

Briefing note

ESMA Q&A updates on investor protection and intermediaries (3 October), transparency and market structures topics (4 October) under MiFID II/R

ESMA has issued further Q&A updates on [investor protection and intermediaries topics](#) on 3 October, [transparency](#) and [market structures topics](#) on 4 October 2018 under MiFID II/R. These updates address in particular:

I. Investor protection and intermediaries topics – 3 October 2018:

- 1) Best execution reporting (RTS 28): Where investment firms use the **RFQ systems of a trading venue** that allow the investment firm to identify the counterparty they are dealing with, **the investment firm should also disclose the identity of the (five) counterparties it most commonly executes against** where they have agreed the trade via an RFQ system of a trading venue that allows the firm to identify the counterparty they are dealing with. The firm should also disclose the **proportion of volume traded with each of these counterparties** as a percentage of the total in that class of financial instruments.
- 2) Investment advice on an independent basis – Use of a ‘look-through’ approach: A firm can hold itself out as providing investment advice on an independent basis only if meeting requirements set out in [Article 24\(7\) of MiFID II](#) as well as additional criteria (see below).

II. Transparency topics – 4 October 2018:

- 1) Default liquidity status of bonds: ESMA replaced its previous guidance with the following:
In case the necessary liquidity assessment for a bond is not published in FITRS, the bond should be considered illiquid. More specifically, a bond should be deemed **illiquid** if:
 - in the case the necessary liquidity assessment for the bond is the one **based on issuance size** under Article 2(1)(17)(a) of MIFIR (further specified under Article 13 (19) and (20) of RTS 2 because the bond is newly admitted to trading or first traded and such assessment is not published in FITRS; or
 - in the case the necessary liquidity assessment for the bond is the one of the latest quarterly liquidity assessment **based on the trading activity** defined under Article 2(1)(17)(a) of MIFIR (further specified under Article 13(18) of RTS 2) when the bond is no longer considered a newly admitted to trading or first traded bond and such assessment is not published in FITRS.
- 2) Classification of derivatives on derivatives: **A derivative on a derivative that is not further specified in the sub-asset classes** set out in RTS 2, e.g. a future on an equity future **should be classified in**

the same sub(-asset) class as the underlying derivative contract for the purpose of determining whether it has a liquid market as well as the relevant SSTI and LIS thresholds pursuant to RTS 2.

- 3) Scope of Article 9(1)(c) of MiFIR: Only derivatives that are both (i) not subject to the trading obligation specified in Article 28 of MiFIR and (ii) for which there is not a liquid market can benefit from the pre-trade transparency waiver set out under Article 9(1)(c) of MiFIR.

III. [Market structures topics – 4 October 2018](#):

- 1) Arranging transactions that are ultimately formalised on another trading venue: A trading venue should not be allowed to arrange transactions without formalising the execution of those transactions under its rules and systems. However, where a trading venue is operated by an investment firm, ESMA considers that these investment firms can arrange transactions as a provider of investment services listed under points (1), (2) or (3) in section A of Annex I of MiFID II, should the investment firm be authorised for the provision of such investment services.
- 2) Registration of a segment of an MTF as an SME growth market: The operator of an MTF can apply for a segment of the MTF to be registered as an SME growth market when the respective requirements and criteria are met. A specific segment registered as an SME growth market should be considered in isolation to other segments within the MTF. Other segments which are not specifically registered as an SME GM, cannot benefit from the SME growth market regime. For this purpose, ESMA has specified the applicable conditions.

+++ ICMA BRIEFING +++

I. ESMA Q&A updates – [MiFID II/R Investor protection and intermediaries](#) (3 October 2018)

- 1) In some instances, investment firms use the RFQ system of a trading venue that allow firms to identify and select the different counterparties they wish to obtain quotes from, before concluding the trade with the selected counterparty on that trading venue's RFQ system.
Where an investment firm agrees a trade via such systems, should it identify the counterparty with whom the transaction was agreed with or the trading venue used to ultimately conclude the transaction for its RTS 28 reporting? [Section 1 Best Execution, Question 19]
 - (i) Sometimes, investment firms select and approach one or more potential counterparties, obtaining quotes from them using the non-anonymous request-for-quote (RFQ) systems of a trading venue and agree the trade with their selected counterparty on that trading venue's RFQ system.
 - (ii) This is common across asset classes, but is especially prevalent, for example, in bond markets, where some trading venues allow investment firms to identify different liquidity providers that the firm may wish to deal with in the transaction, and obtain quotes from them before executing the transaction with their selected counterparty on the trading venue.
 - (iii) ESMA considers that a transaction is deemed to be executed on a trading venue, where it is carried out under the rules of the trading venue. **Correspondingly, a firm executing orders on behalf of clients or decisions to deal under the rules of a trading venue would need to identify the trading venue in question in its RTS 28 reports.**
 - (iv) ESMA also recognises that the objective of RTS 28 is to make the sources of liquidity used as well as firms' order routing practices more transparent. ESMA is of the opinion that **where investment**

