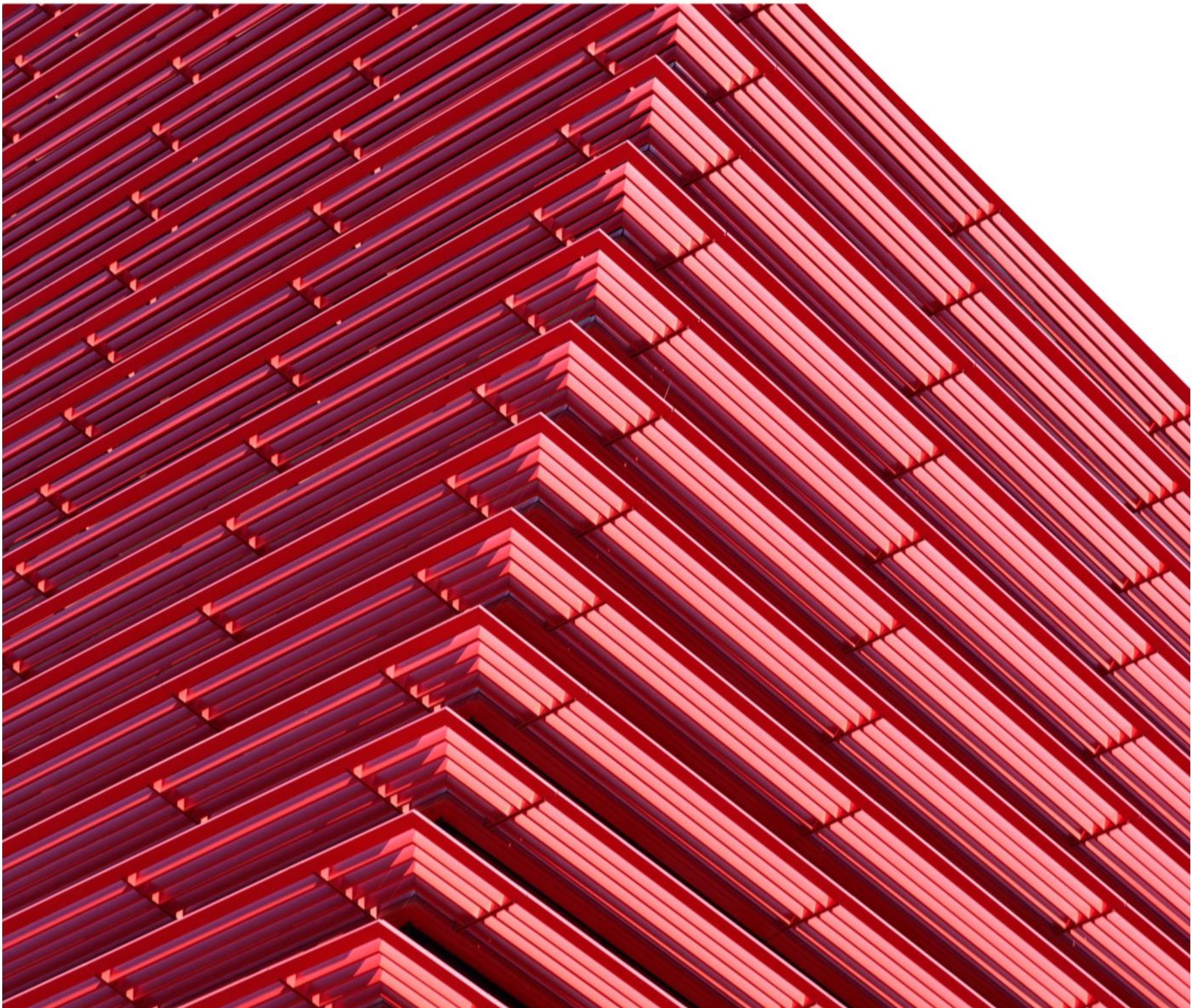
ALLEN & OVERY

The MiFID Review

A ‘stocktake’ on recent publications impacting wholesale financial markets participants

October 2020



Contents

Introduction	3
The Covid-19 “quick fix” proposal	4
Pre and Post Trade Transparency	6
Transaction reporting and reference data	15
The functioning of OTFs	18
What to expect next	20
Contacts	21

Introduction

Over the last two months, the industry have seen a number of proposals from both the European Commission and ESMA in relation to the MiFID Review. In this article we consider those publications most relevant to wholesale financial markets participants focusing on the Commission's "quick fix" Covid-19 proposal, ESMA's reports on pre and post trade transparency requirements, data reporting and the functioning of OTFs.

For an overview of the MiFID Review as a whole and a high level summary of the topics and areas considered to be priority and non-priority by the European Commission as part of their consultation process earlier this year and whether this assessment aligns with other market players, please refer to this bulletin.

The Covid-19 "quick fix" proposal

On 24 July 2020, the Commission published a legislative proposal for targeted amendments to MiFID II (the **Commission's Covid Proposal**) aimed at "facilitating investments in the real economy and allowing for the rapid recapitalisation of European companies". The proposal focuses on removing administrative burdens that result from documentation and disclosure rules as well modifying the commodities regime to allow companies "in the real economy" to react to market volatility. In addition to this proposal, the Commission also launched a public **consultation** on changes to the research regime. In this document, the Commission acknowledges the declining research coverage for SMEs and proposes a number of policy options to relax the requirements, including removing the inducement restrictions on providers of SME research. The proposal suggests making targeted changes to Article 13 of Commission Delegated Directive (EU) 2017/593 (the **MiFID II Delegated Directive**), including that firms will not have to comply with the detailed requirements of the MiFID payment for research regime in the MiFID II Delegated Directive where the research is provided to small and mid-cap issuers in relation, exclusively, to their fixed income instruments. Small and mid-cap issuers will be defined as issuers that did not exceed a market capitalisation of EUR 1 billion over a 12 months period before the provision of the research. Following on from that, the firm will be allowed, if it chooses, to pay for execution services and the provision of research jointly (in other words, bundling will be permitted) provided there is an agreement between the firm and the research provider identifying which part of the bundled payment is attributable to research and the clients have been informed. The consultation closed on 4 September 2020.

Whilst none of these proposals are likely to take effect before the end of the Brexit implementation period (and therefore it is unclear whether all changes will make it into the UK statute book and the Financial Conduct Authority's (FCA) handbook), each of these documents are considered in more detail below.

