

**REUTERS MiFID II:
Preparing for Fundamental Change Event
November 2015**



MiFID II - MiFIR: Key aspects of the markets regulation

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- ☐ **Legal Framework and State of Play**
- ☐ **Market Structure**
 - ✓ Where financial instruments can be traded?
 - ✓ Systemic internalisers regime
- ☐ **Pre and Post Trade Transparency**
 - ✓ Equity instruments
 - ✓ Non-Equity instruments
- ☐ **Commercialization of Market Data**
- ☐ **Electronic Trading**
- ☐ **Tools for Supervisors**

1. Legal Framework

- ❑ **MiFID II regulatory goals** (promote more structured trading, increase transparency, address risks of HFT trading, reasonable cost of data, etc.)
- ❑ Regulation hinges intensely upon **IT developments** (exchange of information, calculation tasks, setting quantitative thresholds)

2. State of play

- ❑ **Level I**, Directive and Regulation, **already in force** (application as of Jan-17)
- ❑ ESMA delivered draft RTS on Sep-15 (3 months delay)
- ❑ European Commission (EC) currently working on delegated acts and final RTS
- ❑ NCAs working on a **centralised calculation and publication mechanism**

3. Main implications for IFs

- ❑ Qualifying as systematic internalizer (SI) implies quoting obligations
- ❑ Specific organisational requirements for IFs due to electronic trading activity
- ❑ Transaction reporting amendments
- ❑ Seller counterparty of an OTC transaction shall make it public through an APA.

MiFID II: State of play and implementing calendar

Regulatory Framework:

Level I: Directive (**MiFID II**) and Regulation (**MiFIR**)

Level II: Delegated Acts, RTS and ITS

Level III: Guidelines (due to Level 1 and others), Q&A, ESMA opinion



CNMV Work:

Nivel I: Collaboration with Spanish Treasury

Nivel II: ESMA SMSC, MDRSC and CDTF and the relevant dependent task forces

Difficult topics: non-equity transparency, commodities derivatives (ancillary test and position limits), IT

