Agenda

Market structure
Derivatives trading obligation
Pre- and post-trade transparency
MiFIR framework for trading of OTC derivatives

New market structure

Implementing G20 trading mandate

New pre- and post-trade transparency regime
Market structure
New market structure

Key changes:
- New trading venue – OTFs
- SIs wider in scope
- Trading pushed on venue or SI
- Align RM and MTFs

MiFID1
- Multilateral*
  - Regulated Markets (RMs)
  - Multilateral Trading Facilities (MTFs)
- Bilateral
  - Systematic internalisers (SIs)
  - OTC

MiFID2
- Multilateral*
  - Regulated Markets (RMs)
  - Multilateral Trading Facilities (MTFs)
  - Organised Trading Facilities (OTFs)
- Bilateral
  - Systematic internalisers (SIs)
  - OTC

* "trading venues"

Trading requirements for derivatives
Key definitions

### Multilateral

**RMs and MTFs**
- a multilateral system... which brings together ... multiple third-party buying and selling interests in financial instruments – in the system and in accordance with non-discretionary rules – in a way that results in a contract

**OTFs (new)**
- A multilateral system or facility, which is not a regulated market or MTF, ... in which multiple third-party buying and selling interests in financial instruments are able to interact in the system in a way that results in a contract

**Multilateral system**
- any system or facility in which multiple third parties buying and selling trading interests in financial instruments are able to interact

### Bilateral

**SIs**
- an investment firm which, on an organised, frequent, systematic and substantial basis, deals on own account by executing client orders outside a regulated market or an MTF or an OTF, without operating a multilateral system.

(Level 2 to specify criteria)

**OTC transactions**
- Not defined in MiFID2 or MiFIR

Relevant Articles
- MiFIR Article 4
### Market structure under MiFID2

<table>
<thead>
<tr>
<th>Operator</th>
<th>RM(s)</th>
<th>MTFs</th>
<th>OTFs[^1]</th>
<th>SIs</th>
<th>OTC</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-discretionary execution</td>
<td>Exchange</td>
<td>Exchange or Firm</td>
<td>Exchange or Firm</td>
<td>Firm</td>
<td>Firm</td>
</tr>
<tr>
<td>Conduct of business rules</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Operator can use own capital</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Access to facilities</td>
<td>Transparent, non-discriminatory rules, objective criteria</td>
<td>Transparent, non-discriminatory rules, objective criteria</td>
<td>Transparent, non-discriminatory rules, objective criteria</td>
<td>Commercial policy (in objective, non-discriminatory way)</td>
<td>Commercial policy</td>
</tr>
<tr>
<td>Admission to trading</td>
<td>Clear, transparent rules (+ other criteria)</td>
<td>Transparent rules (+ adequate PAI[^2])</td>
<td>Transparent rules (+ adequate PAI[^2])</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Resilience, circuit breakers, tick size</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Surveillance required (MAR)</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
</tbody>
</table>

[^1]: Non-equities only;  
[^2]: Publicly available information
## Market structure under MiFID2 (continued)

<table>
<thead>
<tr>
<th></th>
<th>RM</th>
<th>MTF</th>
<th>OTF (^1)</th>
<th>SI</th>
<th>OTC</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Pre-trade transparency</strong></td>
<td>Yes (incl. non-equities)</td>
<td>Yes (incl. non-equities)</td>
<td>Yes</td>
<td>Yes (incl. non-equities)</td>
<td>No</td>
</tr>
<tr>
<td><strong>Pre-trade waiver available</strong></td>
<td>Yes (incl. non-equities)</td>
<td>Yes (incl. non-equities)</td>
<td>Yes</td>
<td>No</td>
<td>N/a</td>
</tr>
<tr>
<td><strong>Post trade transparency</strong></td>
<td>Yes (incl. non-equities)</td>
<td>Yes (incl. non-equities)</td>
<td>Yes</td>
<td>Yes (incl. non-equities)</td>
<td>Yes (incl. non-equities)</td>
</tr>
<tr>
<td><strong>Publish execution quality data</strong></td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes (if liquidity provider)</td>
</tr>
<tr>
<td><strong>Eligible OTC derivs platform</strong></td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td><strong>Authorities can suspend trading</strong></td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td><strong>Record orders</strong></td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
</tbody>
</table>

\(^1\) Non-equities only
Derivatives trading obligation
# Overview: The trading obligation for derivatives

## "Bottom up" process
1. Class of OTC derivatives is declared subject to mandatory clearing under EMIR
2. ESMA consults on whether to impose mandatory trading on that class or a subset of that class
3. ESMA proposes draft regulatory technical standards (RTS) to Commission within six months after adoption of RTS on clearing under EMIR
4. Mandatory trading may be phased-in for some counterparty types

## "Top down" process
1. Where a class of OTC derivatives has not been declared subject to mandatory trading
2. ESMA shall regularly monitor activity in those derivatives to identify cases where this may pose systemic risk and to prevent regulatory arbitrage
3. ESMA shall, on its own initiative, identify and notify to the Commission derivatives that should be subject to the trading obligation but which no CCP is authorised to clear under EMIR or which are not admitted to trading.