Investor protection – best execution

The Commission's Covid Proposal aims to recalibrate information requirements in order to strike a more appropriate balance between protecting investors on the one hand and facilitating the provision of investment services on the other. The majority of the proposed amendments focus on providing alleviations for professional clients and ECPs and many reflect concerns that have been widely discussed by stakeholders and ESMA for some time, not just in the context of the pandemic. In relation to best execution reports, the Commission notes that in their current form best execution reports are not read by investors, while buy-side investment firms receive all the relevant information via other means (e.g. via brokerage meetings). To reduce the burden of producing those reports, this obligation is to be suspended, pending a thorough analysis with regard to a possible streamlining of the reports.

On 22 September, ECON published a draft report on the Commission's Covid Proposal which contained a draft motion for a European Parliament resolution, which sets out amendments to the draft legislative proposals. In relation to best execution, ECON suggests that the application of both RTS27 (as suggested by the Commission) and RTS 28 is suspended given the obligation is actually most troublesome for firms rather than venues.

Commodities

The Commission's Covid Proposal considers amendments to carefully recalibrate the position limit regime and the scope of the hedging exemption in order to ensure that nascent euro denominated markets are able to foster and allow producers and manufacturers to hedge their risks whilst safeguarding the integrity of commodity markets.

The proposed changes include:

- **Amending position limits**: Position limits are to be limited to agricultural commodity derivatives or commodity derivatives designated as significant or critical.
- **Deleting the concept of "same contract"**.
- **Reinforcing position management controls**: ESMA will be mandated to further clarify the content of position management controls taking into account the characteristics of the relevant trading venues.
- Introducing a narrowly defined **hedging exemption** for firms trading for predominantly commercial groups.
- **Simplifying the ancillary activity test** – the proposal would delete all quantitative elements. In the ECON report referenced above, ECON is suggesting technical standards to limit NCA flexibility by giving guidance in terms of qualitative criteria.

Pre and Post Trade Transparency

Under MiFIR, ESMA is required to submit a report to the European Parliament and to the Council on the impact of the transparency obligations and in particular on the impact of the double volume cap (**DVC**) mechanism. In order to provide for a comprehensive and meaningful assessment, ESMA decided to also include an assessment of other key transparency provisions, namely the share trading obligation (**STO**) and the transparency provisions applicable to systematic internalisers (**SIs**).

On 16 July 2020, ESMA published two Final Reports reviewing provisions of the transparency regime - the first reviews the transparency regime for equity and equity-like instruments, aspects of the SI regime and the STO and the second reviews the pre-trade transparency obligations for SIs for non-equity instruments -both reports contain proposed amendments to each regime. The tables below summarises the areas where ESMA proposes change and outlines ESMA's original proposals as set out in its February 2020 preliminary consultation papers and the final proposals. The proposals reflect the tension at the heart of the transparency regime – that is, the tension between balancing transparency against the impact that transparency has on liquidity. The proposals are a complex mix of measures that would adjust and recalibrate that balance in both directions, with some measures increasing the level of transparency and others diminishing factors that could restrict liquidity.

The transparency regime for equity and equity-like instruments

No	Area of review	Current position	Initial proposals	Final proposals
1.	**Waivers**	Under Article 4 of MiFIR, competent authorities are permitted to waive the requirement for pre-trade transparency of order prices and volumes where order prices are derived from a widely published and generally accepted reference price (**RP**); orders that formalise negotiated transactions (**NT**); orders that are large in scale (**LIS**) compared with the normal market size; and orders are held in an order management facility (**OMF**) of a trading venue pending disclosure.	ESMA proposed: – to remove the possibility of a waiver based on RP or NT, subject to a remaining waiver for NT where the transaction is subject to conditions other than the current market price; – to increase the threshold for an order in ETFs to be LIS to EUR 5m; – to prohibit trading venues from using waivers in combination; and – to change reporting requirements to differentiate between different waivers.	**ESMA now proposes:** – **no change to the NT waiver;** – **to limit the RP waiver to orders above a certain threshold (determined by reference to the LIS threshold);** – **to increase the threshold for an order in ETFs to be LIS to EUR 3m;** – **no prohibition on the use of waivers in combination; and** – **to change reporting requirements to differentiate between different waivers.**
2.	**Double volume cap**	Article 5 of MiFIR limits the use of the RP and NT waivers (where the NT waiver is used in relation to liquid transactions) by setting a percentage limit on their use over a 12 month period by reference to all trading of the relevant instrument on a single venue (where the limit is 4%) and across EU venues (where	ESMA proposed: – to remove the RP and NT waivers, thus making the DVC irrelevant; – if the DVC were to remain, to extend it to the use of the NT waiver for illiquid transactions; – to remove the single trading venue limit in the DVC and, potentially, to reduce the EU limit to 7%;	– **ESMA now proposes:** – **to maintain the RP and NT waivers as amended above and therefore to retain the DVC;** – **not to extend the DVC to the NT waiver for illiquid transactions;**

No	Area of review	Current position	Initial proposals	Final proposals
		the limit is 8%). This is referred to as the 'double volume cap'. Where the cap is breached, competent authorities are required to suspend the use of the relevant waivers at trading venue level or EU level as applicable. Trading venues are required to monitor trading to ensure the trading venue cap is not breached. ESMA is required to publish reports on trading covered by the relevant waivers and instruments which come close to breaching the cap. There is no requirement on EU Member States to sanction a breach of the cap or breach of a suspension of trading, although certain Member States do impose sanctions.	– to remove the requirement for competent authorities to issue a formal suspension notice where the DVC is breached; – to remove the requirement for trading venues to ensure the trading venue cap is not breached; – to apply the cap even where there is less than 12 months' reference data; – to extend the deadlines for ESMA to publish its reports on trading; – to remove the requirement for ESMA to publish reports on instruments which come close to breaching the cap; and – to mandate sanctions across all Member States for breaches of DVC related suspensions.	**– to remove the single trading venue limit in the DVC and to reduce the EU limit to 7%;** **– to remove the requirement for competent authorities to issue a formal suspension notice where the DVC is breached;** **– to remove the requirement for trading venues to ensure the trading venue cap is not breached, by way of deleting the trading venue cap;** **– to maintain the current permissive approach to instruments with less than 12 months' reference data;** **– to extend the deadlines for ESMA to publish its reports;** **– to remove the requirement for ESMA to publish reports on instruments which come close to breaching the cap; and** **– to mandate sanctions across all Member States for breaches of DVC related suspensions.**
3.	**Definition of "liquid market"**	The availability of the NT waiver and the obligation on SIs to make public firm orders in equity or equity-like instruments depend in part on whether the instrument in question is "liquid". Commission Delegated Regulation (EU) 2017/567 (the **Level 2 Regulation**) sets out criteria for liquidity based on the value of the free float of those instruments, the average daily number of transactions in those instruments, the average daily turnover of transactions in those instruments and whether those instruments are traded on a daily basis.	ESMA proposed to amend the criteria for liquidity to consider a more limited set of factors, as follows: – The criteria for liquidity of shares should be determined by reference to average daily number of transactions and average daily turnover only, and potentially also market capitalisation. – The criteria for liquidity of ETFs and DRs should be determined by reference to average daily number of transactions and average daily turnover only. – Certificates and other equity-like instruments should automatically be regarded as illiquid.	**ESMA now proposes that the criteria for liquidity should be based on the following factors:** **– The criteria for liquidity of shares should be determined by reference to average daily number of transactions and average daily turnover only, and not market capitalisation.** **– The criteria for liquidity of ETFs and DRs should be determined by reference to average daily number of transactions and average daily turnover only.** **– The criteria for liquidity of certificates should be determined by reference to average daily number of transactions and average daily turnover only.** **– Other equity-like instruments should automatically be regarded as illiquid.**