2013

2014

2015 - 2016

2017

Level I

Level II

Level III

Dialogue

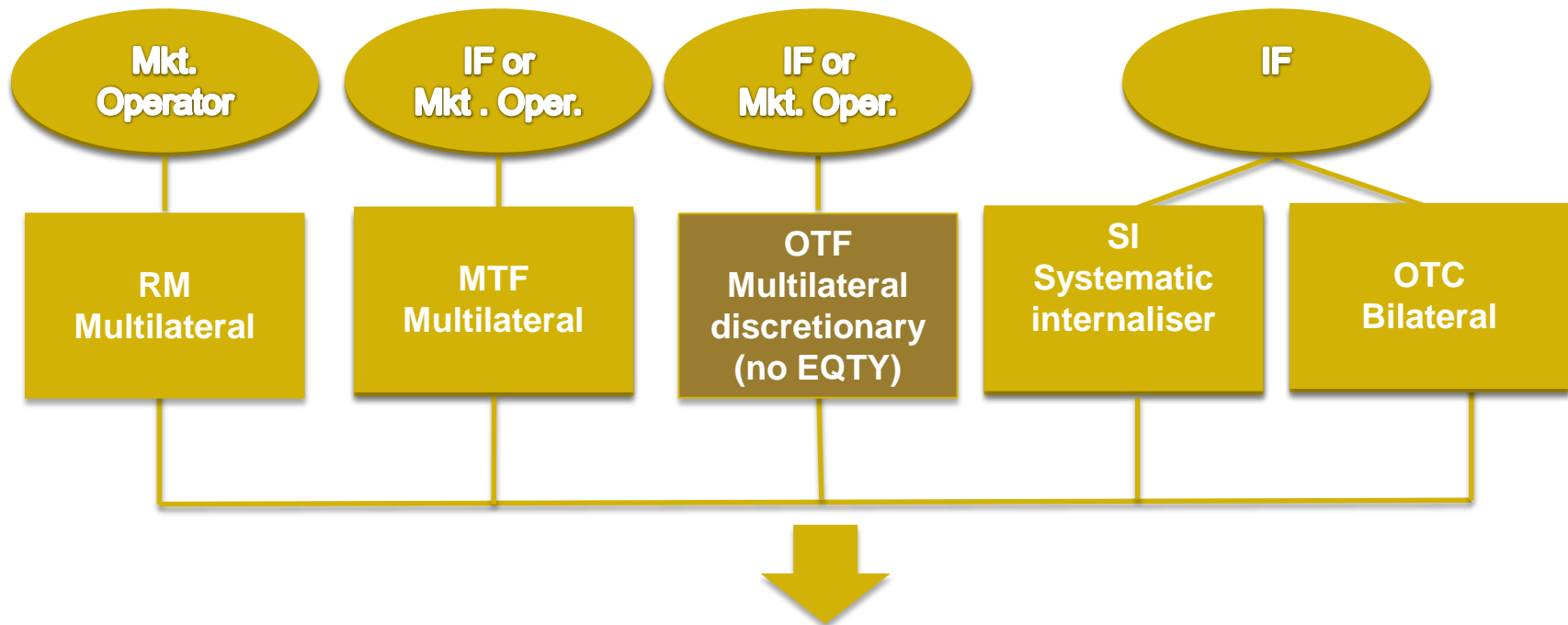
ESMA
Technical
Advice
RTS

Implementing

Application of
MiFID/R

MiFID II: Where equity and non-equity instruments can be traded?

- ☐ Equity and equity-like instruments = shares, ETFs, depositary receipts and certificates
- ☐ Non-equity instruments = bonds, structured finance products, derivatives and emission allowances



Art. 23 MiFIR Trading Obligation for shares (RM, MTF, SI)
Art. 28 MiFIR Trading Obligation for derivatives (RM, MTF, OTF)

MiFID II: Systematic internaliser (equity and non-equity)

- ❑ Systematic internaliser regime
 - Trading OTC own account in a financial instrument
 - Frequent and substantial basis
 - Voluntary application vs mandatory qualification
 - Quoting obligations (pre-trade transparency)
 - Post-trade transparency (APA)

Assessment of frequent and substantial activity

- ❑ Rate of number of trades

$$\text{Rate per instrument} = \frac{\text{IF Number of trades OTC own account}}{\text{Total number of trades EU}} = [0,4\%, 5\%]$$

- ❑ Double rate of substantial activity

$$\text{Rate per instrument} = \frac{\text{IF Turnover OTC own account}}{\text{Total turnover IF}} = [15\%-30\%]$$

$$\text{Rate per instrument} = \frac{\text{IF Turnover OTC own account}}{\text{Total turnover EU}} = [0,4\%-3\%]$$

MiFID II: Equity and equity-like pre-trade transparency

Pre-transparency: real time publication and waiver application

- publication of bid and offer prices and attached volumes

Ord	BidSize	Bid	17:15	Ask	AskSize	Ord	Buyer	On Mkt	Seller	Clc
10.940	+0.225	10.940	10.940	10.940	10.940	10.940				
1	13189	10.925	10.940	327						
7	21331	10.930								
7	16299	10.925								
12	40958	10.920								
7	27879	10.915								

