MiFID 2: Pre- and post-trade transparency

Summary

The revised Markets in Financial Instruments Directive (MiFID 2) and the new Markets in Financial Instruments Regulation (MiFIR) were approved by the European Parliament and European Commission in April/May 2014 and published in the Official Journal of the European Union in June 2014. Following several rounds of consultation, Level 2 legislation supporting MiFID 2 and MiFIR has been (or is in the process of being) adopted by the Commission and is due to be published in the Official Journal of the European Union following a period of scrutiny by the European Parliament and Council.

This briefing provides a refresher on the principal changes introduced in MiFID 2 and MiFIR in relation to pre- and post-trade transparency in financial markets and focuses in addition on some of the key issues coming out of the relevant Level 2 legislation in the form of regulatory technical standards (RTS) and a Delegated Act relevant to pre- and post-trade transparency.

The texts of MiFID 2 and MiFIR are of EEA relevance and hence will be applicable to non-EU, EEA countries once incorporated into the EEA Agreement. Whether MiFID 2 and MiFIR will continue to apply in the UK, if the UK were to invoke Article 50 of the Lisbon Treaty, and consequently leave the EU (Brexit), depends upon the future relationship of the UK and the EU. If the UK were to remain a member of the EEA following a Brexit, they would continue to apply once incorporated into the EEA Agreement; but in other scenarios, the UK would become a third country for the purposes of MiFID 2 and MiFIR, unless special terms were negotiated between the UK and EU.

If the UK becomes a third country for the purposes of MiFID 2 and MiFIR, it is likely to seek to utilise to the maximum the equivalence recognition provisions, where available. The FCA has confirmed that firms should proceed with the implementation of MiFID 2 and MiFIR, which would enable the UK to demonstrate equivalence if necessary.

Following political agreement, the transposition and application date of MiFID 2 and MiFIR have been delayed to 3 July 2017 and 3 January 2018, respectively.

Key business impacts

- Investment firms and trading venues will have to extend their pre- and post-trade reporting to a wide range of equity, fixed income and derivative financial instruments.
- The requirements are intended to improve transparency but may influence the way trading is carried out and might potentially impact liquidity.

Introduction

The parts of MiFID 2 and MiFIR that deal with transparency include some of the most significant changes to the existing MiFID framework. The provisions relating to non-equity instruments have been some of the most contentious.

MiFIR will expand the current pre- and post-trade transparency regime for shares in MiFID to a wider range of 'equity-like' instruments (i.e. exchange-traded funds (ETFs), depositary receipts, certificates and other similar financial instruments), as well as non-equities (i.e. bonds, structured finance products, emission allowances and derivatives). Systematic internalisers (SIs) and regulated trading venues will be subject to these expanded transparency obligations.

Level 2 measures on transparency are set out in:

- RTS 1 (C (2016) 4390): RTS on transparency requirements for trading venues and investment firms in respect of shares, depository receipts, ETFs, certificates and other similar financial instruments and on transaction execution obligations in respect of certain shares on a trading venue or by an SI;
- RTS 2 (C (2016) 4301): RTS on transparency requirements for trading venues and investment firms in respect of bonds, structured finance products, emission allowances and derivatives; and
- Commission Delegated Regulation (C (2016) 2860) of 18 May 2016 (the Delegated Act).

Pre-trade transparency requirements for equity and 'equity-like' instruments

As well as being applicable to shares, MiFIR extends the pre-trade transparency regime to 'equity-like' instruments.

Requirements for RMs and MTFs

Operators of regulated markets (RMs) and multilateral trading facilities (MTFs) will be subject to pre-trade transparency requirements under MiFIR with respect to bids and offers for shares and 'equity-like' instruments, as well as actionable indications of interest (IOIs).

According to Article 2(1)(33) of MiFIR, actionable IOIs are messages between members or participants within a trading venue in relation to available trading interests that contain all necessary information to agree on a trade. During the consultation process, the European Securities and Markets Authority (ESMA) indicated that it understands an actionable IOI to be a message containing a binding expression to trade in a specific financial instrument, which should contain information such as the price, volume and the side or direction (i.e. buy or sell order); however, this is not enshrined in the RTS, which simply refer to the Level 1 Article.

The starting point under the RTS for determining the appropriate level of information to be made public is the type of trading system

Trading venue operators must make public, on a continuous basis during normal trading hours, current bid and offer prices and the depth of trading interest at the prices advertised through their systems for instruments traded on a regulated trading venue (i.e. an RM or MTF for equity and 'equity-like' instruments).

