risks for one of the participants in a way that would have a wider negative impact on the market; and
 - iii. there was no remedial action that could be taken to allow the relevant party to meet its obligations.
49. Many of the responses to the CP questioned why the three conditions were cumulative, and questioned the approach of basing the criteria on compliance with legal obligations rather than with risk management. In the light of these responses, ESMA reformulated its approach to identifying when granting access would threaten the smooth and orderly functioning of the markets or would adversely affect systemic risk. The revised approach is more focused on risk considerations. Accordingly, in addition to liquidity fragmentation, CAs should block an access agreement where the risk management procedures of one or both parties are insufficient to prevent the access agreement creating significant undue risks to third parties and there is no remedial action that would adequately mitigate these inadequacies.

4.3.5 Conditions under which access is granted

Background/Mandate/Empowerment

Article 35(6)(b) of MiFIR

MiFIR ESMA shall develop draft regulatory technical standards to specify:

- (e) conditions for non-discriminatory treatment in terms of how contracts traded on that trading venue are treated in terms of collateral requirements and netting of economically equivalent contracts and cross-margining with correlated contracts cleared by the same CCP*

Article 36(6)(b) of MiFIR

MiFIR ESMA shall develop draft regulatory technical standards to specify:

- (b) the conditions under which access shall be granted, including confidentiality of information provided regarding financial instruments during the development phase and the non-discriminatory and transparent basis as regards fees related to access.*

General terms of access conditions

CP proposal

50. In the DP ESMA proposed a list of minimum requirements for the terms of an access arrangement in order to specify rights and obligations of the parties. In addition to general access specific requirements, ESMA suggested that parties to an access arrangement should also put in place specific policies, procedures and systems to enhance communication, ensure confidentiality and reduce potential risks.
51. Leveraging on the feedback to the DP, some additional conditions were in the CP added to the catalogue of conditions under which access is granted:
 - i. the parties have to specify the instruments subject to the access arrangements;
 - ii. specification of the cover of the one-off and ongoing costs triggered by the access request; and
 - iii. specification of provisions to deal with claims and liabilities stemming from the access arrangements.

Analysis following feedback from stakeholders

52. Respondents generally supported the catalogue of conditions under which access was granted. However, some respondents sought clarifications and suggested some additions. ESMA assessed those comments and, where appropriate and feasible, added them to the relevant text of Article 9 of the draft RTS. For example, the moment of entry of transfer orders was specified. On the other hand, some proposals were not included in the list of conditions, such as the impact of cyber security breaches and sanctions, as this is deemed to be an issue not specific to access conditions. Article 9(1)(d) and (e) were deleted, because they are considered to be not covered by the empowerment and to be redundant.
53. A few respondents suggested that the allocation of costs should be determined in the draft RTS and/or that the applying party should cover costs of access. From ESMA's point of view, the allocation of the costs is not covered by the Level 1 empowerment and should be left to the negotiations of the access parties.
54. Some respondents criticised the possibility of a termination of the access arrangement "in case a risk increases in a way that would have justified denial of access in the first instance" in the CP version. ESMA considers that this provision reflects a general legal principle common in many authorisation proceedings in capital market law and therefore left the proposal in this regard unamended.

Fees charged by CCPs and trading venues

CP proposal

55. According to Article 35(6)(b) of MiFIR, a CCP has to charge clearing fees on a transparent and non-discriminatory basis. In the CP ESMA identified fees charged by a CCP to its clearing members for clearing transactions that take place on a trading venue to which it has granted access as relevant in this context.
56. The CP proposed that non-discrimination in this context implied objective criteria for all clearing members regardless of the trading venue where the transaction takes place. Furthermore all clearing members should be subject to the same fee and rebate schedule, not just a subset of them.
57. According to Article 36(6)(b) of MiFIR, a trading venue has to charge fees related to access on a transparent and non-discriminatory basis. In line with the requirements set out above, the requesting CCPs should be subject to the same fee and rebate schedule as other CCPs accessing the trading venue for the same or similar instruments. The CP pointed out, that the relevant parties are not required to charge identical fees, if a different basis can be objectively justified.

58. Transparency in both cases should mean that all fees are easily accessible, adequately identified per service provided and sufficiently granular to ensure predictability. The terminology is already used in Article 38 of Regulation (EU) No 648/2012 (EMIR).
59. According to the CP, transparency in both cases should mean that all fees are easily accessible, adequately identified per service provided and sufficiently granular to ensure predictability.
60. The CP refrained from specifying a catalogue of relevant fees, since this could be misleading and incomplete. The proposal therefore does not include a list of specific types of fees, but requires that all fees related to access be non-discriminatory and transparent in line with the level 1 text. One-off and ongoing costs of the access arrangement should be included in the fees charged by CCPs and trading venues in this context. However, the CP did not specify which party has to cover these costs, because this issue is not part of the Level 2 mandate and should be left to the negotiation of the involved parties.

Analysis following feedback from stakeholders

61. Respondents generally agreed with the proposal. However, specific remarks and proposals for amendments differ alongside the two stakeholder groups: parties seeking new access possibilities promote wordings which facilitate (low cost) access as much as possible, while some respondents, especially with integrated subsidiaries in a group, stress the need to differentiate regarding the fee schedule in order to cover their costs by fees. The major suggestions were the following:
 - i. ESMA should clarify whether schedule of fees or fees themselves must be the same.
 - ii. Additional measures should be implemented to prevent circumvention by shifting fees from trading to clearing or vice-versa in a corporate family.
 - iii. Some respondents believe, that ESMA's mandate is limited to prescribe fees "related to access" or "clearing fees", and not fees in general.
 - iv. "Non-discriminatory fees" should not be treated as meaning "same fees"
 - v. The costs of connectivity, ongoing operational and strategic development should be taken into consideration, different treatment should be possible as long as there is a rationale.
 - vi. Fee schedules should be available to its members, but not publicly available, and fees charged should be determined as "ascertainable" rather than "predictable".

62. ESMA's maintains the draft RTS as it was consulted upon; the wording strikes a constructive balance between the legitimate positions expressed¹⁹.

4.3.6 Conditions for non-discriminatory treatment of contracts

Conditions for non-discriminatory treatment of contracts

Background/Mandate

Article 35(6)(e) of MiFIR

(e) conditions for non-discriminatory treatment in terms of how contracts traded on that trading venue are treated in terms of collateral requirements and netting of economically equivalent contracts and cross-margining with correlated contracts cleared by the same CCP

63. ESMA has been given the mandate to specify the conditions for non-discriminatory treatment where a CCP grants access to a trading venue with regard to three aspects:

- i. collateral requirements of economically equivalent contracts,
- ii. netting of economically equivalent contracts,
- iii. cross-margining of correlated contracts.

Analysis following feedback from stakeholders

64. **Definition of economically equivalent contracts:** Following the call for guidance on how to determine what contracts traded on different venues can be considered economically equivalent, as emerged from the responses to the first consultation on the DP, ESMA introduced in Article 1(1) of the draft RTS annexed to the CP (renumbered Article 12(1) in the draft RTS 15 in the Annex to this Final Report) a general principle

¹⁹ Although it is recognized, that the wording of Level 1 leaves room for different interpretation: while Art. 35 para 1 MiFIR states "fees relating to access", Article 35, paragraph 6 (b) MiFIR gives the RTS empowerment with regard to "clearing fees". However, the term "related to access" is reflecting the non-discriminatory treatment of other TV's and their members with regard to clearing fees; from ESMA's point of view, Level 1 provides a wide definition of clearing fees, which includes fees "related to access": this is reflected in the wording of Art. 9 para 5 of the RTS draft, which includes one-off and ongoing costs. Article 9 and 10 of the RTS proposal do not require "same fees", as some respondents suggest. This is reflected in the possibility to differentiate when this is objectively justified (Article 9 paragraph 3), which is in line with the requirement of a non-discriminatory treatment. The question of public availability is dealt with in Article 9 paragraph 4 and Article 10 paragraph 2 in alignment with the terminology in Article 38 of EMIR.

according to which “a CCP shall consider economically equivalent all contracts traded on the trading venue to which it has granted access, which are covered by the CCPs’ initial authorisation referred to in Article 14 of Regulation (EU) No. 648/2012 (EMIR), or by any subsequent extension of authorisation referred to in Article 15 of EMIR.”

65. While several respondents to the CP agreed with the draft provision in Article 11(1) of the draft RTS, other respondents were concerned with the wide scope of contracts that the reference to the current authorisation of a CCP could involve. Some of these responses reflected a misinterpretation of the approach proposed, highlighting the need to fine tune the draft language of Article 11(1) of the CP version of the draft RTS to clarify that:
- i. The CCP shall determine whether a contract traded on the trading venue to which it has granted access is economically equivalent to those contracts it clears.
 - ii. Two contracts shall be considered economically equivalent when belonging to the same class of financial instruments and present the same risk characteristics for consistency with the approach used in Article 24(4) of Commission Delegated Regulation 153/2013 supplementing EMIR (RTS on CCP requirements).
 - iii. Where a contract traded on the trading venue to which a CCP has granted access belongs to a class of financial instruments that the CCP is already authorised to clear, that contract shall be considered economically equivalent to the corresponding contracts in the same class of financial instruments already cleared by the CCP.
 - iv. Given that a CCP may clear both OTC and exchange-traded contracts, non-discriminatory treatment of economically equivalent contracts traded on a trading venue requesting access to a CCP should take into account all relevant contracts already cleared by that CCP, irrespective of where the contracts are traded.
66. **“Economically equivalent” versus “correlated” contracts:** Some other respondents instead suggested adopting a stricter definition of economically equivalent contracts based on the definition of correlated contracts provided in Article 27(1) of EMIR RTS on requirements for CCPs²⁰. ESMA considered it inappropriate to use the same definition for both economically equivalent contracts and correlated contracts. The legislator explicitly referred to economically equivalent contracts with respect to collateral requirements and netting, but to correlated contracts with regard to portfolio margining – implying that the two concepts (economically equivalent contracts and correlated contracts) are different from each other and, thus, cannot share the same definition.

²⁰ Commission Delegated Regulation (EU) No 153/2013 of 19 December 2012 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on requirements for central counterparties.

67. ESMA thus confirms the approach proposed in the CP, subject to some fine-tuning of the language of Article 11(1) of the draft RTS, to clarify the points listed above. ESMA believes that the introduction of any deterministic definition of economically equivalent contracts would not be sufficiently dynamic to adjust to future market developments. Moreover, it is noted that Article 35(6)(e) of MiFIR did not mandate ESMA to develop a definition of economically equivalent contracts. The approach proposed in the finalised draft is consistent with the mandate received.

Collateral requirements of economically equivalent contracts

68. On the first aspect of collateral requirements of economically equivalent contracts, several respondents agreed on the approach ESMA proposed in the CP, according to which the CCP should apply to the economically equivalent contracts executed on the trading venue to which it has granted access the same margin and collateral methodologies as applied to economically equivalent contracts already cleared by the CCP, while leaving the CCP with the possibility of introducing changes to models or parameters regarding economically equivalent contracts to mitigate the respective risk factors of these contracts or of the trading venue where the contracts are executed. These respondents also agreed on the principle that, to ensure a non-discriminatory treatment, these changes to models or parameters shall be subject to a review by the Risk Committee of the CCP and be considered significant changes for the purpose of the review procedure referred to in Article 49 of EMIR.

69. **“Same” versus “non-discriminatory”**: Other respondents challenged the language of the draft Article 11(2) of the draft RTS, arguing that Article 35(6)(e) of MiFIR did not mandate to apply the “same” margin and collateral requirements and, therefore, suggesting to replace the term “same” with the term “non-discriminatory”. This proposal would however not fulfil the mandate in Article 35(6)(e) of EMIR, as the so-revised Article 11(2) of the draft RTS would not specify any conditions for the non-discriminatory treatment of economically equivalent contracts. On the contrary, the draft Article 11(2) of the draft RTS stipulates that non-discriminatory treatment is achieved if the same margin and collateral methodologies in place are applied, or if changes to cope with the risk characteristic of the trading venue(s) or of terms of a specific contract are introduced under the review procedure referred to in Article 49 of EMIR.

70. With reference to the examples some respondents brought forward, it should be noted that the draft Article 11(2) does not require a CCP to apply the same margin and collateral requirements to economically equivalent contracts, but the same margin and collateral methodologies. This implies that two economically equivalent contracts with different terms and risk characteristics may finally have different final margin requirements. Indeed, the same methodology applied to the two contracts will consistently consider the specific contract terms and the appropriate parameters, thus, leading to different end-results in terms of margin requirements. Moreover, if the existing margin models and parameters are not adequate to cope with the risk characteristics of

a specific economically equivalent contract, the CCP has to introduce the appropriate change to ensure compliance with the relevant EMIR requirements and the own risk appetite.

71. ***Proportionality of review procedure under Article 49 of EMIR***: a minority of the respondents criticised that the review procedure under Article 49 of EMIR would be disproportional and cumbersome. These respondents were concerned that a CCP could rather accept additional risk by applying to new economically equivalent contracts the existing methodologies instead of introducing any necessary changes, just to avoid the above-mentioned review procedure. It should, however, be clarified that CCPs shall at all-times comply with EMIR requirements and any grant of access should be without prejudice to the compliance with EMIR. Therefore, a CCP cannot omit to introduce changes to models and parameters where required to ensure compliance with EMIR and with the CCP's own risk policies. The CA through its supervisory activity shall ensure that changes will be introduced as appropriate. Furthermore, ESMA believes that the review procedure under Article 49 of EMIR can be expedited within the timeframe given to the CCP to grant access under MiFIR.
72. In light of the explanations above, ESMA confirms the approach proposed in Article 11(2). ESMA also takes note of the need to clarify that, where the CCP will adopt the necessary changes to its models and parameters in order to cope with the specific risk factors of a trading venue or specific contracts, that changes shall be adopted before accepting these contracts for clearing.

Netting of economically equivalent contracts

73. On the second aspect around the netting of economically equivalent contracts, several respondents supported ESMA's approach in the CP, according to which, a CCP shall apply to economically equivalent contracts the same netting processes already in place, irrespective of where the contracts are executed - provided that the applied netting process is valid, binding and enforceable in compliance with the Settlement Finality Directive (SFD) and the relevant applicable insolvency law. However, it remains that the CCP may exclude such contracts from a netting process where the legal risk or the basis risk related to that netting process applied to an economically equivalent contract traded on different trading venues is not sufficiently mitigated. These respondents also agreed on the principle that, to ensure a non-discriminatory treatment, changes to the netting process shall be considered as significant changes that shall be subject to a review by the Risk Committee of the CCP and be subject to the review procedure referred to in Article 49 of EMIR.
74. Other respondents raised several concerns with respect to the proposed draft Article 12, which are summarised as follows:
- i. ***"Same" versus "non-discriminatory"***: Consistently with the feedback provided on Article 11(2), some respondents challenged the language of the draft Article 12(1),

arguing that Article 35(6)(e) of MiFIR did not mandate to apply the “same” netting process and, therefore, suggesting to replace the term “same” with the term “non-discriminatory”. As argued above, this proposal would however not fulfil the mandate in Article 35(6)(e) of EMIR, as the so-revised Article 11(2) would not specify any conditions for the non-discriminatory treatment of economically equivalent contracts. On the contrary, the draft Article 12(1) stipulates that non-discriminatory treatment is achieved if the same netting processes in place at the CCP are applied to economically equivalent contracts, or if changes to the netting process to cope with the risk factors of the trading venue(s) or of a specific contract are introduced under the review procedure referred to in Article 49 of EMIR.

- ii. **Netting validity for CRDIV/CRR and IAS 32:** Some respondents reiterate a comment already conveyed in responses to the DP, stressing that netting (be that via position offsetting, pre-default payment netting or close-out netting) shall be valid, binding and enforceable not only in compliance with the SFD and the relevant insolvency law, but also for the purpose of regulatory capital requirements under the Capital Requirement Directive and Capital Requirement Regulation (CRD IV and CRR) and for balance sheet netting purposes under IAS 32. No reference to the CRDIV and CRR and IAS 32 was included in the draft Article 12(1) of the RTS because Article 35 of MiFIR generically refers to “*the smooth and orderly functioning, the validity or enforceability of netting procedures*” and the feedback received did not include sufficient analysis in support of this proposal, which was considered going beyond the mandate of Article 35(6)(e) of MiFIR. In reiterating this comment, the respondents again did not provide sufficient evidence for the need of such reference. It is noted though that according to Article 12(2), if the CCP considered that the application of a particular netting procedure to specific economically equivalent contracts would raise significant legal risk, for instance, where relevant, in relation to regulatory capital requirements under CRD IV and CRR and balance sheet netting purposes under IAS 32, that CCP can still adopt a change to its models excluding the applicability of that particular netting procedure to that specific economically equivalent contracts. In line with the proposed RTS, this change should be subject to the review procedure referred to in Article 49 of EMIR. ESMA thus concluded that no explicit reference to CRD IV and CRR or IAS 32 is required.
- iii. **Basis risk:** Conflicting views have been expressed on the reference to basis risk in Article 12(2) of the draft RTS. While supporters of the overall approach noted that the reference to basis risk was not included in Article 35 of MiFIR and thus challenged whether the draft Article 12(2) was going beyond the mandate of the Article 35(6)(e); other respondents challenging the overall approach welcomed the inclusion of the reference to basis risks but challenged the definition provided in Article 12(4) of the draft RTS. ESMA included the reference to basis risk in Article 12(2) as follow-up to the responses to the DP which highlighted that in circumstances where basis risk cannot be eliminated (e.g. for exchange-traded

derivatives traded on different trading venues), the netting of economically equivalent contracts could expose the CCP to undue risk. ESMA considers that no regulatory obligation should impose on a CCP any uncovered risk; therefore, the reference to basis risk was introduced in Article 12(2) of the draft RTS as an additional risk consideration that would allow a change to the netting process to be considered as non-discriminatory. With reference to the definition of basis risk, Article 12(4) replicates the definition in Article 1(1) of EMIR RTS on requirements for CCPs. To ensure consistency between the MiFIR and EMIR frameworks, the two definitions shall coincide. As no alternative definition was proposed along the critics to the current definition in the context of the response to the CP, ESMA concluded that the definition in Article 12 can remain unchanged.

- iv. ***Trading Venues' obligations under MiFID II around market surveillance and positions management.*** Some trading venues challenging the overall approach proposed in Articles 11-13 of the draft RTS also noted that the application of netting processes should not endanger the trading venues' ability to perform their obligations under MiFID II around market surveillance and position management. In this context, the trading venues requested to distinguish the netting treatment of exchange-traded derivatives from OTC derivatives, transferable securities and other instruments and to allow CCPs an increased level of flexibility in netting exchange-traded derivatives. ESMA considers that this is a relevant issue that can be addressed under Article 8(2) of the draft RTS, dealing with the terms of the access agreement between the CCP and the trading venue(s).
- v. ***Proportionality of review procedure under Article 49 of EMIR.*** Consistently with the feedback provided on Article 11(2), a minority of the respondents criticised the reference in Article 12(3) to the review procedure under Article 49 of EMIR, which has been considered as being disproportional and cumbersome. These respondents were concerned that a CCP could rather accept additional risk by netting economically equivalent contracts instead of introducing any necessary changes to the netting process, just to avoid the above-mentioned review procedure. It should, however, be clarified that CCPs shall at all times comply with EMIR requirements and any grant of access should be without prejudice to the compliance with EMIR. Therefore, and in line with Article 12(1) of the draft RTS, a CCP cannot apply a netting process which is not valid, binding and enforceable and, in line with Article 12(2) of the draft RTS, a CCP shall not apply a netting process exposing the CCP to uncovered legal or basis risk. The CA through its supervisory activity shall ensure that any netting process will be applied as appropriate. Furthermore, ESMA believes that the review procedure under Article 49 of EMIR can be expedited within the timeframe given to the CCP to grant access under MiFIR.
- vi. ***ESMA Guidelines and Recommendations for netting:*** very few respondents suggested ESMA to issue Guidelines and Recommendations for netting. ESMA would not suggest including a draft provision in the Article 12 of the draft RTS

mandating ESMA to issue guidelines and recommendations for netting. ESMA has a legal basis in its founding regulation and EMIR to issue guidelines and recommendation on this matter, if necessary.

75. In light of the explanations above, ESMA confirms the approach proposed in Article 12 of the the draft RTS. ESMA also took note of some drafting suggestions aiming at clarifying that i) if a particular netting process is excluded in line with Article 12(2), other netting processes can still be applied, and ii) where the CCP will adopt the necessary changes to its models to exclude a particular netting procedure in accordance to Article 12(2), these changes shall be adopted before accepting these contracts for clearing. Finally, in order to realign the text of the draft Article 12 with Article 35 of MiFIR, the term netting “process” is replaced with netting “procedure”.

Cross-margining of correlated contracts (portfolio margining)

76. On the third aspect of cross margining, the respondents largely agreed on the approach proposed in Article 13 of the draft RTS, according to which, in order to ensure non-discriminatory treatment for cross margining with correlated contracts, the CCP shall apply its portfolio margining approach to all relevant correlated contracts (in compliance with Article 41 of EMIR and Article 27 of the RTS on CCP requirements) irrespective of where the contracts are executed.
77. Some respondents suggested amending the language of Article 13 of the draft RTS to add that the portfolio margin approach shall be applied in a non-discriminatory manner. As mentioned in the CP, ESMA noted that the non-discriminatory treatment means these contracts traded on a different trading venue would benefit from the same offsets or reductions as the contracts with significant and reliable correlation, or an equivalent statistical parameter of dependence, already cleared by the CCP.
78. ESMA thus confirms the approach proposed in Article 13 of the draft RTS.

Proposal

79. ESMA confirms the approach proposed in Articles 11 and 13 of the draft RTS (renumbered Articles 12 and 14 in RTS 15 annexed to this Final Report), subject to specific amendments addressing the concerns emerged from the responses to the CP.

4.3.7 Notification procedure and calculation of notional amount with regard to transitional provisions

Background/Mandate/Empowerment

Article 35(6)(d) of MiFIR

ESMA shall develop draft regulatory technical standards to specify:

(c) the procedure for making a notification under paragraph 5.

Article (36(6)(d) of MiFIR

ESMA shall develop draft regulatory technical standards to specify:

(d) the procedure for making a notification under paragraph 5, including further specifications for calculation of the notional amount and the method by which ESMA may verify the calculation of the volumes and approve the opt-out.

Notification procedure

CP proposal

80. Articles 35(5) and 36(5) of MiFIR recognise the potential difficulty for newly established CCPs and smaller trading venues to be able to comply with the access obligations from the application of MiFIR, and therefore allow, under specific circumstances, transitional provisions for a temporary exemption to comply with the obligations for a thirty month period. In the case of Article 36 of MiFIR, the exemption requires the relevant trading venue to be under the threshold of €1,000,000 million annual traded notional amount in exchange-traded derivatives.
81. Due to possible implications for other entities and supervisory authorities, especially with regard to reciprocal effects, opting-out CCPs and trading venues have to undergo a notification procedure involving their national CA and, where relevant, ESMA. In relation to opting-out CCPs, relevant CA must also notify ESMA and the CCP college of their decision regarding any approvals of a transitional. ESMA consulted in the CP on the draft RTS specifying this procedure with a focus on the templates in Annex I to ensure a harmonised application.

Analysis following feedback from stakeholders and proposal

82. Respondents provided strong support for the proposal and suggested only minor amendments: following one suggestion, the information about the authorisation of the entity is not part of the template anymore, as the CA already has the relevant knowledge. Some other minor suggestions, e.g. the timeline of the transitional arrangement, were not incorporated in the draft RTS, because of the limitation of the empowerment to procedural issues.

Calculation of notional amount

CP proposal

83. In the DP and CP, ESMA proposed the approach to notional amount taken in the ESMA Q&A on EMIR implementation, in which examples are given to describe how notional amount should be calculated for certain instrument types where there have been notable differences in industry practices.
84. The CP also set out detailed proposals for the periods for which data should be used for the first application for exemption, and for applications for renewal.
85. The CP proposed that ESMA should have three months for verification and approval of a notification for an opt-out. And that this three month period should be interrupted for any period between ESMA asking for more information and receiving it.

Analysis following feedback from stakeholders and proposal

86. All respondents who expressed a view agreed with the approach taken to calculation of notional amount. One asked for clarification about the treatment of a group with more than one trading venue, but as that is determined by MiFIR Article 36(5) there is no scope to say more in the draft RTS. Several respondents were concerned that the possibility of ESMA interrupting the three month approval period could lead to it being extended indefinitely. ESMA has therefore clarified in the drafting that the

Estimation of notional amount for 2016

For example if at the point of making an application a trading venue does not have actual figures for the last three months of 2016, and the total notional amount for ETD transactions for January to September inclusive was €600 bn, it will estimate a figure for the complete year 2016 by using the figure for the first nine months of 2015 (say €350 bn) and for the full year 2015 (say €560 bn). For these illustrative figures, the 2016 estimate would be €960 bn, thus:

$$600 \times \frac{560}{350} = 960$$

the three months runs from the submission of all necessary documentation to ESMA. ESMA has also clarified the requirement for estimating the 2016 notional amount where less than 12 months actual data is available (see illustration in box.)

87. Subject to those changes and other minor clarifications, the draft RTS is therefore as proposed in the CP.

4.4. Access in respect of benchmarks

4.4.1 Benchmark information

Background/Mandate/Empowerment

Article 37(4)(a) of MiFIR

ESMA shall develop draft regulatory technical standards to specify:

(a) the information through licensing to be made available under paragraph 1(a) for the sole use of the CCP or trading venue;

CP proposal

1. In the CP, non-discriminatory access to and licensing of benchmarks was presented in a single draft RTS along with non-discriminatory access to CCPs and trading venues. In the interests of clarity, there are now two separate RTS, one for each of those subjects.
2. ESMA proposed in the CP the following information to be made available through licensing:
 - i. the information about a benchmark to be made available to a CCP or trading venue should be what is necessary for it to clear or trade instruments based on the benchmark;
 - ii. the applicant must provide an explanation of why the requested information is necessary for clearing or trading;
 - iii. the person with proprietary rights to the benchmark should provide the information on the same basis as it supplied it to other CCPs or trading venues;
 - iv. if requested information is publicly or commercially available, the person with proprietary rights to the benchmark does not need to supply it.
3. ESMA also proposed a list of information that would be relevant.

Analysis following feedback from stakeholders

4. Overall, most responses agreed with the approach, though there were many proposals for changes. These included calls for the scope of benchmarks covered to be limited, or for a right for a person with proprietary rights to a benchmark to be able to deny access, and other suggestions that cannot be addressed in the draft RTS since they are not covered by the empowerment and would change the scope of MiFIR.

5. Whereas some respondents suggested more extensive or stricter information requirements, others asked for lighter ones. It also emerged that the text was not sufficiently clear as a number of responses appeared to be based on different understandings of the draft RTS. ESMA has therefore sought to streamline and clarify the drafting so that the draft RTS are easier to understand.

Proposal

6. ESMA maintained the main principles of the draft RTS on the benchmark information to be made available. However, to ensure legal certainty ESMA clarified the drafting, and has adopted some minor changes proposed by responses to the CP.
7. In particular, ESMA aligned as far as possible the text on the information about methodology with a similar provision in the Commission proposal for a Regulation on indices used as Benchmarks²¹ (Benchmark Regulation) which is under consideration by the Council and the European Parliament. If the Benchmark Regulation comes into effect with its current drafting in this respect, much of this information will have to be published by benchmark administrators, and so it will not be necessary for the persons with proprietary rights to a benchmark to provide it to a CCP or trading venue applying for access under MiFIR.

