

C L I F F O R D

C H A N C E



**EU MIFID REVIEW: THE MIFIR2/MIFID3
LEGISLATIVE PROPOSALS**

EU MIFID REVIEW: THE MIFIR2/MIFID3 LEGISLATIVE PROPOSALS

The European Commission has now published its legislative proposals for a new regulation and directive amending the EU Markets in Financial Instruments Regulation and Directive. This new legislation would create a new process for selecting consolidated tape providers for EU trade data, make significant changes to the EU transparency regimes, update the EU share and derivative trading obligations, ban payments for order flow and make other changes to the EU regime for securities and derivatives trading.

The proposals aim to improve the level-playing field between execution venues, improve transparency and the availability of market data and ensure that EU market infrastructure remains competitive internationally.

*The following discussion is based on the text of the Commission's **legislative proposals** for the new regulation and directive (MiFIR2/MiFID3). The main changes are made by MiFIR2 to the Markets in Financial Instruments Regulation (MiFIR), with MiFID3 making limited and consequential changes to the Markets in Financial Instruments Directive (MiFID).*

Assuming a quick, 15-month legislative process, MiFIR2/MiFID3 could become law in early 2023, with Member States having an additional twelve months to implement the changes to MiFID. There are no proposals for any transitional periods for firms or trading venues, although some of the changes would only take effect when delegated regulations come into force.

Key issues

- The Commission has made legislative proposals to amend both MiFIR and MiFID
- ESMA would be required to create a process for selecting consolidated tape providers for all asset classes
- Substantial changes would be made to the pre- and post-trade transparency regimes for both equities and non-equities
- The share and derivatives trading obligations would be updated
- Payment for order flow would be banned
- Other changes would be made to both MiFIR and MiFID, including ending RTS 27 reports
- The new legislation could become law early in 2023 and Member States will have 12 months to implement the changes to MiFID

Consolidated tape

MiFIR2 aims to remove the obstacles that have prevented applicants seeking authorisation to act as consolidated tape providers (CTPs) under MiFID. First, it aims to ensure that trading venues, systematic internalisers (SIs) and other investment firms, and approved publication arrangements (APAs) are required to provide trade data to CTPs free of charge. Secondly, it aims to ensure that the trade data provided to CTPs is in a harmonised high-quality format, allowing for cost-efficient consolidation of that data. Thirdly, it aims to improve the commercial incentives to become a CTP.

MiFIR2 would require ESMA to establish a competitive process for selection of CTPs for shares, exchange-traded funds (ETFs), bonds and derivatives (or relevant sub-classes of derivatives). Each appointment would be for a five-year term. CTPs would consolidate and publish post-trade data (including prices, volumes and timestamps). After the first five years, the consolidated tape for shares could be extended to include the best bids and offers with corresponding volumes.

Trading venues, SIs and other investment firms, and APAs would be required to contribute trade data free of charge to the appointed CTP for shares, ETFs and bonds traded on a trading venue and OTC derivatives subject to the clearing obligation (but not other OTC derivatives or exchange-traded derivatives) as needed for the CTP to be operational. Contributors would be required to provide that data to CTPs in a harmonised form, through a high-quality transmission protocol, and as close to real-time as is technically possible.

CTPs' bids to ESMA would specify the fees that they will charge users for access to the consolidated data. CTPs would no longer be required to make available trade reports free of charge after 15 minutes (but this obligation would remain in place for trading venues and APAs).

The CTP for shares would establish a revenue sharing scheme for trade data provided by regulated markets (with a preferential allocation to smaller regulated markets). This aims to compensate regulated markets for shares for the loss of revenues resulting from mandatory contribution.

ESMA would be required to organise the first selection procedure for CTPs within three months of MiFIR2 becoming law and to select and authorise those CTPs within three months of initiating that procedure.

The Commission would set up an expert group on market data quality within three months of MiFIR2 becoming law and would also be required to adopt delegated acts on market data quality (and MiFID3 would require investment firms and trading venues to have arrangements to comply with those standards as part of their organisational arrangements). ESMA would also be required to deliver draft regulatory technical standards (RTS) on CTPs' reporting obligations to the Commission within nine months of MiFIR2 becoming law. There may be sequencing issues if the harmonised data and reporting standards are not available when prospective CTPs are submitting their bids to ESMA or when CTPs are authorised to start operations.



**The first CTPs
should be selected
within six months
of MiFIR2
becoming law**



ESMA would also be required to deliver a report on revenue sharing by CTPs within 12 months of MiFIR2 becoming law. Based on that report, the Commission would be able to adjust the revenue sharing formula for regulated markets.

