

MFSA

MALTA FINANCIAL SERVICES AUTHORITY

Circular on Markets in Financial Instruments Directive ('MiFID II') and Markets in Financial Instruments Regulations ('MiFIR')

This Circular is being addressed to all market participants, particularly Market Operators, Trading Venues, Investment Firms, or any other related entities subject to MiFID II and MiFIR. Readers will find updates on the following: [i] Q&As on transparency, market structure, commodity derivatives, and data reporting; [ii] guidelines on transaction reporting, order record keeping and clock synchronisation; [iii] a discussion paper on the trading obligation for derivatives under MiFIR; and [iv] consultation papers on: (a) the draft guidelines on specific notions under MiFID II related to the management body of market operators and data reporting services providers; (b) the draft RTS on package orders for which there is a liquid market; (c) the draft RTS specifying the scope of the consolidated tape for non-equity financial returns; and (d) the guidelines on the calibration, publication and reporting of trading halts.

1) Questions and Answers on MiFID II and MiFIR transparency topics

On the 3rd October 2016, the European Securities and Markets Authority ('ESMA') published a new set of Questions and Answers ('Q&A') on MiFID II/ MiFIR transparency topics, which was further updated on the 3rd November, 18th November 2016 and 19th December 2016. The scope of the Q&A is to provide responses to questions raised by the general public, market participants and competent authorities in relation to the practical application of MiFID II/ MiFIR in this area.

More specifically, this Q&A currently provides explanations on [i] the systematic internaliser regime, [ii] the double volume cap mechanism, [iii] equity transparency, [iv] non-equity transparency, as well as [v] pre-trade transparency waivers.

The Q&A provides key dates for when ESMA intends to publish the first set of data needed to implement and comply with the Systematic Internaliser ('SI') regime.

The earliest mandatory deadline, on which firms must comply with the SI regime, is 1st September 2018 although MiFID II and MiFIR requirements apply from 3rd January 2018. However, ESMA stresses that investment firms may opt-in the SI regime for all financial instruments from 3rd January 2018.

MiFID II introduces the double volume cap mechanism which limits the use of reference price waivers and negotiated price waivers under the new transparency regime of MiFID II.

With respect to the double volume cap mechanism the Q&A provides details regarding:

- clarifications of what data has to be taken into consideration in respect of volumes traded under MiFID I waivers in 2017;
- the application of the double volume cap regarding MTF only shares, depositary receipts, certificates, and newly issues instruments; and
- Mid-month reports.

Furthermore, the Q&A also provides explanations on the review of transparency waivers granted in accordance with MiFID I, as well as on the procedure for granting a waiver from pre-trade transparency obligations for illiquid non-equity financial instruments.

Finally, the Q&A provides the conditions to when existing waivers for shares require a new waiver application. It also provides updates on the waiver application schedule for 2017. The waivers will be processed in two tranches as follows:

Equity and Equity-like instruments:

- Trading venues submit waivers to National Competent Authorities ('NCAs') by 1st February 2017;
- NCAs submit waivers to ESMA by 28th February 2017; and
- ESMA review completed by 31st May 2017.

Bonds and Derivatives:

- Trading venues submit waivers to NCAs by 1st June 2017;
- NCAs submit waivers to ESMA by 31st July 2017; and
- ESMA review completed by 30th November 2017.

A copy of this Q&A may be accessed through the following [link](#).

2) Questions and Answers on MiFID II and MiFIR market structures topics

On the 18th November 2016, ESMA issued an update on the Questions and Answers on MiFID II/ MiFIR market structures topics, which was further updated on the 19th December 2016. The Q&A provides responses to questions raised by the general public, market participants and competent authorities in relation to the practical application of MiFID II/ MiFIR in relation to market structure topics.

This Q&A provides explanations on [i] data disaggregation, [ii] the tick size regime, and [iii] Direct Electronic Access ('DEA') and algorithmic trading.

Data disaggregation relates to the requirement that pre- and post-trade data be made available in an unbundled fashion. This means that when Trading Venues sell their pre- and post-trade data in the same ‘package’, they will have to make it available separately, where separation by asset class, instrument, sector and other criteria is also required. The Q&A clarifies the level at which disaggregation is required, who is entitled to request disaggregated data and how the country of issue for shares is interpreted.