## OTC derivative subject to the clearing obligation under EMIR

- Not an intragroup transaction under Article 3 EMIR
- Not subject to transitional provisions under Article 89 EMIR

## Relevant class/sub-class declared subject to mandatory venue trading obligation

## Must be traded only on:

<table>
<thead>
<tr>
<th>RM</th>
<th>MTF</th>
<th>OTF</th>
<th>Equivalent third country market</th>
</tr>
</thead>
</table>

Trading requirements for derivatives
Trading obligation: The venue and liquidity tests

**Derivatives**

<table>
<thead>
<tr>
<th>Venue Test</th>
</tr>
</thead>
<tbody>
<tr>
<td>Is the relevant class/sub-class of instruments admitted to trading on a RM/MTF/OTF or equivalent third country market?</td>
</tr>
<tr>
<td>• In contrast to the US regime, the test is not ‘venue led’</td>
</tr>
<tr>
<td>• If the class/sub-class fails the venue test no need to consider liquidity. However, ESMA may consider using ‘top-down’ process</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Liquidity Test</th>
</tr>
</thead>
<tbody>
<tr>
<td>Is there sufficient third-party buying and selling interest in the class/sub-class so that such class/sub-class is considered sufficiently liquid to trade only on venue?</td>
</tr>
<tr>
<td>• ESMA will first assess which specific liquidity factors are relevant in a particular case</td>
</tr>
<tr>
<td>• ESMA will then apply the four liquidity criteria based on different weightings as appropriate for the case</td>
</tr>
<tr>
<td>• Ultimately requires an overall assessment of whether a class or sub-class sufficiently liquid to support the introduction of a trading obligation</td>
</tr>
<tr>
<td>• ESMA must also:</td>
</tr>
<tr>
<td>• Consider <strong>anticipated impact</strong> on liquidity of relevant derivatives and commercial activities of end users</td>
</tr>
<tr>
<td>• Consider whether the derivatives are only sufficiently liquid in transactions <strong>below a certain size</strong></td>
</tr>
<tr>
<td>• <strong>Periodically review</strong> the liquidity of the relevant instrument/class and the liquidity thresholds</td>
</tr>
</tbody>
</table>
What venues qualify?

**OTC derivative subject to the clearing obligation under EMIR**

- Not an intragroup transaction under Article 3 EMIR
- Not subject to transitional provisions under Article 89 EMIR

**Relevant class/sub-class declared subject to mandatory venue trading obligation**

**Must be traded only on:**

- RM
- MTF
- OTF
- Equivalent third country market

- Commission decision that there are equivalent legally binding requirements:
  - Authorisation and supervision;
  - Venue has clear and transparent rules on admission to trading;
  - Issuers are subject to periodic information requirements;
  - Market abuse rules

- Effective equivalent recognition for EU trading venues for derivatives

- Commission decision only for purposes of determining eligibility as a trading venue for these purposes, and may be limited to a category or categories of trading venues

- Also need to address licensing issues for third country firms
Who is subject to mandatory trading?

<table>
<thead>
<tr>
<th>FC or NFC+</th>
<th>OTC derivative</th>
<th>FC or NFC+</th>
</tr>
</thead>
<tbody>
<tr>
<td>EU</td>
<td>Non-EU</td>
<td></td>
</tr>
</tbody>
</table>

**FC** = financial counterparty  
**NFC+** = non-financial counterparty over the EMIR clearing threshold  
**TCE** = non-EU entity which would have been subject to the clearing obligation if established in the EU  
**Third country financial institution** = non-EU entity authorised to carry on any of the activities listed in BCD, MiFID 2, Solvency II, UCITS, IORPs, AIFMD

Only if transaction has a direct, substantial and foreseeable effect in the EU or if necessary or appropriate to prevent evasion  
RTS are aligned with EMIR

Note: Exemption for duplicative or conflicting obligations.  
Treatment of entities exempt under Article 1(4) or 1(5) EMIR?  
Treatment of branches of non-EU entities and EU branches of non-EU entities
Avoiding duplicating or conflicting rules

