



European Securities and
Markets Authority

Consultation Paper

Amendments to Commission Delegated Regulation (EU) 2017/587 (RTS 1)



Responding to this paper

ESMA invites comments on all matters in this paper and in particular on the specific questions summarised in Annex 1. Comments are most helpful if they:

- respond to the question stated;
- contain a clear rationale; and
- describe any alternatives ESMA should consider.

ESMA will consider all comments received by **25 January 2018**.

All contributions should be submitted online at www.esma.europa.eu under the heading 'Your input - Consultations'. Please follow the instructions given in the document 'Reply form for the MiFID/MIFIR Consultation Paper' also published on the ESMA website.

Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publically disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESMA's rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESMA's Board of Appeal and the European Ombudsman.

Data protection

Information on data protection can be found at www.esma.europa.eu under the heading [Legal Notice](#).

Who should read this paper

All interested stakeholders are invited to respond to this consultation paper. This consultation paper is primarily of interest to investment firms that might be qualified as systematic internalisers in equity instrument under the new MiFID II / MiFIR legislative framework but responses are also sought from any other market participant which might be impacted by the proposals contained in this document and including trading venues, trade associations and industry bodies, institutional and retail investors.

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Acronyms used

CP	Consultation Paper
ESMA	European Securities and Markets Authority
EU	European Union
MiFIDI	Directive 2004/39 of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directive 85/611/EC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC
MIFID II	Directive 2014/65/EU of the European Parliament and the Council of 15 May 2014 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
MiFIR Quick Fix	Regulation (EU) No 2016/1033 of the European Parliament and of the Council of 23 June 2016 amending Regulation (EU) No 600/2014 on markets in financial instruments, Regulation (EU) No 909/2014 on improving securities settlement in the European Union and on central securities depositories
OTC	Over-the-counter
RTS	Regulatory Technical Standard
RTS 1	Commission Delegated Regulation (EU) 2017/587 of 14 July 2016 supplementing Regulation (EU) No 600/2014 of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards on transparency requirements for trading venues and investment firms in respect of shares, depositary receipts, exchange-traded funds, certificates and other similar financial instruments and on transaction execution obligations in respect of certain shares on a trading venue or by a systematic internaliser
RTS 11	Commission Delegated Regulation (EU) 2017/588 of 14 July 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards on the tick size regime for shares, depositary receipts and exchange-traded funds
SI	Systematic internaliser

Executive Summary

Reasons for publication

Under Article 14(7) of Regulation (EU) No 600/2014 (MiFIR), ESMA received a mandate to develop draft Regulatory Technical Standards (RTS) to specify further, in the context of the quoting obligation for systematic internalisers (SIs), “the determination of whether prices reflect prevailing market conditions”. ESMA finalised its proposal in September 2015 (ESMA/2015/1464) and this proposal was endorsed and published in the Official Journal of the EU on 31 March 2017 (see Article 10 of RTS 1).

Over recent months, it has come to ESMA’s attention that the concept of “prices reflecting prevailing market conditions” may require further clarification. In particular, there have been discussions whether SIs’ quotes should under certain circumstances reflect the same minimum price increments as orders and quotes submitted to trading venues trading for the same financial instrument. ESMA considers that in order to ensure that SIs’ quotes adequately reflect prevailing market conditions it may be necessary to link them to the minimum tick sizes applicable to trading venues.

This consultation paper (CP) explains ESMA’s proposal for amending RTS 1. Stakeholders are invited to provide feedback on this proposal. The input from stakeholders should help ESMA to finalise its amendments to RTS 1.

Contents

Section 1 describes ESMA’s proposal for amending Article 10 of RTS 1 and clarifies the concept of “prices reflecting prevailing market conditions” for instruments subject to the mandatory tick size regime. Section 2 addresses other amendments to RTS 1 which, although being of less significant nature, would allow for a more consistent and unambiguous application of the provisions contained in RTS 1.

Next Steps

On the basis of the responses received to this CP, ESMA will finalise the draft RTS amending RTS 1 and submit the final report to the European Commission for endorsement.

