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Requirements for regulated markets, multilateral trading facilities and organised trading facilities,

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Abbreviations/terms

SI – systematic internaliser

IF – investment firm

Firm – investment firm or a credit institution subject to MIFIDII/MIFIR requirements

RM – regulated market

TVs – Trading Venues

CA – Competent Authority

Overview of MIFID II requirements for trading venues

- Article 1(7) MIFID II: All multilateral systems in financial instruments shall operate either in accordance with the provisions of:
 - MIFID II Title II concerning MTFs or OTFs (requirements for investment firms) or
 - the provisions of MIFID II Title III (regulated markets requirements).

- Definitions (Article 4 MIFID II)

market operator means a person or persons who manages and/or operates the business of a regulated market and may be the regulated market itself

multilateral system means any system or facility in which multiple third-party buying and selling trading interests in financial instruments are able to interact in the system

regulated market means a multilateral system operated and/or managed by a market operator, which brings together or facilitates the bringing together of multiple third-party buying and selling interests in financial instruments – in the system and in accordance with its non-discretionary rules – in a way that results in a contract, in respect of the financial instruments admitted to trading under its rules and/or systems, and which is authorised and functions regularly and in accordance with Title III of MIFID II

Overview - trading venues (2)

- Definitions (Article 4 MIFID II)

multilateral trading facility (MTF) means a multilateral system, operated by an investment firm or a market operator, which brings together multiple third-party buying and selling interests in financial instruments – in the system and in accordance with non-discretionary rules – in a way that results in a contract in accordance with Title II of MIFID II

organised trading facility (OTF) means a multilateral system which is not a regulated market or an MTF and in which multiple third-party buying and selling interests in bonds, structured finance products, emission allowances or derivatives are able to interact in the system in a way that results in a contract in accordance with Title II of MIFID II

trading venue means a regulated market, an MTF or an OTF

- Detailed L1 Rules on MTF/OTF:

Articles 18-20 MIFID II

Key differences of regulated market, MTF and OTF

	Trading venues			Outside trading venues (off-venue)	
	RM	MTF	OTF	SI	OTC
Operator	RM	RM/Firm	RM/Firm	Firm	Firm
Discretionality (execution)	NO	NO	YES	Partial - quotes	YES
Type of instrument	All financial instruments	All financial instruments	Only non-equity type of financial instruments (bonds, structured finance products, emission allowances, derivatives)	Equity-type instruments not traded	Only non traded instruments
Transactions on own account	NO	NO	Only for non-liquid sovereign bonds	YES	YES

Level 1 Requirements for IF/market operator operating MTF/OTF

Trading process and finalisation of transactions in an MTF and an OTF (Art. 18 MIFID II)

- requirements additional to organisational IF and market operator requirements
- establishing of **transparent** rules and procedures for **fair and orderly trading** and
- establishing of **objective** criteria for the **efficient execution of orders**.
- arrangements in place for the **sound management** of the **technical operations** of the facility, including
- the establishment of **effective contingency arrangements** to cope with **risks of systems disruption**
- Establishing of **transparent** rules regarding the **criteria for determining the financial instruments that can be traded** under its systems (admission rules for instruments)
- (where applicable) providing or ensuring that there is **access to, sufficient publicly available information** to enable its users to form an investment judgement, taking into account both the nature of the users and the types of instruments traded
- establishing, publishing and maintaining and implementing **transparent and non-discriminatory rules**, based on objective criteria, **governing access to its facility** (access for participants)
- arrangements to **identify clearly and manage** the potential **adverse consequences for the operation of the MTF or OTF**, or for the **members or participants and users**, of any **conflict of interest** (different interests of MTF/OTF – owners – investment firm/market operator and the sound functioning of the MTF/ OTF)

Level 1 Requirements for IF/market operator operating MTF/OTF (2)

Trading process and finalisation of transactions in an MTF and an OTF

- compliance with Article 48 (**Systems resilience, circuit breakers and electronic trading**) and Article 49 (**Tick sizes**) + in place all the necessary effective systems, procedures and arrangements to comply with those articles
- clearly informing its members or participants of their respective responsibilities for the **settlement** of the transactions executed in that facility
- in place the necessary arrangements to **facilitate the efficient settlement** of the transactions concluded under the systems of that MTF or OTF
- minimum **three materially active members or users**, each having the opportunity to interact with all the others in respect to price formation
- in case a **transferable security admitted to trading** on a RM is also traded on an MTF or an OTF **without the consent of the issuer => No issuer obligations towards MTF/OTF (financial disclosure)**
- immediate **suspension or removal** of a **financial instrument** from trading on request of a CA (according to Art. 69(2) MIFID II)
- provide the CA with a **detailed description of the functioning** of the MTF or OTF (including **links** to or participation by a regulated market, an MTF, an OTF or a SI owned by the same IF or market operator, and a list of their members, participants and/or users. CA informs ESMA on request
- Each authorisation by CA of OTF/MTF notified to ESMA
- ESMA established a **list of all MTFs and OTFs** in the EU (information on the services an MTF or an OTF provides and the unique code identifying the MTF and the OTF for use in reports in accordance with Articles 6, 10 and 26 of MIFIR)