4.4.2 Other conditions under which access must be granted

Background/Mandate/Empowerment

Article 37(4)(b) of MiFIR

ESMA shall develop draft regulatory technical standards specifying the following:

- (b) Other conditions under which access is granted, including confidentiality of the information provide;*

CP Proposal

8. ESMA considers that the diversity of benchmarks and the different identified uses make it difficult to achieve a high degree of harmonisation on the content of licensing agreements and that constraining the conditions to predetermined terms might be detrimental to all parties.

²¹ Proposal for a Regulation of the European Parliament and of the Council on indices used as benchmarks in financial instruments and financial contracts /* COM/2013/0641 final - 2013/0314 (COD)

9. ESMA proposed in the CP that, while persons with proprietary rights to a benchmark should set within the same category of licensees the same rights and obligations, they could set different conditions for different categories of CCPs and trading venues, where those differences were objectively justified based on criteria such as quantity, scope or field of use demanded and that this should be applied in a non-discriminatory way and in a proportionate manner.
10. Additionally, a person with proprietary rights to a benchmark should make the criteria determining the identification of different categories of licensees publicly available. With that information a CCP or a trading venue could then self-assess to which category its activity would correspond and subsequently request to see the conditions applicable to that particular category. ESMA proposed that, in order to protect valid commercial interests of persons with proprietary rights to a benchmark, those will only be required to make available the licensing and pricing conditions applicable to the category to which the CCP or trading venue belongs.
11. The proposal in the CP included a set of mandatory elements to be covered in the conditions such as scope of use, conditions for redistribution of information (if allowed), the technical requirements to provide the service, the fee and payment conditions, the conditions under which the agreement expires, the related contingency circumstances and the governing law and allocation of liabilities.
12. Any additions or modifications by the person with proprietary rights to a benchmark from the set of initial conditions that are granted to a particular CCP or trading venue on a bilateral basis should be made available to the rest of licensees within the same category.
13. Article 37 of MiFIR is silent on whether the foreseen licensing agreement includes the right for licensees (CCP or trading venue) to pass on relevant information to their users. ESMA proposed that the decision to authorise the redistribution of information by licensed CCPs and trading venues to their market members or participants should be left to the discretion of the person with proprietary rights to a benchmark. However, if redistribution of information was allowed for one single CCP or trading venue, other CCPs or trading venues should be able to claim redistribution rights on the same conditions.

Analysis following feedback from stakeholders

14. The responses to the CP covered a diverse representation of industry stakeholders, i.e. benchmark providers, trading venues, CCPs, data vendors, investment firms and associations of investment firms and trading venues.
15. The proposal was supported by a large majority of the respondents, ranging from those who supported the entire proposal to those who expressed general support while indicating concerns about or proposing amendments to some elements.

16. Many of the comments received supported the chosen approach, i.e., not to prescribe concrete contractual terms while preserving current market practices. In particular, respondents referred to non-disclosure agreements (NDA) and letters of intent (LOI) to protect information exchanged prior to the conclusion of an access agreement. Some benchmark providers were concerned about the restriction of the access agreement to clearing and trading activities, the possibility of redistribution of information from CCPs and trading venues towards their members or participants and the reputational dimension derived from granting access. However, the concerns from other respondents focused on the possibility of bundling more elements than requested in the final commercial product proposed to CCPs and trading venues.
17. Some benchmark providers expressed strong objections to the proposal. One of the risks pointed out was the potential conflict with the draft Benchmark Regulation. Some respondents questioned the soundness of the test of objective criteria to set and publish categories of TVs and CCPs, and some made drafting suggestions about the terms related to the minimum content of conditions of the access arrangements and the policies and procedures necessary to permit appropriate service provision.

Proposal

18. After the analysis of the comments received, ESMA has decided to maintain the main lines of the proposal subject to streamlining and further clarifying the draft RTS including minor suggestions and amendments proposed by respondents to the CP. ESMA considers that the proposal strikes a fair balance between the interests of benchmark providers and those of CCPs and trading venues requesting access within the scope set by MiFIR.
19. ESMA acknowledges that certain current market practices such as the signature of NDAs or LOI prior to the licensing agreement may ensure the fair usage of information. ESMA does not think these practices should be prescribed in the draft RTS, but is of the opinion that they are compatible with the draft RTS.
20. The reference to redistribution of information in the draft RTS does not impose redistribution as such but is intended to prevent redistribution being used as a barrier to competition through discriminatory usage. Therefore, if redistribution is permitted to a CCP or trading venue, other CCPs or trading venues may obtain the same conditions.
21. The open approach of categorisation aims to accommodate the different possible usages and the considerable heterogeneity of the benchmarks as defined in Article 2(1)(39) of MiFIR. ESMA is maintaining the discretion of benchmark providers to set the criteria to form the different categories of users, based on reasonable commercial grounds such as the quantity, scope and field of use demanded.

4.4.3 New benchmarks

Background/Mandate/Empowerment

Article 37(4)(c) of MiFIR

ESMA shall develop draft regulatory technical standards specifying the following:

(c) the standards guiding how a benchmark may be proven to be new in accordance with paragraph 2(a) and (b).

CP proposal

22. ESMA proposed five standards to be taken into account in establishing whether a benchmark is new or not, clarifying that the appropriate weighting would depend upon the specific benchmark in question, and that there might be other specific standards that should be considered in relation to particular benchmarks.

Analysis following feedback from stakeholders and proposal

23. Most responses supported the approach taken in the draft RTS, many of them explicitly welcoming the recognition that the assessment would have to be case by case and that the best that can be done is to offer some factors that will apply in most cases. There were a large number of proposals for clarifying the drafting, and ESMA clarified the text in the light of those.

24. The draft RTS are broadly the same as in the CP, with a number of changes to the wording for clarification purposes in the light of the responses to the consultation. The reference to “adaptations” has been removed as this is covered by MiFIR itself.

25. Lastly, minor changes to this provision aiming at providing more legal certainty have been introduced. In particular, a new paragraph on additional standards to be taken into account for commodity benchmarks, which have previously only been included in the recitals, has been introduced.

5. REQUIREMENTS APPLYING ON AND TO TRADING VENUES

5.1. Admission of financial instruments to trading on regulated markets

Background/Mandate

1. Article 51 of MiFID II deals with the basic requirements that shall be fulfilled for the admission to trading of financial instruments to regulated markets.
2. Article 51(6) of MiFID II requires ESMA to develop RTS which shall specify and clarify a number of aspects in relation to the characteristics financial instruments shall have for being considered eligible for admission to trading on a regulated market and the arrangements regulated markets shall have in place concerning certain aspects of disclosure obligations and access to information.

Article 51(6) of MiFID II

ESMA shall develop draft regulatory technical standards specifying the following:

- (a) specify the characteristics of different classes of instruments to be taken into account by the regulated market when assessing whether an instrument is issued in a manner consistent with the conditions laid down in the second subparagraph of paragraph 1 for admission to trading on the different market segments which it operates;*
- (b) clarify the arrangements that the regulated market is required to implement so as to be considered to have fulfilled its obligation to verify that the issuer of a transferable security complies with its obligations under European Union law in respect of initial, ongoing or ad hoc disclosure obligations;*
- (c) clarify the arrangements that the regulated market has to establish pursuant to paragraph 3 in order to facilitate its members or participants in obtaining access to information which has been made public under the conditions established by European Union law.*

3. The Article is virtually identical to Article 40 of Directive 2004/39/EC (MiFID I)²² in respect of which implementing measures have been adopted in the MiFID I Level 2 Regulation (Commission Regulation (EC) No 1287/2006²³).
4. The text of those existing implementing provisions is displayed below.

Article 35 (Article 40(1) of Directive 2004/39/EC) Transferable securities

1. *Transferable securities shall be considered freely negotiable for the purposes of Article 40(1) of Directive 2004/39/EC if they can be traded between the parties to a transaction, and subsequently transferred without restriction, and if all securities within the same class as the security in question are fungible.*
2. *Transferable securities which are subject to a restriction on transfer shall not be considered as freely negotiable unless that restriction is not likely to disturb the market.*
3. *Transferable securities that are not fully paid may be considered as freely negotiable if arrangements have been made to ensure that the negotiability of such securities is not restricted and that adequate information concerning the fact that the securities are not fully paid, and the implications of that fact for shareholders, is publicly available.*
4. *When exercising its discretion whether to admit a share to trading, a regulated market shall, in assessing whether the share is capable of being traded in a fair, orderly and efficient manner, take into account the following:*
 - (a) *the distribution of those shares to the public;*
 - (b) *historical financial information, information about the issuer, and information providing a business overview as is required to be prepared under Directive 2003/71/EC, or is or will be otherwise publicly available.*
5. *A transferable security that is officially listed in accordance with Directive 2001/34/EC of the European Parliament and of the Council, and the listing of which is not suspended, shall be deemed to be freely negotiable and capable of being traded in a fair, orderly and efficient manner.*
6. *For the purposes of Article 40(1) of Directive 2004/39/EC, when assessing whether a*

²² Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC (OJ L 145, 30.4.2004, p. 1).

²³ Commission Regulation (EC) No 1287/2006 of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards record-keeping obligations for investment firms, transaction reporting, market transparency, admission of financial instruments to trading, and defined terms for the purposes of that Directive (OJ L 241, 2.9.2006, p. 1).

transferable security referred to in Article 4(1)(18)(c) of that Directive is capable of being traded in a fair, orderly and efficient manner, the regulated market shall take into account, depending on the nature of the security being admitted, whether the following criteria are satisfied:

- (a) the terms of the security are clear and unambiguous and allow for a correlation between the price of the security and the price or other value measure of the underlying;*
- (b) the price or other value measure of the underlying is reliable and publicly available;*
- (c) there is sufficient information publicly available of a kind needed to value the security;*
- (d) the arrangements for determining the settlement price of the security ensure that this price properly reflects the price or other value measure of the underlying;*
- (e) where the settlement of the security requires or provides for the possibility of the delivery of an underlying security or asset rather than cash settlement, there are adequate settlement and delivery procedures for that underlying as well as adequate arrangements to obtain relevant information about that underlying.*

Article 36 (Article 40(1) of Directive 2004/39/EC) Units in collective investment undertakings

1. A regulated market shall, when admitting to trading units in a collective investment undertaking, whether or not that undertaking is constituted in accordance with Directive 85/611/EEC, satisfy itself that the collective investment undertaking complies or has complied with the registration, notification or other procedures which are a necessary precondition for the marketing of the collective investment undertaking in the jurisdiction of the regulated market.

2. Without prejudice to Directive 85/611/EEC or any other Community legislation or national law relating to collective investment undertakings, Member States may provide that compliance with the requirements referred to in paragraph 1 is not a necessary precondition for the admission of units in a collective investment undertaking to trading on a regulated market.

3. When assessing whether units in an open-ended collective investment undertaking are capable of being traded in a fair, orderly and efficient manner in accordance with Article 40(1) of Directive 2004/39/EC, the regulated market shall take the following aspects into account:

- (a) the distribution of those units to the public;*
- (b) whether there are appropriate market-making arrangements, or whether the management company of the scheme provides appropriate alternative arrangements for*

investors to redeem the units;

(c) whether the value of the units is made sufficiently transparent to investors by means of the periodic publication of the net asset value.

4. When assessing whether units in a closed-end collective investment undertaking are capable of being traded in a fair, orderly and efficient manner in accordance with Article 40(1) of Directive 2004/39/EC, the regulated market shall take the following aspects into account:

(a) the distribution of those units to the public;

(b) whether the value of the units is made sufficiently transparent to investors, either by publication of information on the fund's investment strategy or by the periodic publication of net asset value.

Article 37 (Article 40(1) and (2) of Directive 2004/39/EC) Derivatives

1. When admitting to trading a financial instrument of a kind listed in points of Sections C(4) to (10) of Annex I to Directive 2004/39/EC, regulated markets shall verify that the following conditions are satisfied:

(a) the terms of the contract establishing the financial instrument must be clear and unambiguous, and enable a correlation between the price of the financial instrument and the price or other value measure of the underlying;

(b) the price or other value measure of the underlying must be reliable and publicly available;

(c) sufficient information of a kind needed to value the derivative must be publicly available;

(d) the arrangements for determining the settlement price of the contract must be such that the price properly reflects the price or other value measure of the underlying;

(e) where the settlement of the derivative requires or provides for the possibility of the delivery of an underlying security or asset rather than cash settlement, there must be adequate arrangements to enable market participants to obtain relevant information about that underlying as well as adequate settlement and delivery procedures for the underlying.

2. Where the financial instruments concerned are of a kind listed in Sections C (5), (6), (7) or (10) of Annex I to Directive 2004/39/EC, point (b) of paragraph 1 shall not apply if the following conditions are satisfied:

(a) the contract establishing that instrument must be likely to provide a means of disclosing to the market, or enabling the market to assess, the price or other value measure of the

underlying, where the price or value measure is not otherwise publicly available;

- (b) the regulated market must ensure that appropriate supervisory arrangements are in place to monitor trading and settlement in such financial instruments;*
- (c) the regulated market must ensure that settlement and delivery, whether physical delivery or by cash settlement, can be effected in accordance with the contract terms and conditions of those financial instruments.*

Analysis following feedback from stakeholders

5. The empowerment in substance is virtually identical with the empowerment contained in Article 40(6) of MiFID I.
6. ESMA has noted that the empowerments in Article 40(6) of MiFID I and Article 51(6) of MiFID II consist of three different parts whereas the existing requirements in Articles 35 to 37 of Regulation (EC) No 1287/2006 in essence only provide implementing measures in relation to one of those parts, i.e. the empowerment in letter (a) of Article 40(6) of MiFID I.
7. ESMA developed the Technical Standards under Article 51(6)(a) on the basis of the existing rules in Articles 35 to 37 of Regulation (EC) No 1287/2006, however ESMA has not had the benefit of pre-existing rules on which to develop the technical standards for letters (b) and (c).

Article 51(6)(a), MiFID II – Specifying Characteristics of Different Classes of Financial Instruments

8. Based on an initial fact-finding with competent authorities to assess how the rules in the existing Level 2 Regulation have worked in practice ever since the application of MiFID I from 1 November 2007, ESMA concluded preliminarily that overall the above-mentioned provisions have proven to be appropriate and no specific problems in supervisory practice have been reported.
9. It was also noted that the requirements for admitting securities to trading on a regulated market can operate and may need to be assessed in conjunction with the requirements for admitting securities to official listing on a stock exchange as prescribed by Directive 2001/34/EC (Consolidated Listing Directive)²⁴. Generally speaking, the regulatory requirements for admission to trading on a regulated market as prescribed by MiFID should not be stricter than the requirements for being listed on an official list as

²⁴ Directive 2001/34/EC of the European Parliament and of the Council of 28 May 2001 on the admission of securities to official stock exchange listing and on information to be published on those securities (OJ L 184, 6.7.2001, p. 1).

prescribed by the Consolidated Listing Directive. To be officially listed is normally a label of first rate listing, meaning higher eligibility criteria.

10. In addition, it was considered that any requirements imposed by the Consolidated Listing Directive could not be altered in this process but would require a separate legislative process.
11. Taking past supervisory experiences and the continued application of the Consolidated Listing Directive into consideration, in the DP and CP, ESMA used the existing framework in Articles 35 to 37 of Regulation (EC) 1287/2006 as the benchmark for future RTS in respect of specifying characteristics for transferable securities, units in collective investment undertakings, and derivatives. In both rounds of consultation undertaken, respondents to the consultation were very supportive of this approach. They commented that current requirements have proven to be adequate and satisfactory and that they did not envisage the need to change or amend them. ESMA maintains the main features of the aforementioned regime, considering only minor adaptations to the existing regime as necessary.
12. In this regard, one of the minor adaptations ESMA had considered in the DP was in respect of the requirements applicable to units in collective investment undertakings. Article 36 (3)(b) of Regulation (EC) No 1287/2006 currently requires regulated markets to take into account whether there are appropriate market-making arrangements, or whether the management company of the scheme provides appropriate alternative arrangements for investors to redeem the units when assessing whether units can be traded in a fair, orderly and efficient manner.
13. Likewise, fostering uniform implementation, ESMA does not carry on the discretion currently in the MiFID (I) Implementing Regulation, for Member States to allow the admission to trading of units where the registration, notification or other procedures are not complied with.
14. ESMA had noted that in the context of ETFs, ESMA's Guidelines on ETFs and other UCITS issues clarify that ETFs not only need to have at least one market maker but, if they are admitted to trading on a regulated market, they also need to have alternative arrangements for investors to redeem units at least in cases where the regulated market value of units or shares significantly varies from the net asset value. ESMA therefore considered that all ETFs in order to be capable of being traded in a fair, orderly and efficient manner need to offer market making arrangements and direct redemption facilities at least in cases where the price of units or shares significantly varies from the net asset value. ESMA also noted that its Guidelines on ETFs and other UCITS issues only apply to UCITS ETFs. ESMA however considered the provision of alternative redemption facilities in addition to market making arrangements also important for non-UCITS ETFs so that the draft regulatory technical standard does not differentiate between UCITS ETFs and other ETFs and the new requirement will therefore apply to all ETFs admitted to trading on a regulated market.

15. Respondents in both rounds of consultation were mostly supportive of introducing this requirement considering it as useful and noting that it reflects current practice existing in some markets already. The minority opposing this requirement requested leaving this to the discretion of the market operator or the CA. Therefore ESMA decided to maintain this new requirement and has included it in the draft RTS. This constitutes a change to the existing legal regime, dictated by the aforementioned reasons.

Article 51(6)(b) of MiFID II – Clarifying Arrangements for Verifying Compliance with Disclosure Obligations

16. Article 51(3)(1) of MiFID II requires regulated markets to establish and maintain effective arrangements to verify that issuers of transferable securities comply with obligations of initial, on-going and ad hoc disclosure under Union Law.
17. ESMA shall develop RTS to clarify the arrangements a regulated market has to implement so as to be considered in compliance with this requirement.
18. The obligations under Union law mentioned stem from the Prospectus, the Transparency and the Market Abuse Directive (in the future the Market Abuse Regulation). While it is mainly the issuers who are under the direct responsibility to comply with these obligations, regulated markets shall also have arrangements in place to be able to verify compliance of issuers.
19. Existing practice on regulated markets seems to vary significantly: some regulated markets only require that issuers are aware of their obligation under disclosure rules and under transparency rules applicable to listed companies, others require issuers to adopt an appropriate management control system, others require that a sponsor (or other independent financial advisers) undertake the duty to inform the management body with regard to the responsibilities and obligations resulting under the laws in force from admission to trading.
20. ESMA therefore initially intended to use the DP from May 2014 in order to identify best practices in application on European markets at the moment.
21. However, none of the respondents to the DP had submitted concrete descriptions of arrangements in place. At the same time, none of the respondents had indicated that the practices in place are deficient in any way. On the contrary, there seemed to be agreement that the arrangements in place are adequate and that the details should be left to the discretion of each regulated market.
22. Therefore, ESMA decided in the CP to clarify the arrangements regulated markets are required to implement by imposing on regulated markets the requirement to adopt a policy to verify compliance which shall be published on the website of the regulated markets. Furthermore, ESMA considered that regulated markets should check

compliance with the policy mentioned above and that the mentioned check is adequate to the nature of the obligation under review.

23. In order for the policy to be efficient it should not only entail the processes the regulated market employs, but also give guidance to the issuers on how best to demonstrate compliance in this remit.
24. The regulated market should verify issuers are aware of their obligations.
25. There was some support in the responses to the CP to the proposed approach and ESMA decided to maintain its proposals as published in the CP.
26. Replying to the concerns raised by respondents, ESMA wishes to clarify that neither these provisions, nor the ones drafted under Article 51(6)(c) of MiFID II, in any way place on regulated markets the duty of regulatory supervision. Furthermore, the powers of competent authorities are in no way altered.
27. The obligations stem from MiFID II and as demonstrated above were to a large extent already present in MiFID I.

Article 51(6)(c) of MiFID II – Clarifying Arrangements for Facilitating Access to Information

28. Article 51(3)(2) requires regulated markets to establish arrangements to facilitate the access of members or participants to information being made public under Union law.
29. ESMA shall develop RTS to clarify the arrangements a regulated market has to establish in order to facilitate such access.
30. ESMA noted in the DP that this requirement shall promote access of members and participants on regulated markets to information published in accordance with Union law. The relevant Union law for these purposes appear to be the Prospectus, Transparency and Market Abuse Directives (in the future the Market Abuse Regulation) as well as potentially the trade transparency information required by Regulation (EU) No 600/2014 (MiFIR)²⁵ as it shall be ensured that members and participants are aware of relevant information that may have an influence on the valuation of a financial instrument on as equal terms as possible. Further to comments received in the public consultation ESMA wishes to clarify upfront that the proposed RTS in no way changes the mentioned pieces of legislation, whose contents remain as before applicable. As in the previous case, the substantive requirement without implementing measures is already applicable since 1 November 2007. Therefore, ESMA was also interested in this case to find out about existing arrangements and asked for experiences with them before forming its final view on future implementing measures.

²⁵ 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) No 648/2012 (OJ L 173, 12.6.2014, p. 84).

31. Respondents to the DP pointed out that they had in place appropriate arrangements in order to facilitate access of members or participants to this kind of information either through the regulated market itself or through other mechanisms. The majority of respondents were stock exchanges which agreed that the arrangements were effective in achieving their goals, so there was no need to change or amend them.
32. Respondents broadly agreed that the arrangements for facilitating access to information shall encompass the forthcoming Market Abuse Regulation. Nevertheless, regarding the MiFIR trade transparency obligations, most respondents were not in favour of including them, as they seem to be separate requirements and not obligations relevant to the issuer. Therefore ESMA decided, in the CP to delete the proposal that the arrangements shall include MiFIR trade transparency obligations.
33. ESMA also notes that in both rounds of consultation no members or participants came forward who were dissatisfied with the arrangements currently put in place by regulated markets. Therefore, ESMA does not see a need for detailed, prescriptive requirements in this context and intends to clarify only that arrangements in place should grant easy, fair and non-discriminatory access, free of charge and published on their website while also clarifying the scope of the information obligations. In addition, those arrangements shall be published on the website of the regulated market.
34. A large majority of respondents agreed to this approach and ESMA therefore decided to also include it in the final technical standard.
35. Following the responses received, ESMA wishes to clarify that under Article 51 (6)(c) the obligation of regulated markets to facilitate access are restricted to information already made public. ESMA also wishes to clarify that one of the ways a regulated market can meet its obligation to facilitate access to information is by providing a link to where the information is available.

5.2. Suspension and removal of financial instruments from trading – connection between a derivative and the underlying financial instrument

Background/Mandate

1. Article 52(1) of MiFID II empowers a market operator (MO) to suspend or remove from trading financial instruments which no longer comply with the rules of the regulated market (RM), unless such a step would be likely to cause significant damage to investors' interests or the orderly functioning of the market.
2. Article 52(2) of MiFID II also requires that “a market operator that suspends or removes from trading a financial instrument also suspends or removes from trading the derivatives as referred to in points (4) to (10) of Section C of Annex 1 that relate or are referenced to that financial instrument where necessary to support the objectives of the suspension or removal of the underlying financial instrument”.
3. According to Article 52(2) of MiFID II the CA in whose jurisdiction the suspension or removal originated has to decide whether it is necessary to expand the suspension or removal if one of the three reasons for doing so exists, i.e. suspected market abuse, a take-over bid or the non-disclosure of inside information about the issuer or financial instrument in breach of Articles 7 and 17 of Regulation (EU) No. 596/2014 on market abuse (MAR). The expansion would apply to the trading of the same financial instrument or related derivatives on other RM, MTFs, OTFs and SIs within its jurisdiction. If none of the three reasons apply, the CA is not required to expand the suspension or removal and does not need to inform ESMA and the CAs of the other Member States.
4. If the suspension is due to one of the three reasons and in the event of a suspension originating from a MO, Article 52(2) of MiFID II details the process that must be followed:
 - i. The MO suspends the derivatives where this is necessary to support the objectives of the suspension or removal of the underlying financial instrument.
 - ii. The MO makes public its decision to suspend the financial instrument and any related derivatives and communicates relevant information to its CA.
 - iii. If the suspension or removal is due to suspected market abuse, a take-over bid or non-disclosure of inside information about the issuer or financial instrument in breach of Articles 7 and 17 of MAR, the CA shall require that other RMs, MTFs, OTFs and SIs, which are under its jurisdiction and trade the same financial instruments or any related derivatives, suspend or remove that financial instrument or derivatives unless this could cause significant damage to investors' interests or the orderly functioning of the market.

- iv. The CA makes public such a suspension decision and communicates it to ESMA and other CAs ('notified CAs') including an explanation if the decision was not to follow the suspension.
 - v. The notified CAs order suspension of trading on RMs, other MTFs, other OTFs and SIs in their jurisdictions trading the suspended instruments or any related derivatives, unless this could cause significant damage to investors' interests or the orderly functioning of the market in the notified CAs' jurisdictions.
 - vi. The notified CAs communicated their decision on whether to follow the suspension to ESMA and other CAs, including an explanation if the decision was not to follow the suspension.
5. This regime is without prejudice to the power of CAs to initiate a suspension or removal from trading at their own initiative under points (m) and (n) of Article 69(2) of MiFID II.
 6. The process detailed above also applies - in general - in the case of removal of a financial instrument and any related derivatives from trading and when a suspension is lifted, whereas a removal decision by the originating CA does not necessarily lead to mandatory removal by the notified CA(s) but could lead to a mere 'suspension' as well.
 7. Article 52(2) of MiFID II also stipulates that the above notification process applies in the case where the decision to suspend or remove a financial instrument from trading is taken by the CA pursuant to points (m) and (n) of Article 69(2) of MiFID II.
 8. Article 32 of MiFID II applies the same rules as outlined above where the operator of an MTF or OTF suspends or removes a financial instrument and related derivatives from trading. All the explanations and statements in this section in respect of Article 52 shall be read as applying to Article 32 as well.

Article 52(2) of MiFID II (and Article 32(2) of MiFID II)

[...]

In order to ensure that the obligation to suspend or remove from trading such derivatives is applied proportionately, ESMA shall develop draft regulatory technical standards to further specify the cases in which the connection between a derivative relating or referenced to a financial instrument suspended or removed from trading and the original financial instrument implies that the derivative are also to be suspended or removed from trading, in order to achieve the objective of the suspension or removal of the underlying financial instrument.

[...]

9. Article 52 of MiFID II contains three empowerments for implementing measures in Level 2. The first one, in Article 52(2), requires ESMA to specify cases in which the connection between a derivative relating or referenced to a financial instrument suspended or removed from trading and the original financial instrument implies that the derivative should also be suspended or removed from trading, in order to achieve the objective of the suspension or removal of the underlying financial instrument.
10. The second one, in Article 52(3) of MiFID II, requires ESMA to develop implementing technical standards to determine the format and timing of all the communications and publications. This, and some other empowerments to develop Implementing Technical Standards, will be consulted upon by ESMA in 2015.
11. The third empowerment in Article 52(4) of MiFID II empowers the Commission to adopt delegated acts in order to specify a list of circumstances constituting significant damage to investors' interests and the orderly functioning of the market which could then be the basis of a decision not to follow a suspension or removal notification. Such list of circumstances is in ESMA's Technical Advice to the Commission.
12. Article 32 of MiFID II contains a parallel set of empowerments for MTFs and OTFs. Therefore all the proposals shall be read as applying to regulated markets, MTFs and OTFs.

