10 November 2015

InfoNet

MiFID II/R Seminar

Transparency

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AGENDA

08.30 - 09.00	Registration
09.00 - 09.10	Introduction
	Corinna Schempp, Director of Regulation, FIA Europe
09.10 - 09.30	Presentation
	Fabio Braga, Technical Specialist, Trading Venues Policy, FCA
09.30 - 09.50	Presentation
	Farid Anvari, Of Counsel, Baker & McKenzie
09.50 - 10.30	Panel session
	Farid Anvari, Of Counsel, Baker & McKenzie
	Fabio Braga, Technical Specialist, Trading Venues Policy, FCA
	Corinna Schempp, Director of Regulation, FIA Europe (Moderator)
	Vassiliki Veliou, Vice President, Market Structure, Eurex

Fabio Braga, Technical Specialist, Trading Venues Policy, FCA

Transparency & Market Structure

FIA Europe
Breakfast Seminar

Fabio Braga

Trading Venues Policy – Markets Policy

10 November 2015

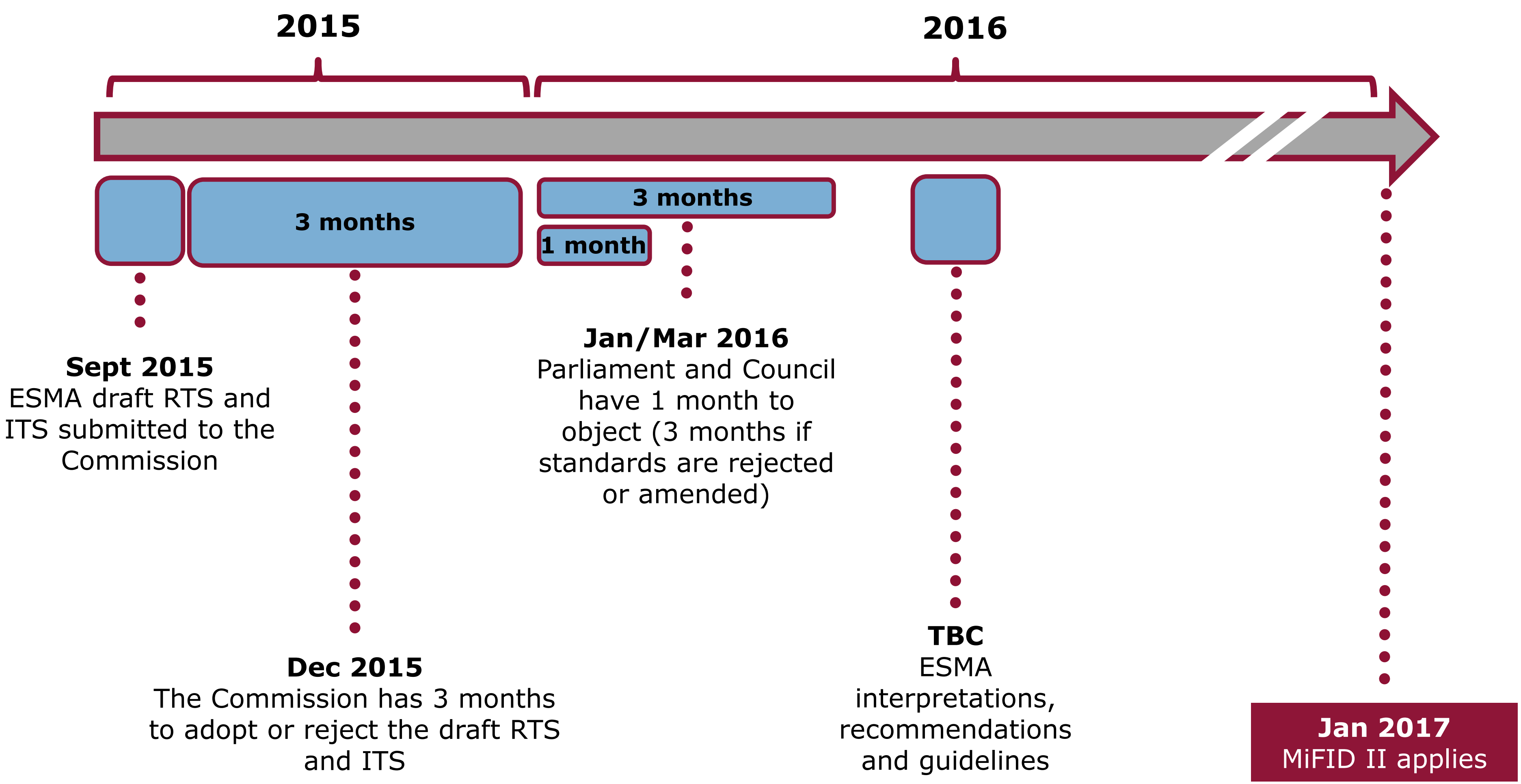
In this seminar we will talk about

1. EU and UK timelines

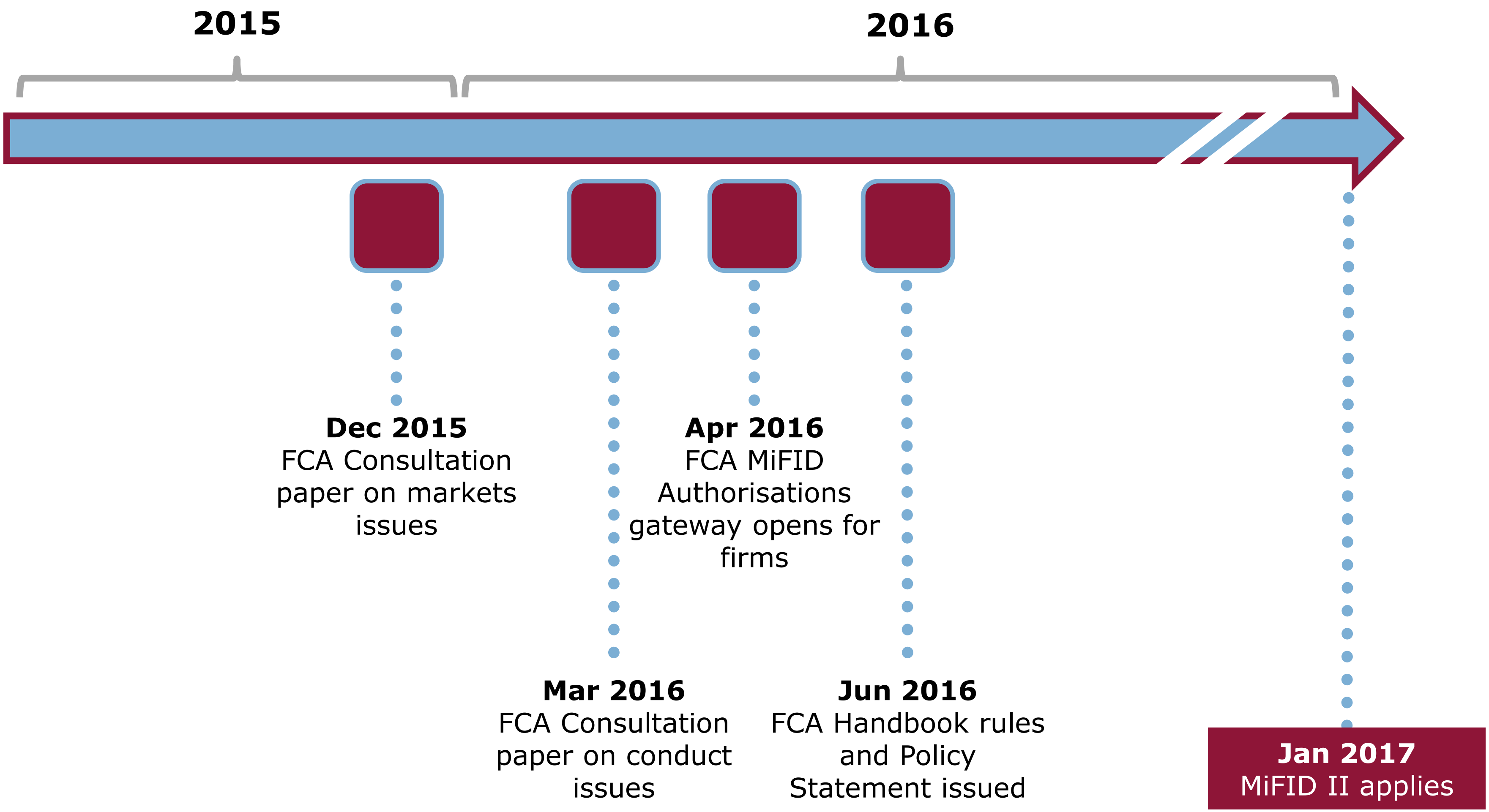
2. Market Structure

3. Transparency

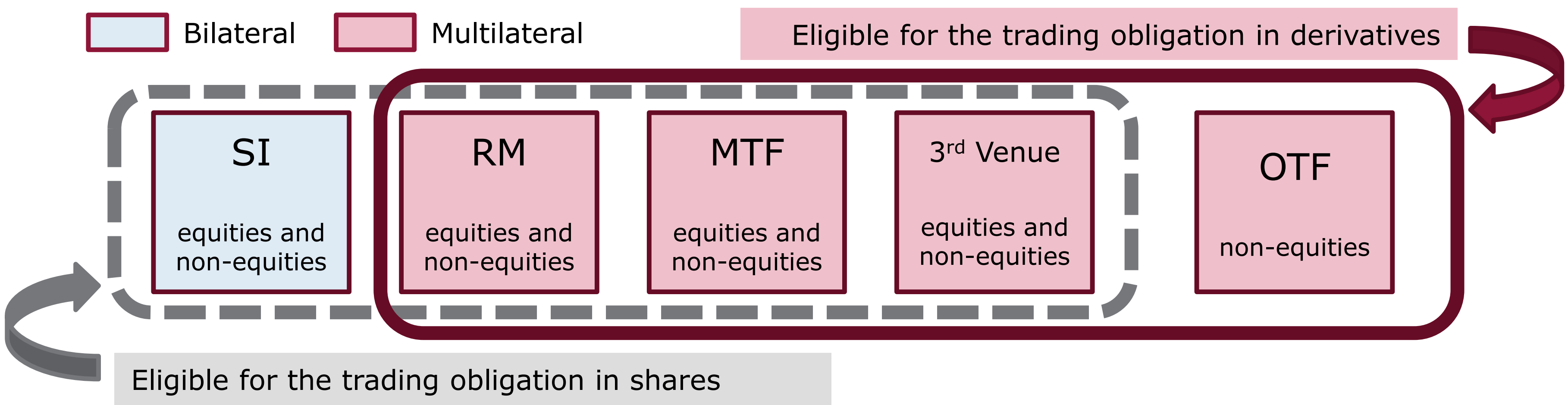
EU timelines



UK timelines

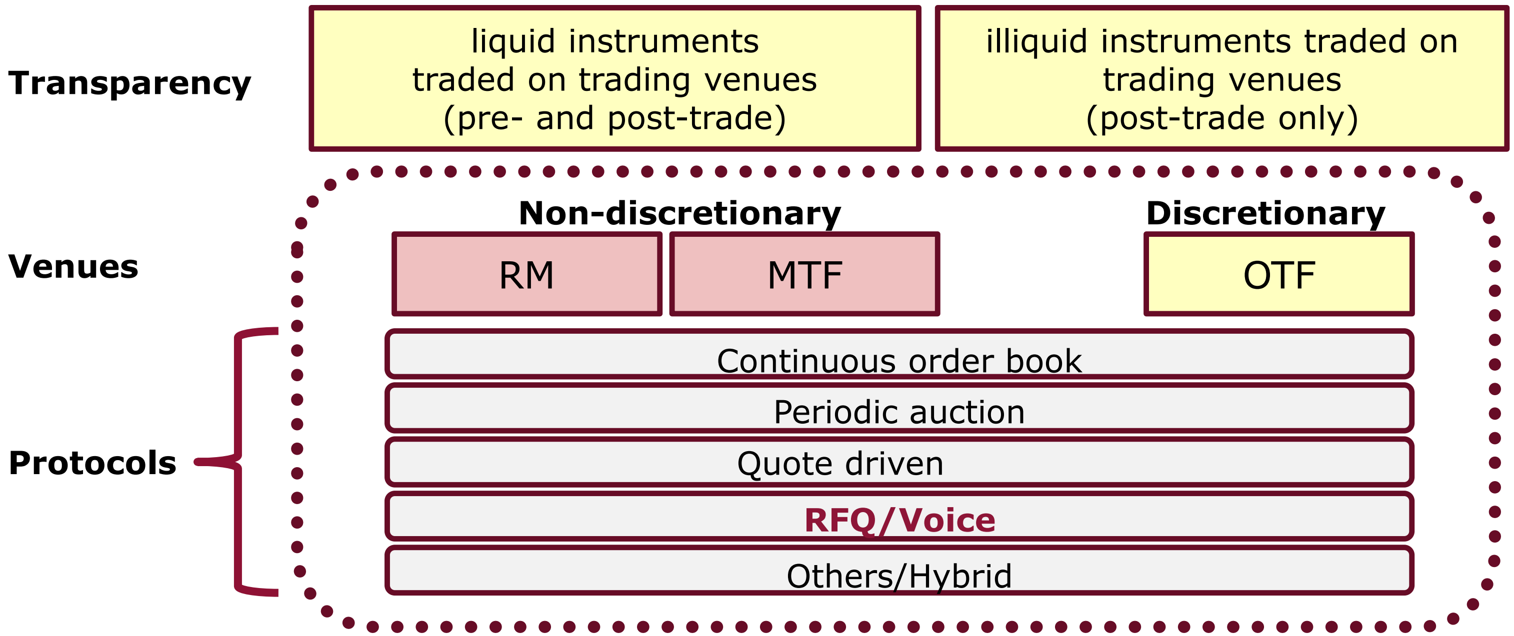


Market structure



	RM	MTF	OTF
Prop cap (same LE)	NO	NO	NO, except sovereign bonds
MP	NO	NO	YES, except G20 derivatives
SI (same LE)	YES	YES	NO
Discretion	NO	NO	YES
COBs	NO	NO	YES

Transparency



For liquid(*) instruments **pre-trade** transparency applies unless:

a) the order is above LiS

b) the order is executed on an RFQ/voice system and is above a specific size

c) the order is held on an order management facility pending disclosure

