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REVISION OF MiFID 2
SYSTEMATIC INTERNALISER REGIME FOR OTC DERIVATIVES & REFERENCE DATA
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AMAFI Proposals

BACKGROUND

Article 15 of Delegated Regulation (EU) 2017/565 provides that an investment firm will be considered to be a systematic internaliser for derivatives belonging to a class of derivatives if it internalises to such an extent that certain pre-established limits for a frequent and systematic basis and for a substantial basis are both exceeded. Regardless of whether these thresholds are exceeded, investment firms may also choose to opt for the systematic internaliser regime for these same derivatives.

The classes of derivatives covered by Delegated Regulation (EU) 2017/565 are defined in Annex 3 of Delegated Regulation (EU) 2017/583.

The calculations to determine the transparency obligations and thresholds of the mandatory regime are set out in Article 13 of Delegated Regulation (EU) 2017/583. The data ESMA makes available to establish the reference basis for these calculations includes only data relating to TOTV instruments because ESMA bases its calculations on data supplied by trading venues, APAs and CTPs[1]. Moreover, ESMA states in its Q&A on transparency[2] that it only publishes information on TOTV instruments in order to determine whether an investment firm meets the thresholds required to be considered a systematic internaliser[3].

The information provided in ESMA's Q&A referred to above is consistent with the fact that (i) the transparency rules only apply to TOTV instruments and (ii) only data relating to such TOTV instruments is taken into account for threshold calculations. Therefore, this information seems to justify the conclusion that non-TOTV instruments are not to be included in these threshold calculations.

Instruments classified as "uTOTVs" are defined in Article 26(2)(b) and (c) of Regulation (EU) 600/2014. They may or may not be traded on a trading venue. In either case, the underlying is a TOTV and, therefore, this category includes:

- Financial instruments whose underlying is a financial instrument admitted to trading or traded on a trading venue;
- Financial instruments whose underlying is an index or basket composed of financial instruments admitted to trading or traded on a trading venue.

Under current law, a firm that is a systematic internaliser is required to supply the competent authority with reference data relating to uTOTV instruments traded on its system.[4] In addition, Delegated Regulation (EU) 2017/585 on reference data provides that an investment firm that is a systematic internaliser for an asset class and trades in a non-TOTV instrument, but whose underlying is a TOTV, must assign an ISIN code to that uTOTV instrument.

[1] According to MiFIR Article 22

[2] ESMA70-872942901-35

[3] ESMA70-872942901-35 Section 7, Q11

[4] Pursuant to MiFIR Article 27.

THE SYSTEMATIC INTERNALISER REGIME AND NON-TOTV AND uTOTV INSTRUMENTS

- **Issue**

Application of the systematic internaliser regime to non-TOTV instruments and the requirement to supply reference data for uTOTV instruments impose major burdens. Furthermore, assigning ISIN codes to uTOTV instruments creates difficulties in terms of transparency, efficiency and costs for both regulators and investment firms.

- If a uTOTV instrument is traded on a trading venue

If a uTOTV instrument is traded on a trading venue it becomes a TOTV and the trading venue is required by Article 3 of Delegated Regulation (EU) 2017/585 to assign it an ISIN. Therefore, an investment firm that is an SI for this instrument should not be required to do so.

- If a uTOTV instrument is not traded on a trading venue

Under current law, Article 27 of MiFIR and Article 3 of Delegated Regulation (EU) 2017/585 require that reference data be supplied and an ISIN code be assigned to any financial instrument that is traded by an SI. In this particular case, the cost-benefit analysis of the burdens imposed by these information obligations with respect to uTOTV instruments is negative.

Firstly, the obligation to supply reference data significantly increases the volume of such data and the number of ISIN codes to be assigned by institutions, which imposes significant operating costs on them. The volume of reference data and the number of ISIN codes created are increasing exponentially, making it considerably more difficult to populate the FIRDS database, at the expense of the quality of transparency data. In fact, because uTOTV instruments are not subject to transparency obligations, the creation of ISINs for these products increases the volume of ISINs assigned without making transparency data more efficient or improving effective use of the FIRDS database. For example, in April 2018, according to ANNA DSB[5], 8.2 million OTC ISINs were created, 16% of which are in the FIRDS Reference Data database (1.3 million) and only 140,000 are in the FIRDS Transparency Data database. In other words, 6.9 million ISIN codes have been created in ANNA DSB but have not been reported to FIRDS.

