European Securities and Markets Authority

Final Report

Amendment to Commission Delegated Regulation (EU) 2017/588 (RTS 11)

12 December 2018 | ESMA70-156-834

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Acronyms used

CA	Competent Authority
CP	Consultation Paper on the proposed amendments to Commission Delegated Regulation (EU) 2017/588 (ESMA70-156-357)
ESMA	European Securities and Markets Authority
ETF	Exchange Traded Fund
EU	European Union
FITRS	Financial Instruments Transparency System
MiFID I	Directive 2004/39 of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directive 85/611/EC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC
MIFID II	Directive 2014/65/EU of the European Parliament and the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (OJ L 173, 12.6.2014, p. 349)
MIFIR	Regulation (EU) No 600/2014 of the European Parliament and of the Council on markets in financial instruments and amending Regulation (EU) No 648/2012 (OJ L 173, 12.6.2014, p. 84)
MiFIR Quick Fix	Regulation (EU) No 2016/1033 of the European Parliament and of the Council of 23 June 2016 amending Regulation (EU) No 600/2014 on markets in financial instruments, Regulation (EU) No 909/2014 on improving securities settlement in the European Union and on central securities depositories (OJ L 175, 30.6.2016, p. 1)
MTF	Multilateral Trading Facility
OTC	Over-the-counter
RCA	Relevant Competent Authority, i.e. the competent authority of the most relevant market in terms of liquidity as specified in Article 16 of the Commission Delegated Regulation (EU) 2017/590.
RTS	Regulatory Technical Standard
RTS 1	Commission Delegated Regulation (EU) 2017/587 of 14 July 2016 supplementing Regulation (EU) No 600/2014 of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards 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 11	Commission Delegated Regulation (EU) 2017/588 of 14 July 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards on the tick size regime for shares, depositary receipts and exchange-traded funds (OJ L 87, 31.3.2017, p. 411)
SI	Systematic internaliser
TV	Trading Venue

Executive Summary

Reasons for publication

Under Delegated Regulation (EU) 2017/588 (RTS 11), the minimum tick size applicable to shares and depositary receipts is calibrated to the average daily number of transactions (ADNT) on the most liquid market in the EU. While this metric is a good and simple liquidity indicator for the vast majority of equity instruments, it may not be well suited to instruments where the main pool of liquidity is located outside the EU (third-country instruments). In these cases, the mandatory tick size may be calculated based only on a subset of the overall trading activity. EU trading venues might therefore be subject to minimum tick sizes that are larger than those applicable on non-EU venues which would, as an unintended result, put them at a competitive disadvantage. This might result in scarcer and less deep liquidity being available on EU trading venues which could be detrimental not only for investors trading on those EU venues but also for orderly trading on EU markets.

In this context, ESMA considers it necessary to introduce amendments to RTS 11 to ensure that the tick sizes applicable to third-country instruments are adequate, and appropriately calibrated. On 13 July 2018, ESMA therefore published a Consultation Paper (CP) (ESMA70-156-357) presenting some options to address the identified issues.

This final report describes the feedback received in the public consultation, ESMA's reaction to the feedback received, and the final proposal for amending RTS 11.

Contents

Section 1 provides a general description of the issues identified with respect to the tick sizes applicable to third-country instruments. Section 2 sets out the feedback statement to the CP providing a summary of the responses, describing how those responses have been taken into consideration when drafting the final amendments to RTS 11 and explaining the changes made to the final proposed amendments in light of the feedback received. The annexes present the cost-benefit analysis (Annex I) as well as draft amendments to RTS 11 (Annex II).

This final report includes only a high-level description of the options and proposals presented in the CP. It is therefore recommended to read this final report together with the CP published on 13 July 2018. In addition, public responses to the CP can be found on the ESMA website should readers need more details on them.

Next Steps

ESMA submitted the final report to the European Commission on 12 December 2018. The Commission has three months to decide whether to endorse the proposed amendments to RTS 11.

1 Introduction

1. Since 3 January 2018, trading venues in the EU have had to comply with a mandatory tick size regime as prescribed under Article 49 of MiFID II and as further specified in RTS 11. Under this regime, orders in shares and depositary receipts are subject to minimum tick sizes that are determined based on both (i) the average daily number of transactions (ADNT) on the most relevant market in terms of liquidity (i.e. the trading venue in the EU with the highest turnover) and (ii) the price of the order.

2. MiFID II and RTS 11 do not include any specific provisions with respect to third-country instruments, i.e. financial instruments traded or admitted to trading on an EU trading venue where the most liquid trading venue by turnover is located outside the Union. As a consequence, the minimum tick size for these financial instruments is determined solely by trading activity in the EU, with no consideration of the liquidity on non-EU venues.

3. For financial instruments where only a marginal proportion of trading is executed on EU trading venues, the minimum tick size is potentially, from a world-wide perspective, based on "underestimated" liquidity. This might unintentionally create a competitive disadvantage for EU trading venues offering these instruments for trading compared to their non-EU competitors since the latter are usually subject to a narrower tick size regime, or no mandatory tick size regime at all, and can therefore offer tighter spreads. This might trigger a liquidity shift from EU trading venues to third-country venues and ultimately result in scarcer and less deep liquidity available on EU trading venues to the detriment of investors trading on those EU venues and ultimately orderly markets in the EU.

4. Over the first weeks of application of MiFID II / MiFIR, this situation appeared to have already materialised as some trading venues reported a shift of liquidity to non-EU exchanges operating under a more granular tick size regime.

5. In this context, ESMA has considered it necessary to gather more information on this issue and published a consultation paper (CP) on 13 July 2018 (ESMA70-156-357).

2 Amendment to RTS 11

2.1 Amendment to Article 3 of RTS 11

6. ESMA received 20 responses to its CP. A majority of the responses came from EU trading venues while others were from third-country trading venues, asset managers, investors (investment firms and retail investors) and algorithmic traders.