Level 1 Specific requirements for IF/market operator operating MTF (Art. 19 MIFID II)

- establishing and implement **non-discretionary rules for the execution of orders**
- rules on access to an MTF comply with the conditions established in Article 53(3) (conditions for participants of RM)
- ability to **manage the risks** to which it is exposed, to implement appropriate arrangements and systems to **identify all significant risks** to its operation, and to put in place effective measures to **mitigate** those risks
- arrangements in place to **facilitate** the **efficient** and **timely finalisation of the transactions** executed under its systems
- availability (at the time of authorisation and on an ongoing basis) **sufficient financial resources** to facilitate its orderly functioning, having regard to the nature and extent of the transactions concluded on the market and the range and degree of the risks to which it is exposed
- rules on **product governance** and **information to clients** (provided in Art. 24 MIFID II); on **suitability, appropriateness, reporting to clients** (as regulated in Art. 25 MIFID II); on **best execution** (as in Art. 27(1-2, 4-10 and Article 28 of MIFID II) **not applicable to the transactions** concluded under the rules governing an MTF between its members or participants or between the MTF and its members or participants in relation to the use of the MTF (those rules used by participants towards their clients)
- **no execution of client orders against proprietary capital**
- **no engaging in matched principal trading**

Level 1 Specific requirements for IF/market operator operating OTF (Art. 20 MIFID II)

- **no execution** of client orders in an OTF **against the proprietary capital** of IF/market operator or from any group entity
- possible **engaging in matched principal trading** in bonds, structured finance products, emission allowances and certain derivatives only where the **client has consented**
- **no matched principal trading** to execute client orders in an OTF in derivatives pertaining to a class of derivatives that has been declared subject to the **clearing obligation** (according to EMIR)
- arrangements in place ensuring compliance with the definition of matched principal trading (Article 4(1)38)

matched principal trading means a transaction where the **facilitator** interposes itself between the buyer and the seller to the transaction in such a way that it **is never exposed to market risk** throughout the execution of the transaction, with both sides executed simultaneously, and where the transaction is concluded at a price where the **facilitator makes no profit or loss, other than a previously disclosed commission, fee or charge** for the transaction

- possible engaging in **dealing on own account** other than matched principal trading only with regard to **sovereign debt instruments** for which there is **not a liquid market**.

Level 1 Specific requirements for OTF (Art. 20 MIFID II) (2)

- OTF and SI not possible within the same entity
- no connections between OTF and SI (no interactions between orders/quotes)
- no connections between OTFs (no interaction between orders of different OTFs)
- IF/market operator operating OTF may become **market maker** (on independent basis) on another OTF
- in case of **close links** between market maker and the IF/market operator operating OTF, **market making on independent basis not possible**
- **Obligatory execution of orders** on an OTF is carried out **on a discretionary basis**, ie. only in either or both of the following circumstances:
 - when deciding to place or retract an order on the OTF they operate;
 - when deciding not to match a specific client order with other orders available in the systems at a given time, provided it is in compliance with specific instructions received from a client and with its obligations in accordance with best execution rules (Art. 27 MIFID II)
- Specific rules on order-crossing systems of IF/market operator OTF
- **CA may require** (during authorisation or ad-hoc) :
 - a detailed explanation why the system does not correspond to and cannot operate as a regulated market, MTF, or SI,
 - detailed description as to how discretion will be exercised
 - in addition IF/market operator of an OTF shall provide the CA with information explaining its use of matched principal trading
- contrary to MTF, in case of OTF – rules on product governance/information to clients /suitability, appropriateness, reporting to clients/ best execution **applicable to the transactions on OTF**

