

Clients & Friends Alert

MiFID and MiFIR on the Obligation to Trade Derivatives on Regulated Markets and Revisions to the Best Execution Regime

25 October 2011

Introduction

This is the second in our series of briefings on MiFID and MiFIR. Below, we describe new obligations to trade certain derivatives on regulated markets, MTFs or OTFs and the Commission's proposals for the best execution regime.

A. Trading Derivatives On-Exchange

Key Points

- sufficiently liquid derivatives contracts between financial counterparties/non financial counterparties (as defined in EMIR¹) must be traded on a regulated market, MTF or OTF;
- ESMA will submit draft implementing technical standards within three months of the adoption by the European Commission of EMIR implementing technical standards;
- trading of derivative contracts captured by MiFIR may take place on third country trading venues provided those venues meet certain criteria;
- trading with third country entities may be captured if those entities would have been subject to EMIR's clearing obligations if established in Europe; and
- trading between third country entities may be captured if the contracts involve "a direct, substantial and foreseeable effect" within the European Union.

Legislative Provisions

1. *MiFIR Article 24 (Obligation to trade on regulated markets, MTFs or OTFs):* Derivatives counterparties designated as "financial counterparties" and "non financial counterparties" according to EMIR and trading in a class of derivative declared subject to a trading

¹ European Market Infrastructure Regulation (draft)

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obligation via the procedure set out in Article 26 (see below) must trade on a regulated market, MTF, OTF or third country trading venue. Appropriate third country trading venues are those that the European Commission has determined: (i) require participants to comply with legally binding requirements that are equivalent to European requirements; (ii) are subject to “effective supervision and enforcement in that third country”; and (iii) give equivalent reciprocal recognition to MiFID-authorized European trading venues.

The trading obligation also applies to: (i) financial counterparties or non financial counterparties entering into derivatives that are subject to the obligation with third country entities that would be subject to the clearing obligation set out in EMIR if the third country entity were established in Europe; and (ii) third country entities that would be subject to the clearing obligation if they were established in Europe. This obligation arises where the third country entities are trading derivatives that are subject to the trading obligation and which have a “direct, substantial and foreseeable effect within the Union or where such obligation is necessary or appropriate to prevent the evasion of any provision of this Regulation.”

2. *MiFIR Article 26 (Trading obligation procedure)*: ESMA will develop implementing technical standards for sufficiently liquid contracts, taking into account average frequency and size of trades and the number and type of active market participants. The technical standards will determine which of those derivatives deemed eligible for clearing under EMIR must be traded on a regulated market, MTF or OTF and the date from which that trading obligation takes place.

B. Best Execution

Key Points

- firms must put in place order execution policies and provide information on those policies to clients;
- firms must also obtain their clients' consent to order execution policies;
- firms must publish information annually on their top five execution venues.

Legislative Provisions

1. *MiFID Article 27 (Obligation to execute orders on terms most favourable to the client)*: Investment firms remain subject to the requirement to take “all reasonable steps” to obtain the best possible result for clients when executing their orders. Results should be judged taking into account price, costs, speed, likelihood of execution and settlement, size, nature or any other consideration relevant to the execution of the order.

Investment firms must establish and implement order execution policies to achieve the best possible results, and those policies must include information on the different venues used for execution and the factors affecting the choice of venue. Article 27(4) requires that the

policy must “at least include those venues that enable the investment firm to obtain on a consistent basis the best possible result for the execution of client orders.” Investment firms must provide “easily understood” information on their policies to clients, obtain the prior consent of their clients to the execution policy and be able to demonstrate to clients (at their request) that they have executed their orders in accordance with the policy.

Investment firms are to be required to summarise and make public annually, and for each class of financial instrument, the top five execution venues used in the preceding year. Execution venues must also make data available to the public at least annually on the quality of executions on that venue, including details of price, speed and likelihood of execution for individual financial instruments.

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