7. All respondents supported the ESMA initiative to amend RTS 11 in order to address the identified shortcomings (in particular with respect to third-country instruments).

8. Beyond providing feedback to the specific questions asked in the CP (see below), most respondents reiterated the need to apply the tick size regime in a consistent and

harmonised way throughout the EU and across all possible execution venues – including systematic internalisers (SIs). A majority of respondents urged regulators to ensure SIs are subject to the tick size regime, not only up to SMS but irrespective of the order size. A respondent stressed that as long as SIs are not bound by the tick size regime, there is no fair competition between different execution venues.

9. ESMA is aware of this issue and has made, within the framework of its mandate, some proposals in this respect. ESMA has submitted a draft amendment to Commission Delegated Regulation (EU) 2017/587[1] (RTS 1) to the Commission further specifying the concept of prices reflecting prevailing market conditions, and clarifying that SIs' quotes would only reflect prevailing market conditions where those quotes reflect the minimum price levels applicable to on-venue orders and quotes. ESMA considers that further aligning the tick size regime applicable to trading venues and SIs would require level 1 amendments which is outside its competence. This issue has therefore not been tackled in this Final Report.

Instruments within the scope

10. In the CP, ESMA proposed to restrict the possibility to derogate from the general tick size regime established under Article 49 of MiFID II and RTS 11 to shares that satisfy the two following conditions ("third-country shares" thereafter):

    a. the competent authority for the share is able to reasonably demonstrate, based on numerical evidence, that the most liquid trading venue for that share is located outside the Union; and

    b. the ADNT on the most liquid EU venue is equal to, or greater than one.

11. Respondents expressed some concerns regarding the ESMA proposal to identify third-country shares. In their view, access to the necessary data might prove challenging in practice, in particular for third-country venues' trading data. More generally, they considered that the proposed assessment would be too burdensome for National Competent Authorities (NCAs), requiring them to dedicate substantial resources to the identification of third-country shares.

12. Some respondents suggested, as an alternative and in order to "maximize the coverage ratio", to introduce an alternative criterion. In their view, financial instruments should qualify as third-country instruments either where the most liquid venue is located outside the EU or where the legal headquarters of the issuer is established outside the EU.

13. ESMA is aware that the identification of eligible third-country shares might require some resource commitments on the NCA side. However, ESMA would like to highlight that the

[1] Commission Delegated Regulation (EU) 2017/587 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).

issue was raised with respect to shares for which the ADNT on the most liquid EU trading venue is smaller than the ADNT on a third-country venue creating a de facto unlevel playing field for the EU venue. It remains therefore in ESMA's view appropriate to limit the exercise to those shares where the main pool of liquidity is effectively located outside the EU. ESMA also notes that the feedback received has not fundamentally called into question the methodology, but have rather flagged the technical obstacles to implement it.

14. ESMA has considered other methodologies that would allow for easier identification of affected third-country shares, but none appear to achieve a satisfactory outcome. With specific regard to the alternative method proposed by some respondents (i.e. the legal headquarters of the issuer being established outside the EU), ESMA is concerned that this might result in false positives (false negatives being possibly managed through the other criteria) as the headquarters location is not a very good indicator of where liquidity is concentrated. This would, for instance, be the case for firms with their headquarters located outside the EU for tax reasons but whose shares remain primarily traded in the EU. More generally, this could create an additional regulatory incentive for EU firms to expatriate, which is not a desirable outcome.

15. Furthermore, a similar obligation already exists for NCAs under Article 16 of the Short Selling Regulation[2] (SSR) which prescribes that "*the relevant competent authority for shares of a company that are traded on a trading venue in the Union and a venue located in a third country shall determine, at least every 2 years, whether the principal venue for the trading of those shares is located in a third country*". ESMA therefore believes that this identification methodology does not necessarily create any additional burden for NCAs since they are already required to perform a similar assessment for SSR purposes. In order to ensure that the SSR assessment can also be used for tick size purposes, ESMA proposes to align more closely the drafting of the proposed amendment to RTS 11 with the drafting of Article 16 of SSR.

16. ESMA did not receive much feedback regarding its proposal to limit the possibility to adjust ADNT to shares trading on average at least once per day on the most liquid EU trading venues (i.e. ADNT on the most relevant market in terms of liquidity for the previous year is equal to or higher than one). Only one respondent raised questions regarding the proposed threshold, questioning whether an ADNT on the most relevant market in terms of liquidity equal to or higher than one would be sufficient to demonstrate that the share is traded with reasonable frequency in the EU. They invited ESMA to align the threshold with the one used for the definition of liquid shares (i.e. ADNT > 250).

17. It has however never been ESMA's intention to limit the possibility to adjust the ADNT to liquid shares only. ESMA therefore does not see the benefit of ensuring full consistency between the two tests. In addition, the ADNT used for liquidity assessment purposes is not limited to the most relevant market in terms of liquidity but takes into account all

[2] Regulation (EU) No 236/2012 of the European Parliament and of the Council of 14 March 2012 on short selling and certain aspects of credit default swaps (OJ L 86, 24.3.2012, p. 1–24).

transactions executed within the EU. ESMA has therefore decided to maintain this criterion as proposed in the CP.

18. However, regarding the proposal to limit the ability to adjust for ISINs with an ADNT on the most liquid EU trading venue equal to or higher than 1, ESMA does see merit in further clarifying when this criterion should be used. In the CP, it was not sufficiently clear whether this criterion should be used in all circumstances and including for newly admitted to trading or newly traded instruments. For those instruments, the ADNT on the most relevant market in terms of liquidity calculated as per the methodology set out in RTS 11 is indeed less reliable since it is based on shorter historical data and is expected to change more frequently (estimated ADNT, then 4-weeks ADNT and then regular ADNT). For these reasons, ESMA has decided to limit the application of the second eligibility criterion (ADNT criterion) to instruments for which the "regular" ADNT (i.e. the ADNT calculated as per the methodology set out in Article 3(2) to (4) of RTS 11) is available. With respect to financial instruments that are newly admitted to trading or newly traded in the EU, NCAs can adjust the ADNT regardless of the estimated ADNT or 4-weeks ADNT published in FITRS.