If no consolidated tape has emerged through this new process within one year after MiFIR2 becomes law, the Commission would be required to conduct a review and, if appropriate, to submit a new legislative proposal setting out how ESMA should provide a consolidated tape.

Changes to the pre- and post-trade transparency regimes

MiFIR2 would make significant changes to the pre- and post-trade transparency regimes for both equities and bonds and derivatives.

Pre-trade transparency: equities

MiFIR2 would restrict trading venues from executing trades in equities under the reference price waiver where the size of the trade is less than twice standard market size (but would also allow execution under the waiver at the consolidated tape midpoint). In addition, it would replace the double volume cap with a single volume cap set at 7% of trades executed under the reference price waiver or the negotiated trade waiver.

The draft would also extend SIs' quotation obligations for equities to cover trades of up to twice the standard market size and increase SIs' minimum quote size from 10% of standard market size to twice standard market size. SIs would not be allowed to match smaller trades at midpoint.

SIs' quotes, price improvements on those quotes and execution prices would still have to comply with the tick size rules applicable to trading venues and SIs would still be able to match orders at midpoint where the orders are large-in-scale (LIS) but also, subject to compliance with the tick size rules, between twice standard market size and LIS.

Pre-trade transparency: bonds and derivatives

MiFIR2 would remove the ability of trading venues to obtain a waiver of pre-trade transparency for actionable indications of interest for trades above the size specific to the financial instrument (SSTI). MiFIR2 does not directly amend the provisions of MiFIR setting out SIs' pre-trade transparency obligations in relation to bond or derivatives. However, the removal of the SSTI waiver regime for trading venues would mean that SIs' pre-trade transparency obligations would also apply to bond and derivatives trades above SSTI (with no exception for large-in-scale trades as ESMA had recommended).

Publication of pre- and post-trade data

MiFIR2 would require ESMA to draft RTS specifying the content, format and terminology of the pre- and post-trade data that trading venues, APAs, CTPs and SIs are required to make available on a reasonable commercial basis (as the requirements have been interpreted in different ways, notwithstanding the existing ESMA guidelines). ESMA would be required to deliver the draft RTS to the Commission within nine months of MiFIR2 becoming law.



MiFIR2 would end the pre-trade transparency waiver for trades above SSTI



Share and derivatives trading obligations

MiFIR2 would also make significant changes to the share trading obligation and the derivatives trading obligation under MiFIR.

Share trading obligation

MiFIR2 would apply the share trading obligation to any shares with an EEA ISIN. ESMA would be required to establish an official list of the shares covered by the obligation.

The amendments to the share trading obligation would delete the condition to the application of the obligation that the shares be admitted to trading on a regulated market or traded on an EU trading venue (although the explanatory memorandum suggests that the obligation would be limited to shares admitted to trading on a regulated market). MiFIR2 would also delete the exception from the share trading obligation for trades that are non-systematic, ad-hoc, irregular and infrequent. However, in line with ESMA's October 2020 statement on EEA shares traded in sterling on UK venues, MiFIR2 would add a new exception for trades in shares executed on a non-EU venue in the local currency (but it does not address the treatment of over-the-counter trading in shares traded on a non-EU venue with non-EU market makers).

Derivatives trading obligation

MiFIR2 would align the scope of the entities subject to the derivatives trading obligation with the scope of the entities subject to the clearing obligation under the European Market Infrastructure Regulation (EMIR), as amended by the 2019 EMIR Refit regulation. EMIR Refit had exempted some smaller financial counterparties from the clearing obligation and changed the way in which the clearing thresholds apply to non-financial counterparties. MiFIR2 would also give the Commission a power to suspend the trading obligation when the clearing obligation is suspended under the Commission's new powers added by EMIR Refit.

In addition, MiFIR2 recognises that the derivatives trading obligation can prevent EU investment firms providing liquidity to non-EU counterparties in derivatives subject to the trading obligation (e.g., where, like the UK, the non-EU country has its own, conflicting derivatives trading obligation and the Commission has not made an equivalence decision in relation to its trading venues). It would give the Commission a stand-alone power, exercisable at the request of a Member State competent authority, to suspend the trading obligation in relation to investment firms that regularly act as market makers in derivatives subject to the trading obligation and that regularly receive requests for quote for those derivatives from non-EU counterparties which do not have an active membership on an EU trading venue that trades those derivatives. However, MiFIR2 would not give the Commission a stand-alone power to suspend the trading obligation to deal with other cases of the kind recommended by ESMA.