No	Area of review	Current position	Initial proposals	Final proposals
4.	**Frequent Batch Auctions**	The information to be made public under MiFIR depends on the kind of trading system involved. Different trading systems are differentiated in Table 1 of Annex 1 of Commission Delegated Regulation (EU) 2017/587 (**RTS 1**) and include "periodic auction trading systems". Frequent Batch Auctions (**FBAs**) are generally considered to fall within this type of trading system – however, there is no specific regulation for them and it has been argued that they do not constitute price-forming systems.	ESMA proposed: – to develop a specific regime for FBAs with specific pre-trade transparency requirements; and – to require FBAs and all other non-price forming trading systems to operate under a transparency waiver (and therefore limit their activities to meet the requirements of the waivers).	**ESMA now proposes:** – **to develop a specific regime for FBAs with specific pre-trade transparency requirements;** – **to set out a uniform approach to identifying non-price forming systems and transactions; and** – **to require non-price forming transactions to operate under a transparency waiver.**
5.	**Systemic internalisers**	SIs are only required to give pre-trade transparency in relation to equity and equity-like instruments for which there is a liquid market. In addition, SIs can choose which size of quote they give, subject to a minimum of 10% of the standard market size (**SMS**). They are not subject to pre-trade transparency where they deal in sizes above the SMS.	ESMA proposed: – to increase the minimum quote size to be given by SIs; – to extend the transparency regime to illiquid instruments; and – to determine the SMS by reference to average daily turnover rather than average value of transactions, potentially with a variation for illiquid transactions (should they be brought within scope).	**ESMA now proposes:** – **to increase the minimum quote size to 100% of SMS;** – **not to extend the regime to illiquid instruments; and** – **to determine the SMS by reference to average daily turnover rather than average value of transactions.**
6.	**Deferred post-trade publication for ETFs**	Article 6 of MiFIR requires real-time publication by trading venues of the price, volume and time of transactions in ETFs. Article 7 of MiFIR allows publication to be delayed in certain circumstances specified in RTS 1. For ETFs, publication may be delayed by 60 minutes for transactions over EUR 10 million.	ESMA proposed to increase the transaction size threshold for deferred publication of ETF transactions from a size of EUR 10 million to a size of EUR 20 million.	**ESMA now proposes to increase the transaction size threshold for deferred publication of ETF transactions from a size of EUR 10 million to a size of EUR 15 million.**
7.	**Post-trade transparency for OTC share transactions**	Article 20 of MiFIR requires investment firms to make public post-trade details for transactions in shares traded on a trading venue where those transactions are done on an OTC basis. Articles 12 to 15 of RTS 1 align the transparency requirements for such OTC trades with those for trades done on a trading venue.	ESMA considered whether the rules in RTS 1 should continue to align the requirements for OTC trades with trades on a trading venue. In particular, it considered whether to amend the definition of "real-time" publication, which currently refers to a deadline of one minute following the transaction, to put in place a different deadline (albeit without making any proposals). ESMA also proposed to require investment firms to specifically flag to ESMA's Financial Instruments Transparency System (FITRS)	**ESMA now proposes only to require investment firms to specifically flag to ESMA's Financial Instruments Transparency System (FITRS) transactions in those shares which are not subject to the STO in Article 23 of MiFIR but are subject to post-trade transparency.**

No	Area of review	Current position	Initial proposals	Final proposals
			transactions in those shares which are not subject to the STO in Article 23 of MiFIR but are subject to post-trade transparency.	
8.	**STO**	Article 23 of MiFIR requires EU investment firms who trade in shares admitted to trading on a regulated market or traded on a trading venue in the EU only to trade those shares on a regulated market, MTF or SI, or a third-country trading venue assessed as equivalent. This obligation is subject to exceptions for trades (1) which are non-systematic, ad-hoc, irregular and infrequent or (2) are carried out between eligible and/or professional counterparties (each as defined in MiFID II) and do not contribute to the price discovery process.	ESMA proposed: – to exempt shares which have their "main pool of liquidity" on a third-country trading venue from the STO; – to remove the exemption for non-systemic, ad-hoc, irregular and infrequent trades, or at least to clarify these concepts within MiFIR; and – to remove the reference to eligible and/or professional counterparties in the second exemption. ESMA also considered (without making a proposal) whether trading through SIs should continue to be compliant with the STO.	**ESMA now proposes:** – **to limit the STO to those shares which have an International Securities Identification Number (ISIN) which identifies them as being EU shares (since ISINs begin with a country identifier).** – **to permit shares within the scope of the STO to be traded on third-country trading venues where they are traded in a third-country currency;** – **to remove the exemption for non-systemic, ad-hoc, irregular and infrequent trades; and** – **to remove the reference to eligible and/or professional counterparties in the second exemption.** **ESMA does not propose to make changes to the use of SIs to comply with the STO.**

The pre-trade transparency regime for SIs in non-equities

No	Area of review	Current position	Initial proposals	Final proposals
1.	**Exceptional market conditions and quote withdrawal**	Article 18(3) of MiFIR allows SIs to withdraw the quotes they publish only in "exceptional market conditions".	ESMA proposed that "exceptional market conditions" should be clarified to bring it in line with the definition of "exceptional circumstances" used in Article 3 of Commission Delegated Regulation 2017/578, which provides an exception to the obligation on investment firms to provide liquidity. As summarised by ESMA, this would include circumstances where the SI's ability to maintain prudent risk management practices is prevented by (i) technological issues, including problems with a data feed or other system that is essential to carry out its SI activity, (ii) risk management issues	**ESMA now proposes, instead of clarifying the definition of "exceptional market conditions", to allow SIs to withdraw their quotes at any time.**