Tick size regime to be applied for eligible instruments

19. In the CP, ESMA presented four different options which could be considered as possible ways to address the identified issue:

   a. Authorising EU trading venues to use the tick size applicable to the most liquid third-country venue;

   b. Subjecting third-country shares to a regime similar to Exchange-Traded Funds (ETFs);

   c. Taking into account trading volumes executed on the most liquid third-country venue for the determination of the ADNT;

   d. Allowing the CAs of trading venues trading a third-country instrument to coordinate and to agree on an adjusted ADNT that reflects the liquidity available on third-country venues on a case-by-case basis.

20. Respondents' views were split between those supporting option (a) and those (the majority of the respondents) supporting option (d) (ESMA's preferred approach). No respondent supported options (b) or (c). One respondent was in favour of a hybrid solution combining both option (a) and (d).

21. More specifically, the respondents supporting option (d) agreed that this option would "strike a reasonable balance between the regulatory objectives of harmonising tick sizes for non-EU shares across the EU, avoiding competitive distortions between the EU and third countries, as well as within the EU, and establishing a workable and efficient process". They however suggested some adjustments regarding (i) the identification of third-country

instruments, (ii) the required coordination between NCAs, and (iii) the dissemination of the information regarding adjusted ADNT.

22. Respondents supporting option (a) stressed that it is the most pragmatic and the only option that will ensure full alignment between EU and third-country venues. They insisted on the fact that any difference of tick sizes between trading venues is detrimental to investors and creates a competitive advantage. Such differences should therefore be avoided at all cost, including differences that would prove beneficial to EU trading venues compared to their third-country peers. Those respondents also noted that while not all third countries have a mandatory tick size regime, all trading venues observe in practice a specific tick size regime (and their market participants have to adhere to it).

23. Regarding the suggested combined approach (in a nutshell, to use option (a) for those countries that have a tick size regime in place and option (d) for those countries that don't have such a regime), the respondent stressed that this would ensure full alignment with the regime applicable to third-country venues while addressing the concerns raised by ESMA in the CP (i.e. what to do for countries that do not have a mandatory regime in place).

24. Regarding the comments made on option (d), ESMA agrees that some of the proposed adjustments might be relevant. Those are discussed in more details in the relevant sections above and below.

25. Regarding the responses supporting option (a), ESMA agrees that this would ensure full alignment between EU and non-EU trading venues. However, ESMA maintains its view that this alignment would be at the expense of legal certainty. While it is true that there is always a tick size applicable (otherwise, the venue cannot operate), this tick size regime is not necessarily publicly displayed (at least not with all necessary details). In addition, nothing prevents trading venues that are not bound by any specific regulatory regime to change the applicable tick size from one day to another (either as an attempt to gain market share or due to a change of the liquidity profile of the instrument). Again, this lack of clarity regarding the applicable tick size and how it can change over time would create legal uncertainty and might eventually be detrimental to the orderly functioning of EU markets.

26. Regarding the proposed hybrid approach (combining features of options (a) and (d)), this would similarly not ensure adequate legal certainty since, in practice, there would be three co-existing tick size regimes: the general regime as well as the two possible derogatory regimes. In addition, it is not clear whether the proposal is to apply option (a) also to third-country venues that have voluntarily decided to apply a specific tick size regime or only to third-country venues operating in a jurisdiction where there is a mandatory tick size regime in place. With respect to the former (which appears to be the proposal made), it remains unclear when a venue should be considered to operate under a tick size regime.

Coordination between NCAs

27. In the CP, ESMA proposed that any adjusted ADNT should be agreed in a coordinated manner between all relevant NCAs (i.e. NCAs supervising at least one trading venue where the concerned share is traded).

28. Many respondents, while they saw merit in ensuring a certain level of coordination, raised concerns regarding the suggested coordination mechanism. In their view, such a coordination entails a significant risk of disagreement or deadlock, granting de facto a veto power to those relevant NCAs. For those respondents, it is essential to avoid situations where one single NCA can block the decision to adjust ADNT. They therefore suggested to rely solely on the NCA for the financial instruments (i.e. the NCA of the most relevant market in terms of liquidity - the RCA) who should have discretion to amend the ADNT with respect to instruments that it is responsible for. They added that RTS 11 does not currently foresee any coordination mechanism between NCAs and do not see why the same logic should not apply to ADNT amendments.

29. ESMA acknowledged the expressed concerns and sees merit in further simplifying the procedure by relying solely on the RCA. However, ESMA believes that it remains important to ensure that other relevant NCAs are duly informed about the ADNT adjustments. This has therefore been reflected in the revised amendments to RTS 11.

<u>Operational implementation and dissemination of the information regarding the adjusted ADNT</u>

30. Currently, the ADNT to be determined for the purposes of the mandatory tick size regime as per the methodology prescribed under Article 3 of RTS 11 is automatically calculated and published by FITRS. In the CP, ESMA recommended not recalibrating its system at this stage to avoid causing any disruption or creating any additional reporting burden for CAs and trading venues. Instead, ESMA proposed to maintain the system as it works today and to require NCAs to bilaterally communicate adjusted ADNTs to the concerned trading venues.

31. Respondents expressed strong support for ESMA to take a more active role in the dissemination of adjusted ADNTs. In their views, only bilaterally communicating adjusted ADNTs would not lead to a consistent application of the tick size regime, and would fail to ensure a level playing field between EU trading venues. More generally, respondents considered that a central publication of adjustments would be the most cost-efficient way to disseminate the information, reducing the number of data sources for trading venues. Duplicative sources of information would entail significant costs for trading venues and, according to the responses received, those costs might even become very significant for smaller EU trading venues.