Analysis following feedback from stakeholders

13. The rationale of this proposal was covered already in the DP and CP to which no relevant changes have been introduced, so it is not developed again in this report. The related legal text can be found in the relevant sections of the annexes. ESMA recommends, therefore, reading this report together with the DP and CP to have a complete vision of the rationale for the proposed measures.
14. ESMA consulted on a draft RTS according to which;
 - i. a derivative that is related or referenced to only one financial instrument should also be suspended or removed as a consequence of the suspension or removal of the underlying instrument, and;
 - ii. a derivative, that is related or referenced to more than one financial instrument , should not be suspended or removed as a consequence of the suspension or removal of one of the underlying instruments.
15. Respondents to the consultation broadly agreed with ESMA's proposal.
16. ESMA therefore maintains in the draft RTS on the suspension and removal of financial instruments from trading its proposal with respect to the connection between a derivative and the underlying financial instrument as it was consulted upon.

5.3. Description of the functioning of MTFs and OTFs

Background/Mandate

Article 18(11) and (10) of MiFID II

10. *Member States shall require that investment firms and market operators operating an MTF or an OTF provide the competent authority with a detailed description of the functioning of the MTF or OTF, including [...] any links to or participation by a regulated market, an MTF, an OTF or a systematic internaliser owned by the same investment firm or market operator, and a list of their members, participants and/or users.*

11. *ESMA shall develop draft implementing technical standards to determine the content and format of the description and notification referred to in paragraph 10.*

1. Article 18(10) of MiFID II requires investment firms and market operators running an MTF or an OTF to provide a detailed description of the functioning of the trading venue to the CA.
2. To ensure all necessary information is provided, Article 18(10) of MiFID II specifies that this detailed description of the functioning of the MTF or OTF has to include any links to or participation by a regulated market, an MTF, an OTF or a SI owned by the same investment firm or market operator, and a list of their members and users.
3. This information should build upon the information an investment firm or market operator is required to provide as part of the general authorisation requirements under MiFID II. It should focus upon the specific functionality of the trading system to enable national authorities to assess whether the system satisfies the definition of an MTF or OTF and to assess its compliance with the particular, venue-orientated requirements of MiFID II and MiFIR. The requirement for a detailed description does not affect the duty of an investment firm or market operator to provide other information to its CA as required under other provisions of MiFID II and MiFIR, or the rights of competent authorities to request other information as part of their on-going supervision of trading venues.

Analysis following feedback from stakeholders

4. The draft ITS proposed by ESMA has been drafted under the following assumptions:
 - i. Since SME Growth Markets are subject to additional rules compared to other MTFs, it is necessary for SME Growth Markets to provide additional information;
 - ii. The provision of information for existing MTFs shall take into account the information already provided to CAs under the current MiFID I regime. However, since OTFs

represent a new type of trading venue, it is appropriate that OTFs provide systemically all the necessary information required in this Regulation for their initial authorisation.

- iii. Given that OTFs are distinguished from MTFs in that the trading process will involve the use of discretion by the operator, and because the operator of an OTF will owe client facing responsibilities to users of the system, it is necessary for OTFs to provide further information compared to MTFs.
 - iv. An exhaustive list of types of information which the investment firms and market operators operating an MTF or an OTF shall provide will ensure certainty and clarity. It will also facilitate the central collection of information by ESMA for the purpose of publication of the list of the MTFs and the OTFs in the Union.
 - v. ESMA has considered that MTF and OTF operators shall provide the competent authority with detailed information both as part of the general authorisation requirements, as well as in advance of the start-up date of a new functionality implemented by an already authorised MTF or OTF. The information should focus upon the specific functionality of the trading system enabling CAs to assess compliance with the particular, venue-orientated requirements of MiFID II. In addition, ESMA has considered necessary for MTF and OTF operators to provide competent authorities with all relevant information in case of any material change in the information provided.
5. On that basis, ESMA consulted on a draft ITS listing the details and information on the functioning of the system, to be provided by investment firms and market operators operating an MTF or an OTF to competent authorities, according to a template which is established under Annex I of the draft ITS.
 6. The rationale of the proposal was covered already in the CP and since no relevant changes have been introduced, it is not developed again in this report. ESMA recommends, therefore, reading this report together with the CP to have a complete vision of the rationale for the proposed measures.
 7. The proposed content and format of the description of the functioning of the MTF or OTF was generally recognised fit for purpose and no other factors were highlighted as relevant, whereas a minority of the respondents to the CP stressed that, given the commercial sensitivity of the information provided, this should be treated confidentially. In this respect ESMA noted that information received by competent authorities should be processed in accordance with the provisions of Article 76 of MiFID II on professional secrecy and the treatment of confidential information.
 8. As urged by some respondents, it has been specified that only when the functionalities or arrangements of an MTF or OTF are differentiated by asset class, the information provided shall accordingly be differentiated.

9. A few respondents considered it relevant to further specify the non-discrimination standard embedded in Article 18(3) of MiFID II by way of distinguishing among regulated markets, MTFs and OTFs. ESMA notes that this is not part of the empowerment as per Article 18(11) of MiFID II. However, notwithstanding the empowerment laid down under Article 4(2) of MiFID II, according to which the Commission may adopt delegated acts to elaborate on the definitions, ESMA could take action to clarify the aspect of the non-discrimination in the future through Level 3 instruments, if needed.

6. COMMODITY DERIVATIVES

6.1. Establishing when an activity is to be considered ancillary to the main business

Background/Mandate

1. The revised Article 2 of MiFID II intends to provide for a more narrow interpretation of exempt activities thereby capturing within the scope of MiFID II a range of firms previously excluded and addressing competitive distortions that may arise under the existing exemptions for commodity firms under Articles 2(1)(i) and 2(1)(k) of MiFID I.
2. The current regulatory regime of Article 2(1)(i) of MiFID I exempts persons dealing on own account in financial instruments, or providing investment services in commodity derivatives to clients of their main business, under the following two circumstances:
 - i. this is an ancillary activity to their main business, when considered on a group basis, and
 - ii. that the main business is not the provision of investment services within the meaning of MiFID or banking services under Directive 2000/12/EC.
3. This exemption and the one currently provided by Article 2(1)(k) of MiFID I are intended to cover commercial users and producers of commodities, under the assumption that commercial firms and specialist commodity firms neither pose systemic risks comparable to traditional financial institutions nor interact with investors, who may be put at risk
4. The exemptions currently available are effectively carried over under Article 2(1)(j) of MiFID II in similar but not identical terms. However, the exemption that is currently available under Article 2(1)(k) of MiFID I will cease to exist, thereby placing additional focus on those exemptions that are carried over. Article 2(1)(j) sets forth that MiFID II shall not apply to persons:
 - i. dealing on own account, including market makers, in commodity derivatives, emission allowances or derivatives thereof, excluding persons who deal on own account when executing client orders; or
 - ii. providing investment services, other than dealing on own account, in commodity derivatives or emission allowances or derivatives thereof to the customers or suppliers of their main business.
5. In both cases the exemption is subject to the condition that the activity is an ancillary activity individually and on an aggregate basis to the person's main business, when considered on a group basis, and that the main business is not the provision of

investment services within the meaning of MiFID II or banking activities under Directive 2013/36/EU, or acting as a market maker in relation to commodity derivatives, and the persons do not apply a high frequency algorithmic trading technique. Furthermore, making use of the exemption requires:

- i. that the persons concerned notify annually the relevant CA that they make use of this exemption; and
 - ii. upon request report to the CA the basis on which they consider that their activity is ancillary to their main business.
6. Article 2(4) of MiFID II requires ESMA to develop draft RTS to specify the criteria for establishing when an activity is to be considered as ancillary to the main business on a group level²⁶.

Article 2(4) of MiFID II

4. *ESMA shall develop draft regulatory technical standards to specify, for the purposes of point (j) of paragraph 1 the criteria for establishing when an activity is to be considered to be ancillary to the main business at a group level:*

Those criteria shall take into account at least the following elements:

- (a) the need for ancillary activities to constitute a minority of activities at a group level;*
- (b) the size of their trading activity compared to the overall market trading activity in that asset class*

In determining the extent to which ancillary activities constitute a minority of activities at a group level ESMA may determine that the capital employed for carrying out the ancillary activity relative to the capital employed for carrying out the main business is to be considered. However, that factor shall in no case be sufficient to demonstrate that the activity is ancillary to the main business of the group

The activities referred to in this paragraph shall be considered at a group level.

The elements referred to in the second subparagraph shall exclude:

- (a) intra-group transactions as referred to in Article 3 of Regulation (EU) No 648/2012 that serve group-wide liquidity or risk management purposes;*

²⁶ When specifying those criteria ESMA has to consider the elements mentioned in Article 2(4) of MiFID II. Recital 20 sets forth that the criteria specified by ESMA should ensure that non-financial firms dealing in financial instruments in a disproportionate manner compared with the level of investment in the main business are covered by the scope of MiFID II.

- (b) transactions in derivatives which are objectively measurable as reducing risks directly related to the commercial activity or treasury financing activity;*
- (c) transactions in commodity derivatives and emission allowances 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.*

Explanations

7. It is important to explain ESMA's understanding of the MiFID II text in relation to the exemptions, as the draft RTS are based on such understandings. In this regard the following aspects are relevant: the combination of the exemptions, the applicable notion of group and the consequences of becoming a MiFID firm.

Combination of exemptions

8. MiFID II provides for additional exemptions in Article 2(1)(d) and (e). Article 2(1)(e) exempts operators covered by the EU emission trading scheme from MiFID II and Article 2(1)(d) exempts persons who deal on own account in financial instruments other than commodity derivatives, emission allowances or derivatives thereof if they do not provide any other investment services or perform any other investment activities in such instruments. The Article 2(1)(d) exemption is, however, not available for market makers, members or participants of an RM or an MTF, persons having direct electronic access to a trading venue, persons applying a high frequency algorithmic trading technique or persons dealing on own account when executing client orders.
9. Recital 22 clarifies that exemptions may apply cumulatively and that the exemptions under Article 2(1)(d) and (j) MiFID II can be used in conjunction. However, Recital 23 clarifies that market makers in financial instruments, other than market makers covered by the exemption in Article 2(1)(j), persons dealing on own account when executing client orders or persons applying a high frequency technique, should be covered by the scope of MiFID II and should not benefit from any exemption. Taking into account Recitals 24 and 25, ESMA is of the view that the execution of orders in financial instruments between two non-financials directly and without any further intermediation by third parties as ancillary activity, is not covered by the term 'dealing on own account when executing client orders. Therefore, this would not prevent the persons concerned from using the exemptions under paragraphs (d) and (j) of Article 2(1) MiFID II.
10. Commodity derivatives traders can combine the exemptions available under Articles 2(1)(d) and 2(1)(j) MiFID II if they meet the requirements set forth by those provisions. However, they are not able to make use of the exemption for dealing on own account in financial instruments other than commodity derivatives, emission allowances and derivatives thereof under Article 2(1)(d) MiFID II if they are either a member or

participant of an RM, an MTF, or if they have direct electronic access. ESMA is of the view that the last sentence of Article 2(1)(d) cannot be understood in a way that persons fulfilling the criteria of Article 2(1)(j) are not required to meet the conditions of Article 2(1)(d) in order to be exempt in relation to dealing on own account in financial instruments other than commodity derivatives, emission allowances and derivatives thereof. The differentiation between Article 2(1)(d) and (j) reflects different criteria being applied to different asset classes. Consequently, ESMA understands the second sentence of Article 2(1)(d) to mean that persons seeking exemption under Article 2(1)(j) are not additionally required to meet the conditions laid down in Article 2(1)(d) in order to be exempt for the exemption under Article 2(1)(j).

11. ESMA considers that activities exempt under Article 2(1)(e) count towards the ancillary activity threshold: to exclude them would result in enlarging the scope of privileged transactions²⁷ mentioned in Article 2(4) and is therefore not in line with the MiFID II Level 1 text. However, as far as transactions in emission allowances can be considered as being part of the privileged transactions, they will not count towards the ancillary activity.
12. ESMA adheres to the view that persons exempt under Article 2(1)(j) who are a member or participant of an RM or an MTF must comply with the organisational requirements for algorithmic trading set forth in Articles 17(1) and (6) as this is in line with Article 1(5) of MiFID II. In accordance with Article 1(6), position limits and position reporting obligations will always be applicable, even if commodity derivatives traders are exempt under Articles 2(1)(d) and 2(1)(j). However, positions held by or on behalf of non-financials which are objectively measurable as reducing risks directly relating to commercial activity will not count towards the limits. In accordance with Article 1(3) of MiFIR, the trading and clearing obligations apply to all financial counterparties as defined in Article 2(8) of EMIR and to all non-financial counterparties falling under Article 10(1)(b) of EMIR (i.e. non-financial counterparties who exceed the clearing threshold).

Notion of 'group'

13. MiFID II refers to the Accounting Directive for the definitions of 'parent', 'subsidiary', 'group' and 'control'²⁸. According to this definition, 'group' means a parent undertaking and all its subsidiary undertakings, whereupon a parent undertaking is an undertaking which controls one or more subsidiary undertakings. A subsidiary undertaking is an

²⁷ Privileged transactions is the collective term for the following transactions:

1. intra-group transactions as referred to in Article 3 of EMIR that serve group-wide liquidity and/or risk management purposes;
2. transactions in derivatives which are objectively measurable as reducing risks directly related to the commercial activity or treasury financing activity; and
3. transactions in commodity derivatives and emission allowances entered into to fulfil obligations to provide liquidity on a trading venue, where such obligations are required by regulatory authorities in accordance with Union or national laws, regulations and administrative provisions or by trading venues.

²⁸ Article 4(1)(34) of MiFID II cross-refers its definition of 'group' to the one under Article 2(11) of Directive 2013/34/EU on the annual financial statements, consolidated financial statements, and related reports of certain types of undertakings (Accounting Directive).

undertaking controlled by a parent undertaking, including any subsidiary undertaking of an ultimate parent undertaking. Article 22 of the Accounting Directive (to which Articles 4(1)(32) and (33) of MiFID II also refer) sets forth elements of control characterising the relationship between a parent undertaking and a subsidiary undertaking.

14. On this basis ESMA considered that the term “group” comprises the parent undertaking and all its subsidiary undertakings without being a legal person itself. Subsidiary undertakings are those undertakings that are controlled by a parent undertaking under consideration of the elements of control set out in Article 22(1) and (2) of the Accounting Directive.

Consequences of becoming a MiFID II authorised firm

15. The exemptions under Article 2 of MiFID II should be viewed in a broad context as they will interact with other legislation and may have a significant impact on firms that currently use the exemptions under MiFID.
16. If firms cannot make use of an exemption under MiFID II, capital requirements under the new banking regulatory framework will apply to them. This new framework consists of Regulation EU No 575/2013 (CRR) and Directive 2013/36/EU (CRD IV), repealing Directives 2006/48/EC and 2006/49/EC. While CRD IV is addressed to CAs and includes, inter alia, qualitative provisions on the Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP), the new CRR imposes quantitative requirements and disclosure obligations pursuant to Basel III recommendations on credit institutions and investment firms, including own funds definition, minimum own funds requirements and liquidity requirements. However, under Article 498(1) of CRR, some commodity dealers falling within the scope of MiFID are transitionally exempt from the CRR’s provisions on own funds requirements until 31 December 2017 at the latest, if their main business consists exclusively of providing investment services or activities relating to commodity derivatives.
17. Moreover, firms falling within the scope of MiFID II will be considered to be financial counterparties rather than non-financial counterparties under Article 2(8) of EMIR. Therefore, they will not be able to benefit from the clearing thresholds or the hedging exemption available to the latter under Article 10 of EMIR. An additional consequence of being classified as a financial counterparty will be that the trading obligation (i.e. the obligation to trade derivatives which are subject to the clearing obligation and sufficiently liquid on trading venues only, cf. Article 28 of MiFIR) would apply in full without being subject to a threshold.
18. For firms that fall under MiFID II, it is also worth keeping in mind that the hedging exemption in relation to the position limits regime will only apply to non-financial entities as Article 57(1) of MiFID II states that “position limits shall not apply to positions held by or on behalf of a non-financial entity which are objectively measurable as reducing risks directly related to the commercial activity of that non-financial entity”. Furthermore,

derivative transactions of non-financial counterparties which are objectively measurable as reducing risks directly related to commercial activity, or treasury financing activity of the non-financial counterparty, or of the group, are not subject to pre-trade transparency requirements in accordance with Article 8(1) of MiFIR.

19. In relation to derivative contracts listed in Annex I Section C paragraph (6) of MiFID II relating to coal or oil that are traded on an OTF and must be physically settled the clearing obligation set out in Article 4 of EMIR and the risk mitigation techniques set out in Article 11(3) of EMIR shall not apply for a transitional period of six years if entered into by non-financial counterparties that meet the conditions of Article 10(1) EMIR or that shall be authorised for the first time as an investment firm under MiFID II (cf. Article 95 of MiFID II). Furthermore, such derivative contracts on coal or oil shall not be considered as OTC derivative contracts for the purpose of the clearing threshold set out in Article 10 of EMIR during the transitional period.

Proposals in CP

20. In the CP ESMA proposed two tests (as required by MiFID II), that have to be passed cumulatively in order for investment activities to be considered as ancillary and therefore an exemption from MiFID II to apply:
 - i. The first test (the “trading activity thresholds”) expresses the relationship between “speculative” activity and the overall EU market activity in each class of commodity derivatives. The rationale is that firms having a significant share of the market in a particular class of derivatives will not be allowed to benefit from the exemption as they should compete with other market participants on a level playing field.
 - ii. The second test shall determine whether investment activity is large in size relative to what the entity does as its main business (the “main business thresholds”).

6.1.1 Trading activity thresholds (or Market Share test)

Analysis following feedback from stakeholders and proposal

21. This test compares the size of the firm’s trading activity to the size of the overall market trading activity in the EU, i.e., determining the market share of a given entity in a commodities derivatives class. In this regard, the objective should be to capture the size of the firm’s trading activity in the EU rather than all trading activity, noting that there may be practical difficulties in doing this. Respondents generally welcomed the approach of using only EU trading activity, notably for issues of data availability. Again it is necessary to define how to exclude the physical hedging activities discussed below and how to define the size of the trading activity and the size of the overall market trading activity.

Methodology for calculating the size of trading activity

22. The size of the relevant trading activity to be used in the calculation should be defined by deducting the sum of the volume of the privileged transactions from the total volume of the trading activity of the person undertaken in the EU at group level²⁹ (obtaining the size of the speculative trading activity). The size of the (speculative) trading activity of the person must then be compared with the size of the overall market trading activity in the relevant asset class in the EU:

<p><u>Calculation of market share (trading activity threshold)</u></p> <p>Size of the relevant trading activity at group level in a commodity asset class in the EU (numerator)</p> <p style="text-align: center;"><i>divided by</i></p> <p>Size of the overall market trading activity in the relevant commodity asset class in the EU (denominator)</p>
<p><u>Size of the relevant trading activity at group level in a commodity asset class in the EU (numerator of the previous table)</u></p> <p>Volume of the overall trading activity in the relevant commodity asset class of the person seeking the exemption at group level in the EU</p> <p style="text-align: center;"><i>minus</i></p> <p>Volume of privileged transactions (i.e. for intra-group transactions, transactions in derivatives reducing commercial and treasury financing risks, and transactions entered into to fulfil obligations to provide liquidity) in the relevant commodity asset class at group level in the EU</p>

23. When defining the size of the trading activity it should be noted that derivatives on wholesale energy products defined under Article 2(4) REMIT are not financial instruments in accordance with Article 4(1)(15) and Annex I C 6 MiFID II provided that they are traded on an OTF and ‘must be physically settled’.

²⁹ Pls check the applicable notion of group on paragraphs 13 and 14 of this section.

24. ESMA maintains the approach of measuring trading volume by the gross notional value of contracts to which a given person is a party.

Commodity asset classes

25. In the CP, ESMA acknowledged concerns expressed by market participants about a separate freight rate derivatives asset class as they considered freight to be a commodity which is ancillary to the trading of other commodities. ESMA therefore did not consider freight as a separate asset class but instead proposed replacing the class 'freight' with 'other commodities, including freight and commodities referred to in Section C 10 of Annex I of MiFID II.
26. As a consequence, ESMA divided the size of the trading activity into the following broad asset classes:
- i. Metals;
 - ii. Oil and oil products;
 - iii. Coal;
 - iv. Gas;
 - v. Power;
 - vi. Agricultural products;
 - vii. Other commodities, including freight and commodities referred to in Section C 10 of Annex I of MiFID II.
 - viii. emission allowances or derivatives thereof
27. Respondents to the consultation did not agree with the creation of this new C 10 asset class as they considered it still to be too small in comparison to the others, therefore raising the concern that being a big player in a small market may trigger a MiFID licensing requirement while in absolute terms such players would be trading in substantially smaller quantities compared to players in bigger markets who would not face a licensing obligation.
28. In addition, respondents were concerned that freight would still be by far the largest component of a C 10 asset class so that essentially being a big player in freight rate derivatives would trigger the licensing requirement. The freight rate market is deemed to have a limited number of participants (estimates range from 60 to 200), meaning that any participant would automatically have a significant market share.

29. As an alternative proposal respondents suggested integrating freight volumes with the classes to which the specific freight contracts relate as freight is seen as instrumental to trading in other commodity derivatives.
30. Other proposals included, raising the threshold for freight rates significantly or disregarding the C 10 category for the purposes of the ancillary activity test.
31. ESMA appreciates the concerns raised by respondents. However, it cannot disregard the C 10 class as it is expressly qualified as a commodity derivative class in the Level 1 text and there are no legal grounds on which to exclude it from this provision.
32. ESMA sees the rationale in integrating freight rate derivatives trading with those classes the specific freight contracts relate to but notwithstanding the technical problems this proposal raises ESMA would still face the problem of dealing with the other derivative types included in the C 10 class (derivatives as diverse as having inflation rates, the weather or telecommunications bandwidth as underlyings).
33. Therefore, taking into account the limited size of the C 10 market overall and the limited number of market participants ESMA has opted in favour of increasing the threshold. In the final technical standard ESMA proposes to set the threshold at 15%.

Setting the thresholds

34. In the CP, ESMA proposed setting the threshold in relation to the trading activity test at 0.5% of the overall market trading activity in each of the eight different asset classes proposed.
35. A majority of respondents, predominantly from non-financial firms, did not agree with the 0.5% threshold considering it to be too low. They expressed concerns about the impact on the real economy, a reduction in liquidity, and of small- and medium-sized firms potentially leaving the market. Some respondents also asked ESMA to set the thresholds at a high enough level to prevent accidental crossings due to market evolution. Others asked ESMA to only set an absolute threshold.
36. Financial firms and non-governmental organisations responding to the relevant question raised in the CP expressed the opposite view, asking ESMA to set ambitious thresholds and either agreed to the 0.5% threshold or proposed decreasing it to 0.25%.
37. Additionally, most respondents urged ESMA to provide the figures for the overall market trading activity for them to be able to perform the test going forward, despite the absence of an obligation for ESMA to provide these figures in the Level 1.
38. Many respondents also asked ESMA for a phased-in approach to the ancillary test.

39. When defining a threshold for determining whether the person's trading activity is high in relation to the overall market trading activity, ESMA notes Recital 20 of MiFID II requiring that the criteria specified by ESMA should ensure that non-financial firms dealing in financial instruments in a disproportionate manner compared with the level of investment in the main business are covered by the scope of MiFID II.
40. ESMA also notes that for the trading activity test, only activity undertaken for non-hedging purposes has to be taken into account. Transactions undertaken in order to hedge commercial activities, intragroup transactions and transactions undertaken to fulfil liquidity obligations are deducted from the size of the trading activity of the person seeking the exemption before the comparison with the overall market trading activity in the relevant asset class takes place.
41. Taking the responses and those factors into account, ESMA considers that there is merit in applying the trading activity test at an asset class specific level.
42. ESMA has already described its reasoning for setting a higher threshold for the C 10 asset class.
43. ESMA is also aware that trading activity in the secondary market for emission allowances and their derivatives is currently relatively low and is conscious of the fact that the Level 1 text does not include a specific exemption for compliance buyers of emission allowances. ESMA does consider it as disproportionate to potentially require non-financial firms to apply for an investment firm licence based on a relatively low absolute amount of trading in the small emission allowance market, especially if this trading is due to compliance activity. Therefore ESMA considers it is justified to impose a significantly higher threshold for emission allowances and their derivatives at 20%.
44. When determining the thresholds for the different asset classes, ESMA took into consideration that firms having a significant share of the market in a particular class of derivatives will not be allowed to benefit from the exemption as they shall compete with other market participants on a level playing field and that an asset class in which the trading activity is considerable should be awarded with a lower threshold than an asset class where such activity would be smaller. In this way the test that is primarily designed to look into the relative size of a particular firm also takes into consideration elements of its absolute size.
45. ESMA proposes establishing the thresholds below, which have been determined following a data collection as part of the CBA and after establishing total EU market sizes based on trading venues and trade repositories data. The thresholds have been selected by looking at those total market sizes and factors such as the number of active market participants. ESMA however did only have a small data sample available and, therefore, has set these thresholds cautiously (in the CP, the proposal was to have 0.5% thresholds across all asset classes), considering the large impact of being caught by the test will have on firms. The expectation, based on our sample data, is that a number of

firms would be caught by the test. ESMA recommends that the calibration of the thresholds is reviewed when more data becomes available under the new MiFID II regime.

46. In this regard the following thresholds were set:

Threshold	Class of derivatives
4 %	derivatives on metals
3 %	derivatives on oil and oil products
10 %	derivatives on coal
3 %	derivatives on gas
6 %	derivatives on power
4 %	derivatives on agricultural products;
15 %	derivatives on other commodities, including freight and commodities referred to in Section C 10 of Annex I of Directive 2014/65/EU
20 %	emission allowances or derivatives thereof

6.1.2 Minority of activities – ‘main business threshold’

Analysis following feedback from stakeholders and proposal

47. MiFID II states that ancillary activities must constitute a minority of activities at group level. In order to define the minority of activities, ESMA consulted in the CP on a proposal that was based on considering the ratio of the capital employed for carrying out the ancillary activity to the capital employed for carrying out the main business.

Scope of the ancillary activity and the main activity at group level and calculation method

48. On the question of whether the calculation should be computed at the level of the group or of the person, respondents were split. A significant number of the respondents agreed with the approach of performing the calculations at group level. The other respondents disagreed, arguing that the licensing regime also applies at person level and seemed to understand the group level approach would entail that all entities within the group would be required to obtain a MiFID license where a threshold is exceeded.

49. ESMA notes that the MiFID regime distinguishes between on the one hand (i.) the person who has to apply for an authorisation and can benefit from an exemption and, on the other hand, (ii.) the requirements for the exemption to the authorisation regime. The latter refer to the group.
50. As respondents rightly noted both the licensing requirement and the exemption apply to persons. The persons who can apply for an exemption, i.e., persons dealing on own account or providing investment services, need to make sure that the activity is ancillary to their main business, either on their own personal basis, or regarding the group they belong to.
51. ESMA therefore considers that where in a group the thresholds are exceeded, the group has to ensure that the thresholds are not breached in the future, i.e. by setting up a MiFID licensed entity.