For liquid instruments **post-trade** transparency applies unless:

a) the trade is above LiS

b) the trade is above SSTI and the investment firm deals on own account other than on a MP basis

(*) Derivatives which are not subject to the trading obligation benefit from the same waivers/deferrals available to illiquid instruments

Focus on RFQ and voice systems

1. RFQ and voice systems must publish indicative bid and offer prices
   a) By <u>appropriately</u> combining actionable indications of interest of a certain size; and
   b) Through electronic means
2. RFQs are required to disclose indications of interest when they become actionable

The determination of liquid market

- Calibrated by asset class
- Generally dynamic with annual recalculation
- Based on trading patterns and asset class-specific characteristics
- To apply instrument-by-instrument for bonds
- Temporary suspension of pre- and post-trade transparency

Size specific to the instrument and LiS

- Calibration of the SSTI and LiS by asset class
- Dynamic approach to recalculations
- Floors
- Exclusion of transactions below €100k for bonds

Post-trade transparency and deferrals

- Real-time publication of transactions
- Deferrals and options available to Competent Authorities
- Exemptions for certain types of transactions

Transition towards MiFID II: data

- Competent Authorities will collect data in advance of 2017
- ESMA will be the central hub for the calculation and publication of all transparency calculations
- The calculations will apply until the first half of 2018 when new calculations will be performed on the basis of data collected once MiFIR applies.