Eligible participants of regulated market, MTF and OTF

Regulated Market - Article 53 MIFID II

- obligation to establish, implement and maintain **transparent** and **non-discriminatory** rules, based on **objective criteria**, governing access to or membership of the regulated market
- RM may admit as members or participants **investment firms, credit institutions** authorised under CRD IV and **other persons** who (ACCESS CONDITIONS):
 - are of sufficient good repute
 - have a sufficient level of trading ability, competence and experience
 - have, where applicable, adequate organisational arrangements
 - have sufficient resources for the role they are to perform, taking into account the different financial arrangements that the RM may have established in order to guarantee the **adequate settlement** of transactions.
- possible direct or remote participation of investment firms and credit institutions

MTF:

- the same ACCESS CONDITIONS as for RM (according to Article 19(2) MIFID II)
- no provisions on remote participation

OTF:

- general rules for MTF/OTF in Article 18(3) MIFID II
- able to determine and restrict access based (inter alia) on the role and obligations which they have in relation to their clients (more influence of OTF on the access by participants)

L1 - RM – Organisational requirements (Article 47 MIFID II)

- arrangements in place to identify and manage the potential adverse consequences, for the operation of the RM or for its members/participants, of any conflict of interest between the interest of the RM, its owners or its market operator and the sound functioning of the RM, and in particular where such conflicts of interest might prove prejudicial to the accomplishment of any functions delegated to the RM by the CA
- adequate arrangements to **manage the risks** to which it is exposed, to implement appropriate arrangements and systems to **identify all significant risks** to its operation, and to put in place effective measures to **mitigate those risks**
- arrangements for the **sound management of the technical operations** of the system, including the establishment of **effective contingency arrangements** to cope with risks of systems disruptions
- **transparent** and non-discretionary rules and procedures that provide for **fair and orderly trading** and establish **objective criteria for the efficient execution of orders**
- effective arrangements to **facilitate the efficient and timely finalisation** of the **transactions** executed under its systems
- available (during authorisation and on going bases) **sufficient financial resources** to facilitate its orderly functioning, having regard to the **nature and extent of the transactions concluded on the market** and the **range and degree of the risks to which it is exposed** (additional activity should be taken into account and obligations arising from ownership in other regulated entities, eg. CSD, CCP, ARM, APA)
- execution of clients orders against **proprietary capital** or **matched principal trading** not allowed

L1 - RM – Systems resilience, circuit breakers, electronic trading

(Article 48 MIFID II)

- effective systems, procedures and arrangements in place to ensure its trading systems are **resilient**, have **sufficient capacity to deal with peak order and message volumes**, are able to ensure **orderly trading** under conditions of **severe market stress**, are **fully tested** to ensure such conditions are met and are subject to effective business continuity arrangements to ensure continuity of its services if there is any failure of its trading systems
- written agreements with IF being market makers
- sufficient number of market makers (competitive pricing, liquidity)
- effective systems, procedures and arrangements to **reject orders** that exceed pre-determined volume and price thresholds or are clearly erroneous
- regulated market to be able to **temporarily halt** or **constrain trading** (significant price movement in a financial instrument during a short period) and, in **exceptional cases**, to be able to **cancel, vary or correct any transaction**
- ensure that the parameters for halting trading are appropriately calibrated in a way which takes into account the liquidity of different asset classes and sub-classes, the nature of the market model and types of users and is sufficient to avoid significant disruptions to the orderliness of trading
- effective systems, procedures and arrangements, including requiring members or participants to carry out appropriate testing of algorithms and providing environments to facilitate such testing - to ensure that **algorithmic trading systems cannot create or contribute to disorderly trading conditions on the market** and to **manage any disorderly trading conditions**

L1 - RM – Systems resilience, circuit breakers, electronic trading (Article 48 MIFID II) (2)

- detailed conditions for RM allowing Direct Electronic Access (DEA)
- co-location services are transparent, fair and non-discriminatory
- **fee structures** including execution fees, ancillary fees and any rebates are **transparent, fair and non-discriminatory** and that they do **not create incentives** to place, modify or cancel orders or to execute transactions in a way which contributes to disorderly trading conditions or **market abuse**; eg. to impose market making obligations in individual shares or a suitable basket of shares in exchange for any rebates that are granted
- be able to **identify**, by means of **flagging** from members or participants, **orders generated by algorithmic trading**, the different algorithms used for the creation of orders and the relevant persons initiating those orders - information available to CA upon request

L2 – Organisational requirements - Trading Venues – algorithmic trading

Commission Delegated Regulation (EU) **2017/584** of 14 July 2016 - **organisational requirements of trading venues** (enabling algorithmic trading)