Assessing the size of the activities - 'capital' and alternative approach

52. The term "capital" may be interpreted in different ways and either a regulatory, economic or accounting capital measure could be used. Due to the lack of a clear definition, ESMA considered that economic capital would be difficult to measure. Furthermore, ESMA envisaged calculating the capital measure by using figures that firms already calculate, rather than requiring new calculations. As using a regulatory capital measure would be inappropriate for unregulated firms that may not perform a regulatory capital calculation, ESMA favoured the use of an accounting capital measure.
53. Most of the respondents preferred the use of the accounting capital measure for reasons of simplicity and availability. They believed that this approach would enable a consistent application of the rules across all market participants as company balance sheets and financial figures are independently audited on a yearly basis mainly relying on IFRS or equivalent principles and are publicly available. This approach would avoid additional compliance burden for firms. However, some respondents pointed out that it may be difficult to assign capital under accounting capital measures to the different activities, i.e. the ancillary activities, the group's main business and the privileged transactions. They saw a need for further clarification on the definition of accounting capital and a need for identifying proxies in order to determine the respective amount of the capital employed for the different activities. It was suggested that ESMA defines capital as encompassing equity, current debt and non-current debt. Potential proxies suggested for the capital employed for ancillary activity and privileged transactions include the fair value considering the net position of all deals and the amount of collateral posted with CCPs and other counterparties as initial margin when trading in commodity derivatives.
54. As the responses to the CP mentioned above alluded to and the data collection for the CBA substantiated, the use of capital could prove to be extremely challenging for firms as they would have to collect financial information that not all are currently collecting, unreliable as the relevant data sets are difficult to circumscribe and could imply

considerable discretion as to determining their relevant perimeter, and in some combinations not particularly meaningful, i.e. capital measures are imprecise and proved unable to cater for the need for legal certainty.

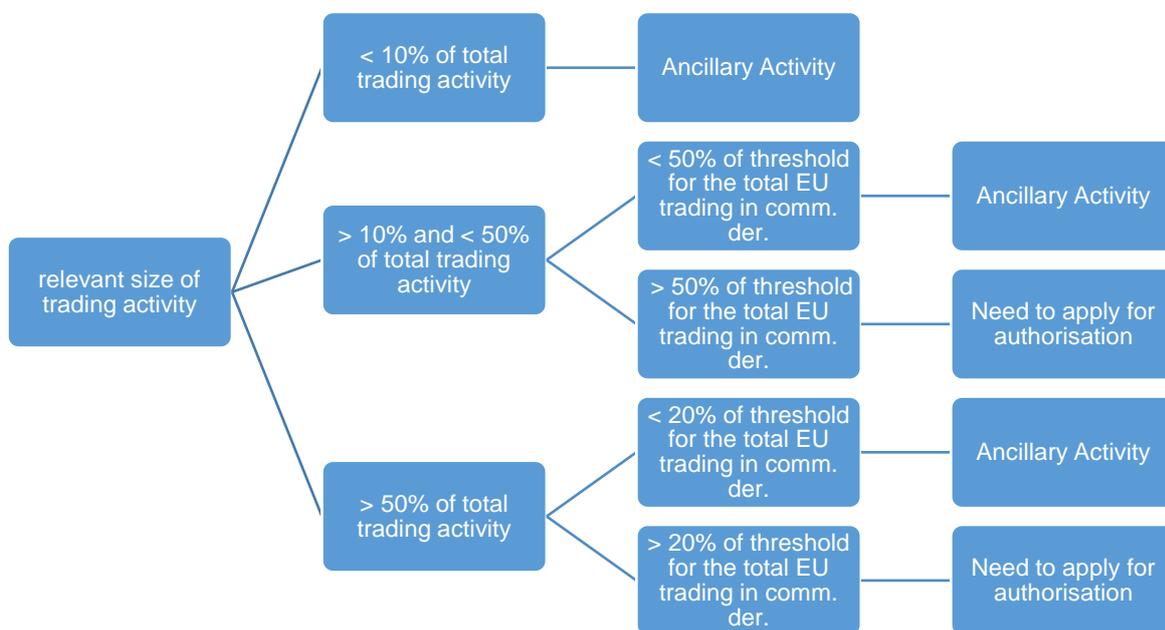
55. ESMA developed therefore an alternative approach: applying the group test that is required by Level 1 by measuring the size of “speculative” trading over total group trading, re-using for the most part parameters which have to be collected for the market share test already.

<p><u>Calculation for the main business threshold</u></p> <p>Size of trading activity, excluding privileged transactions and transactions executed by authorised entities of the group, undertaken by the group in all asset classes (the numerator)</p> <p><i>divided by</i></p> <p>size of the overall trading activity, including privileged transactions and transactions executed by authorised entities of the group, undertaken by the group in total for all asset classes (the denominator)_____</p> <p><i>Equals</i></p> <p>% of firm’s speculative trading activity vis a vis its main business</p>
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56. The size of the trading activity as proposed for use in the second test, including privileged transactions and transactions executed by authorised entities is taken as a proxy for the commercial activity that the person or group conducts as its main business. This proxy should be easy and cost efficient for persons to apply as it builds on data already required to be collected for the first test while at the same time establishing a meaningful test.
57. ESMA considers that a rational risk-averse entity such as a producer, processor or consumer of commodities will seek to hedge the volume of the commercial activity of its main business with an equivalent volume of commodity derivatives, emission allowances or derivatives thereof. Therefore the volume of turnover of commodity derivatives, measured in the gross notional value of the underlying, that are purchased or sold is an appropriate proxy for the size of the main business of the group.
58. ESMA is aware that the second test may inadvertently capture persons with a high proportion of trading which is neither privileged transactions nor executed in an

authorised entity of the group but nevertheless have a very low level of trading activity in total.

59. ESMA is also aware that hedging activity cannot be considered a 100% correct measure for the commercial activity that the person or group conducts as its main business as it does not take into account other investments of commodity market participants in fixed assets unrelated to derivative markets. Therefore, the second test should not solely operate on the basis of the application of this proxy but rather should encompass a backstop mechanism which takes into account the trading activity undertaken by the persons within the group. If the latter also exceeds a certain percentage of any of the thresholds set under the first test for each relevant asset class the person cannot benefit from the exemption.
60. The higher the percentage of the speculative activity over all trading activity, the lower should the threshold applied by the backstop mechanism be. Calibrating the main business test this way should ensure that only relevant and sizable participants in European commodity derivatives markets should be assessed as not conducting their activities as ancillary to their main business. The two limbs of this second test and their consequences are described in the diagram below.



Setting the threshold

61. For the assessment of whether the ancillary activity constitutes a minority of activities at group level ESMA suggested in the DP that a firm can only be below the threshold if the ancillary activities individually and on an aggregate basis account for less than a maximum of 50% of the group's main business.

62. While many respondents supported setting the threshold close to 50%, others are of the view that a threshold of 50% is too high. They believe that the threshold should be lower in order to ensure that any ancillary activity fairly represents a minority of activities at group level. Some are of the view that a 50% threshold is not in line with the intent of the legislator as it was the goal of MiFID II to mitigate systemic risk, improve the functioning of the market, and increase the level of investor protection. They advocate a lower threshold as the capital employed for privileged transactions is already excluded from the calculation. Respondents believing that a threshold of 50% is too high suggested a threshold of either 10-15% or of 5%. In the CP the proposed threshold was significantly lowered.
63. ESMA has reviewed and fundamentally changed the approach in relation to the calculation, abandoning the capital employed test and taking into account the overall activity of a group's main business without any further reductions, i.e., encompassing privileged transactions and transactions executed in an entity of the group authorised in accordance with MiFID II or Directive 2013/36/EU.
64. ESMA believes it is necessary to adopt stringent thresholds as otherwise entities with a very low level of commercial activity would not exceed the threshold. Furthermore, as set forth by Recital 19, it is the intention of MiFID II in line with the communiqué of the G20 finance ministers and central bank governors of 15 April 2011 that participants on commodity derivatives markets are subject to appropriate regulation and supervision.
65. For this reason, the co-legislators have modified and narrowed down the exemptions provided for in MiFID I. In particular, MiFID II aims to capture non-financial firms dealing in financial instruments in a disproportionate manner compared with the level of investment in the main business. In order to ensure appropriate regulation, the co-legislators have determined that (i) intra-group transactions, (ii) transactions in derivatives that are objectively measurable as reducing risks directly relating to commercial activity or treasury financing activity and (iii) transactions in commodity derivatives and emission allowances entered into to fulfil obligations to provide liquidity shall be deducted from the ancillary activities. Therefore, in relation to the first test, only trading activity undertaken for non-hedging purposes has to be taken into account.
66. ESMA would also like to clarify that the comparison of the ancillary activity against the main activity (the ancillary test) should be done by comparing all ancillary activities taken together against the main activity. Where a firm undertakes only one of the ancillary activities mentioned in Article 2(1)(j) (e.g. dealing on own account or providing investment services), it would only have to undertake the ancillary test on the basis of this individual ancillary activity.

“De minimis” exemption

67. Following suggestions from respondents ESMA has explored the option of introducing a “de minimis” threshold under which smaller firms should not be required to undertake

further calculations and should not be required to make an annual notification to the CA. However, the mandate given to ESMA in the Level 1 text leaves very limited scope for the introduction of a “de minimis” threshold.

68. It should be noted that ESMA simplified the calculations so that the effort to perform them could be reduced for market participants as it is easier to obtain data and perform the calculations. In this regard, the need for a “de minimis” exception is less pressing.

6.1.3 Privileged transactions

Analysis following feedback from stakeholders and proposal

69. Article 2(4) of MiFID II permits three types of transactions to be exempt from the thresholds calculations:
- i. intra-group transactions as referred to in Article 3 of EMIR that serve group-wide liquidity and/or risk management purposes;
 - ii. transactions in derivatives which are objectively measurable as reducing risks directly related to the commercial activity or treasury financing activity; and
 - iii. transactions in commodity derivatives and emission allowances entered into to fulfil obligations to provide liquidity on a trading venue, where such obligations are required by regulatory authorities in accordance with Union or national laws, regulations and administrative provisions or by trading venues.
70. Recital 21 of MiFID II stipulates that the activities that are deemed to be objectively measurable as reducing risks directly related to commercial activity or treasury financing activity and intragroup transactions should be considered in a consistent way with EMIR.
71. ESMA stated in the CP that it considers Article 3 of EMIR is sufficiently clear regarding what is defined as intra-group transactions serving group-wide liquidity and risk management purposes. The main comment made by respondents in relation to this exemption is that Article 3 of EMIR specifies that an EU counterparty can use this exemption with a counterparty in the same group but in a third country only where the European Commission has adopted an implementing act to deem the third country equivalent to the EU (Article 13(2) of EMIR). ESMA is aware of the issue. ESMA is aware that it cannot in this process change the regime under EMIR.
72. For transactions objectively mitigating risks relating to commercial or treasury financing activity, ESMA proposed in the CP that the definition should be the same as that under Article 10 of the Commission Delegated Regulation (EU) No 149/2013 supplementing

EMIR with the one amendment that under MiFID II, this exemption should apply to all derivatives and not just OTC derivatives, as is the case under EMIR.

73. The majority of respondents agreed with ESMA's approach but argued that the further clarification of how this exemption should be applied in ESMA's EMIR Q&A (question 10) should not be adopted on the basis that firms look at whether a portfolio of positions is risk reducing in aggregate and it is difficult to segregate what is hedging and what is speculation. A few respondents proposed a different approach to defining 'hedging' transactions entirely, referring to the Canadian regulator's approach and the existing CFTC approach for US agricultural contracts.
74. ESMA has decided to retain its proposal that the same definition of hedging under EMIR will be used under MiFIR. Moreover, it intends to adopt the clarifications developed in the EMIR Q&A. ESMA disagrees that the positions taken are too restrictive and notes that it does permit portfolio hedging. It is also reasonable to require a firm to demonstrate some linkage between transactions and its hedging position.
75. Transactions in commodity derivatives and emission allowances entered into to fulfil obligations to provide liquidity on a trading venue shall not be taken into account, where such obligations are required by regulatory authorities in accordance with EU or national laws, regulations and administrative provisions or by trading venues. An example of such obligations is the mandatory market making requirements established by the UK energy regulator Ofgem obliging the 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 these prices. A number of respondents asked for ESMA to publish a definitive list of such obligations, noting that the Ofgem example given may not always be exempt due to physical nature of the trades. Some others asked for transactions undertaken to fulfil temporary obligations to provide liquidity into the market (e.g. by position management controls) to be considered as privileged transactions as the company does not control when such provision is required.
76. ESMA previously expressed the view that the obligation to provide liquidity when engaging in algorithmic trading and pursuing market making strategies under Article 17(3) of MiFID II will not be considered as falling under the hedging exemption as the persons performing that activity are excluded from the exemption. Moreover, the requirement imposed by trading venues by means of position management controls under Article 57(8)(d) of MiFID II to provide liquidity back into the market at an agreed price and volume on a temporary basis with the express intent of mitigating the effects of a large or dominant position, will not be considered as falling into the hedging exemption as this obligation only applies on a temporary basis. ESMA considers that the obligation to provide liquidity under Article 17(3) and Article 57(8) of MiFID II will not be taken into account for triggering the hedging exemption under Article 2(4)(c).
77. Finally a number of respondents argued that emission allowances held for regulatory purposes (especially due to requirements of the EEAS) should be included as "privileged

transactions”. They were concerned that operators of the EU ETS scheme will be caught as a result of their positions when dealing in emission allowances for compliance obligations under Directive 2003/87/EC.

78. ESMA does not believe there is a legal basis to exempt these transactions as privileged transactions. It does, however, recognise that it is counterproductive for firms to be captured as MiFID II firms on the basis of emission allowance compliance activity. Therefore, to address this issue ESMA has proposed a significantly higher threshold of 20% in its draft final RTS for the emission allowance class.

6.1.4 Period for calculation in relation to exemption

Analysis following feedback from stakeholders and proposal

79. Recital 36 sets forth that, in order to benefit from the exemptions, the person concerned should comply on a continuous basis with the conditions laid down for the exemptions and when services or activities when considered on a group basis, are no longer ancillary to the main business, the person should no longer be covered by the exemption. Furthermore, persons that intend to make use of the exemption have to notify the CA accordingly and then on an annual basis. Upon request of the CA, such firms have to justify to the CA the basis on which they consider that their activity is ancillary to their main business.
80. ESMA proposed that the CA to which firms should make the annual notification would be the authority in the jurisdiction in which the firms have their head office. ESMA also noted that entities situated in a third country which undertake ancillary activities in the EU wishing to benefit from the exemption should make the notification to the CA of the Member State where their branch is situated. Some respondents interpreted this proposal as a requirement for firms to establish a branch in the EU as a pre-requisite to using the ancillary activity exemption. ESMA does not impose such a requirement, neither does it have any mandate under Article 2(1)(j) that would enable it to.
81. In the CP, ESMA suggested determining the qualification for exemption on the basis of a rolling average of three years, although the notification to the CA would be made annually, and proposed the following interim approach: on 3 January 2017, persons aiming to make use of the ancillary activity exemption for 2017 must notify the CA accordingly, based on the trading data from January 2016 to December 2016 (simple average of monthly input). On 3 January 2018 CAs will receive the notifications for the ancillary activity exemption of 2018, based on the trading data from January 2016 to December 2017 (simple average of 24 monthly inputs). At the beginning of 2019, the interim period will end as the notifications to make use of the ancillary activity exemption for 2019 will be based on calculations using the 3 year rolling average procedure.

82. There was broad disagreement with the proposals above. Respondents were against firms having to declare whether they could use the exemption or not based on only one year's data being taken into account. They also noted it would be unworkable for firms to make their notifications to the CA by 3 January 2017 if they had to take into account the 2016 calendar year and proposed a variety of phase-in approaches. In addition, respondents noted the definition of commodity derivative under MiFID II is not yet final so calculations would be made on MiFID I definitions, not MiFID II.
83. ESMA has decided to propose that a firm should calculate a simple average for the figures of three years on a rolling basis once the regime is in place and three years of data are available to determine whether it falls above or below the thresholds.
84. An interim approach was also developed:

Notifications made	Relevant data in calendar years
Before 1 July 2017	1 July 2015 to 30 June 2016
Between 1 July 2017 and 30 June 2018	1 July 2015 to 30 June 2017

85. Another question that ESMA addressed was how to calculate the thresholds for a person commencing trading activity for the first time after the beginning of one of the data periods specified in the table above which is now specified in Article 4(2)(c) of the draft RTS.
86. A number of respondents asked ESMA to clarify that legacy transactions (i.e. historic transactions that may still have an open position at the start of the assessment period would not count towards the thresholds): only trades entered into in the relevant assessment period would be included in the calculation. ESMA is of the view that legacy positions should not be an issue as the two tests are based on trading turnover – activity - over a defined period.
87. With respect to the timing of the annual exemption notification to the CA, respondents noted that firms have different accounting periods and that they will need some time, following the end of the reference period, in order to perform the threshold calculations and to prepare the notifications for the CA. This aspect is catered for in the timelines proposed above.
88. Respondents also asked ESMA to clarify that when applying for a MiFID license, firms should be able to continue performing its activities. A firm first exceeding a threshold, can technically no longer use the exemption and there will be a period of time (likely to be several months) during which the firm will be in the process of obtaining its license

and during which that firm would probably and reasonably want to carry on the trading activities. Whilst ESMA recognises the legitimate concern expressed above, it also notes that it has no power to address this situation by implementing measures.

6.2. Methodology for the calculation and application of position limits for commodity derivatives traded on trading venues and economically equivalent OTC contracts

6.2.1 Methodology for calculating position limits

Background

Article 57(3) of MiFID II

3. *ESMA shall develop draft regulatory technical standards to determine the methodology for calculation that competent authorities are to apply in establishing the spot month position limits and other months' position limits for physically settled and cash settled commodity derivatives based on the characteristics of the relevant derivative. The methodology for calculation shall take into account at least the following factors:*

- (a) the maturity of the commodity derivative contracts;*
- (b) the deliverable supply in the underlying commodity;*
- (c) the overall open interest in that contract and the overall open interest in other financial instruments with the same underlying commodity;*
- (d) the volatility of the relevant markets, including substitute derivatives and the underlying commodity markets;*
- (e) the number and size of the market participants;*
- (f) the characteristics of the underlying commodity market, including patterns of production, consumption and transportation to market;*
- (g) the development of new contracts.*

ESMA shall take into account experience regarding the position limits of investment firms or market operators operating a trading venue and of other jurisdictions.

ESMA shall submit those draft regulatory technical standards referred to in the first subparagraph to the Commission by 3 July 2015.

Power is delegated to the Commission to adopt the regulatory technical standards referred to in the first subparagraph in accordance with Articles 10 to 14 of Regulation (EU) No 1095/2010.

1. Article 57(1) of MiFID II requires Member States to ensure that CAs establish and apply position limits on the size of a net position which a person can hold at all times in commodity derivatives traded on trading venues and economically equivalent OTC (EEOTC) contracts.
2. The position limits are intended to prevent market abuse, support orderly pricing and settlement conditions (including preventing market distorting positions) and ensure, in particular, the convergence between prices of derivatives in the delivery month and spot prices for the underlying commodity, without prejudice to price discovery on the market for the underlying commodity.
3. Article 57(3) of MiFID II requires ESMA to develop draft RTS to determine the methodology for the calculation that CAs are to apply in establishing the spot month position limits and other months' position limits for physically settled and cash settled commodity derivatives based on the characteristics of the relevant derivative. Article 57(3) also requires the methodology to take into account at least the following seven factors: the maturity of the commodity derivative contracts; the deliverable supply in the underlying commodity; the overall open interest in that contract and the overall open interest in other financial instruments with the same underlying commodity; the volatility of the relevant markets, including substitute derivatives and the underlying commodity markets; the number and size of the market participants; the characteristics of the underlying commodity market, including patterns of production, consumption and transportation to market; and, the development of new contracts.

The framework methodology

Feedback from stakeholders

4. In the CP, ESMA proposed to set position limits for both cash settled and physically settled contracts with reference to the deliverable supply of the underlying commodity. The baseline figure for the position limit would be 25% of deliverable supply available for the spot month contract, and 25% of predicted deliverable supply available to meet the obligations arising for the other months. ESMA defined deliverable supply as the commodity used either as settlement for, or as a pricing reference to, that commodity derivative contract. It proposed that the limit for the spot month should in general be lower than the other months' limit to reflect the fact that the spot month limit will apply to a much shorter period than the other months' limit which applies to positions that are held across a multiple of expiries.
5. The proposed methodology incorporated some flexibility so that in assessing the factors under Article 57(3)(a) to (g) of MiFID II, CAs would be able to adjust the 25% baseline figure by plus or minus 15% (so that no position limit would be higher than 40% or lower than 10% of deliverable supply). The limit itself would be specified for market

participants in lots, with lots meaning the unit of quantity used by the trading venue on which the commodity derivative contract trades.

6. Respondents agreed that deliverable supply should be the baseline for spot contracts; however, a large number favoured open interest for the other months' baseline with some proposing that open interest should also be used for spot cash-settled contracts because deliverable supply cannot be used, for example, for cash settled derivatives falling under Annex I, Section C10 with more "exotic" underlyings such as climatic variables and inflation rates. Respondents noted that in the US markets, spot month limits are not applied to commodity derivatives such as weather, but rather a system of position accountability is maintained, premised on a general assessment of large positions across the futures curve.
7. With respect to the quantitative levels proposed, some respondents noted they could not provide a view on whether a baseline of 25% of deliverable supply was suitable for all commodity derivatives due to lack of information. Others considered that 25% of deliverable supply may be appropriate providing CAs are given sufficient flexibility to adjust the baseline against the methodology factors outlined by ESMA. A small number of respondents said the baseline should be 10% with limited flexibility to adjust it.
8. Most respondents considered that 40% would probably be a suitable upper limit for the most liquid contracts but that higher position limits would be required for new and/or illiquid contracts to support the development of new contracts and to accommodate contracts where a few participants hold large positions because of the functioning of those contracts and its underlying market. A small number of respondents said that an upper limit of 40% was too high. Respondents agreed with ESMA that in general the spot month should be lower than the other months' limit and added that the cash-settled spot month limit should be higher than the physically settled spot month limit in general.
9. The majority of respondents supported CAs having the flexibility to adjust position limits, in particular to set higher position limits in exceptional circumstances. Respondents had a number of comments regarding sourcing and measuring deliverable supply and some proposed that ESMA provides a methodology or definition for calculating deliverable supply and publishes deliverable supply estimates. However, there was general support for the proposal that trading venues should provide the source information to the extent possible. For the purposes of clarification, several respondents asked that spot month be defined in order to identify spot contracts and that ESMA should specify how the scope of the EU position limits regime will interact with with third country regimes and persons.
10. Finally, ESMA sought views from respondents regarding how the methodology should address the issue of new contracts and illiquid markets as these are the two circumstances which ESMA considers may justify greater flexibility in setting position limits. Respondents agreed and suggested that a de minimis threshold should be applied for new and/or illiquid contracts so that position limits are only applied to contracts above a certain level of open interest. Some respondents also proposed that

position limits should initially be set at a higher level and then potentially be lowered in light of operational experience which would mitigate the risk of introducing position limits which could adversely impact the functioning and settlement of contracts.

Analysis following feedback from stakeholders and proposal

11. ESMA is maintaining its proposal that position limits in the spot month should be based on deliverable supply but has decided, based on feedback, that position limits in other months should be based on total open interest. ESMA also agrees that where there is no underlying deliverable supply for a commodity derivative, the spot month position limit should be based on open interest, too.
12. The wide number and range of commodity derivatives captured (typically which do not have existing position limits) and uncertainties about the impact of position limit hedging exemptions on the size of positions that persons might hold renders data collections and analysis an extremely demanding task and implies that a 'one-size fits-all' approach is unsuitable.
13. Too prescriptive rules would risk incorrectly and arbitrarily setting position limits at the wrong level which would damage the functioning of commodity derivatives and their underlying market. The system has to rely on the role of CAs, which will need to take into account that different factors will have a different impact on the functioning of different commodity derivatives. ESMA will annually monitor the consistent application of position limits by CAs.
14. In answer to requests from stakeholders, ESMA also clarifies in the draft RTS recitals what should be understood by 'spot month' in reference to the position limits regime. ESMA has taken a broad approach so that the spot month period does not need to correspond to a time period which is a month but rather is specific to each commodity derivative contract and is the contract next to expire, as determined by the rules of the relevant trading venue. A contract that is economically equivalent OTC to an ETD is considered a spot month contract when the commodity derivative traded on a trading venue to which it is equivalent is the spot month. For securitised commodity derivatives which do not have a maturity date or a series of different maturity dates no difference is made between the spot month and other months' for the purposes of the position limits regime.
15. Since publishing the CP, ESMA has looked at the results from the cost benefit analysis it has conducted on position limits, data used by CAs and feedback to the CP. This data has been instructive in determining the metrics: specifically, at what level to set the baseline and within what parameters should CAs have flexibility to deviate from the baseline.

Spot month limits

16. The spot month period is specific to each commodity derivative contract for the physical delivery of a contract and may not necessarily correspond to a time period which is a month, i.e. it could be 3 days, 2 weeks, 3 months etc. Spot month in the context of the EU position limits regime means the contract that is the next contract in that commodity derivative to mature.
17. Spot month position limits for cash settled and physically settled commodity derivatives are based on a percentage of deliverable supply. The exception is the spot month position limits for cash settled commodity derivatives with no deliverable supply (commodity derivatives listed under Annex I, Section C10 e.g. weather) which are based on a percentage of total open interest in the spot month.
18. Having regard to the need to have an efficient, yet flexible system of position limits, ESMA changed the proposed approach, adopting a more stringent formulation, i.e. allowing CAs to increase the position limits to only 35% and to decrease to 5% of the deliverable supply. By adopting this asymmetric spread, ESMA does diminish the size of position limits. ESMA also notes that it is possible to adopt this more stringent approach as new and illiquid contracts will be subject to a special regime. Crafting a special regime for new and illiquid contracts enables ESMA to adopt a more demanding regime for other contracts. The resulting two tiered regime reflects better the different trading characteristics of the instruments.
19. In obtaining information on deliverable supply in the spot month, trading venues will play an important role in providing estimates to the CA.

Other months' limits

20. The other months' period is the whole of the curve of the contract, excluding the spot month period.
21. The other months' limits for both cash settled and physically settled commodity derivatives are based on a percentage of total open interest in the contract commodity contract excluding open interest in the spot month.
22. Other months' limits are calculated as 25% of average annual open interest, expressed in lots in the underlying commodity ('the baseline').
23. ESMA also adopted the asymmetric spread for the other months, giving the CA the power to adjust the baseline down to 5% and only up to 35% of open interest, taking into account the factors listed under Article 57(3)(a) to (g).
24. Therefore, ESMA is proposing an overall stricter position limit regime as envisaged in the CP which ESMA considers justified as many illiquid contracts for which a larger position limit may be justified are already covered by the standard limit set for illiquid contracts.

