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Trade/Invest/Inform

Trading obligations and OTC markets across asset classes

The trading obligation for equity and equity-like instruments

Financial instruments that are subject to a trading obligation (TO) are restricted in terms of their OTC trading. MiFIR Article 23 defines the TO for equities and equity-like products. There are three notable points: first, only shares are subject to a TO; second, a TO can be met by trading on a Systematic Internaliser (SI), next to trading venues; and third, ESMA has decided to use the same threshold to define (a) the maximum allowable pure OTC (i.e. without an SI licence); and (b) the minimum amount that triggers the mandate to become an SI.

All equity and equity-like products will have a limited amount of pure OTC and the remaining share of the market will be competed for by MTFs, RMs and SIs. Taking it all together, whether or not ETFs or DRs have a TO like share is not relevant.

Figure 1: Trading obligations across instruments

	TO Equities(-like)	TO Non-Equities
Shares	Yes	
Depository Receipts (DRs)	No	
Exchange Traded Funds (ETFs)	No	
Other Similar Financial Instruments	No	
Bonds		No
Structured Finance Products		No
Derivatives		Potentially*
Emission allowances		No

* Depending on the requirements set out in MiFIR Article 28.

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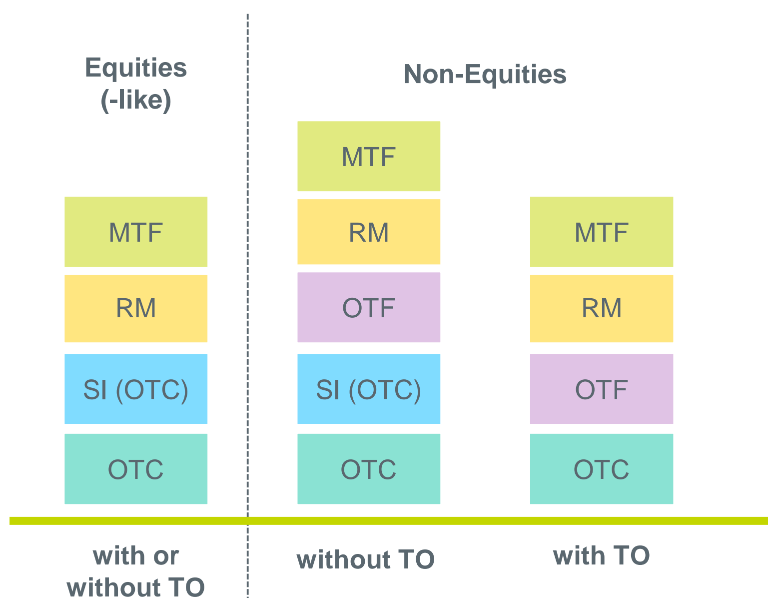
Systematic Internaliser in non-equity instruments

MiFIR Article 28 outlines the TO for non-equity instruments. It applies only to derivatives that have an EMIR clearing obligation and which ESMA deems as sufficiently liquid. By implication all other non-equity instruments are out of scope. In order to comply with a TO in derivatives, trading on an SI is not sufficient as it is for equities. SIs are therefore not very attractive for derivatives that are at risk of being subject to a TO. With regard to SIs in the remaining non-equity types, it is interesting to see how they can compete against OTFs that are also new to the market, as firms can't operate an SI and an OTF in the same instruments.

Restriction of OTC volume

MiFID II Article 4(1)(20) defines the SI. Interestingly the definition has no restriction regarding asset classes, so if a firm conducts a certain amount of OTC activity in any instrument then it must become an SI. Considering that each firm can only do a limited amount of pure OTC, the overall market share will be even more limited given that many firms will likely stop executing pure OTC altogether.

Figure 2: Possible execution channels under MiFID II



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