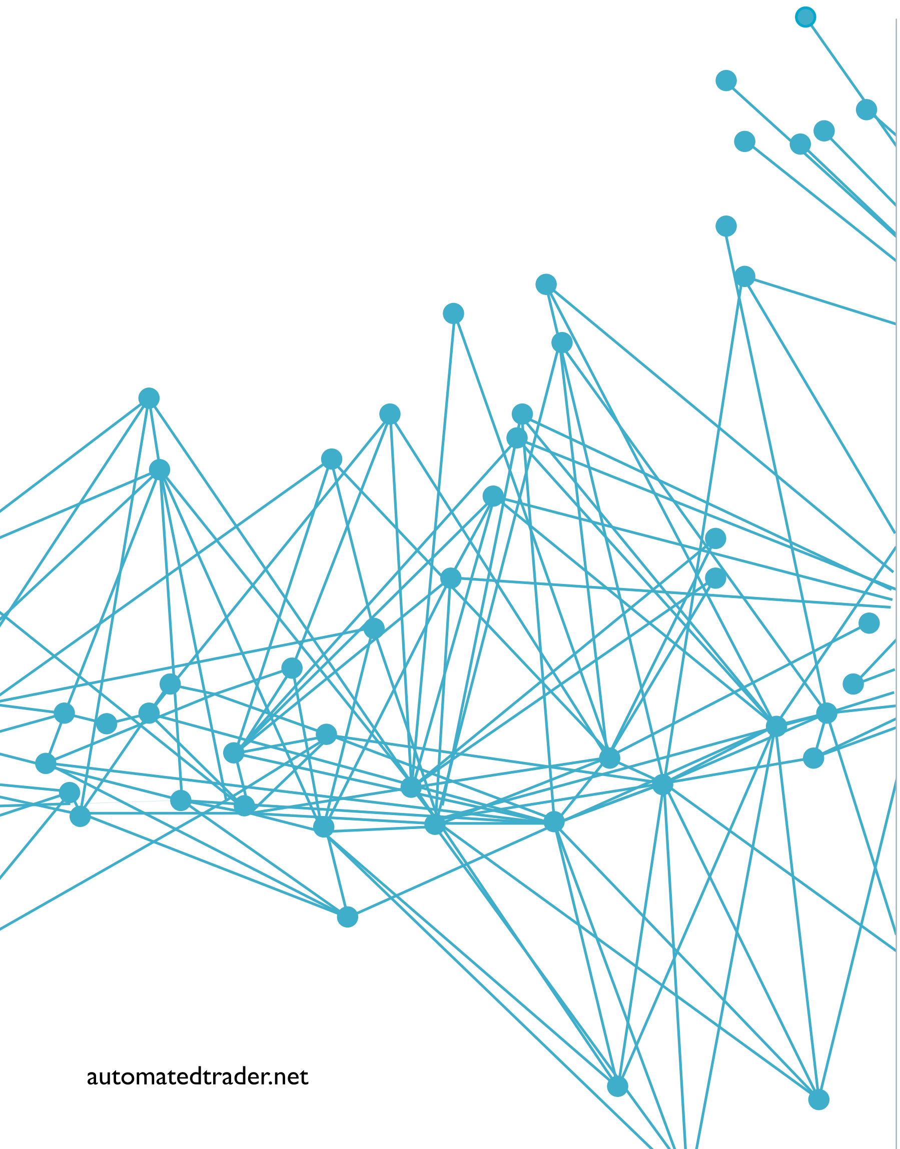
AUTOMATED TRADER

STRATEGIES | COMPLIANCE | TECHNOLOGY

ISSUE 39
Q2 | 2016



THE DELAY *(OR NOT)* OF MIFID 2 AND THE RELEASE *(OR NOT)* OF THE COMMISSION DELEGATED ACTS FOR MIFID 2

by Sam Tyfield

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The biggest news in compliance this year is that MiFID 2 is likely to be delayed until January 2018. What are the implications?

Its original implementation date was January 2017. This amendment has been introduced due to concerns by ESMA (the pan-EU financial services regulator) and member states' national regulators (NCAs). In their view, delays in providing consent to draft technical standards by the EU Commission have a knock-on effect on the building of systems and controls and infrastructure necessary to put the terms of MiFID 2 into force.

There are a few significant issues which remain open or of concern. Below is a small selection, which is by no means exhaustive.

1. *Will this be the only delay and/or will this delay be acceptable to the EU Parliament (which was and is the driving force behind MiFID 2)?* Significant details remain to be fleshed-out in technical standards. It is only once these technical standards have been approved finally by the various EU institutions that NCAs, ESMA and investment firms can start to build the systems and infrastructure or make appropriate changes to their group structures or trading strategies in order to comply. The timetable for approval of the standards keeps getting pushed-out. We do hope that the approval of the standards (or at the least written comments on them) will be released by the time this article goes to print. This is more a hope than an expectation. If the standards are delayed much further, then it might be that the implementation date will need to be delayed further, too. Counterintuitively, the EU Parliament has stated a number of times that if the EU Commission and ESMA do not work 'harder' to produce standards, it will consider not approving a delay. This

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could create the situation where MiFID 2 comes into force but NCAs and ESMA would need to forbear enforcement of some or all of the rules to give participants time to comply.