The starting point under the RTS for determining the appropriate level of information to be made public is the type of trading system (i.e. quote driven trading system, periodic auction trading system, continuous action order book trading system, request for quote (RFQ) trading system or other trading systems not falling within the previous categories.) In order to ensure that conditions are applied uniformly between trading venues, the same pre-trade requirements at the level of the trading system will apply to RMs and MTFs.

The RTS provide a description of the different trading systems and a summary of the information to be made public.

An RFQ system is described in the RTS as follows:

> *"A trading system where a quote or quotes are provided in response to a request for quote submitted by one or more members or participants. The quote is executable exclusively by the requesting member or participant. The requesting member or participant may conclude a transaction by accepting the quote or quotes provided to it on request."*

In respect of an RFQ system, the RTS allow for publication of all submitted quotes in response to an RFQ at the same time, i.e. once all quotes have been provided and no later than when they become executable under the system's rules. This is intended to provide some flexibility and to prevent members or participants that provide their quotes first from being disadvantaged.

MiFIR has been amended by an EU Regulation dated 23 June 2016 (Quick Fix Regulation) to exclude securities financing transactions (SFTs) from the transparency requirements, given that SFTs are not considered to contribute to the price discovery process.

Waivers

MiFIR specifies waivers that competent authorities may grant from pre-transparency requirements for:

- orders that are large in scale compared to normal market size;
- orders held in an order management facility;
- systems that formalise negotiated transactions (where negotiated trades are (i) made within the current volume-weighted spread on the order book or the quotes of market makers; (ii) for illiquid instruments and are dealt with within a percentage of a suitable reference price; or (iii) subject to conditions other than current market price); and
- systems matching orders on the basis of a widely published reference price.

(i) Large in scale waiver

The large in scale waiver is intended to protect large orders from adverse market impact and avoid abrupt price movements that could cause market distortion.

Although a similar waiver exists under MIFID, for which the thresholds are based on average daily turnover (ADT), ESMA consulted on whether existing thresholds should be amended. On the basis of industry feedback, ESMA appreciated that ADT may not provide the best metric to establish the large in scale threshold in all cases, but nevertheless emphasised that it is a reliable metric positively correlated with liquidity, which can be collected and processed in a relatively simple way.

Therefore, the RTS prescribe that ADT is to be used as the relevant metric to establish orders that are large in scale in respect of shares and depositary receipts. However, further granularity is introduced to accommodate less liquid shares with an additional category for shares with an ADT of less than €50,000 with a corresponding minimum size of orders of €15,000 to qualify as large in scale.

The large in scale waivers for ETFs and certificates are considered separately. A single threshold of €1 million will apply to all ETFs regardless of their underlying or liquidity. Certificates are subject to a different regime, with only two ADT classes and large in scale thresholds, given that these have different payoffs from shares.

ADT calculations should include all transactions executed in the relevant financial instrument, regardless of whether they are traded on- or off-exchange.

The RTS allow for large in scale orders to remain protected under the waiver even when they fall below the relevant large in scale threshold following partial execution ('stubs'), provided the price and other relevant conditions for execution are not amended.

(ii) Negotiated trade waiver

With respect to the negotiated trade waiver, the RTS describe the characteristics of such transactions as involving members or participants of an RM or an MTF, but with the transaction being negotiated privately and then reported under the rules of the trading venue.

Transactions are not be restricted to those entered into between participants dealing on own account and may involve a member's or participant's client. The RTS specify the different ways a member or participant of a trading venue can execute such transactions, including instances when 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).

In respect of the waiver for negotiated trades that are subject to conditions other than current market price, the RTS contain an exhaustive list of the types of transactions that fall into this category despite concerns raised by respondents during ESMA's consultation process. However, a number of circumstances were added to the list during the consultation process to make it consistent with the list of transactions that do not contribute to the price discovery process for the purposes of the shares trading obligation in Article 23 of MiFIR. Non-standard or special settlement trades have not been included as ESMA was unconvinced of there being sufficient legitimate reasons to consider such transactions as not contributing to price formation. The final item in the list permits some flexibility to include new and equivalent types of trades that may arise in future.

(iii) Reference price waiver

The MiFID reference price waiver has been amended under the new MiFIR regime. In future, it can only be established by taking the midpoint within current bid and offer prices on the trading venue where the instrument was first admitted to trading or the most relevant market in terms of liquidity, provided the reference price is widely published and reliable. Where a midpoint price is not available, opening or closing prices of the relevant trading session may instead be referenced outside the continuous trading phase of the relevant trading session.

The RTS provide that the most relevant market in terms of liquidity must be determined on an annual basis and should be the trading venue with the highest turnover in the relevant financial instrument, regardless of the trading system under which the trading venue operates. Transactions executed under the reference price waiver, the negotiated trade waiver and the large in scale waiver would be excluded from the turnover calculation. However, large in scale transactions should only be excluded where the transaction size was above the applicable large in scale threshold and at least one of the orders benefited from the large in scale waiver.