With respect to the tick size regime, the Q&A provides explanations regarding

- Who is responsible for calculating and publishing the average daily number of transactions (‘ADNT’);
- The types of corporate actions for an instrument that may trigger a recalculation of ADNT;
- The scope of non-EU instruments and how their ADNT is required to be performed;
- The application of the tick size for instruments trading in different currencies;
- Ad hoc changes in applicable tick sizes;
- The tick size regime and pre-trade transparency waivers, and
- Orders remaining on the order book at the moment the tick size increases.

Finally, the Q&A provides explanations (a) whether a simple algorithm is required to be treated as algorithmic trading, (b) regarding the transmission of orders and algorithmic trading, and (c) regarding the requirements for an Automated Order Router (‘AOR’).

A copy of this Q&A may be accessed through the following [link](#).

3) Questions and Answers on MiFID II/MiFIR commodity derivatives topics

On the 19th December 2016, ESMA published a new set of Q&As on MiFID II/ MiFIR commodity derivatives topics. The scope of the Q&A is to provide responses to questions raised by the general public, market participants and competent authorities in relation to the practical application of MiFID II/ MIFIR in this area.

More specifically, this Q&A currently provides explanations on ancillary activities requirements and position limits.

MiFID II introduces a quantitative test for non-financial firms that trade in commodity derivatives to determine whether their speculative trading activities, i.e. their ‘ancillary activities’ are of a certain size to be authorised as a financial firm. Non-financial firms that are below the thresholds set out in the underlying RTSs¹ are exempt from being authorised under MiFID II.

The Q&A clarifies that the aforementioned exemption does not apply to legal entities which deal in commodity derivatives within a financial group. Each person (legal or natural) is

¹ http://ec.europa.eu/finance/securities/docs/isd/mifid/rts/161201-rts-20_en.pdf

responsible for notifying the relevant regulator when they make use of the ancillary activity exemption.

Furthermore, the Q&A also explains how financial instruments which fall under the definition of MiFID II Annex I Section C (6)² are required to be included by firms when calculating the size of their ancillary activities.

With respect to position limits, the Q&A provides an explanation on [i] what is considered a ‘lot’ for energy products and economically equivalent OTC contracts, [ii] when securitised derivatives are to be classed as commodity derivatives and their typical features which ESMA takes into consideration to differentiate the commodity derivatives from exchange traded commodities, and [iii] how position limits for futures and options should be applied.

A copy of this Q&A may be accessed through the following [link](#).

4) Questions and Answers on MiFIR data reporting

On the 20th December 2016, ESMA published a new set of Q&As on MiFIR data reporting. The scope of the Q&A is to provide responses to questions raised by the general public, market participants and competent authorities in relation to the practical application of MiFID II and MIFIR in this area.

More specifically, this Q&A currently provides explanations on [i] Legal Entity Identifiers (‘LEIs’) of issuers; [ii] the date and time of the request for admission; and [iii] the date and time of the admission.

The LEI is a 20-character, alpha-numeric code which identifies legally distinct entities that engage in financial transactions. The Q&A offers guidance regarding the:

- LEI of the issuer;
- LEI of an operator of a trading venue or a systematic analyser;
- Issuer LEI vs Ultimate Parent LEI; and
- LEI annual maintenance.

Lastly, the Q&A clarifies issues regarding [i] the date and time of the request for admission and of the admission of instruments in the past; [ii] the unknown time of the request for admission and of the admission of instruments; and [iii] the coinciding date and time of the request for admission and of the admission of instruments.

A copy of this Q&A may be accessed through the following [link](#).

² Options, futures, swaps, and any other derivative contract relating to commodities that can be physically settled provided that they are traded on a regulated market, a MTF, or an OTF, except for wholesale energy products traded on an OTF that must be physically settled.

5) Guidelines on transaction reporting, order record keeping and clock synchronisation under MiFID II

On the 10th October 2016, ESMA published guidelines to provide clarifications on the submission of transaction reports by an investment firm directly, an Automated Reporting Mechanism acting on behalf of an investment firm, or by the trading venue through which system the transaction was completed, pursuant to Article 26 of MiFIR. Also guidelines on record keeping of orders by investment firms and regulated markets pursuant to Article 25 of MiFIR, and synchronisation of business clocks for regulated markets and its members pursuant to Article 50 of MiFID II.

