



SPECIAL REPORT SERIES: TRANSPARENCY

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This Special Report is the ninth and final in the FIA and FIA Europe's series covering specific areas of the European Securities and Markets Authority's ("ESMA") consultation process for the implementation of the recast Markets in Financial Instruments Directive ("MiFID II") and Regulation ("MiFIR"). It provides an overview of the proposals relating to transparency set out in the recently published Consultation Paper and Discussion Paper, which include ESMA's draft technical advice, as well as reasoning and questions on draft Regulatory Technical Standards ("RTS") and Implementing Technical Standards ("ITS").

TRANSPARENCY IN MiFID II AND MiFIR

Transparency, as a theme, permeates the primary legislation and the Discussion Paper. There are 13 sub-sections on transparency, spanning over 150 pages. Among others, the Discussion Paper covers (i) pre-trade and post-trade transparency requirements for equities; (ii) pre-trade and post-trade transparency requirements for non-equity instruments; (iii) the systematic internaliser regime; and (iv) the definition of a "liquid market", which is a key component of the transparency provisions. The Consultation Paper has eight sub-sections on transparency, spanning over 30 pages and analysing, among others: (i) liquid markets for equities; (ii) the systematic internaliser regime; and (iii) pre-trade transparency requirements for systematic internalisers in non-equity instruments.

This Special Report briefly outlines the above-mentioned issues. Due to the detailed character of the transparency sections of the Discussion and Consultation Paper, we only provide a high-level overview of ESMA's reasoning and proposals.

PRE-TRADE AND POST-TRADE TRANSPARENCY FOR EQUITIES

Pre-trade transparency requirements

MiFID I imposed pre-trade transparency obligations for equities trading on regulated markets ("RMs") in order to better inform the investing public about trading opportunities. MiFIR amends that regime by (i) extending the pre-trade transparency requirements to "equity-like instruments" (ETFs, depositary receipts, certificates, and other similar financial instruments) and actionable indications of

interest;¹ (ii) extending those requirements to multilateral trading facilities (“MTFs”); and (iii) imposing strict limits on the use of pre-trade transparency waivers aimed at “dark pool” trading.

The Discussion Paper focusses on the waivers to pre-trade transparency requirements, set out in Article 4 of MiFIR, and the controversial “double volume cap” mechanism, set out in Article 5 of MiFIR. This mechanism is aimed at limiting the use of, and trading under, the reference price waiver and the negotiated trade waiver. (The reference price waiver is granted for a system matching orders in accordance with a reference price generated by another system, where that reference price is widely published and is generally regarded as a reliable reference; the negotiated trade waiver is granted for negotiated transactions that involve one or more members or participants of a trading venue who negotiate privately the terms of a transaction which is then reported under the rules of the trading venue.)

In particular, the Discussion Paper sets out ESMA’s analysis of trading across different trading systems in order to define average daily turnover (“ADT”) and assess what is “large in scale” for the purposes of the associated waiver and the volume cap. The Discussion Paper also includes ESMA’s proposal for managing the information requirements of the volume cap: ESMA proposes to place the onus on trading venues using the relevant waivers to provide information on trading under the waivers (past 12 months); this would be measured against the overall trading information that ESMA would receive from (i) all trading venues or (ii) consolidated tape providers (“CTPs”).

Post-trade transparency requirements

The post-trade transparency requirements in MiFIR are largely unchanged from MiFID I. Consequently, ESMA proposes in the Discussion Paper to base the required draft RTS on Article 27(1) of the MiFID Implementing Regulation. ESMA believes that the 2010 CESR technical advice on post-trade transparency standards remains valid.

PRE-TRADE AND POST-TRADE TRANSPARENCY FOR NON-EQUITY INSTRUMENTS

Articles 8 to 11 of MiFIR introduce pre-trade and post-trade transparency regimes with respect to non-equity instruments (bonds, structured finance products, derivatives, and emission allowances). ESMA is charged with drafting the RTS specifying the details of these new regimes and the Discussion Paper sets out ESMA’s initial thinking on those points.

¹ An actionable indication of interest (“IOI”) is defined under Article 2(1)(33) of MiFIR as “a message from one member or participant to another within a trading system in relation to available trading interest that contains all the necessary information to agree on a trade”.

Trading venues admitting non-equities to trading may benefit from some waivers from pre-trade transparency requirements, listed in Article 9 of MiFIR, including the waiver for “large in scale” orders. ESMA is of the opinion that granting waivers of large in scale orders and authorisation of deferred publication for large in scale transactions should be regulated under a common framework in order to avoid inconsistent application of distinct but correlated MiFIR provisions. ESMA also proposes preliminary methodology on (i) the calibration of the large in scale regime within asset classes and (ii) the determination of the thresholds above which an order and/or a transaction is considered to be large in scale.

Regarding calibration, ESMA suggests the following possible options:

- Option 1: As is the case under the current large in scale regime for shares, the determination of the thresholds should take into account the different levels of liquidity within the same asset class. As a result, the thresholds would be different for instruments clustered in a given liquidity band compared to those clustered in another band of the same asset class.
- Option 2: The thresholds should be determined without any further consideration of liquidity within an asset class, under the assumption that the classification is sufficiently granular to aggregate instruments on the basis of homogenous patterns of liquidity and taking into account that MiFIR provisions include *ad hoc* exemptions for “illiquid instruments”.

