

# Clients & Friends Alert

## MiFID on Client Categorisation and Transactions with 'Eligible Counterparties' – and – Organised Trading Facilities

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### Introduction

This is the fourth in our series of briefings on MiFID and MiFIR. Below, we describe the proposed changes to the current client classification regime, and in particular, amendments to the regime for transactions with 'eligible counterparties'. We will also discuss the introduction of a new concept of regulated 'organised trading facilities'.

### (A) Client Categorisation and Transactions with 'Eligible Counterparties'

#### Key Points

- The existing classification of clients into retail clients, professional clients, and eligible counterparties is unchanged.
- Local authorities and municipalities will not automatically be classified as professional counterparties, but may opt to be treated as such.
- Transactions with eligible counterparties now will be subject to providing clients with more information and documentation.
- The overarching requirement for fair treatment and clear communication in client relationships has been extended to transactions with eligible counterparties.

#### Legislative Provisions

1. *MiFID Annex II (Treatment of local authorities and municipalities)*: Municipalities and local public authorities are now excluded from the list of *per se* professional clients and would therefore automatically be treated as retail clients. However, the proposed rules allow them to waive this protection and be treated as professional clients if they satisfy certain requirements, which Member States will set out in delegated legislation.

2. *MiFID Article 30 (Conduct of business requirements for eligible counterparties)*: The overarching high-level requirement for investment firms to act honestly, fairly and professionally

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and the obligation to be fair, clear and not misleading is proposed to be extended to dealings with eligible counterparties.

Investment firms entering into transactions with eligible counterparties will now be obliged to provide their clients with (i) information on issues such as proposed investment strategies, execution venues and costs and associated charges<sup>1</sup> and (ii) reports on the services provided, in particular, periodic communications in light of factors such as the complexity of the financial instruments involved.<sup>2</sup> These obligations will apply to the relevant transaction and any ancillary service directly related to the transaction.

## **(B) Organised Trading Facilities**

### **Key Points**

- MiFID and MiFIR will introduce 'organised trading facilities' (also known as OTFs), a category of trading venue which sets out to capture venues that do not correspond to any of the existing categories, for instance, dark liquidity pools, voice brokers and interdealer brokers.
- OTFs require authorisation.
- The proposed rules impose strict segregation of the OTF from the proprietary capital of the investment firms which operate them, as well as other OTFs, and do not allow for investment firms to act as a systemic internaliser in OTFs that they operate. OTFs may not execute client orders against their own assets.
- OTFs will be subject to some of the same conduct of business requirements applicable to regulated markets and MTFs.

### **Legislative Provisions**

1. *MiFIR Article 2(7) (Definition)*: "any system or facility, which is not a regulated market or MTF, operated by an investment firm or a market operator, in which multiple third-party buying and selling interests in financial instruments are able to interact in the system in a way that results in a contract in accordance with the provisions of MiFID."

2. *MiFID Article 20(2) (Authorisation)*: OTFs must apply for authorisation and in their request, explain in detail why the system does not correspond to and is unable to operate as either a regulated market, an MTF or a systematic internaliser.

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<sup>1</sup> Article 24(3)

<sup>2</sup> Per Article 25(5)

3. *MiFID Article 20(1) (Segregation)*: Investment firms operating OTFs will not be able to execute client orders against their own proprietary capital, and must not act as systemic internalisers of OTFs that they operate. Additionally, OTFs are banned from connecting with other OTFs in a way which enables orders in different OTFs to interact.

4. *MiFID Article 20(3) (Conduct of Business)*: OTFs will be subject to various conduct of business rules, including the same transparency, reporting, best execution and client order handling requirements which apply to regulated markets and MTFs.<sup>3</sup>

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<sup>3</sup> Articles 24, 25, 27 and 28 of MiFID