(Article 33 MiFIR)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>A counterparty to a derivative will be deemed to have complied with the mandatory derivatives trading and clearing obligations under MiFIR where:</td>
<td>The legal, supervisory and enforcement arrangements of the relevant third country:</td>
<td>European Commission</td>
<td>The European Commission (together with ESMA) is required to monitor the laws of any jurisdiction declared equivalent, and report on at least an annual basis to the European Parliament and Council</td>
</tr>
<tr>
<td>- at least one counterparty is established in an equivalent non-EU jurisdiction and</td>
<td>- are equivalent to the requirements resulting from Articles 28 and 29 MiFIR</td>
<td>Implementing act on equivalence</td>
<td>The equivalence decision may be withdrawn</td>
</tr>
<tr>
<td>- the counterparties are in compliance with the relevant rules in that jurisdiction</td>
<td>- ensure protection of professional secrecy that is equivalent to that set out in MiFIR</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- are being effectively applied and enforced in an equitable and non-distortive manner so as to ensure effective supervision and enforcement in that third country</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
ESMA Consultation Paper on trading obligation (June 2017)

Proposed scope of obligation:
- Specified classes of fixed-floating IRS denominated in EUR (euribor), USD (Libor), GBP (Libor) - benchmark tenors
- 5 year index CDS – iTraax Europe Main and iTraxx Europe Crossover (on the run, first of the run)
- Applying the trading venue test and liquidity test
- Not fully aligned with US classes

Proposed date of application:
- 3 January 2018
- Date clearing obligation takes effect for counterparties (if later)

No proposal to limit application for
- Transactions in large size
- Package transactions
- Alignment of liquidity tests in transparency regime
Pre- and post-trade transparency
Systematic internaliser

“an investment firm which, on an organised, frequent systematic and substantial basis, deals on own account when executing client orders outside a regulated market, an MTF or an OTF without operating a multilateral system”

Article 4(1)(20) MiFID2
## Systematic internalisers: proposed thresholds

<table>
<thead>
<tr>
<th>Frequent and systematic basis threshold (liquid instruments)</th>
<th>Shares, etc.</th>
<th>Bonds</th>
<th>SFPs</th>
<th>Derivatives</th>
<th>Emission allowances</th>
</tr>
</thead>
<tbody>
<tr>
<td>No. of own account * OTC transactions/ total no. of transactions in EU in same instrument/class</td>
<td>0.4% and at least once a day</td>
<td>2.5% and at least once a week</td>
<td>4% and at least once a week</td>
<td>2.5% and at least once a week</td>
<td>4% and at least once a week</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Frequent and systematic basis threshold (illiquid instruments)</th>
<th>Shares, etc.</th>
<th>Bonds</th>
<th>SFPs</th>
<th>Derivatives</th>
<th>Emission allowances</th>
</tr>
</thead>
<tbody>
<tr>
<td>Minimum own account OTC trading frequency</td>
<td>at least once a day</td>
<td>at least once a week</td>
<td>at least once a week</td>
<td>at least once a week</td>
<td>at least once a week</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Substantial basis threshold (Criteria 1)</th>
<th>Shares, etc.</th>
<th>Bonds</th>
<th>SFPs</th>
<th>Derivatives</th>
<th>Emission allowances</th>
</tr>
</thead>
<tbody>
<tr>
<td>Size of own account* OTC trading/firm's total volume in same instrument/class</td>
<td>15%</td>
<td>25%</td>
<td>30%</td>
<td>25%</td>
<td>30%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Substantial basis threshold (Criteria 2)</th>
<th>Shares, etc.</th>
<th>Bonds</th>
<th>SFPs</th>
<th>Derivatives</th>
<th>Emission allowances</th>
</tr>
</thead>
<tbody>
<tr>
<td>Size of own account* OTC trading/total EU volume in same instrument/class</td>
<td>0.4%</td>
<td>1%</td>
<td>2.25%</td>
<td>1%</td>
<td>2.25%</td>
</tr>
</tbody>
</table>

**Source:** Delegated act  
Conditions assessed on a quarterly basis based on data from last 6 months.  
For shares, etc., bonds and structured finance products (SFPs), conditions are assessed on instrument by instrument basis. For derivatives they are assessed by reference to the class or type of instrument.  
* Only counts trades executed on own account when executing client orders.
Pre-trade transparency for SIs – OTC derivatives (Article 18 MiFIR)

Scope of obligations

Applies to SIs for derivatives traded on a trading venue where the SI deals in sizes at or below the size specific to the financial instrument (SSTI).