Common aspects to spot and other months limits

25. In setting the thresholds, ESMA considered the data from its CBA and looked to the CFTC position limits regime as it has been operational for many years. The CFTC regime differs to what is prescribed under MiFID II in that it sets position limits for single-month and for all-months-combined (which includes the spot month) as well as for the spot month and applies to the most liquid contracts only (under the new regime, 28 physical commodity futures and options contracts and to swaps which are economically equivalent to those contracts). In contrast, the MiFID II regime is binary in that a limit is set for the spot month and for other months, which is all months excluding the spot month). Generally the CFTC's methodology for determining the spot month limit is 25% of estimated spot month deliverable supply in the relevant commodity which is the approach ESMA proposes to adopt.
26. The CFTC's position limits for the single-month and all-month is based on a formula of 10% of estimated average open interest for the first 25,000 contracts and 2.5% of the open interest above that level. For the other months' limits, ESMA has tracked the CFTC approach in terms of setting a minimum threshold and percentage measure, but framed it differently. Under both regimes 2,500 contracts is used as a threshold. Under the CFTC regime 10% of estimated average open interest for the first 25,000 contracts means the maximum limit is 2,500 up to the first 25,000 contracts and under ESMA's regime, 2,500 is the fixed position limit until there are 10,000 contracts. Above 10,000 contracts, a flat 25% will be applied as the baseline for the position limit, because as 25% of 10,000 is 2,500, at this point the limit will rise incrementally. ESMA considers it is appropriate to build in a fixed threshold of 2,500 lots into the methodology because of the vast difference in the liquidity of the instruments which will fall under the position limits regime. This is very different to the US position limits regime which is applied at a legislative level to only the most liquid instruments which have sufficient participants and open interest.

Securitised commodity derivatives limits

27. Further considering the broad definition of commodity derivative³⁰ under MiFID II, ESMA has further refined the methodology to accommodate this wide range of instruments with different structures. The final draft RTS distinguishes between four categories with

³⁰ The definition of "commodity derivative" under Article 4(1)(50) of MiFID II cross references the definition of "commodity derivative under Article 2(1)(30) of MiFIR which states "'commodity derivative' means those financial instruments defined... [under Article 4(1)(44)(c) of MiFID II]; which relate to a commodity or an underlying referred to in Section C(10) of Annex I [of MiFID II]; or in points (5), (6), (7) and (10) of Section C of Annex I thereto".

Article 4(1)(44)(c) of MiFID II defines transferable securities as instruments of payment such as "any other securities giving the right to acquire or sell any such transferable securities or giving rise to a cash settlement determined by reference to transferable securities, currencies, interest rates or yields, commodities or other indices measures."

Broadly speaking, (5) of Annex I, Section C relates to cash settled derivatives, (6) physically settled derivatives traded on trading venues, (7) physically settled derivatives traded outside trading venues and (10) cash settled derivatives with what ESMA has termed as more "exotic" underlyings such as climatic variables, freight rates or inflation rates or other. [In its final draft RTS on non-equities, ESMA classifies exchange traded commodities and exchange traded notes as debt instruments and so these instruments are not securitised commodity derivatives for the purposes of this position limits regime.]

associated ways to calculate the spot and other months' limits. For cash settled and physically settled commodity derivatives which have a deliverable underlying, the spot month limit is based on deliverable supply and the other months' limit on open interest. For cash settled derivatives with more 'exotic' underlyings, such as weather, with no quantifiable deliverable supply, the other months' limit and the spot month limit is based on open interest.

28. Applying a position limit regime to securitised commodity derivatives under Article 4(1)(44)(c) of MiFID II is more challenging: these instruments do not have an underlying with a deliverable supply and the concept of maturities and open interest does not apply. Usually an issuer issues a number of units which have a basket of commodities. Consequently, as well as requiring a different measure for applying position limits, a number of the seven factors which competent authorities must take into account when setting the limit will not be relevant for securitised derivatives. ESMA has decided that the position limits will have to be applied to these instruments on the basis of a percentage of the instruments in issuance for both the spot month and other months'.
29. Position limits for both the spot month and other months' position limits will be based on 25% of units in issue.

Table 41: Summary of position limits' thresholds

	Spot months			Other months		
	Baseline measure	Baseline %	CA flexibility to deviate from baseline based on factors	Baseline measure	Baseline %	CA flexibility to deviate from baseline based on factors
Physically delivered commodity derivatives	Deliverable supply	25%	+10%- 20%	Open interest	25% of total open interest unless open interest is less than 10,000 lots in which case, baseline is 2,500 lots	+10%- 20%
Cash settled commodity derivatives	Deliverable supply	25%	+10%- 20%	Open interest	25% of total open interest unless open interest is less than 10,000 lots in which case, baseline is 2,500 lots	+10%- 20%
Commodity derivatives with no deliverable	Open interest	25%	+10%- 20%	Open interest	25% of total open interest unless open interest is less	+10%- 20%

supply					than 10,000 lots in which case, baseline is 2,500 lots	
Securitized commodity derivatives	Number of units in issue	25% unless less than 10million securities in issue.	+10%- 20%	Number of units in issue	25% unless less than 10million securities in issue	+10%- 20%

The assessment of factors under Article 57(3)(a) to (g) of MiFID II

30. Article 57(3) states that “The methodology for the calculation shall take into account at least the following factors”. Apart from noting the special case of illiquid instruments, ESMA stated in its CP that it did not intend to add any additional factors to those listed in MiFID II under Article 57(3)(a) to (g) and outlined how it intended to build those seven factors into its methodology.
31. The major changes to the factors to be assessed when establishing position limits are discussed in the following text. A full overview is presented in the table at the end of this section.

Maturity (Article 57(3)(a))

32. In determining whether the baseline figure for the position limit should be adjusted due to maturity, ESMA proposed that CAs adjust the baseline on the principle that (1) the longer the maturity of a commodity derivative, the higher the overall position limit for the other months’ limit, as there will be a greater number of open positions held by persons; and (2) the greater the frequency of expiry of a commodity derivative contract, the higher the overall position limit because traded volume or open interest of a specific contract is smaller when the contract expires more frequently e.g. daily.
33. There was general support for this approach. However, one respondent disagreed that the frequency of expiry should equate to a higher limit on the basis this could aid a participant squeeze the market by buying up higher quantities in a short space of time. The respondent proposed instead that the exposures in daily contracts over a given month should be aggregated, netted together and subject to one limit.
34. ESMA maintains the proposed approach.

Deliverable supply (Article 57(3)(b))

35. ESMA proposed that CAs adjust the initial baseline for this factor on the basis that (1) the greater the quantity of deliverable supply in the underlying commodity, the higher the overall position limit and (2) the accuracy with which the deliverable supply can be

determined (for example, where delivery is from licenced warehouses, the deliverable supply can be measured more precisely and frequently updated).

36. Respondents concluded that the assessment of deliverable supply should include a variety of factors such as historical and expected production, consumption and storage levels, historical and expected import and export flows, the number of delivery locations, the delivery capacity and type of delivery available at each location and the time period of delivery in question. One respondent proposed that for the sake of clarity, ESMA should distinguish between “hub markets”, where delivery occurs as part of a commodity’s transportation process from producer to consumer, for example, gasoil and natural gas contracts, and “storage markets”, where a commodity is stored and delivery occurs through the transfer of ownership of the static commodity, such as certain base metals markets or agricultural markets.
37. As there is currently no EU common definition of ‘deliverable supply’, a couple of respondents proposed that ESMA refer to the CFTC’s definition. A number of respondents emphasised that as each commodity market is structured differently, trading venues should have the flexibility to assess deliverable supply of each type of commodity using different data and different calculation assumptions and similarly CAs should have the equivalent flexibility to accept assessments with differing structures.
38. ESMA maintains the proposed approach.

Open Interest (Article 57(3)(c))

39. With respect to open interest, ESMA proposed that the CA should make the adjustment based on the principle that the greater the volume of overall open interest, the higher the overall position limit. ESMA also stated that other financial instruments which are correlated to the commodity derivative should not be included in the calculation of the volume of the overall open interest.
40. The main comment made in relation to this factor was that open interest for other months contracts would likely already take into account other factors such as maturity, volatility, and number and size of participants.
41. ESMA maintains the proposed approach.

Volatility (Article 57(3)(d))

42. ESMA proposed that the CA should adjust the baseline due to volatility on the basis that position limits should not further increase volatility by, for example, being so restrictive that they drive liquidity from the market.
43. Most respondents considered that volatility should have a lesser weighting than other factors and noted the difficulty of accurately factoring into a methodology this criterion. A

couple of respondents argued that volatility does not necessarily arise due to a lack of liquidity. Others argued that in volatile markets there is an increase in demand for price risk management services and therefore argued against a single direction approach i.e. that where there is greater volatility the position limit should be lowered. However, some respondents agreed with ESMA's assessment and several respondents considered there is no clear link between derivatives trading and volatility in the underlying market.

Analysis following feedback from stakeholders and proposal

44. Following responses to the CP, ESMA decided not to specify how volatility of contracts affects the setting of position limits further on Level 2.

Number and Size of Participants (Article 57(3)(e))

45. ESMA proposed that the CA should make any adjustment to the baseline due to the number and size of participants in line with the principle that the greater the number of position holders, the lower the overall position limit. ESMA's proposal was on the basis that a person's position can become individually dominant at a lower level where there are a greater number of participants. In a new or illiquid market, the reverse is true where the lack of participants can lead to a participant having a sizeable, and potentially dominant, market share, perhaps regardless of whether they intended to.
46. ESMA has considered the size of market participants as a factor for CAs to take into consideration when setting position limits. Having in mind the stated objectives³¹ of the position limits regime, it is not clear how the size of the market participants should influence the setting of the limits by CAs.
47. Therefore, ESMA has decided not to assign a general direction of how the limits should be set based on the size of market participants but leave this to the individual decision of CAs on a per contract basis. ESMA has maintained its proposal in respect of the number of market participants.

Characteristics of the underlying commodity markets (Article 57(3)(f))

48. ESMA proposed the CA should adjust the baseline due to the characteristics of the underlying market in line with the principle that the greater the flexibility of the commodity market, the higher the position limit. In considering the extent to which the underlying commodity market is flexible, ESMA noted the CA should consider whether there are

³¹ To prevent market abuse and to support orderly pricing and settlement conditions, including preventing market distorting positions, and ensuring, in particular, convergence between prices of derivatives in the delivery month and spot prices for the underlying commodity, without prejudice to price discovery on the market for the underlying commodity.

restrictions on supply, the method of transportation and delivery of the commodity, the structure of the market and the features of the underlying market.

49. Feedback included the point that the term “flexible” is not defined and therefore provides no clarity on what ESMA would consider to be the relationship between a position limit and a characteristic of the underlying market. It was suggested instead that ESMA list the factors relevant to the characteristics of the underlying commodity markets and allow CAs to determine the relationship to the limit without specifying a lower or higher direction.
50. ESMA followed the suggestion above on the grounds also stated above.

Development of new contracts (Article 57(3)(g))

51. As noted above, ESMA considered there may be justification for permitting greater flexibility in setting position limits when new commodity derivatives are being developed and when the markets in commodity derivatives are illiquid. Consequently, it proposed that the CA should set the position limit at a higher level for new contracts. ESMA also noted there is a commonality between this factor and the factors for the number and size of participants and for the amount of overall open interest.
52. ESMA asked for opinions on what length of time a contract could be considered as “new” and whether “less-liquid parameters” should be applied as a function of the age of the contract or as a function of its ongoing liquidity. The majority of the respondents stated that a single time period across all types of contracts is a sub-optimal way of determining whether a contract should be subject to higher position limits. Consistent with this response, almost all the respondents were in favour of using the ongoing liquidity of a contract as a measure, commenting that age is irrelevant for the application of less-liquid parameters as contracts (even old ones) may never reach trading levels which are sufficiently high to need a position limit.
53. In the proposed draft RTS new and illiquid contracts are treated as a single category. In fact, from a position limits setting perspective, there are no grounds to distinguish between them as a lower liquidity will dictate the need to adopt higher position limits. Any other action would harm liquidity as only a very small position in absolute terms would be possible. As noted above, applying these rules to new and illiquid contracts enabled ESMA to modify its proposal regarding the ability of CAs to establish the limits in relation to the baseline from 40%-10% to 35%-5%.

Different asset classes

54. ESMA sought comments on its decision not to incorporate asset-class specific elements (e.g. metal, oil, etc.) because the proposed methodology provided CAs with sufficient scope and flexibility to take into account the specificities of these different markets. The majority of respondents agreed with this proposal.

55. ESMA maintains the proposed approach.

Table 42: Summary of how factors are to be taken into account by CAs when setting position limits

Factor	Application	Rationale
<p>New and illiquid contracts</p>	<p>For venue traded commodity derivatives where the open interest is lower than 10,000 lots over a three month period, the position limit is set at 2,500.lots.</p> <p>For securitised derivatives where the number of securities issued is lower than 10 million over a three month period, the position limit is set at 2.5 million securities.</p>	<p>As the position limits regime aims at preventing market abuse and supporting orderly settlement and pricing conditions there is a need to address the risk that low position limits on less-liquid commodity derivatives contracts could adversely impact on the functioning of those contracts and their underlying commodities market by disrupting the settlement of those contracts. That would inadvertently prevent commercial entities from being able to use commodity derivatives to better manage the risks to their commercial activities.</p> <p>New contracts require a higher position limit because they typically have very few participants - sometimes in single figures – which means participants may automatically have a dominant position when they establish a position in the contract. Such participants may also hold larger positions as a result of providing liquidity to the contract to support its development.</p> <p>It fosters the development of new contracts for less developed commodity markets which do not have commodity derivatives available to hedge and better manage their risks</p> <p>Competent Authorities will already be monitoring whether positions being developed or held in the market are manipulative and abusive as part of monitoring trading behaviour under MAR.</p>
<p>Maturity of contract</p>	<p>Where the contract has a comparatively short maturity, the CA can decide to raise the position limit below the baseline.</p> <p>Where there are a large number of separate expiries, the CA can decide to raise the position limit <u>above</u> the baseline.</p>	<p>Persons may establish large positions for contracts with long maturities. It is more difficult for participants to establish market distorting positions further down the curve which will have an impact on pricing and settlement of the contract because the markets have sufficient time to react to and counter them.</p> <p>More frequent expiries may mean there is more risk of participants inadvertently holding a larger position as a result of changes in other person’s positions.</p>
<p>Deliverable supply</p>	<p>Where the deliverable supply in the</p>	<p>A limited quantity of the underlying</p>

<p>in underlying commodity</p>	<p>underlying commodity can be restricted or controlled, the CA can decide to lower the position limit <u>below</u> the baseline.</p> <p>Where the level of deliverable supply is low relative to the amount required for orderly settlement, the CA can decide to lower the position limit <u>below</u> the baseline.</p>	<p>commodity available for delivery during the spot month period means that a market participant could corner the market with a relatively small quantity of the commodity, particularly where multiple participants may need to obtain the underlying commodity to deliver into trading venue delivery points to settle their contracts.</p>
<p>Overall open interest</p>	<p>Where the contract has a comparatively large volume of total open interest, the CA can decide to lower the position limit <u>below</u> the baseline.</p>	<p>The most liquid contracts should as a general rule have stricter limits.</p>
<p>Number of participants</p>	<p>Where there is a comparatively significant number of participants (based on daily average number over a one year period) holding positions in the contract, the CA can decide to lower the position limit <u>below</u> the baseline.</p>	<p>Where there are a lot of participants holding the commodity derivative, a participant can establish a market distorting position at a lower level than if there were few participants.</p>
<p>Characteristics of underlying commodity market</p>	<p>Where the characteristics of the underlying commodity market may lead to market participants holding or maintaining sizeable positions, the CA should have regard to the extent to which market participants may hold and maintain a dominant position.</p>	<p>The characteristics of the underlying commodity market may impact on the availability of the underlying commodity to settle commodity derivatives and may result in certain participants holding larger positions as a result of the functioning of that commodity market.</p>

6.2.2 Application of position limits

Background/Mandate

Article 57(12) of MiFID II

12. *ESMA shall develop draft regulatory technical standards to determine:*

- (a) the criteria and methods for determining whether a position qualifies as reducing risks directly relating to commercial activities;*
- (b) the methods to determine when positions of a person are to be aggregated within a group;*
- (c) the criteria for determining whether a contract is an economically equivalent OTC contract to that traded on a trading venue, referred to in paragraph 1, in a way that facilitates the reporting of positions taken in equivalent OTC contracts to the relevant competent authority as determined in Article 58(2);*
- (d) the definition of what constitutes the same commodity derivative and significant volumes under paragraph 6 of this Article;*
- (e) the methodology for aggregating and netting OTC and on-venue commodity derivatives positions to establish the net position for purposes of assessing compliance with the limits. Such methodologies shall establish criteria to determine which positions may be netted against one another and shall not facilitate the build-up of positions in a manner inconsistent with the objectives set out in paragraph 1 of this Article;*
- (f) the procedure setting out how persons may apply for the exemption under the second subparagraph of paragraph 1 of this Article and how the relevant competent authority will approve such applications;*
- (g) the method for calculation to determine the venue where the largest volume of trading in a commodity derivative takes place and significant volumes under paragraph 6 of this Article.*

ESMA shall submit those draft regulatory technical standards referred to in the first subparagraph to the Commission by 3 July 2015.

Power shall be delegated to the Commission to adopt the regulatory technical standards referred to in the first subparagraph in accordance with Articles 10 to 14 of Regulation (EU) No 1095/2010.

56. Article 57(1) of MiFID II requires Member States to ensure that CAs establish and apply position limits on the size of a net position which a person can hold at all times in commodity derivatives traded on trading venues and EEOTC contracts. Article 57 of MiFID II sets out how CAs should establish and apply positions. Article 57(12) of MiFID II requires ESMA to develop draft RTS to further specify how the following elements should be applied for position limits:

- i. the criteria and methods for determining whether a non-financial entity's position qualifies as reducing risks directly relating to commercial activities (the 'hedging exemption') and therefore may be exempt from position limits;
- ii. the methods for determining when positions of a person are to be aggregated within a group;
- iii. the criteria for determining whether a contract is an EEOTC contract to a contract traded on a trading venue, in a way that facilitates the reporting of positions taken in equivalent OTC contracts to the relevant CA as determined in Article 58(2) of MiFID II;
- iv. the definition of what constitutes the same commodity derivative and significant volumes under Article 57(6) of MiFID II;
- v. the methodology for aggregating and netting OTC and on-venue commodity derivatives positions to establish the net position for the purpose of assessing compliance with the limits. The methodology should establish criteria to determine which positions may be netted against one another and should not facilitate the build-up of positions in a manner inconsistent with the objectives set out in Article 57(1) of MiFID II.
- vi. the procedure to set out how non-financial entities can apply for the hedging exemption to position limits and how the relevant CA will approve such applications;
- vii. the method of calculation to determine the venue where the largest volume of trading in a commodity derivative takes place and significant volumes under Article 57(6) of MiFID II.

Feedback from stakeholders

Risk Reducing positions Article 57(12)(a)

57. Article 57(1) of MiFID II states that position limits will not apply to positions held by or on behalf of a non-financial entity which are objectively measurable as reducing risks directly relating to its commercial activity. In the absence of a definition of 'non-financial entity', ESMA proposed that a non-financial entity should be considered as any entity which is not a financial institution under MiFID II or other relevant EU legislation and that

the definition of a financial entity (in other words, the inverse of a non-financial entity) should include entities that are outside the EU that would be a financial entity (or a non-financial entity) under the various Directives and Regulations if their activities were performed in the EU.

58. There was general support for ESMA's approach to defining what a non-financial entity is. The main concern for non-financial respondents was the interaction between the ancillary activity exemption and the hedging exemption for position limits, specifically, that if they exceeded the thresholds and were required to be authorised under MiFID II, and whether they would still be permitted to use this exemption.
59. In line with its proposal for the hedging exemption in relation to the ancillary activity exemption, for positions objectively mitigating risks relating to commercial activity, ESMA proposed the definition should be the same as that under Article 10 of the Commission Delegated Regulation (EU) No 149/2013 supplementing EMIR with the one amendment that under MiFID II, this exemption should apply to derivatives traded on trading venues and EOTC, and not just OTC derivatives, as is the case under EMIR.
60. The majority of respondents made similar points to those in relation to the hedging exemption for the ancillary activity exemption. They agreed with ESMA's approach but argued that the further clarification of how this exemption should be applied in ESMA's EMIR Q&A (question 10) should not be adopted on the basis that firms look at whether a portfolio of positions is risk reducing in aggregate, and that it is difficult to segregate what is hedging and what is speculation. Financial respondents were concerned that they cannot use this hedging exemption and therefore suggested the rules should permit them to net off positions against physical inventory exposures providing they can demonstrate there is a correlation and connection with financing commodity trading participants. A couple of respondents argued for a stricter exemption to ensure anticipatory hedging is not permitted.

Analysis following feedback and proposal

61. MiFID II permits a non-financial entity to apply for an exemption from position limits for positions in commodity derivatives which are objectively measurable as reducing risks directly relating to the commercial activities of that entity. As MiFID II does not provide a definition of what a 'non-financial entity' is, ESMA has clarified in a recital that it is the inverse of a financial counterparty as defined under EMIR: in other words, a non-financial entity for the purposes of the position limits regime is the same as a non-financial counterparty under EMIR.
62. Given the language of the hedging exemption for position limits is the same as that under Article 10(3) of EMIR, with the exception that it applies to commercial activities only and not to treasury activities, ESMA considers that the EMIR definition for hedging should be used as the basis of the position limits hedging definition. ESMA has amended the definition under EMIR so that for position limit purposes it also applies to

derivatives traded on trading venues and those elements which refer to treasury activities have been removed.

63. In line with its position on the hedging exemption under the ancillary activity exemption, ESMA has decided to retain its proposal that it intends to use the clarification under the EMIR Q&A (question 10) and has included the spirit of this guidance in a recital. ESMA disagrees that the questionnaire provides an interpretation which is too restrictive, and believes that it does permit portfolio hedging and that it is reasonable to require a firm to demonstrate some linkage between transactions and its hedging position. ESMA does not, however, think there is a need to further limit the application of the exemption, as requested by a couple of respondents and does not agree that it would be desirable or in line with MiFID II to de facto enlarge the scope of the exemption by providing that financial firms can net off positions in commodity derivatives against physical inventory.

Methods for aggregation of a person's positions within a group (Article 57(12)(b))

64. ESMA is required by Article 57(12)(b) of MiFID II to develop the methods to determine when positions of a person should be aggregated within a group. In the context of MiFID II, the term "group" is defined in Article 2(34) and provides a cross-reference to Article 2(11) of Directive 2013/34/EU ("Accounting Directive"). Article 2(11) of the Accounting Directive states that a group is "a parent undertaking and all its subsidiary undertakings" and the proposals relating to position limits are to be read in relation to this definition.
65. Article 57(1) of MiFID II states that the position limit requirement applies to positions which a 'person' can hold. In common with the position reporting obligations set out in Article 58(2) and (3), this requires application of the limits to positions held by the end customer, which may be either a legal person or a natural person. Applying limits at the level of the end customer addresses the risk of a customer holding, through several intermediaries, positions which are individually of moderate size but in aggregate may be considered significant. ESMA proposed that the positions of a person (whether held directly by itself or on its behalf by third parties such as investment firms under a client relationship) should be aggregated together with those of any wholly or partly owned subsidiaries of that entity, but not aggregated with the positions of fellow subsidiaries of a mutual parent or ultimate holding company.
66. A number of respondents noted there was a need to clarify how positions limits would apply to funds, proposing positions held by funds should not be aggregated at either manager or investor level. Respondents agreed with ESMA that it would be appropriate to apply limits at the level of the end customer for situations in which an investment firm holds assets on behalf of a third party under a client relationship. However, for the fund investors, the more relevant consideration would be whether the investor's ownership stake in the fund amounts to control as defined in the Accounting Directive.
67. Respondents also raised questions about how position limits would apply to a fund's investment in a corporate entity with some arguing that owning a majority of a

company's voting shares does not necessarily imply control over its trading decisions. There was a preference for ESMA to consider ownership in terms of "control over trading", rather than beneficial ownership of positions. Some respondents referenced the proposed position limit rules by the CFTC that give control over trading precedence over beneficial ownership. Respondents also highlighted that there are independence requirements set out in European legislation (for example UCITS, AIFMD).

68. Some respondents noted that positions should be aggregated with other entities within the group where such entities are not included in the same fully consolidated accounting group as this is consistent with Article 3(1) of EMIR. They also highlighted that in Europe the principal-to-principal model is used for ETDs which means that positions held by an intermediary on behalf of a client are held as principal. Therefore the RTS should be amended to provide further clarification for ETDs.
69. ESMA also sought views on its proposal that the commodity derivative positions of a person should be aggregated on a 'whole' position basis with those that are held for a beneficial ownership basis. This means that although a firm may own a percentage of another firm it must aggregate the position of that firm in its entirety and not on a pro rata basis according to the percentage of its holding.

Analysis following feedback and proposal

70. ESMA recognises that there is a need to further elaborate how a person's positions should be aggregated within a group and how funds must comply with the regime. Having considered the approach taken under other EU legislation which requires aggregation in some instances, e.g. the short-selling Regulation and the transparency Directive, and the need to ensure that position limits cannot be easily circumvented by the creation of new entities and subsidiaries, ESMA considers the regime should address both the corporate group relationship between entities and trading control.
71. A person's position is established by:
 - i. summing up its positions in the commodity derivative contract, same commodity derivative contracts and EETOC contracts and where the person holds both long and short positions, in netting them down;
 - ii. aggregating its positions with the positions in that commodity derivative contract of its subsidiary undertakings.
72. Positions must be aggregated with the positions of its subsidiary undertakings. The only exception to the above calculation is where the management company of a collective investment scheme does not control or in any way influence the investment decisions in the collective investment scheme. In such cases it cannot aggregate the fund's position with the positions held by other group companies

73. A separate calculation is required for the spot month contract and for the other months' contract in a commodity derivative contract to assess compliance against the spot month and other months' position limits.

Economically Equivalent OTC Contracts (Article 57(12)(c))

74. To prevent avoidance of position limits on ETD contracts by persons entering into OTC contracts instead, ESMA is required by Article 57(12)(c) of MiFID II to determine the criteria by which an OTC contract is judged to be economically equivalent (an EEOTC) to an ETD that is traded on an EU trading venue.
75. The CA of the trading venue on which the commodity derivative is traded sets the position limit applicable to the commodity derivative and its EEOTC contract, regardless of where in the EU the EEOTC is traded.
76. Similar to the CFTC approach to defining equivalence for its position limits regime, ESMA proposed that the criteria for an EEOTC would be based upon an OTC contract being referenced to an ETD contract that is traded on a trading venue within the European Union, or has fundamentally the same characteristics with regard to the contract specification as the relevant ETD contract.
77. ESMA notes that respondents continue to have different views concerning the scope of EEOTC contracts. Some respondents argue for a wide scope for EEOTC contracts so that they can net down their long and short positions over a wider number and range of contracts. The main concerns put forward were that limited netting possibilities would negatively affect the availability of financial products and hedging instruments, restrict capacity for financial institutions to provide liquidity to real economy customers and pose a risk of trading activity shifting to non-EU markets.
78. Several respondents requested ex ante certainty on whether contracts are recognised as EEOTC before entering into transactions.

Analysis following feedback and proposal

79. ESMA maintained the essence of the proposed definition, further refining it. The EEOTC is, thus, defined as a contract which has the identical contractual specifications and terms and conditions, excluding post trade risk management arrangements, as a contract traded on a trading venue.