1 Prices reflecting prevailing market conditions

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.*

1. Articles 14 and 15 of MiFIR establish the obligations for SIs to make public firm quotes in equity instruments. While for liquid instruments, SIs are required to make public quotes on a regular and continuous basis, for illiquid instruments they are only obliged to disclose quotes to their clients upon request.
2. In particular, according to Article 14(3) of MiFIR SIs' quotes have to essentially (i) be at least equivalent of 10% of the standard market size for the quoted instrument, (ii) include both a bid and offer price and (iii) reflect the prevailing market conditions for that instrument.
3. As regards the latter element, Article 10 of RTS 1 specifies the concept of "prices reflecting prevailing market conditions" by stating that: "*The prices published by a systematic internaliser shall reflect prevailing market conditions where they are close in price, at the time of publication, to quotes of equivalent sizes for the same financial instrument on the most relevant market in terms of liquidity as determined in accordance with Article 4 for that financial instrument*".
4. Over recent months, the question has emerged whether the quotes of an SI can adequately reflect prevailing market conditions when those quotes do not reflect the minimum price increments ('tick sizes') applicable on-venue to the quoted financial instrument.
5. In particular, for shares, depositary receipts and certain ETFs (i.e. those that have underlying financial instruments subject to the tick size regime), prices and quotes on MTFs and regulated markets (including the most relevant market in terms of liquidity that Article 10 of RTS 1 refers to) will always have to comply with the minimum tick size regime as per Article 49 of MiFID II and RTS 11. Therefore, one could consider that an SI quote can only reflect the on-venue prevailing market conditions where such quote uses the same price increments applicable to the concerned financial instrument.
6. This appears even more relevant for shares which are subject to the trading obligation under Article 23 of MiFIR and which will be available for trading only on regulated markets, MTFs, SIs and equivalent third country trading venues.

7. In addition, it has been brought to ESMA's attention that, if only on-venue orders and quotes had to comply with the minimum tick size regime applicable to a specific instrument, this might create a competitive disadvantage for trading venues compared to SIs and result in moving large volumes currently traded on-venue to OTC execution.
8. The additional flexibility provided to SIs and the possibility to use smaller price increments compared to price increments available on trading venues could indeed allow them to offer quotes with marginally improved prices thereby making it more attractive to trade with them rather than on-venue. Such an outcome appears likely in today's technology driven environment where the order flow is automatically redirected to the best priced quote in particular as a result of the increasing use of Smart Order Routers by market participants and in application of best execution obligations.
9. However, it is doubtful that such an outcome would go hand in hand with real benefits for end clients. While it would result in marginally better prices, it would at the same time undermine the overall quality of the liquidity available, the efficient valuation of equity instruments as well as the efficient pricing of instruments traded.
10. The tick size regime of Article 49 of MiFID II was introduced in order to harmonise price increments on European trading venues, prevent tick sizes being used as a tool for competition between venues and thereby remove the risk of a "race to the bottom". Such a "race to the bottom" has been observed after the introduction of MiFID I where ever smaller tick sizes were used by new competing venues to gain market share. Such highly granular tick sizes had a very detrimental effect on market depth and on the quality of liquidity (liquidity being scattered over too many price points) forcing European trading venues to voluntarily agree on common tick size tables before the mandatory tick size regime was enshrined in MiFID II. In that context, it would appear contradictory to the general MiFID II objective of levelling the playing field between means of trading if the new tick size regime resulted in "artificially" moving volumes from trading venues to SIs based on systematic internalisers quoting at price levels that are not available for trading venues.
11. This interpretation is also supported by recital 18 of MiFIR which clarifies that "in order to ensure that trading carried out OTC does not jeopardise efficient price discovery or a transparent level playing field between means of trading, appropriate pre-trade transparency requirements should apply to investment firms dealing on own account in financial instruments OTC insofar as it is carried out in their capacity as systematic internalisers". In this context, it is questionable whether SIs' quotes at price levels that could not trade on a trading venue would allow ensuring a "level playing field between means of trading" and hence being consistent with the spirit of the Regulation.
12. For those reasons, ESMA would like to propose an amendment to RTS 1 to clarify that, for equity instruments subject to the minimum tick size regime under RTS 11, SI quotes would only be considered to reflect the prevailing market conditions where those quotes reflect the price increments applicable to EU trading venues trading the same instruments.

