



Market Structure under MiFID2/MiFIR

Chris Bates

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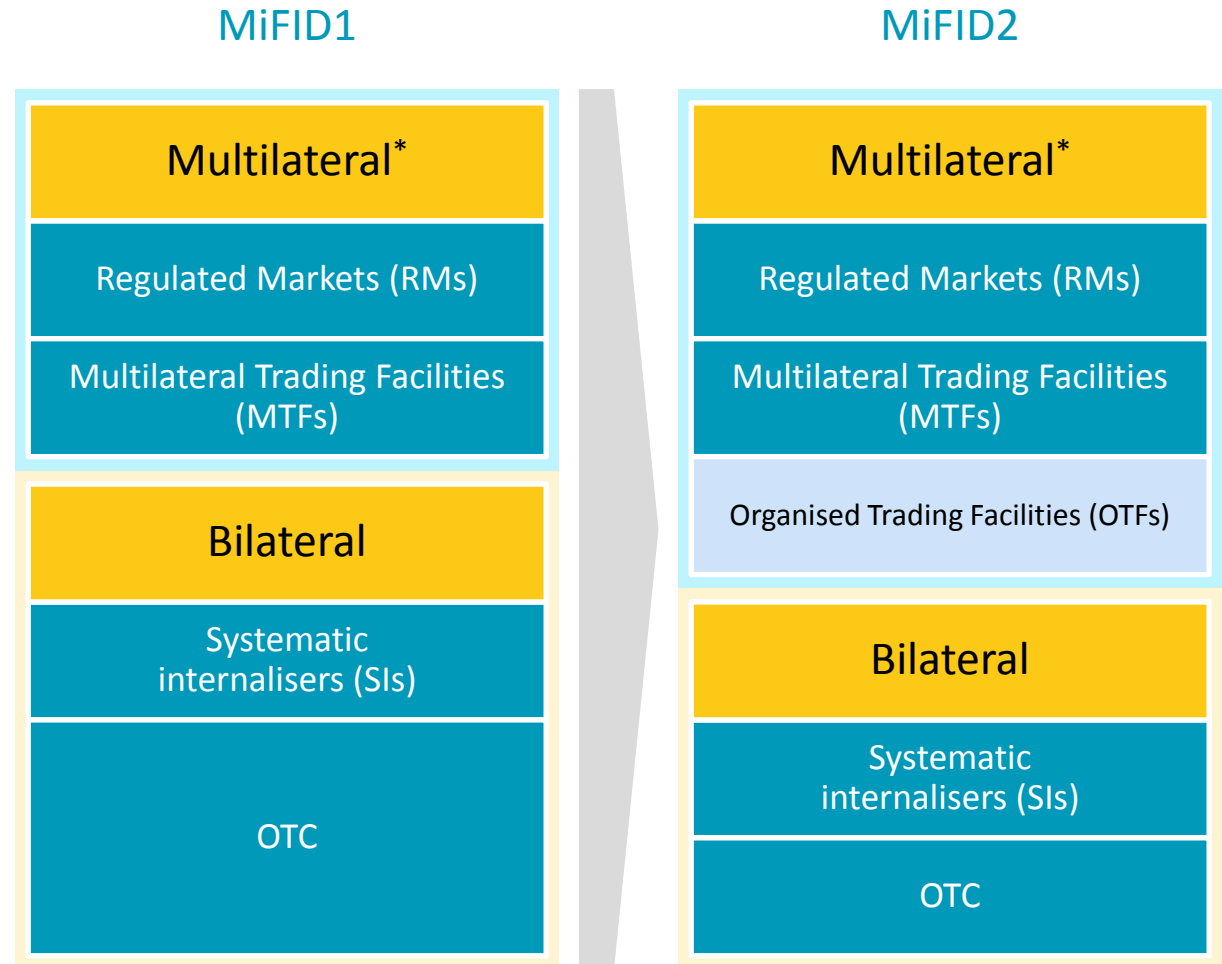
Agenda