32. ESMA acknowledges the comments made and agrees that the bilateral communication process proposed in the CP is not ideal and would indeed fail to ensure adequate dissemination of information.

33. In addition, as explained above, ESMA has recently proposed to amend RTS 1 to clarify that, for equity instruments subject to the minimum tick size regime under RTS 11, SI quotes would only be considered to reflect the prevailing market conditions where those quotes reflect the same price increments applicable to EU trading venues trading the same instruments. This means that in the future, information regarding the applicable tick sizes will not only be relevant for trading venues but also for SIs. This reinforces the need for ensuring as much visibility as possible regarding the future adjusted ADNTs.

34. In this context, ESMA would like to reiterate its intention to publish this information centrally on its website. Regarding the specific arrangements that could be used in practice, respondents were supportive of publishing adjusted ADNT via FITRS to ensure one single communication channel between ESMA and trading venues. ESMA agrees that maintaining duplicative sources of information on the ESMA website might be misleading and is therefore investigating more integrated solutions where adjusted ADNTs would be communicated through FITRS directly.

35. However, as it is currently the case in Article 3 of RTS 11 with respect to the publication of ADNTs, formally NCAs remain responsible for calculating and ensuring publication of the ADNT on the most liquid EU trading venue. This task has later been delegated to ESMA and the calculations and publication are effectively made in FITRS. Similarly, for adjusted ADNTs, NCAs will therefore remain responsible for the dissemination of information to trading venues (and SIs) although it is likely that this task will also be delegated to ESMA in due course.

36. Lastly, respondents stressed that the proposal that adjusted ADNTs would apply the day after they are communicated to trading venues was perceived as too challenging to implement. Respondents generally supported a longer delay (only one day in the CP) between the publication of the amended ADNT and its application by trading venues (T+2 or even T+5). ESMA agrees and has decided to extend the adjusted ADNT application deadline to T+2 after publication.

Possible inclusion of depositary receipts (DRs)

37. In the CP, ESMA proposed to keep DRs outside the scope of financial instruments for which the ADNT could be adjusted. ESMA explained that, in its view, DRs would, by design, fall outside the scope of third-country financial instruments since those are usually created to facilitate trading in foreign shares on local exchanges and, therefore, it appears less likely that those instruments are traded in several jurisdictions (including a non-EU jurisdiction).

38. The majority of respondents concurred with ESMA's view and agreed to keep DRs outside the scope of the proposed amendment. A few respondents disagreed but their views diverge regarding the tick size regime that should apply to those instruments:

    a. Two respondents were in favour of allowing a similar mechanism as the one proposed for third-country shares. One respondent clarified that there might be around 30 DRs currently traded on its platform for which an adjusted ADNT would be relevant. The other respondent explained that, while it does not currently seem to have an issue with DRs, it might be relevant to include DRs within the scope as a preventive measure and in particular in the context of Brexit.

b. Two other respondents suggested another mechanism whereby DRs would be bound by the same tick size regime as the one applicable to their underlying share.

39. While it is possible to have DRs traded both on EU and non-EU trading venues, responses received suggest that this situation remains marginal with about 30 instruments for which the main pool is actually located outside the EU. ESMA remains unconvinced that the benefits of including DRs within the scope of the proposed RTS 11 amendments merit the additional complexity and costs this inclusion would entail. ESMA has therefore decided to maintain its initial proposal that was supported by the majority of the respondents and to limit the ability to adjust the ADNT to shares only.

Final proposed amendments to Article 3 of RTS 11

40. As a consequence of these considerations, ESMA is suggesting to add the following paragraph 10 to Article 3 of RTS 11 (changes made following the consultation are highlighted):

8. The competent authority for a specific share ***~~which has its main pool of liquidity located outside the Union~~*** *may****~~, for that share,~~*** *adjust the average daily number of transactions* ***for that share*** *calculated* ***~~as per~~ in accordance with*** *the procedure* ***~~prescribed under~~ set out in*** *paragraphs* ***1 ~~2~~*** *to 7* ***~~so as to take into account more comprehensive trading data and ensure that trading in the concerned share is not unduly constrained and does not create disorderly trading conditions.~~ where the following conditions are met:***

~~Prior to this adjustment, the competent authority for the share shall coordinate with the competent authorities of the other trading venues operating in the Union where this share is also traded to ensure that they agree with the proposed adjusted average daily number of transactions. Pending such an agreement between those competent authorities, the average daily number of transactions calculated in accordance with the procedure set out in paragraphs 2 to 7 shall continue to apply.~~

~~9. The possibility to make adjustments to the average daily number of transactions as set out in paragraph 8 shall be limited to shares for which the two following conditions are fulfilled:~~

~~(a) the competent authority for the relevant share proposing the adjustment shall be able to reasonably demonstrate, based on numerical evidence, that the most liquid trading venue for that share is located outside the Union;~~

(a) the principal venue for the trading of the share is located in a third country;

(b) the average daily number of transactions calculated ***and published*** *in accordance with the procedure set out in paragraphs* ***~~2 to 7~~ 1 to 4*** *is equal to or greater than one.*

Where the date on which a share has been traded for the first time on a trading venue within the Union is a date not less than 4 weeks prior to the end of the preceding year, the condition set out under paragraph b shall not apply.

The competent authority shall make the adjustment taking into account the transactions executed on the third-country principal venue.

For the purpose of this Article a principal venue means the venue for the trading of that share with the highest turnover.