Summary and closing remarks

- Transparency will extend to almost all non-equity instruments available for trading on a trading venue
- Exemptions from pre- and post-trade transparency will depend on quantitative thresholds and trading patterns
- Dynamic approach to transparency, pre- and post-trade
- Data collection and calculations crucial for implementing MiFIR

Farid Anvari, Of Counsel, Baker & McKenzie

Baker & McKenzie

MiFIR transparency requirements

Effect on market participants

Farid Anvari, Of Counsel Baker & McKenzie LLP

November 2015

Introduction

G20 and the mandate for greater market transparency

– EMIR reporting obligation to a Trade Repository
– MiFID II mandatory transparency requirements
  - Recital 1 - **Strengthening transparency** is one of the shared principles to strengthen the financial system as confirmed by the G20 Leaders' statement in London on 2 April 2009. In order to strengthen the transparency and improve the functioning of the internal market for financial instruments, a new framework establishing uniform requirements for the transparency of transactions in markets for financial instruments should be put in place. The framework should **establish comprehensive rules for a broad range of financial instruments**. It should complement requirements for the transparency of orders and transactions in respect of shares established in [MiFIDI]."

MiFID II Transparency Overview

- MiFID I Transparency regime
  - applied only to shares admitted to trading on a Regulated Market (RM)
- MiFID II transparency regime can be split into two categories
  - general transparency requirements
    - pre-trade and post-trade disclosure of transactions conducted on RMs, Multi-lateral Trading facilities (MTFs), Organised Trading Facilities (OTFs), Systemic Internalisers (SIs)
  - transaction reporting requirements
    - notifying the competent authority of identifying reference and post-trade data
- 'Level 2' implementing measures

Transparency 'Level 2' draft RTS

- RTS 1 - transparency requirements in respect of shares, depositary receipts, exchange-traded funds, certificates and other similar financial instruments
- **RTS 2 - transparency requirements in respect of bonds, structured finance products, emission allowances and derivatives**
- RTS 3 the volume cap mechanism and the provision of information for the purposes of transparency and other calculations
- RTS 4 - the criteria for determining whether derivatives should be subject to the trading obligation
- RTS 5 - the criteria for determining whether derivatives have a direct, substantial and foreseeable effect within the EU

Important dates

- **12th June 2014** final MiFID II (Directive 2014/65/EU) and MiFIR (Regulation (EU) 600/2014) texts were published in the Official Journal of the EU on and entered into force 20 days later on 2 July 2014
- **19th December 2014** Key Consultation published
  - 645 pages plus draft RTS 520 pages
- **18th February 2015** Addendum to December Consultation
  - transparency requirements for non-equity instruments
  - assessment of the liquidity and the specification for large in scale and size-specific to the instrument for fx derivatives, credit derivatives, other derivatives and contracts for difference
- **28th September 2015** ESMA published Final Report with draft RTS (550+ pages)
- **28th December 2015** EC has 3 months to decide whether to endorse the technical standards
- **3rd July 2016** Member states are to adopt measures transposing MiFID II into national law
- 3rd January 2017 - MiFID II applies

Material Changes from the MiFID Transparency Regime

– Expansion of transparency requirements from "equity" instruments, to **"equity-like"** and **"non-equity" financial instruments** including:
  - Corporate bonds
  - Structured finance products
  - Emissions allowances
  - Derivatives
– MiFIR Recital 16 – calibrate transparency requirements for different types of
  - **financial instruments**, including equities, bonds, and derivatives, taking into account the **interests of investors, issuers** and **market liquidity** and
  - trading, including order-book and quote-driven systems and take account of **transaction size**, including turnover, and other relevant criteria.