Definition of the same commodity derivative (Article 57(12)(d))

80. A central CA has the responsibility for setting the position limits on the same commodity derivative, when the same commodity derivative is traded in more than one jurisdiction within the EU. ESMA is required under Article 57(12)(d) of MiFID II to define what constitutes the same commodity derivative.

81. In ESMA's view, 'same' is a subset of economically equivalent. A commodity derivative is the same if it is at least economically equivalent. In addition to be considered the same it must have other equivalent properties, such as accepting the same deliverable supply for settlement, and that the contracts are traded under, or with reference to, the same set of trading venue rules and form part of a single fungible pool of open interest.
82. ESMA notes that a cash-settled contract is not the same as a physically-settled contract and, by definition, an EOTC contract cannot be the same as a contract that is traded on a trading venue under the rules of that trading venue.
83. The majority of respondents agreed with ESMA's proposal on the definition of the same derivative contract. A small number of respondents pointed out the narrowness of this definition, whilst others considered the terms "same" and "economically equivalent" were synonyms and the definition and usage should be identical.

Analysis following feedback and proposal

84. ESMA maintains its proposal, adapting it in order to take into account securitised commodity derivatives.
85. "Same commodity derivative" is defined as a contract traded on a trading venue which is economically equivalent to another commodity derivative traded on a trading venue with the additional requirement that both contracts form a single fungible pool of open interest, or, in the case of securitised commodity derivatives, of securities in issue.

Aggregation and netting of OTC and on-venue commodity derivatives (Article 57(12)(e))

86. ESMA is required under Article 57(12)(e) of MiFID II to define the methodology for aggregating and netting OTC and on-venue commodity derivative positions for the purpose of assessing compliance with the position limits. It is important that the methodology should not permit the build-up of positions that are inconsistent with the objectives of the position limits regime that are set out in Article 57(1) of MiFID II.
87. As MiFID II does not address the possibility of the same derivative contract being listed on a third-country venue (i.e. a venue that is not a trading venue as defined by MiFID II), ESMA stated in its CP that it considered the geographical scope of Article 57 to be limited to Europe. Therefore the netting and aggregation of positions on third-country venues were not included within the draft RTS.
88. Respondents main proposal was that netting across contracts traded in other jurisdictions should be permitted in order to ensure that position limits reflect the economic reality and the real risk exposure of a participant's activity. They argued that the term 'economically equivalent' OTC contracts is not defined by Level 1 and therefore there is scope for ESMA to provide for a broader definition. Some respondents thought that netting should take into account physical holdings (where the deliverable supply of

physical stock can be known with relative certainty) as these can be used to deliver against short positions. More broadly, for the avoidance of doubt, respondents requested a clear definition of OTC in this context.

Analysis following feedback and proposal

89. ESMA's view is that there should be a reasonably narrow scope for EEOTC contracts as a wider scope would risk diluting the integrity of position limits for commodity derivatives by allowing inappropriate netting of positions. A wide approach would also create additional complexity and uncertainty for position holders as the same EEOTC commodity derivative could be potentially subject to several position limits simultaneously.
90. A conclusive list of EEOTC contracts would be very helpful in this regard, but creating such a list may be unworkable and would in any event need to be regularly updated. ESMA has retained its proposal whereby a person's net position in a commodity derivative is the sum of its positions held in the commodity contract, same commodity contracts and EEOTC contracts. Where a person holds both long and short positions, the positions must be netted together.
91. Netting of instruments against physical holdings and instruments outside of MiFID II's scope is not permitted. This is due to the fact that in establishing the exemption for wholesale energy products under the definition of C6 financial instruments, MiFID II expresses the intent that these instruments will be subject to the REMIT regime and not the MiFID II regime. Therefore it would be inappropriate for persons to be permitted to net, or be required to aggregate, instruments that are not financial instruments under MiFID II. Equally, ESMA notes that Article 57(1) of MiFID II refers to the holdings of a person in a commodity derivative and EEOTC contracts: it does not refer to holdings of an underlying commodity and therefore the netting and/or aggregation of underlying physical assets is not considered to be within the intentions of MiFID II.

Procedure for applying for an exemption from commodity derivative position limits (Article 57(12)(f))

92. ESMA is required under Article 57(12)(f) to determine the procedure by which non-financial entities that are holding positions for the purpose of risk-reduction may be exempted from the position limits regime. ESMA is also required to specify how the relevant CA will approve such applications.
93. In the CP, ESMA noted that the intention of MiFID II is that the exemption is available only in respect of specific positions: it is not a universal exemption for certain types of persons, which exempts them from position limits for all activities undertaken in all commodity derivative contracts, regardless of whether they are risk-reducing or speculative.

94. MiFID II does not define to whom the notification of exemption should be made. However, as the notification is an exemption from the position limits regime in relation to holdings in a specific contract, ESMA considers that this is the basis for the notification. Persons incorporated in an EU Member State and persons that are incorporated in a third country should make the notification to the CA of the relevant trading venue on which the contract trades. ESMA considers this to be appropriate as a person may be eligible, as noted above, for an exemption in relation to certain contracts, e.g. in relation to its commercial activities, and not eligible for an exemption for other activities or other contracts.
95. ESMA proposed that a person should apply for an exemption from a position limit for risk reducing positions to the CA of the trading venue for that contract. The CA may require the person to demonstrate that a specific position is risk reducing and may withdraw the exemption for that position if insufficient information is provided.
96. ESMA proposed that CAs would have up to 30 calendar days to consider whether to grant an exemption. The majority of respondents disagreed with ESMA's proposed procedure, considering it impractical as it would hinder non-financial firms' ability to manage risks relating to their commercial activity. A number of respondents proposed replacing the proposed ex ante procedure with an ex post procedure which would allow immediate trading. Others proposed an ex ante approval as a general rule but that nevertheless it should be possible for a firm to seek an ex post approval.

Analysis following feedback and proposal

97. Following the input received in the public consultation ESMA revised its approach and significantly reduced the proposed period available for CAs to consider applications for exemptions from 30 to 21 calendar days.
98. ESMA notes that replacing the proposed ex ante procedure with an ex post procedure would fall outside the legal powers available to ESMA.

Trading venue where the largest volume of trading takes place and significant volume

99. Where the same contracts are traded in different Member States, there is a need to assign one CA to set a limit which applies in all relevant countries. This assignment is made on the basis of the country in which the trading venue with the largest average daily volume is located. Where the "same" commodity derivative is traded in significant volume on two or more trading venues in two or more Member States, the CA of the trading venue with the largest volume will be the central CA.
100. ESMA is required under Article 57(12)(d) to define what is a significant volume of trading in a same commodity derivative. For clarity, ESMA notes that this will only be required where the same commodity derivative is traded on two or more trading venues within the European Union.

101. According to ESMA's proposal in the CP, where the same commodity derivative contract is traded on two or more trading venues within the European Union, the determination of a central CA would be required whenever there were at least three lots of open interest in the same commodity derivative contract simultaneously traded on more than one trading venue. A majority of the respondents agreed with ESMA's proposal on this matter, recognising the importance of establishing a framework in which avoiding position limits regime is not possible. Other considered the limit too low.

Analysis following feedback and proposal

102. Although ESMA shares the view that the determination of the central CA is needed and an important piece of the regulatory regime, it also acknowledges that the regime entails inherent cost and would only be efficient beyond a higher significance threshold. Therefore, ESMA aligned the threshold for significant volumes with the threshold for new and illiquid contracts, thus adopting a consistent approach to the threshold.

103. Therefore ESMA considers a commodity derivative to be traded in significant volume, when:

- i. It has an average daily open interest which is above 10,000 lots in the spot and other months' combined on a trading venue over a consecutive three month period; or
- ii. in the case of securitised commodity derivatives defined under point (c) of Article 4(1)(44), when the number of units traded multiplied by the price exceeds an average daily amount of €1,000,000.

104. Largest volume is calculated over a period of one year.

105. ESMA notes that trading venues that list the same commodity derivative contract must put in place appropriate communication and liaison arrangements to ensure that the volumes of open interest are known at all times to the relevant CAs.

7. MARKET DATA REPORTING

7.1. Reporting obligations under Article 26 of MiFIR

Background/Mandate

Article 26(9) of MiFIR

ESMA shall develop draft regulatory technical standards to specify:

- (a) data standards and formats for the information to be reported in accordance with paragraphs 1 and 3, including the methods and arrangements for reporting financial transactions and the form and content of such reports;*
- (b) the criteria for defining a relevant market in accordance with paragraph 1;*
- (c) the references of the financial instruments bought or sold, the quantity, the dates and times of execution, the transaction prices, the information and details of the identity of the client, a designation to identify the clients on whose behalf the investment firm has executed that transaction, a designation to identify the persons and the computer algorithms within the investment firm responsible for the investment decision and the execution of the transaction, a designation to identify the applicable waiver under which the trade has taken place, the means of identifying the investment firms concerned, the way in which the transaction was executed, data fields necessary for the processing and analysis of the transaction reports in accordance with paragraph 3; and*
- (d) the designation to identify short sales of shares and sovereign debt as referred to in paragraph 3;*
- (e) the relevant categories of financial instrument to be reported in accordance with paragraph 2;*
- (f) the conditions upon which legal entity identifiers are developed, attributed and maintained, by Member States in accordance with paragraph 6, and the conditions under which those legal entity identifiers are used by investment firms so as to provide, pursuant to paragraphs 3, 4 and 5, for the designation to identify the clients in the transaction reports they are required to establish pursuant to paragraph 1;*
- (g) the application of transaction reporting obligations to branches of investment firms;*
- (h) what constitutes a transaction and execution of a transaction for the purposes of this Article.*
- (i) when an investment firm is deemed to have transmitted an order for the purpose of*

Analysis following feedback from stakeholders

Data standards and Formats for reporting

1. In the CP, ESMA sought feedback on the implementation challenges that would result from election of one of the proposed formats for the purpose of transaction and reference data reporting.
2. The formats considered were: FpML, ISO 20022, TREM (a custom XML format defined by ESMA and currently used for Transaction Reporting and Instrument Reference data exchanges between CAs), IFX, FIX and XBRL.
3. Out of 50 respondents 21 have indicated one or more formats that would cause most significant implementation challenges. TREM has been indicated as a most troublesome format by a highest number of respondents (18). The least indicated format was ISO 20022 (5) and FpML (7).
4. Additionally, 29 respondents indicated also their preferences for the format to be chosen. Among these respondents majority (16) indicated FpML, followed by FIX (7) and ISO 20022 (6).
5. Furthermore, 10 respondents have expressed a general preference for a XML-based standard to be used. 6 respondents indicated that non-XML standards would pose most significant implementation challenges. Out of the considered formats FpML, XBRL and TREM are based on XML syntax. ISO 20022 is the ISO-approved standardisation methodology for financial messages and data sets. It is syntax-independent but includes a set of XML design rules to convert the message models into XML schemas, whenever the use of the ISO 20022 XML-based syntax is preferred.
6. Many respondents stressed that the chosen format should be standardised, non-customised and non-proprietary.
7. According to the received feedback ISO 20022 and FpML are the standards that have been preferred by most respondents and at the same time are perceived least challenging. Also, a preference for XML-based standards has been expressed by the respondents.
8. Furthermore, ESMA with assistance of external consultants has conducted a study to assess which technical format is most appropriate for the transaction and reference data reporting. Following the results of the study it has been concluded that ISO 20022 is most suitable due to the high level of compliance with envisaged legal requirements as well as its performance and extensibility capability.

9. Having considered the feedback to the CP, as well as results of the study, ESMA has decided that transactions and instrument reference data should be reported under MiFIR in a common XML format and in accordance with ISO 20022 methodology.

Transaction and execution

10. In the CP, ESMA sought feedback on its proposed definitions for transaction and execution and in particular on whether there was any additional activity that should be excluded from the definitions.
11. Of the 45 respondents, 18 respondents supported the proposed definitions for transaction and execution and had no issues or had no substantive comments. Five other respondents generally supported the definitions but raised particular issues.
12. Overall however, as with the Discussion Paper the focus of the responses was on exactly where the boundaries lay for what was reportable.
13. Several respondents raised issues with respect to specific aspects of the proposed definitions, a summary of their opinions and ESMA conclusions is included in the following sub-sections:

Definition of transaction

General definition and list of exclusions

14. Some respondents raised queries about what they perceived as discrepancies between the general definition of a transaction and the list of exclusions. There were also requests from some respondents for ESMA to draft a specific list of transaction types or activity to be reported and a specific list of excluded activity.
15. ESMA believes that the general rule for what constitutes a transaction should be drafted on a broad principle basis with a specific limited set of exclusions. This is to ensure that competent authorities are able to capture activity where the investor or the investment firm makes an investment decision at the time of acquisition or disposal. ESMA has therefore decided to retain the general approach but has expanded the list of specific exclusions to take into account consultation feedback and has provided clarification for some exclusions.

Securities Financing Transactions

16. The issue that received by far the largest response (26 respondents) was securities financing transactions where respondents were looking for clarification that they need not report this activity before the Securities Financing Transactions Regulation (SFTR) comes into effect (i.e. applicability of the exception). To do so would place a heavy burden on firms for reporting that would only be required for a limited period of time.

Respondents also sought confirmation that reporting would not be required by parties that did not have an obligation to report under the SFTR (i.e. scope of the exemption).

17. On the applicability of the exemption, ESMA confirms that a securities financing transaction (SFT) as defined under the SFTR for which there would be a reporting obligation if the SFTR was applicable will not be required to be reported before the SFTR regime becomes applicable.
18. On the scope of the exemption, ESMA confirms that it would apply only where all the following conditions are met:
 - a. the transaction is an SFT as defined in the SFTR,
 - b. there is a reporting obligation under the SFTR,
 - c. the transaction has been reported under the SFTR.

Importantly, if the above conditions are met and there is a requirement to report a given SFT under MiFIR, such requirement would apply only to those market participants who are investment firms subject to reporting under Art. 26 of MiFIR.

Exercises of reportable financial instruments

19. There were also a significant number of responses concerning the exercise of a reportable financial instrument. The CP proposed that the exercise of a reportable instrument should not be reportable but the resultant transaction in the underlying would be reportable with a flag to indicate that it was the result of an exercise.
20. Several respondents requested clarification or raised issues with respect to this approach, noting that the result of exercise flag would be difficult to implement because it would require the transaction in the underlying to be linked to exercise of the financial instrument and the proposal was not consistent with the definition of a transaction. Clarification was also requested on whether transactions in the underlying were required for expiry exercises as well as early exercises.
21. Various options were suggested but there was no general consensus amongst respondents.
22. ESMA recognises that while it would be desirable for the competent authorities to receive information on exercises where the investor is making a positive decision to carry out the exercise, there are significant difficulties associated with reporting the exercise and the resultant transaction in a meaningful way and believes that the additional complexity required does not justify the benefit.
23. ESMA has therefore decided to exclude all activity connected with the exercise of financial instruments and extended this to also exclude conversion of convertible bonds.

Lifecycle events

24. A few respondents raised concerns that there should be greater alignment with EMIR generally, and a few of these raised the fact that the reporting of changes of notional differed from how these are reported under EMIR.
25. Some respondents also queried whether reporting of changes in notional was intended to also apply to changes that were intrinsic to the terms of the contract as well as to negotiated amendments to the notional value of an existing contract between two counterparties.
26. A few respondents requested clarification on the exclusion of assignments and novations. Their understanding was that the remaining party of a novation has no transaction reporting responsibility as it is part of a novation and there is no change of notional for them but that parties stepping-in and out as a result of novation have an obligation to transaction report.
27. There was also a query on whether the exclusion on portfolio compression would include netting activity. ESMA's intention is to exclude netting activity and this has been made clear by the addition of a separate exclusion for netting.
28. ESMA has tried to align requirements with EMIR where possible but this is only possible to a limited extent since the purposes of EMIR and transaction reporting are quite different and reporting for EMIR takes place at the position level rather than the transaction level. As stated in the CP, ESMA wants to avoid adopting the same method of reporting as for EMIR as this would introduce a lot of additional complexity and would blur the line between clearing activity and execution. For market abuse monitoring it is not necessary for competent authorities to be able to link the subsequent lifecycle events to the original transaction since competent authorities are primarily interested in the change of position at the time of the modification.
29. ESMA confirms that it is not its intention to capture changes in notional that are envisaged in the contractual terms of the original contract and this has been made clear in the RTS by the addition of a specific exclusion. ESMA also confirms that the intention is to exclude all reporting of novations by all parties.

Transfers and gifts

30. There were several requests for clarifications around transfers and gifts, including transfers into and out of portfolios.
31. ESMA confirms that gifts are reportable under the general definition of transaction which includes an acquisition or disposal.

Custodial activity

32. Some respondents queried whether pure custodial activity i.e. transfers between a custodian and the custodian's client should be reportable since there is a change in legal ownership but no change in beneficial ownership. ESMA agrees that since there is no risk of market abuse for this type of activity it should be excluded. For transactions where a custodian is acting for a client with a change of beneficial ownership of the client competent authorities are interested in the identity of the investor rather than the custodian and this will be made clear in the level 3 guidance.

Creation and redemption of funds

33. Several respondents argued that the exemption for creation and redemption of an exchange traded fund by the administrator of the fund should be extended to all funds where the asset management company determines the (fixed) issue price or redemption price. ESMA agrees to this proposal and therefore the exclusion has been broadened accordingly.
34. A few respondents requested clarification around inter-group activity and the reference to internal transactions in Article 3(3)(f) of the draft RTS arguing that transactions between different firms with different LEIs within the same group should be reportable but that transactions between branches within the same legal entity should not be, citing consistency with EMIR. They assumed that this was what the phrase internal transfers was trying to capture but requested it be made clearer in the RTS.
35. ESMA confirms that transactions between different firms with different LEIs within the same group are reportable and that transactions between branches within the same legal entity are not reportable. Any transfers between clients are reportable under the general definition of transaction. Purely internal transfers within a firm for operational reasons where there is no change of position for the firm or client are not included in the definition of transaction and are not reportable. Since these requirements are all covered by other provisions ESMA has deleted this exclusion that was set out in Article 3(3)(f).

Changes to the composition of an index/basket

36. A few respondents argued that if a change in the composition of an index after a transaction occurred is not reportable then this should also extend to changes in the composition of baskets and sectors. ESMA has decided to extend the exclusion for a change in the composition of an index to also cover baskets.

Pre-determined contractual terms and mandatory events

37. Respondents supported the exclusion of mandatory events and requested further clarity on exactly what was reportable and how it should be reported.
38. ESMA wishes to clarify that the exclusion for pre-determined contractual terms or a result of mandatory events which are beyond the control of the investor is not intended

to be limited to corporate events such as mergers, takeovers bankruptcy but also applies to other events meeting this criteria such as issue of scrip dividends, automatic expiries on a contractual termination date, etc. It has also been made clear that this exclusion does not exclude initial public offerings or secondary offerings, placings or debt issuance which are therefore reportable provided that the activity takes place in a reportable financial instrument.

39. The specific exclusion for scrip dividends has therefore been removed.
40. Several respondents raised concerns about the criteria (eg. time delay of at least 10 business days) and value cap. There were concerns over how the cap would be applied in practice and respondents queried whether the criteria alone were sufficient. Several options were proposed including removing the cap for some or all activity, increasing the cap, expanding the exclusion for share incentive plans.
41. ESMA has decided to exclude all DRIPs on the basis that they already tend to have these features and therefore there is no need to also apply the criteria and they are similar to scrip dividends except they take place on the secondary market rather than the primary market.
42. ESMA confirms that it is the intention to keep this exclusion quite narrow to avoid inadvertently excluding activity that is of interest to competent authorities and is not in favour of extending the exclusion more widely to other savings plans. The criteria will therefore be retained for the other activity but the value cap for a particular investor in a particular instrument will be doubled, resulting in an amount of the equivalent of one thousand euros for a one off transaction and 500 euros per calendar month.

Definition of execution

43. The majority of the 45 respondents to Q214 and Q215 did not make any comments concerning execution.
44. A trade association requested a specific exclusion from execution for transmitted orders that met the conditions for transmission.
45. ESMA agrees that while an investment firm that is receiving an order from a client or clients and sends it to a third party or makes an investment decision under a discretionary mandate for clients is executing, where for a particular transaction the firm meets the transmission requirements set out in Article 5(1) it will no longer be considered to be executing that transaction and shall not report the transaction. This has been clarified in Article 4(2).
46. A couple of respondents wanted adviser-arranger activity to be expressly excluded where the firms may identify investment opportunities for other investment managers within the group and may assist in arranging the ultimate transaction but did not receive

and transmit distinct orders. It was suggested that this could be addressed by providing a definitive list of activity or by a specific carve out for adviser-arrangers.

47. ESMA appreciates that the proposed definition for execution could be overly broad and foresees difficulties in retaining such a broad definition while carving out activity that should be excluded with sufficient certainty.
48. ESMA has therefore amended the RTS to limit it to an exhaustive list of services or activities that result in a transaction being concluded. The services or activities are the ones mentioned in Annex 1, section A, points 1, 2, 3 of MiFID II as well as the following two additional activities: (1) making an investment decision in accordance with a discretionary mandate given by a client; (2) transfer of financial instruments to or from accounts.

Transmission of orders

49. ESMA sought feedback on its proposal for transmission of an order.
50. In particular, ESMA provided clarification on the following:
 - i. The circumstances in which transmission can take place – namely that transmission applies where an investment firm receives an order and sends it to a third party to be filled (receipt and transmission) as well as where the firm is acting on a discretionary basis and sends an order to a third party to be filled;
 - ii. Who can be a receiving firm – for example whether a non-MiFID firm can be a receiving firm;
 - iii. How a transmitting and receiving firm should populate certain fields such as the short selling flag field;
 - iv. The time by which a reporting firm must submit a transaction report.
51. Generally the issues raised by the respondents were very similar to those raised in the feedback to the Discussion Paper. There was continuing concern expressed about the burden that the proposed approach would impose on both transmitting and receiving firms as a result of the complexity arising from capturing the additional data and systems changes. Of the 44 respondents, however, 19 either expressed support, conceded that the level 1 text did not allow much flexibility, advised that they had no issues or did not make any comment.
52. Various alternative proposals were made by a very limited number of respondents, as follows:
 - i. that a transmission agreement should not have to exist in advance of trading if the transmitting firm checked that the receiving firm was a MiFID investment firm with

transaction reporting responsibilities that would be able to submit a transaction report with the cooperation of the transmitting firm;

- ii. that transmitting firms should be able to rely on non MiFID firms to report as receiving firms if they had such a contractual arrangement in place;
 - iii. that there should be an exemption for reporting the client for aggregated trades;
 - iv. that the time for reporting of allocations should be extended to T+5 and gradually reduced to T+1 over time.
53. Similar issues were raised around timing for the transaction reports as in the feedback to the Discussion Paper, particularly with aggregated reports where respondents advised that the allocations might not be available by T+1 and that this could result in incomplete or amended reports. The length of time to put transmission agreements in place was also raised as an issue because of the concern that it might interfere with the ability to trade spontaneously with a broker.
54. Other than these issues, most of the responses sought clarification of how transmission might apply to their business and requested more granular detail on the data required to be provided by transmitting firms and the data to be reported by the receiving firm.
55. Generally the reporting mechanism was better understood by respondents than following the Discussion Paper. However, some respondents were still confused, for example believing that the receiving firm would submit two reports – one for its own report and one for the transmitting firm and clarification were requested on whether an agreement was required for each broker per client.
56. There was also a request for clarification on reporting of aggregated orders by a firm when acting under a discretionary mandate and placing an order with a third party. The trade association proposed that while the allocations needed to be reported there should not be an obligation to also report the aggregated level, since it did not provide any additional information.
57. ESMA does not believe that it would be appropriate to grant an exemption from having to report client allocations where the transaction involved aggregated orders. This is because competent authorities require full visibility of client information for assisting in market abuse detection.
58. Competent authorities need to have direct jurisdiction over receiving firms that are reporting in order to be able to enforce accuracy of the data and therefore these firms must be MiFID firms. While this may appear restrictive, ESMA notes that complying with the conditions for transmission is only one choice that is available for transmitting firms. As an alternative a transmitting firm can report itself.

59. ESMA confirms that the specific conditions and the timing need to be agreed between the transmitting firm and the receiving firm. However, ESMA has decided not to stipulate the form this must take or the timing because this should be left as a commercial arrangement between the transmitting and receiving firm. The conditions for transmission need to be agreed with each receiving firm that a transmitting firm is seeking to rely on to report but this is not on a per client basis.
60. To clarify the means of reporting in a transmission scenario, ESMA confirms that the receiving firm will always send its reports under its own name to meet its own reporting obligations but where the transmission conditions have been satisfied, the receiving firm will incorporate the information received from the transmitting firm into its own reports and has now clarified this in recital 4. ESMA has also amended the RTS and Annex I to more clearly state which information is to be provided by the transmitting firm and which pieces of data are to be included in the report from the receiving firm.
61. ESMA confirms that for consistency with the approach for transaction reporting generally, reporting of aggregated transactions is required at both the aggregate and allocation level. Therefore if a firm chooses not to meet the conditions for transmission and reports itself it shall report the transaction with the receiving firm and the allocation to the clients.
62. ESMA wishes to provide the following additional clarifications:
 - i. In the absence of agreement between the transmitting firm and receiving firm, an order should be treated by the receiving firm as a direct order.
 - ii. A receiving firm cannot be a trading venue.
 - iii. The application of transmission to DMA is no different to its general applicability. If a DMA user meets the transmission requirements then it will not have to transaction report and the DMA provider will report the details transmitted by the DMA user.
 - iv. Where there is successful transmission the receiving firm shall report the market side and the client side of the transaction. The client side would include the information provided by the transmitting firm.

General approach to reporting

63. In the CP, ESMA sought feedback on its proposal to replace the existing transaction reporting framework (buy/sell indicator, counterparty and client fields) with buyer and seller fields.
64. The vast majority of the forty six respondents supported the proposal because it would be simpler and more intuitive, technically feasible, easy to interpret and less prone to mistakes. In addition, the respondents appreciated the benefit of making the trading

capacity information independent of the determination of who is buying and who is selling, as this would reduce the complexity in reporting.

65. Those respondents not in favour of the proposal argued that the solution would require significant system changes with no additional benefits. Also, the proposal would require more translation of the data and transfer the client and counterparty information either to the buyer or the seller fields depending on the trade direction. Finally, some respondents stated that they did not believe that the proposal would solve the reporting problems since these can only be addressed via further guidance on how to transaction report in specific trading scenarios.
66. ESMA understands the points raised by those opposing the proposed new reporting framework. In response, ESMA confirms that most of those concerns are likely to be addressed through future ESMA guidelines. Furthermore, ESMA acknowledges that the simplified approach will represent a significant change to the current transaction reporting framework. However, in light of the feedback received, ESMA believes that in the long term it will benefit the quality of transaction reporting data since the information can be more intuitively populated by reporting entities and interpreted by competent authorities
67. In conclusion, given the clear support expressed by most of the respondents and that most concerns raised are going to be addressed by future guidelines, ESMA has decided to pursue the new transaction reporting framework.