firms use the RFQ systems of a trading venue that allow the investment firm to identify the counterparty they are dealing with, this objective is better achieved if an investment firm provides information about the counterparty it has approached for a quote and selected to execute the transaction through such systems, before concluding the trade on that trading venue's RFQ system.

- (v) For the RTS 28 reports to accurately reflect the investment firm's venue selection process and order execution policy and behaviour, and to provide an accurate picture of the investment firm's order routing practices and considerations, ESMA considers that as part of the summary of the quality of execution obtained on the different venues used ([Article 3\(3\), Recital 11](#)), **the investment firm should also disclose the identity of the (five) counterparties it most commonly executes against where they have agreed the trade via an RFQ system of a trading venue that allows the firm to identify the counterparty they are dealing with.**
- (vi) **The firm should also disclose the proportion of volume traded with each of these counterparties as a percentage of the total in that class of financial instruments.** This disclosure should also include information about the existence of any close links, conflicts of interest, common ownerships and specific arrangements with such counterparties in its summary of execution quality,¹⁴ and for this information to be consistent with the information to be provided under Article 3(3) of RTS 28.

See [RTS 28](#) and the [annex to RTS 28](#) for further information.

- 2) **An investment firm only offers financial instruments issued or provided by the investment firm itself or by entities having close links with the investment firm.** On a look-through basis, the financial instruments offered (for example, investment funds, wrappers) allow the investor to indirectly invest in financial instruments issued by entities who do not have close links with the investment firm.

Can such investment firm hold itself out as providing investment advice on an independent basis?
[Section 5 Investment advice on an independent basis, Question 2]

- (i) **No.** In accordance with [Article 24\(7\) of MiFID II](#), a firm can hold itself out as providing investment advice on an independent basis **only if that investment firm assesses “a sufficient range of financial instruments available on the market which must be sufficiently diverse with regard to their type and issuers or product providers to ensure that the client's investment objectives can be suitably met and must not be limited** to financial instruments issued or provided by:
 - (i) the investment firm itself or by entities having close links with the investment firm; or
 - (ii) other entities with which the investment firm has such close legal or economic relationships, such as contractual relationships, as to pose a risk of impairing the independent basis of the advice provided”.
- (ii) When determining the range of financial instruments assessed, an investment firm providing investment advice must consider the financial instruments (directly) offered by the investment firm.

II. ESMA Q&A updates – [MiFID II/R Transparency topics](#) (4 October 2018)

- 1) **In case the liquidity assessment for a bond under Article 2(1)(17)(a) of MIFIR as further specified in Article 13(18), (19) and (20) of RTS 2 – see below – is not published, what is the liquidity status of the bond to be applied until it is published by ESMA or the relevant non-delegating NCA?** [Section 4 Non-equity transparency, Question 10 – **modified**]

ESMA update of 4 October 2018:

- (i) **In case the necessary liquidity assessment for a bond is not published in FITRS, the bond should be considered illiquid.**
- (ii) More specifically, a bond should be deemed **illiquid if**:
- in the case the necessary liquidity assessment for the bond is the one **based on issuance size** under Article 2(1)(17)(a) of MIFIR (further specified under Article 13 (19) and (20) of RTS 2 because the bond is newly admitted to trading or first traded and such assessment is not published in FITRS; or
 - in the case the necessary liquidity assessment for the bond is the one of the latest quarterly liquidity assessment **based on the trading activity** defined under Article 2(1)(17)(a) of MIFIR (further specified under Article 13(18) of RTS 2) when the bond is no longer considered a newly admitted to trading or first traded bond and such assessment is not published in FITRS.