The calculation will not be made where the relevant instrument was first admitted to trading or traded on a trading venue four weeks or less before the end of the preceding calendar year. Until the most relevant market in terms of liquidity has been determined, the most relevant market will be the trading venue where the financial instrument is first admitted to trading or first traded.

(iv) Order management facilities waiver

The order management facilities waiver is subject to further specification at Level 2. In particular, the type and minimum size of orders held in a facility are specified in the RTS.

The reference price and negotiated trade waivers will be subject to a volume cap mechanism, which will limit the availability of the waivers

During the consultation process, ESMA noted that there are two main groups of orders that can be exempted: 'stop orders' (i.e. an order to buy or sell an instrument that remains inactive (invisible and not executable)) and 'reserve or iceberg orders' (i.e. where only part of the volume is visible to others and the remainder is hidden). However, the relevant characteristics of orders held in an order management facility are not restricted to 'stop' and 'iceberg' orders (in fact, such orders are no longer specifically mentioned in the RTS), but are described as orders (i) intended to be disclosed to the order book contingent on objective conditions pre-defined by the system's protocol; (ii) that cannot interact with other trading interests prior to disclosure to the order book; or (iii) that once disclosed to the order book, interact with other orders in accordance with rules applicable to orders of that kind at the time of disclosure.

In relation to minimum size, orders should be greater than or equal to the minimum tradable quantity established by the trading venue, both at the point of entry and following any amendment. For reserve orders, the minimum size should be greater than or equal to €10,000.

Volume cap on waivers

The reference price and negotiated trade waivers will be subject to a volume cap mechanism, which will limit the availability of the waivers by reference to a percentage of trading carried out using the waivers. This will be assessed for each trading venue as well as for overall EU trading.

Each individual trading venue will be subject to a limit so that the waiver cannot cover trades in a particular instrument exceeding 4 per cent of total trading in that instrument on all trading venues across the EU. The waiver will be subject to an overall limit so that no more than 8 per cent of all trades in a particular instrument on all trading venues in the EU can be covered by the waiver.

Both caps will be calculated by reference to trading carried out over the previous 12 months on a rolling basis. The intention is to ensure that the use of the waivers does not unduly harm price formation.

ESMA will publish total EU volumes per financial instrument and the percentage of trading carried out under the waivers and on each trading venue in the previous 12 months on a monthly basis. In some cases, where the report identifies a trading venue where trading carried out under a waiver exceeds 3.75 per cent of total trading in the EU, a second monthly report will be published.

The volume cap will not apply to negotiated transactions in shares and 'equity-like' instruments that are illiquid and dealt within a certain percentage of a suitable reference price or to negotiated transactions that are subject to conditions other than current market price.

If the limits are breached, the relevant competent authorities for the trading venues will suspend operation of the waivers.

Given the potential commercial consequences of venues publishing incorrect information which leads to the suspension of a waiver across the EU for a particular financial instrument, it is crucial that timely and correct data is provided by trading venues to competent authorities

Given the potential commercial consequences of venues publishing incorrect information which leads to the suspension of a waiver across the EU for a particular financial instrument, it is crucial that timely and correct data is provided by trading venues to competent authorities. Separate RTS on the volume cap mechanism specify the relevant reporting and calculation requirements, as well as the publication by ESMA of the relevant volume information. Data must be provided by trading venues and consolidated tape providers, and calculations performed, twice a month. In addition, competent authorities may submit ad-hoc volume requests to trading venues and consolidated tape providers.

Importantly, the RTS clarify that transactions executed on the basis of two orders benefiting from the large in scale waiver should be excluded from the volumes calculated under the reference price waiver and the negotiated trade waiver. The need for both orders to benefit from the waiver may mean a number of transactions will be included that the industry had hoped would be excluded from the calculations.

To ensure the operation of the volume cap from the point in time that MiFIR takes effect, trading venues will in addition to the reports described above be required to submit an initial report on the day of entry into effect of MiFID 2 and MiFIR, which should include trading volumes for the preceding calendar year. These volumes should be based on adjusted volumes of trading under equivalent waivers pursuant to the current MiFID regime.

In its Questions and Answers on MiFID II and MiFIR transparency topics (the Q&A), ESMA noted that:

"...*all transactions executed in 2017 in accordance with reference price waivers granted under MiFID I should be included in the numerator for the purposes of the double volume cap calculations as per Article 5 of MiFIR*."