- The new venues
- Systematic internalisation
- “Traded on venue”
- Bias to trading on venue
- Package trades
- Impact on best execution policies
- Corporate market users
- Cross-border business with non-EU clients

New market structure

Key changes:

- New trading venue – OTFs
- SIs wider in scope
- Trading pushed on venue or SI
- Align RM and MTFs



* "trading venues"

The new venue type

- Organised trading facility
 - Non-equities only
 - Trading venue for derivatives
 - Restrictions on proprietary trading/systematic internalisation
 - Need for discretion
 - Physically settled contracts on power and gas
 - C6 energy derivatives (coal, oil)
 - “Traded on venue” – impact on OTC trading
- Prohibition on other multilateral systems
 - Bulletin boards, portfolio compression
 - Agency and matched principal business

Systematic internaliser

“an investment firm which, on an organised, frequent systematic and substantial basis, deals on own account when executing client orders outside a regulated market, an MTF or an OTF without operating a multilateral system”

Article 4(1)(20) MiFID2

Systematic internalisers: proposed thresholds

		Shares, etc.	Bonds	SFPs	Derivatives	Emission allowances
Frequent and systematic basis threshold (liquid instruments)	No. of own account * OTC transactions/ total no. of transactions in EU in same instrument/class	0.4% and at least once a day	2% to 3% and at least once a week	3% to 5% and at least once a week	2% to 3% and at least once a week	3% to 5% and at least once a week
Frequent and systematic basis threshold (illiquid instruments)	Minimum own account OTC trading frequency	at least once a week	at least once a week	at least once a week	at least once a week	at least once a week
Substantial basis threshold (Criteria 1)	Size of own account* OTC trading/firm's total volume in same instrument/class	15%	25%	30%	25%	30%
Substantial basis threshold (Criteria 2)	Size of own account* OTC trading/total EU volume in same instrument/class	0.4%	0.5% to 1.5%	1.5% to 3%	0.5% to 1.5%	1.5% to 3%

Source: ESMA technical advice to Commission (December 2014)

Conditions assessed on a quarterly basis based on data from last 6 months. If a firm satisfies both the frequent and systematic basis threshold and the substantial basis threshold (Criteria 1 or 2), then it must comply with SI rules within 2 months.

For shares, etc., bonds and structured finance products (SFPs), conditions are assessed on instrument by instrument basis. For derivatives and emission allowances, they are assessed by reference to the class or type of instrument.

* For shares, the advice only counts trades executed on own account when executing client orders.

