European Securities and Markets Authority

# Consultation Paper

**MiFIR report on Systematic Internalisers in non-equity instruments**

3 February 2020 | ESMA70-156-1757

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## Responding to this paper

ESMA invites comments on all matters in this paper and in particular on the specific questions summarised in Annex 1. Comments are most helpful if they:

1. respond to the question stated;
2. indicate the specific question to which the comment relates;
3. contain a clear rationale; and
4. describe any alternatives ESMA should consider.

ESMA will consider all comments received by **18 March 2020.**

All contributions should be submitted online at www.esma.europa.eu under the heading 'Your input – Open Consultations'.

### Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESMA's rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESMA's Board of Appeal and the European Ombudsman.

### Data protection

Information on data protection can be found at www.esma.europa.eu under the heading 'Data protection'.

### Who should read this paper?

This paper is of interest mainly to systematic internalisers active in non-equity instruments as well as clients of such systematic internalisers, and any associations representing their interest.

# Table of Contents

## Acronyms and definitions used

| | |
|---|---|
| APA | Approved Publication Arrangement |
| CP | Consultation Paper |
| EC | European Commission |
| EU | European Union |
| ESMA | European Securities and Markets Authority |
| FIRDS | Financial Instruments Reference Data System |
| FITRS | Financial Instruments Transparency System |
| MiFID II | Markets in Financial Instruments Directive (recast) - Directive 2014/65 of the European Parliament and of the Council |
| MiFIR | Markets in Financial Instruments Regulation – Regulation 600/2014 of the European Parliament and of the Council |
| NCA | National Competent Authority |
| Q&A | Question and answer |
| RTS | Regulatory Technical Standard |
| RTS 1 | Commission Delegated Regulation (EU) 2017/587 of 14 July on transparency requirements for trading venues and investment firms in respect of shares, depositary receipts, exchange-traded funds, certificates and other similar financial instruments and on transaction execution obligations in respect of certain shares on a trading venue or by a systematic internaliser |
| RTS 2 | Commission Delegated Regulation (EU) 2017/583 of 14 July on transparency requirements for trading venues and investment firms in respect of bonds, structured finance products, emission allowances and derivatives |
| RTS 8 | Commission Delegated Regulation (EU) 2017/578 of 13 June 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards specifying the requirements on market making agreements and schemes |
| RTS 27 | Commission Delegated Regulation (EU) 2017/575 of 8 June 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards concerning the data to be published by execution venues on the quality of execution of transactions |
| SI | Systematic Internaliser |
| SSTI | Size Specific to the Instrument |
| ToTV | Traded on a trading venue |

# 1 Executive Summary

## Reasons for publication

Under MiFIR, competent authorities and ESMA shall monitor the application of the pre-trade transparency obligations applicable to systematic internalisers in respect of bonds, structured finance products, emission allowances and derivatives (non-equity instruments). This monitoring shall focus on the sizes at which quotes are made available to clients of the investment firm and to other market participants relative to other trading activity of the firm, and the degree to which the quotes reflect prevailing market conditions. Based on this monitoring, ESMA shall submit a report to the European Commission. This Consultation Paper intends to collect stakeholders view on the findings and proposals that ESMA is proposing to include in this report.

## Contents

Section 3 explains the legal framework and presents an overview of European SIs. It also provides an assessment of the effectiveness of the regime for SIs on liquid and illiquid instruments and exposes preliminary recommendations to address possible inefficiencies. Section 4 provides the outcome of the quantitative monitoring of sizes at which quotes are made available to clients and other market participants. The Annexes include a summary of the questions, the legal mandate and further information regarding the data used to perform the monitoring.

## Next Steps

ESMA will consider the feedback it received to this consultation and expects to publish a final report and submit it to the European Commission by July 2020.

# 2 Introduction

1. Systematic Internalisers (SIs) are subject to the obligation to make public firm quotes, subject to certain conditions, both in respect of equity instruments and non-equity instruments. While for equity instruments, the MiFIR provisions are further specified via a Commission Delegated Regulation[1], there are no equivalent Level 2 measures for non-equity instruments.

2. However, the application of the transparency provisions, which apply to SIs dealing in non-equity instruments, are to be monitored by competent authorities (CAs) and ESMA as specified in Article 19(1) of MiFIR. Based on such monitoring, ESMA should submit a report to the European Commission by 3 July 2020[2].

3. This consultation paper (CP) seeks stakeholders' views on the findings and proposals that ESMA is proposing to include in this report. Based on the feedback received, ESMA will prepare its final report for submission to the EC.

# 3 Pre-trade transparency obligations for SIs in respect of non-equity

## 3.1 Legal framework

4. As part of the MiFIR objective of achieving greater transparency through the introduction of a pre- and post-trade transparency regime for non-equities, Article 18 of MiFIR sets out specific pre-trade transparency requirements for SIs. Those requirements, which differ substantially from the requirements to be met by SIs in respect of equity instruments, strike a delicate balance between the objective of ensuring meaningful pre-trade transparency in non-equity instruments whilst limiting the risks SIs may be faced with when trading against their proprietary capital for the execution of client orders. This results in rather complex provisions and ESMA had to publish various Q&As to further clarify how those obligations are expected to be met by non-equity SIs.

5. Under Article 18(1) of MiFIR, investment firms have to make public firm quotes in respect of bonds, structured finance products, emission allowances and derivatives ("non-equity instruments") traded on a trading venue for which they are SIs and for which there is a liquid market when

— they are prompted for a quote by the client of the systematic internaliser; and

[1] Commission Delegated Regulation (EU) 2017/587 of 14 July on transparency requirements for trading venues and investment firms in respect of shares, depositary receipts, exchange-traded funds, certificates and other similar financial instruments and on transaction execution obligations in respect of certain shares on a trading venue or by a systematic internaliser (OJ L 87, 31.3.2017, p. 387.) ("RTS 1")

[2] The deadline set in the regulation (3 January 2020) has been modified to 3 July 2020 following an agreement between the European Commission and ESMA on the overall planning for the MiFID II/MiFIR review reports (see letter ESMA70-156-907 dated 16 January 2019)

— they agree to provide a quote.

6. When the non-equity instrument does not have a liquid market, SIs are required to disclose quotes to their clients on request if they agree to provide a quote. This is without prejudice to the possibility for SIs to benefit from a waiver for this obligation where, as set out in the last sentence of Article 18(2) of MiFIR, the conditions in Article 9(1) of MiFIR are met.

7. In order to limit the market risk they may be faced with, SIs may update their quotes at any time. They may also withdraw their quotes under exceptional market conditions. Furthermore, the quoting obligations in relation to non-equity instruments with a liquid market are suspended where the liquidity of a class of instruments falls below a certain threshold and the CA of the trading venue where that class of instruments is traded temporarily suspends pre-trade transparency obligations on that venue in accordance with Article 9(4) of MiFIR.

8. To ensure that the pre-trade transparency provided relates to available liquidity, Article 18(5) of MiFIR sets out that the firm quotes published by SIs in relation to liquid instruments must be made available to the other clients of the concerned SI. However, to limit the risks they may face, including credit, counterparty or settlement risks, SIs may decide, on the basis of their commercial policy and in an objective and non-discriminatory way, the clients to whom they give access to those quotes. Likewise, SIs are required to enter into transactions under the published conditions with the other clients to whom the quote is made available.

9. The requirements for SIs in relation to liquid instruments are illustrated in a diagram available in Question 9 of Section 7 of the ESMA Q&A on MiFID II / MiFIR transparency topics[3] and reproduced below (Diagram 1).

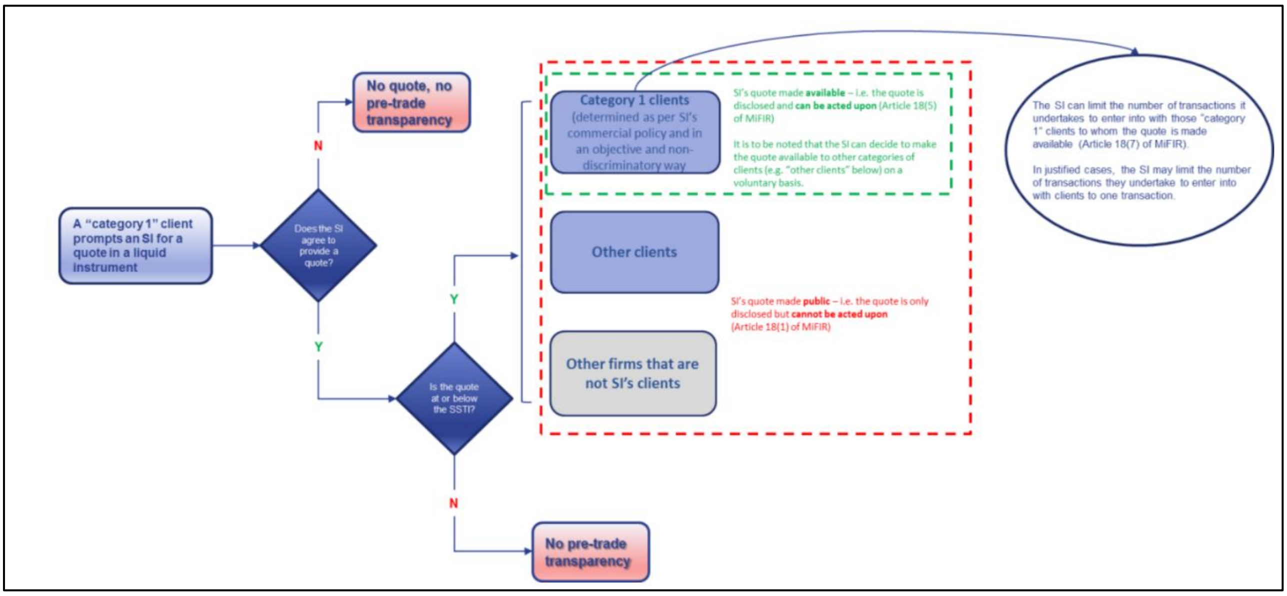


**Diagram 1: SIs obligation in relation to liquid non-equity instruments**

[3] Questions and Answers on MiFID II and MiFIR transparency topics (ESMA70-872942901-35)

10. In addition, and to put a cap on the amount of capital an SI may have to put at risk for the execution of client orders when publishing a quote, Article 18(7) of MiFIR sets out that SIs may establish non-discriminatory and transparent limits on the number of transactions they undertake to enter into with clients pursuant to any given quote.

11. The quotes published by an SI in relation to liquid instruments must be published in a manner that is accessible to other market participants on a reasonable commercial basis. Articles 6 to 11 of Commission Delegated Regulation (EU) 2017/567[4] further specify the obligations to be met by SIs to comply with the “reasonable commercial basis” requirements. The “reasonable commercial basis” obligations for SIs are the same as the ones applying to market operators and investment firms operating a trading venue.

12. The prices quoted must allow the SI to comply with its best execution obligations, where applicable. They also have to reflect prevailing market conditions, i.e. the prices at which transactions are concluded for the same or similar financial instruments on a trading venue. However, in justified cases, SIs may execute orders at a better price provided that the price falls within a public range close to market conditions

13. SIs have no pre-trade transparency obligations when they deal in sizes above the SSTI.

14. Possibly due to the conflicting objectives of increasing pre-trade transparency whilst limiting the risks that SIs may incur when putting their capital at risk to execute client orders, the Level 1 provisions governing pre-trade transparency obligations for SIs appear somewhat complex and sometimes difficult to understand. In the absence of Level 2 measures and in response to the many interpretation questions received from CAs and market participants, ESMA issued various Q&As aiming at enhancing supervisory convergence in the implementation of those pre-trade obligations.