ESMA expresses a clear preference for Option 2.

Regarding thresholds, ESMA proposes to base them on ADT (Option 1) or the average value of transactions (Option 2). ESMA has a preference for the former option.

“LIQUID MARKET” DEFINITION

Under MiFIR, a “liquid market” for a financial instrument or a class of financial instruments is a market where there are ready and willing buyers and sellers on a continuous basis. There are a number of specific criteria aimed at determining whether a financial instrument or a class of financial instruments is liquid; those criteria are trade-based, order-based, and market-structure based.

MiFIR requires the adoption of a number of implementing measures which are contingent on the concept of a liquid market. Some of the key measures relate to pre-trade and post-trade transparency requirements for equities and equity-like instruments as well as non-equity financial instruments.

Liquid market for equities

Article 2(1)(17)(b) of MiFIR defines “liquid market” for the purposes of applying transparency measures to equity and equity-like instruments. According to that provision, a liquid market means: a market for a financial instrument that is traded daily where the market is assessed according to the free float, the average daily

number of transactions in those financial instruments, and the average daily turnover for those financial instruments.

In the Consultation Paper, ESMA sets out its findings based on data collection exercises and a detailed analysis and proposes to consider the equity markets as liquid if the following thresholds are met:

	Free float	Average daily number of transactions	ADT (EUR)
Equities	EUR 100,000,000	250	1,000,000
Depository receipts	EUR 100,000,000	250	1,000,000
Exchange traded funds	100 (units issued for trading)	20	500,000
Certificates	1,000,000 (issuance size in EUR)	20	500,000

Liquid market for non-equity instruments

Article 2(1)(17)(a) of MiFIR defines “liquid market” for the purposes of applying transparency measures to non-equity instruments. According to that provision, a liquid market means: a market for a financial instrument or a class of financial instruments, where there are ready and willing buyers and sellers on a continuous basis, and where the market is assessed in accordance with the following criteria, taking into consideration the specific market structures of the particular financial instrument or of the particular class of financial instruments: the average frequency and size of transactions over a range of market conditions, having regard to the nature and life cycle of products within the class of financial instrument; the number and type of market participants, including the ratio of market participants to traded financial instruments in a particular product; and the average size of spreads, where available.

In the Discussion Paper, ESMA outlines its preliminary views regarding the different components of a liquid market for non-equity instruments; the decision mechanisms for assessing the liquidity criterion and combining the liquidity characteristics; two approaches for applying the liquidity components to the different classes of non-equity instruments; and the potential temporary suspension from transparency requirements. We discussed those elements in more detail in our Fourth Special Report.

SYSTEMATIC INTERNALISER REGIME

MiFID II and MiFIR extend the “systematic internaliser” (“SI”) regime beyond equities, as is the case under MiFID I, to all financial instruments. They further

tighten the scope of the SI regime and extend pre-trade transparency requirements to SIs.

Article 4(1)(20) of MiFID II defines an SI as an investment firm which “on an organised, frequent systematic and *substantial* basis” deals on its own account when executing client orders outside a regulated market, an MTF, or an OTF without operating a multilateral system. In the Consultation Paper, ESMA discusses the meaning of “sufficiently frequent, systematic and substantial” both in general terms and in the context of equities, equity-like instruments, and non-equity instruments:


- Frequent and systematic: For liquid instruments, ESMA proposes to set a threshold as a percentage of the total number of trades calculated for each financial instrument; for illiquid instruments, ESMA proposes setting an absolute number of transactions;
- Substantial: ESMA’s discussion focuses on the determination of two thresholds: the extent to which internalisation is substantial compared to the firm’s total trading in a particular financial instrument and the size of the internalisation activity compared to the total trading in the EU for that instrument.

Transparency obligations apply to SIs only when dealing in financial instruments of sizes up to “standard market size”. While MiFIR maintains the core elements of the existing regime for SIs in relation to standard market size, it makes two important changes to that regime. Firstly, it introduces a minimum quotation requirement in the form of 10% of the standard market size for the particular financial instrument. Secondly, it requires SIs to make available two way quotes, a bid price, and an offer price, for each instrument for which they are a SI. In the Discussion Paper, ESMA analyses those requirements in more detail in relation to equities.

SPECIAL REPORT SERIES AND UPCOMING ESMA HEARINGS ON COMMODITY DERIVATIVES, MARKET ISSUES, AND INVESTOR PROTECTIONS

The full series of special reports issued by FIA and FIA Europe over the past month is available [here](#).

ESMA will also hold open hearings on market issues on 7 July 2014 and investor protection issues on 8 July 2014. Additional details on these hearings are located [here](#). ESMA will hold an open hearing on commodity derivatives on 8 July 2014. Additional details on the hearing are located [here](#).



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Additional MiFID II/MiFIR documents are available [here](#).

Disclaimer: This report was drafted by the London office of [Covington & Burling LLP](#) on behalf of FIA and FIA Europe. The report is part of a series of reports intended to provide factual summaries of MiFID/MiFIR on certain topics of interest to the members of FIA and FIA Europe. The reports are provided for general informational purposes only. They do not constitute legal or regulatory advice and should not be relied upon for this purpose.

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