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#### COVER NOTE

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From: Secretary-General of the European Commission,  
signed by Mr Jordi AYET PUIGARNAU, Director

date of receipt: 18 May 2016

To: Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of  
the European Union

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Subject: COMMISSION DELEGATED REGULATION (EU) .../... of 18.5.2016  
supplementing Directive 2014/65/EU of the European Parliament and of  
the Council on markets in financial instruments with regard to regulatory  
technical standards for the ratio of unexecuted orders to transactions in  
order to prevent disorderly trading conditions

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Delegations will find attached document C(2016) 2775 final.

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Encl.: C(2016) 2775 final



Brussels, 18.5.2016  
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**COMMISSION DELEGATED REGULATION (EU) .../...**

**of 18.5.2016**

**supplementing Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards for the ratio of unexecuted orders to transactions in order to prevent disorderly trading conditions**

(Text with EEA relevance)

## EXPLANATORY MEMORANDUM

### **1. CONTEXT OF THE DELEGATED ACT**

Directive 2014/65/EU on Markets in Financial Instruments ('MiFID II') introduces specific requirements with respect to algorithmic trading, both for investment firms and trading venues, with the aim of mitigating the potential risks from increased use of technology in trading and strengthening the resilience of markets. Trading venues must, amongst other things, have in place effective systems, procedures and arrangements to ensure algorithmic trading systems cannot create or contribute to disorderly trading conditions on their market. This includes a limitation of the messages that can be entered by a member/participant through a maximum ratio of unexecuted orders compared to the transactions executed by that member/participant.

In this context, Article 48(12)(b) of MiFID II empowers the Commission to adopt, following submission of a draft regulatory technical standard by the European Securities and Markets Authority (ESMA), a delegated Regulation further specifying the ratio of unexecuted orders to transactions, taking into account factors such as the value of unexecuted orders in relation to the value of executed transactions.

The draft regulatory technical standards were submitted to the Commission on 28 September 2015. In accordance with Article 10(1) of Regulation No (EU) 1095/2010 establishing ESMA, the Commission shall decide within three months of receipt of the draft standards whether to endorse them. The Commission may also endorse the draft standards in part only, or with amendments, where the Union's interests so require, having regard to the specific procedure laid down in those Articles.

### **2. CONSULTATIONS PRIOR TO THE ADOPTION OF THE ACT**

In accordance with Article 10 of the Regulation (EU) 1095/2010 ESMA has carried out a public consultation on the draft regulatory technical standards. A consultation paper was published on 19 December 2014 on ESMA website and the consultation closed on 2 March 2015. In addition, ESMA sought the views of the Securities and Markets Stakeholder Group (SMSG) established in accordance with Article 37 of the ESMA Regulation. The SMSG chose not to provide advice on these issues due to the technical nature of the standards.

Together with the draft technical standards, and in accordance with the third subparagraph of Article 10(1) of Regulation (EU) No 1095/2010, ESMA has submitted its impact assessment, including the analysis of costs and benefits related to the draft technical standards. This analysis is available at [http://www.esma.europa.eu/system/files/2015-esma-1464\\_annex\\_ii\\_-\\_cba\\_-\\_draft\\_rts\\_and\\_its\\_on\\_mifid\\_ii\\_and\\_mifir.pdf](http://www.esma.europa.eu/system/files/2015-esma-1464_annex_ii_-_cba_-_draft_rts_and_its_on_mifid_ii_and_mifir.pdf)

### **3. LEGAL ELEMENTS OF THE DELEGATED ACT**

The right to adopt a Delegated Regulation is provided for under Article 48(12) (b) of MiFID II. Under this provision, the Commission is empowered to adopt a Delegated Regulation to specify the ratio of unexecuted orders to transactions, taking into

account factors such as the value of unexecuted orders in relation to the value of executed transactions.

Article 1 of this Delegated Regulation defines the term "order", "transactions" and "volume" for the purposes of the Regulation.

Article 2 lays down the obligation to calculate the ratio of unexecuted orders to transactions by trading venues.

Article 3 specifies the methodology to be used by trading venues to calculate an order-to-trade-ratio (OTR) for each member or participant and for each financial instrument traded on an electronic continuous order book, a quote-driven or a hybrid trading system.