Material Changes from the MiFID Transparency Regime

- MiFIR Recital 8 –
  - “In order to make Union financial markets more transparent and efficient and to level the playing field between various venues offering multilateral trading services it is necessary to introduce a **new trading venue category of organised trading facility (OTF)** for bonds, structured finance products, emissions allowances and derivatives…Consequently, appropriate organisational requirements and transparency rules which support efficient price discovery need to be applied.
- MiFIR Recital 18 –
  - pre-trade transparency requirements should apply to **systematic internalisers** (widened definition)

Pre-trade transparency

- Trading Venues required to make public the range of bid and offer prices and depth of trading interest at those prices, in accordance with the type of trading system they operate
  - RFQ must make public all quotes received in response to the RFQ and do so at the same time
  - RFQ and Voice must make public at least indicative bid and offer prices, where interest is above a specified threshold

Pre-trade transparency - Waivers

Waivers are available for the following:

- Derivatives which are **not subject to a trading obligation** (TO) (the TO applies to transaction subject to the EMIR clearing obligation where there is a liquid market)
- Orders that are **large in scale** compared to normal market size
- Orders that held in a **order management facility** of a trading venue pending disclosure
- Actionable indications of interest in RFQ or Voice that are **above a size specific to that financial instrument**, which would expose liquidity providers to undue risk.

Post-trade transparency

- Trading Venues and Investment firms trading outside venues required to make public each transaction in as close to real-time as possible
  - and in any case within a maximum 15 minutes of execution which is reduced to 5 minutes after 1 January 2020
  - includes for example: execution date and time; venue; instrument type code; price; notional; transaction identification code; whether it is to be cleared; whether it is a package transaction

Post-trade transparency - Deferrals

– Deferrals may be granted (2 working days) for transactions which are either
  - **large in scale** (LIS) compared to normal market size for the financial instrument, or
  - financial instruments for which there is **not a liquid market**, or
  - above a **size specific to that financial instrument** (SSTI) trading on a venue, which would expose liquidity providers to undue risk
  - it is a package transaction (subject to certain criteria)

Liquidity assessment

– In latest RTS ESMA proposes
  - static or periodic determination based on quantitative and, where appliable, qualitative criteria
  - to use a revised more granular *Classes of financial instrument approach* (COFIA) for non–equity financial instruments (other than bonds) and
  - to use *Instrument by instrument approach* (IBIA) for bonds
  - a periodic (yearly) liquidity assessment

– For derivatives asset class the liquidity assessment uses two criteria, specified for a Sub-Asset Class and Sub-Class:
  - Average Daily Notional Amount
  - Average Daily Number of Trades

Liquid Market – Example Interest Rate Derivatives Asset Class

Extract from RTS 2

Asset class - Interest Rate Derivatives				
Sub-asset class	**For the purpose of the determination of the classes of financial instruments considered not to have a liquid market as per Articles 6 and 8(1)(b), each sub-asset class shall be further segmented into sub-classes as defined below**	**Each sub-class shall be determined not to have a liquid market as per Articles 6 and 8(1)(b) if it does not meet one or all of the following thresholds of the quantitative liquidity criteria. For sub-classes determined to have a liquid market the additional qualitative liquidity criterion, where applicable, shall be applied**		
		Average daily notional amount (ADNA) [quantitative liquidity criterion 1]	**Average daily number of trades** [quantitative liquidity criterion 2]	**Additional qualitative liquidity criterion**
Float-to-Float 'single currency swaps' and futures/forwards on Float-to-Float 'single currency swaps' a swap or a future/forward on a swap where two parties exchange cash flows denominated in the same currency and where the cash flows of both legs are determined by floating interest rates	a float-to-float single currency sub-class is defined by the following segmentation criteria: **Segmentation criterion 1** - notional currency in which the two legs of the swap are denominated **Segmentation criterion 2** - time to maturity bucket of the swap defined as follows: **Maturity bucket 1**: 0 < time to maturity ≤ 1 month **Maturity bucket 2**: 1 month < time to maturity ≤ 3 months **Maturity bucket 3**: 3 months < time to maturity ≤ 6 months **Maturity bucket 4**: 6 months < time to maturity ≤ 1 year **Maturity bucket 5**: 1 year < time to maturity ≤ 2 years **Maturity bucket 6**: 2 years < time to maturity ≤ 3 years ... **Maturity bucket m**: (n-1) years < time to maturity ≤ n years	EUR 50,000,000	10	