"... *all transactions executed under the MiFID I negotiated trade waivers in liquid shares should count towards the double volume cap and should be reported by trading venues for the purpose of the double volume cap calculations. However, the calculation should exclude negotiated transactions in liquid shares subject to conditions other than the current market price executed in accordance with Article 18(b)(ii) of MiFID I implementing regulation*."

However, for instruments not covered by the current MiFID pre-trade transparency regime, the volume traded under current MiFID waivers will be zero for the monitoring period starting one year before the date of application of MiFID 2 and MiFIR. ESMA will then accumulate the volume traded under the reference price and negotiated trade waivers over the next 12 months in order to calculate actual volumes traded under the waivers compared with total trading over the previous 12 months at each point in time.

Requirements for SIs

SIs will be required to make public, on a regular and continuous basis during normal trading hours, firm quotes for equity and 'equity-like' instruments traded on a trading venue for which they are SIs and for which there is a liquid market. Where there is no liquid market, SIs must disclose quotes to their clients upon request.

The requirements apply only when dealing in sizes up to standard market size. SIs will be able to decide sizes at which they will quote, provided they are at least 10 per cent of standard market size.

The standard market size is set out in the RTS as a size representative of the 'average value of transactions' (AVT) executed in the market for that financial instrument. The AVT calculation will be carried out by competent authorities taking into account the transactions executed in the EU (excluding certain post-trade large in scale transactions), including transactions executed on or outside a trading venue. There will be a recalculation for each financial instrument on an annual basis.

The RTS provide arrangements for the publication of quotes intended to ensure information is sufficiently reliable and free from errors, that it can be consolidated with data from other sources and that it is made available on a non-discriminatory basis. In addition, the RTS require SIs to timestamp their quotes in order to ensure quotes are firm and reliable and that clients can analyse the quality of prices quoted ex-post.

Quotes must reflect prevailing market conditions and orders from clients must generally be executed at the quoted prices. Price improvement will only be permitted in limited justified cases, provided the price falls within a public range close to market conditions. As part of the consultation process, ESMA considered that an important aspect of the SI's publication of a firm quote is to ensure quoted prices provide meaningful information to clients and other market participants. The RTS describe a quote as reflecting prevailing market conditions when it is close in price, at the time of publication, to comparable quotes for the same financial instrument on the most relevant market in terms of liquidity.

In respect of executing at a better price, the Delegated Act states that a price would be within a range close to market conditions where the price is within the bid and offer quotes of the SI, provided those quotes reflect prevailing market conditions for the financial instrument.

SIs will have some discretion to determine the clients who get access to their quotes

SIs may update quotes that have been published at any time and, in exceptional market conditions, withdraw quotes. The criteria for specifying what can be regarded as exceptional market conditions and the conditions for updating quotes are set out in the Delegated Act. A non-exhaustive list of exceptional circumstances include circumstances when trading is halted under Article 48 of MiFID 2, market making obligations are suspended, a competent authority prohibits short sales or a reliable market price is not available for a number of instruments underlying an ETF. In addition, the Delegated Act states that an SI should be able to update its quotes at any time, provided the quote is consistent with genuine trading intentions and non-discriminatory treatment of clients.

SIs may execute orders from professional clients at different prices where execution in several securities is part of one transaction or where orders are subject to conditions other than current market price. The Delegated Act refers to an order being considered subject to conditions other than current market price where the criteria laid down in the RTS for negotiated transactions subject to conditions other than the current market price are fulfilled. Whilst the Delegated Act also refers to the same RTS for determining when execution of several securities shall be considered part of one transaction, we expect this is intended to refer specifically to circumstances where the execution is part of a portfolio trade.

Additionally, an SI can, in a non-discriminatory way, limit the total number of transactions that it will enter into with the same client and with different clients at the same time, in the latter case only when the number or volume of orders sought considerably exceeds the norm. In this connection, the Delegated Act provides that orders should be regarded as considerably exceeding the norm if the SI cannot execute them without exposing itself to undue risk. This is something each SI would have to determine in advance in an objective way, consistent with its risk management policy. The SI would need to maintain and implement a non-discriminatory policy for identifying the number or volume of orders that it can execute without being exposed to undue risk, taking into account the capital available to cover the risk and prevailing market conditions.

SIs will have some discretion to determine the clients who get access to their quotes on the basis of their commercial policy and provided this is done in an objective and non-discriminatory way.

ESMA stated during the consultation process that it was of the view that the ability of SIs to trade on a riskless principal basis by taking very limited market and counterparty risk would go against the political, technical and legal agreement underpinning the Level 1 text. However, ESMA noted it had no relevant empowerment to provide clarification in this regard.