15. The first set of clarifications provided by ESMA deals with publication arrangements and the information to be disclosed. Article 18(8) of MiFIR requires the SI quotes to be “made public in a manner which is easily accessible to other market participants”. However, by contrast with Article 13 of the Commission Delegated Regulation (EU) No 2017/567 that specifies how SIs should make their quotes public and easily accessible for equity instruments, there are no corresponding provisions on the publication arrangements for non-equity SIs.

16. ESMA therefore clarified that SIs should use the same means and arrangements when publishing firm quotes in non-equity instruments as for equity instruments. This includes requiring SIs to disclose their identity in the quotes when the quotes are made public through the arrangements of a trading venue or an Approved Publication Arrangement (APA). Furthermore, the quotes should be made public in a machine-readable format as specified in Commission Delegated Regulation (EU) No 2017/567 and the quotes should be time-stamped as specified in Article 9(d) of RTS 1.

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[4] Commission Delegated Regulation (EU) 2017/567 of 18 May 2016 supplementing Regulation (EU) No 600/2014 of the European Parliament and of the Council with regards to definitions, transparency, portfolio compression and supervisory measures on product intervention and positions (OJ L 87, 31.3.2017, p. 90–116).

17. The other set of clarifications provided relates to the circumstances when a quote published by an SI can be acted upon. ESMA clarified that although an SI may update its quotes at any time, the quote should remain valid for a reasonable period of time so as to allow clients to trade against them. Further guidance has been provided on the potential limitation of clients that may have access to, i.e. that can trade against, the SI quote under the SI commercial policy. ESMA also noted that, whilst SIs may limit the number of transactions they undertake to enter into with clients under Article 18(7) of MiFIR to one transaction, any such limits should be made public and be justified.

## 3.2 Overview of European non-equity SIs

### 3.2.1 European non-equity SIs on the basis of ESMA's register

18. In accordance with Article 18(4) of MiFIR, firms that meet the definition of a SI shall notify their NCAs, and such notification shall be transmitted to ESMA. On that basis, ESMA shall establish a list of all systematic internalisers in the Union. ESMA is fulfilling this obligation via the ESMA register, under the section MiFID/UCITS/AIFMD entities.

19. The list of SIs is available for download in csv format with a set of reference data associated with each SI. Additional information on the types of instruments for which each entity is an SI is also available, at the granularity of the MiFIR identifier[5].

20. Based on this register, the number of SIs active in non-equity instruments (NEQ) is significantly larger than the number of SIs active in equity instruments (EQU) (see Table 1). One additional observation is that SIs tend to specialise in either equity (EQU) or non-equity (NEQ), with only about 25% of SIs being active in both EQU and NEQ.

| | Number of SI (MIC code) |
|---|---|
| Active in both | 59 |
| Active in NEQ only | 139 |
| Active in EQU only | 29 |
| **Grand Total** | **227** |

**Table 1: Overview of European SIs in equity and non-equity (source: ESMA register as of 7 January 2020)**

21. Zooming in on the SIs active in NEQ, there were around 200 SIs registered with ESMA, with the vast majority active in bonds (Table 2). In general, SIs tend to be active in a small number of different asset classes, with more than half of them active in only one asset class, and more than 80% active in one, two or three asset-classes (Table 3).

[5] i.e., for non-equity instruments: Securitised derivatives, Structured Finance Products, Bonds, ETCs, ETNs, Emission Allowances and Derivatives

| | Unique SI (non-equity) | Bonds | Derivatives | Emission Allowances | ETCs | ETNs | Securitised Derivatives | SFPS | Grand Total |
|---|---|---|---|---|---|---|---|---|---|
| AUSTRIA | 7 | 6 | | | | | 1 | | 14 |
| BELGIUM | 4 | 3 | 2 | | | | 1 | | 10 |
| CYPRUS | 4 | 4 | | | | | | 1 | 9 |
| CZECH REPUBLIC | 3 | 3 | | | | | | | 6 |
| DENMARK | 7 | 7 | 2 | | | | | | 16 |
| FINLAND | 3 | 3 | 1 | | | | | | 7 |
| FRANCE | 15 | 11 | 10 | 1 | 5 | 5 | 6 | 6 | 59 |
| GERMANY | 37 | 31 | 19 | 7 | 15 | 15 | 17 | 17 | 158 |
| GREECE | 2 | 2 | | | | | | | 4 |
| HUNGARY | 7 | 7 | 1 | | | | | | 15 |
| IRELAND | 5 | 5 | 2 | | 2 | 2 | 2 | 2 | 20 |
| ITALY | 12 | 11 | 1 | | | | | | 24 |
| LATVIA | 1 | 1 | | | | | | | 2 |
| LIECHTENSTEIN | 3 | | 3 | | | | | | 6 |
| LUXEMBOURG | 2 | | 2 | | | | | | 4 |
| NETHERLANDS | 6 | 5 | 4 | | 1 | | 2 | 1 | 19 |
| NORWAY | 3 | 3 | 1 | | | | | | 7 |
| POLAND | 8 | 8 | | | | | | | 16 |
| ROMANIA | 1 | 1 | | | | | | | 2 |
| SLOVAKIA | 1 | 1 | | | | | | | 2 |
| SPAIN | 5 | 5 | 2 | | | | 1 | 1 | 14 |
| SWEDEN | 4 | 4 | 4 | 1 | 1 | 1 | 2 | 1 | 18 |
| UNITED KINGDOM | 58 | 45 | 42 | 4 | 9 | 8 | 13 | 18 | 197 |
| **Grand Total** | **198** | **166** | **96** | **13** | **33** | **31** | **45** | **47** | **629** |

**Table 2: Overview of European SIs in non-equity instruments, per country and asset class (source: ESMA register as of 7 January 2020)**

| | Number of SI (MIC Code) | As % of total |
|---|---|---|
| Active in 1 asset-class(es) | **115** | **58%** |
| Active in 2 asset-class(es) | **27** | **14%** |
| Active in 3 asset-class(es) | **20** | **10%** |
| Active in 4 asset-class(es) | **11** | **6%** |
| Active in 5 asset-class(es) | **1** | **1%** |
| Active in 6 asset-class(es) | **11** | **6%** |
| Active in 7 asset-class(es) | **13** | **7%** |
| **Grand Total** | **198** | **100%** |

**Table 3: European SIs in non-equity instruments, per number of available asset class (source: ESMA register as of 7 January 2020)**

### 3.2.2 SI opting-in under the SI regime

22. Many stakeholders have reported that a significant number of investment firms have decided to voluntarily opt-in under the SI regime as contemplated in Article 4(1)(20) of MiFID II, rather than becoming SIs as a result of the assessment per the relevant Articles of Commission Delegated Regulation (EU) No 2017/565[6]. This assertion is confirmed by a number of SIs having made that information public on their website, as well as a survey performed by ESMA in November 2019 (covering 40 SIs). Two thirds of the investment firms responding to the survey have opted-in under the SI regime either exclusively (59%) or in combination with performing the SI calculation for specific asset-classes (10%) (Figure 1).

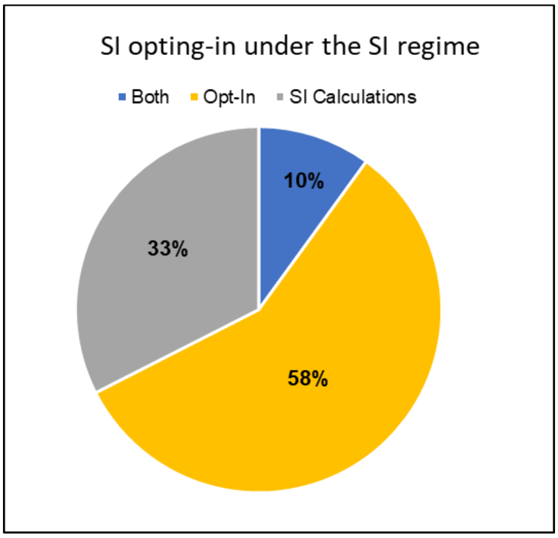


**Figure 1: SI opting-in under the SI regime (source: SIs survey November 2019)**

23. The reason underlying the decision to opt-in appears to be linked to the post-trade obligations for OTC transactions under Article 7 of RTS 2. In general, where a transaction between two investment firms is concluded OTC, only the seller shall make the transaction public through an APA. However, where one of the parties to the transaction is a SI, this reporting obligation to the APA is to be fulfilled by the SI only. This appears to have prompted numerous investment firms to opt-in under the SI regime as a response to clients requests eager to delegate their APA post-trade reporting to such investment firms.

## 3.3 ESMA's assessment of pre-trade transparency obligations for SIs

24. Given that the pre-trade transparency requirements in respect of liquid and illiquid instruments are different, the assessment of the regimes are presented in two distinct sections below. The ad-hoc data collection exercise performed by ESMA ("ad-hoc SI data" thereafter) includes a segmentation of quoted and traded volumes depending on the

[6] Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive (*OJ L 87, 31.3.2017, p. 1–83*)

liquidity status of the instrument and provides an estimation of the SI volumes that would be covered by the obligations for liquid and illiquid instruments respectively. Those figures help to form an idea of the relevance of each provision (for liquid and illiquid instruments) depending on the asset class.

25. For bonds, quoting activity is balanced between liquid and illiquid instruments while trading activity mainly takes place on liquid instruments (see Table 4 to Table 7). This tends to indicate that despite the low number of liquid bonds in absolute terms, the volumes that they represent is significant, pointing to a reasonable discrimination between liquid and illiquid bonds as per the RTS 2 determination.

26. In relation to derivatives, most sub-classes of equity derivatives, and all securitised derivatives, are deemed to have a liquid market as per the static determination, while all FX derivatives are deemed not to have a liquid market as per the static determination (Article 13(1)(a) of RTS 2), which explains the dichotomic breakdown between liquid and illiquid instruments in those classes.

27. Finally, for the remaining classes of derivatives with coexistent liquid and illiquid instruments (credit and interest rate derivatives), the large majority of quoted and traded volume reported in the ad-hoc SI data was on illiquid instruments. This could be explained by (1) the small number of instruments that would classify as liquid at the moment; and/or (2) the activity on liquid instruments being mainly done on multilateral trading venues in application of the derivatives trading obligation.

| | Bonds excl. ETC and ETN | ETC/ETN | Credit derivatives | Equity derivatives | FX derivatives | Interest rate derivatives | Securitised derivatives | Structured finance products |
|---|---|---|---|---|---|---|---|---|
| LIQUID | 48.7% | 18.5% | 13.1% | 95.6% | 0.0% | 2.9% | 100.0% | 0.0% |
| ILLIQUID | 51.3% | 81.5% | 86.9% | 4.4% | 100.0% | 97.1% | 0.0% | 100.0% |
| **Grand Total** | **100.0%** | **100.0%** | **100.0%** | **100.0%** | **100.0%** | **100.0%** | **100.0%** | **100.0%** |

**Table 4: Quoted volumes based on liquidity - per asset class (source: ESMA based on ad-hoc SI data June 2019)**

| | Bonds excl. ETC and ETN | ETC/ETN | Credit derivatives | Equity derivatives | FX derivatives | Interest rate derivatives | Securitised derivatives | Structured finance products |
|---|---|---|---|---|---|---|---|---|
| LIQUID | 81.7% | 0.6% | 10.3% | 95.0% | 0.0% | 4.7% | 100.0% | 0.0% |
| ILLIQUID | 18.3% | 99.4% | 89.7% | 5.0% | 100.0% | 95.3% | 0.0% | 100.0% |
| **Grand Total** | **100.0%** | **100.0%** | **100.0%** | **100.0%** | **100.0%** | **100.0%** | **100.0%** | **100.0%** |