13. More specifically, ESMA proposes to amend Article 10 of RTS 1 as follows (proposed changes in **bold**): “The prices published by a systematic internaliser shall reflect prevailing market conditions where they are close in prices to quotes of equivalent sizes for the same financial instrument on the most relevant market in terms of liquidity as determined in accordance with Article 4 for that financial instrument **and where the price levels could be traded on a trading venue at the time of publication**”.
14. This approach is also consistent with the recently published Q&As on MiFID II / MiFIR market structures topics (reference ESMA70-872942901-38, [here](#)) providing guidance on Article 15(2) of MiFIR. To recall, SIs are able to execute orders at a better price than the quoted prices “in justified cases”, provided that the price falls within a public range close to market conditions (Article 15(2) of MiFIR). ESMA has considered it necessary to publish a Q&A clarifying that in order “to ensure that price improvements do not undermine the efficient pricing of instruments traded, price improvements on quoted prices would only be justified when they are meaningful and reflect the minimum tick size applicable to the same financial instrument traded on a trading venue”.

Q1: Do you agree with ESMA’s proposal to clarify that SIs’ quotes would only reflect prevailing market conditions where the price levels could be traded on a trading venue at the time of publication?

2 Other amendments to RTS 1

15. ESMA has identified a number of provisions in RTS 1 that had been marginally amended in the version published in the Official Journal compared to the initial ESMA proposal sent to the Commission in September 2015 (ESMA/2015/1464). While at first glance these changes appear to be of a minor nature, they amend in some areas the substance of the provisions as proposed by ESMA and may result in inconsistent application. ESMA therefore considers it important to take this opportunity and amend those provisions of RTS 1 and to ensure the application of a consistent and unambiguous legal text. Furthermore, ESMA suggests to remove the references to securities financing transactions in RTS 1 since these transactions, following the amendment of MiFIR (Regulation (EU) 2016/1033 of the European Parliament and of the Council of 23 June 2016 (MiFIR Quick Fix), are not anymore within the scope of the transparency provisions of MiFIR.
16. As a consequence, ESMA proposes to introduce the following changes to RTS 1 (proposed changes in **bold**)
- Article 2(b): “the transaction is part of a portfolio trade **which includes five or more different shares**”.

In accordance with the definition under Article 1 of RTS 1, a portfolio trade does not necessarily consist of the same type of financial instruments (e.g. under the current drafting a portfolio trade consisting of one share and four ETFs would comply). Therefore, it is important to clarify that the exemption from the trading obligation for

shares only concerns portfolio trades, which include five or more different shares as initially proposed by ESMA. In any case, negotiated transactions in equity instruments that are executed as a portfolio trade are eligible for a pre-trade transparency waiver under Article 4(1)(b)(iii) as supplemented by Article 6(b) of RTS 1. portfolio trades.

- Article 2(h) is deleted.

This change is proposed to reflect the fact that with the MiFIR Quick Fix securities financing transactions are no longer in the scope of Title II and III of MiFIR.

- Article 3(2): “The transparency requirements referred to in paragraph 1 shall also apply to any 'actionable indication of interest' as defined in Article 2(1)(33) and pursuant to ~~Article 8~~ **Article 3** of Regulation (EU) No 600/2014”.

Article 8 of MiFIR defines the pre-trade transparency for non-equity instruments. The relevant cross-reference is therefore Article 3 of MiFIR.

- Article 6(h) is deleted

This change is proposed to reflect the fact that with the MiFIR Quick Fix securities financing transactions are no longer in the scope of Title II and III of MiFIR.

- Article 11(4): “[...] the competent authority shall estimate the average **value of transactions daily turnover** for that financial instrument taking into account any previous trading history of that financial instrument and of other financial instruments that are considered to have similar characteristics, and ensure publication of that estimate”.

