

04/17 – Level 3 ESMA Q & As related to MiFID II/MiFIR

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ESMA published and updated in the last couple of days additional Level 3 Q&A papers. Due to the specification and clarification purposes of the Level 3 papers, this should help you during the implementation phase and could clarify open questions. Please find the relevant April 2017 Q&As below.

PwC provides you with this Newsletter an overview of the latest questions related to the following topics:

1. Transparency

- Best execution
- Inducements

2. Market Structure

- Direct Electronic Access (DEA) and algorithmic trading
- Multilateral and bilateral systems
 - i. Organised Trading Facilities (OTFs)
 - ii. Systematic internalisers and riskless transactions

3. Data Reporting

- Field 23 – Seniority of the Bond
- Business Case: Inflation Indexed Bond
- Transaction reporting

We are happy to discuss with you any thoughts and issues or are happy to review your solutions with regard to MiFID II and MiFIR.

Please do not hesitate to contact us.

1. MiFID II and MiFIR - transparency topics (4 April 2017 | ESMA35-43-349)

Link to the document:

https://www.esma.europa.eu/sites/default/files/library/esma35-43-349_mifid_ii_qas_on_investor_protection_topics.pdf

Topics:

Best execution

- Question 1 – How soon after MiFID II comes into effect will venues and firms have to publish RTS 27 and 28 reports?
- Question 2 – If portfolio managers or receivers and transmitters of orders use different entities within a single group to execute orders, should they list those entities separately, or aggregate them and list the group parent as a single entry for the purposes of the RTS 28 report that it is required to be published under Article 65(6) of the Delegated Regulation?
- Question 3 – Are eligible counterparty transactions to be included in the data required to be published by execution venues under RTS 27?

- Question 4 –
 - i. When an investment firm operates an OTF, at which level should the best execution policy be set?
 - ii. At the level of the investment firm or at the level of the OTF or both?
 - iii. Would similar requirements apply to a market operator operating an OTF?
- Question 5 – How should passive and aggressive orders be understood in the context of portfolio management or of reception and transmission of orders for the purposes of the RTS 28 report to be published under Article 65(6) of the Delegated Regulation?

Inducements

- Question 1 – Can the service of a third party arranging meetings with the management of a corporate issuer for an investment firm ('corporate access') be considered as research that can be paid for from an RPA under Article 13(1)(b) of the Delegated Directive, and if not, how should firms providing independent investment advice or portfolio management services treat such services?
- Question 2 – Can macro-economic analysis be considered research that can be paid for from an RPA and client research charges under Article 13(1)(b) of the Delegated Directive?
- Question 3 – How should research related to fixed income, currencies or commodities (FICC) be treated for the purposes of the MiFID II inducements restriction for firms providing portfolio management or independent investment advice (Article 24(7) and (8))?
- Question 4 – What approach should firms adopt to ensure that the allocation of their research budget to third party providers and the determination of the payments made from it are in the best interests of the firm's clients under Article 13(6)?
- Question 5 – How should the estimated client research charge disclosure be presented for the purposes of Article 13(1)(c)(i)?

2. MiFID II and MiFIR - market structures topics (5 April 2017 | ESMA70-872942901-38)

Link to the document:

https://www.esma.europa.eu/sites/default/files/library/mifid_ii_mifir_qa_on_market_structures_topics.pdf

Topics:

Direct Electronic Access (DEA) and algorithmic trading

- Question 1 – How should the identification and authorisation take place for those firms applying a High-Frequency Trading (HFT) technique?
- Question 2 – Given that the identification of HFT technique takes into account the previous twelve months of trading and that trading venues are only obliged to provide the data under Article 19 of Commission Delegated Regulation (EU) 2017/565 as of 3 January 2018, when the actual identification as high-frequency traders is expected to take place?
- Question 3 – Can DEA users be identified as applying a HFT technique?
- Question 4 – When would an investment firm using only algorithms which draw human traders' attention to trading opportunities qualify as engaged in algorithmic trading?