Trading Obligation
(art. 23 MiFIR)
RM, MTF, SI

Adjusted per trading
system: order driven,
quote driven, RFQ, hybrid
RTS Table 1

Reference Price Waiver
RPW

Large in scale
LIS

Negotiated trade
NTW

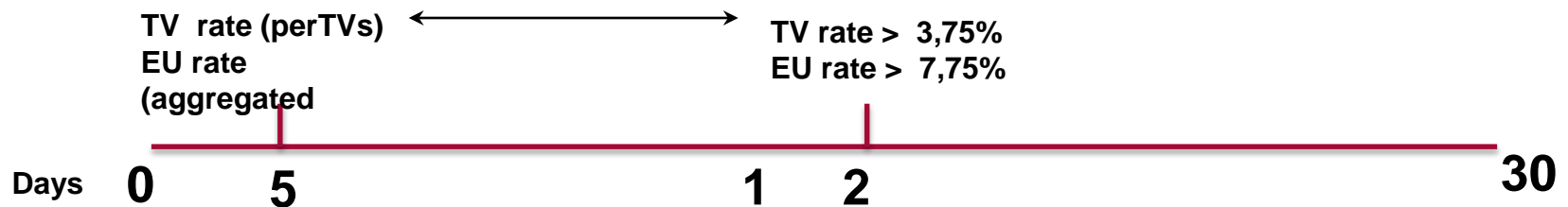
Order Mgmt Facility
(icerberg/stop orders)

The application of a waiver is subject to a process of approval through NCA and ESMA
(Pre-trade Transparency Review Group)

MiFID II: Pre-trade waivers cap (double volume cap art. 5 MiFIR)

- ❑ The use of the reference price waiver (RPW) and the negotiated trade waiver for liquid FIs (NTW*) is subject to traded volume limits
 - **4%** at a TV level over a 12 months rolling period
 - **8%** at a EU level over a 12 months rolling period
- ❑ In case traded volume exceeds the **4%** threshold the Competent Authority of the TV suspends the use of the waiver for a six months period
- ❑ In case traded volume exceeds the **8%** threshold all CAs suspend the use of the waiver for a six months period across the EU

To articulate this mechanism ESMA shall publish rates twice a month



ESMA IT delegated project (CNMV semi-delegated country):
 i) data collection (CNMV), ii) processing (CNMV), iii) calculation (ESMA) and
 iv) publication (ESMA)

MiFID II: Equity Post-trade Transparency

Post-trade transparency: General regime and deferred publication

- publication of **price, volume and time of execution** (maximum delay 1 minute)
- **deferred publication** (LIS transactions Annex 2 RTS Table 4)
- **flagging** use of waivers (RTS Annex 1 Table 4)

Equity CONSOLIDATED TAPE (100% level of consolidation)

APPROVED
PUBLICATION
ARRANGEMENT
(APA)
¿?

OTC transaction
(seller IF or SI)

MULTILATERAL
TRADING
FACILITY
(MAB, Latibex)

REGULATED
MARKETS
(Bolsa Madrid,
Barcelona, Valencia,
Bilbao)

ORGANIZED
TRADING
FACILITY
(no for eqty
instruments)

The deferred publication is a faculty of the Competent Authority
In Spain, equity post-trade transparency occurs on real-time (MiFID I)

MiFID II: Liquidity determination for equity and equity-like instruments (methodology)

To articulate the transparency regime in equities and alike products is necessary to perform liquidity calculations:

- ☐ Liquid instrument definition (Average Daily Turnover, Daily Transactions, Free-Float) = IBIA instrument-by-instrument
 - e.g. a share is deemed to be liquid if daily traded, the average daily turnover is greater than 1 million €, free-float greater than 100 million € (market cap greater than 200 mn. € if traded exclusively on a MTF) and daily transactions greater than 250.
- ☐ The Standard Market Size (SMS) hinges upon the calculation of the AVT (average value of transactions) and serves for the purpose of determining the minimum quoting obligation of a systematic internaliser (i.e. quoting obligation in liquid shares for an equivalent of 10% of the SMS)
- ☐ ESMA will publish the results in a similar manner as in current MiFID I framework

ESMA MiFID Database

Search

CSV download: [Full list](#) | [Current search](#)

Version date: 14 September 2015

Date of update: - - -

[View all shares](#)

[Reset search fields](#)

Search complete and partial ISIN and share names:

ES0178430E18

Share name

Liquid shares

Country Code

Relevant Authority

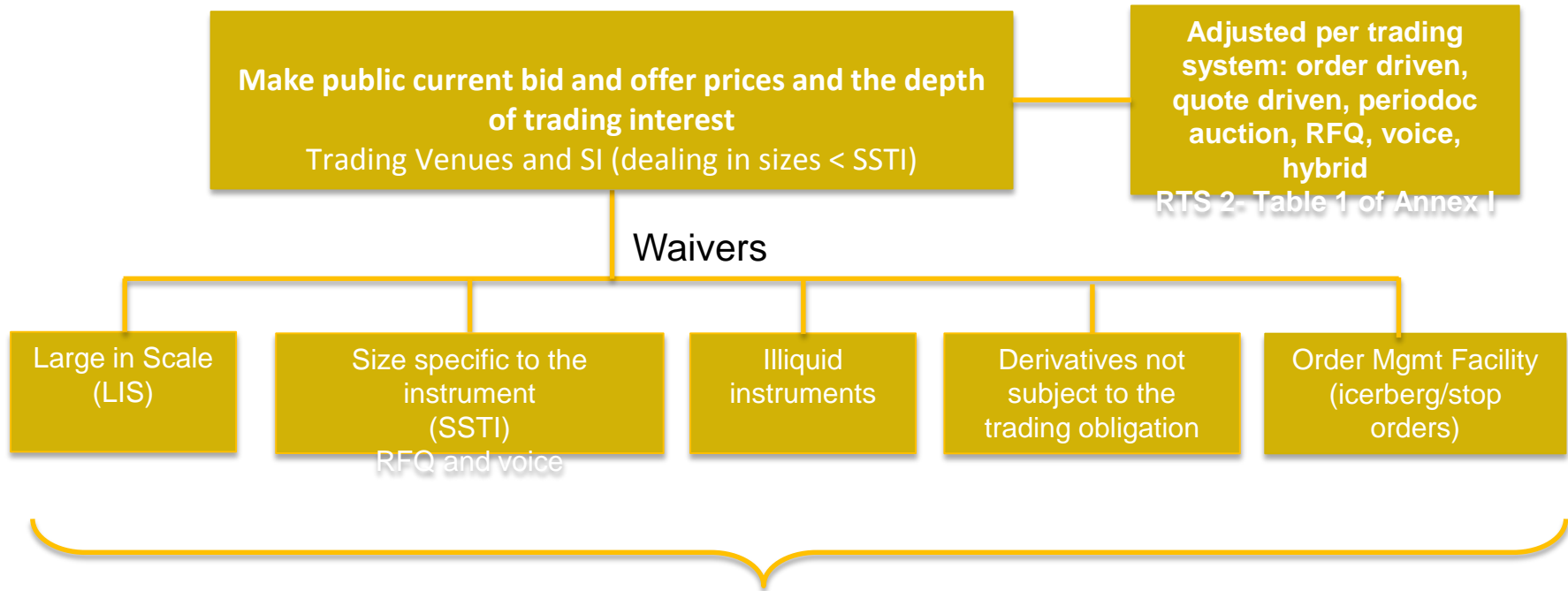
Go

1 shares found1

ISIN	Name	ADT	Daily Transactions	Free Float	AVT	SMS	Authority for Liquid Share	Authority	Country Code	Exchange Rate	Updated on
<div><div></div><div>ES0178430E18</div></div>	TELEFONICA, S.A., ACCIONES POR DESDOBLAMIENTO	458936834.00	18799.00	44000-45000 million	12991.00	15000.00		CNMV	ES	1 EUR=1 EUR	30/03/2015