**Table 5: Traded volumes based on liquidity - per asset class (source: ESMA based on ad-hoc SI data June 2019)**

| | Bonds excl. ETC and ETN | ETC/ETN | Credit derivatives | Equity derivatives | FX derivatives | Interest rate derivatives | Securitised derivatives | Structured finance products |
|---|---|---|---|---|---|---|---|---|
| LIQUID | 25.3% | 63.0% | 12.2% | 94.7% | 0.0% | 3.4% | 100.0% | 0.0% |
| ILLIQUID | 74.7% | 37.0% | 87.8% | 5.3% | 100.0% | 96.6% | 0.0% | 100.0% |
| **Grand Total** | **100.0%** | **100.0%** | **100.0%** | **100.0%** | **100.0%** | **100.0%** | **100.0%** | **100.0%** |

**Table 6: Number of quotes based on liquidity - per asset class (source: ESMA based on ad-hoc SI data June 2019)**

| | Bonds excl. ETC and ETN | ETC/ETN | Credit derivatives | Equity derivatives | FX derivatives | Interest rate derivatives | Securitised derivatives | Structured finance products |
|---|---|---|---|---|---|---|---|---|
| LIQUID | 55.2% | 10.5% | 16.7% | 99.1% | 0.0% | 22.2% | 100.0% | 0.0% |
| ILLIQUID | 44.8% | 89.5% | 83.3% | 0.9% | 100.0% | 77.8% | 0.0% | 100.0% |
| **Grand Total** | **100.0%** | **100.0%** | **100.0%** | **100.0%** | **100.0%** | **100.0%** | **100.0%** | **100.0%** |

**Table 7: Number of trades based on liquidity - per asset class (source: ESMA based on ad-hoc SI data June 2019)**

### 3.3.1 Effectiveness of the regime for liquid instruments

28. Notwithstanding ESMA's Q&As, the pre-trade transparency regime for liquid instruments appears to leave quite some room for discretion to SIs in the way they implement their pre-trade transparency obligations, hence potentially challenging the effectiveness of the requirements set out in MiFIR. Here again, a random check of publicly available non-equity SIs' commercial policies shows the variety of arrangements put in place.

29. Whilst the commercial policies checked typically refer to the publication of "firm quotes" as stated in Article 18(1) of MiFIR without further elaboration, one commercial policy provides a definition of a firm quote, stating that "*Firms quotes are executable prices provided by a SI on a given financial instrument that guarantees a bid or ask price up to the amount quoted, without negotiation. Indicative quotes that are not actionable are not firm quotes and therefore are not published or otherwise communicated to clients other than the client for which it is intended*".

30. This interpretation entails that when a SI is prompted for a quote by a client, and when there are multiple interactions between the client and the SI before the SI comes up with a price that both parties understand to be the final one, only that final price will be made public. It is also worth noting that the SI may not know whether the quote provided is the final one until the client agrees to trade on that quote, which means that pre-trade transparency will be made available almost at the same time as post-trade transparency.

**Q 1: Do you consider that there is a need to clarify what a "firm quote" is? If so, in your view, what are the characteristics to be met by such quote?**

31. With regards to access to quotes, and beyond the criteria related to credit status, counterparty risk and final settlement set out in Article 18(5) of MiFIR, SIs' commercial policies include various other factors or criteria to deny access to their quotes. Those other factors may for instance include the regulatory status of the client (e.g. a SI in the relevant non-equity instrument to which the published quote relates will be denied access to the quote) or the trading type (e.g. whether the counterparties are trading via algorithm). One SI states that it may refuse access to its quotes to clients when "such execution would have a material adverse impact on market prices". Client tiering for access to quotes may include factors such as volume of trades or client profitability for the SI.

32. With regards to the number of transactions that SIs undertake to execute at the published quote, most of the commercial policies reviewed restrict execution to one transaction or to quoted size in case of partial first execution making de facto the liquidity not addressable to any other client. Some commercial policies refer to the SI's discretion to decide whether to agree to execute more than one transaction at the quoted price.

33. As all-in prices are published, commercial policies provide warning on potential price adjustments when the counterparty to the transaction would not be the client that requested the quote. Alternatively, access may be denied for instance for non-cleared derivatives in case a "material" XVA- would be required.

34. Commercial policies also differ by the details provided on the exceptional market conditions under which circumstances the SI considers it may withdraw quotes, one end of the spectrum being a long list setting out those exceptional market conditions and the other end the absence of any elaboration of those market conditions.

**Q 2: (For SI clients) As a SI client, do you have easy access to the quotes published, i.e. can you potentially trade against those quotes when you are not the requestor? Do you happen to trade against SIs quotes when you are not the initial requestor? How often? If it varies across asset classes, please explain.**

**Q 3: What is your overall assessment of the pre-trade transparency provided by SIs in liquid non-equity instruments? Do you have any suggestion to amend the existing pre-trade transparency obligations? If so, please explain which ones and why.**

### 3.3.2 Effectiveness of the regime for illiquid instruments

35. Assessing the effectiveness of the pre-trade transparency regime for SIs in illiquid instruments is a difficult exercise as the quotes are not subject to publication or reporting requirements. Likewise, there is no public information on the number of clients that have requested to have access to the SI quotes, either on a systematic or on an on-request basis.

36. In addition, whilst the requirement to disclose the quote to other clients upon request may be waived when the conditions for granting a pre-trade transparency waiver to the trading venue where the illiquid instrument is traded are met, the procedure for waiving the SIs' obligations varies across Member States.

37. In some jurisdictions, the SI has to formally apply for a waiver with its CA. In some others, once the waiver for illiquid instruments has been granted to a trading venue, the waiver is automatically extended to SIs in those instruments. There is therefore no clear picture within easy reach of SIs that avail themselves of the pre-trade transparency waiver for illiquid instruments. A sample check of some SIs' commercial policies publicly available does however tend to suggest that most of them are operating under the pre-trade transparency waiver for illiquid instruments.

38. This assumption is further confirmed by the ad-hoc SI data. The dataset provided by SIs includes a segmentation of quoted and traded volumes depending on whether a waiver

has been granted, which provides an estimation of the SI volumes that would be covered by the obligations under Article 18(2) and those for which those obligations are waived.

39. Those figures are provided in Table 8 and Table 9 below, only for the asset classes where all or some instruments do not have a liquid market as explained in paragraph 25. This data suggests that, in all asset classes, the very large majority of trading and quoting activity in illiquid instruments (if not all of it) is performed under the waiver provided in Article 18(2).

| | Bonds excl. ETC and ETN | ETC/ETN | Credit derivatives | FX derivatives | Interest rate derivatives | Structured finance products |
|---|---|---|---|---|---|---|
| NO WAIVER | 16.2% | 0.0% | 7.2% | 0.0% | 0.4% | 0.0% |
| WAIVER | 83.8% | 100.0% | 92.8% | 100.0% | 99.6% | 100.0% |
| **Grand Total** | **100.0%** | **100.0%** | **100.0%** | **100.0%** | **100.0%** | **100.0%** |

**Table 8: Breakdown of quoted volumes based on waiver - per asset class (source: ESMA based on ad-hoc SI data June 2019)**

| | Bonds excl. ETC and ETN | ETC/ETN | Credit derivatives | FX derivatives | Interest rate derivatives | Structured finance products |
|---|---|---|---|---|---|---|
| NO WAIVER | 27.5% | 0.0% | 12.5% | 0.0% | 1.2% | 0.0% |
| WAIVER | 72.5% | 100.0% | 87.5% | 100.0% | 98.8% | 100.0% |
| **Grand Total** | **100.0%** | **100.0%** | **100.0%** | **100.0%** | **100.0%** | **100.0%** |

**Table 9: Breakdown of traded volumes based on waiver - per asset class (source: ESMA based on ad-hoc SI data June 2019)**

**Q 4: (For SI clients) do you have access to quotes in illiquid instruments? If so, how often do you request access to those quotes? What is your assessment of the pre-trade transparency provided by SIs in illiquid instruments?**

**Q 5: (For SIs) Do you disclose quotes in illiquid instruments to clients upon request or do you operate under a pre-trade transparency waiver? In the former case, how often are you requested to disclose quotes (rarely, often, very often)? Does it vary across instruments / asset classes?**

### 3.3.3 Level playing field with trading venues

40. Since the MiFID II/MiFIR application start date, the potential unlevel playing field between SIs and multilateral trading venues has been a recurrent theme. Concerns have been expressed by some stakeholders that the build-up of some SIs' activity, including via a network of SIs, results in some SIs operating de facto as multilateral systems without being subject to similar authorisation and operating requirements.

41. On the one hand, concerns have also been expressed that the SIs' quoting obligations and related transparency requirements are less demanding than those applicable to trading venues, thereby creating an incentive for market participants to move trading on such bilateral systems.

42. On the other hand, one would note that pre-trade transparency is provided by trading venues on an anonymous basis, i.e. without disclosing the identity of members or participants whereas SIs have to disclose their identity when the quotes are made public through the arrangements of a trading venue or an APA and SIs are putting their own capital at risk.

**Q 6: Do you consider that there is an unlevel playing field between SIs and multilateral trading venues active in non-equity instruments, in particular with respect to pre-trade transparency? If so, please explain why and suggest potential remedies.**

**Q 7 (for SIs who are also providing liquidity on trading venues): What are the key factors that determine whether quote requesters (your clients) want to receive the quote through the facilities of a trading venue or through your own bilateral trading facilities?**

## 3.4 Preliminary recommendations

### 3.4.1 Simplify the requirements for SI quotes in liquid instruments

43. In spite of the quote access limitation set out in Article 18(7)[7], the wording of the first paragraph of Article 18(6)[8] tends to suggest that the intention of the co-legislators was that a firm quote published by a SI was to reflect somewhat broadly available liquidity.

44. However, and as noted in paragraph 32, common practice across SIs appears to restrict the commitment to trade on the quote published to one client except where the initial quote would be partially executed with the initial requesting client and the remaining volume with another client.

45. Taking into consideration the fact that dealers on trading venues do not have to commit to trade multiple times on a displayed quote, there seems to be little ground to require SIs to be subject to more stringent requirements and be required to enter into transactions with multiple clients under each quote published. It is therefore suggested to simplify the SI pre-trade transparency obligations for liquid instruments by deleting:

- the first paragraph of Article 18(6) i.e. "Systematic internalisers shall undertake to enter into transactions under the published conditions with any other client to whom the quote is made available in accordance with paragraph 5 when the quoted size is at or below the size specific to the financial instrument determined in accordance with Article 9(5)(d)"; and
- Article 18(7) i.e. "Systematic internalisers shall be allowed to establish non-discriminatory and transparent limits on the number of transactions they undertake to enter into with clients pursuant to any given quote."

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[7] "Systematic internalisers shall be allowed to establish non-discriminatory and transparent limits on the number of transactions they undertake to enter into with clients pursuant to any given quote."
[8] "Systematic internalisers shall undertake to enter into transactions under the published conditions with any other client to whom the quote is made available in accordance with paragraph 5 when the quoted size is at or below the size specific to the financial instrument determined in accordance with Article 9(5)(d)."

46. As a result, SIs would only be required to trade on the published quote with the requesting client and would have discretion to trade with other clients on a case by case basis.

**Q 8: What is your view on the proposal to simplify the requirements in relation to SI quotes in liquid non-equity instruments under Article 16(6) and 18(7)?**

### 3.4.2 Simplify the requirements for SI quotes in illiquid instruments

47. The pre-trade transparency regime applicable to SIs in relation to non-equity instruments for which there is not a liquid market appears to be overly complex in comparison to the delivered outcome. In practice, as evidenced by the ad-hoc SI data and the magnitude of quoted volumes provided under a pre-trade transparency waiver, it would appear that the obligation to "disclose quotes to clients on request" is hardly ever applied.