Pre-trade transparency for SIs: Non-equities v equities

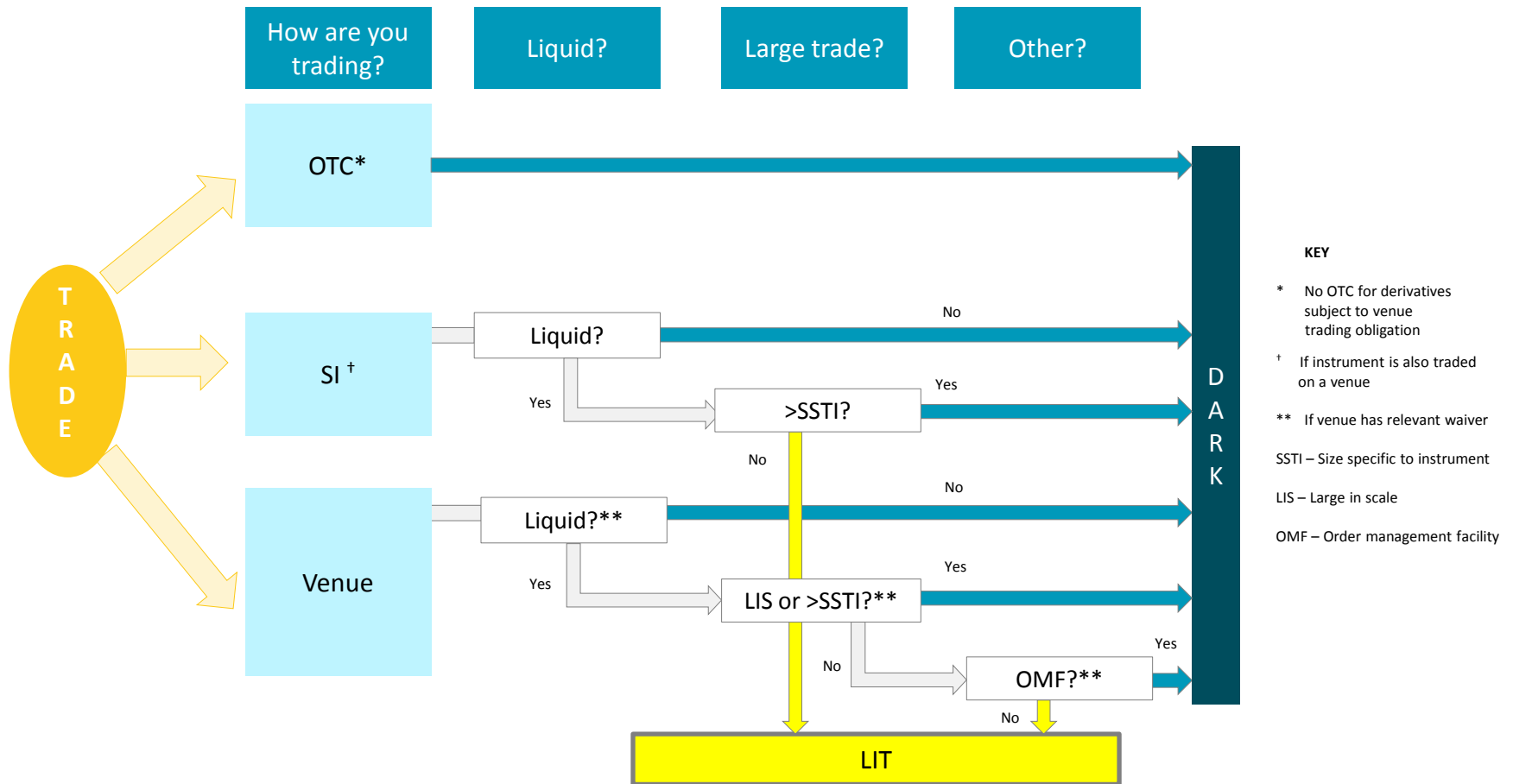
	Non-equities	Equities
Coverage	Bonds, structured finance products, emission allowances and derivatives traded on a trading venue	Shares, depository receipts, ETFs, certificates and other similar financial instruments traded on a trading venue
Obligations do not apply	Transactions above size specific to the instrument (SSTI)	Transactions above standard market size (SMS)
Notification to competent authority	Yes, if SI	Yes, if SI
Liquid classes: quote obligation	If agree to provide a quote to a client, must publish a firm quote (no level 2)	Must publish firm quote on a regular and continuous basis during normal trading hours (as specified by delegated acts)
Manner of publication	Manner easily accessible to other market participants (no level 2) On a reasonable commercial basis (as specified by delegated acts)	Manner easily accessible to other market participants (as specified by RTS and delegated acts) On a reasonable commercial basis (as specified by delegated acts)
Non-liquid classes: quote obligation	Must disclose quotes to clients on request, if agree to provide a quote (but obligation may be waived)	Must disclose quotes to clients on request (no provision for waiver of obligation)
Execution obligation	Must allow other clients to execute against published quotes on published conditions (only liquid classes)	Must execute client orders at quoted prices at time of reception of order (may execute at quote for hits above quote size and below SMS or between quote sizes)
Price improvement in justified cases	Permitted within a public range close to market conditions (no level 2)	Permitted within a public range close to market conditions (specified by RTS)
Execution of orders away from quote	No provision	Permitted for professional clients for package transactions and orders subject to conditions other than current market price (as specified by delegated acts)

Pre-trade transparency for SIs:

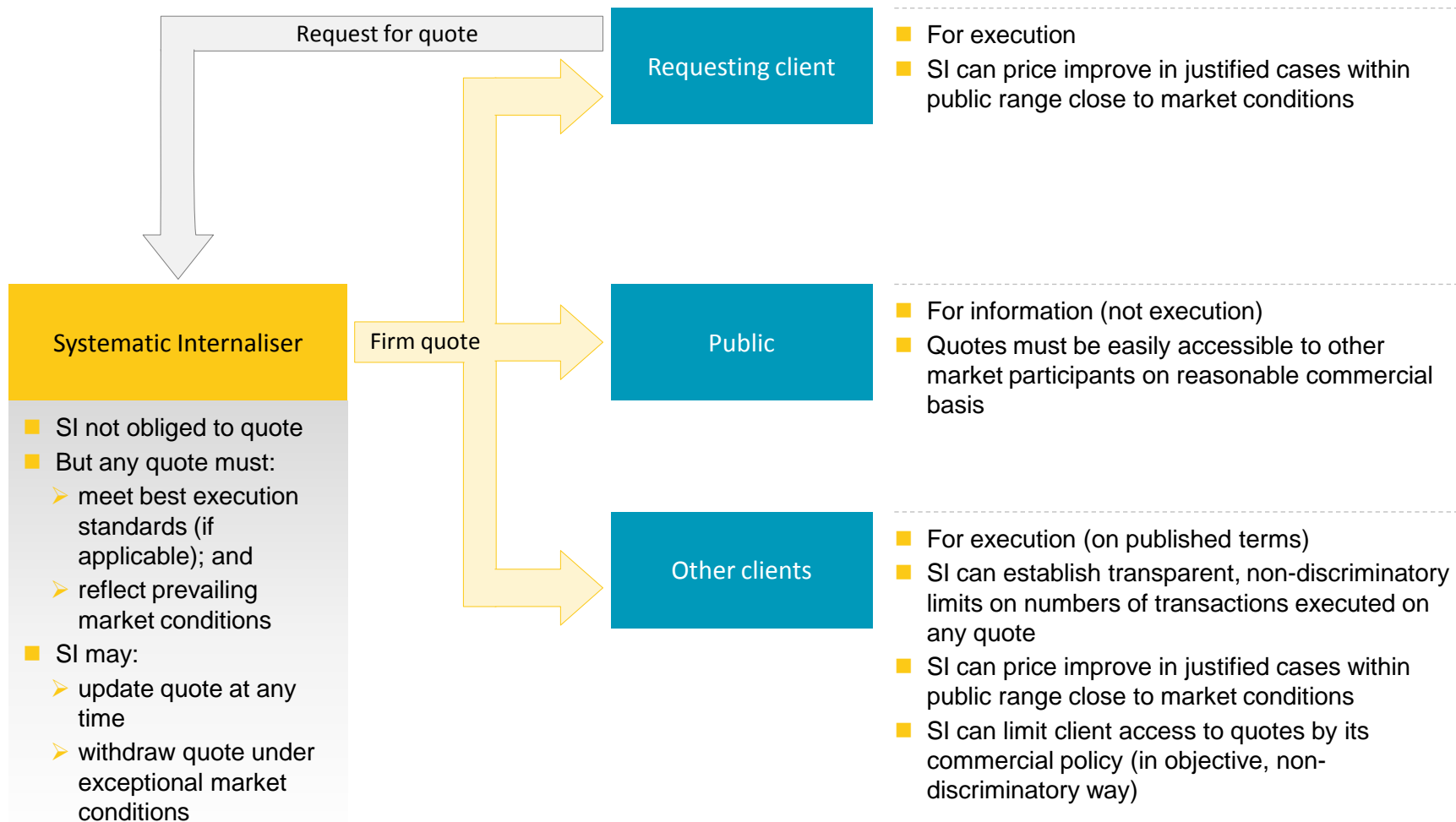
Non-equities v equities (continued)