The standard market size is determined based on the average value of transactions (as correctly defined in Article 11(1) of RTS 1) and not the average daily turnover.

- Article 11(5): “The estimated average value of transactions laid down in paragraph 4 shall be used **to determine as** the standard market size for a share, depositary receipt, ETF, certificate or other similar financial instrument [...]”.

The average value of transactions is not, per se, the standard market size but is used as a proxy to determine the standard market size for the instrument.

- Article 17(2): “~~Competent authorities, market operators and investment firms including investment firms operating a trading venue shall use the information published in accordance with paragraph 1 for the purposes of points (a) and (c) of Article 4(1) and paragraphs 2 and 4 of Article 14 of Regulation (EU) No 600/2014, for a period of 12 months from 1 April of the year in which the information is published.~~

~~Where the information referred to in the first subparagraph is replaced by new information pursuant to paragraph 3 during the 12-month period referred to~~

~~therein, competent authorities, market operators and investment firms including investment firms operating a trading venue shall use that new information for the purposes of points (a) and (c) of Article 4(1) and paragraphs 2 and 4 of Article 14 of Regulation (EU) No 600/2014.~~

The information published in accordance with paragraph 1 shall apply from 1 April following its publication”.

The Commission has further specified the initial provision proposed by ESMA. ESMA is concerned that this drafting does not cover all the use cases. The average daily turnover is used not only for the purpose of determining orders that are Large in Scale (LIS) but also for the purpose of determining the applicable deferral regime as set out in Article 15(2) of this RTS. This would require to add references to Articles 7(1) and 20(2) of MiFIR.

Furthermore, ESMA believes that the initial drafting proposed was simpler and clearer by avoiding to cross-refer to the related Level 1 proposal, thereby increasing legal certainty and predictability. By not specifying a pre-established period of application (12 months), the ESMA’s drafting indeed allows for the published information to continue to apply (beyond 12 months) in the very unlikely case where ESMA or the relevant competent authority would not be in a position to publish new information by the given deadline. ESMA therefore proposes to revert back to the initial drafting proposed.

Q2: Do you agree with the drafting amendment described above?

3 Annexes

3.1 Annex 1

Summary of questions

Q1: Do you agree with ESMA proposal to clarify that SIs' quotes would only reflect prevailing market conditions where the price levels could be traded on a trading venue at the time of publication?

Q2: Do you agree with the drafting amendment described above?

3.2 Annex II

Cost-benefit analysis

ESMA considers that the costs and benefits attached to the proposal for amending Article 10 of RTS 1 are included in the section on “prices reflecting prevailing market conditions”. Respondents are therefore invited to provide any comments they may have on the costs and benefits attached to the proposal directly in their answer to questions 1 and 2.

3.3 Annex III

COMMISSION DELEGATED REGULATION (EU) .../...

of []

amending Commission Delegated Regulation (EU) 2017/587 of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards on transparency requirements for trading venues and investment firms in respect of shares, depositary receipts, exchange-traded funds, certificates and other similar financial instruments and on transaction execution obligations in respect of certain shares on a trading venue or by a systematic internaliser

(Text with EEA relevance)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to 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, and in particular Article 4(6), Article 14(7), Article 22(4) and Article 23(3) thereof,

Whereas:

- (1) Commission Delegated Regulation (EU) 2017/587¹ sets out transparency requirements for trading venues and systematic internalisers in respect of shares, depositary receipts, exchange-traded funds, certificates and other similar financial instruments. In particular, Commission Delegated Regulation (EU) 2017/587 determines whether prices quoted by systematic internalisers in accordance with the obligation to make public firm quotes as set out in Regulation (EU) 600/2014 reflect prevailing market conditions.
- (2) In order to ensure a level playing field between trading venues and systematic internalisers, it is important to further clarify whether prices published by systematic internalisers reflect prevailing market conditions. This Regulation therefore amends Commission Delegated Regulation (EU) 2017/587 by specifying that prices published by a systematic internaliser reflect prevailing market conditions only where they have a price level that could be traded on a trading venue.