~~10.~~ 9. A competent authority that decides to adjust the average daily number of transactions for a specific share in accordance with paragraph 8 shall ensure the publication of this adjusted average daily number of transactions. Prior to this publication, the competent authority shall communicate the adjusted average daily number of transactions to the competent authorities of the other trading venues operating in the Union where this share is also traded. ~~Competent authorities, the day after they agreed on an adjusted average daily number of transactions as set out in paragraph 8, shall communicate this adjusted average daily number of transactions to the trading venues in their respective jurisdiction where the relevant share is admitted to trading or traded.~~

The trading venues shall apply the adjusted average daily number of transactions the ***second calendar*** *day after* ***its publication ~~it has been communicated to them~~****.*

2.2 Other possible amendments to RTS 11

41. In the CP, ESMA has proposed to keep the changes to RTS 11 limited to Article 3. In ESMA's view, it is premature to employ a thorough review of the regime and methodology of RTS 11. During the first few months of application of MiFID II / MiFIR the calibration of the tick size regime has not been called into question and therefore no further amendments were proposed on the CP. ESMA however asked stakeholders whether additional changes should be included in the proposed amendment to RTS 11.

42. A vast majority of respondents agreed with ESMA's view and did not suggest any other amendments to RTS 11. In general, respondents considered that the tick size regime should be further assessed over time before conclusions regarding its impact can be drawn and therefore agreed with ESMA that the calibration of the regime should not be further amended.

43. Despite overall agreement not to further amend RTS 11 at this time, one responded noted that it is essential that the execution of mid-point orders that fall at half a tick are permitted. The respondent suggested that rounding these executions results in detrimental execution outcomes for end investors. ESMA reminds stakeholders that it is possible to match two

LIS orders at mid-point, in particular in facilities benefitting from the reference price waiver and therefore does not propose to amend RTS 11 further.

44. ESMA has also requested that market participants share their views on whether it should introduce some clarifications on the scope of the tick size regime for ETFs as it seems there is a certain degree of uncertainty on the scope of the regime.

45. Most respondents called for some clarifications on the applicability of the mandatory tick size regime to ETFs. These respondents suggested an industry initiative to address the issue by recommending the evaluation of the constituents of an ETF once a year since it is not easy to track them at any point in time. To do so, the respondents suggest the timeline in place for shares and depository receipts, i.e. 1 March of every year. The applicability of the ETF regime should be based on the list of shares and depository receipts published by ESMA's FIRDS database. Should the industry, in close contact with individual NCAs, take forward the proposal presented by respondents, ESMA would be supportive of such initiative noting that further thinking should be done in order to incorporate new ETFs.

46. Other respondents argued that given the specificity of the ETF market, it should have its own liquidity bands, which should be independent of those applicable to other instruments to better reflect the liquidity in these instruments. Finally, some respondents are of the view that ESMA should provide some clarifications regarding the applicability of the tick size to multi asset ETFs.

47. ESMA is of the view that, despite the clarifications requested by market participants, an amendment to RTS 11 would not be the appropriate tool since it relates to the practical implementation of the regime. ESMA will however keep monitoring the application of the regime to ETFs and provide clarification should it be deemed necessary using the tools at its disposal, specifically via Q&As.

3 Annexes

3.1 Annex I: Cost-benefit analysis

Pursuant to Articles 10(1) and 15 of the Regulation establishing ESMA[3], ESMA is empowered to develop draft regulatory technical standards (RTS) or draft implementing technical standards (ITS) where the European Parliament and the Council delegate power to the Commission to adopt the RTS/ITS by means of delegated acts under Article 290 of the Treaty on the Functioning of the European Union (TFEU) in order to ensure consistent harmonisation in the areas specifically set out in the legislative acts within the scope of action of ESMA. The same article obliges ESMA to conduct open public consultations on draft RTS/ITS and, where appropriate, to analyse the related potential costs and benefits. Such consultations and analyses shall be proportionate in relation to the scope, nature and impact of the draft RTS/ITS.

This section contains a cost-benefit analysis (CBA) of the proposed amendments to RTS 11.

This document has four sections: (1) an introduction to the topic discussed (Introduction), (2) the baseline considered to determine the incremental costs and benefits arising from the draft RTS (Baseline), (3) an identification of the stakeholders subject to those amendments and a description of how they may be affected (Stakeholders) and (4) an analysis of the costs and benefits arising from the incremental obligations attributed to the draft RTS compared to the baseline (Cost Benefit Analysis).

3.1.1 Introduction

Under RTS 11, the minimum tick size applicable to shares and depositary receipts is calibrated to the ADNT on the most liquid market in the EU. While this metric appears as a straightforward liquidity indicator for the vast majority of equity instruments, experience since the entry into application of MiFID II demonstrates that it may not be well suited to instruments for which the most liquid venue is located outside the EU (third-country instruments).

The amendments proposed to RTS 11 aim at ensuring that the tick sizes applicable to third-country instruments are adequate and properly calibrated to contribute to the orderly functioning of the market in those instruments.

The costs and benefits section provides an analysis of the potential effects of the draft RTS on the stakeholders directly and indirectly affected, taking into account the comments received on the CP published on 13 July 2018, including responses to the CBA questions. In practice, however, it may sometimes be very difficult to disentangle the effects of the Level 1 legislation, for which an impact assessment covering the general aspects of the Directive has been already performed and published by the European Commission, and the effects of the Level 2

[3] Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC (OJ L 331, 15.12.2010, p. 84).

Regulation. It may also be difficult to disentangle the impact of RTS 11, which has already been assessed in a CBA published by ESMA, and the costs attached to the proposed amendments. As only limited responses were received to the CBA questions included in the CP, the final CBA remains mainly of a qualitative nature.

ESMA notes that the costs incurred by market participants in relation to RTS 11 may partially depend on whether the tick size regime will apply to SIs' quotes. ESMA also notes that many respondents to the CP discussed the application of the tick size regime to SIs in their comments. However, this issue was not within the scope of this consultation and is therefore not taken into consideration in this CBA.

3.1.2 Baseline

From a legal perspective, the baseline to consider is Article 49 of MiFID II that introduces a tick size regime for trading venues, as supplemented by RTS 11 specifying the tick size regime for shares, depositary receipts and ETFs.