	Non-equities	Equities
Multiple hits	SI may set non-discriminatory and transparent limits on number of transactions with clients against one quote (no level 2)	SI may limit number of transactions with one client at published conditions. May also limit total number of transactions at same time from different clients (where number / volume considerably exceeds norm – as specified by delegated acts).
Client access to quotes	SI can limit on basis of commercial policy and in objective, non-discriminatory way (must set clear standards on access to quotes)	SI can limit on basis of commercial policy and in objective, non-discriminatory way (must set clear standards on access to quotes)
Client relationships	SI may accept or end client relationships based on commercial considerations	SI may accept or end client relationships based on commercial considerations
Quote size	Not restricted	At least 10% of SMS
Two-way quote required	No	Yes
Price quoted	Must reflect prevailing market conditions (no level 2) and must enable compliance with best execution obligation if applicable	Must reflect prevailing market conditions (as specified by RTS) and must comply with best execution obligation when executing orders
Updating of quotes	Permitted at any time (no level 2)	Permitted at any time (as specified by delegated acts)
Withdrawal of quotes	Permitted under exceptional market conditions (no level 2)	Permitted under exceptional market conditions (as specified by delegated acts)

Can you trade OTC derivatives in the dark?



Non-equities pre-trade transparency: Liquid classes (transaction size below SSTI)



Other rules for SIs

- Permitted trading venue for mandatory trading of shares
- Restrictions on:
 - Operation of SI and OTF in same legal entity
 - OTFs connecting with SIs to enable interaction
- Suspension of trading powers for instruments traded on venues
- Must publish execution quality data
- Post trade transparency discloses “SI” execution
- Transaction reporting
- Obligation to provide reference data
- Restriction on “use” of benchmarks

“Traded on venue”

■ Relevant rules

- Pre- and post-trade transparency
- Transaction reporting
- Trading mandate for shares and OTC derivatives
- Position limit/reporting regime
- Market abuse regime
- Restriction on “use” of benchmarks

■ Sources of data

- Venue information under Market Abuse Regulation
- Reference data under MiFIR

■ Application to OTC derivatives

MTF v SI – RFQs for non-equities

	MTF	SI: non-equities
Permitted execution venue for OTC derivatives subject to trading mandate	Yes	No
Obligation to quote	No (subject to algo rules)	No
Quote can be subject to "last look"	Yes (subject to algo rules)	No?
Rules regulate the price quoted	No (subject to algo rules)	Yes
Best execution duties apply	No	Possibly
Pre-trade transparency:		
<ul style="list-style-type: none"> ■ Quote must be publicly disclosed 	Yes (exc. NFCs' hedges)	Yes
<ul style="list-style-type: none"> ■ Public quote disclosure identifies dealer 	No	Yes?
<ul style="list-style-type: none"> ■ Quote must be made available to other participants/clients for execution 	No	Yes
Corporate or other unregulated entity can access quotes	Restricted	Yes
Dealer's use of algorithmic trading subject to MTF operator review	Yes	No
Dealer must comply with rules on direct electronic access	Yes	No
Responsibility for:		
<ul style="list-style-type: none"> ■ public quote disclosure (pre-trade transparency) ■ post-trade transparency ■ including trade in periodic execution quality reports 	MTF	SI
Responsibility for transaction reporting	Dealer	Dealer
Trades count towards thresholds for SI status	No	Yes

Assumes that trade size is below SSTI, that there is a liquid market for the instrument and that the instrument is already traded on a trading venue. Additional issues apply in relation to "commodity derivatives" (including inflation swaps) under the position limits and reporting regimes.

■ Package trades

- Pre-trade obligations for venues and SIs
- Trading mandate for derivatives

■ Impact on best execution policies

- Availability of pre- and post-trade transparency data
- Execution quality data published by trading venues, SIs and execution venues
- Data on top 5 venues and execution quality published by firms executing client orders

■ Corporate users of trading venues

- Article 2(1)(d) MiFID2 exemption for firms dealing on own account
- Not available if a member of a venue or have direct electronic access

■ Impact on cross border business

- EU booking vehicles for cross-border business
- Impact on firm and client behaviour
- Trading on non-EU venues

Questions?

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