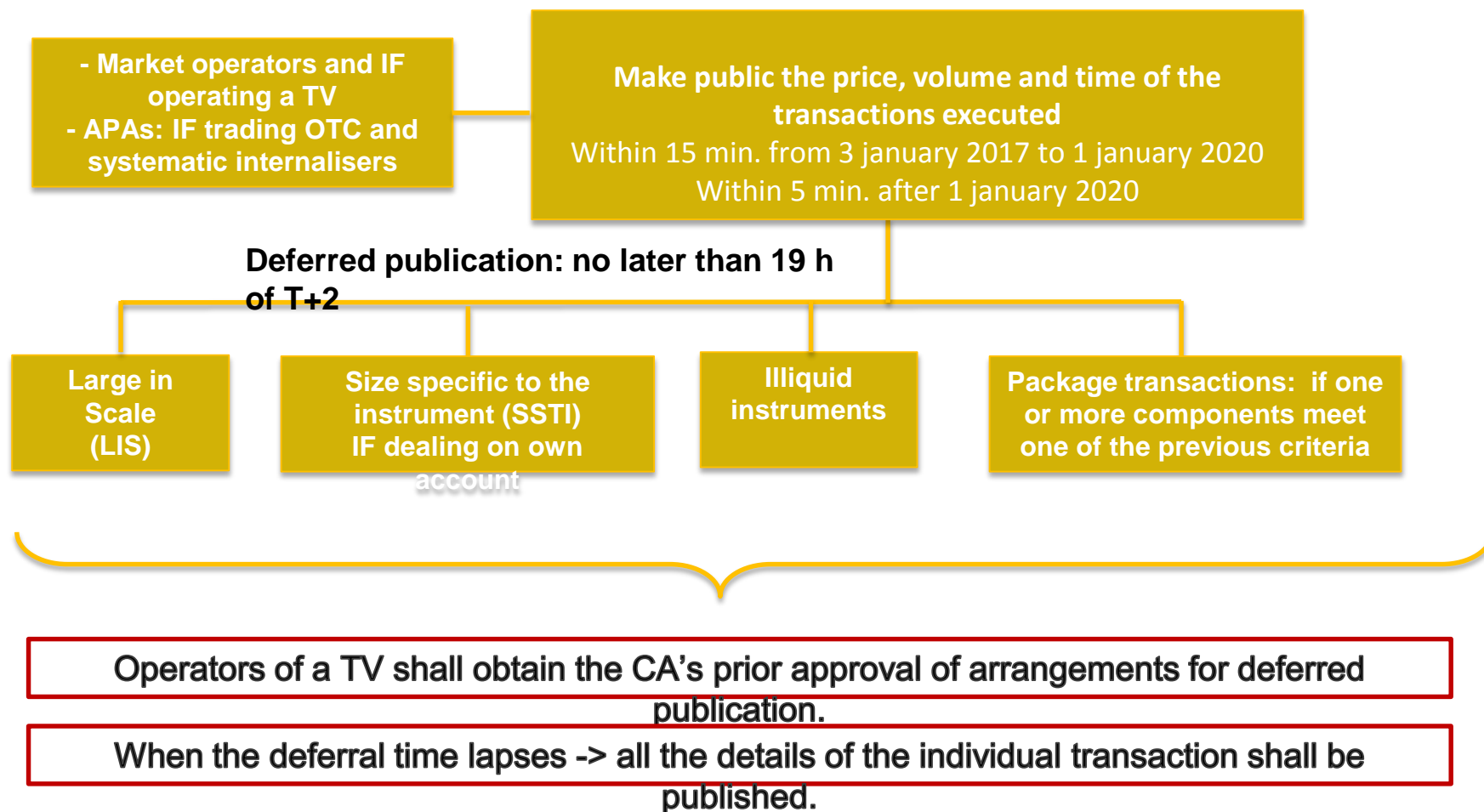
Route: ESMA website > Registries and databases > MiFID Databases > Shares admitted to trading in EU Markets

MiFID II: Non-equity pre-transparency



The application of a waiver is subject to a process of approval through NCA and ESMA

Where a waiver is granted (SSTI for RFQ and voice) -> make public at least indicative pre-trade bid and offer prices



In conjunction with an authorisation of deferred publication NCAs may:

- ☐ **Increase transparency** before 19h of T+2 requesting the publication of:
 - ✓ all the details of a transaction, except volume, or
 - ✓ daily aggregation of transactions (minimum of 5) before 9 h of T+1

- ☐ **Allow less transparency** during an extended time period:
 - ✓ allow volume omission of an individual transaction for **4 weeks**
 - ✓ allow weekly aggregation of several transactions to be published the following Tuesday before 9 h for **4 weeks**
 - ✓ in respect of **sovereign debt**, allow weekly aggregation of several transactions to be published on the following Tuesday before 9 h for an **indefinite period** of time