48. One option to address this situation would be to re-enforce the requirements in respect of illiquid non-equity instruments to make sure that there is genuine pre-trade transparency and apply Article 18(1) (obligation to make public firm quotes) to both liquid and illiquid instruments. To level the playing field with trading venues where a waiver is available for illiquid instruments, it would be necessary to introduce a waiver for illiquid instruments, if the conditions of Article 9(1)(c) (i.e. the illiquid waiver) are met.

49. But similar to the present situation, this construction appears circular, complex and suboptimal, with also possible inconsistent application across the EU: the only cases where Article 18(1) would apply to illiquid instruments would be when a CA decides not to grant the illiquid waiver.

50. An alternative option would be to remove the obligation to "disclose quotes to clients on request" for illiquid non-equity instruments (i.e. to delete Article 18(2)). Arguably, with possibly the exception of bonds, there would be little difference in outcome to the current situation as this would merely remove an obligation that is almost always waived. SIs would continue to have the possibility to publish quotes on a voluntary basis. Indeed, according to a survey performed by ESMA in November 2019 (covering 40 SIs), 30% of the firms responded that they regularly or occasionally publish quotes on a voluntary basis.

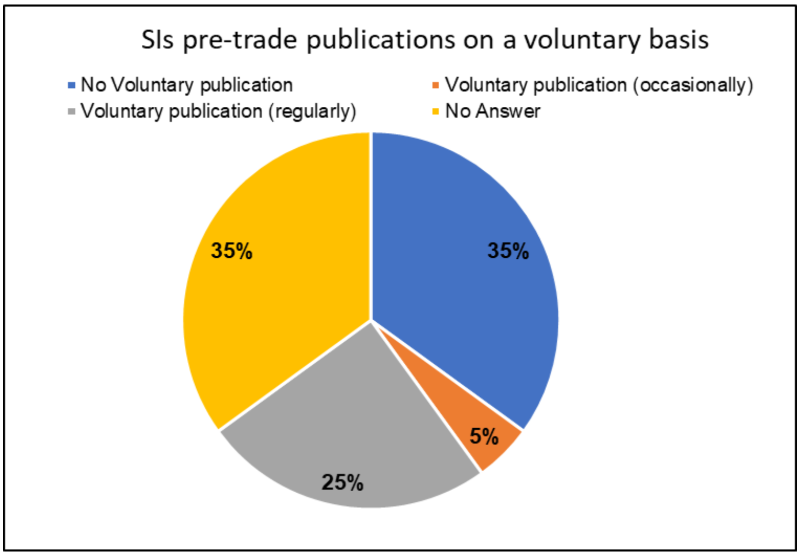

**Figure 2: SIs pre-trade publications on a voluntary basis**

51. In addition, to ensure a consistent application of Article 18(1) without creating a fully-fledged "waiver" process for SIs (i.e. similar to the one for trading venues), ESMA could foster supervisory convergence via e.g. drafting a template questionnaire in relation to SIs' procedures to determine which quotes are subject to Article 18(1) (i.e. liquid above SSTI) and which are not, on the basis of which NCAs could undertake the necessary follow-up actions with SIs under their supervision, as appropriate. The objective of such workstream would be to maintain a level of monitoring on the way in which SIs are classifying instruments as liquid, but in a simpler form compared to the one envisaged for trading venues under Article 9(2) of MiFIR.

52. To summarise, ESMA is presenting the following options with a preference for Option 3:

- Option 1: status quo (do nothing);

- Option 2: Article 18(1) applies to both liquid and illiquid instruments and includes a waiver;

- Option 3: Article 18(2) is deleted and ESMA develops ad-hoc supervisory convergence tools for SIs as described in paragraph 51.

**Q 9: Do you consider that the requirements in relation to SI quotes in illiquid non-equity instruments (Article 18(2)) are appropriate? What is your preference between the options presented in paragraph 52 (please justify)?**

### 3.4.3 Define exceptional market circumstances

53. To foster a more convergent application of SIs' pre-trade transparency obligations, ESMA considers that there would be merit in developing a shared understanding of the exceptional market conditions under which SIs may withdraw quotes in Level 2. As a preliminary view, ESMA considers that such exceptional market conditions should be consistent with the ones set out in Article 3 of Commission Delegated Regulation (EU) 2017/578[9] (RTS 8) for suspending investment firms' market making obligations on trading venues.

54. Exceptional market circumstances under which an SI may withdraw quotes in liquid instruments would thus 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 in relation to regulatory capital, margining and access to clearing, and (iii) the inability to hedge a position due to a short selling ban.

[9] Commission Delegated Regulation (EU) 2017/578 of 13 June 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards specifying the requirements on market making agreements and schemes (*OJ L 87, 31.3.2017, p. 183–188*)

### 3.4.4 Harmonise the pre-trade transparency data

55. ESMA notes that whilst Annex II of RTS 2 provides for the details of non-equity transactions to be made public (symbols and list of details), no such details are provided with regards to pre-trade transparency. To improve the usefulness and comparability of the quotes published by SIs, it is proposed that the Level 1 text is amended to mandate ESMA to develop draft RTS to specify the content and format of the pre-trade transparency information to be made public for non-equity instruments.

56. As this pre-trade transparency data harmonisation would not be limited to SIs' quoting obligations but would also apply to trading venues' pre-trade transparency, ESMA's proposal will be further developed in the Consultation Paper on MiFIR Transparency for non-equity instruments ("the CP on non-equity Transparency") to be published in Q1 2020. Comments from stakeholders in this respect should hence only be made when responding to the CP on non-equity Transparency.

### 3.4.5 Specify the arrangements for publishing the quotes

57. To increase legal certainty, ESMA suggests setting out in a Level 2 text, possibly through an amendment to Commission Delegated Regulation (EU) No 2017/567, the requirements to be met by SIs in non-equity instruments for publishing their quotes. As provided for in the Q&A published on this topic, ESMA proposes that the requirements set out in Article 13 of Commission Delegated Regulation EU) No 2017/567 on Obligations for systematic internalisers to make quotes easily accessible is extended to SIs in non-equity instruments.

**Q 10: What is your view on the recommendation to specify the arrangements for publishing quotes?**

# 4 Monitoring the application of the pre-trade transparency regime for SIs in non-equity instruments

58. Article 19(1) of MiFIR states that "Competent authorities and ESMA shall monitor the application of Article 18 regarding the sizes at which quotes are made available to clients of the investment firm and to other market participants relative to other trading activity of the firm, and the degree to which the quotes reflect prevailing market conditions in relation to transactions in the same or similar financial instruments on a trading venue". The result of this monitoring is expected to be presented in a report to be submitted to the Commission by 3 July 2020.

59. Furthermore, Article 19(1) specifies that in case of significant quoting and trading activity just beyond the SSTI thresholds, or outside prevailing market conditions, the report to the Commission shall be submitted in advance of the foreseen date.

60. MiFIDII/MiFIR does not include a reporting obligation on SIs with respect to their quotes. To fulfil the mandate described above, ESMA has therefore decided to set-up an ad-hoc data request to collect the necessary information.

61. After consulting a subset of SIs and their NCAs over the summer of 2019 on a possible template for the data collection, the data request has been simplified to the extent possible and the look back period has been reduced to one month.

62. In relation to the first part of the mandate (i.e. the sizes of the quotes, and the potential quoting and trading activity just beyond the SSTI threshold), SIs have been asked to provide quoting and trading data for the month of June 2019 according to specific data segmentations (e.g. liquid versus illiquid instruments, ToTV versus non ToTV instruments) and to group the quoting and trading data according to specific deviations from the SSTI threshold. The underlying intention was then to analyse whether the quoting and trading activity was mainly below the SSTI thresholds, close to them or well above. The outcome of this exercise is developed in Section 4.1.

63. In relation to the second part of the mandate (i.e. whether quotes reflect prevailing market conditions), SIs consulted during the summer indicated that the data request was overly complex and that the costs would largely outweigh the benefits. They also considered that the analysis expected from ESMA could be performed using the data that SIs have to produce under Commission Delegated Regulation (EU) 2017/575[10] (RTS 27 on Best Execution). The status of this workstream is expanded in Section 4.2

## 4.1 Monitoring the sizes at which quotes are made available

### 4.1.1 Overview of the data and quality issues

64. In October 2019 ESMA via NCAs collected data from 60 SIs located in 20 different jurisdictions, i.e. from roughly 30% of the total number of non-equity SIs that are listed on ESMA's register (Table 10). Most of those SIs are active in bonds (54 out of 60), which is consistent with the data included in the ESMA SI register. In terms of coverage, there are a few asset classes on which SIs did not report any activity (C10 derivatives, CFD, emission allowances and derivatives thereof). Information on the data quality is provided in Annex 5.3.

[10] Commission Delegated Regulation (EU) 2017/575 of 8 June 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards concerning the data to be published by execution venues on the quality of execution of transactions (OJ L 87, 31.3.2017, p. 152.)

| | Bonds excl. ETC and ETN | ETC/ETN | Commodity derivatives | Credit derivatives | Equity derivatives | FX derivatives | Interest rate derivatives | Securitised derivatives | Structured finance products | Unique SI |
|---|---|---|---|---|---|---|---|---|---|---|
| CYPRUS | 4 | | | | | | | | | 4 |
| CZECH REPUBLIC | 3 | | | | | | | | | 3 |
| DENMARK | 1 | | | | | 1 | 1 | 1 | 1 | 1 |
| FINLAND | 1 | | | | | | | | | 1 |
| FRANCE | 6 | 1 | | 2 | 2 | 2 | 4 | 3 | 2 | 6 |
| GERMANY | 2 | 1 | 1 | 1 | | 1 | 1 | 3 | 1 | 4 |
| GREECE | 1 | | | | | | | | | 1 |
| HUNGARY | 5 | | | | | | | | | 5 |
| IRELAND | | | | | | 1 | 1 | | | 1 |
| ITALY | 3 | | | | 1 | | | | | 5 |
| LATVIA | 1 | | | | | | | | | 1 |
| LITHUANIA | 3 | | | | | | | | | 3 |
| NORWAY | 2 | | | | | 1 | 1 | | | 2 |
| POLAND | 8 | | | | | | | | | 8 |
| ROMANIA | 1 | | | | | | | | | 1 |
| SLOVAKIA | 1 | | | | | | | | | 1 |
| SPAIN | 2 | | | | | 1 | 1 | | | 2 |
| SWEDEN | 4 | 1 | | | 3 | 2 | 3 | 1 | | 4 |
| THE NETHERLANDS | 2 | | | | | 2 | 2 | 1 | | 2 |
| UNITED KINGDOM | 4 | 2 | 1 | 4 | 2 | 4 | 4 | 3 | 2 | 5 |
| **Grand Total** | **54** | **5** | **2** | **7** | **8** | **15** | **18** | **12** | **6** | **60** |

**Table 10: SIs who responded to the ad-hoc data request, per country and asset-class**

65. The tables below show, for each SI, the percentage of quoting and trading activity (both in terms of volumes and number of quotes/trades) according to four different buckets:

- Below SSTI;
- Between 100% and 101% of SSTI;
- Between 101% and 105% of SSTI;
- Greater than 105% of SSTI

66. The analysis is performed per asset class and includes only instruments which have a liquid market in the MiFIR sense (as the obligation to publish firm quotes only exists for liquid instruments). Some SIs reported only trading activity while others reported only quoting activity. Hence the population of SIs in the tables related to quoting and trading behaviours may differ.