Liquid Market – Example Interest Rate Derivatives Asset Class

- The extract from RTS 2 shows that for each maturity there needs to be an Average Daily Notional of at least EUR 50 million and an Average Daily Number of Trades of at least 10.
- By 3 July 2016 ESMA is due to publish its first assessment of which financial instruments are liquid

Liquidity Assessment, LIS and SSTI thresholds

- Latest RTS use a dynamic calculation for setting LIS and SSTI
- Pre-trade thresholds for LIS and SSTI are set at a lower level than the post-trade thresholds for LIS and SSTI
- These are specified based on a trade or volume percentile

Liquidity Assessment, LIS and SSTI thresholds

Example: Asset Class Interest Rate Derivatives

Asset class - Interest Rate Derivatives											
Sub-asset class	Percentiles and threshold floors to be applied for the calculation of the pre-trade and post-trade SSTI and LIS thresholds for each sub-class determined to have a liquid market										
	Transactions to be considered for the calculations of the thresholds	SSTI pre-trade		LIS pre-trade		SSTI post-trade			LIS post-trade		
		Trade - percentile	Threshold floor	Trade - percentile	Threshold floor	Trade - percentile	Volume - percentile	Threshold floor	Trade - percentile	Volume - percentile	Threshold floor
Float-to-Float 'multi currency swaps' or 'cross-currency swaps' and futures/forwards on Float-to-Float 'multi currency swaps' or 'cross-currency swaps'	calculation of thresholds should be performed for each sub-class of the sub-asset class considering the transactions executed on financial instruments belonging to the sub-class	60	EUR 4,000,000	70	EUR 5,000,000	80	60	EUR 9,000,000	90	70	EUR 10,000,000

Package Transactions

– Issue where one of items in package caught by regulation

– At least 3 types of packages:

1. Bespoke transactions
2. Strategy based package (e.g. bufferfly options)
3. Exchanges for physicals

– Limited scope for ESMA due to text of Level 1
→ ESMA recommends amendment to MiFIR

Package Transactions (cont.)

– ESMA proposal in RTS:
  1. Introduction of definition for package transactions
  2. Individual components of a package will be published
  3. Deferral may apply where one component qualifies

– Package transaction flag

– Nature of package transactions will be taken into account for trading obligation
  → US position has been to exempt package from SEF requirements

Commodities & Exchanges for Physicals

- ESMA proposes to apply COFIA as with other instruments
- Calculations → notional amounts <u>not</u> commodity units
- New C10 asset class for exotics (freight, weather, emissions derivatives) dealt with separately to commodities
- Sub-asset class determined by:
    1. Underlying commodity
    2. Notional currency
    3. Time to maturity
- Exchange for physicals → subset of package transactions
- EFP flag

Systematic Internalisers

- MiFID II/MiFIR → definition broadened as well as extended to non-equity financial instruments
- Cannot be an SI and OTF in same legal entity
- Trading thresholds for OTC activity
- Same pre-trade transparency as markets, MTFs, OTFs but → same waivers for LIS, SSTI, order book management
- Same post-trade transparency and waivers as markets, MTFs, OTFs

Extraterritoriality & Third Country Firms

• Art. 39 MiFID II	→	local requirements for third country firms
• Art. 46 MiFIR	→	equivalence regime for third countries
• Definition of OTF	→	may capture third country firms

Any questions?

MiFIR transparency requirements

Effect on market participants

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PANEL

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