¹ Commission Delegated Regulation (EU) 2017/587 of 14 July 2016 supplementing Regulation (EU) No 600/2014 of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards on transparency requirements for trading venues and investment firms in respect of shares, depositary receipts, exchange-traded funds, certificates and other similar financial instruments and on transaction execution obligations in respect of certain shares on a trading venue or by a systematic internaliser (OJ L 87, 31.3.2017, p.387).

- (3) This amendment ensures that prices published by systematic internalisers reflect the minimum price increments applicable to orders and quotes advertised on trading venues. This appears to be even more relevant for shares that are subject to the trading obligation under Regulation (EU) 600/2014 in order to create a level playing field between regulated markets, MTFs and systematic internalisers.
- (4) For reasons of consistency and to ensure the convergent application as well as to provide market participants with adequate legal certainty, it is necessary to amend certain provisions of Commission Delegated Regulation (EU) 2017/587.
- (5) Since Regulation (EU) 2016/1033 of the European Parliament and of the Council² removes securities financing transactions from the scope of the transparency provisions for trading venues and systematic internalisers, it is necessary to remove references to securities financing transactions also from this Regulation.
- (6) This Regulation is based on the draft regulatory technical standards submitted by the European Securities and Markets Authority (ESMA) to the Commission.
- (7) ESMA has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Securities and Markets Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1095/2010 of the European Parliament and of the Council³,

HAS ADOPTED THIS REGULATION:

Article 1

Amendments to Delegated Regulation (EU)2017/587

- (1) Article 2 is amended as follows:
 - (a) point (b) is replaced by the following:

‘(b) the transaction is part of a portfolio trade which includes five or more different shares.’;
 - (b) point (h) is replaced by the following:

² Regulation (EU) 2016/1033 of the European Parliament and of the Council of 23 June 2016 amending Regulation (EU) No 600/2014 on markets in financial instruments, Regulation (EU) No 596/2014 on market abuse and Regulation (EU) No 909/2014 on improving securities settlement in the European Union and on central securities depositories (OJ L 175, 30.6.2016, p. 1).

³ 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 (OJ L 331, 15.12.2010, p. 84).

‘(h) 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 ⁽⁴⁾

(c) point (i) is deleted;

(2) Article 3, paragraph 2 is replaced by the following:

‘The transparency requirements referred to in paragraph 1 shall also apply to any 'actionable indication of interest' as defined in Article 2(1)(33) and pursuant to Article 3 of Regulation (EU) No 600/2014.’;

(3) Article 6 is amended as follows

(a) point (h) is replaced by the following:

‘(h) the transaction 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;’

(b) point (i) is replaced by the following:

‘(i) any other transaction equivalent to one of those described in points (a) to (h) in that it is contingent on technical characteristics which are unrelated to the current market valuation of the financial instrument traded.

(c) point (j) is deleted.

(4) Article 10 is replaced by the following:

‘The prices published by a systematic internaliser shall reflect prevailing market conditions where they are close in prices to quotes of equivalent sizes for the same financial instrument on the most relevant market in terms of liquidity as determined in accordance with Article 4 for that financial instrument and where the price levels could be traded on a trading venue at the time of publication.’

(5) Article 11, paragraphs 4 and 5 are replaced by the following:

‘4. Before a share, depositary receipt, ETF, certificate or other similar financial instrument is traded for the first time on a trading venue in the Union, the competent authority shall estimate the average value of transactions for that financial instrument taking into account

⁴ Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012 (OJ L 257, 28.8.2014, p. 1)

any previous trading history of that financial instrument and of other financial instruments that are considered to have similar characteristics, and ensure publication of that estimate;

5. The estimated average value of transactions laid down in paragraph 4 shall be used to determine the standard market size for a share, depositary receipt, ETF, certificate or other similar financial instrument during a six-week period following the date that the share, depositary receipt, ETF, certificate or other similar financial instrument was first admitted to trading or first traded on a trading venue.’;

(6) Article 17, paragraph 2 is replaced by the following:

The information published in accordance with paragraph 1 shall apply from 1 April following its publication.’

Article 2

Entry into force

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels, []

For the Commission
The President