Post-trade transparency requirements for equity and 'equity-like' instruments

Post-trade transparency requirements for equity instruments have been expanded in scope under MiFIR and will apply in respect of 'equity-like' instruments as well as equities. All investment firms (including SIs) as well as relevant regulated trading venues (MTFs and RMs) will be subject to post-trade transparency obligations.

RMs and MTFs must make public the price, volume and time of transactions executed on the trading venue as close to real-time as technically possible. Investment firms must make public such data in respect of transactions they conclude on own account or on behalf of clients.

Information to be made public

The information required currently under MiFID (i.e. the trading day and time, instrument identifier, unit price and price notation, quantity and venue identifier) remains valid and applicable for shares and other 'equity-like' instruments, but certain changes and additions have been made to the list with the result that the following information needs to be published: the trading date and time, instrument identification code, price, price currency, quantity, venue of execution, publication date and time, venue of publication and transaction identification code.

A unique code identifying the venue of execution is required to be published, but for transactions executed through an SI this will be "SINT" rather than revealing the specific SI's identity.

The RTS introduce a new set of trade flags and identifiers to provide additional information in respect of a transaction, improve the efficiency of price discovery, support firms achieving best execution for their clients and permit clients to monitor whether they are receiving best execution.

There is no flag to identify transactions executed under the large in scale pre-trade transparency waiver due to concerns raised during the consultation process that this would create exposure to the rest of the market (e.g. in the case of a partial execution) and therefore discourage execution of large trades through central order books.

Other flags include transactions not contributing to the price discovery process, post-trade large in scale transactions, transactions executed through an SI that are above the standard market size, illiquid instrument transactions, transactions that have received price improvement and duplicative trade reports (which aims to indicate transactions that have been reported to more than one approved publication arrangement (APA)).

The RTS specify how the post-trade disclosure requirements apply in respect of over-the-counter (OTC) transactions. The post-trade transparency requirements would not apply to: (i) transactions that are excluded from transaction reporting under Article 26 of MiFIR, including SFTs, contracts arising exclusively for clearing or settlement purposes, portfolio compression transactions, the exercise of a right embedded in a financial instrument or the conversion of a convertible bond etc., (ii) transactions executed by a management company or an alternative investment fund manager which transfers the beneficial ownership of financial instruments from one collective investment undertaking (CIU) to another and where no investment firm is party to the transaction, (iii) give-up and give-in transactions and (iv) transfers 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.

Timing of disclosure

The post-trade transparency requirement necessitates disclosure to be made as close to real time as technically possible

Under MiFIR, the post-trade transparency requirement necessitates disclosure to be made as close to real time as technically possible, and in any case within one minute of the relevant transaction. This maximum delay of one minute represents a reduction from the current three minutes allowed under MiFID. The recitals to the RTS make clear that the expectation is for information to be made available 'as instantaneously as technically possible', which assumes both efficiency and systems expenditure on the part of the persons concerned. Information should be published close to the maximum time limit only in exceptional cases where available systems do not allow for publication in a shorter period of time.

Despite concerns raised in respect of the shortened timeframes for disclosures, there are no permissible delays for different types of transactions (e.g. for non-electronic transactions).

Where a transaction takes place on a trading venue outside its daily trading hours, details should be made public before the opening of the next trading day of the relevant venue. Where OTC transactions are entered into outside normal trading hours applicable to the most relevant market in terms of liquidity and outside the investment firm's daily trading hours, post-trade information must be made public immediately upon commencement of the investment firm's daily trading hours and at the latest before the opening of the next trading day of the most relevant market in terms of liquidity.

Deferred publication regime

MiFIR provides a deferral regime based on the type or size of transaction and, in particular, for large in scale transactions. ESMA's concern throughout the consultation process was that although a delay may be justified in order to unwind large positions, delays under the current regime are often too long and jeopardise adequate transparency. Therefore the RTS are intended to achieve an appropriate balance between ensuring market transparency, preventing an adverse impact on price discovery of large transactions and protecting market participants.

In particular, the RTS confirm that publication may only be deferred if the transaction is between an investment firm dealing on own account (other than on a matched principal basis) and another counterparty where the size of the transaction is equal to or exceeds the relevant specified minimum qualifying size. A deferral will only be available if authorised by the competent authority.

The RTS establish different deferred publication thresholds and publication timings for shares and depositary receipts, ETFs and certificates and other similar financial instruments.

Pre-trade transparency requirements for non-equity instruments

MiFIR introduces pre-trade transparency requirements for trades in non-equity instruments (i.e. bonds, structured finance products, emission allowances, derivatives) traded on RMs, MTFs and organised trading facilities (OTFs) and certain package orders.

