

Overview

MiFID II Series: Issue 1—April 2017

What is MiFID II?

The first iteration of the Markets in Financial Instruments Directive (MiFID I) was implemented on 1 November 2007. The aim of MiFID I was to increase competition, improve investor protection and create a single market for financial services in the European Economic Area (EEA).

The revision of MiFID is in two parts: a revised directive (MiFID II)—which the National Competent Authorities will ‘translate’ into local law, and a new regulation (MiFIR)—which will be implemented across all member states in exactly the way it is written. The new regulations will be implemented on 3 January 2018, delayed by a year from the original deadline of 3 January 2017¹.

Among the key changes in MiFID II / MiFIR are:

- **MARKET STRUCTURE**—Changes to encourage more trading on regulated trading venues, and rules designed to more clearly separate trading on own account from client crossing activity. Where MiFID investment firms continue to trade on a substantial basis outside of trading venues, more conditions and requirements have been applied in the form of the systematic internaliser regime;
- **TRANSPARENCY**—Expansion of the pre and post-trade transparency requirements beyond shares to other instruments traded on a trading venue such as ETFs, derivatives and bonds;
- **TRADING OBLIGATIONS**—There are now new obligations for both shares and for derivatives.

For shares admitted to trading on a trading venue, MiFID investment firms must ensure trades take place on a regulated market (RM), a multilateral trading facility (MTF), organised trading facility (OTF), systematic internaliser (SI) or an equivalent third-country trading venue, with some limited exemptions. For derivatives that are deemed subject to mandatory clearing under EMIR, an assessment will be made to determine whether such instruments should also be mandatory tradable on trading venues only;

- **TRANSACTION REPORTING**—Changes to the transaction reporting regime, including an expansion of products, client and transactional data fields (e.g. legal entity identifiers) alongside new rules governing firms’ obligation to report;
- **INVESTOR PROTECTION**—Enhanced conduct of business requirements around suitability, conflicts and inducements (including unbundling and payment for research), product governance, costs and charges and best execution;
- **EXECUTION QUALITY**—MiFID investment firms will now be required to report annually on the top 5 execution venues (in terms of trading volume) where they executed orders in the preceding year, including the proportion of aggressive, passive and direct orders for each class of financial instrument (see Issue 5: Best Execution and Top 5 Venue Reporting). In addition, execution quality data is to be published quarterly at an instrument level for each execution venue

¹ For updates from ESMA on their MiFID II timeline follow <https://www.esma.europa.eu/newsletter/subscriptions>

(including systematic internalisers and market makers/liquidity providers);

- **THIRD COUNTRY ACCESS**—Changes to the rules governing access of non-EEA firms to EEA markets and clients, giving passporting rights to undertake investment services with eligible counterparties and professional clients where a non-EEA state's regulatory framework is deemed to have equivalence;
- **COMMODITIES**—Introduction of reporting and position limits following the US rules applied by the CFTC.

What will it mean in practice?

MiFID II is a multifarious regulatory framework that will have an impact on many parts of investment businesses for the majority of market participants across multiple asset classes.

Contained in this series of MiFID II / MiFIR summaries is an overview of the key areas of change that market participants should be aware of.

What are the things to look out for?

Additional to the Level 1 regulatory text of MiFID II/MiFIR, the European Commission has also now adopted most of the expected Level 2 standards and guidance including delegated directives, delegated regulations and most of the regulatory technical standards (RTS)². National Competent Authority transposition of MiFID II is ongoing with the FCA expected to incorporate the required updates in the FCA Handbook by July 2017 (this will include the final rules around inducements and payment for research amongst other things).

It is worth monitoring the different approaches that National Competent Authorities may take to transposition of MiFID II. The contrast in the AMF's and FCA's approach to the application of the

inducement / research unbundling rules is a good example of that, whereby the FCA has taken the decision to include a much broader set of market participants (notably AIF and UCITS managers) under the requirements.

Further industry debate is ongoing regarding many of the technical aspects in implementing the required measures, such as how financial instruments are to be identified for the purposes of transaction reporting, trading obligations and transparency requirements. Firms are also working hard to be in a position to communicate with clients during the course of 2017 on changes to their business and what those changes mean in practice, look out for your brokers approaching you to start the process of MiFID II readiness. It is anticipated that a significant number of client documents will be updated before MiFID II go live.

There are several industry fora and meetings that local regulators, trade associations and trading venues are currently running designed to educate market participants on the MiFID II / MiFIR requirements.

² Regulatory texts adopted by the European Commission can be found on the ESMA website - <https://www.esma.europa.eu/policy-rules/mifid-ii-and-mifir>