Under RTS 11, the minimum tick size is based on (i) the ADNT on the most relevant market in terms of liquidity, i.e. the EU trading venue with the highest turnover (ii) the price of the order.

The ADNT is currently automatically calculated and published by FITRS, a database operated by ESMA, based on quantitative information received from EU trading venues and NCAs.

For NCAs, the additional obligations for NCAs arising from the proposed amendments to RTS 11 would consist in determining whether an instrument traded on their domestic trading venues is eligible to an adjusted ADNT calculation. The NCA would then have to determine an adjusted ADNT and communicate that information to NCAs of the other trading venues where the third-country instrument is traded, ESMA and ultimately market stakeholders.

The proposed amendment to RTS 11 does not however create any obligation for NCAs to adjust the ADNT for third-country instruments but rather give them the possibility to do so for instruments for which they consider that the ADNT and tick size based only on EU liquidity could unduly constrain trading or does not allow for orderly trading conditions.

3.1.3 Stakeholders

The stakeholders identified are:

- Trading venues: Trading venues trading third-country shares may have to adjust parameters in their IT systems to take into account the new tick size determined by their relevant competent authorities. Trading venues may also have to gather liquidity data to assess which instruments traded on their trading venue is eligible to a revised ADNT where this task would be outsourced to them by CAs. Those potential additional efforts are expected to be outweighed by the positive impact on the competitiveness of those trading venues compared to the non-EU trading venues trading the same shares.

- Members and participants of trading venues: Likewise, those stakeholders might have to do one-off and potentially on-going adjustments to their IT system parameters, including brokers using order management systems.

- Institutional investors, buy-side firms and end-investors more broadly: Those stakeholders might be impacted to the extent that they will potentially have to adjust their IT systems, including trading algorithms, to the new tick sizes resulting from the amended RTS.

- Competent authorities: Competent authorities for third-country shares would need to gather liquidity data on those third-country shares to assess eligibility and make the necessary ADNT adjustments. They may however consider delegating the gathering of liquidity data to trading venues.

3.1.4 Cost-Benefit Analysis

In order to remedy the current situation where EU trading venues are put at a disadvantage in comparison with non-EU trading venues due to the mandatory tick size regime under RTS 11 and to ensure orderly markets, the CP considered four possible options that would apply to "third-country shares" traded in the EU. Those options are summarised in the table below.

Policy Objective	Ensuring that the tick size for third-country shares contributes to orderly markets and does not create an unlevel playing field for EU trading venues compared to non-EU trading venues.
Option (a)	Allow EU trading venues to use the tick size of the most liquid third-country venue.
Option (b)	Apply the same tick size regime as ETFs to third-country shares.
Option (c)	Take into account trading volumes on the most liquid third-country venue to determine the ADNT.
Preferred Option (d)	Allow NCAs of EU trading venues where third-country shares are traded to agree on an adjusted ADNT on a case-by-case basis.

The CP also made proposals regarding the scope of instruments eligible for ADNT adjustments.

a. Adjusted tick size regime for third-country shares

A majority of respondents supported Option (d) allowing NCAs of EU trading venues where third-country shares are traded to decide on an adjusted ADNT on a case-by-case basis.

Some respondents supported Option (a), under which tick sizes on EU trading venues trading third-country shares could be aligned with the applicable tick sizes on the most liquid third-country trading venue. Although ESMA understands the benefit of a full alignment of tick sizes to address level playing issues, ESMA remains concerned about the lack of legal certainty embedded in Option (a), including where there would be no mandatory tick size regime in the relevant third-country. The suggested combination of Options (a) and (d) was considered overly complex, and thereby costly to implement.

As a majority of respondents supported ESMA's preferred Option (d), the final draft RTS retains this approach. However, whilst mainly supporting Option (d), respondents suggested some adjustments to the initial proposal.

In particular, some respondents expressed concerns about the potential burdensome and lengthy coordination process between NCAs having to agree on an adjusted ADNT when a third-country share would be traded on more than one EU trading venue. The lengthier the process before an agreement is found, the higher the costs for trading venues as they would continue to suffer from loss of market share to their non-EU competitors. ESMA has taken those concerns into account and new amendments propose that the RCA of the concerned third-country share has a decisive role in setting the adjusted ADNT, whilst informing the NCAs of the other trading venues where the instrument is also traded of the change to be made.

ESMA also heard many concerns expressed about the lack of a central publication of information on the adjusted ADNT. This was identified by some trading venues as a source of significant costs of communication to market participants and as a potential obstacle to a smooth and harmonised implementation of the new regime. ESMA has reiterated its intention to publish this information centrally on its website and is committed to investigating possible integrated solutions where adjusted ADNTs would be communicated to trading venues through a single communication channel, e.g. FITRS. However, since the practicalities of such arrangements are not finalised, the draft RTS does not include any specific provision in that regard.

In addition, a number of trading venues commented on the practical difficulties arising from the implementation of an adjusted ADNT on the day following its publication. Those responses suggested to have a slightly longer delay between the publication of the adjusted ADNTs and their entry into application. The revised draft RTS incorporates the suggestion made by those respondents and provides for an entry into application of the revised tick size regime on the second calendar day after publication.