No	Area of review	Current position	Initial proposals	Final proposals
			in relation to regulatory capital, margining and access to clearing, and (iii) the inability to hedge a position due to a short selling ban.	
2.	**Access to quotes**	The quotes referred to in Article 18 of MiFIR are quotes to specific clients. Articles 18(5) to 18(7) set out conditions for those quotes to be used for other clients. These conditions allow for some discretion on the part of the SI while also setting boundaries on that discretion. Notably, an SI must trade at the quote where the quote is at or below a "size specific to the financial instrument" (Article 18(6)), but it may establish "non-discriminatory and transparent limits on the number of transactions they undertake to enter into with clients pursuant to any given quote" (Article 18(7)).	ESMA proposed to simplify this regime by giving the SI complete discretion as to the clients it gives access to quotes to, subject only to the requirement in Article 18(5) for clear standards for governing access to quotes.	**ESMA now proposes to remove the regime for access to quotes by other clients from Article 18 of MiFIR entirely.**
3.	**Requirements for publishing quotes**	There are no requirements setting out exactly how SIs should publish quotes in non-equity instruments, whereas the Article 13 of the Level 2 Regulation does set out certain requirements in respect of equity or equity-like instruments. ESMA has set out its preferred approach in Q&As[1].	ESMA proposed setting out the requirements it has included in its Q&As in an amendment to the Level 2 Regulation.	**ESMA now proposes setting out the requirements it has included in its Q&As in an amendment to the Level 2 Regulation.**
4.	**Pre-trade transparency for illiquid instruments**	Article 18(2) of MiFIR requires SIs to disclose quotes to their clients for illiquid non-equity instruments where they agree to do so. The obligation may be waived by the SI's national competent authority.	ESMA proposed simplifying the regime, either by requiring the full pre-trade transparency regime to apply to illiquid instruments, or by removing any obligations in respect of non-liquid instruments altogether. ESMA also considered doing nothing, and had no firm preference between the three options.	**ESMA now proposes to delete Article 18(2) of MiFIR entirely and therefore have no obligations for disclosure in respect of illiquid non-equity instruments.**
5.	**Level playing field with trading venues**	The pre-trade transparency requirements for SIs differ significantly from those imposed on trading venues.	ESMA sought views on whether the divergence in rules for SIs and trading venues should be addressed, but without any firm proposals.	**ESMA has not made any proposals in relation to this issue, but has committed to review the position in further reviews and has clarified that the obligations on SIs only apply in respect of instruments otherwise traded on a trading venue.**

[1] Section 7, Question 5(e) of ESMA's Q&A on MiFID II and MiFIR transparency topics (**https://www.esma.europa.eu/sites/default/files/library/esma70-872942901-35_qas_transparency_issues.pdf**)

The transparency regime for non-equity instruments

In addition to the above, ESMA has also been seeking industry feedback on the transparency regime for non-equities. Whilst ESMA made clear in the **consultation paper** published in March that it does not intend to redefine the general objectives and goals that were set by co-legislators when designing the regime, it did propose legislative amendments aimed at simplifying a regime that has proved to be rather complex to apply and supervise in practice – for example, in relation to post trade transparency, the deferral regime which is subject to national discretion and therefore the application of different rules across the EU. On 25 September 2020, ESMA published their **Review Repo**rt reviewing the transparency regime for non-equity instruments and the derivatives trading obligation (**DTO**) under Article 28 of MiFIR. The tables below summarises the areas where ESMA proposes change and outlines ESMA's original proposals as set out in its March 2020 preliminary consultation papers and the final proposals:

No	Area of review	Current position	Initial proposals	Final proposals
1.	**SSTI waiver**	Under Articles 9 and 11 of MiFIR, competent authorities are permitted to waive the requirement for pre-trade transparency of order prices and volumes for non-equity instruments, or allow deferral of publication of post-trade details, where, among other possible waivers, orders or transactions are large in scale (**LIS**) compared with the normal market size or transactions or actionable indications of interest in request for quote and voice trading systems are "above a size specific to the financial instrument" (**SSTI**). The thresholds above which an order or indication of interest is LIS or SSTI in relation to each relevant instrument are set out in Commission Delegated Regulation 2017/583 (**RTS 2**). Where the SSTI waiver applies, trading venues must nevertheless disclose indicative prices.	ESMA proposed: – to delete the SSTI waiver; and – to lower the LIS threshold.	**ESMA now proposes:** – **to delete the SSTI waiver; and** – **to lower the LIS threshold (such threshold to be determined in further consultation).**
2.	**Definition of liquidity for bonds**	Article 9(1)(c) of MiFIR provides a potential waiver for instruments for which there is not a liquid market. Article 13 of RTS 2 provides for quarterly assessment of whether bonds are liquid, based on various factors.	ESMA sought views on whether the current quarterly approach or any of the factors used to assess liquidity should be reformed.	**ESMA has made no firm proposals, but considers that something should be done to increase the number of bonds deemed liquid and therefore open to pre-trade transparency. Options floated include removing the concept of liquidity entirely and replacing it with LIS, and using different measures of liquidity.**