It seems clear that this reference data makes no positive contribution to market transparency because the transparency rules apply only to TOTV instruments.

Moreover, with respect to the reports to be submitted to regulators, it should be pointed out that Delegated Regulation (EU) 2017/590 requires that fields 42 to 56 of Table 2 be completed for instruments for which an ISIN code is not assigned. It would seem that the information provided pursuant to this requirement is more relevant than simply assigning an ISIN code, as it is more detailed and focuses on the uTOTV instrument itself. Therefore, it provides the competent authorities with sufficiently granular and complete information about the type of the instrument in which a transaction has been made.

Lastly, in the specific case of systematic internalisers, providing reference data for and assigning ISIN codes to transactions which, by their nature, are carried out with only one investor is likely to provide irrelevant information to other investors.

[5] https://www.anna-dsb.com/2018/05/04/firds-data-analysis-for-april-2018/

For these reasons, AMAFI proposes that MiFIR and Delegated Regulation (EU) 2017/585 be amended to delete the obligation imposed on investment firms to supply reference data for uTOTV instruments, yet leave room for discretion for institutions that have adopted this practice. In fact, despite the burdens imposed by this obligation, certain institutions have already implemented this system. In such case, those institutions may not wish to modify their information systems accordingly and should retain a certain amount of discretion in this respect.

By amending the laws in this way, the obligations that would apply to an investment firm that is a systematic internaliser would in practice be limited to TOTV instruments only. Therefore, the definition of systematic internaliser should be amended and ESMA's Q&A on "transparency topics" should be clarified accordingly to make it clear that only investment firms that have opted to follow the systematic internaliser regime for non-TOTV instruments will be required to supply reference data.

These suggestions to amend the level 1 MiFIR laws could be adopted in connection with the MiFID refit, whereas the suggested clarification of the Q&A could be done within a shorter period of time.

- **Solutions and proposed changes to the laws**

Based on the points discussed above, it is imperative to eliminate the burdens and practices that hinder the effectiveness of the transparency provisions by amending the aforementioned laws.

Accordingly, the objectives of the amendments proposed below are to:

(i) Make clear that the decision to be a systematic internaliser for non-TOTV instruments can be voluntary only;
(ii) Eliminate the requirement for investment firms that become an SI for an asset class or an instrument only[6] to supply reference data and assign an ISIN code to uTOTV instruments. However, investment firms that may wish to adopt this system would still be entitled to do so.

The Association suggests adopting the amendments below and changing in consequence thereof the points in ESMA's Q&A that are inconsistent with these amendments[7]:

Text of MiFID	AMAFI amendment
Article 4 Definitions	*Article 4* Definitions
20) "systematic internaliser" means an investment firm which, on an organised, frequent systematic and substantial basis, deals on own account when executing client orders outside a regulated market, an MTF or an OTF without operating a multilateral system.	20) "systematic internaliser" means an investment firm which, on an organised, frequent systematic and substantial basis, deals on own account when executing client orders outside a regulated market, an MTF or an OTF without operating a multilateral system.
The frequent and systematic basis shall be measured by the number of OTC trades in the	The frequent and systematic basis shall be measured by the number of OTC trades in ~~the~~ **a**

[6] The optional regime allows for finer granularity with respect to the instruments for which an investment firm chooses to be an IS. See ESMA70-872942901-35 Section 7, Q11a.
[7] The points that should be changed are found in Q11 of the "Systematic internaliser regime" section of ESMA70-872942901-35 Q&A on the transparency regime.