Policy Objective	Ensuring that the tick sizes applicable to third-country shares contributes to orderly markets and does not create an unlevel

	playing field for EU trading venues compared to non-EU trading venues.
Technical Proposal	The NCAs of a third-country share may, on a case-by case basis, determine an adjusted ADNT reflecting the liquidity available on third-country venues.
Benefits	This proposal alleviates the concerns identified by trading venues with respect to an unlevel playing field with third-country venues. It also ensures that the applicable tick size in the EU is calibrated in a convergent way. The flexibility provided allows NCAs to better take into account the overall liquidity of a third-country share without prescribing a specific and rigid methodology for doing so. The proposal would alleviate constraints around data availability from the third trading venue as other public data sources can be used.
Cost to regulators: - *One-off* - *On-going*	NCAs would incur one-off and on-going staff costs to determine an adjusted ADNT, unless those costs are outsourced to the relevant trading venues. Those costs are expected not to be very significant, as the liquidity data needed to determine the adjusted ADNT will already have been gathered to assess whether the third-country share is eligible to the revised tick size regime. Regulators will incur non-significant one-off and on-going costs for the publication of adjusted ADNTs. It is also possible that this task will ultimately be done centrally by ESMA. Regulators will incur non-significant one-off and recurring IT costs to adjust parameters of their market surveillance tool to the revised tick sizes.
Compliance cost: - *One-off* - *On-going*	Where requested by NCAs, trading venues will incur one-off staff costs to establish a procedure to evaluate the appropriate adjusted ADNT as well as one-off and on-going staff costs to come up with the adjusted ADNT on a case by case basis. The magnitude of the costs incurred will depend on the number of instruments to which the revised approach applies, which is expected to increase post-Brexit. Trading venues trading third-country shares will also incur one-off staff costs to possibly amend rule book/annexes as well as one-off

	and on-going IT costs to adjust the parameters of their trading system(s) following the publication of an adjusted ADNT.
Cost to other stakeholders	Members and participants of trading venues as well as other market participants conducting algorithmic and HFT trading or using order routing systems for order execution may incur one-off costs to adjust the parameters of the IT systems used. Those costs are not expected to be significant.
Indirect costs	The resulting applicable tick size (determined based on the adjusted ADNT) may not be perfectly aligned with the tick sizes applicable on non-EU venues.

b. Scope of instruments eligible to ADNT adjustments

The CP proposed to revise the RTS 11 tick size regime for instruments that i) have their main pool of liquidity outside the EU, ii) that are traded at least once a day on average on an EU trading venue and iii) with a limitation to shares.

i. Instruments with their main pool of liquidity outside the EU

Although supportive of Option (d), many trading venues responding to the CP, including smaller regional exchanges, anticipated that the task of assessing whether the instruments traded on their systems have their main pool of liquidity outside the EU would be delegated to them by the NCAs and complained about the one-off and recurring costs thereof. Those costs would include fees to be paid by data vendors to access third-country trading venue market data and human costs at the trading venue to process the data received. For trading venues with thousands of potentially eligible instruments, those costs could be significant. It is unclear how those costs would compare to the benefits arising from the revised applicable tick size for those instruments.

As an alternative, those trading venues suggested that the eligibility to the adjusted tick size approach be based on two alternative criteria, the first one being the liquidity test proposed in the CP and the other one the location of the head-office of the issuer. Where the head-office would be located in a third country, the instrument would automatically be considered as a third-country instrument.

ESMA took note of the concerns expressed in the responses to the CP and considered the alternative proposed. However, ESMA was concerned that the head-office criteria may not be a meaningful proxy for liquidity location and noted that it that it could also potentially lead to some unintended consequences.

After further inquiry, ESMA also noted that the very high number of potentially eligible third-country shares provided by some trading venues in their response to the CBA questionnaire, and which may have indeed triggered very significant implementation costs, has been substantially overestimated as most of them did not take into account the second criteria set out in the CP (i.e. ADNT > 1). In addition, some third-country shares that are traded on multiple exchanges or facilities were double-counted.

ESMA has nonetheless explored other options to reduce the costs associated with the identification of eligible instruments. In that regard, ESMA noted that under the Short Selling Regulation (SSR), NCAs have an obligation to identify at least every 2 years, whether the principal venue for the trading of the shares within their remit is located in a third country. The SSR list could then be used by NCAs, and trading venues, as a reference for the adjusted ADNT thereby avoiding duplication of work and costs.

For this to be a workable option, the drafting of the draft RTS has been aligned with the wording of the relevant SSR provision, which should contribute to substantially reduced implementation costs.

ii. At least one trade a day

The CP also proposed to limit the scope of eligible instruments to circumstances where this appears indeed necessary to address effective competition concerns. Only shares that at traded at least once a day on average would therefore be eligible to adjusted ADNT. As no comments were received on this specific point, the final draft RTS remains unchanged.

iii. For shares only

Whereas under RTS 11, the tick size regime applies to shares, depositary receipts and certain ETFs, the CP proposed to introduce a revised approach for shares only and not for depositary receipts as it appeared unlikely that a depositary receipt aiming at facilitating trading of the underlying share in the EU has its main pool of liquidity outside the EU.

Some respondents disagreed with ESMA’s assessment and supported including depositary receipts in the scope of instruments eligible to an adjusted ADNT. However, no single view was expressed amongst those respondents as to whether eligible depositary receipts should have a tailored adjusted ADNT or whether the applicable tick size should simply mirror the underlying share’s adjusted ADNT. Furthermore, a majority of respondents were in favour of ESMA’s initial proposal not to have depositary receipts eligible to an adjusted ADNT and the final draft RTS therefore remains unchanged in that regard.

Policy Objective	Ensure that the revised tick size approach is limited to circumstances justified by EU competitiveness and orderly trading concerns.