The above ESMA update replaces the below guidance, published previously:

Case 1: No liquidity assessment based on trading activity; information on issuance size in reference data

In case the liquidity assessment for a bond under Article 2(1)(17)(a) of MIFIR based on the trading activity as further specified in Article 13(18) of RTS 2 is not published, the bond should be considered to have a liquid market based on its issuance size as specified in Table 2.2 of Annex III of RTS 2. The issuance size should be determined based on the reference data published for that bond (fields 14 and 16 of Table 3 of RTS 23). The liquidity assessment based on these fields should apply from the day after the publication of the fields. The liquidity assessment is valid until the liquidity assessment under Article 2(1)(17)(a) of MiFIR as further specified in Article 13(18) of RTS 2 is published. The liquidity assessment should apply from the day following its publication.

Case 2: No liquidity assessment based on trading activity; no information on issuance size in reference data

In case the liquidity assessment for a bond under Article 2(1)(17)(a) of MIFIR based on the trading activity as further specified in Article 13(18) of RTS 2, and the necessary information in the reference data to determine the issuance size of the bond (fields 14 and 16 of Table 3 of RTS 23) as specified in Table 2.2 of Annex II of RTS 2 are not published, the bond should be considered not to have a liquid market until either the liquidity assessment on the basis of the trading activity or the reference data to determine the issuance size of the bond is published. The liquidity assessment should apply from the day following the publication of the fields or of the liquidity assessment based on trading activity. If both are published at the same time, the liquidity assessment based on trading activity should prevail.

Case 3: Newly issued bonds: no information on issuance size in reference data

In case the liquidity assessment for a newly issued bond under Article 2(1)(17)(a) of MIFIR as further specified in Article 13(19) and (20) of RTS 2 is missing because the necessary information to determine the issuance size in the reference data (Fields 14 and 16 of Table 3 of RTS 23) is not published, the bond should be considered not to have a liquid market until the liquidity assessment can be performed according to these fields or the liquidity assessment under Article 2(1)(17)(a) of MiFIR as further specified in Article 13(18) of RTS 2 is published. The liquidity assessment should apply from the day following its publication.

RTS 2 – Article 13 – Methodology to perform the transparency calculations

18. For the purposes of the calculations in paragraph 1(b)(i),
[Periodic assessment based on quantitative and, where applicable, qualitative liquidity criteria for all bond types except ETCs and ETNs],
and by way of derogation from paragraphs 7, 15 and 17, **competent authorities shall, in respect of bonds except ETCs and ETNs, ensure the publication of the calculations referred to under paragraph 5(a) on a quarterly basis, on the first day of February, May, August and November** following the date of application of Regulation (EU) No 600/2014 and on the first day of February, May, August and November each year thereafter. The calculations shall include transactions executed in the Union **during the preceding calendar quarter** and shall apply for the 3 month period beginning on the sixteenth day of February, May, August and November each year.
19. Bonds, except for ETCs and ETNs, that are admitted to trading or first traded on a trading venue **during the first two months** of a quarter shall be considered to have a liquid market as specified in **Table 2.2 of Annex III** until the application of the results of the calculation **of the calendar quarter**.
20. Bonds, except for ETCs and ETNs, that are admitted to trading or first traded on a trading venue **during the last month** of a quarter shall be considered to have a liquid market as specified in **Table 2.2 of Annex III** until the application of the results of the calculation **of the following** calendar quarter.

[Annex to RTS 2](#)

Table 2.2

Bonds (all bond types except ETCs and ETNs) – classes not having a liquid market

Asset class – Bonds (all bond types except ETCs and ETNs)			
Each individual bond shall be determined not to have a liquid market as per Article 13(18) if it is characterised by a specific combination of bond type and issuance size as specified in each row of the table.			
Bond Type		Issuance size	
Sovereign Bond	means a bond issued by a sovereign issuer which is either: (a) the Union; (b) a Member State including a government department, an agency or a special purpose vehicle of a Member State; (c) a sovereign entity which is not listed under points (a) and (b).	smaller than €	1,000,000,000
Other Public Bond	means a bond issued by any of the following public issuers: (a) in the case of a federal Member State, a member of that federation; (b) a special purpose vehicle for several Member States; (c) an international financial institution established by two or more Member States which have the purpose of mobilising funding and providing financial assistance to the benefit of its members that are experiencing or are threatened by severe financial problems; (d) the European Investment Bank; (e) a public entity which is not an issuer of a sovereign bond as specified in the previous row.	smaller than €	500,000,000
Convertible Bond	means an instrument consisting of a bond or a securitised debt instrument with an embedded derivative, such as an option to buy the underlying equity	smaller than €	500,000,000
Covered Bond	means bonds as referred to in Article 52(4) of Directive 2009/65/EC	during stages S1 and S2	during stages S3 and S4
		smaller than € 1,000,000,000	smaller than € 500,000,000
Corporate Bond	means a bond that is issued by a Societas Europaea established in accordance with Regulation (EC) n° 2157/2001 or a type of company listed in Article 1 of Directive 2009/101/EC or equivalent in third countries	during stages S1 and S2	during stages S3 and S4
		smaller than € 1,000,000,000	smaller than € 500,000,000
Bond Type	For the purpose of the determination of the financial instruments considered not to have a liquid market as per Article 13(18), the following methodology shall be applied		
Other Bond	A bond that does not belong to any of the above bond types is considered not to have a liquid market		