- Question 5 –
 - i. Does the MiFID II obligation relating to algorithmic trading apply to electronic OTC trading?
 - ii. Are algorithms that provide quotes/orders to customers subject to the requirements set out in MiFID II?
- Question 6 – Please explain what is meant by Article 17(3) of RTS 6 which requires investment firms to “reconcile” their own electronic logs with information about their outstanding orders and risk exposures as provided by the trading venues to which they send orders, their brokers or DEA providers, their clearing members or CCP, their data providers or other relevant business partners?
- Question 7 – Are firms required to store market data in order to fulfil the requirements contained in Article 13(7) of RTS 6 regarding the replay functionality of surveillance systems?
- Question 8 – Article 20 of Commission Delegated Regulation (EU) 2017/565 further clarifies the definition of direct electronic access as per Article 4(1)(41) of MiFID II by stating that persons shall be considered not capable of electronically transmitting orders relating to a financial instrument directly to a trading venue in accordance with Article 4(1)(41) of MiFID II where that person cannot exercise discretion regarding the exact fraction of a second of order entry and the lifetime of the order within that timeframe. What does “exercise discretion regarding the exact fraction of a second” mean?

Multilateral and bilateral systems

Organised Trading Facilities (OTFs)

- Question 1 –
 - i. What are the characteristics of an OTF?
 - ii. When is the authorisation for the operation of an OTF required?
- Question 2 – Does the concept of OTF apply to voice trading and, if yes, when an investment firm executing transactions through voice negotiation should be considered as falling under the definition of OTF?
- Question 3 – What distinguishes an OTF from an MTF?
- Question 4 – The operator of an OTF may engage in dealing on own account other than matched-principal trading only with regard to sovereign debt instruments that do not have a liquid market. (Article 20(3) of MiFID II. How should the liquidity of sovereign debt instruments be assessed?
- Question 5 – On what basis can a third party investment firm carry out market making on an OTF on an independent basis (cf. Article 20(5) of MiFID II)?
- Question 6 – Can an SI and an OTF be operated by the same legal entity when they do not trade the same instruments or class of instruments (e.g. an SI in equities and an OTF in derivatives)?
- Question 7 – Where an investment firm that is an SI has to set up a separate legal entity to operate an OTF (or vice-versa), can those two entities have shared resources?
- Question 8 – Under which conditions can an OTF connect to other liquidity pools such as an SI or another OTF?
- Question 9 –
 - i. When an investment firm operates an OTF, at which level should the best execution policy be set?
 - ii. At the level of the investment firm, at the level of the OTF or both?

- iii. Would similar requirements apply to a market operator operating an OTF?
- Question 10 – Does the exercise of any form of discretion mean that a venue is an OTF?
- Question 11 – Does discretion have to be exercised on an order by order basis?
- Question 12 – Does a fully automated system exclude the exercise of discretion and should therefore be automatically classified as an MTF?

Systematic internalisers and riskless transactions

- Question 1 – Recital 19 of the Commission Delegated Regulation (EU) 2017/565 clarifies the conditions under which an SI may engage in matched principal trading to execute client orders. To what extent can SIs engage in other types of riskless back-to-back transactions?
- Question 2 – Recital (19) of the Commission Delegated Regulation (EU) 2017/565 foresees that a SI can undertake matched principal trading provided it does so on an occasional, and not a regular, basis. How is “occasional basis” expected to be assessed?

3. MiFID II and MiFIR - MiFID II implementation / MiFIR data reporting (3 April 2017 | ESMA70-1861941480-56)

Link to the document:

https://www.esma.europa.eu/sites/default/files/library/esma70-1861941480-56_qas_mifir_data_reporting_o.pdf

Topics:

Field 23 – Seniority of the Bond

- Question 1 – Do the same standards apply to the character denoting seniority of a bond in field 3 and the attributes listed in field 23 (seniority of the bond) of RTS 23 of MiFIR?

Business Case: Inflation Indexed bond

- Question 1 – How should transactions on “inflation indexed bonds” be reported under RTS 22?

Transaction reporting

- Question 1 – Where the price of a transaction is not available at the time of execution (e.g. the NAV for certain ETFs), how can investment firms fulfil their post-trade transparency obligations under Articles 20 and 21 of MiFIR and their transaction reporting obligations under Article 26 of MiFIR for those transactions?
- Question 2 – How are different national identifiers specified in Annex II of RTS 22 represented?