The following are some of the main points of the guidelines:

I. Transaction reporting:

- a) How a transaction report should be constructed, and in what circumstances and where the report should be sent.
- b) Blocks (collection of fields), where the relevant fields for a particular topic is addressed by each block, with complementary examples that illustrate how they should be populated. Examples are provided based on different trading scenarios that a reporting party might exercise, in particular, transactions resulting from transmissions of orders, grouped orders and the provisions of Direct Electronic Access ('DEA') are presented.
- c) Reporting guidance for various financial instruments.

II. Record Keeping

- a) The record keeping requirements apply to operators of Trading Venues in respect to *'all orders in financial instruments which are advertised through their systems'*, as per Article 25(2) of MiFIR. They apply in respect of orders, which include those that are active, inactive, suspended, implicit and rerouted orders as well as order modifications, cancellations and rejections. Such requirements also apply to firm and indicative quotes.

III. Clock synchronisation

- a) Article 50 of MiFID II and the related RTSs apply to Trading Venues and their members and participants; they are required to comply with accuracy requirements, namely, the maximum divergence of their business clocks from UTC and the timestamp granularity of reportable events.

A copy of the guidelines may be accessed through this [link](#).

6) Discussion Paper on the trading obligation for derivatives under MiFIR

On the 20th September 2016, ESMA issued a Discussion Paper on the trading obligation for derivatives under MiFIR, which provides ESMA's first proposals of how to implement the trading obligation for derivatives as per Articles 28 and 32 of MiFIR and ESMA's preliminary analysis of some classes of derivatives that could be subjected to the trading obligation.

Article 32 of MiFIR provides the process for deciding which derivatives are to be subjected to mandatory trading. Amongst others, it is explained that once a class of derivatives has been made subject to the clearing obligation under EMIR, ESMA must then determine whether this class of derivatives should be subject to the trading obligation.

The trading obligation does not solely depend on whether a class of derivatives is subject to the clearing obligation under EMIR. MiFIR also requires two tests to determine the trading obligation. [i] The venue test - the trading obligation takes effect once the class of derivatives is admitted to trading or traded on at least one trading venue. [ii] The liquidity test - 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)'* of MiFIR.

ESMA has 6 months to declare whether derivatives are subject to the trading obligation by way of a draft RTS. The derivatives can only be traded on a Trading Venue or a third country venue deemed to be equivalent by the Commission.

A copy of the Discussion Paper may be accessed through this [link](#). ESMA is currently in the process of reviewing replies to this Consultation Paper.

7) Consultation Paper on the draft guidelines on specific notions under MiFID II related to the management body of market operators and data reporting services providers.

On the 4th October 2016, ESMA published a Consultation Paper on guidelines on specific notions under MiFID II to the management body of market operators and data reporting services providers.

Article 45(2)(a) to (c) of MiFID II requires the members of the management body of market operators to act with honesty, integrity and independence, be of sufficiently good repute, whilst possessing the necessary knowledge, skills and experience to fulfil their duties, and commit sufficient time to perform their functions. Adequate human and financial resources shall be allocated to the induction and training of the management body besides promoting diversity.

Article 63 of MiFID I and recital 53 of MiFID II have similar requirements for the management body of Data Reporting Service Providers ('DRSPs'), however there are differences in the applicable requirements for market operators and the requirements for DRSPs, namely the requirements for induction and training resources, the provision of diversity and the employment of a broad set of qualities and competencies in the recruitment process within the management body.

The Consultation paper also covers record-keeping obligations for orders and transactions of investment firms and trading venues, as per Article 25 of MiFIR.

ESMA invites respondents to comment on all matters relating to this Consultation Paper by the 5th January 2017. Respondents should submit an online form, which is published on the ESMA website, www.esma.europa.eu.

A copy of the Consultation Paper may be accessed through this [link](#).

8) Consultation Paper on the draft RTS on package orders for which there is a liquid market

On the 10th November 2016, ESMA issued a Consultation Paper on draft regulatory technical standards on package orders for which there is a liquid market.