No	Area of review	Current position	Initial proposals	Final proposals
3.	**Calibration of transparency requirements to different kinds of trading venue**	Article 8(2) provides that pre-trade transparency requirements should be calibrated to different kinds of trading venue. Annex I of RTS 2 specifies, for a list of trading venues defined in that Annex, what information should be disclosed. There is a catch-all category for trading venues outside the list which specifies that "adequate information" shall be provided.	ESMA commented that where a new type of trading venue emerges, or where a trading venue combines features of trading venue types specified in Annex I of RTS 2, it is unclear what should be disclosed. ESMA therefore proposed: – to issue guidance opinions in respect of the information to be provided for new types of trading venues not covered or intended to be covered by Annex I of RTS 2; and – to amend Annex I of RTS 2 to provide further details in respect of so-called "hybrid systems" which combine features of already listed systems to clarify that the information required is that required by those systems.	**ESMA now proposes simply to clarify the definition of hybrid systems and detach it from the catch-all category. It intends in a future review of RTS 2 to specify that such hybrid systems should disclose what is required for each component system.**
4.	**Quality and availability of data in pre-trade transparency**	Annex II of RTS 2 sets out the details to be provided for post-trade transparency for non-equities, but there is a more limited equivalent for pre-trade transparency. Article 13 of MiFIR specifies that trading venues must make pre-trade information available to the public after it is published, but there is no equivalent obligation for SIs.	ESMA considered that the accessibility and content of information provided as part of the pre-trade transparency regime for non-equities to be below the required standard. ESMA therefore proposed: – to require SIs to make pre-trade data available free of charge 15 minutes after publication; and – to harmonise to a greater extent the content and format of pre-trade transparency to be published.	**ESMA now proposes:** – not to impose any new obligations on SIs; and – to harmonise to a greater extent the content and format of pre-trade transparency (with the number of fields kept to a minimum).
5.	**Deferred publication of post-trade transparency**	Article 11 of MiFIR allows competent authorities to permit deferred publication of post-trade details of transactions where they are LIS, are not on a liquid market, or are above a SSTI. Where exercising this power, competent authorities can also mandate the omission of the volume of a transaction once the details are eventually published.	ESMA considered different options, in conjunction with the deletion of the SSTI waiver (see above) to simplify the regime, including limiting "volume masking" to LIS and restricting all deferrals to a maximum of 2 weeks or 4 weeks.	**ESMA now proposes:** – **to limit deferrals to volume masking for LIS and illiquid markets, with limited discretion for national competent authorities; and** – **to require publication of trade volumes in any event after 2 weeks.**
6.	**Temporary suspension of transparency**	Articles 9(4), 11(2) and 21(4) of MiFIR provide the possibility for competent authorities to temporarily suspend the pre- and post-trade transparency requirements for non-equity instruments where the liquidity of a class of financial	ESMA proposed to delete these provisions in their entirety, or at least to require them to be applied in the same way across the EU.	**ESMA now proposes only to put in place an EU-wide mechanism for ESMA to declare an EU-wide temporary suspension of transparency.**

No	Area of review	Current position	Initial proposals	Final proposals
		instruments falls below a certain threshold.		
7.	**Definition of "traded on a trading venue"**	The transparency obligations apply, in certain cases, most notably derivatives, only to instruments "traded on a trading venue" (**TOTV**). There is no clear definition of this, and ESMA has previously published an Opinion giving a narrow scope to the term in respect of OTC derivatives[2].	ESMA sought views on whether the TOTV concept should apply to a wider range of OTC derivatives.	**ESMA now proposes:** – **to continue to apply the same TOTV concept across relevant MiFIR obligations; and** – **to consider further whether TOTV should include derivatives traded by SIs (but without making any firm proposals at this stage).**
8.	**Derivatives trading obligation (DTO)**	Article 28 of MiFIR requires certain derivatives to be traded on a trading venue, including third-country trading venues deemed equivalent by the Commission. Article 32 of MiFIR allows ESMA to propose technical standards to the Commission as to which derivatives subject to the clearing obligation contained within Regulation (EU) 648/2012 (**EMIR**), as recently amended by Regulation (EU) 2019/834 (**EMIR Refit**), should be subject to the DTO. This is subject to the conditions that the derivatives are already traded on a trading venue and that there is sufficient liquidity for those derivatives, although ESMA may also propose a wider scope if it chooses. Under Article 32(5) of MiFIR, ESMA may also propose a suspension of the DTO to the Commission.	ESMA proposed: – to align the scope of the DTO with that the EMIR clearing obligation following the amendments made by EMIR Refit; and – to introduce a fast track system for suspending the DTO in cases of emergency. ESMA also sought more general views on the operation of the DTO.	**ESMA now proposes:** – **full alignment between the EMIR clearing obligation, as amended by EMIR Refit, and DTO provisions;** – **additional criteria for third-country trading venues to be deemed equivalent, including non-discriminatory access and equivalent transparency provisions;** – **to consider the extension of the DTO to derivatives based on risk-free rates;** – **to consider whether more granular reporting is required for derivatives subject to the DTO;** – **to introduce a shorter procedure for self-standing suspension of the DTO; and** – **to consider aligning the assessment of liquidity for transparency purposes and for the purposes of the DTO.**
9.	**Segmentation criteria**	The assessment of liquidity, LIS and SSTI thresholds for non-equity instruments depends in certain cases on "segmentation criteria" set out in Annex III of RTS 2 for each type of instrument.	ESMA proposed: – to use the segmentation criteria "delivery/cash settlement location" and "settlement type" for all commodity derivatives, not just some; and – to use pre-existing standards to populate fields, and to specify those standards in RTS 2.	**ESMA now proposes:** – **to use the segmentation criterion "delivery/cash settlement location" for all commodity derivatives, not just some;** – **not to make any changes in respect of the segmentation criterion "settlement type"; and** – **to use pre-existing standards to populate fields, and to**

2 **https://www.esma.europa.eu/sites/default/files/library/esma70-156-117_mifir_opinion_on_totv.pdf**

No	Area of review	Current position	Initial proposals	Final proposals
				specify those standards in RTS 2.

In parallel with each of the above, on 1 September 2020, ESMA announced a **call for evidence** seeking information about the application of RTS 1 and RTS 2, which contain the main implementing measures relating to the MiFIR transparency regime. The purpose of this exercise is to gather input and views on practical issues related to the application of RTS 1 and RTS 2 that market participants have identified since the application of MiFID II/ MiFIR. ESMA would also like to receive feedback on any technical issue and policy gap that market participants have encountered at implementation level, as well as unclear provisions. The deadline for responding to the call for evidence is 31 October 2020.

Transaction reporting and reference data

On 24 September 2020, ESMA published a **consultation paper** on the functioning of the transaction reporting regime. The transaction reporting and reference data requirements under Articles 26 and 27 of MiFIR were introduced in the wake of the financial crisis, which revealed weaknesses in the former reporting requirements due to their narrow scope and lack of harmonisation. The MiFIR reporting requirements were designed to provide national competent authorities (**NCAs**) with a full view of the market when conducting their market surveillance activities. Each national supervisor in the EU receives transaction data under Article 26 and this data contains information about each executed transaction, which is combined with the reference data related to the instrument in which the transaction is executed that is published by ESMA under Article 27 of MiFIR. In addition to Article 27, Article 4 of the Market Abuse regulation (**MAR**) on the notifications and list of financial instruments introduced a mirror requirement to provide instrument reference data.