MiFID II: Non-equity calculations

Liquidity assessment

- ☐ Instruments grouped at 3 levels: asset class; sub-asset class; homogeneous sub-class on the basis of segmentation criteria (e.g. contract type, underlying, time to maturity, currency, etc.)
- ☐ Liquidity is assessed according to one of the following methods:
 - ✓ Static assessment of liquidity (e.g. an asset class is liquid or illiquid as a whole)
 - ✓ Dynamic assessment of liquidity providing for periodic recalculations based on quantitative (and qualitative) liquidity criteria and thresholds or based on qualitative liquidity criteria

LIS-SSTI thresholds

- ☐ Dynamic approach providing for annual recalculations
- ☐ Pre-trade thresholds for liquid sub-classes calculated as the greater of: a floor and a trade percentile
- ☐ Post-trade thresholds for liquid sub-classes calculated as the greater of: a floor, a trade percentile and a volume percentile
- ☐ Pre- and post-trade thresholds for illiquid sub-classes set at fixed values

Pre- trade SSTI < Pre-trade LIS

<
=

Post-trade SSTI < Pos-trade LIS

MiFID II: Non-equity calculations

Special case - Bonds Liquidity assessment

Instrument by Instrument Approach (IBIA):

Dynamic assessment of real trading performed quarterly at instrument level. Bond liquidity is determined by the following three quantitative criteria to be met on a cumulative basis:

- i. average daily nominal amount (\geq EUR 100,000);
- ii. average daily number of trades (\geq 2);
- iii. minimum percentage of days traded (\geq 80%)

Liquidity of newly issued instruments is determined by the issuance size:

Bond Type	Issuance size
Sovereign Bond	EUR 1,000,000,000
Other Public Bond	EUR 500,000,000
Convertible Bond	EUR 500,000,000
Covered Bond	EUR 500,000,000
Corporate Bond	EUR 500,000,000

Temporary suspension of transparency obligations (≤ 3 months) if:

- ☐ Liquid instruments: total volume traded for a class of financial instrument (30 days) $< 40\%$ average monthly volume (12 months)
- ☐ Illiquid instruments: total volume traded for a class of financial instrument (30 days) $< 20\%$ average monthly volume (12 months)

Exempt transactions where the counterparty is a member of the ESCB (only where entered into in performance of monetary, foreign exchange and financial stability policy).

MiFID II: Market Data (RCB and data disaggregation)

- ❑ RCB Commercialization of market data on a reasonable commercial basis (trading venues, data reporting services providers and systematic internalisers)
- ❑ ESMA technical advice to EC (delegated act on-progress):
 - ✓ Transparency: pricing, content of data, revenue information and cost information
 - ✓ Criteria to prove commercialization on a reasonable commercial basis
 - ✓ Cost of information production: either published or just reported to CA (EC to decide)
 - ✓ Unbundling of data services from other possible services (e.g. trading fees)
 - ✓ Non discrimination

Unbundling commercialization

- Pre-trade transparency
- Post-trade transparency

Disaggregated commercialization

- Nature of asset class
- Country of issue for shares and sov debt
- Currency of trading
- Trading phase (continuous vs auction)

MiFID II: Electronic trading regulatory package

Electronic trading
(algo and HFT trading)

Risk associated to
electronic trading
(disorderly trading)

Organisational
Requirements for
trading venues

Organisational
Requirements for
investment firms

Tick Size

OTR

Market making
(strategies and
schemes)

· A significant proportion of trading is due to electronic trading (ESMA CEMA)

· Uncontrolled or malfunctioning of systems, insufficient testing, insufficient capacity and resilience, uncontrolled access, lack of circuit breakers, etc.

