

## MiFID II: The New Transparency Regime

### Overview

The overhaul of the Markets in Financial Instruments Directive (“**MiFID**”) that was agreed by European legislators on 14 January 2014 includes sweeping changes to the pre- and post-trade transparency regime for EU financial markets. The current requirements under MiFID, which are limited to shares admitted to trading on regulated markets, will be extended to cover other equity-like and non-equity instruments traded on any trading venue, including multilateral trading facilities (“**MTFs**”) and the new category of organised trading facilities (“**OTFs**”). Systematic internalisers (“**SIs**”) and other investment firms that trade over-the-counter in financial instruments will also be subject to expanded pre- and post-trade transparency obligations. A framework has been introduced for trade data to be published through approved arrangements and made available via a consolidated tape. The transaction reporting obligations of MiFID have also been expanded, though these are beyond the scope of this note.

The revised transparency regime is primarily contained in a new Regulation (“**MiFIR**”) which, together with a new Directive (“**MiFID II**”), will replace the existing MiFID. As a regulation, MiFIR will have direct effect in all EU Member States, while MiFID II will require transposition into national law. The new legislation must now be formally adopted by the European Parliament and the Council of the European Union, and will not be implemented until late 2016 at the earliest.

Many details of the new transparency requirements will be set out in Level 2 acts consisting of regulatory technical standards (“**RTS**”) and delegated acts. The RTS will be drafted by the European Securities and Markets Authority (“**ESMA**”) and adopted by the European Commission, while the Commission will draft the delegated acts, with advice from ESMA. It is expected that ESMA will launch a public consultation in the coming months so that market participants can comment on the substance of these measures.

### Background

MiFID, which entered into force in November 2007, established a harmonised regulatory framework for the provision of investment services and the operation of regulated markets across the European Union. Among other things, it sought to make the financial markets more transparent and to level the playing field between trading venues.

### Contents

Overview.....	1
Background.....	1
Impact on equity markets .	2
Impact on non-equity markets .....	2
Availability and access .....	3
Impact on systematic internalisers and investment firms .....	4
Consolidated tape.....	4
What happens next?.....	5
Contacts.....	6

The Commission's proposals arose out of a review in which the Commission had identified a number of issues with the existing regime. Market fragmentation made the collection of trade data more complex. A significant amount of bonds and derivative instruments were traded outside organised venues, hindering price discovery. The Commission concluded that changes were needed to increase transparency and create a more level playing field.

While the final legislation largely follows the Commission's recommendations, a number of significant changes have been introduced.

## **Impact on equity markets**

The existing pre- and post-trade transparency requirements will be extended to cover shares and other equity-like instruments such as depositary receipts, exchange-traded funds and certificates that are traded on regulated markets, MTFs and OTFs. Pre-trade transparency requirements will be calibrated for different types of trading systems including order-book, quote-driven, hybrid, and periodic auction trading systems. ESMA will specify in RTS the scope of pre-trade information to be made public.

Competent authorities will continue to be able to waive pre-trade transparency obligations in certain cases such as for orders that are large in scale. The reference price waiver, which the Commission had deleted in its proposal, has been retained for equity instruments, and a negotiated price waiver added. Order management waivers will also be available. However, the volume that can be traded on dark pools under the reference price waiver and the negotiated price waiver will be capped at 4% per trading venue and 8% overall across the EU. How this will work in practice is unclear, particularly in the absence of a consolidated tape. Details of the different types of waivers and the volume cap mechanism will be clarified in RTS.

A competent authority wishing to waive pre-trade transparency will need to notify other competent authorities as well as ESMA, which will issue a non-binding opinion on whether the waiver complies with the requirements of MiFIR. If another competent authority disagrees with a waiver, ESMA will help mediate a solution and could order a waiver to be withdrawn.

As is currently the case for shares, the publication of post-trade information may be deferred for equity instruments in some cases. ESMA may mediate disputes between the competent authorities of different Member States regarding the authorisation of deferred publication. The scope and timing of post-trade transparency, as well as the conditions for deferral, will be detailed in RTS.

## **Impact on non-equity markets**

MiFIR will introduce a new pre- and post-trade transparency regime for bonds, structured finance products, emissions allowances and derivatives traded on regulated markets, MTFs and OTFs. As with equities, the requirements will be the same regardless of trading venue, though pre-trade

transparency requirements will be calibrated for different types of trading systems including order-book, quote-driven, hybrid, and periodic auction trading systems. Pre-trade transparency for non-equity instruments will also be calibrated for voice trading systems.

Waivers relating to pre-trade transparency will be available for large-in-scale orders and orders held pending disclosure, actionable indications of interest in request-for-quote and voice trading systems above a specified size that would expose liquidity providers to undue risk, derivatives not subject to the trading obligation, and other financial instruments for which there is no liquid market. If a waiver is granted, indicative pre-trade bid and offer prices must be published continuously during trading hours. Derivative transactions of non-financial counterparties entered into for hedging purposes will be exempt from pre-trade transparency together.