Requirements for RMs, MTFs and OTFs

Trading venue operators must make public current bid and offer prices and the depth of trading interests at those prices on a continuous basis during normal trading hours. The requirements will apply, in addition, to actionable IOIs.

Transparency requirements are calibrated for different types of trading systems, including continuous auction order-book, quote-driven, periodic auction trading, RFQ, voice and other trading systems.

The definitions of voice trading and RFQ systems are key to determining minimum amounts of pre-trade information. In addition, they are important for determining the application of the waiver for actionable IOIs in such systems. The definition of RFQ system in the RTS is identical to the one given for pre-trade transparency requirements for equity and 'equity-like' instruments.

The RTS include the following definition of a voice trading system:

"A trading system where transactions between members are arranged through voice negotiation."

The RTS clarify that RFQ systems may publish submitted quotes in response to a RFQ at the same time, but not later than when they become executable. However, all quotes must be disclosed - it is not sufficient to publish average prices.

The publication obligation will not apply to certain derivative transactions of non-financial counterparties that are "objectively measureable as reducing risks directly relating to the commercial activity or treasury financing activity of the non-financial counterparty or of that group" (i.e. trades entered into for hedging purposes).

Waivers

Competent authorities may grant waivers from pre-transparency requirements for:

- orders that are large in scale compared with normal market size;
- orders held in an order management facility;
- actionable IOIs in RFQ and voice trading systems that are above certain sizes specific to the instrument;
- derivatives that are not subject to the mandatory trading obligation and other non-liquid financial instruments;
- exchange for physical orders; and
- certain package orders.

(i) Large in scale and size specific to the instrument waivers

The pre-trade large in scale and size specific to the instrument thresholds for each asset class are set at a lower level in the RTS than the post-trade thresholds (see below for post-trade requirements). The methodology determining the thresholds is described separately for different asset classes.

(ii) Order management facility waiver

The RTS define the key characteristics of orders held in an order management facility without narrowly prescribing the characteristics of those orders, which may include reserve orders, stop orders and other orders that fulfil the relevant criteria.

Minimum sizes for reserve orders should be greater than or equal to €10,000 at the point of entry and following any amendment. All other orders should be greater than or equal to the minimum tradable quantity set in advance by the system's operator.

(iii) Actionable IOIs waiver

Where a waiver is granted for actionable IOIs in RFQ and voice trading systems that are above certain sizes specific to the instrument, market operators must make public at least indicative pre-trade bid and offer prices.

The RTS set out the valid methodologies to be used when publishing indicative prices, but allow trading venues flexibility to choose the methodology that they consider most appropriate. The RTS require trading venue operators to make public the methodology for calculating pre-trade prices and the time of publication when entering and updating indicative pre-trade prices.

The final RTS take a more cautious approach to the calculation of the size specific to the instrument waiver thresholds

Given concerns relating to the persistence of liquidity in non-equity markets, the final RTS take a more cautious approach to the calculation of the size specific to the instrument waiver thresholds than initially proposed by ESMA. The RTS set out initial thresholds for certain non-equities, including bonds, structured finance products and types of derivatives, and provide for a gradual increase according to four successive thresholds.

Every year ESMA must submit to the Commission an assessment of the operation of the thresholds, taking into account the evolution of trading volumes in the segments covered by the pre-trade transparency requirements and other relevant factors that may affect liquidity. Once ESMA is satisfied that liquidity and market making will not be negatively affected by an increase in the threshold, the move to the next threshold would be implemented by a new RTS.

(iv) Non-liquid financial instruments waiver

ESMA considers that the waiver for derivatives that are not subject to the trading obligation only applies to derivatives that are subject to the clearing obligation under the European Market Infrastructure Regulation (EMIR), but for which the trading obligation does not apply (i.e. the waiver provision does not permit competent authorities to waive transparency obligations for all derivatives that are not subject to the trading obligation, but is limited to a subset of such derivatives). This position is reflected in the recitals to the RTS and in ESMA's Discussion Paper published in September 2016 on the implementation of the trading obligation for derivatives.

ESMA has noted that the second part of the waiver in Article 9(1)(c) of MiFIR refers to all other instruments for which there is not a liquid market, including (in its view) all other derivatives not subject to the clearing obligation.

It was proposed early on in the consultation process to use the classes of financial instrument approach (COFIA) as the basis for determining the financial instruments for which there is not a liquid market for the purposes of this waiver. However, following significant market concern, the final RTS prescribe a more granular approach as the basis for determining liquidity of non-equity financial instruments.

In respect of bonds, the instrument by instrument approach (IBIA) will be used instead of COFIA. However, newly issued instruments will be deemed to be liquid according to their issuance size.