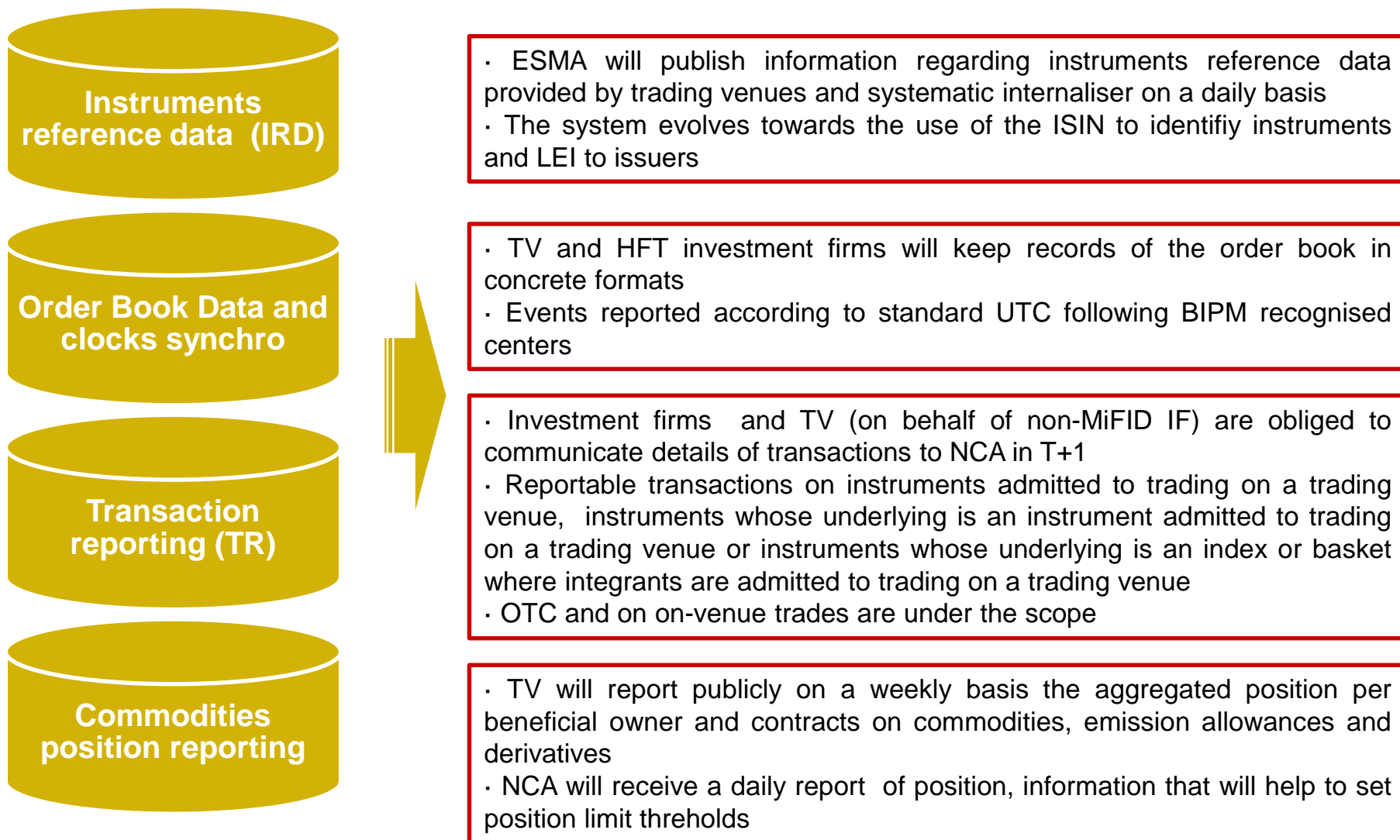
· Requirements on corporate governance, capacity and resilience outsourcing, testing of trading systems and testing of member's algos, pre-trade and post trade controls, kill functionality, mechanism to manage volatility, business continuity plans (BCP), DEA framework and security

· Harmonised minimum tick-size regime for equities and ETFs to prevent flickering effect (ghost liquidity) and race to the bottom

· Methodology to help trading venues to set a maximum order-to-trade ratio to prevent abusive use of the system's capacity

· Market making obligations for investment firms using algo trading techniques and pursuing market making strategies
· Market making obligations for trading venues (market making schemes)

Regulatory Tools: IRD, TR and commodities position reporting



E-mail for questions related to markets and instruments

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Thanks