Obligations for liquid classes of OTC derivatives

SI must make public firm quotes where SI is prompted for a quote by a client and it agrees to provide a quote

- Must be made public in a manner easily accessible to other market participants on a reasonable commercial basis
- No obligation to execute with public on the basis of those quotes
- Obligation ceases if pre-trade transparency obligation of trading venue suspended because instrument falls below threshold of liquidity

However, SI must make those quotes available to its other clients and must undertake to transact with those clients on the quote

- SI must have clear standards on access to quotes but can decide on basis of commercial policy and in objective and non-discriminatory way which clients get access to quotes and may refuse to or discontinue business relationships on basis of commercial criteria, including credit status, counterparty risk and settlement
- SIs may establish non-discriminatory and transparent limits on the number of transactions they will execute pursuant to a quote

Obligations for non-liquid classes of OTC derivatives

SI must disclose quotes to clients on request if they agree to provide a quote (competent authorities can waive in some cases), but no obligation to publish those quotes or make them available for execution to other clients
“ESMA is of the view that only OTC derivatives sharing the same reference data details as the derivatives traded on a trading venue should be considered to be TOTV and, hence, subject to the MiFIR transparency requirements and to transaction reporting according to Article 26(2)(a) of MiFIR.”

“In this context, “sharing the same reference data details” should mean that the OTC derivatives should share the same values as the ones reported in accordance with the fields of [RTS 23] for derivatives admitted to trading or traded on a trading venue, except fields 5 to 12 (the trading venue and issuer-related fields).”

“Since the trading venue and issuer related fields are only applicable to trading venues when submitting reference data for derivatives but are not applicable for trading those contracts bilaterally outside of trading venues, ESMA considers it appropriate not to take into account these fields when determining whether an OTC derivative traded outside of a trading venue is to be considered TOTV.”

“Nevertheless, ESMA is aware that what is to be considered the “same” reference data details may need to be revisited by ESMA taking into account the evolution of markets post 3 January 2018.”
Obligations with respect to quotes

Quotes for liquid classes of instrument must be “firm quotes”

SIs may update their quotes at any time

SIs may withdraw their quotes “under exceptional market conditions”

Quotes must “reflect prevailing market conditions in relation to prices at which transactions are concluded for the same or similar financial instruments on a trading venue”

Quotes must be such as to ensure that SI complies with its best execution duties, where applicable

SIs may execute orders at a better price than quote “provided that price falls within a public range close to market conditions”

Treatment of packages

Level 2 measures

Commission delegated acts:

- Specify sizes at which SI must enter into transactions with other clients
- Clarify what constitutes a “reasonable commercial basis” to make quotes public
Pre-trade: can you trade OTC derivatives in the dark?

How are you trading?  Liquid?  Large trade?  Other?

OTC*  SI †  Venue

Liquid?  >SSTI?  Liquid?**  LIS or >SSTI?**  OMF?**

No  Yes  No  No  Yes

Yes  No  Yes  No  No

LIS  OMF

KEY
* No OTC for derivatives subject to venue trading obligation
† If instrument is also traded on a venue
** If venue has relevant waiver
SSTI – Size specific to instrument
LIS – Large in scale
OMF – Order management facility
RFQ venues may delay publication of quotes until available for execution
Venues relying on LIS waiver must publish indicative bid/offer prices close to trading interests advertised on the venue (e.g. best or simple or volume weighted average prices)
Post-trade transparency for OTC derivatives

Publication of price, volume and time “as close to real time as technically possible”

Responsibility for disclosure is with trading venue or investment firm (via approved publication arrangement – APA)

Applies to derivatives “traded on a trading venue” including when those derivatives are traded with an SI or over-the-counter

Disclosure in any case within 15 minutes (until 1 Jan 2021) or within 5 minutes (thereafter)

Competent authorities for venue may authorise deferred publication

Where transaction is LIS, related to a derivative or class of derivatives for which there is not a liquid market or (if involves an investment firm dealing on own account not on a matched principal basis) above SSTI

“Package transaction” may also benefit from deferral if one or more of its components would be eligible for deferral

Competent authority may authorise deferred publication with publication of full details by no later than 19:00 local time on T+2 (but may request publication of details other than volume or publication of aggregated transactions during that period)

Competent authority may authorise deferred publication for extended period (up to four weeks) subject to:

Publication of all transaction details (except volume) during that period; or
Publication of several transactions executed over a week on an aggregate basis (by 9:00 on following Tuesday); and
Publication of full details of individual transactions by 9:00 on day after expiry of four week period
Questions