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MIFID II – Reporting And Transparency And Rules Applying To Third Countries

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This is the fourth and final part in a series of Legal Longs on the MiFID II Directive [2014/65/EU] and the Markets in Financial Instruments Regulation (MiFIR) (together, "MiFID II"), which will come into effect on 3 January 2017. This final part provides a brief summary of the reporting and transparency rules introduced by MiFID II and the rules applying to third countries.

Transparency

The transparency rules currently only apply to shares admitted to trading on a regulated market (RM). MiFID II will increase transparency, such that organised trading facilities (OTFs) will be subjected to the same transparency rules as other trading venues in order to improve trading transparency in non-equity markets as well as equity markets.

A new trading transparency regime for non-equity markets (i.e. bonds, structured finance products, derivatives and emissions allowances) will therefore be introduced and transparency requirements will be extended to "equity-like" transactions, such as depositary receipts, ETFs and certificates traded on an RM or multi lateral trading facility (MTF).

The exact transparency regime will be tailored to the instrument in question, but the aim is to ensure that the regime only applies to more liquid and frequently traded instruments.

Trading venues will need to make pre- and post-trade information about trading interest publicly available, but, subject to indicative prices being publicly disseminated, this obligation will not apply where:

1. there is not a liquid market for an instrument;
2. an order is large-in-scale compared with normal market size;
3. an order is held in an order management facility; or
4. an order is trading interest above a size that that would expose liquidity providers to undue risk.

Details of transactions conducted on trading venues must be made available within certain time limits. The post-trade transparency requirement for equities is currently three minutes and this will be reduced to one minute under MiFID II. For non-equity products, the proposal is for this period to be 15 minutes for the first three years following the entry into force of MiFID II and five minutes thereafter. Deferred publication will be possible for under certain circumstances including when a transaction is large in scale compared to normal market size.

Dark pools and volume caps

MiFID currently contains an important waiver from the obligation that falls on firms and markets to provide pre-trade transparency. Two examples of such waiver are: (i) the reference price waiver (RPW), where no transparency is required if the price is taken from another market such as a mid-point price; and (ii) negotiated trades (NPW), where it is thought that direct negotiations between parties leading to a bilateral transaction do not need to be subject to pre-trade transparency. This is referred to as "dark pool" trading and many RMs and MTFs currently operate on the basis of these waivers. However, concern has grown that the waivers have not been implemented across markets and venues consistently, with a consequent lack of price transparency. MiFID II aims to provide greater transparency of dark pools in the EU and caps on the volume that can be traded on dark pools under the RPW and NPW waivers will be introduced, namely:

1. an 8% cap on the amount of trading in a given share on on all EU trading venues where the share trades; and
2. a 4% cap on the amount of trading in a given share on on all EU trading venues that can be carried out by an individual trading venue.

The volume cap is calculated on a trading venue by trading venue basis, but is set at a percentage of the overall trading across all venues in the EU. The two waivers (RPW and NPW) are aggregated across all venues, so that the use of both waivers combined must stay below 8%.

Each trading venue has to submit information about its use of the waivers to its regulator annually.

Transaction Reporting

The transaction reporting regime requires the reporting of transactions to national regulators. This enables regulators to monitor activities of investment for evidence of market abuse.

The existing regime applies to financial instruments admitted to trading on an RM. Under MiFID II, the scope of the transaction reporting requirements will, subject to certain exceptions, be extended to all financial instruments to ensure that the MiFID requirements mirror those of the Market Abuse Directive (MAD). Reporting will not be required in respect of those financial instruments:

1. which are not admitted to trading or traded on an MTF or OTF;
2. whose value does not depend on that of a financial instrument admitted to trading or traded on an MTF or OTF; or
3. which do not or are not likely to have an effect on a financial instrument admitted to trading or traded on an MTF or OTF.

Double reporting of the same information under MiFIR and EMIR will be avoided and EMIR will be amended to that effect. ESMA proposes that no MiFID reporting should be required for stock lending when the Securities Financing Transactions Regulation has been implemented, as reporting is also required under that Regulation. ESMA proposes excluding assignments and novations in derivatives and portfolio compression, in order to focus on decreases and increases in notional as being reportable events.

MiFID II will also require additional information to be included in transaction reports, in particular whether a transaction in shares or sovereign bonds is a short sale and whether a transaction took place under an applicable waiver.

MiFID II introduces a number of amendments to improve the quality of reporting. The UK established a regime for approved reporting mechanisms (ARMs) in implementing MiFID and MiFID II introduces an EU-wide ARMs regime, under which investment firms can make transaction reports through firms authorised to act as ARMs where trades are not executed through an RM, MTF or OTF.

ESMA has also proposed that reporting by branches to host authorities should be abolished, and that all reports by an entity should be sent to its home regulator. However, flags will have to be used to identify transactions that involve a branch to indicate if the branch has the primary relationship with the client.

Finally, with regard to client reporting on execution of orders and portfolio management, MiFID II will require investment managers to provide quarterly, rather then six-monthly, reports, which will also need to be provided to professional clients as well as to retail clients. ESMA has refined its original technical advice, however, by proposing that if a portfolio manager offers clients access to up-to-date valuations using an online or equivalent system, which qualifies as a durable medium and where the firm has evidence that the client has accessed this valuation at least once during the quarter, they do not need to provide the client with a quarterly report for that period. Firms can generally satisfy themselves that a client has accessed the valuation if they have a record that the client has logged onto the online system and accessed the relevant section of the system where this valuation is provided.

Rules applying to third countries

MiFID II aims to provide harmonised rules for authorisation and conduct of business of EU branches of third-country firms. Article 39 MiFID II (the ("Article 39 Regime") requires non-EU firms wishing to provide investment services to retail clients and elective professional clients to do so through a branch.

A non-EU firm that has established a branch will then be able to passport services in relation to eligible counterparties and per se professional clients only across the EU if they are based in an equivalent jurisdiction, as determined by the European Commission. Such firms will be required to register with ESMA and provide factual information, plus a written declaration from the firm's regulator stating that it is subject to supervision and details of the services and activities for which the firm is authorised. Member States have the right to choose whether to opt in to the Article 39 Regime.

HM Treasury has published a consultation paper on transposing MiFID II into national law, which sets out, among other things, the UK's approach to the third country regime under MiFID II. The UK has chosen to opt out of the Article 39 Regime and proposes to retain the current MiFID regime, insofar as it is permitted by MiFID II. HM Treasury considers that the current regime has the virtue of being sufficiently tailored to client types and to the risks in question and balances the need to maintain investor protection, market integrity and financial stability, while remaining open to business internationally.

The government acknowledges that in not electing to implement the Article 39 Regime, the UK retail client base will not be able to rely on the strengthened branch requirements specified at Article 39(2) MiFID II, namely that the branch must have sufficient initial capital and the third country firm's jurisdiction of establishment must pay due regard to relevant anti-money laundering regulations.

Additionally, UK branches will not have the benefit of the branch passport described above, which means that third country firms who establish branches in the UK will not be able to passport wholesale business across Europe but will have to establish a legal subsidiary with appropriate MiFID authorisations in the relevant member states. The consultation paper acknowledges that the Article 39 Regime has a number of potential benefits and seeks stakeholder views on whether the UK should further consider implementing the Article 39 Regime. Comments on the consultation paper are invited by 18 June 2015.

If you would like to discuss this further, please contact Claire Cummings at Claire.Cummings@cummingslaw.com or on 020 7585 1406.

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CUMMINGS
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42 Brook Street, London W1K 5DB +44 20 7585 1406 | Neuhofstrasse 3d, CH-6340 Baar +41 41 544 5549