

Clients & Friends Alert

MiFID and MiFIR on Supervision of Products – and – Circuit Breakers

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Introduction

This is the fifth in our series of briefings on MiFID and MiFIR. Below, we describe new powers of product intervention granted to ESMA and local regulators under MiFIR and new obligations set out in MiFID for regulated markets to have in place measures to ensure systems' resilience, including circuit breakers and controls over algorithmic trading.

A. Product Intervention

Key Points

- a direct power to prohibit a particular investment and/or investment activity is given its first legislative expression;
- regulators are the first line of intervention;
- ESMA has the power temporarily to ban products or practices in the absence of regulatory intervention.

Legislative Provisions

1. *MiFIR Article 32 (Product intervention by competent authorities):* A regulator may prohibit or restrict the marketing, distribution or sale of a particular financial instrument, a "financial instrument with certain features" or a type of financial activity or price if satisfied on reasonable grounds that: (i) the instrument or activity gives rise to significant investor protection concerns or poses a serious threat to the orderly functioning and integrity of financial markets or systemic stability; (ii) existing regulatory requirements are insufficient to address the risk(s) and the issue would not be better addressed by supervision or enforcement measures; (iii) the action is proportionate; (iv) consultation with other affected regulators has taken place; and (v) the action will not have a discriminatory effect elsewhere in the European Union.

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2. *MiFIR Article 31 (ESMA powers to temporarily intervene)*: ESMA may also intervene to restrict a particular financial instrument or activity on a temporary basis, provided that conditions (i) and (ii) above are met and no regulator has already intervened.

B. Circuit Breakers

Key Points

- regulated markets must have circuit breakers in place;
- regulated markets must also have arrangements in place to control algorithmic trading, e.g., the ability to slow down order flow or limit minimum tick size;
- end-users of direct market access facilities must be “suitable”;
- the Commission is to adopt delegated legislation that sets out the parameters and conditions for exercise of these control mechanisms.

Legislative Provisions

1. *MiFID Article 51 (Systems resilience, circuit breakers and electronic trading)*: Regulated markets are subject to an overarching obligation to put in place systems in order to ensure resilient trading, sufficient capacity, orderly trading during conditions of market stress and business continuity. These systems should themselves be stress tested.

Regulated markets are also subject to a number of individual systems requirements aimed at ensuring orderly markets through:

- arrangements to reject orders exceeding pre-determined volume and price thresholds or orders that are “clearly erroneous” and to enable a temporary halt to trading if there is a significant price movement in a financial instrument in a short period of time. In exceptional cases, the regulated market should also be able to cancel, vary or correct any transaction;
- arrangements to ensure algorithmic trading systems cannot create or contribute to disorderly trading conditions, including arrangements to limit the ratio of unexecuted orders to transactions that may be entered into the system, arrangements to slow down the flow of orders and arrangements to limit minimum tick size;
- arrangements to ensure that participants in direct electronic access systems are MiFID-authorized, to set and apply appropriate criteria for determining the suitability of those to whom the participants provide direct access and to ensure that members or participants retain responsibility for orders executed *via* direct access. In addition, regulated markets will be required to set “appropriate standards” for risk controls and thresholds for direct electronic access and to have the means of distinguishing and (if necessary) stopping orders or trading by the end-user.

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