financial instrument carried out by the investment firm on own account when executing client orders. The substantial basis shall be measured either by the size of the OTC trading carried out by the investment firm in relation to the total trading of the investment firm in a specific financial instrument or by the size of the OTC trading carried out by the investment firm in relation to the total trading in the Union in a specific financial instrument. The definition of a systematic internaliser shall apply only where the pre-set limits for a frequent and systematic basis and for a substantial basis are both crossed or where an investment firm chooses to opt-in under the systematic internaliser regime;	financial instrument**, <u>traded on a trading venue</u>**, carried out by the investment firm on own account when executing client orders. The substantial basis shall be measured either by the size of the OTC trading carried out by the investment firm in relation to the total trading of the investment firm in a ~~**specific**~~ financial instrument **<u>traded on a trading venue</u>** or by the size of the OTC trading carried out by the investment firm in relation to the total trading in the Union in a specific financial instrument. The definition of a systematic internaliser shall apply only where the pre-set limits for a frequent and systematic basis and for a substantial basis are both crossed or where an investment firm chooses to opt-in under the systematic internaliser regime;[8]
Text of MiFIR	**AMAFI amendment**
Article 27 *Obligation to supply financial instrument reference data* *1. With regard to financial instruments admitted to trading on regulated markets or traded on MTFs or OTFs, trading venues shall provide competent authorities with identifying reference data for the purposes of transaction reporting under Article 26. With regard to other financial instruments covered by Article 26(2) traded on its system, each systematic internaliser shall provide its competent authority with reference data relating to those financial instruments.* *Identifying reference data shall be made ready for submission to the competent authority in an electronic and standardised format before trading commences in the financial instrument that it refers to. The financial instrument reference data shall be updated whenever there are changes to the data with respect to a financial instrument. Those notifications are to be transmitted by competent authorities without delay to ESMA, which shall publish them immediately on its website. ESMA shall give competent authorities access to those reference data.*	*Article 27* Obligation to supply financial instrument reference data 1. With regard to financial instruments admitted to trading on regulated markets or traded on MTFs or OTFs, trading venues shall provide competent authorities with identifying reference data for the purposes of transaction reporting under Article 26. With regard to other financial instruments covered by Article 26(2) traded on its system, each systematic internaliser shall provide its competent authority with reference data relating to those financial instruments. Identifying reference data shall be made ready for submission to the competent authority in an electronic and standardised format before trading commences in the financial instrument that it refers to. The financial instrument reference data shall be updated whenever there are changes to the data with respect to a financial instrument. Those notifications are to be transmitted by competent authorities without delay to ESMA, which shall publish them immediately on its website. ESMA shall give competent authorities access to those reference data.

[8] Consideration should be given to whether the amended definition of systematic internaliser requires the provisions on transparency calculations (in particular in Articles 12-16 of Delegated Regulation (EU) 2017/565) to be amended accordingly.

Text of Delegated Regulation (EU) 2017/585	AMAFI amendment
N/A	*Article 1a* Definitions **For the purposes of this Delegated Regulation, "systematic internaliser" means an investment firm that has opted into the systematic internaliser regime for the financial instruments referred to in Article 26(2)(b) and (c) of Regulation (EU) No 600/2014.**
Article 3 Identification of financial instruments and legal entities 1. Prior to the commencement of trading in a financial instrument in a trading venue or systematic internaliser, the trading venue or systematic internaliser concerned shall obtain the ISO 6166 International Securities Identifying Number ('ISIN') code for the financial instrument.	*Article 3* Identification of financial instruments and legal entities 1. Prior to the commencement of trading in a financial instrument in a trading venue or systematic internaliser, the trading venue or systematic internaliser concerned shall obtain the ISO 6166 International Securities Identifying Number ('ISIN') code for the financial instrument. **1 *bis*. The obligation specified in paragraph 1 shall not apply to the instruments referred to in Article 26(2)(b) and (c) of Regulation (EU) 600/2014**.

The proposed amendments do not affect the transparency objectives because:

- uTOTV instruments traded on a trading venue will, in effect, become TOTVs and, therefore, will be assigned an ISIN code by the trading venue and will be subject to the transparency requirements;
- uTOTV instruments not admitted to trading on a trading platform are not subject to the transparency rules;
- Delegated Regulation (EU) 2017/590 already applies to information about non-TOTV instruments (i.e. instruments without ISIN codes).[9]

However, AMAFI notes that under current law nothing prevents institutions that already assign ISIN codes to uTOTV instruments (non-TOTVs) from continuing to do so.

[9] See Delegated Regulation (EU) 2017/590 Table 2, fields 42 to 56.