

# Clients & Friends Alert

## Markets in Financial Instruments Directive: agreement in principle on revised European rules

17 January 2014

### Introduction

On 14 January 2014 the European Parliament, the Council and the Commission reached a high-level [agreement](#) in principle on updating the rules for the revised Markets in Financial Instruments Directive (MiFID II) and Regulation (MiFIR). Further technical issues that remain outstanding are expected to be finalised over the coming weeks. Moreover, a number of provisions require further delegated legislation and/or technical standards to be finalised. As a result, implementation of final rules may not be complete until up to three years after the legislation is formally adopted, which could be late 2016 or 2017. Drafts of MiFID II and MiFIR were first published by the European Commission (EC) on 20 October 2011. They are intended to bring more efficiency and transparency to the financial markets (including commodity markets), and to strengthen the protection of investors. The fact that over two years have passed and we are now into the 6th rotating EU presidency to marshal the legislative process is reflective of how contentious many of the issues being dealt with in the new legislation have been.

MiFID II and MiFIR are intended to eliminate the structural weaknesses that became apparent in the original MiFID following its transposition into local law throughout the EU in 2008, and particularly highlighted in the global financial crisis.

Key points of the agreement reached this week are set out below.

### 1. Market Structure Framework

Transparency requirements will change significantly. MiFID will ensure that trading takes place on regulated platforms in order to maintain a level playing field with regulated markets and multilateral trading facilities (MTFs). Accordingly shares will be subject to a trading obligation, as will derivatives which are eligible for clearing under the European Markets Infrastructure Regulation and are sufficiently liquid.

Further, investment firms that operate an internal matching system to execute client orders on a multilateral basis will have to be authorised as a MTF. A new multilateral trading venue for non-

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equity instruments to trade on organised multilateral trading platforms will be introduced (the “Organised Trading Facility” (OTF)),

The pre- and post-trade transparency regime will be extended to include non-equity instruments. In order to enhance the effective consolidation and disclosure of trading data, trading venues will be obliged to make pre- and post-trade data available on a reasonable commercial basis and through the establishment of a consolidated tape mechanism for post-trade data. Also, an approved reporting mechanism and authorised publication arrangement for trade reporting and publication will be established.

MiFID II will establish an EU regime for non-discriminatory access to trading venues and central counterparties. The non-discriminatory access regime will also apply to benchmarks for trading and clearing purposes.

## **2. Position Limits**

MiFID II establishes a harmonised position-limits regime for commodity derivatives, pursuant to which competent authorities will impose limits on persons' positions in accordance with a methodology for calculation set by the European Securities and Markets Authority (ESMA). Position limits will apply to both physically and financially-settled contracts in spot and non-spot months. MiFID II also introduces a position-reporting obligation by category of trader.

## **3. Introduction of Trading Controls for Algorithmic Trading Activities**

Safeguards will be introduced with respect to algorithmic trading activities, including a requirement that algorithmic traders will be properly regulated and provide liquidity when pursuing a market-making strategy. Investment firms will be required to have systems and risk controls in place to prevent trading that may contribute to a disorderly market or involve market abuse where they provide direct electronic access to a trading venue.

## **4. Stronger Investor Protection**

Investor protection is enhanced through client asset protection or product governance, which in turn will strengthen the role of management bodies. The new regime also augments the conduct rules, such as an extended scope for the appropriateness tests and reinforced information to clients. Independent advice is clearly distinguished from non-independent advice and limitations are imposed on the receipt of commissions (inducements). ESMA will have the power to prohibit or restrict the marketing and distribution of certain financial instruments; the European Banking Authority will have similar powers in respect of structured deposits.

## **5. Effective and Harmonised Administrative Sanctions**

The existing regime will be strengthened. There will be greater cooperation between authorities and transparency of criminal sanctions. This will improve the effective detection of breaches of MiFID II.

**6. A Harmonised Regime for Granting Access to EU Markets for Firms From Third Countries**

This will be based on an equivalence assessment of third country jurisdictions by the EC, and will apply to the cross-border provision of investment services and activities provided to professional and eligible counterparties.

**7. Scope of Financial Instruments**

The definition of commodity derivatives within the scope of MiFID is extended to cover physically-settled contracts traded on an OTF other than contracts that constitute “wholesale energy products” (i.e. electricity and natural gas contracts) as defined in the Regulation on Energy Market Integrity and Transparency that must be physically settled. Furthermore, the meaning of “must be physically settled” is going to be further defined in subsequent, delegated legislation. At a minimum, this definition will state that the contract cannot be unwound, cash-settled or offset, except in the case of force majeure, default or other bona fide inability to perform.

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