67. Finally, due to the data quality issues described in Annex 5.3 and in particular the possible inconsistent methodologies for reporting quoting activity, ESMA has voluntarily refrained from aggregating data across SIs. It is however assumed that the data is consistent at the level of each SI.

### 4.1.2 Bonds - quoting and trading activity in relation to the SSTI

68. The analysis in relation to bonds (excluding ETCs and ETNs) is provided in the four tables below: quoted volumes in Table 11, traded volumes in Table 12, number of quotes in Table 13 and number of trades Table 14.

69. Regarding ETCs and ETNs, only 5 SIs provided data and out of those, only 2 reported volumes on liquid instruments. This coverage was considered insufficient to allow for a meaningful presentation. Therefore, in the rest of the analysis “bonds” should be read as “bonds excluding ETCs and ETNs”

70. Filtering the SIs that provided figures on *liquid* instruments reduced the population of SIs from 54 (as shown in Table 10) to 27. This means that a number of SIs only reported volumes on *illiquid* bonds.

71. Both for traded volumes and quoted volumes (Table 11 and Table 12), the most striking feature is the very low volume of activity close to the SSTI thresholds, i.e. between 100% and 105% of those thresholds. Instead, the activity as measured by volumes is in most cases concentrated above 105% of the SSTI thresholds. For a few SIs, it is concentrated below the SSTI thresholds.

72. In addition, the analysis based on the number of quotes and number of trades (Table 13 and Table 14), which provides a representation that is not tilted by the actual size of the transaction, leads to a similar result as the analysis based on volumes: there is little (if any) quotes and trades close to the SSTI thresholds.

73. As a result, on the basis of the data collected for bonds, there is no evidence of significant quoting and trading activity just beyond the SSTI thresholds. It follows that the data does not suggest any intention to circumvent the pre-trade transparency obligation via the SSTI thresholds (i.e. by quoting “just beyond” the threshold).

74. In addition, the percentage of quotes and trades below SSTI (Table 13 and Table 14) varies from 0% from some SIs to 100% for other SIs, with a smooth distribution of SIs in the middle. This means that, as measured by number of quotes/trades, the SI bond activity subject to pre-trade transparency (below SSTI) and the SI activity not subject to pre-trade transparency (above SSTI) follows a relatively smooth distribution: some SIs are subject to pre-trade transparency for all their activity, others are not subject to it at all, and for others there is a mix of both under different proportions.

75. The same conclusion cannot be made on the basis of volume data, which is expected since volumes above SSTI are by definition higher than volumes below.

**Q 11: Do you have any comment on the analysis of Bond data and the relation with the SSTI thresholds as presented above?**

| Count | SI Code | Quoted volumes below SSTI | Quoted volumes ]100-101% SSTI] | Quoted volumes ]101-105%] SSTI | Quoted volumes > 105% SSTI |
|---|---|---|---|---|---|
| 1 | SI 58 | 0.0% | 0.0% | 0.0% | 100.0% |
| 2 | SI 37 | 0.0% | 0.0% | 0.0% | 100.0% |
| 3 | SI 34 | 0.0% | 0.0% | 0.0% | 100.0% |
| 4 | SI 28 | 0.0% | 0.0% | 0.0% | 100.0% |
| 5 | SI 47 | 0.1% | 0.0% | 0.0% | 99.9% |
| 6 | SI 39 | 0.1% | 0.0% | 0.0% | 99.9% |
| 7 | SI 13 | 0.1% | 0.0% | 1.3% | 98.6% |
| 8 | SI 50 | 0.1% | 0.0% | 0.0% | 99.9% |
| 9 | SI 38 | 0.2% | 0.0% | 0.0% | 99.8% |
| 10 | SI 31 | 0.3% | 0.0% | 0.0% | 99.7% |
| 11 | SI 30 | 0.3% | 0.0% | 0.0% | 99.7% |
| 12 | SI 1 | 0.3% | 0.0% | 0.0% | 99.7% |
| 13 | SI 40 | 0.4% | 0.0% | 0.0% | 99.6% |
| 14 | SI 15 | 0.8% | 0.0% | 0.0% | 99.2% |
| 15 | SI 27 | 1.4% | 0.0% | 0.0% | 98.5% |
| 16 | SI 41 | 1.7% | 0.0% | 0.1% | 98.2% |
| 17 | SI 48 | 2.0% | 0.0% | 0.0% | 98.0% |
| 18 | SI 49 | 2.4% | 0.0% | 0.0% | 97.6% |
| 19 | SI 26 | 3.7% | 0.0% | 0.0% | 96.3% |
| 20 | SI 9 | 9.5% | 0.0% | 0.0% | 90.5% |
| 21 | SI 16 | 26.4% | 0.0% | 0.0% | 73.6% |
| 22 | SI 2 | 33.3% | 0.0% | 0.0% | 66.7% |
| 23 | SI 60 | 37.0% | 0.0% | 0.0% | 62.9% |
| 24 | SI 4 | 72.5% | 0.0% | 27.5% | 0.0% |
| 25 | SI 43 | 97.5% | 0.0% | 0.0% | 2.5% |
| 26 | SI 23 | 100.0% | 0.0% | 0.0% | 0.0% |
| 27 | SI 29 | 100.0% | 0.0% | 0.0% | 0.0% |

**Table 11: Bonds having a liquid market – Quoted volumes against SSTI**

| Count | SI Code | Traded volumes below SSTI | Traded volumes ]100-101% SSTI] | Traded volumes ]101-105%] SSTI | Traded volumes > 105% SSTI |
|---|---|---|---|---|---|
| 1 | SI 22 | 0.0% | 0.0% | 0.0% | 100.0% |
| 2 | SI 40 | 0.0% | 0.0% | 0.0% | 100.0% |
| 3 | SI 37 | 0.0% | 0.0% | 0.0% | 100.0% |
| 4 | SI 34 | 0.0% | 0.0% | 0.0% | 100.0% |
| 5 | SI 60 | 0.0% | 0.0% | 0.0% | 100.0% |
| 6 | SI 28 | 0.0% | 0.0% | 0.0% | 100.0% |
| 7 | SI 39 | 0.0% | 0.0% | 0.0% | 100.0% |
| 8 | SI 50 | 0.1% | 0.0% | 0.0% | 99.9% |
| 9 | SI 13 | 0.1% | 0.0% | 1.3% | 98.6% |
| 10 | SI 38 | 0.2% | 0.0% | 0.0% | 99.8% |
| 11 | SI 54 | 0.2% | 0.0% | 0.0% | 99.8% |
| 12 | SI 30 | 0.3% | 0.0% | 0.0% | 99.7% |
| 13 | SI 1 | 0.3% | 0.0% | 0.0% | 99.7% |
| 14 | SI 48 | 0.3% | 0.0% | 0.0% | 99.7% |
| 15 | SI 47 | 0.4% | 0.0% | 0.0% | 99.6% |
| 16 | SI 49 | 0.6% | 0.0% | 0.0% | 99.4% |
| 17 | SI 15 | 0.7% | 0.0% | 0.0% | 99.3% |
| 18 | SI 41 | 0.7% | 0.0% | 0.0% | 99.3% |
| 19 | SI 27 | 1.2% | 0.0% | 0.0% | 98.8% |
| 20 | SI 16 | 2.3% | 0.0% | 0.0% | 97.7% |
| 21 | SI 26 | 5.7% | 0.0% | 0.0% | 94.2% |
| 22 | SI 9 | 23.1% | 0.0% | 0.0% | 76.9% |
| 23 | SI 2 | 33.3% | 0.0% | 0.0% | 66.7% |
| 24 | SI 4 | 81.4% | 0.0% | 18.6% | 0.0% |
| 25 | SI 43 | 97.5% | 0.0% | 0.0% | 2.5% |
| 26 | SI 23 | 100.0% | 0.0% | 0.0% | 0.0% |
| 27 | SI 29 | 100.0% | 0.0% | 0.0% | 0.0% |

**Table 12: Bonds having a liquid market – Traded volumes against SSTI**

| Count | SI Code | Number of Quotes below SSTI | Number of Quotes ]100-101% SSTI | Number of Quotes ]101-105%] SSTI | Number of Quotes > 105% SSTI |
|---|---|---|---|---|---|
| 1 | SI 37 | 0.0% | 0.0% | 0.0% | 100.0% |
| 2 | SI 58 | 0.0% | 0.0% | 0.0% | 100.0% |
| 3 | SI 28 | 1.4% | 0.0% | 0.0% | 98.6% |
| 4 | SI 34 | 4.6% | 0.0% | 0.0% | 95.4% |
| 5 | SI 39 | 6.9% | 0.0% | 0.0% | 93.1% |
| 6 | SI 47 | 8.0% | 0.0% | 0.0% | 92.0% |
| 7 | SI 50 | 12.1% | 0.1% | 0.2% | 87.7% |
| 8 | SI 13 | 14.3% | 0.0% | 7.1% | 78.6% |
| 9 | SI 31 | 15.9% | 0.0% | 0.5% | 83.6% |
| 10 | SI 38 | 26.3% | 0.2% | 0.0% | 73.5% |
| 11 | SI 40 | 28.6% | 0.0% | 0.0% | 71.4% |
| 12 | SI 9 | 30.0% | 0.0% | 0.0% | 70.0% |
| 13 | SI 30 | 32.2% | 0.0% | 0.1% | 67.7% |
| 14 | SI 1 | 39.9% | 0.0% | 0.0% | 60.1% |
| 15 | SI 15 | 45.8% | 0.0% | 0.0% | 54.2% |
| 16 | SI 41 | 47.7% | 0.0% | 0.6% | 51.7% |
| 17 | SI 27 | 48.5% | 0.0% | 0.3% | 51.2% |
| 18 | SI 26 | 49.2% | 0.0% | 0.1% | 50.7% |
| 19 | SI 49 | 57.9% | 0.0% | 0.0% | 42.1% |
| 20 | SI 2 | 63.2% | 0.0% | 0.0% | 36.8% |
| 21 | SI 48 | 76.4% | 0.0% | 0.2% | 23.4% |
| 22 | SI 16 | 85.7% | 0.0% | 0.0% | 14.3% |
| 23 | SI 43 | 95.8% | 0.0% | 0.0% | 4.2% |
| 24 | SI 4 | 96.4% | 0.0% | 3.6% | 0.0% |
| 25 | SI 60 | 97.2% | 0.0% | 0.0% | 2.7% |
| 26 | SI 23 | 100.0% | 0.0% | 0.0% | 0.0% |
| 27 | SI 29 | 100.0% | 0.0% | 0.0% | 0.0% |