Given the interconnection between the transaction data and the reference data, ESMA has decided to provide in this report an additional assessment of the functioning of Article 27 of MiFIR on the supply of financial instruments reference data and Article 4 of MAR on the notification and list of financial instruments.

The table below summarises some of the key proposals – ESMA has invited responses by 20 November 2020:

Topic	Proposal
Scope: Entities	
AIFMs & UCITS Managers	AIFMs and UCITS managers providing one or more MiFID services to third parties should be subject to transaction reporting in accordance with Article 26 of MiFIR.
Reference to "members/participants/users" of trading venues	Under Article 26(5) of MiFIR, venues have to submit transaction reports on transactions in financial instruments traded on their platforms which are executed through their systems by '*firms*' that are not subject to MiFIR. The reference to '*a firm*' has proven to be problematic because there is no definition of '*firm*' in MiFID II/MIFIR. ESMA proposes replacing this references with "*any member, participant or user*".
Branches of EEA entities	Article 26(8) seems to indicate that reports of transactions executed through a branch should be first submitted to the competent authority of the host member state, which in turn would transmit them to the competent authority of home member state. The process outlined in RTS 22 prescribes that reporting investment firms should submit the reports in relation to transactions executed through branches to the NCA of their home member state. To avoid any doubts on the application of this obligation, ESMA considers that the text in Article 26(8) should be aligned with the process described in RTS 22.
Concept of ToTV	Further to the points outlined above in relation to ESMA's review report on the transparency regime for non-equity instruments, ESMA is now consulting on an additional proposal that departs from the ToTV concept altogether and is based on a different criterion to define which OTC instruments should be brought into the scope of the relevant transparency and reporting obligations. ESMA is considering three options to increase the scope of (i)

Scope: Entities	
	reference data reporting, (ii) transaction reporting and (iii) transparency by including derivative instruments traded through an SI: – **Option 1**: reporting obligations are extended beyond derivatives for which the firm qualifies as SI. – **Option 2**: reporting obligations cover all transactions in derivatives or class of derivatives for which the firm qualifies as SI regardless of whether the firm is acting in its SI capacity or not. – **Option 3**: reporting obligations cover all transactions in derivatives or class of for which the firm qualifies as SI and the firm is executing the transaction in its SI capacity.
Transaction reporting indices	ESMA considers that the text of Article 26(2)(c) does not provide NCAs with the precise set of information needed for the purpose of market monitoring under Article 24 of MiFIR because MiFIR does not provide any definition or clarification of the term “index”. ESMA is therefore proposing to replace the reference to the term “index” with the term “benchmark” as defined under Article 3(3) of the Benchmark Regulation.
Scope of reference data – merging Article 4 of MAR into Article 27 of MiFIR	Despite alignment between Level 2 measures under the two regimes, there remains discrepancies between the Level 1 texts which cause confusion. ESMA is therefore proposing: – **Instrument listed on an MTF**: Article 27(1) of MiFIR to be amended to reflect the wording used in Article 4 of MAR: “With regard to financial instruments admitted to trading **or traded on a trading venue**, trading venues shall provide competent authorities with identifying reference data for the purposes of transaction reporting under Article 26.” – **Approval of trading on an MTF/OTF**: Article 27 of MiFIR to be amended in such a way that the focus is on the issuer’s earlier consent to trading - such wording would be consistent with the text used in the related RTS 23. – **Approval of admission to trading**: Article 27 to be brought in line with Article 4 of MAR which stipulates that financial instruments must be reported as soon as an application for admission to a regulated market has been made. – **Instruments exclusively traded on SIs**: ESMA’s preliminary view is that the obligation to send reference data should be extended to derivatives executed on an SI regardless of whether these instruments are covered by the current Article 26(2) of MiFIR or whether they are already reported by a venue or not. – **Frequency of updates to instrument reference data (defined list)**: ESMA considers that the requirement of daily submission should be extended to the venues and SIs that do not operate on the basis of a defined list. – **Deletion of Article 4 of MAR**.
Trading Venue Transaction Identification; chain of transactions (TVTIC)	Article 26 of MiFIR should be amended so that: – the TVTIC is not limited to transactions executed on a trading venue, the obligation should also apply to transactions executed by a SI; – both sides of a transaction could be linked where the INTERNAL code is used - this would allow matching of the venue executions with the client allocations; and – there is a separate code that would enable regulators to link all transactions pertaining to the same transaction chain. All counterparties included in such a transaction chain would be required to make sure to transmit the code to its direct counterparty.
Identifiers to be used for parties	As regards Article 26(3) of MiFIR, ESMA proposes that the identification of the decision maker for clients should be explicitly mentioned in the Level 1 text. The term “client” used in that article is considered too restrictive and ESMA proposes replacing it with a more general term such as “parties” to identify all participants - consistent with the terminology used under EMIR reporting.

Scope: Entities	
Designation to identify a short sale	ESMA is considering two options: – the removal of the short sale indicator information from the transaction reporting considering that the definition of a short sell in the short selling regulation and its application within MiFIR transaction reporting cannot be reconciled; or – the definition of a new indicator more in line with the transaction reporting.
Indicators for waivers; OTC post-trade deferrals; commodity derivatives	The current regime requires investment firms to indicate in the report whether the transaction was executed under a pre-trade waiver. ESMA proposes to extend the scope of this obligation to the transactions in non-equity instruments executed on a SI.
Obligations for investment firms transmitting orders	
Transmitting orders	ESMA has identified cases when investment firms interested in the transmission of orders and seeking a transmission agreement were unable to find another investment firm willing to conclude such an agreement. It is therefore proposing to introduce an obligation for the receiving investment firm to report the transaction which pertains to a transmitted order, when the transmitting investment firm requests to transmit its orders.

Interaction with the reporting obligations under EMIR	
Alignment of MiFIR empowerments with EMIR Refit	ESMA proposes to leverage on existing empowerments included in EMIR Refit and SFTR, and aims to harmonize the wording of the empowerments, especially the obligation to take into account the international developments and standards.
LEI of the issuer of the financial instrument	
LEI of the issuer	While the obligation for EU investment firms to identify their clients with the LEI is enshrined in the MiFIR Level 1 framework, this is not the case for the LEI of issuers. Similar to the requirement for clients behind transactions in financial instruments under Article 26 of MiFIR, ESMA is proposing that the use of the LEI to identify the issuer of the financial instrument is explicitly referred in Article 27 of MiFIR.