- 2) **How should derivatives on derivatives be treated pursuant to RTS 2 for the purpose of determining whether they have a liquid market and, accordingly, the SSTI and LIS thresholds?** [Section 4 Non-equity transparency, Question 13]
- (i) **A derivative on a derivative that is not further specified in the sub-asset classes** set out in RTS 2, e.g. a future on an equity future **should be classified in the same sub(-asset) class as the underlying derivative contract** for the purpose of determining whether it has a liquid market as well as the relevant SSTI and LIS thresholds pursuant to RTS 2.
 - (ii) This is without prejudice to the classification of derivatives on derivatives that are specifically identified in RTS 2, such as swaptions.
- 3) **What types of derivatives can benefit from the pre-trade transparency waiver provided under Article 9(1)(c) of MiFIR?** [Section 4 Non-equity transparency, Question 14]
- (i) **Only derivatives** that are **both (i) not subject to the trading obligation** specified in Article 28 of MiFIR and **(ii) for which there is not a liquid market can benefit from the pre-trade transparency waiver** set out under Article 9(1)(c) of MiFIR.

III. ESMA updates - [MiFID II/R market structures topics](#) – 4 October 2018

- 1) **Can a trading venue use its trading systems and platforms to arrange transactions that are then reported and ultimately executed on another trading venue?** [Section 5 Multilateral and bilateral systems, Question 7]
- (i) **No, the fundamental characteristic of a trading venue is to execute transactions.** As defined under Article 4(1)(21), (22) and (23) of MiFID II, trading venues under all its possible forms as regulated market, multilateral trading facility and organised trading facility are multilateral systems “which bring together multiple third-party buying and selling interests in financial instruments [...] in a way that results in a contract”.
 - (ii) **Therefore, a trading venue should not be allowed to arrange transactions without formalising the execution of those transactions under its rules and systems.** ESMA has also already clarified that a transaction cannot be concluded on more than one trading venue at the same time.
 - (iii) However, where a trading venue is operated by an investment firm, **ESMA considers that these investment firms can arrange transactions as a provider of investment services listed under points (1), (2) or (3) in section A of Annex I of MiFID II**, should the investment firm be authorised for the provision of such investment services.
 - (iv) This is without prejudice to the guidance provided by ESMA in Q&A 10 of section 5.2 clarifying the characteristics of an OTF and, more generally, what constitutes a multilateral activity and should be authorised as such.
- MiFID II – Annex 1***
Section A Investment services and activities
 (1) Reception and transmission of orders in relation to one or more financial instruments;
 (2) Execution of orders on behalf of clients;
 (3) Dealing on own account;
- 2) **Can a market operator or an investment firm operating an MTF apply for a single segment of the MTF to be registered as an SME growth market?** [Section 5 Multilateral and bilateral systems, Question 8]

- (i) The operator of an MTF can apply for a segment of the MTF to be registered as an SME growth market when the requirements and criteria set out in Article 33 of MiFID II and Articles 77 and 78 of the [Commission Delegated Regulation 2017/565](#) are met in respect of that segment.
- (ii) **A specific segment registered as an SME growth market should be considered in isolation to other segments within the MTF.** Other segments which are not specifically registered as an SME GM, cannot benefit from the SME growth market regime. For this purpose **the following conditions should apply:**
 - a. An SME growth market segment is clearly separated from the other market segments operated by the MTF operator. **Clear separation implies at least a different name, rulebook, marketing strategy, and publicity as well as the allocation of the dedicated “Segment MIC”** to the SME GM segment.
 - b. Trades made on a specific SME growth market segment should be clearly distinguished from other market activity within the other segments of the MTF.
- (iii) Furthermore, on demand of the competent authority and with the aim of avoiding circumvention of the definition of an SME growth market, **the MTF should provide a comprehensive list of the instruments listed on an SME growth market segment** and provide any further requested information on the operation of the SME growth market segment.

Prepared by:
Gabriel Callsen,
ICMA, October 2018

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