**Table 13: Bonds having a liquid market – Number of quotes against SSTI**

| Count | SI Code | Number of trades below SSTI | Number of trades ]100-101% SSTI | Number of trades ]101-105%] SSTI | Number of trades > 105% SSTI |
|---|---|---|---|---|---|
| 1 | SI 22 | 0.0% | 0.0% | 0.0% | 100.0% |
| 2 | SI 37 | 0.0% | 0.0% | 0.0% | 100.0% |
| 3 | SI 40 | 0.0% | 0.0% | 0.0% | 100.0% |
| 4 | SI 28 | 1.9% | 0.0% | 0.0% | 98.1% |
| 5 | SI 39 | 3.1% | 0.0% | 0.0% | 96.9% |
| 6 | SI 34 | 4.6% | 0.0% | 0.0% | 95.4% |
| 7 | SI 54 | 8.3% | 0.0% | 0.1% | 91.6% |
| 8 | SI 50 | 11.0% | 0.1% | 0.1% | 88.8% |
| 9 | SI 60 | 11.2% | 0.0% | 0.0% | 88.8% |
| 10 | SI 13 | 14.3% | 0.0% | 7.1% | 78.6% |
| 11 | SI 47 | 16.2% | 0.0% | 0.0% | 83.8% |
| 12 | SI 30 | 32.2% | 0.0% | 0.1% | 67.6% |
| 13 | SI 49 | 33.3% | 0.0% | 0.0% | 66.7% |
| 14 | SI 41 | 35.9% | 0.0% | 0.0% | 64.1% |
| 15 | SI 38 | 39.0% | 0.0% | 0.0% | 61.0% |
| 16 | SI 15 | 39.8% | 0.0% | 0.0% | 60.2% |
| 17 | SI 1 | 40.5% | 0.0% | 0.0% | 59.5% |
| 18 | SI 27 | 54.3% | 0.0% | 0.3% | 45.4% |
| 19 | SI 9 | 60.0% | 0.0% | 0.0% | 40.0% |
| 20 | SI 2 | 63.2% | 0.0% | 0.0% | 36.8% |
| 21 | SI 26 | 63.3% | 0.0% | 0.1% | 36.6% |
| 22 | SI 16 | 66.7% | 0.0% | 0.0% | 33.3% |
| 23 | SI 48 | 82.5% | 0.0% | 0.1% | 17.4% |
| 24 | SI 43 | 85.7% | 0.0% | 0.0% | 14.3% |
| 25 | SI 4 | 98.0% | 0.0% | 2.0% | 0.0% |
| 26 | SI 23 | 100.0% | 0.0% | 0.0% | 0.0% |
| 27 | SI 29 | 100.0% | 0.0% | 0.0% | 0.0% |

**Table 14: Bonds having a liquid market – Number of trades against SSTI**

### 4.1.3 Derivatives

76. The following paragraphs provide an analysis of trading and quoting activity in relation to the SSTI thresholds for derivatives. The analysis could only be performed for interest rate, equity and securitised derivatives for the following reasons:

- Credit derivatives: only 7 SIs provided data and out of those, only 2 reported volumes on liquid instruments. In addition, the number of quotes and trades reported by those 2 SIs was very limited. This coverage was considered insufficient to allow for a meaningful presentation;

- Commodity derivatives: only 2 SIs provided data and this was only on illiquid instruments.

- FX derivatives: instruments in this asset-class are all considered not to have a liquid market hence the analysis in relation to SSTI is irrelevant;

- No data was reported for the remaining asset classes (C10 derivatives, CFDs, Emission allowances, Emission allowances derivatives)

77. Irrespective of the type of derivatives presented below, and both for traded and quoted volumes, the same feature as for bonds is observed: there is very little (if any) activity close to the SSTI thresholds, i.e. between 100% and 105% of those thresholds. Instead, the activity as measured by volumes is in most cases concentrated above 105% of the SSTI thresholds or, for a few SIs, concentrated below those thresholds.

78. In addition, the analysis based on the number of quotes and number of trades, which provides a representation that is not tilted by the actual size of the transaction, leads to a similar result as the analysis based on volumes: there are little (if any) quotes and trades close to the SSTI thresholds.

79. As a result, on the basis of the data collected for interest rate, equity and securitised derivatives, there is no evidence of significant quoting and trading activity just beyond the SSTI thresholds. It follows that the data does not suggest any intention to circumvent the pre-trade transparency obligation via the SSTI thresholds (i.e. by quoting "just beyond" the threshold).

80. For interest rate derivatives, the analysis of the number of quotes/trades (Table 17 and Table 18.) leads to a similar conclusion as for bonds: the percentage of quotes and trades below SSTI varies from 0% from some SIs to 100% for other SIs, with a relatively smooth distribution of SIs in the middle (this should however be nuanced by the small number of SIs in the sample). This means that, as measured by number of quotes/trades, some SIs are subject to pre-trade transparency for all their activity, others are not subject to it at all, and for others there is a mix of both.

81. For securitised derivatives (Table 25 and Table 26) the outcome seems slightly different, with more SIs subject to pre-trade transparency for an important proportion of their activity as measured by the number of quotes/trades. For credit and equity derivatives, a similar conclusion is more difficult to draw due to the limited number of SI included in the analysis.

82. The sections below present the detailed numbers for each asset-class.

**Q 12: Do you have any comment on the analysis of derivatives data and the relation with the SSTI threshold as presented above?**

4.1.3.1 Interest rate derivatives - quoting and trading activity in relation to SSTI

83. The analysis in relation to interest rate derivatives (IRD) is provided in the four tables below: quoted volumes in Table 15, traded volumes in Table 16, number of quotes in Table 17 and number of trades in Table 18.

84. Filtering the SIs that provided positive figures on liquid instruments reduced the population of SIs from 18 (as shown in Table 10) to 13 (for quote data) and 12 (for trade data). This means that a few SIs only reported positive volumes on illiquid interest rate derivatives.

| Count | SI Code | Quoted volumes below SSTI | Quoted volumes ]100-101% SSTI] | Quoted volumes ]101-105%] SSTI | Quoted volumes > 105% SSTI |
|---|---|---|---|---|---|
| 1 | SI 31 | 0.5% | 0.0% | 0.0% | 99.5% |
| 2 | SI 28 | 0.6% | 2.5% | 0.0% | 96.8% |
| 3 | SI 26 | 1.2% | 0.0% | 0.0% | 98.8% |
| 4 | SI 48 | 1.2% | 0.0% | 0.0% | 98.8% |
| 5 | SI 39 | 1.8% | 0.0% | 0.0% | 98.2% |
| 6 | SI 50 | 2.4% | 0.0% | 0.0% | 97.6% |
| 7 | SI 34 | 3.6% | 0.1% | 0.1% | 96.3% |
| 8 | SI 1 | 7.4% | 0.0% | 0.0% | 92.6% |
| 9 | SI 30 | 15.7% | 0.9% | 0.9% | 82.5% |
| 10 | SI 38 | 17.4% | 0.0% | 1.3% | 81.3% |
| 11 | SI 49 | 39.5% | 0.0% | 0.0% | 60.5% |
| 12 | SI 24 | 100.0% | 0.0% | 0.0% | 0.0% |
| 13 | SI 40 | 100.0% | 0.0% | 0.0% | 0.0% |

**Table 15: IRD having a liquid market – Quoted volumes against SSTI**

| Count | SI Code | Traded volumes below SSTI | Traded volumes ]100-101% SSTI] | Traded volumes ]101-105%] SSTI | Traded volumes > 105% SSTI |
|---|---|---|---|---|---|
| 1 | SI 26 | 0.0% | 0.0% | 0.0% | 100.0% |
| 2 | SI 48 | 0.8% | 0.0% | 0.0% | 99.2% |
| 3 | SI 28 | 1.2% | 4.9% | 0.0% | 93.9% |
| 4 | SI 39 | 1.7% | 0.0% | 0.0% | 98.3% |
| 5 | SI 54 | 2.2% | 0.0% | 0.0% | 97.8% |
| 6 | SI 50 | 2.4% | 0.0% | 0.0% | 97.6% |
| 7 | SI 34 | 3.6% | 0.1% | 0.1% | 96.3% |
| 8 | SI 1 | 4.2% | 0.0% | 0.0% | 95.8% |
| 9 | SI 30 | 15.6% | 0.9% | 0.9% | 82.6% |
| 10 | SI 38 | 21.3% | 0.0% | 1.5% | 77.2% |
| 11 | SI 49 | 29.7% | 0.0% | 0.0% | 70.3% |
| 12 | SI 24 | 100.0% | 0.0% | 0.0% | 0.0% |

Table 16: IRD having a liquid market – Traded volumes against SSTI

| SI Code | Number of Quotes below SSTI | Number of Quotes ]100-101% SSTI | Number of Quotes ]101-105%] SSTI | Number of Quotes > 105% SSTI |
|---|---|---|---|---|
| SI 28 | 4.3% | 8.7% | 0.0% | 87.0% |
| SI 31 | 11.5% | 0.0% | 0.0% | 88.5% |
| SI 48 | 20.0% | 0.0% | 0.0% | 80.0% |
| SI 50 | 22.2% | 0.0% | 0.0% | 77.8% |
| SI 26 | 35.9% | 0.0% | 0.1% | 64.0% |
| SI 34 | 40.3% | 0.4% | 0.4% | 59.0% |
| SI 39 | 41.9% | 0.0% | 0.0% | 58.1% |
| SI 30 | 56.7% | 1.3% | 1.0% | 41.0% |
| SI 38 | 63.8% | 0.0% | 2.1% | 34.0% |
| SI 49 | 66.7% | 0.0% | 0.0% | 33.3% |
| SI 1 | 76.5% | 0.0% | 0.0% | 23.5% |
| SI 24 | 100.0% | 0.0% | 0.0% | 0.0% |
| SI 40 | 100.0% | 0.0% | 0.0% | 0.0% |

Table 17: IRD having a liquid market – Number of quotes against SSTI

| SI Code | Number of trades below SSTI | Number of trades ]100-101% SSTI | Number of trades ]101-105%] SSTI | Number of trades > 105% SSTI |
|---|---|---|---|---|
| SI 26 | 0.3% | 0.0% | 0.0% | 99.7% |
| SI 28 | 7.7% | 15.4% | 0.0% | 76.9% |
| SI 48 | 20.0% | 0.0% | 0.0% | 80.0% |
| SI 50 | 22.2% | 0.0% | 0.0% | 77.8% |
| SI 54 | 27.3% | 0.1% | 0.1% | 72.5% |
| SI 34 | 40.3% | 0.4% | 0.4% | 59.0% |
| SI 39 | 42.5% | 0.0% | 0.0% | 57.5% |
| SI 1 | 44.8% | 0.0% | 0.0% | 55.2% |
| SI 38 | 46.3% | 0.0% | 1.9% | 51.9% |
| SI 30 | 56.5% | 1.3% | 1.0% | 41.1% |
| SI 49 | 70.0% | 0.0% | 0.0% | 30.0% |
| SI 24 | 100.0% | 0.0% | 0.0% | 0.0% |

Table 18: IRD having a liquid market – Number of trades against SSTI

#### 4.1.3.2 Equity derivatives - quoting and trading activity in relation to SSTI

85. The analysis in relation to equity derivatives (EQD) is provided in the four tables below: quoted volumes in Table 19, traded volumes in Table 20, number of quotes in Table 21 and number of trades in Table 22.