Trading capacity

68. Following the feedback to the CP the trading capacity field, which shall be populated independently from the identification of the Buyer and the Seller, only refers to the following Level 1 definitions in MiFID II: 'dealing on own account' and 'matched principal trading'. Where none of the two definitions applies, the transaction falls under a third residual category.
69. As there is no mentioning of "acting on behalf" in the above-mentioned Level 1 definitions, the description of the trading capacity field addresses the industry's concerns of an unclear distinction between the different capacities.
70. Further instructions on how to use the trading capacities will be given in future ESMA Guidelines.

Identification of investment firms executing a transaction

71. ESMA considered that according to the Level 1 definition in MiFID II, undertakings which are not a legal persons may be licensed as an investment firm only if they fulfil the following conditions: (a) their legal status ensures a level of protection for third parties'

interest equivalent to that afforded by legal persons and (b) they are subject to equivalent prudential supervision appropriate to their legal form.

72. In addition, a recent statement of the LEI ROC (the committee established by the FSB to coordinate and oversee a worldwide framework of legal entity identification) clarified that individuals acting in a business capacity are eligible to obtain LEIs, subject to the following conditions; they conduct an independent business activity as evidenced by registration in a business registry; only one LEI is issued for the same individual and adequate verifications are made that data protection, privacy or other obstacles do not prevent the publication of the current LEI data file.
73. Considering the strict conditions of MiFID II for undertakings that are not legal persons to be licensed as investment firms and the additional clarifications provided by the LEI ROC, ESMA concluded that there is no need to allow alternative identifiers to be used for the purpose of the identification of MiFID investment firms.

Conditions for the use of Legal Entity identifiers

74. The large majority of respondents reiterated their concerns with the level 1 obligation. In particular, respondents were concerned about the scope of clients that Article 26(6) of MiFIR requires to identify with a LEI. In this respect, it is important to recall that MiFIR L1 does not foresee any exemptions from the investment firms' obligation to identify clients who are eligible for a LEI.
75. Concerning the Level 2 requirement, many respondents did not have specific objections to the proposal in the CP. The main concern related to the lack of clarity with respect to the following issues:
- i. Whether the LEI validation against the global LEI database would need to apply on a transaction by transaction basis. If this was the case, respondents claimed that the requirement would constitute a barrier to trading as the process to issue and renew a LEI is not real-time.
 - ii. Whether the validations against the LEI database would also include the validation of status (e.g. lapsed status). Some respondents were concerned about firms being held responsible for the lapsed status of their clients. Some others were concerned that the smaller clients would not be able to bear the costs of yearly renewal of the LEI.
76. With respect to the intention of the Level 2 requirements, ESMA established the following:
- i. The proposed requirement to validate against the global LEI database is not intended to apply on a transaction by transaction basis.

- ii. The requirement to validate against the global LEI database does not include an obligation for investment firms to ensure that the LEI status of their clients is not lapsed due to lack of payment of the maintenance fee.
77. In light of the above clarifications, ESMA concluded that there seemed to be no fundamental concerns regarding the proposed requirement on the use of LEIs, therefore ESMA has decided to follow the approach as proposed in the CP.

Designation of natural persons

78. There was no overall support or refusal from the industry to this particular proposal regarding the client identification code for natural persons, but many doubts and concerns were raised.
79. Some respondents argued that, on one hand, national ID numbers are robust and uniquely identifies each individual, since they provide all relevant information for the purpose of further investigation. Thus, there was some disagreement with the client additional information requested. On the other hand, other respondents argued that national ID numbers can change over time so they are not persistent identifiers. The same concern applies to National Passport numbers.
80. Complexity was pointed out in relation to IT and organisational investments (huge costs) where National Passport Number or National Identity Card is used, since they are usually kept manually in client's files. Additionally, this information will have to be accommodated across the whole order transmittal and execution chain within the investment firms. Due to the complexity and the costs that the client ID code would entail, there were some suggestions for implementation to be phased in.
81. Data protection issues were once more included in the majority of the responses, fearing that the implementation of the client ID would unnecessary increase on the risk of personal data fraud. Likewise, the problem of bank secrecy regarding the inclusion of the non-EEA client ID is still deemed to be unresolved, since it is necessary to get client's prior approval.
82. Several investment firms complained about the lack of consistency between the method chosen by ESMA to identify natural persons and the method applied in the EU Money Laundering Directive (2006/60/EC) where there is no priority order for the different passports.
83. Regarding the rule to obtain the code identifier for natural persons, some respondents expressed doubts on what "obtainable" of the higher priority identifier is meant. It was also argued that there was no single and common EU definition of nationality.
84. Validation of the data was raised as an issue that needed further clarification, since firms have no ability to validate whether a client has, or is entitled to have, a particular

identifier. As such, ESMA was asked to make clear whether firms are only required to provide these identifiers when the client has provided them to the firm in the normal course of business. Gathering client identifiers is considered to be quite complex and challenging provided that clients are not obliged to provide this identification.

85. CONCAT identification code received overall support since it is sufficiently consistent and should be extended to identify all individuals across EEA and non EEA jurisdictions. It should be considered as a fall back solution, but some improvements on the generation of the code were proposed, such as the use of special language-characters (diacritical marks).
86. ESMA has assessed the industry's concerns and proposals and therefore has modified the existing approach as follows:
 - i. Providing a straight forward rule in article 7 to provide clearer guidance on the rule to obtain the priority identifier for each client based on nationality; on the other hand, detailed rules for the CONCAT code generation have been added.
 - ii. Introducing priority of EEA nationality over non-EEA nationality.
 - iii. To address data protection concerns, ESMA confirms that confidentiality of the data will be ensured.
 - iv. Despite of maintaining the requirement of collecting and using client ID codes for transaction reporting purposes, ESMA has established limits for the validation to be undertaken by investment firms on such codes.
87. However, the proposal on introducing a phase in approach to collect client ID codes starting on January 2017 to enable investment firms to accommodate their IT systems gradually, is not foreseen in MIFIR level 1 and therefore cannot be adopted.

Identification of persons responsible for investment decision/execution (Trader ID)

88. The feedback to the ESMA CP in particular on the question of the identification of the person responsible for the investment decision or execution within the investment firm asked for the use of firm internal codes, the registration number with the CA or the default identification by use of the CONCAT.
89. The idea behind the proposal for using the same identification method as used when identifying natural persons as clients of the investment firm was to have a uniform logic for identifying natural persons in transaction reporting.
90. The use of internal codes would hinder the ability of Competent Authorities to efficiently analyse information reported for clients and traders by using the same method of identification while the concept of registration of traders with the CA is not established in

all Member states and therefore cannot be considered an alternative. The default use of CONCAT deviates from the approach chosen to identify natural persons as clients and would thus create an inconsistency and a potential source of errors. Therefore after assessing the industry's concerns and proposals, ESMA decided to follow the approach as proposed in the CP.

Identification of the Algo responsible for investment decision/execution

91. There seemed to be no fundamental concerns regarding the identification of algos, therefore ESMA has decided to follow the approach as proposed in the CP.

Designation to identify the applicable waiver

92. A few respondents did not foresee any problems or did provide any comments. The main issues raised by the majority of the respondents were the following ones:

- i. clarify whether the designation to identify an applicable waiver applies only to market-facing transaction executed on EEA trading venues or also on non-EEA trading venue;
- ii. clarify how to report multiple waivers and in particular if investment firms shall report all of them or only one, and in the latter case which one;
- iii. introduce a specific enforcement to trading venues to provide timely and accurate information to investment firms, possibly as part of the trade confirmation process and not in the end of the day report.

93. ESMA has taken into consideration the above industry's comments and clarified that:

- i. the designation to identify an applicable waiver applies only to market-facing transactions executed on EEA trading venues. In the relevant field of the Annex I, it has now been specified that the waiver indicator is applicable only if the transaction is executed under a waiver on a trading venue (i.e. an EEA trading venue). Moreover, ESMA further clarifies that as, only trading venues direct members can benefit of pre transparency obligations waivers (and not also indirect ones, such as transmitters of orders), waiver flags have to be populated only by trading venues direct members and not by transmitting firms;
- ii. in case of multiple waivers, the waiver indicator field has to be populated with all the pertinent flags. This circumstance has been clarified in the relevant field of the Annex I;
- iii. as per the last topic, ESMA believes that there is no specific level 1 mandate to enforce trading venues to provide the requested information to investments firms.

Having said that ESMA believes that investment firms should not face any problem in this respect given the current trade confirmation process.

Designation to identify a short sale

94. The large majority of respondents reiterated their concerns with the level 1 obligation. Aside from the concerns with the level 1 obligation, some respondents further suggested removing the reference to the best effort approach for obtaining the relevant short selling information from clients as provided in the CP. They argued that there was no requirement for the clients inform the investment firm whether the transaction would amount to a short sale. In this respect, ESMA would like to highlight that by requiring executing investment firms to obtain the short selling information from the client on “a best effort basis only” the RTS aims at precisely addressing the respondents’ comment.
95. There seemed to be no other fundamental concerns regarding the ESMA proposed level 2 obligations, therefore ESMA has decided to follow the approach as proposed in the CP.

Reporting transactions executed by branches

96. In general stakeholders agreed with the approach taken by ESMA regarding branches. However there were two particular issues which raised concerns. These issues were:
- i. Identifying the branch that holds the relationship with the client
 - ii. Absence of rules by which EEA branches of non EEA branches need to report.
97. In regards to the first issue there were three major difficulties seen by the stakeholders. The first difficulty being multiple branches dealing with the same client. The second being the relationship with the client can change over time. The third being that there seems to be no clear criteria to determine the closest relationship. Some stakeholder argued that the solution mentioned in the Discussion Paper was easier to implement.
98. Concerning the first issue, given the objections raised by stakeholders, ESMA returned to the proposal mentioned in the Discussion Paper and therefore decided to request the branch that got the order directly from the client, or that has made the investment decision pursuant to a discretionary mandate given to it by the client.
99. Following concerns that were raised during the consultation, ESMA has now also introduced new rules to govern how EEA branches of non-EEA firms should transaction report.
100. As a result, non-EEA firms with EEA branches should report as follows:
- i. Where there is only one branch in the EEA: all transaction reports should be sent to the CA of the Member State where that branch is located;

- ii. Where there is more than one branch in the EEA the branches shall jointly choose one of the competent authorities from the Member States to whom the transaction report is to be sent. This selection can only be made from one of the competent authorities in whose Member State the non-EEA firm has a branch. For example, if a non-EEA firm has branches in France, Germany and Spain, the transaction report can only be sent to the AMF or BAFIN or CNMV.

Methods and arrangements for reporting financial transactions

101. In general stakeholders agreed with the approach taken by ESMA regarding methods and arrangements. However there was one particular issue which raised concerns, this was related to the requirement for investment firms to 'have adequate arrangements in place to ensure that the transaction reports submitted by the firm accurately reflect the changes in position of the firm'. Firms were concerned that compliance with this provision would not be possible as not all actions that have an impact on positions are reportable, thus it would be impossible for competent authorities to use transaction reports to calculate firms' exact positions.
102. Considering that the intention of the requirement was not to enable competent authorities to reconstruct the absolute size of the position but only to enable them to assess the changes in the positions resulting from the execution of a given reportable transaction, ESMA concluded that there seemed to be no fundamental concerns regarding the ESMA proposed level 2 obligations.

Determination of the most relevant market in terms of liquidity

103. There seemed to be no fundamental concerns regarding the identification of algos, therefore ESMA has decided to follow the approach as proposed in the CP.

Fields to be reported in transaction reports

104. Several respondents raised issues with the table of fields. A summary of their opinions and ESMA conclusions is included in the following sections:

Excessive number of fields in the CP-table, and questions regarding mandatory fields

105. Respondents were concerned about the high number of fields in the data table of the CP; many indicated that the data collection was excessive. Further, there was a clear concern regarding lack of clarity of what fields was supposed to be populated in the various scenarios. Based on the feedback, it was clear that the CP opened up several interpretations on how to do this.
106. The fields in the reporting table have shrunk to 64, partially a consequence of applying the ISO20022 standard. Further, several fields, including "client address", "client post code" have been removed as they were not considered critical to the

purpose of the reporting. However, the majority of the fields remain, and some additional fields have been introduced to cater for information required by Transparency directive.

107. ESMA acknowledges the lack of clarity in the CP on what data-fields are mandatory or optional. Changes have already been incorporated in the RTS text to address this. ESMA will keep working on resolving all ambiguity in the specifications with the future publication of guidelines. When finalized, reporting entities will have to consult both the final RTS and the guidelines in order to get a complete understanding of the format and data to be reported for all cases.

The fields are not sufficient to properly handle complex derivatives

108. Industry expressed concern that the CPs field set, was not sufficient to describe complex derivatives.
109. ESMA recognizes that there are derivatives that might not easily fit into the current structure of the table. There is a trade-off between the complexity and number of the fields, and their ability to capture any exotic financial derivative. At the moment, we consider the current field structure to be sufficient to capture enough details of the reportable financial instruments. Any exotic derivatives which have no clear mapping to the current set of fields will be covered in the business cases.

Request for two trading capacities

110. Respondents argue that there might be need for two trade capacities in the reporting, as venues who report on behalf of non-MiFID firms will have to populate both buyers and seller.
111. This relates to the ambiguous level 1 text, and is resolved if the non-MiFID firm is considered as the reporting firm, instead of the trading venue. The trading venue will be the "submitting venue", but the data it submits will be as if the non-MiFID member is the "reporting entity". This of course implies that the non-MiFID will provide all necessary info to the trading venue so that they are able to populate all data fields. Consequently, there is no need for two capacities fields, as the single capacity field will always be from the non-MiFID members' point of view.

Trading venue as counterparty

112. Respondents asked ESMA for clarity on the inclusion of a 'trading venue' as a counter party to a trade. They consider this is a misunderstanding of the role of a trading venue as a trading venue can never be a 'counter party' to a trade.
113. This situation only arises when an investment firm deals with a trading venue, with no CCP, and where the investment firm is not aware of the actual counterparties it is trading against. For the purpose of transaction reporting, the trading venue may then be



populated in the 'buyer' or 'seller' field. This does not imply in any way that the trading venue legally is the counterparty. This is merely a reporting convention, and a placeholder for an unknown real counterparty

7.2. Obligation to supply financial instrument reference data under Article 27 of MiFIR

Background/Mandate

Article 27(3) of MiFIR

ESMA shall develop draft regulatory technical standards to specify:

- (a) data standards and formats for the financial instrument reference data in accordance with paragraph 1, including the methods and arrangements for supplying the data and any update thereto to competent authorities and transmitting it to ESMA in accordance with paragraph 1, and the form and content of such data;*
- (b) the technical measures that are necessary in relation to the arrangements to be made by ESMA and the competent authorities pursuant to paragraph 2.*

Analysis following feedback from stakeholders

Fields to be reported as instrument reference data

1. Several respondents raised issues with the table of fields. A summary of their opinions and ESMA conclusions is included in the following sub-sections:

Excessive number of fields in the CP-table

2. Some respondents raised concerns with the number and type of fields to be reported. They considered the scope of reference data to be too broad and not required for CAs to fulfil their obligations. Furthermore, trading venues are concerned that in some cases they are not the ones holding the IP rights, therefore a publication of such data on ESMA's website would be from their point of view legally problematic. Therefore a limited scope of reference data was proposed that could be made publically available free of charge.
3. The required fields in the reference data table have been changed to some extent, partially being a consequence of applying the ISO20022 standard. Furthermore, several fields have been removed, however, the majority of the fields remain, and some additional fields have been introduced. ESMA acknowledges the concern raised by the industry regarding the missing IP rights for some of the reportable information. However, it is already stated on level 1 that the reports made under Art. 27 MiFIR shall contain all information authorities need to use, analyse and exchange transaction reports (recital 33). All information to be provided in this table is from ESMA's point of view required to fulfil this purpose.

Questions regarding mandatory fields and requirement of alignment of tables of fields

4. Further, there was a concern regarding lack of clarity of which fields to be populated in various scenarios. In addition to that, respondents asked for alignment between both tables of fields (transaction reporting and reference data).
5. ESMA acknowledges the need for consistent tables of fields for both transaction reporting and reference data. After having performed various crosschecks between both tables and the usage of the ISO 20022 data format, both tables will be consistent in the final version of RTS 22 and 23.

Golden Source

6. Some respondents proposed that the publication of the reported reference data on ESMA's website should be considered to be a golden source for transaction reporting, meaning that only those financial instruments should fall under the reporting obligation that are contained in this list.
7. ESMA acknowledges the need of market participants for clarity on which financial instruments are reportable and which are not. However, the reportability of a financial instrument is subject to the legal definition in Art. 26 (2) MiFIR. ESMA is not in a position to overrule this legal definition by defining the reportability of a financial instrument only by its availability on such a list, even though this list will be a good reference source for market participants.

Reasons and frequency of updates of instrument reference data

8. There was a broad agreement on the proposal to submit a full file once per day (with 18 respondents unconditionally agreeing).
9. 2 trading venue operators agreed with the principle, but suggested that the transmission should occur after trading hours in general instead of by a specific time, since some markets are still operating at the time specified in the draft RTS (9:00 pm).
10. Considering that CAs and ESMA need time to compile and publish the list of instrument reference data, the deadline for submission by the trading venues has been maintained at 21:00 CET, it being understood that the data submission will cover only the instruments that were admitted to trading or traded until 18:00 CET on that same day.
11. Lastly, there was broad support for the proposed requirement for trading venues that do not work with a defined list of instruments to submit reference data when the first order/quote is placed or the first trade occurs. The instruments for which reference data has to be provided on a given day are those that were admitted to trading, or traded, or for which orders/quotes were placed on that day (no cumulative list).

Organisational requirements

12. The main concerns of respondents on the organisation of the reporting requirements related to the absence of a golden source of reportable instruments. Some respondents suggested that ESMA should be responsible for holding and maintaining this golden source. In relation to these concerns, it is stressed that even if the ESMA instrument reference data database is not intended to be the golden source for financial instruments reference data, it can nonetheless be expected to assist investment firms in complying with their transaction reporting obligations by providing them with relevant information being available for a daily downloading.

Usage of instruments identifiers

13. In general the respondents did not agree with the approach taken by ESMA regarding the suggested usage of ISIN and alternative instrument identifiers (Aii) as instrument identifiers.

14. Main issues include:

- i. The Aii is not a standard and generally not used outside of EEA.
- ii. The ISIN's applicability is considered limited

15. Most respondents did provide feedback on alternative solutions to the suggested approach, however, there was not a clear preference on what that alternative solution should be.

16. After reviewing all the existing industry initiatives for reference data, ESMA has decided to use ISINs to identify reference data, given the open source nature and the low cost of the solution as well as the flexibility and speed with which ISINs could be allocated to existing/new financial instruments.

7.3. Maintenance of relevant data relating to orders in financial instruments

Background/Mandate

1. Article 25(2) of MiFIR requires ESMA to develop technical standards in relation to the obligation for trading venues to maintain records of orders.

Article 25(3) of MiFIR

ESMA shall develop draft regulatory technical standards to specify the details of the relevant order data required to be maintained under paragraph 2 of this Article that is not referred to in Article 26.

Those draft regulatory technical standards shall include the identification code of the member or participant which transmitted the order, the identification code of the order, the date and time the order was transmitted, the characteristics of the order, including the type of order, the limit price if applicable, the validity period, any specific order instructions, details of any modification, cancellation, partial or full execution of the order, the agency or principal capacity.

Analysis following feedback from stakeholders

Identification of the relevant parties

2. Generally, respondents to the CP globally agreed with the proposed provisions on the identification of stakeholders.
3. Regarding the identification of clients, some respondents disputed the usefulness of this information within the order data at the trading venue's level. In this respect and as already specified in the CP, ESMA considers that the client identification constitutes a key tool in the monitoring of trading activities (from the submission of an order, its evolution via modifications and finally its execution) and in the detection of cross-market manipulations based on orders (e.g. layering like manipulation). Experience shows that a number of market abuse cases relate to orders and that market abusers are not exclusively investment firms. The requirement to store client ID is fully consistent with the Market Abuse Regulation objectives. In particular, this data will allow CAs to confirm or, on the contrary, set aside the suspicious nature of any cases identified.
4. Also, some respondents showed concerns in relation to the disclosure of the ultimate beneficiary's identity where the order is transmitted through a chain of intermediaries before reaching the trading venue. To address this confidentiality issue, the RTS has

been modified to require that trading venues maintain the identification element of the immediate client of their members even if the client is itself an intermediary.

5. Regarding the case of aggregated orders, some respondents questioned the numbering of beneficiaries under the flag “Aggregated_X”. In light of these remarks and considering that order-driven market manipulation is most likely to be carried out by single individuals or entities, the RTS no more requires the numbering of the beneficiaries behind aggregated orders.
6. In addition, a few respondents raised questions regarding the availability of the client ID at the time aggregated orders are submitted to the trading venue. While pre-allocation of orders before execution is mandatory in most Member States, ESMA understands that this is not the case under a few local regulations. In order to reflect all market models, the indicator “Pending allocation – Pnal” has been introduced and may only be used under the strict condition that the non-allocation of orders prior to their execution is permitted under national law.

Client ID – aggregated/allocated orders

7. The feedback received from stakeholders on the above-mentioned question primarily focussed on opposing the suggested inclusion of client IDs in the order data to be maintained by trading venues in general. Stakeholders e.g. argued that the inclusion of client ID would be a considerable technology change for firms and would incur complexity and costs for corresponding IT projects. In addition, adding client ID would require encryption of the order messages themselves which would create a significant processing overhead and potentially lead to negative impact on performance and stability of trading systems. Moreover, pursuant to the stakeholders this information should already be known to the CAs through the transaction reporting obligation. Lastly, problems in gathering requested end client ID may occur as trading venues may not have contractual relationships with the end clients.
8. ESMA stresses that the recording of the identification of the direct client is essential to fulfil the objectives of Regulation (EU) No 596/2014 as well as of Article 24 of Regulation (EU) No 600/2014. The relevance of order data will be expected to increase as a result of the broadening of the scope of Regulation (EU) No 596/2014 to cover attempted market abuse. These considerations prevail over potential issues regarding complexity and costs for corresponding IT projects. Hence, ESMA has added further reasoning for the inclusion of the direct client ID to the order data to be maintained by operators of trading venues to the recital paragraphs of the RTS.
9. Although ESMA believes that it should be clear from Level 1 text that only the client ID of the direct client must be maintained by the operators of the trading venues, the Annex to the RTS has been amended (N. 3, Field “Client identification code”) to specify whose client ID must be maintained by the member or participant and who is considered to be

the client in a DEA scenario. . In the case of a DEA scenario, the client will be the DEA user.

10. In relation to aggregated orders, the draft RTS set out in the CP required aggregated orders to be flagged using the code “AGGREGATED_X” where “X” represents the number of clients on whose behalf orders have been aggregated. However, the aggregated orders flag in the RTS has now been amended to only refer to “AGG”. This is because ESMA is of the opinion that it is not necessary to obtain information about how many client orders have been aggregated into a single order as this would not necessarily contribute to more successful investigations of market abuse cases.
11. The responses to the CP also indicated that in some cases the allocation of aggregated orders are not known at the point of order submission but are only known after execution (e.g. where business is conducted by fund managers and allocation of the trades to the funds takes place after the execution). This led the respondents to the conclusion that in these cases there should not be an obligation on trading venues to subsequently source the individual client IDs related to the order.
12. In the case of pending allocations a new flag “PNAL” has been included in Art. 2(e) of the RTS which should be used where national legislation in a Member State allows for client allocation to take place after the submission of an order. In that case, operators of trading venues will not require to subsequently obtain information from the member or participant about each of the client IDs associated with the order following allocation.

Liquidity provision

13. The feedback indicated some concerns over the usefulness and costs of requiring the identification of provision liquidity activity. ESMA believes that this piece of information is important for the purpose of a more efficient detection of market manipulation as it allows the competent authorities to distinguish the order flow coming from an investment firm acting on the basis of public trading conditions which are pre-determined by the issuer or the trading venue from the order flow coming from an investment firm acting at its own or at its client discretion. Moreover, it should be taken into consideration that, according to article 48 of Directive 2014/65, trading venues shall have in place systems to monitor market making activity. Therefore, the cost should be very low for the trading venues given the fact that this identification is already required and that the trading venues will receive this piece of information from their members or participants.
14. Some respondents to the CP pointed out that there could be participants of some trading venues that, according to RTS 15, may be deemed as market makers in non-equity markets where they themselves would not consider as acting in this capacity. ESMA considered that criteria established in the mentioned RTS should not have an impact in the obligation of maintaining record of orders.

15. Some responses to the CP asked for more clarity on what the liquidity provision activity encompasses. Also, the feedback indicated that trading venues should be able to operate other liquidity provision or market making schemes. Consequently, the RTS has been modified for the sake of clarity and simplicity and includes any market making scheme or liquidity provision activity carried out on the basis of conditions which are pre-determined by an issuer or the trading venue.

Identification of the order and strategy orders

16. ESMA received feedback from eight derivative trading venues/trade associations regarding the proposal around how implied orders should be maintained. The feedback indicated that industry practice did not operate in the proposed way and that when a number of implied order strategies are offered, the number of different possible combinations were significant. As a result, it would not be practical for a trading venue to maintain full order details of all implied order combinations. Instead, ESMA understands that the current practice is for trading venues to tend to only disseminate a subset of implied orders and then maintain the full implied order details on execution. One response indicated that the strategy order link ID is only provided on execution of the implied orders to link all the relevant implied orders. Therefore the RTS has been amended to reflect these points around the current market practice.
17. ESMA also received other feedback in response to Q229. For example, some respondents stated that not all financial instruments have an ISIN or Aii code and therefore the respondents queried how to construct the order ID given that one of the elements used in constructing the code is the ISIN or Aii (if there is no ISIN). One response indicated that the Exchange Product code would be most relevant.
18. Following feedback from Q238 of the CP (usage of instrument identifiers in reference data) ESMA has determined that each financial instrument admitted to trading or traded on a trading venue must be identified by the trading venue using an ISIN. Given that trading venues must comply with both the order data and reference data obligations set out in Articles 25(2) and 27 of MiFIR respectively, ESMA believes that the financial instruments identification code should be harmonised across the two obligations and has therefore stated in the order data RTS that the financial instrument identification code should also be the ISIN.

7.4. Clock synchronisation

Background/Mandate

1. Article 50(1) of MiFID II requires Member States to oblige all trading venues and their members or participants to synchronise the business clocks that they use to record the date and time of any reportable event.

Article 50(2) of MiFID II empowerment

ESMA shall develop draft regulatory technical standards specifying the level of accuracy to which clocks are to be synchronised in accordance with international standards.

Analysis following feedback from stakeholders

Reference time

2. The feedback indicated general support for the adoption of UTC as the reference time and therefore the RTS has kept the methodology. The draft RTS defined reference time as being UTC maintained by one of the timing centres listed in the latest Bureau International des Poids and Mesures (BIPM) Annual Report on Time Activities. There was feedback received indicating that this was too restrictive and did not include certain scenarios, for example, where UTC time is disseminated via a satellite system such as GPS. The RTS has amended the definition to also include UTC disseminated via a satellite system which for example, would include the use of a GPS receiver or the use of the Galileo satellite system when it is launched (provided the offset from UTC is removed, currently 16 'leap' seconds as of April 2015).

Different types of trading systems

3. The responses to the CP also indicated some non-central limit order book trading models where orders are negotiated prior to execution that would be included in the electronic systems rather than the voice trading systems. Given the manual trading element involved in some of these particular trading models, the RTS have been supplemented with these additional trading models and the requirements have been aligned with those for voice trading systems as opposed to electronic trading systems.