Member State regulators may withdraw waivers for non-equity instruments in certain circumstances. Regulators may also temporarily suspend pre-trade transparency requirements for non-equity instruments if liquidity falls below a specified threshold. The scope of pre-trade information to be made public, and details of the different types of waivers, will be clarified in RTS, as will the methods and parameters for calculating the liquidity threshold.

As with equities, ESMA and other competent authorities will need to be informed of any waivers, and ESMA will issue an opinion and mediate any disputes between authorities. ESMA must also be notified of any suspension of obligations by competent authorities.

Deferred publication of post-trade information may be authorised for large-in-scale transactions, illiquid financial instruments and transactions above a specified size that would expose liquidity providers to undue risk. When authorising deferred publication, regulators may allow limited or aggregated information to be published during the deferral period or for a longer time in some cases. Regulators may also temporarily suspend post-trade transparency requirements if liquidity falls below a specified threshold. The scope and timing of post-trade transparency, as well as the conditions for deferral, will be detailed in RTS.

## **Availability and access**

Trading venues must make pre- and post-trade information available to the public separately and on a reasonable commercial basis and ensure non-discriminatory access. Information must be made available free of charge 15 minutes after publication. The offering of data, including the level of disaggregation required, will be specified in RTS. The Commission will clarify in delegated acts what constitutes a “reasonable commercial basis.”

Trading venues must also make their publication arrangements available, on a reasonable commercial and non-discriminatory basis, to investment firms fulfilling their transparency obligations as described below.

## Impact on systematic internalisers and investment firms

### > Firm quote requirements

In the case of SIs, as proposed by the Commission, firm quote requirements will be extended to non-equity and other equity-like instruments traded on a trading venue and for which there is a liquid market, in addition to shares. The minimum quote size for equity instruments must be at least 10% of the standard market size, and prices must reflect prevailing market conditions. The modalities of publication, as well as the determination of “standard market size” and “prevailing market conditions,” will be detailed in RTS. For structured finance products, emission allowances and derivatives traded on a trading venue for which there is no liquid market, SIs must disclose quotes to clients on request if they agree to provide a quote, subject to pre-trade transparency waivers.

SIs must make their published firm quotes for non-equity instruments available to their other clients, though they may decide, on a non-discriminatory basis and consistent with their commercial policy, the clients to whom they give access to their quotes, as is the case for equity instruments. SIs must undertake to enter into transactions in non-equity instruments with any other client under the published conditions when the quoted size is below a specified amount. Firm quote requirements will not apply to non-equity transactions above a specified size that would expose liquidity providers to undue risk, and SIs will not be obliged to publish firm quotes for non-equity instruments that fall below the liquidity threshold referred to above.

### > Post-trade disclosures

Post-trade disclosure requirements for investment firms, including SIs, have also been extended to include non-equity and equity-like instruments and instruments traded on an MTF or OTF. This information will be published through an “approved publication arrangement” (“**APA**”) meeting the requirements of MiFID II, which will make the information public as close to real time as technologically possible on a reasonable commercial basis and free of charge 15 minutes after publication. As with post-trade transparency for trading venues, post-trade disclosures by investment firms may be deferred in certain circumstances.

ESMA will develop draft RTS specifying the identifiers to be used in these disclosures for different types of transactions, the application of the disclosure requirements to transactions involving financial instruments that are used for collateral, lending or other purposes, and which party must make the disclosure when both parties to a transaction are investment firms.

## Consolidated tape

The agreed text of MiFID II also includes an amended version of the Commission’s proposals for a consolidated tape provider (“**CTP**”), which will consolidate post-trade information into a continuous electronic data stream

and made it publicly available as close to real time as technologically possible on a reasonable commercial basis and free of charge after 15 minutes. Both APAs and CTPs are new concepts under MiFID II and MiFIR. As of yet, no CTP has been identified.

Requirements for a non-equity consolidated tape will not take effect until 50 months after MiFID II enters into force. ESMA will develop data standards and formats for information to be published and will report on the functioning of the consolidated tape for equities and for non-equities within two years of the application date for each.

## What happens next?

The texts of MiFID II and MiFIR are currently being reviewed by jurist-linguists, who will produce final versions and translate them into the different languages of the Member States. The exact dates for implementation will not be known until the final texts are formally adopted by the Parliament and Council and published in the Official Journal.

The following provisional schedule is based on the likely dates of approval by the EU legislators and is subject to change.

<b>15 April 2014</b>	Final text approved by Parliament plenary
<b>April-June 2014</b>	Final text approved by EU Council
<b>May/June 2014</b>	ESMA consults on technical standards and delegated acts
<b>June 2014</b>	Publication in Official Journal
<b>July 2014</b>	MiFID II and MiFIR enter into force (20 days after publication in Official Journal)
<b>December 2014</b>	ESMA submits advice on delegated acts to Commission
<b>January 2015</b>	Second ESMA consultation on technical standards
<b>July 2015 (1 year after entry into force)</b>	ESMA submits draft regulatory technical standards to Commission
<b>January 2016 (18 months after entry into force)</b>	ESMA submits draft implementing technical standards to Commission
<b>July 2016 (2 years after entry into force)</b>	MiFID II must be transposed into national law of Member States
<b>January 2017 (30 months after entry into force)</b>	MiFID II and MiFIR apply within Member States

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