86. Filtering the SIs that provided positive figures on liquid instruments reduced the population of SIs from 8 (as shown in Table 10) to 6 (for quote data) and 5 (for trade data). This means that a couple of SI only reported volumes on illiquid equity derivatives.

| Count | SI Code | Quoted volumes below SSTI | Quoted volumes ]100-101% SSTI | Quoted volumes ]101-105%] SSTI | Quoted volumes > 105% SSTI |
|---|---|---|---|---|---|
| 1 | SI 50 | 0.0% | 0.0% | 0.0% | 100.0% |
| 2 | SI 58 | 0.1% | 0.0% | 0.0% | 99.9% |
| 3 | SI 40 | 13.4% | 0.0% | 0.0% | 86.6% |
| 4 | SI 43 | 27.7% | 0.0% | 0.0% | 72.3% |
| 5 | SI 26 | 100.0% | 0.0% | 0.0% | 0.0% |
| 6 | SI 49 | 100.0% | 0.0% | 0.0% | 0.0% |

**Table 19: Equity derivatives having a liquid market – Quoted volumes against SSTI**

| Count | SI Code | Traded volumes below SSTI | Traded volumes ]100-101% SSTI | Traded volumes ]101-105%] SSTI | Traded volumes > 105% SSTI |
|---|---|---|---|---|---|
| 1 | SI 5 | 0.0% | 0.0% | 0.0% | 100.0% |
| 2 | SI 50 | 0.0% | 0.0% | 0.0% | 100.0% |
| 3 | SI 58 | 0.2% | 0.0% | 0.0% | 99.8% |
| 4 | SI 40 | 13.3% | 0.0% | 0.0% | 86.7% |
| 5 | SI 43 | 69.6% | 0.0% | 0.0% | 30.4% |
| 6 | SI 26 | 100.0% | 0.0% | 0.0% | 0.0% |
| 7 | SI 49 | 100.0% | 0.0% | 0.0% | 0.0% |

**Table 20: Equity derivatives having a liquid market – Traded volumes against SSTI**

| Count | SI Code | Number of Quotes below SSTI | Number of Quotes ]100-101% SSTI | Number of Quotes ]101-105%] SSTI | Number of Quotes > 105% SSTI |
|---|---|---|---|---|---|
| 1 | SI 50 | 2.8% | 0.0% | 0.0% | 97.2% |
| 2 | SI 58 | 3.3% | 0.0% | 0.1% | 96.6% |
| 3 | SI 43 | 35.4% | 0.0% | 0.0% | 64.6% |
| 4 | SI 40 | 76.1% | 0.1% | 0.3% | 23.6% |
| 5 | SI 49 | 100.0% | 0.0% | 0.0% | 0.0% |
| 6 | SI 26 | 100.0% | 0.0% | 0.0% | 0.0% |

**Table 21: Equity derivatives having a liquid market – Number of quotes against SSTI**

| Count | SI Code | Number of trades below SSTI | Number of trades ]100-101% SSTI | Number of trades ]101-105%] SSTI | Number of trades > 105% SSTI |
|---|---|---|---|---|---|
| 1 | SI 5 | 0.0% | 0.0% | 0.0% | 100.0% |
| 2 | SI 58 | 2.9% | 0.0% | 0.1% | 97.0% |
| 3 | SI 50 | 10.1% | 0.0% | 0.0% | 89.9% |
| 4 | SI 43 | 44.4% | 0.0% | 0.0% | 55.6% |
| 5 | SI 40 | 61.7% | 0.1% | 0.4% | 37.7% |
| 6 | SI 49 | 100.0% | 0.0% | 0.0% | 0.0% |
| 7 | SI 26 | 100.0% | 0.0% | 0.0% | 0.0% |

**Table 22: Equity derivatives having a liquid market – Number of trades against SSTI**

#### 4.1.3.3 Securitised derivatives - quoting and trading activity in relation to SSTI

The analysis in relation to securitised derivatives (IRD), which are all considered to have a liquid market, is provided in the four tables below: quoted volumes in Table 23, traded volumes in Table 24, number of quotes in Table 25 and number of trades in Table 26.

| Count | SI Code | Quoted volumes below SSTI | Quoted volumes ]100-101% SSTI] | Quoted volumes ]101-105%] SSTI | Quoted volumes > 105% SSTI |
|---|---|---|---|---|---|
| 1 | SI 39 | 0.0% | 0.0% | 0.0% | 100.0% |
| 2 | SI 58 | 5.5% | 0.1% | 0.3% | 94.2% |
| 3 | SI 44 | 13.0% | 0.1% | 0.2% | 86.7% |
| 4 | SI 48 | 25.0% | 0.0% | 0.3% | 74.7% |
| 5 | SI 43 | 42.6% | 0.0% | 0.0% | 57.4% |
| 6 | SI 26 | 45.0% | 0.1% | 0.5% | 54.4% |
| 7 | SI 46 | 80.0% | 0.1% | 0.5% | 19.4% |
| 8 | SI 31 | 100.0% | 0.0% | 0.0% | 0.0% |
| 9 | SI 38 | 100.0% | 0.0% | 0.0% | 0.0% |

**Table 23: Securitised derivatives having a liquid market – Quoted volumes against SSTI**

| Count | SI Code | Traded volumes below SSTI | Traded volumes ]100-101% SSTI] | Traded volumes ]101-105%] SSTI | Traded volumes > 105% SSTI |
|---|---|---|---|---|---|
| 1 | SI 39 | 0.0% | 0.0% | 0.0% | 100.0% |
| 2 | SI 54 | 0.0% | 0.0% | 0.0% | 100.0% |
| 3 | SI 44 | 9.2% | 0.0% | 0.1% | 90.6% |
| 4 | SI 58 | 15.4% | 0.1% | 0.4% | 84.1% |
| 5 | SI 48 | 32.9% | 0.0% | 0.5% | 66.6% |
| 6 | SI 43 | 42.6% | 0.0% | 0.0% | 57.4% |
| 7 | SI 26 | 51.1% | 0.2% | 0.7% | 48.1% |
| 8 | SI 46 | 77.6% | 0.2% | 0.8% | 21.3% |
| 9 | SI 28 | 95.1% | 0.1% | 0.3% | 4.5% |

**Table 24: Securitised derivatives having a liquid market – Traded volumes against SSTI**

| Count | SI Code | Number of Quotes below SSTI | Number of Quotes ]100-101% SSTI | Number of Quotes ]101-105%] SSTI | Number of Quotes > 105% SSTI |
|---|---|---|---|---|---|
| 1 | SI 39 | 0.0% | 0.0% | 0.0% | 100.0% |
| 2 | SI 58 | 42.7% | 0.2% | 0.9% | 56.2% |
| 3 | SI 43 | 80.0% | 0.0% | 0.0% | 20.0% |
| 4 | SI 48 | 87.4% | 0.0% | 0.3% | 12.4% |
| 5 | SI 44 | 96.5% | 0.0% | 0.1% | 3.4% |
| 6 | SI 26 | 99.1% | 0.0% | 0.0% | 0.9% |
| 7 | SI 46 | 99.5% | 0.0% | 0.0% | 0.5% |
| 8 | SI 38 | 100.0% | 0.0% | 0.0% | 0.0% |
| 9 | SI 31 | 100.0% | 0.0% | 0.0% | 0.0% |

**Table 25: Securitised derivatives having a liquid market – Number of quotes against SSTI**

| Count | SI Code | Number of trades below SSTI | Number of trades ]100-101% SSTI | Number of trades ]101-105%] SSTI | Number of trades > 105% SSTI |
|---|---|---|---|---|---|
| 1 | SI 39 | 0.0% | 0.0% | 0.0% | 100.0% |
| 2 | SI 54 | 7.5% | 0.0% | 0.0% | 92.5% |
| 3 | SI 58 | 45.8% | 0.3% | 0.9% | 53.0% |
| 4 | SI 28 | 77.7% | 0.0% | 0.0% | 22.3% |
| 5 | SI 43 | 80.0% | 0.0% | 0.0% | 20.0% |
| 6 | SI 48 | 87.3% | 0.0% | 0.3% | 12.3% |
| 7 | SI 44 | 96.1% | 0.0% | 0.1% | 3.8% |
| 8 | SI 26 | 98.0% | 0.0% | 0.1% | 1.9% |
| 9 | SI 46 | 99.3% | 0.0% | 0.1% | 0.6% |

**Table 26: Securitised derivatives having a liquid market – Number of trades against SSTI**

### 4.1.4 Preliminary recommendation in relation to SSTI

87. As a preliminary conclusion to the analysis presented above, the examination of the data collected by ESMA for the purpose of this consultation paper does not provide clear evidence of significant quoting or trading activity "just beyond" the SSTI threshold. Hence it does not appear that SIs would somehow artificially provide quotes at specific levels to make sure that they are not subject to the pre-trade transparency requirements for liquid instruments under Article 18(2).

88. In fact, when replying to the ad-hoc data collection exercise, a couple of SIs have provided explanations of two different natures which could shed some light on why, as we see in the data, there is virtually no trading and quoting activity very close to the SSTI thresholds.

89. First, the explanation could be that the level of the SSTI thresholds are, at least for some asset classes, so low that by construction almost any quote would be above the SSTI. This would be for instance the case for some equity derivative contracts (where the SSTI threshold is 20,000 EUR in a large number of cases) where it has been evidenced that even quoting a single lot leads to such quote being above the SSTI threshold.

90. Second, another explanation for certain SIs could be that they provide quotes in relation to two distinct market segments, retail flow which tends to be well below the SSTI thresholds, and wholesale flow which would typically be significantly above the SSTI thresholds.

91. Overall, whether or not a quote is subject to pre-trade transparency depends on a series of factors: first the instrument should be traded on a trading venue (ToTV)[11], second it should be liquid and third the quote should be above the SSTI threshold. While this paper does not measure the influence of the first two factors on the overall level of pre-trade transparency in non-equity traded on SIs, it suggests that the third one alone does not appear to be used by market participant to circumvent their obligations under Article 18(2).

92. Any reflections around the overall level of transparency (such as the liquidity determination or the level of the SSTI thresholds) is expected to be covered at a more general level (i.e. not for SI only) in the CP on non-equity Transparency introduced in paragraph 56 and expected to be published in Q1 2020. ESMA wishes to highlight that any change to the transparency regime may have an impact on the SI regime in Article 18 of MiFIR therefore it is important to perform a holistic review of the relevant Level 1 requirements.

93. With regards to the strict mandate covered in this report, i.e. the impact of the SSTI threshold on SI's obligation to publish firm quotes in non-equity instruments, ESMA's preliminary view is that in the absence of obvious issues linked to possible circumvention of the pre-trade transparency obligations via the SSTI threshold, no change to the legal framework appears necessary.

[11] As explained in the Annex 5.3, for the purpose of this analysis all instruments have been considered ToTV.

**Q 13: What is your view on the influence of the SSTI thresholds on the pre-trade transparency framework for SI active in non-equity instruments? Are there any changes to the legal framework that you would consider necessary in this respect?**

## 4.2 Monitoring whether quoted prices reflect prevailing market conditions

94. Article 19(1) of MiFIR states that “Competent authorities and ESMA shall monitor the application of Article 18 regarding […] the degree to which the quotes reflect prevailing market conditions in relation to transactions in the same or similar financial instruments on a trading venue.”. It also states that in the event of “significant quoting and trading activity […] outside prevailing market conditions”, ESMA shall submit its report to the Commission in advance of the legislative deadline.

95. This mandate implies that ESMA collects on the one side information on quoted and traded prices and, on the other side, information on prevailing market conditions on the basis of transactions taking place on venue, and finally designs a methodology to compare those two to formulate a general assessment of whether there is any significant quoting and trading activity “outside” prevailing market conditions.

### 4.2.1 Collecting ad-hoc data from SIs

96. To fulfil this mandate ESMA had initially envisaged to collect quoting and trading data, as well as market prices, directly from SIs for three main reasons. Firstly, data on individual quotes are not part of the transparency data which is submitted to ESMA under MiFIR. Secondly, the post-trade transparency data submitted to ESMA is aggregated per ISIN, trading day and reporting entity, hence there is no information at individual transaction level including on price.

97. Thirdly, the analysis of quotes that SIs are required to publish under Article 18(1) of MiFIR, which could be used in this context, would not allow for a thorough analysis because the quotes subject to publication only concern a limited subset of the total quoting activity (liquid instruments above SSTI) and would not cover the whole mandate. In addition, there is no centralised access point to those published quotes and they prove difficult to capture on a systematic basis (an issue that the recommendation in sections 3.4.2 and 3.4.4 aims to address).

98. ESMA therefore initially produced a template to collect data from SI on quoted and traded prices and whether they reflect prevailing market conditions, as it did to collect the data related to the first part of the mandate (i.e. whether there is a significant trading and quoting activity just beyond the SSTI threshold). When ESMA consulted SIs on this template over the summer 2019, the general feedback was that this exercise would be extremely complex, costly, time consuming or simply impossible.