ESMA must submit to the Commission an assessment of the operation of the thresholds on an annual basis

Given concerns about the persistence of liquidity in non-equity markets, the final RTS take a more cautious approach to the average daily number of trades above which a bond market is deemed liquid than initially proposed by ESMA. The RTS set out an initial liquidity threshold at 15 daily trades and a gradual decrease of the daily trades that denote a liquid market according to four successive thresholds.

ESMA must submit to the Commission an assessment of the operation of the thresholds on an annual basis. Once ESMA is satisfied that liquidity and market-making will not be negatively affected by a subsequent move in the threshold, the move to the next threshold would be implemented by new RTS.

For structured finance products, the RTS set out a two-step liquidity assessment. If a test assessing liquidity of the asset class as a whole is passed, then a second test is applied on an IBIA basis. This is intended to ensure structured finance products will become subject to transparency if the overall market becomes more liquid again.

For derivatives and emission allowances, a periodic liquidity assessment has been introduced for most asset classes. The RTS provide (i) a detailed taxonomy including segmentation criteria for defining the classes and their related granularity for the liquidity assessment; and (ii) quantitative liquidity criteria and related thresholds and qualitative criteria to be used for the liquidity assessment.

However, all securitised derivatives are being qualified as liquid, whilst all foreign exchange derivatives are being deemed illiquid until better data becomes available, at which point the RTS would need to be revised.

(v) Exchange for physical

The Quick Fix Regulation amended MiFIR so as to include a waiver for orders for the purpose of executing an exchange for physical. An exchange for physical is defined as a transaction in a derivative contract or other financial instrument contingent on the simultaneous execution of an equivalent quantity of an underlying physical asset.

(vi) Package orders

The Quick Fix Regulation further amended MiFIR so as to include a waiver from pre-trade transparency requirements for certain package orders. It was considered appropriate to waive pre-trade transparency requirements for certain interlinked, contingent trades, in which the price of each trade reflects the overall risk of the package rather than the component trade.

The waiver will be available in certain circumstances, including when at least one of the components is a financial instrument for which there is not a liquid market or is large in scale, unless there is a liquid market for the package as a whole.

ESMA is required to draft RTS establishing a methodology for determining those package orders for which there is a liquid market. The RTS are due by the end of February 2017.

Requirements for SIs

An SI will be subject to a requirement to make public firm quotes for non-equity instruments traded on a trading venue for which it is an SI and for which there is a liquid market when the SI is prompted for a quote and agrees to provide it.

Where there is no liquid market and the SI has agreed to provide a quote, it will be obliged to disclose that quote to a client upon request. However, the requirement may be waived in the same circumstances as pre-trade transparency requirements may be waived for non-equities traded on RMs, MTFs and OTFs. The provisions relevant to waivers set out above in respect of trading venues will therefore also be of relevance to SIs.

The SI requirements apply only when dealing below certain sizes specific to the instrument. As part of the consultation process, ESMA noted that these sizes must be calibrated for all asset classes and that in order to ensure legal certainty and practicability, there needs to be a matrix that assigns automatically to each financial instrument a specific size based on certain parameters and characteristics. The Delegated Act establishes these sizes by reference to the size thresholds for the trading venue waiver for actionable IOIs in RFQ and voice trading systems.

As for equity instruments, prices quoted must reflect prevailing market conditions. SIs must undertake to enter into transactions under the published conditions with other clients to whom a quote in liquid instruments is made available when the quoted size is at or below the size specific to the instrument. However, in justified cases, an SI may execute orders at a better price provided the price falls within a public range close to market conditions.

SIs will have some discretion to determine the clients which get access to their quotes on the basis of their commercial policy and provided this is done in an objective non-discriminatory way. In addition they may establish non-discriminatory and transparent limits on the number of transactions they undertake to enter into.

We note the terminology used for non-equities is similar to that used in respect of equities transparency requirements. However, neither ESMA nor the Commission appear to have a mandate to consider the use of many of these terms in the non-equities context, which may leave some gaps in interpretation and could potentially lead to legal uncertainty.

Post-trade transparency requirements for non-equity instruments

MiFIR introduces post-trade transparency requirements for non-equity instruments, which apply to all investment firms (including SIs) as well as trading venues (MTFs, OTFs and RMs).

Information to be made public

The details required to be made public under MiFIR are similar for non-equities as for equities, with the addition of fields for instrument identification code type, quantity in measurement unit and price notations, notional amount and notional currency, quantity in measurement unit, ‘type’ (for emission allowances and emission allowance derivatives) and transaction to be cleared (for derivatives). The more granular fields take account of the different characteristics of non-equity financial instruments.