Technical Proposal	Under the draft RTS, the revised tick size regime applies to shares traded on an EU trading venue where the NCA for that share can reasonably demonstrate that the most liquid trading venue for that share is located outside the EU and where the share trades, on average, at least once a day on the most liquid EU trading venue.
Benefits	The draft RTS will contribute to predictability and legal certainty by ensuring that the mandatory tick size regime under current RTS 11 remains the predominant one. The draft RTS will ensure that the exceptions to the tick size regime are duly limited to circumstances required to maintain a level playing field with third-country venues and orderly trading, and do not become the norm.
Cost to regulator: - *One-off* - *On-going*	Unless delegated to the relevant trading venues, NCAs would incur one-off and on-going staff costs to identify third-country shares traded on their domestic trading venues that are eligible to the exemption, i.e. shares that have their most liquid venue located outside the EU. However, the test would only have to be performed for the subset of shares that trades at least once a day on average. NCAs would incur on-going costs to periodically assess that the relevant shares continue to qualify as third-country instruments and identify new third-country shares. Costs would ultimately depend on the number of instruments passing the ADNT threshold criteria and eligible to an adjusted ADNT. However, since NCAs are already required to identify shares with the principal venue located in a third country under SSR, incremental costs for identifying third-country shares eligible to the revised tick size regime would be significantly reduced.
Compliance cost: - *One-off* - *On-going*	Trading venues may be required by NCAs to identify third-country shares traded on them and that are eligible to the exemption, i.e. that have their most liquid trading venue located outside the EU and that are traded at least once a day on average. Where this is the case, trading venues will incur one-off and on-going staff costs to retrieve data for third-country shares. Other

	compliance costs will include data vendors' costs to retrieve turnover of shares outside the Union. The magnitude of costs for trading venues will ultimately depend on the number of instruments with an ADNT>1 eligible to an adjusted ADNT, which some trading venues expect to increase post-Brexit. However, where trading venues are already asked by NCAs to establish and update the list of shares with the principal venue of trading being located in a third country for SSR purposes, costs for identifying third-country shares eligible to the revised tick size regime would be significantly reduced.
Cost to other stakeholders	Investors, including retail investors, trading shares that have their most liquid venue located outside the EU but that trade less than once a day on average will not benefit from reduced tick size on EU venues. However, the related potential costs are expected to be limited due to infrequent trading in those instruments. The costs associated with the exclusion of the few potentially eligible depositary receipts from the revised tick size regime are expected to be outweighed by the benefit of keeping the tick size regime not overly complex.
Indirect costs	None identified

3.2 Annex II: Draft amendments to RTS 11

COMMISSION DELEGATED REGULATION (EU) .../...

of [ ]

amending Delegated Regulation (EU) 2017/588 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards on the tick size regime for shares, depositary receipts and exchange-traded funds

(Text with EEA relevance)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2011/61/EU, and in particular Article 49(3) and (4) thereof,

Whereas:

(1) Commission Delegated Regulation (EU) 2017/588[4] sets out the mandatory tick size regime for shares, depositary receipts and certain exchange-traded funds. In particular, under Delegated Regulation (EU) 2017/588 the minimum tick size applicable to shares is calibrated to the average daily number of transactions on the most liquid market in the Union. While this metric is a good and simple liquidity indicator for the vast majority of equity instruments, it is not well suited to those shares for which the trading venue with the highest turnover is located outside the Union. In this case, the mandatory tick size may be calculated only on a small subset of the overall activity. It is therefore important to introduce the possibility for the competent authorities of those shares to adjust the average daily number of transactions and reflect more accurately the overall liquidity profile for those financial instruments.

(2) The mandatory tick size was established in order to harmonise price increments on trading venues in the Union and to prevent tick sizes being used as a tool for competition. This might otherwise result in ever smaller tick sizes being used with detrimental effects on market depth, on the quality of liquidity and ultimately on the orderly functioning of markets. It is therefore important that the information regarding any adjusted average daily number of transactions is available to all trading venues trading the same share at the same

[4] Commission Delegated Regulation (EU) 2017/588 of 14 July 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards on the tick size regime for shares, depositary receipts and exchange-traded funds (OJ L 87, 31.3.2017, p. 411).

time and that the trading venues start applying any adjusted average daily number of transactions on the same day. To this end, all competent authorities supervising trading venues where the concerned share is traded should be informed prior to the publication of any adjusted average daily number of transactions and trading venues should be given sufficient time to reflect this adjustment in their system.

(3) In order to ensure legal certainty and predictability of the mandatory tick size regime, it is important to limit the possibility for competent authorities to perform adjustments of the applicable averages daily number of transactions to cases where such adjustments are necessary to reflect more precisely the liquidity profile of the concerned shares which will ultimately contribute to the smooth and orderly functioning of markets. This would notably be the case for shares for which the most liquid trading venue in turnover terms is located outside the Union and that are traded regularly in the Union.

(4) This Regulation is based on the draft regulatory technical standards submitted by the ESMA to the Commission.

(5) ESMA has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Securities and Markets Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1095/2010 of the European Parliament and of the Council[5],

HAS ADOPTED THIS REGULATION:

Article 1

Amendment to Delegated Regulation (EU) 2017/588

In Article 3, the following paragraphs 8 and 9 are added:

‘8. The competent authority for a specific share may adjust the average daily number of transactions for that share calculated in accordance with the procedure set out in paragraphs 1 to 7 where the following conditions are met:

(a) the principal venue for the trading of the share is located in a third country;

(b) the average daily number of transactions calculated and published in accordance with the procedure set out in paragraphs 1 to 4 is equal to or greater than one.

[5] Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC (OJ L 331, 15.12.2010, p. 84).

Where the date on which a share has been traded for the first time on a trading venue within the Union is a date not less than 4 weeks prior to the end of the preceding year, the condition set out under paragraph b shall not apply.

The competent authority shall make the adjustment taking into account the transactions executed on the third-country principal venue.

For the purpose of this Article a principal venue means the venue for the trading of that share with the highest turnover.

9. A competent authority that decides to adjust the average daily number of transactions for a specific share in accordance with paragraph 8 shall ensure the publication of this adjusted average daily number of transactions. Prior to this publication, the competent authority shall communicate the adjusted average daily number of transactions to the competent authorities of the other trading venues operating in the Union where this share is also traded.

The trading venues shall apply the adjusted average daily number of transactions on the second calendar day after its publication.

Article 2

Entry into force

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels, []

For the Commission
The President

[For the Commission
On behalf of the President

[Position]