

The MiFID II Proposals — 10 Key Points

Background

On 20 October the European Commission tabled proposals to revise the Markets in Financial Instruments Directive (MiFID). These proposals (known as MiFID II) are intended to:

- Make financial markets more efficient and resilient;
- Take account of technological developments since MiFID was implemented in November 2007;
- Increase transparency of both equity and non-equity markets;
- Reinforce supervisory powers and introduce a stricter framework for commodity derivatives markets;
- Strengthen investor protection.

10 Key Points:

1. **Organised trading facilities.** Creation of a new type of trading venue within the regulatory framework: the organised trading facility (OTF) (alongside Regulated Markets and MTFs). OTFs are organised trading platforms that are not currently regulated, but have an increasingly important role. For example, standardised derivatives contracts are increasingly traded on these platforms. The new proposal will close this loophole. The definition of OTFs captures all forms of organised trading that do not match existing categories.
2. **High frequency trading (HFT).** As widely expected, the updated MiFID will introduce new safeguards for algorithmic and high frequency trading activities which have drastically increased the speed of trading and pose possible systemic risks. These safeguards include the requirement for:
 - all algorithmic traders to become properly regulated,
 - HFT firms to have in place effective systems and risk controls to ensure that their trading systems are resilient and have sufficient capacity, are subject to appropriate trading thresholds and limits and prevent the sending of erroneous orders or the system otherwise functioning in a way that may create or contribute to a disorderly market;

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- HFT firms at least annually provide to their home regulator a description of the nature of their algorithmic trading strategies, details of trading parameters or limits to which their system is subject and their key compliance and risk controls;
 - New appropriate liquidity and rules to prevent HFT firms from adding to volatility by moving in and out of markets;
 - An investment firm that provides direct electronic access to a trading venue to have in place effective systems and controls which ensure a proper assessment and review of the suitability of persons using the service, that persons using the service are prevented from exceeding appropriate pre set trading and credit thresholds, that trading by persons using the service is properly monitored and that appropriate risk controls are in place to prevent risks to the investment firm or which may create a disorderly market. Similar requirements apply to a general clearing firm.
3. **The Scope and Exemptions from MiFID have been amended.** The proposals limit the exemptions more clearly to activities which are less central to MiFID and primarily proprietary or commercial in nature, or which do not constitute high-frequency trading. Any firms relying on these exemptions should prudently take legal advice to ensure they meet the terms of these exemptions.
 4. **Improvements to corporate governance:** the proposals strengthen the provisions with regard to the profile, role, responsibilities of both executive and non-executive directors and balance in the composition of management bodies. The proposals also seek to ensure that members of the management body possess sufficient knowledge and skills and comprehend the risks associated with the activity of the firm in order to ensure the firm is managed in a sound and prudent way in the interests of investors and market integrity.
 5. **Market transparency.** OTFs will be subject to the same transparency rules as other trading venues to improve trading transparency in equity markets. Dark pools (trading volumes of liquidity that are not available on public platforms) will continue to be allowed, but only where they do not cause competitive distortions and reduce the overall efficiency of the price discovery process. The proposals also include a new trade transparency regime for non-equities markets (i.e. bonds, structured finance products and derivatives).
 6. **Transaction reporting.** Extension of the scope of the transaction reporting requirements to all financial instruments.
 7. **Reinforced supervisory powers.** The proposals reinforce the role and powers of European regulators. Supervisors will be able to ban specific products, services or practices in case of threats to investor protection, financial stability or the orderly functioning of markets. The proposals also foresee stronger supervision of commodity derivatives markets. It introduces a position reporting obligation by category of trader. This will help regulators and market participants to better assess the role of speculation in these markets. In addition, the Commission proposes to empower financial regulators to monitor and intervene at any stage in trading activity in all commodity derivatives, including in the shape of position limits if there are concerns about disorderly markets.
 8. **Extension of scope.** Broadening of the scope of MiFID to cover financial products (such as structured deposits), services and entities not currently covered.
 9. **Stronger investor protection:** Enhanced conduct of business requirements will provide additional protection to investors. These include new requirements for advisers wishing to describe themselves as "independent"; a ban on independent advisers and portfolio managers making or receiving third-party payments or other monetary gains; enhanced information disclosure to different categories of client.
 10. **Third-country firms.** Introduction of a harmonised third country equivalence regime for the access of

third country investment firms and market operators to the EU. The proposal introduces a regime based on a preliminary equivalence assessment of third country jurisdictions by the Commission. Third country firms from third countries for which an equivalence decision has been adopted would be able to request to provide services in the Union. The provision of services to retail clients would require the establishment of a branch; the third country firm should be authorised in the Member State where the branch is established and the branch would be subject to EU requirements in some areas. Services provided to eligible counterparties would not require the establishment of a branch; third country firms could provide them subject to ESMA registration. They would be supervised in their country.

The Commission has also published its legislative proposals on amendments to the Market Abuse Directive. Please see our separate alert on these proposals for further information.

If you would like to discuss any aspect of this alert or require further information on the matters referred to, please contact Tony Katz (+44 207 862 4822) or Sam Millar (+44 207 862 4821), partners in the Orrick London Financial Institution Regulatory practice .

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