Level of accuracy

4. There was a significant amount of feedback highlighting the technical issues in attempting to achieve the draft RTS proposals in relation to the accuracy and the associated costs. Some of these technology issues were around the use of Network Time Protocol (NTP) not being able to achieve accuracy of more than a millisecond

resulting in a change to other methods, most likely to be Precision Time Protocol (PTP). It was also pointed out that certain common operating systems do not support precision timing and that this would require changes to alternative operating systems, again at significant cost and risk. Feedback also highlighted that the national timing centres have drift from UTC measured in the nanoseconds and therefore having similar requirements for financial institutions was not proportionate (the Circular T publication by BIPM shows the offset from UTC by National Timing Centres <http://www.bipm.org/jsp/en/TimeFtp.jsp?TypePub=publication>). On this basis the RTS has been amended such that the most stringent requirement will be for maximum divergence from UTC of 100 microseconds for investment firms' activity that uses high frequency algorithmic trading techniques or for trading venues that have a gateway to gateway latency time that is faster than a millisecond. The other categories for maximum divergence from UTC depend on the system and/or activity and will either be 1 millisecond or 1 second divergence.

Point of timestamping

5. In the feedback, ESMA received requests for clarification about the point at which events should be timestamped as there may be multiple points within the trading venue's systems where a timestamp could be applied.
6. ESMA has now clarified in the draft RTS 24 on the maintainance of relevant data relating to orders that in general, all events such as new orders, order modifications etc should be timestamped using the business clocks used by the trading venue's matching engine. The only exception to this is for rejected orders where the orders should be timestamped at the point when the order is rejected. This is because by their nature, rejected orders will not reach the trading venue's matching engine.

Members or participants of trading venues

7. Feedback also indicated concerns over the same standard being applied to both trading venues and firms which could result in a trading venue coming under pressure from its members not to reduce latency as members systems would require upgrading. An unintended consequence could also be that members or participants then resign from the trading venues and use direct electronic access provided by other members in order to avoid meeting the new requirements. Therefore the RTS has been changed to remove the connection between the requirements for member or participants and trading venues. A specific category has been added for systems used for HFT activity with increased timestamp granularity of 1 microsecond.

Documenting compliance

8. Responses also indicated that there were no details provided on how trading venues and their member or participants should review compliance, how often this should be reviewed and the acceptable level of compliance. Article 5 of the RTS has been added

to provide details on this area. Venues will have to be able to provide documentation explaining their system design and the specifications to show the accuracy will be maintained to within the required parameters. The RTS have also been written so that trading venues and members or participants who operate multiple systems can apply different standards to different systems. For example a member or participant that operates a system that submits orders on a high frequency basis to a trading venue and has another system to submit RFQs via a human to the same trading venue can apply different clock synchronisation requirements for each system rather than the most stringent requirements occurring at the legal entity level.

8. POST-TRADING ISSUES

8.1. Obligation to clear derivatives traded on regulated markets and timing of acceptance for clearing (STP)

Background/Mandate

Article 29 of MiFIR

1. *The operator of a regulated market shall ensure that all transactions in derivatives that are concluded on that regulated market are cleared by a CCP.*

2. *CCPs, trading venues and investment firms which act as clearing members in accordance with Article 2(14) of Regulation (EU) No 648/2012 shall have in place effective systems, procedures and arrangements in relation to cleared derivatives to ensure that transactions in cleared derivatives are submitted and accepted for clearing as quickly as technologically practicable using automated systems.*

In this paragraph, “cleared derivatives” means:

(a) *all derivatives which are to be cleared pursuant to the clearing obligation under paragraph 1 of this Article or pursuant to the clearing obligation under Article 4 of Regulation (EU) No 648/2012;*

(b) *all derivatives which are otherwise agreed by the relevant parties to be cleared.*

3. *ESMA shall develop draft regulatory technical standards to specify the minimum requirements for systems, procedures and arrangements (including the acceptance timeframes) under this Article taking into account the need to ensure proper management of operational or other risks, and shall have ongoing authority to update those requirements*

1. Under MIFIR, CCPs, trading venues and clearing members shall have rules ensuring that transactions in cleared derivatives are submitted and accepted for clearing as quickly as technologically possible.
2. ESMA is mandated to develop draft RTS in order to specify the minimum requirements for systems, procedures and arrangements to ensure Straight-Through Processing (STP), taking into account the need to ensure proper management of the operational or other risks.

Analysis following feedback from stakeholders and proposals

3. Following the publication of the MiFIR CP 2014/ESMA/1570 on 19 December 2014, the responses from stakeholders were analysed and their comments on the draft RTS on STP were taken into account as detailed in the following sections

Pre-checks

Requirements for regulated markets when clearing certainty is already achieved

4. With regard to trades executed on a regulated market, a majority of respondents supported the objective of clearing certainty ensured as early as possible, i.e. pre-execution. However, many of these respondents indicated that, where clearing certainty was already achieved and can be ensured, then an exemption to the proposed solution should be provided. They explained that:
 - i. the current process applicable to trades executed on Regulated Markets already achieves clearing certainty;
 - ii. the proposal of the draft RTS would require significant rebuild across the market for no additional benefit; and
 - iii. it would prevent the current give-up process to continue.
5. With regard to the first comment (a), respondents explained that clearing certainty is achieved thanks to the rulebooks of the trading venues (TV) and CCPs, and that behind every trader on the TV there is the contractual commitment from a clearing member. This way, once the trade is matched, the trade can be immediately cleared. The clearing members become the counterparties to the trade (clearing member of the buyer versus the CCP and the CCP versus the clearing member of the seller) until each leg of the trade is allocated to the respective executing parties.
6. With regard to the second comment (b), market participants would need to rebuild communication flows incurring significant costs.
7. With regard to the third comment (c), given the way in which give-ups are conducted, the final allocation may only be known much later. However the trade is cleared immediately and the clearing member is accountable for this trade in the meantime. The objective of having the trade cleared as quickly as possible is met even though the final allocations may only be known later.
8. ESMA agrees that as long as the objective of clearing certainty is met and as long as this objective can continue to be ensured through contractual arrangements, then the drafting of the RTS can be amended accordingly to allow the current practice to continue. The pre-checks as presented in the CP are kept but now include an exception when the rulebooks and the contractual arrangements ensure the same objective of clearing certainty.

Variety of limit communication models being used (Ping/Push/Hub)

9. An important number of respondents indicated that the market has developed multiple solutions to communicate the applicable limits for the pre-trade checks. In particular, some solutions rely on clearing members sending the limits to the TVs, some rely on TVs sending requests to clearing members, some other rely on utilities acting as credit hubs where limits can be centralised, updated and requested.
10. ESMA agrees that the requirements can allow for different communication models. As a result, the drafting of the RTS is amended to allow this flexibility.

Consistent treatment of mandatorily cleared and voluntarily cleared OTC derivatives

11. Many respondents commented on the fact that mandatorily cleared and voluntarily cleared OTC derivatives should not be distinguished, when the decision to clear them is known at the time of execution. Indeed, they indicated that when parties enter into an OTC derivative trade that is not required to be cleared but with the intent to clear it, the clearing component is an integral part of its price, whether it is voluntarily cleared or mandatorily cleared.
12. Therefore counterparties would also benefit from the same level of clearing certainty for voluntarily cleared OTC derivatives as for mandatorily cleared OTC derivatives. This comment was not only made in the question on pre-checks but throughout the entire section on STP.
13. ESMA agrees that cleared OTC derivatives, whether mandatorily or voluntarily cleared, can be treated the same way (the term 'cleared derivatives' refers to the term as defined in Article 29(2) of MiFIR, which includes derivatives which are to be cleared). As a result, the draft RTS is amended so that the distinction would be whether cleared OTC derivatives were traded on a TV or not, and not distinguish mandatorily cleared and voluntarily cleared. The proposed set of Articles and how they are sequenced reflects this approach.

Timeframes to send trades to the CCP

Considerations on whether the requirement should be within 10 seconds on average rather than 10 seconds on a trade by trade

14. An important number of respondents broadly agreed with the proposed timeframes to send trades to the CCP, but a few additional comments were made. The first one was with regard to the 10 seconds proposal for trades executed electronically on a trading venue.
15. Several respondents indicated that although this 10 second deadline is met for the vast majority of trades (some respondents quoting a 99% ratio), they suggested changing this

requirement for more flexibility as there are circumstances when this deadline is not met, such as peak trading times. The main suggestions were to amend the provision to “within 10 seconds on average” or “within 10 seconds for the substantial majority of trades”, or adding the possibility of exceptions: “within 10 seconds except where it is not reasonably practicable to conduct them within the deadline”.

16. ESMA believes the time requirement should remain unchanged, reinforcing the goal of STP at all times, and to leave to supervision the cases when this deadline is not met.

Reinforcing the goal of STP for OTC derivatives that are traded purely bilaterally

17. Many respondents flagged that when an OTC derivative trade is negotiated bilaterally, away from a TV, the clearing members become aware of the execution of the trade only after the executing parties have entered the trade in the systems and the post-trade processing has started.
18. Some OTC derivative trades are entered in the systems quickly but sometimes they are not entered in the systems for quite some time. During that period between the execution of the trade and the booking and processing of the trade through the infrastructure, clearing members are usually not aware of the trade. As a result, these respondents claimed that clearing members are in the incapacity to monitor trades against the 30 minute deadline.
19. ESMA recognises that in the current market practice clearing members are often not aware of the execution of an OTC derivative contract that they will later be asked to clear. However, this situation works against the STP objectives of MiFIR as it prolongs (a) the period of bilateral counterparty risk (for as long as the trade is not cleared), as well as (b) the period with uncertainty on the trade as there is still a risk the trade gets rejected for clearing when it is finally submitted (in the meantime, the market may have moved significantly).
20. ESMA believes the STP objective for OTC derivatives traded bilaterally still needs to be pursued and the proposed requirement has been amended to take into account the feedback from the consultation. The amendment to the requirement is to request clearing members to have procedures in place to obtain evidence of the execution timeframe of the OTC derivative contract they clear. The clearing members would need to agree with their clients on the necessary information for the records of the clearing members in order for them to have evidence of the execution timeframe of the OTC derivative contract they have accepted to clear, in compliance with this STP regulation.
21. With regard to the requirement to submit OTC derivative trades executed bilaterally to the CCP within 30 minutes, several respondents also commented on the actual timeframe. Respondents indicated that there was no equivalent timeframe requirement in other jurisdictions, in particular the US, and that bilateral agreements containing details on the timeframe to submit OTC derivative trades were instead permitted. With

regard to the bilateral agreements, they indicated that the most commonly used execution agreement template included a market standard of 150 minutes instead of the 30 minutes of the draft RTS.

22. However, for the reasons explained in paragraph 19, ESMA believes the goal should be to bring the submission of a trade to the CCP closer to its time of execution and therefore has maintained the current 30 minute timeframe in the draft RTS.

Timeframes for the clearing member to accept or refuse trades

Facilitating STP while ensuring CCPs and/or clearing members can conduct checks

23. The draft RTS addressed the question of the timeframe for CCPs to send bilateral OTC derivative trades to the clearing member and the timeframe for the clearing member to accept or refuse these trades. This part of the RTS was the most broadly supported part by respondents and only raised a few comments.
24. The first comment related to the actual time CCPs or clearing members would have under this RTS to run checks on the submitted trades and to communicate the resulting information. Some respondents commented on providing a much longer timeframe to CCPs and clearing members to enable them to run more extensive checks than what is possible under the current 60 second deadlines. They were suggesting using a 30 minute window. It should be noted that similar comments were made for the next section which addressed the time imparted to CCPs to accept or refuse trades. Similarly they were suggesting a much longer timeframe for CCPs to run these checks so the checks could be more extensive, claiming that STP should not be at the expense of safety.
25. However, a majority of respondents agree that the timeframes provided in the draft RTS allow sufficient checks on a trade by trade basis. This does not prevent full portfolio calculations, intra-day margin calls between CCPs and clearing members or between clearing members and their clients, and any other risk management mechanics, to take place away from the STP flow. As a result, the current timeframes have been kept unchanged.

Variety of flows in relation to the acceptance of the trade by the clearing member within the proposed timeframe

26. Several respondents indicated that other flows exist for the CCPs to check whether clearing members accept or reject the submitted trade. One such example is when the CCP has a limit management module where the clearing member can directly manage the limits of the counterparties for which it clears trade. In this case, the CCP does not send a message to the clearing member to check whether the clearing member accepts the trade but can check that trade in its own system against the limits managed by the clearing member.

27. Therefore, these respondents requested an amendment of the draft RTS to allow different workflows than the one described in the draft RTS to be permitted as long as they achieve the same result, i.e. validating the acceptance of the trade by the clearing member within the same deadline.
28. ESMA agrees that alternate workflows can be allowed and thus that the draft RTS does not need to be prescriptive in terms of the workflows. The draft RTS has been modified to focus on the necessary outcome of this requirement and the associated timeframe, rather than what the possible workflows should be.

Timeframes for CCPs to accept or refuse trades

Consider longer timeframes initially for the start of the STP regulation while processes are improved

29. The majority of respondents were supportive of the proposed timeframes related to the requirements for CCPs to accept or refuse trades, agreeing on ensuring standardised and harmonised timeframes and ensuring international convergence where possible.
30. With regard to this section the main feedback was on the actual timeframe. Although the majority of respondents was supportive of the proposed timeframes, some respondents commented on taking into account the practical challenges that can be expected to arise during the implementation phase, when finalising the exact timeframes for the draft RTS.
31. These respondents indicated that 10 seconds might be difficult to achieve for all in the initial phase, in particular for complete new flows like with cleared OTC derivatives. They referenced the US approach which allowed for a timeframe of 60 seconds initially before moving to a shorter timeframe later on. Some respondents suggested a phased-in approach for these timelines while the teething issues are fixed or for longer timeframes for some of the scenarios.
32. ESMA is of the view that the mandate does not provide for phased-in time requirements. In addition, ESMA considers that it would be complex to amend the RTS shortly after they have entered into force and the implementation has been completed,. As a result, the proposed timeframes have been kept unchanged.

Treatment of rejected trades

Split views from respondents on the treatment of trades executed electronically on a TV and that are rejected for clearing

33. In relation to the treatment of rejected trades, also referred to as trades not accepted for clearing, the CP reported the varied feedback received from the discussion paper and explained the decision that had been made for the draft RTS with regard to the chosen approach. Notably, it explained that when trades are executed electronically on a TV and

are mandated to be cleared, the time between execution and acceptance or rejection is thus short. Therefore, in the case of a rejection when trades are executed electronically on a TV, as the time between the execution and a rejection is short, the market could not have moved significantly in the meantime and thus the potential damages suffered by the parties in should be limited. As a result, the chosen approach for the requirement had been to void such trades without breakage costs.

34. Like with the discussion paper, this topic was the most controversial, with split views on the approach with regard to trades executed electronically on a TV. Respondents diverged again on the approach for rejected trades that had benefited from STP. Some suggested they should be void without further obligation on the executing parties. Some suggested they should be void but with possible breakage costs allocated as per the rules of the TV. Others suggested there should not be any specific requirement in the RTS and that it should be left instead to the rules of the TV to decide on the treatment of such rejected trades.
35. However, most respondents tend to agree that the more STP a trade is (i.e. the more swiftly a trade is processed) then the smaller the damage is expected to be on the counterparties to the trade if the trade gets rejected. Indeed, when the time period between execution and rejection is small, the market has had less time to move, minimising possible breakage costs for the counterparties and allowing these counterparties to re-trade or to hedge as appropriate sooner.
36. In addition, several participants supported the approach envisaged in the draft RTS as described above, because it is aligned with the US regulation, which provides for a similar treatment (void without further obligation for the parties) when a trade executed on a Swap Execution Facility (SEF) is rejected.
37. With the STP objective in mind, ESMA is still of the opinion that voidance without additional obligations on the executing parties should be maintained in the RTS requirements.

Expand time window to 30 minutes for resubmission and include not only technical problems but also other non-credit justifications such as operational set-up issues

38. With regard to the treatment of rejected trades, another topic which attracted a lot of feedback was the possibility to resubmit trades that had been rejected for non-credit related reasons. However, in this case, the feedback was rather consistent. A majority of respondents indicated supporting the resubmission of rejected trades under certain conditions.
39. First they indicated it should only be for non-credit related reasons, however they suggested expanding the scope covered in the current draft RTS to include issues of a more operational nature, in addition to technical problems.

40. Secondly, they indicated that 10 seconds were not sufficient to identify the cause of the problem and thus advocated allowing 30 minutes instead. They mentioned that this would allow further international consistency as this was the time provided in the US. However, it should be noted that the CFTC issued a no-action letter³² on 22 April 2015, extending this timeframe to one hour.
41. Thirdly, respondents commented on this resubmission not being an actual resubmission of the same contract, but instead, as the first submission would be rejected and voided, that the RTS should clarify that the resubmission would actually be the submission of a new contract with the exact same trade details.
42. ESMA believes that these proposed changes do not undermine the objective of STP and also further support international convergence; as a result these comments are reflected in the amended draft RTS.

Amend requirements to ensure the executing counterparties are informed by intermediaries of the non-acceptance of a trade

43. Finally, some respondents commented on the need to ensure the executing parties are made aware as quickly as possible of the rejection of a trade. Similarly, they extended this principle to other situations when a trade is not accepted. Specifically, they mentioned the executing parties should also be made aware as quickly as possible when a trade limit is breached or when a trade is not accepted by a clearing member.
44. Several provisions in the draft RTS contain requirements to inform of such cases, however these respondents flagged the need to include all relevant parties in this requirement to ensure the executing parties are made aware.
45. For instance, in the case of a trade acceptance or rejection by a CCP, Article 4(3) of the draft RTS requires CCPs to “inform the clearing member and the trading venue on a real time basis”, however respondents suggested that TVs should also be required to use appropriate communication tools to inform the counterparties of the acceptance or rejection of a trade on a real time basis. Under the current Article 4(3), the requirement is to inform the clearing member and the TV, but there is no requirement for the clearing member and/or the TV to inform the executing parties quickly.
46. Some of the comments indicated that a delay in the executing parties finding out that their trade had been rejected would have a similar impact as having larger timeframes in the RTS. Indeed, it could expose these executing parties to market risk for longer if they do not know their trade has been rejected and it could prevent them from continuing their trading and hedging activity accordingly during that period.

³²Details of the no-action letter are available at the following address: <http://www.cftc.gov/PressRoom/PressReleases/pr7158-15>

47. As a result, some respondents requested an obligation for all the relevant intermediaries (the TVIs, the CCPs and/or the clearing members where appropriate) to have communication flows in place to inform the executing parties.
48. ESMA is of the opinion that indeed the relevant parties should be informed quickly as detailed in the previous paragraphs. The requirements to inform of a rejection, a limit breach or a trade non-acceptance have been amended where required to extend the requirement to all relevant intermediaries.

9. BEST EXECUTION

9.1. Information relating to best execution

Background/Mandate

Article 27(10) of MiFID II

ESMA shall develop draft regulatory technical standards to determine:

- (a) the specific content, the format and the periodicity of data relating to the quality of execution to be published in accordance with paragraph 3, taking into account the type of execution venue and the type of financial instrument concerned;*
- (b) the content and the format of information to be published by investment firms in accordance with paragraph 6.*

ESMA shall submit those draft regulatory technical standards to the Commission by 3 July 2015.

Analysis following feedback from stakeholders

Regulatory technical standards under Article 27(10)(a)

1. ESMA received a large number of responses to its proposals in respect of its obligation to produce RTS under 27(10)(a) of MiFID II. While a number of respondents were supportive of the proposals and welcomed the approach on the basis that timely, standardised execution quality metrics across all venues will illustrate to investors the relative merits of different market structures for order execution services, a large number of respondents raised concerns about some of the proposals in the CP.
2. One of the main issues raised was on the extension of the scope of the proposals to market makers and other liquidity providers for financial instruments subject to the trading obligation as set out in MiFIR. ESMA agrees with the arguments made by the respondents and has amended the RTS to ensure that only trading venues and systematic internalisers (SIs) will be subject to publishing data for financial instruments subject to the trading obligation.
3. Another concern raised was the large quantity of data required to be published under the proposals in the CP. ESMA has sought to address this concern by re-assessing its initial proposals and reducing the number of metrics required in the RTS and the quantity of data sought by some of those metrics. Further, ESMA has simplified the requirements

dealing with the cost of execution, moving them from the financial instrument level to a more general disclosure at the venue level. Additionally, ESMA has simplified and reduced to three, the number of ranges of financial instruments for which venues are required to publish information. This also reduces the quantity of data to be produced.

4. Many respondents raised issues about being required to publish of data on illiquid instruments that are rarely traded. To address these concerns ESMA has clarified that where no transactions occurred in a particular financial instrument on a particular day, execution venues are not required to publish the reports dealing with price information. This should materially reduce the volume of reporting, and ensure that readers do not have to sift through vast quantities of nil returns.
5. Many respondents raised the issue of consistency between reporting requirements for SIs, as proposed in the CP, and the SI regime under Regulation (EU) No 600/2014, including specific publication deferrals for post trade transparency purposes. They expressed concerns on the proposal concerning the publication of trade-level data by SIs and noticed that, in other draft RTS (relating to post trade transparency) in the same CP, ESMA had recognised the sensitivity of similar data by not requiring disclosure of the SI's identity when reporting post trade data. In order to mitigate risks for SIs, some respondents suggested a delayed publication of up to 4 months and the limitation of the reporting requirement to the first transaction, irrespective if it is a purchase or a sale. ESMA has carefully considered this issue and, while acknowledging the sensitivity of the issue for SIs, also notes that the usefulness of the information under this RTS would be extremely limited if SIs were to be exempted from the information to be published or from being identified. In this context, in order to balance these obligations for execution venues and to take account of the specific situation of SIs, ESMA requires that the information required by this Regulation should be published within three months, rather than one month, after each quarter. ESMA also requires that SIs, market makers and other liquidity providers are exempt from reporting point-in-time transaction data for any transactions above Standard Market Size or Size Specific to the financial instrument. ESMA considers that these amendments will provide sufficient protection for SIs by avoiding commercially sensitive information being made public and therefore ensures that their ability to hedge exposures and provide liquidity will not be affected.
6. A large number of respondents also stated that simply dividing venues between order driven markets and quotes driven markets did not take account of significant differences in how RFQ venues and continuous quote venues operate. They also raised concerns about a lack of consistency of such terms with the terms used in MiFIR and the draft RTS issued by ESMA for post trade transparency purposes. ESMA has taken these views on board and has better clarified the type of venues by adopting the taxonomy developed for the purpose of post trade transparency, such as continuous auction order book trading systems, quote driven trading system or RFQ trading systems.

7. A number of respondents also raised concerns about a lack of data comparability in relation to the point in time requirements and about the clarity of some of the metrics proposed in the CP. ESMA has amended the point in time requirements to capture the average price during a two minute period and has removed or better clarified some of the other metrics.
8. In its CP, ESMA also specifically asked whether other metrics to measure likelihood of execution should be used. A number of respondents provided some useful information and ESMA has taken on board some of these suggestions.
9. A large number of respondents commented that the requirement to have information calculated and recorded on a daily basis was too onerous. They requested that the information to be published by venues should instead be aggregated over annual or quarterly periods. ESMA considers that certain information such as general information on the venue or the cost applied by the venue to its users or members does not have to be captured for each trading day. However, ESMA is of the view that execution quality information on factors such as price, speed, and likelihood of execution has to be captured for each instrument for each trading day in order for the data to be comparable and to be of value for users.
10. In order to ensure that execution venues that operate a number of different markets do not provide a single report and thus provide distorted market data, the RTS now require that such venues provide the information for each segment they operate. An example would be where an established regulated market has a main order book and a separate order book for equities of smaller or growing companies. ESMA considers that in such instances, the relevant venue should provide the information as set out in the RTS for each order book in order to ensure that the public has information on the quality of execution on all markets.
11. In considering respondents' views on publication of information on costs, ESMA has clarified that such information should only capture data relating to costs that arise for the user of the venue or the client who has given the order (i.e. the investor) when orders are executed on that venue and when the venue has sight of them. ESMA considers that such information should include costs such as settlement fees or taxes (such as stamp duties) while these fees and taxes may not be received by the venue, they are nonetheless imposed on the investors through the execution of a client order on that venue.
12. A large number of respondents raised concerns about the timing of the report and its split into monthly sub reports. As noted above, ESMA has amended the RTS to now require publication should take place within three months from the quarter end and has removed the required to sub-divide the publication into monthly reports.

Regulatory technical standards under Article 27(10)(b)

13. ESMA received a large number of responses to its proposals in respect of the draft RTS it proposed under 27(10)(b) of MiFID II. A significant number of the respondents agreed with ESMA's approach. However, a large number of respondents raised issues about the publication of commercially sensitive information as required under the proposals. ESMA has carefully considered these concerns and in order to protect sensitive information requires that the number and volume of client orders executed on each of the top five venues are provided as a percentage of the firm's total for that class of financial instruments. A number of respondents were also concerned about the amount of information that was required from the proposals as a result of the large number of classes of financial instruments, as specific information on the top five venues must be gathered for each class. ESMA has considered this concern and significantly reduced the number of classes of financial instruments while maintaining enough granularity to ensure meaningful reporting.
14. A large number of respondents stated that some of the proposals exceeded Level 1 and that obligation to publish execution quality should only extend to the top five venues. ESMA does not agree and considers that the proposals are completely in keeping with the requirements set out in Level 1. ESMA has therefore maintained the requirement for the publication of information on quality of execution obtained on all execution venues for each class of financial instruments where the investment firm executed client orders during the year. Furthermore, in order to reduce duplication of information, the information relating to the order flow to the top five execution venues and the quality of execution have now been placed in the same article.
15. A number of respondents also questioned whether the large amount of data on order flow and execution quality could be easily processed by retail clients. ESMA has considered these responses and has amended the RTS to ensure that the information on the order flow to the top five venues is clearly separate to any information in relation to the quality of execution obtained. In addition reducing the number of the financial classes and changes to the format of the publication clearly enhance the readability of the information to be published. Furthermore, retail clients are not the only users of this data and professional clients will also benefit from publication of this information.
16. A number of respondents raised issues with the inclusion of market makers and systematic internalisers among the top 5 venues. ESMA is of the view that the inclusion of "execution venues" in Article 27(6) of MiFID II clearly requires information on order flow beyond trading venues. ESMA has therefore maintained the definition of execution venues that was used in the CP.
17. Some respondents asked for more clarity on the issue of Securities Financing Transactions. ESMA agrees that order flow in relation to client orders executed solely in respect of Securities Financing Transactions should not be considered in the same way as the general execution of client orders, as their large average transaction size and very specific nature will distort the information on firms' ordinary flows of client orders.

ESMA has therefore amended the RTS to require that Securities Financing Transactions are separately captured.

18. Responses to the CP also suggested that client categorisation should be taken into account for order flow reporting on the top five venues. ESMA agrees that information relating to client orders could easily be distorted if client orders executed on behalf of professional clients were combined with orders in respect of retail clients. ESMA has amended the RTS accordingly.
19. Some respondents stated that clarity should be provided on passive and aggressive orders and that the RTS should be amended to refer to “liquidity adding” and “liquidity removing”. ESMA agrees and has defined passive and aggressive orders accordingly.