99. For example, some SIs mentioned that they stored the market inputs used for the fair price but not the prices in the same or similar financial instruments on a trading venue. Others mentioned that there were several sources of “market data” (including sometimes both internal and external sources), and several ways to aggregate them, hence further

guidance would be needed on how the “price prevailing market condition” should be calculated/provided.

100. Finally, some SIs also stressed that performing such analysis on a systematic basis (e.g. all quotes from all SIs for a given time period) would produce gigantic amounts of data, rendering the subsequent data analysis very complex. Taken the above feedback into account, ESMA has decided not to collect ad-hoc data from SIs in this context.

101. As suggested by some SIs, there could be alternative ways for ESMA to fulfil its mandate: one possibility would be to source this information from APAs, and the other one to retrieve the information published by SIs under Commission Delegated Regulation (EU) 2017/575 (RTS 27 on Best Execution). Those options, not mutually exclusive, are described below.

### 4.2.2 Relying on data published under RTS 27

102. RTS 27 specifies inter alia the content, format and periodicity of data relating to the quality of execution to be published by execution venues (i.e. including SIs) in accordance with Article 27(3) of MiFID II (best execution).

103. ESMA has initiated a workstream to search, store and aggregate parts of the data published by SIs under RTS 27, in particular Table 3 of this RTS which includes data at a level of granularity that is compatible with the analysis required (i.e. transaction level).

104. The scope of the data published under RTS 27 would by definition not completely overlap with the data needed to cover ESMA’s mandate for this report, in two ways: the data does not reflect quoting activity, but only trading activity (when a quote results in no trade, there is no obligation to report it under RTS 27); and SIs activity above the SSTI threshold is exempted from the reporting of intra-day transaction data (such as covered by Table 3) under RTS 27 (see recital 10 of RTS 27).

105. Although the intra-day data expected to be published is limited to four specific points in time for each day (9.30, 11.30, 13.30 and 15.30), ESMA considers that such time granularity would be sufficient for the analysis to be performed.

106. From the large sample of SIs’ RTS 27 reports examined by ESMA, the main limit identified lies in the significant differences in the way SIs make their RTS 27 report publicly available.

107. Finally, Table 3 of RTS 27 mandates SIs to publish information on the “Best bid and offer or suitable reference price at time of execution”, which could be considered equivalent to the “prevailing market conditions” and hence provide a valuable source of data for the analysis ESMA is expected to make. However, this specific column of Table 3 of RTS 27 is only mandatory in the situation where “no transactions occurred during the first two minutes of the relevant time periods[12]”. The information from the RTS 27 reports alone

[12] Article 4 point (a)(x) of RTS 27

would not enable a proper assessment of whether the quotes would reflect prevailing market conditions.

### 4.2.3 Relying on APA data

108. APAs could be a source of information in two different ways. First, in relation to pre-trade data (hence information on SI quoting activity), some SIs are complying with their pre-trade transparency obligation under Article 18(1) by publishing quotes via an APA. APAs could hence constitute a centralised source of data in relation to quoted prices, with one limitation being that according to a survey performed by ESMA in November 2019 (covering 40 SIs), roughly only half of the SIs are using such publication arrangement (Figure 3).

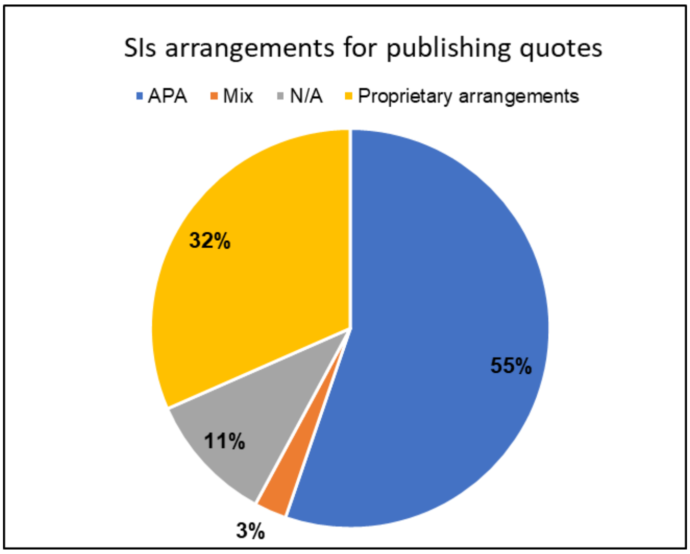


**Figure 3: SIs arrangements for publishing quotes (source: SIs survey November 2019)**

109. The other SIs that responded to the survey indicated that they are fulfilling this obligation via a trading venue or making the pre-trade information available on their own website. In addition, as mentioned above, pre-trade publication is only mandatory for quotes in liquid instruments below SSTI, hence covering only one part of the Commission's mandate.

110. Second, in relation to post-trade data (hence information on SI trading activity), ESMA could leverage on Article 21 of MiFIR which requires SIs to make public the volumes and prices of all their non-equity transactions through an APA. Opting for this data source would, of course, limit the analysis to trading activity but would cover a broader scope of transactions and instruments compared to pre-trade data, as the APA post-trade reporting is not limited to transactions in liquid instruments below SSTI.

### 4.2.4 Market data source

111. None of the data sources described above, i.e. RTS 27 reports and APA data, appear to be a reliable source of data concerning the "prevailing market conditions in relation to transactions in the same or similar financial instruments on a trading venue".

112. Based on a preliminary assessment, the possibility to source this data from trading venues has been excluded due to complexity. It would indeed first require mapping each instrument with the (possibly numerous) trading venues on which it is available, then designing data requests which would be ad-hoc to each trading venue and finally re-aggregating the pricing data afterwards. Instead, ESMA is examining the possibility to use external data sources with pre-aggregated data from multiple trading venues, but the extent to which this will be sufficient to deliver a meaningful analysis is yet to be determined.

113. As explained above, ESMA is faced with multiple challenges when it comes to fulfilling the second part of the mandate on whether quoted/traded prices reflect prevailing market conditions. Several options have been identified as possible data sources, but all appear to have their own drawbacks. Choices have yet to be made as regards the scope of the data set (both in terms of instruments, number of SIs and time period) with the view to strike a balance between the representativeness of the sample and its complexity, having in mind the impact on affected stakeholders' as well as ESMA's resources. ESMA continues to explore the best way forward and will submit its findings either in a separate consultation paper, or in its final report to the Commission.

**Q 14: What is your view on the best way for ESMA to fulfil the mandate related to whether quoted and traded prices reflect prevailing market conditions and in particular: (1) the source of data for the SI quotes/trades (RTS 27, APA); (2) the source of market data prices; and (3) the methodology to compare the two and formulate an assessment?**

# 5 Annexes

## 5.1 Annex 1: Summary of questions

## 5.2 Annex 2: Legal Mandate

Article 19(1) of MiFIR:

**Monitoring by ESMA**

1. Competent authorities and ESMA shall monitor the application of Article 18 regarding the sizes at which quotes are made available to clients of the investment firm and to other market participants relative to other trading activity of the firm, and the degree to which the quotes reflect prevailing market conditions in relation to transactions in the same or similar financial instruments on a trading venue. By 3 January 2019, ESMA shall submit a report to the Commission on the application of Article 18. In the event of significant quoting and trading activity just beyond the threshold referred to in Article 18(6) or outside prevailing market conditions, ESMA shall submit a report to the Commission before that date.

## 5.3 Annex 3: Data collection exercise

### 5.3.1 Quality of reference data

114. In terms of quality of the reference data, ESMA performed some consistency checks. Minor adjustments were made to the data submitted when such adjustments were straightforward as described below.

115. In relation to the LIQUIDITY flag, ESMA changed the liquidity flag as reported by SI on the basis of the sub-asset class reported, in the following cases:

- Securitised derivatives should all be LIQUID as per Article 13(1)(a)(i) of RTS 2;
- Equity derivatives different from “Other Equity derivatives”, “Swap” and “Portfolio swap” should all be LIQUID as per Table 6.1 of Annex III of RTS 2
- SFP should all be ILLIQUID as per the transitional transparency calculations

116. Other sub-asset classes have a fixed liquidity status (e.g. all FX derivatives are illiquid, all derivatives in the “Other” category are illiquid) but there was no instances of misreporting for those cases.

117. In relation to the field “WAIVER”, which indicates whether the quotes are subject to a waiver under Article 18(3): since this waiver is only available to quotes in illiquid instruments, ESMA changed the flag from “WAIVER” to “NA” on all liquid instruments.

118. SI have been asked to segment the data provided based on whether the instrument was traded on a trading venue (ToTV) or not. For the analysis presented in the CP this breakdown has not been taken into account for the following reasons:

- For bonds (including ETCs and ETNs) as well as interest rate derivatives, virtually all volumes have been reported as ToTV hence the exclusion of "non-ToTV" data would not have made a difference to the analysis;

- For other derivatives on the contrary, the exclusion of "non-ToTV" data would have led to a significant cut in an already limited sample of data and would have rendered any analysis quite difficult. Given that this CP does not address the question of the ToTV definition, and that whether an instrument is ToTV may be subject to changes over time, it has been considered reasonable to assess the data irrespective of the ToTV status.

### 5.3.2 Quality of quantitative data

119. In terms of quality of the quantitative data, the following data analysis should be understood with the following caveats in mind:

- Only a subset of SIs has been invited to provide data even though the overall number of SIs who participated in the exercise is meaningful (about 1/3 of the total SI population);

- SIs who reported data flagged that retrieving the data ex post as framed in the data request has been a complex exercise and they have not always been able to retrieve data for all of their activity.

- Some SIs have not reported data in relation to asset classes that are illiquid (e.g. FX).

- The assumptions and methodologies that SIs have used to aggregate quoting data are not always known and are likely to differ from one SI to another. This is in particular relevant for SIs that are streaming quotes on a continuous basis or reproducing the order book of a trading venue. Some have calculated quoted volumes by considering each change of price/quantity as a new quote, leading to extremely high quoted volumes (which are out of proportion compared to their traded volumes, or to the quoted volumes of other SIs). Other SIs have merged quotes with identical quotes details within a specific time period.

120. ESMA also performed a consistency analysis between (1) the traded volumes reported in the ad-hoc data request; and (2) those reported to FITRS by the same SIs over the same period. For bonds, the results turned out satisfactory with a high consistency rate[13], with however non-negligible differences between SIs (some reported higher volumes in FITRS, others reported higher volumes in the ad-hoc data request). In addition, the total volumes reported under the ad-hoc data request represented roughly 60% of the total FITRS

[13] Sum of (Volumes reported under the ad-hoc data) divided by Sum of (Volumes reported in FITRS) for the month of June 2019, across SI that have reported in both systems.

volumes reported by all SIs over the same time period, indicating a reasonable coverage of the ad-hoc data sample.

121. For interest rate derivatives and securitised derivatives, the consistency rate as described above also turned out reasonable however the coverage was much lower than in the case of bonds. For equity derivatives, the number of common SI between the two datasets was too small to come up with a meaningful comparison.

122. Such consistency checks on *quoted* volumes were not possible as no other source of data could be identified for the comparison.

123. Taking the above considerations into account, another possible way forward would have been to re-specify the data request and gather data from additional SIs. However, having heard the feedback from SIs on the complexity of retrieving the data already provided, as well as the deadline for providing the report to the Commission, ESMA considered that this would have been disproportionate and lengthy, and opted instead to work on the basis of the data as provided, subject to the corrections and caveats mentioned above.