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

**of 18.5.2016**

**supplementing Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards for the ratio of unexecuted orders to transactions in order to prevent disorderly trading conditions**

(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 2002/92/EC and Directive 2011/61/EU<sup>1</sup>, and in particular Article 48(12)(b) thereof,

Whereas:

- (1) Trading venues should have a number of systems, procedures and arrangements in place to ensure that algorithmic trading systems cannot create or contribute to disorderly trading conditions including systems to monitor and, where appropriate, limit the ratio of unexecuted orders to transactions.
- (2) Taking into account their nature, voice trading systems should be exempt from the scope of this Regulation which should only apply to trading venues operating electronic continuous auction order book or quote-driven or hybrid trading systems.
- (3) Directive 2014/65/EU extends the requirements relating to the determination of the ratio of unexecuted orders to transactions to multilateral trading facilities and organised trading facilities. It is therefore important that those venues are also within the scope of this Regulation.
- (4) Trading venues should calculate the ratio of unexecuted orders to transactions effectively incurred by their members or participants at the level of each financial instrument traded on them in order to ensure effectively that the ratio does not lead to excessive volatility in that instrument.
- (5) In order to ensure sufficient harmonisation across the Union of the arrangements to prevent disorderly trading conditions through the limitation of the ratio between unexecuted orders and transactions, a clear methodology to calculate the ratio of

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<sup>1</sup> OJ L 173, 12.6.2014, p. 349

unexecuted orders to transactions with respect to all market participants should be laid down.

- (6) The meaning of certain essential parameters to be used for the calculation of the ratio of unexecuted orders to transactions should be clarified.
- (7) The calculation of the ratio of unexecuted orders to transactions entered into the system by a member or participant should be supported by an adequate observation period. On that basis, the calculation period of the effective ratio of unexecuted orders to transactions should not be longer than a trading session. However, trading venues should be allowed to set out shorter observation periods in case such shorter observation periods would contribute more effectively to maintain orderly trading conditions.
- (8) For reasons of consistency and in order to ensure the smooth functioning of the financial markets, it is necessary that the provisions laid down in this Regulation and the related national provisions transposing Directive 2014/65/EU apply from the same date.
- (9) This Regulation is based on the draft regulatory technical standards submitted by the European Securities and Markets Authority to the Commission.
- (10) The European Securities and Markets Authority 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 by Article 37 of Regulation (EU) No 1095/2010 of the European Parliament and of the Council<sup>2</sup>,

HAS ADOPTED THIS REGULATION:

### *Article 1* *Definitions*

For the purposes of this Regulation, the following definitions shall apply:

- (a) ‘order’ includes all input messages, including messages on submission, modification and cancellation sent to the trading system of a trading venue, relating to an order or a quote, but excluding cancellation messages sent subsequent to:
  - (i) uncrossing in an auction;
  - (ii) a loss of venue connectivity;
  - (iii) the use of a kill functionality;
- (b) ‘transaction’ means a totally or partially executed order;

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<sup>2</sup> 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).

- (c) 'volume' means the quantity of financial instruments traded expressed as any of the following:
- (i) the number of instruments for shares, depositary receipts, ETFs, certificates and other similar financial instruments;
  - (ii) the nominal value for bonds and structured finance products;
  - (iii) the number of lots size or contracts for derivatives;
  - (iv) metric tonnes of carbon dioxide for emission allowances.

#### *Article 2*

#### ***Obligation to calculate the ratio of unexecuted orders to transactions***

Trading venues shall calculate the ratio of unexecuted orders to transactions effectively entered into the system by each of their members and participants for every financial instrument traded under an electronic continuous auction order book or a quote-driven or a hybrid trading system.

#### *Article 3*

#### ***Methodology***

1. Trading venues shall calculate the ratio of unexecuted orders to transactions for each of their members or participants at least at the end of every trading session in both of the following ways:
  - (a) in volume terms:  $(\text{total volume of orders} / \text{total volume of transactions}) - 1$ ;
  - (b) in number terms:  $(\text{total number of orders} / \text{total number of transactions}) - 1$ .
2. The maximum ratio of unexecuted orders to transactions calculated by the trading venue shall be deemed to have been exceeded by a member or participant of the trading venue during a trading session if the trading activity of that member or participant in one specific instrument, taking into account all phases of the trading session, including the auctions, exceeds either or both of the two ratios set out in paragraph 1.
3. Trading venues shall calculate the number of orders received from each member or participant following the counting methodology per order type set out in the Annex.
4. Where a trading venue uses an order type which is not explicitly laid down in the Annex, it shall count the messages in accordance with the general system behind the counting methodology and on the basis of the most similar order type appearing in the Annex.

*Article 4*  
***Entry into force and application***

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

This Regulation shall apply from the date that appears first in the second subparagraph of Article 93(1) of Directive [65/2014/EU](#).

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

Done at Brussels, 18.5.2016

*For the Commission*  
*The President*  
*Jean-Claude JUNCKER*