- detailed rules for the organisational requirements of the systems of the trading venues allowing or enabling **algorithmic trading**, in relation to their **resilience** and **capacity**, requirements on trading venues to ensure **appropriate testing of algorithms** and requirements in relation to the **controls concerning DEA** pursuant to Article 48(12)(a),(b) and (g) of MIFID II
- trading venue allows or enables algorithmic trading where **order submission** and **order matching** is facilitated by electronic means
- any **arrangements** or **systems** that allow or enable algorithmic trading shall be considered '**algorithmic trading systems**'
- before the deployment of a trading system and at least once a year, trading venues shall carry out a **self-assessment of their compliance with Article 48** of MIFID II, taking into account the nature, scale and complexity of their business. The self-assessment shall include an **analysis of all parameters set out in the Annex** to this Regulation.
- TVs shall keep a record of their self-assessment for at least **five years**

L2 – Organisational requirements - Trading Venues – algorithmic trading (2)

Governance of Trading Venues

TVs shall establish and monitor their trading systems through a **clear** and **formalised** governance arrangement setting out:

- their analysis of technical, risk and compliance issues when taking critical decisions
- clear lines of accountability, including procedures to approve the development, deployment and subsequent updates of trading systems and to resolve problems identified when monitoring the trading systems
- effective procedures for the communication of information such that instructions can be sought and implemented in an efficient and timely manner
- separation of tasks and responsibilities, to ensure effective supervision of compliance by the trading venues.

The **management body** or the **senior management** of TVs shall approve:

- a) the self-assessment of compliance with Article 48 of MIFID II
- b) measures to expand the capacity of the trading venue where necessary in order to comply with Article 11 (TVs capacity requirements)
- c) actions to remedy any material shortcomings detected in the course of their monitoring in accordance with Articles 12 and 13 and after the periodic review of the performance and capacity of the trading systems in accordance with Article 14.

L2 – Organisational requirements - Trading Venues – algorithmic trading (3)

Compliance function in TVs

- providing clarity to all staff involved in algorithmic trading about the trading venues' legal obligations with respect to such trading
- developing and maintaining the policies and procedures to ensure that the algorithmic trading systems comply with those obligations
- compliance staff has at least a general understanding of the way in which algorithmic trading systems and algorithms operate
- compliance staff shall be in continuous contact with persons within the trading venue who have detailed technical knowledge of the venue's algorithmic trading systems or algorithms
- compliance staff have, at all times, direct contact with persons who have access to the functionality referred to in Article 18(2)(c) (**'kill functionality'**) or access to that kill functionality and to those who are responsible for the algorithmic trading system
- **Outsourcing of compliance function** (or parts) - trading venues shall provide the third party with the same access to information as they would to their own compliance staff.
- In case of outsourcing - obligation of TVs to enter into **outsourcing agreement** with such compliance consultants, ensuring that: (a) data privacy is guaranteed; (b) auditing of the compliance function by internal and external auditors or by the competent authority is not hindered

L2 – Organisational requirements - Trading Venues – algorithmic trading (4)

Staffing – TVs obligations

- TVs shall employ a **sufficient number** of staff with the necessary skills to manage their algorithmic trading systems and trading algorithms and with sufficient knowledge of systems, their monitoring, types of trading and legal obligations
- define necessary skills needed at recruitment and through training after recruitment (up to date skills – evaluation on regular basis)
- Trainings tailored to experience, responsibility, scale, complexity of activities performed
- sufficient seniority of staff

Outsourcing

- the outsourcing agreement exclusively relates to **operational functions** and does not alter the responsibilities of the senior management and the management body
- the relationship and obligations of the trading venue towards its members, competent authorities, or any third parties, such as clients of data feed services are not altered
- outsourced systems meet the requirements that they must comply with in order to be authorised in accordance with Title III of MIFID II
- **operational functions** include all direct activities related to the performance and surveillance of the trading systems supporting elements enlisted in Article 6(2)
- the process of selecting the service provider ('the service provider') – shall be documented
- TVs to ensure, before concluding the outsourcing agreement and throughout its duration, that specific conditions are satisfied (ia. ability of the provided to deliver, ability to supervise)

L2 – Organisational requirements - Trading Venues – algorithmic trading (5)

Outsourcing – other requirements:

- written agreement with Provider (detailed content specified: ia. termination, conflicts of interest, responsibility)
- TVs shall report to the CA their intention to outsource operational functions in the following cases:
 - where the service provider provides the same service to other trading venues
 - where **critical operational functions** necessary for business continuation would be outsourced, in which case the trading venues shall request a **prior authorisation from the CA**
- **critical operational functions** shall include those functions necessary to comply with the obligations referred to in Article 47(1)(b), (c) and (e) of MIFID II:
 - to be adequately equipped to manage the risks to which it is exposed, to implement appropriate arrangements and systems to identify all significant risks to its operation, and to put in place effective measures to mitigate those risks;
 - to have arrangements for the sound management of the technical operations of the system, including the establishment of effective contingency arrangements to cope with risks of systems disruptions;
 - to have effective arrangements to facilitate the efficient and timely finalisation of the transactions executed under its systems
- TVs shall inform the CA of **any outsourcing agreements not subject to prior authorisation** requirement immediately **after** the signature of the agreement.