Payment for order flow

MiFIR2 would prohibit investment firms acting on behalf of clients receiving any fee, commission or non-monetary benefits from a third party for forwarding client orders to that third party for execution. The explanatory statement suggests that this would be limited to retail client orders but that is not reflected in the proposed text of MiFIR2. ESMA had already asked Member State competent authorities to give priority to payment for order flow in their supervisory activities for 2021 or early 2022, especially in those Member States in which the practice has been observed.



MiFIR2 recognises that the DTO can prevent EU market makers providing liquidity to non-EU counterparties



Other changes

The legislative proposals would make other changes to MiFIR and MiFID.

- **Execution quality reports:** MiFID3 would amend MiFID to remove the requirement for execution venues to publish ‘RTS 27’ execution quality reports. The 2021 MiFID ‘quick-fix’ amendments to MiFID suspend this requirement until 28 February 2023 (but it is possible that the MiFID3 changes do not become law before this suspension expires). However, MiFID3 makes no changes to the MiFID requirement for investment firms to publish annual ‘RTS 28’ execution quality reports. ESMA consulted in September 2021 on possible changes to both the RTS 27 and RTS 28 requirements to address concerns about the burdens and limited utility of these reports.
- **Exemptions - direct electronic access:** MiFID3 would amend the exemptions in MiFID to allow firms dealing on own account to have direct electronic access to an EU trading venue (otherwise than as a member or participant) without being required to be authorised under MiFID.
- **Bilateral vs multilateral systems:** The provisions currently in MiFID requiring multilateral systems to operate as trading venues would be moved to MiFIR. The aim is to achieve greater harmonisation of how the difference between bilateral trading and multilateral systems operates in practice.
- **Clock synchronisation:** MiFIR2 would require trading venues and their members or participants, SIs, APAs and CTPs to synchronise their business clocks. MiFID3 would delete the current provisions in MiFID on clock synchronisation which only apply to trading venues and their members or participants. ESMA would be required to deliver new draft RTS on clock synchronisation within six months of MiFIR2 becoming law.
- **Open access obligations:** MiFIR2 would remove the “open access” obligations for exchange-traded derivatives (and the related transitional provisions that had suspended the application of those obligations). EU CCPs would not be obliged to clear exchange-traded derivatives executed on non-affiliated trading platform. Likewise, EU trading venues would not need to provide trade feeds to non-affiliated CCPs clearing exchange-traded derivatives.
- **Transaction reporting:** MiFIR2 would allow ESMA to propose amendments to its RTS on transaction reporting and financial instrument reference data reporting to specify the date by which transactions and reference data must be reported. It would also direct that those RTS take account of international developments, EU and international standards and the consistency of the RTS with the reporting requirements under EMIR and the EU Securities Financing Transaction Regulation. This may result in ESMA proposing revisions to the RTS on transaction and reference data reporting to achieve greater alignment with the timing and content of EMIR and SFTR reporting. In addition, MiFIR2 would require ESMA to deliver a report within two years of it becoming law on more integration in transaction reporting and the streamlining of data flows of transaction reports.

UK Wholesale Markets Review

The objectives of the legislative proposals have much in common with the objectives of the UK Wholesale Market Review (WMR) in their desire to improve the workings of the transparency regime, by facilitating the provision of a consolidated tape, improving post-trade transparency arrangements for bonds and derivatives and improving the quality of published trade data, and to align transaction reporting requirements across different regimes. However, the UK Government is of the view that there is more urgency to develop a consolidated tape for fixed income data. The WMR also focuses on some issues not addressed in the EU proposals, such as the permitted activities of multilateral and organised trading facilities, the definition of an SI, the scope of the transparency obligations in relation to derivatives 'traded on a trading venue' and the need for more useful identifiers to support a meaningful transparency regime for derivative trades. In addition, the WMR would also go further than the EU proposals by abolishing the UK volume price cap, share trading obligation and RTS 28 reporting obligation, allowing wider use of the reference price waiver and midpoint execution for equities, and limiting the scope of the UK pre-trade transparency regime for non-equities.

Next steps

The European Parliament and the Council may amend the legislative proposals during the legislative process. The Commission has invited feedback on the legislative proposals by 27 January 2022. The Commission will summarise the feedback for the European Parliament and the Council to assist in their discussion of the proposals.

The Commission is also assessing the MiFID rules on inducements and disclosure, possible reductions in the administrative burden and information requirements for a subset of retail investors and new requirements for financial advisers. The Commission plans to publish a comprehensive study on retail investment and a feasibility assessment of a pan-EU label for financial advisers in the first quarter of 2022 and to adopt a retail investment strategy in the fourth quarter of 2022.



The objectives of the proposals have much in common with those of the UK Wholesale Market Review



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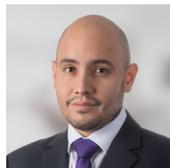
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