The functioning of OTFs

On 25 September 2020, ESMA published a consultation paper setting out proposals to clarify the MiFID II provisions relating to OTFs and, more generally, multilateral systems to "ensure efficient EU market structures and a more level playing field between all firms operating in the EU while reducing the level of complexity for market participants." The report looks at the number of OTFs authorised in the Union and their market share, examines whether any adjustment to the definition of OTFs is needed and observes their use of matched principal trading (**MPT**).

The consultation addresses a range of topics and sets out a number of recommendation, including:

Multilateral systems

In order to ensure more legal certainty, to foster EU-wide consistency and convergence in the application of the framework, and to avoid any issues of transposition, ESMA proposes that: (a) the restriction set out in Article 1(7) of MiFID II is moved into MiFIR; and (b) this restriction is worded as a prohibition so as to make it suitable for direct applicability in Member states. As an example, ESMA suggests:

- It is forbidden to operate any type of multilateral system that does not also fit the definition of a regulated market (**RM**), MTF or OTF; and
- All multilateral systems in financial instruments are required to seek authorisation as a RM, MTF or OTF and where necessary modifying their operating arrangements to comply with the applicable trading venue definition.

In addition, ESMA proposes:

- **Materiality applied to non-automated systems**: ESMA remains of the view that authorisation of OTFs should be independent of the scale and complexity of the concerned entities; however, it acknowledges that it is important that such regime does not put smaller brokerage businesses at risk. As a result, ESMA is ready to consider possible amendments to the OTF regime aimed at reducing the regulatory burden and facilitating the operation of an OTF for less sophisticated brokers.
- **Network of SIs**: ESMA is of the view that the clarifications provided in its Level 3 Q&As are sufficiently clear to distinguish where the trading activity of an SI is purely bilateral and which arrangements should be considered as multilateral activity. As such, any arrangements operating without the proper authorisation under MiFID II should be subject to NCA supervisory measures; however, ESMA is seeking participants' views as to whether such clarifications are sufficiently clear or whether a Level 1 amendment should be proposed in order to give market participants more legal certainty.
- **Software providers**: In ESMA's view, a software provider that operates a multilateral system but without executing trades (the transaction being formalised on another authorised venue) may still require authorisation as a trading venue – for example, it could be considered that the software provider operates an OTF or MTF but with an execution system outsourced to another trading venue (acting here not as trading venue but as a simple service provider).
- **Boundaries between venues and bulletin boards**: ESMA believes that there should be a principle-based approach on what should be considered a bulletin board to ensure that those systems (where it is not possible for users to act upon advertised interests) are not to be subject to authorisation as a trading venue. Paragraph 80 of the paper sets out the characteristics

which would define a "bulletin board" and ESMA proposes to amend the Level 1 text to include a definition of bulletin boards which takes those characteristics into account.

- **Operation of internal crossing systems by fund managers**: ESMA states that the question about the regulatory framework applicable to internal crossing systems is not straightforward. As a result, ESMA would like to gather more input on the functioning of those systems before possibly developing guidance about whether the regulation of internal crossing systems falls within the remit of MiFID II or the UCITS Directive/AIFMD. More generally, ESMA is interested in market participants' views on the regulatory framework applicable to internal crossing systems (MiFID II or UCITS Directive/AIFMD) and whether it would be useful to clarify this through targeted Level 1 changes.

Matched Principal Trading

- **Use of MPT by OTFs**: Based on preparatory review, ESMA does not consider that the use of MPT raises any supervisory concerns. It states that the use of MPT appears to be limited to few instruments and ESMA further understands that the consent of the client is either requested before engaging in MPT or included in the rulebook with a detail of the fees applied, to which the client agrees. As a result, ESMA does not believe it needs to undertake any specific review or recommend changes unless market participants suggest that it is required in response to the consultation.
- **Restrictions to MPT on RMs and MTFs**: ESMA believes that it would be helpful for the Level 1 text to clarify that the restriction on dealing on own account in Articles 19(5) of MiFID II should be interpreted as applying only to the MTF operated by the investment firm and not that an investment firm operating an MTF could not act in a principal capacity. Market participants are therefore asked for views on whether the wording in Articles 19(5) and Article 47(2) of MiFID II should be aligned to clarify that for MTFs, as for RMs, the restriction on dealing on own account holds only in relation to the MTF operated by the investment firm and does not imply that an investment firm operating an MTF could not act in a principal capacity.

The consultation closes on 25 November 2020. ESMA expects to publish a final report for submission to the Commission by March 2021.

What to expect next

It is clear that the focus in the short term will be on the measures that form part of the Commission's overall Covid-19 recovery strategy. None of those proposed amendments will take effect before the Brexit transition period ends meaning they will only apply in the UK if the UK government is minded to adopt the same changes to the onshored MiFD II/MiFIR regime.

As regards ESMA's ongoing work as part of the broader MiFID Review, it is now for the Commission to consider which of ESMA's proposals in relation to transparency it takes forward as legislative proposals. Since MiFID II was implemented, market participants have been keen to ensure that this review clarifies existing requirements rather than providing for wholesale re-writes. However, the volume of proposals published already indicates that many aspects of the MiFID II framework are on the table for review, and the end legislative outcome could involve some significant and substantial revisions to the regime. ESMA is clearly trying to bring together a number of interlinking elements, particularly in relation to transparency, whether this is translated appropriately into the legislative revisions remains to be seen.

Contacts

Belgium

Sylvia Kierszenbaum
Partner – Antwerp
Tel +32 3 287 74 10
sylvia.kierszenbaum@allenovery.com

Czech Republic

Petr Vybíral
Partner – Prague
Tel +420 222 107 173
petr.vybiral@allenovery.com

France

Brice Henry
Partner – Paris
Tel +33140065366
brice.henry@allenovery.com

Germany

Dr Alexander Behrens
Partner – Frankfurt
Tel +49 69 2648 5730
alexander.behrens@allenovery.com

Hungary

Zoltan Lengyel
Partner – Budapest
Tel +36 1 429 6033
zoltan.lengyel@allenovery.com

Italy

Lisa Curran
Senior Counsel – Rome
Tel +39 06 6842 7537
lisa.curran@allenovery.com

Luxembourg

Henri Wagner
Partner – Luxembourg
Tel +352 44 44 5 5409
henri.wagner@allenovery.com

Netherlands

Gerard Kastelein
Partner – Amsterdam
Tel +31 20 674 1371
gerard.kastelein@allenovery.com

Spain

Salvador Ruiz Bachs
Partner – Madrid
Tel +34 91 782 99 23
salvador.ruizbachs@allenovery.com