L2 – Organisational requirements - Trading Venues – algorithmic trading (6)



Requirements on capacity and resilience of trading venues

- Due diligence for members of trading venues
- Testing of the trading systems
- Conformance testing
- Testing the members' algorithms to avoid disorderly trading conditions
- Trading venues' capacity requirements (input/output requirements and conditions)
- General monitoring obligations
- Ongoing monitoring
- Periodic review of the performance and capacity of the algorithmic trading systems
- Business continuity arrangements
- Business continuity plan
- Periodic review of business continuity arrangements
- Prevention of disorderly trading conditions
- Mechanisms to manage volatility
- Pre-trade and post-trade controls
- Pre-determination of the conditions to provide direct electronic access
- Specific requirements for trading venues permitting sponsored access
- Security and limits to access

Overview of L2 for RM/MTF/OTF

- Commission Delegated Regulation (EU) **2017/568** of 24 May 2016 - standards for the **admission of financial instruments to trading on regulated markets**
- Commission Implementing Regulation (EU) **2016/824** of 25 May 2016 - the content and format of the description of the functioning of MTF and OTF and the notification to the ESMA according to MIFID II
- Commission Delegated Regulation (EU) **2017/575** of 8 June 2016 - the data to be published by **execution venues** on the **quality of execution of transactions**
- Commission Delegated Regulation (EU) **2017/570** of 26 May 2016 - determination of a **material market** in terms of **liquidity** in relation to **notifications of a temporary halt in trading**
- Commission Delegated Regulation (EU) **2017/573** of 6 June 2016 - requirements to ensure **fair and non-discriminatory co-location services and fee structures**
- Commission Delegated Regulation (EU) **2017/566** of 18 May 2016 - the **ratio of unexecuted orders to transactions** in order to **prevent disorderly trading conditions**
- Commission Delegated Regulation (EU) **2017/574** of 7 June 2016 - level of accuracy of business clocks

Overview of L2 for RM/MTF/OTF (2)

- Commission Implementing Regulation (EU) **2017/1093** of 20 June 2017 - the format of position reports by investment firms and market operators
- Commission Implementing Regulation (EU) **2017/953** of 6 June 2017 - the format and the timing of position reports by investment firms and market operators of trading venues
- Commission Delegated Regulation (EU) **2017/569** of 24 May 2016 - the suspension and removal of financial instruments from trading
- Commission Implementing Regulation (EU) **2017/1005** of 15 June 2017 - the format and timing of the communications and the publication of the suspension and removal of financial instruments
- Commission Delegated Regulation (EU) **2017/1018** of 29 June 2016 - information to be notified by investment firms, market operators and credit institutions
- Commission Implementing Regulation (EU) **2017/2382** of 14 December 2017 - standard forms, templates and procedures for the transmission of information (Article 34(9), 35(12) of MIFID II)
- Commission Delegated Regulation (EU) **2017/584** of 14 July 2016 - **organisational requirements of trading venues** (enabling algorithmic trading)
- Commission Delegated Regulation (EU) **2017/588** of 14 July 2016 - the tick size regime for shares, depositary receipts and exchange-traded funds

Implementation of RM/MTF/OTF to Polish regulations

- Most rules on RM/MTF were implemented after MIFID I
- Need to delete some rules (eg. transparency, reporting, part of outsourcing) due to L1/L2 directly binding regulations after MIFID II/MIFIR
- Act on trading in financial instruments:
 - Section II - Secondary Trading In Financial Instruments
- Secondary Legislation still in the legislative process
- ESMA Guidelines partially transposed to the secondary legislation
- Large number of ESMA 3 Level acts (guidelines, Q&As) not transposed to legislation
- Key challenges in implementation:
 - New OTF regime
 - Need to introduce transitional regime (eg. transparency, OTF)
 - Regulation of outsourcing of activities not regulated in RTS on organisational requirements