2. *What impact will MiFID 2 have on non-EU firms which trade EU markets?* This remains unclear. Within the last few weeks, the EU Parliament has commented on the EU Commission's proposal to delay MiFID 2 by proposing an amendment to MiFID 2 itself. Certain types of firms are exempt from MiFID 2. What the EU Parliament proposes is that firms which trade their own capital as members of (or through DMA/SA to) EU trading venues will not be exempt from MiFID 2 if they trade using a 'high frequency trading technique'. Obviously, this is not a settled amendment, but it gives a strong indication (to me at least) that the EU Parliament intends to capture under MiFID 2 non-EU firms which are HFT. This would follow the German model from a few years ago.

3. *When do member states have to put MiFID 2 into their national laws?* Notwithstanding the proposed delay of MiFID 2 to January 2018, the date by which member states need to have put MiFID 2 into national law has not changed. It remains July 2016: this summer. I understand that this is deliberate, but am not sure why. I am also not sure how it will work. Given that MiFID 2 is (for the most part) a framework, unless a significant number of details are filled in, there is a risk that each member state implements MiFID 2 in a different way, raising the spectre of what ESMA is calling 'regulatory arbitrage'. This is particularly the case for issues such as access for/regulation to non-EU firms.

4. *What impact will MiFID 2 have on non-financial corporate firms?* A large number of industry participants have expressed their concern regarding corporates which trade on EU trading venues for corporate purposes (e.g. hedging future opex). The amendment proposed by the EU Parliament referred to above (impacting HFT firms) was expressed to be for the benefit of those firms. In fact, this is true – any firm which is not HFT but trades on its own account will (most likely) not fall under MiFID 2.

5. *What is the definition of 'high frequency trading technique'?* This actually remains open. Everyone is proceeding on the basis that a firm will be measured against quantitative criteria (e.g. two messages per second per venue per liquid instrument or four messages per second per firm per venue). However, the definition remains in the EU Commission's court to confirm.

6. *What about the new market abuse and manipulation rules?* These come into force in July 2016, notwithstanding that a large number of the metrics required to 'measure' or identify market abuse will not be present. For example, MiFID 2 contains obligations in relation to clock synchronisation, details to be included in order/trade reports, pre- and post-trade risk monitoring measures and references to Organised Trading Facilities and will (at some point) define 'HFT'.

7. *Will the technical standards provide all the answers?* In short, no, they will not. ESMA can provide guidance only on matters on which it has been specifically mandated to do so. The EU Commission can pass delegated regulations only on matters MiFID 2 permits them to do. Therefore, the industry (and the NCAs) will need to rely on (potentially non-binding) Q&A and 'level 3' texts. It is possible, even, that the Q&A will not be released until after MiFID 2 comes into force. Given the time (and expense) it would take for a firm to change its structure and trading strategies or to become authorised and regulated by a NCA, this could have a significant knock-on effect on the industry.

8. *Brexit?* This will create a lot of heat and light around financial services regulation. Ultimately, a UK that is no longer part of the EU will in all likelihood have financial services regulations strikingly similar to MiFID 2. This seems the only logical choice if the UK wishes its firms to have reasonable access to EU markets and EU clients. In any case, the timetable for Great Britain to leave the EU would likely fall beyond a MiFID 2 implementation date (even a delayed one), leaving things even more murky.

In conclusion, since there has been no real progress in MiFID 2 for some time, the industry faces as many challenges now as it did a year ago and there is as much to do over the next two years as there was a year ago. I prefer to think of the 'delay' to MiFID 2 as a 'deferral' of the rule-making process. I would have liked to finish with some good news. However, other than the usual stuff about 'firms having an opportunity to innovate and take advantage of challenges', I have not really got any. Sorry.

MITIGATING THE IMPACT OF THE DOUBLE VOLUME CAPS

MiFID 2 introduces very specific regulations on how much trading can take place in dark pools (compared to regular or lit venues) via so-called "Double Volume Caps" (DVCs). They specifically limit the use of two pre-trade transparency waivers: the Negotiated Trade Waiver (NTW) and the Reference Price Waiver (RPW).

Faced with the reality and uncertainty of the effects of DVCs, market participants must choose a path forward. Options include:

> To trade in the lit book. Instead of crossing two agency orders, each order is sent to the lit book for execution at the bid (the sell-order) and the offer (for the buy-order). Buyer and seller share the spread cost, instead of trading within the spread.

> To wait until order volume reaches the large in scale (LIS) threshold. This would (theoretically) allow trade reporting, even if the instrument is capped. However, the Technical Advice [ESMA/2014/1569] states "…ESMA should explicitly specify that aggregation of client orders should not be used for the purpose of artificially creating a total order size that results in an order size which falls above the LIS thresholds and therefore can be executed without full transparency".

> To trade OTC. However, the regulators have clearly stated that OTC trading must not be used to circumvent the DVC.

> To hope for the emergence of a new innovation to reduce the risk that the caps are hit. The industry will expect innovation, but the regulators will be monitoring attempts to circumvent the caps.

> To use the negotiated transactions subject to "conditions other than the market price". For these transactions, the DVC does not apply. However, as said above, the regulators' intention is not that these exemptions should be used for anything else than "technical trades".

> To use a Systematic Internaliser regime. This might be an effective way to mitigate the caps — in specific cases.

A recent Itiviti white paper explores each of these options, including a systematic internaliser regime.

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