UK

Damian Carolan
Partner – London
Tel +44 20 3088 2495
damian.carolan@allenovery.com

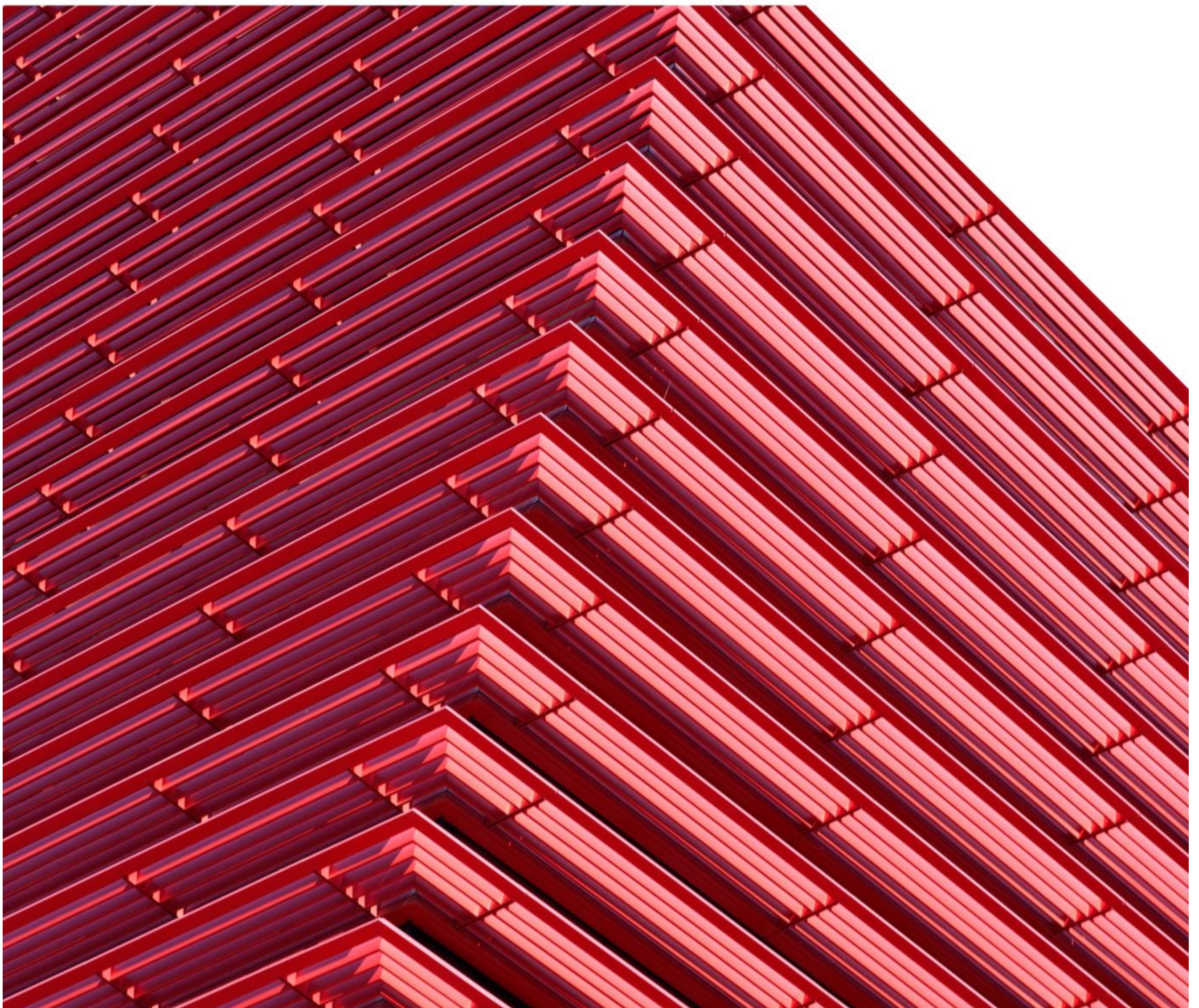
Nick Bradbury
Partner – London
Tel +44 20 3088 3279
nick.bradbury@allenovery.com

Bob Penn
Partner – London
Tel +44 20 3088 2582
bob.penn@allenovery.com

UK

Oonagh Harrison
Senior PSL – London
Tel +44 20 3088 3255
oonagh.harrison@allenovery.com

Stephen Curtis
Associate – London
Tel +44 20 3088 1389
stephen.curtis@allenovery.com



For more information please contact

London

Allen & Overy LLP
One Bishops Square
London
E1 6AD
United Kingdom

Tel +44 20 3088 0000
Fax +44 20 3088 0088

GLOBAL PRESENCE

Allen & Overy is an international legal practice with approximately 5,500 people, including some 550 partners, working in more than 40 offices worldwide. Allen & Overy LLP or an affiliated undertaking has an office in each of:

Abu Dhabi
Amsterdam
Antwerp
Bangkok
Barcelona
Beijing
Belfast
Bratislava
Brussels
Budapest
Casablanca
Dubai
Düsseldorf
Frankfurt
Hamburg
Hanoi
Ho Chi Minh City
Hong Kong
Istanbul
Jakarta (associated office)
Johannesburg
London
Luxembourg
Madrid
Milan
Moscow
Munich
New York
Paris
Perth
Prague
Rome
São Paulo
Seoul
Shanghai
Singapore
Sydney
Tokyo
Warsaw
Washington, D.C.
Yangon

Allen & Overy means Allen & Overy LLP and/or its affiliated undertakings. Allen & Overy LLP is a limited liability partnership registered in England and Wales with registered number OC306763. Allen & Overy (Holdings) Limited is a limited company registered in England and Wales with registered number 07462870. Allen & Overy LLP and Allen & Overy (Holdings) Limited are authorised and regulated by the Solicitors Regulation Authority of England and Wales.

The term **partner** is used to refer to a member of Allen & Overy LLP or a director of Allen & Overy (Holdings) Limited or, in either case, an employee or consultant with equivalent standing and qualifications or an individual with equivalent status in one of Allen & Overy LLP's affiliated undertakings. A list of the members of Allen & Overy LLP and of the non-members who are designated as partners, and a list of the directors of Allen & Overy (Holdings) Limited, is open to inspection at our registered office at One Bishops Square, London E1 6AD.

© Allen & Overy LLP 2020. This document is for general guidance only and does not constitute advice. | UKO1: 2002289406.1