Where an SI is the venue of execution, it should be identified simply by using the code ‘SINT’

Following consultation, ESMA accepted the position of market participants by agreeing that SIs need not make their identity public as part of post-trade data, given the risks they take on. Where an SI is the venue of execution, it should be identified simply by using the code ‘SINT’.

The set of trade identifiers for non-equity transactions are similar, but not identical, to those put forward for equities. As with equities, some of the non-equity trade flags aim to identify those transactions that have benefited from pre-trade transparency waivers.

For OTC transactions, the RTS contain a list of types of transactions to which post-trade transparency requirements will not apply. As for equities, these include (i) transactions that are excluded from transaction reporting under Article 26 of MiFIR,

(ii) transactions executed by a management company or an alternative investment fund manager which transfers the beneficial ownership of financial instruments form one CIU to another where no investment firm is 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 or collateral requirements or as part of the default management process of a CCP.

Timing of disclosure

As with equity and equity-like instruments, post-trade information for non-equities must be made public as close to real-time as technically possible.

The maximum permissible delay is 15 minutes for three years after MiFIR comes into force. After that initial period, the maximum permissible delay will be reduced to five minutes after execution. It is intended that this transition will enable market participants to adapt to the five minute maximum delay.

From the recitals to the RTS, it is clear that information should be made available 'as instantaneously as technically feasible', which assumes both efficiency and systems expenditure on the part of the market operator, APA or investment firm concerned. Information should be published close to the maximum time limit only in exceptional cases where available systems do not allow for publication in a shorter period of time.

Deferred publication regime

National competent authorities may authorise deferred publication of the details of a transaction based on its size or type.

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Standard deferral

Competent authorities may authorise deferred publication if the transaction is (i) large in scale compared with the normal market size, (ii) in a financial instrument or class of financial instruments for which there is not a liquid market, (iii) executed between an investment firm dealing on own account, other than on a matched principal basis, and another counterparty and the size of the transaction is equal to or exceeds the relevant size specific to the instrument or (iv) the transaction is a package transaction fulfilling certain criteria.

All details of the transaction must be made public no later than 19.00 on the second working day after the date of the transaction provided that no extended or infinite time period of deferral is granted.

The RTS calibrate the threshold floors for deferrals, considering the specific market structure of the respective asset class. The post-trade thresholds are set at a higher level than the pre-trade thresholds.

Publication of limited or aggregated details during the standard deferral period

Unlike the post-trade deferral regime for equities, which is entirely 'dark' during the deferral period, competent authorities have discretion to request either that:

- any or all information on the transaction which would otherwise need to be made public is made public during the deferral period, with the exception of details relating to volume which can be deferred; or
- information about a minimum of five transactions executed on the same day is published in a daily aggregated form the following working day before 09.00 local time.

Extended deferral at the competent authority's discretion

In conjunction with the authorisation of a standard deferral, competent authorities may authorise enhanced deferral. There are a range of options for this and competent authorities may be able to combine certain deferrals.

(i) Deferral of volume information

During a four week deferral period, competent authorities may allow omission of the publication of volume, whilst all other details of the individual transactions will need to be made public.

(ii) Aggregated publication of transactions (non-sovereign debt)

During a four week deferral period, aggregated details of transactions executed over the course of one calendar week will need to be made public on the Tuesday following the end of the calendar week no later than 09.00 local time.

(iii) Aggregated publication of transactions (sovereign debt)

During the deferral period (which, unlike for non-sovereign debt, may be indefinite) aggregated details of transactions executed over the course of one calendar week will need to be made public on the Tuesday following the end of the calendar week no later than 09.00 local time.

(iv) Extended deferral for volume followed by aggregated publication of transactions (sovereign debt)

During a four week deferral period, all other details of the individual transactions (except for volume) will need to be made public.

Once the four week extended deferral for volume period has expired, aggregated details of transactions executed over the course of one calendar week will need to be made public no later than 09.00 local time on the Tuesday following the expiry of the extended period of deferral of four weeks counting from the last day of that calendar week.

Suspension of transparency requirements for non-equity instruments

Competent authorities can suspend the transparency obligations in relation to a particular class of non-equity instruments on a temporary basis where the liquidity of that class of instrument falls below a specified threshold.

The RTS set different thresholds for financial instruments for which there is a liquid market and financial instruments for which there is not a liquid market. Transparency may be suspended where the total volume calculated for the previous 30 days represents, (i) in the case of instruments for which there is a liquid market, less than 40 per cent and (ii) in the case of instruments for which there is not a liquid market, less than 20 per cent, of the average monthly volume calculated for the 12 full calendar months preceding those 30 calendar days.

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