The Quick-Fix Regulation³ introduces a pre-trade transparency regime for package orders. The possibility to waive package orders from pre-trade transparency was introduced by two new sub-paragraphs of MiFIR: Article 9(1)(d) and Article 9(1)(e).

The Consultation Paper seeks to assess whether packages are standardised and frequently traded, where both qualitative and quantitative criteria are used. It also seeks stakeholders' views on the methodology for determining whether there is a liquid market for a package order. Furthermore, the Consultation Paper presents the initial treatment of packages for transparency purposes, especially focusing on the pre-trade transparency regime for package orders in the EU and the US.

ESMA invites respondents to comment on all matters relating to this Consultation Paper by the 3rd January 2017. Respondents should submit an online form, which is published on the ESMA website, www.esma.europa.eu.

A copy of the Consultation Paper may be accessed through this [link](#).

³ Quick-Fix Regulation: 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 (MiFIR), 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.

9) Consultation Paper on the RTSs specifying the scope of the consolidated tape for non-equity financial returns

On the 3rd October 2016, ESMA issued a Consultation Paper on the draft RTSs specifying the scope of the consolidated tape for non-equity financial instruments.

MiFID II requires the establishment of a Consolidated Tape ('CT') for both equity and non-equity instruments. The RTSs relating to the scope of the equity-type instruments has already been submitted by ESMA and endorsed by the European Commission⁴. However it is considered that the non-equity CT is more sophisticated, and coupled with the fact that the relevant requirements will apply from September 2019, ESMA decided to deliver the draft RTSs which specify the scope of the non-equity CT at a later stage.

ESMA's draft RTSs seek to be attractive to potential Consolidated Tape Providers ('CTPs') whilst also being able to provide a user-friendly approach, as overly rigid requirements on non-equity CTs may prevent such CTPs to emerge in the first place.

To increase the chances of non-equity CT business viability, ESMA allows CTPs to provide services that cover only one or a group of asset classes, rather than the entire heterogeneous universe of non-equity instruments.

Furthermore, CTPs should not be required to collect information from all trading venues and Approved Public Arrangements ('APAs'), since the costs of including these sources outweigh the added value for users. ESMA therefore recommends allowing CTPs to exclude trading venues and APAs of an insufficient size by introducing thresholds.

Finally, ESMA considers it appropriate for non-equity CTPs to include data from new trading venues or new APAs as soon as possible and not later than 6 months after the start of the trading venues or the APAs operations, similar to the provisions for equity CTPs.

A copy of the Consultation Paper may be accessed through this [link](#). ESMA is currently in the process of reviewing replies to this Consultation Paper.

10) Consultation Paper on the Guidelines on the calibration, publication and reporting of trading halts

On the 6th October 2016, ESMA issued a Consultation Paper on Guidelines on the calibration, publication and reporting of trading halts. Article 48(5) of MiFID II provides that, *'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*

⁴ <https://ec.europa.eu/transparency/regdoc/rep/3/2016/EN/3-2016-3201-EN-F1-1.PDF>

related market during a short period and, in exceptional cases, to be able to cancel, vary or correct any transaction’.

The guidelines illustrate how trading halts are to be communicated to market participants and other venues. Moreover, they seek to ensure consistency and comparability of reports to competent authorities relating to regulated markets and the parameters for halting trading, as well as any material changes to these parameters. Competent authorities are consequently required to report to ESMA. The guidelines seek to offer guidance on:

1. The calibration of trading halts;
2. The dissemination of information regarding the activation of mechanisms to manage volatility on a specific trading venue; and
3. The procedure and format to submit the reports on ‘trading halts’ parameters from national competent authorities to ESMA.

Trading venues are responsible for the initial and on-going calibration of the parameters of trading halts and the disclosure of trading halts. Even though Article 48 of MiFID II specifies regulated markets, Article 18(5) expands the obligations to apply to MTFs and OTFs.

Furthermore, ESMA considers that the Guidelines should encompass all classes of financial instruments, regardless whether considered liquid or not, which are within the scope of MiFID II.

A copy of the Consultation Paper may be accessed through this [link](#). ESMA is currently in the process of reviewing replies to this Consultation Paper.

Contacts

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