MiFID2/MiFIR – the new framework for derivatives
Chris Bates
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Objectives for derivatives markets

New market structure

Completing clearing mandate

Implementing G20 trading mandate

New pre- and post-trade transparency regime
Market structure
### Market structure

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

<table>
<thead>
<tr>
<th>MiFID1</th>
<th>MiFID2</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Multilateral</strong>&lt;br&gt;Regulated Markets (RMs)&lt;br&gt;Multilateral Trading Facilities (MTFs)</td>
<td><strong>Multilateral</strong>&lt;br&gt;Regulated Markets (RMs)&lt;br&gt;Multilateral Trading Facilities (MTFs)&lt;br&gt;Organised Trading Facilities (OTFs)</td>
</tr>
<tr>
<td><strong>Bilateral</strong>&lt;br&gt;Systematic internalisers (SIs)</td>
<td><strong>Bilateral</strong>&lt;br&gt;Systematic internalisers (SIs)</td>
</tr>
<tr>
<td>OTC</td>
<td>OTC</td>
</tr>
</tbody>
</table>

* "trading venues"
Key definitions

Multilateral

RMFs and MTFs
- a multilateral system... which brings together ... multiple third-party buying and selling interests in financial instruments – in the system and in accordance with non-discretionary rules – in a way that results in a contract

OTFs (new)
- A multilateral system or facility, which is not a regulated market or MTF, ... in which multiple third-party buying and selling interests in financial instruments are able to interact in the system in a way that results in a contract

Multilateral system
- any system or facility in which multiple third parties buying and selling trading interests in financial instruments are able to interact

Bilateral

SIs
- an investment firm which, on an organised, frequent, systematic and substantial basis, deals on own account by executing client orders outside a regulated market or an MTF or an OTF, without operating a multilateral system.
  (note likely change to implementing acts)

OTC transactions
- Not defined in MiFID2 or MiFIR

Relevant Articles
MiFIR Article 4
## Market structure under MiFID2

<table>
<thead>
<tr>
<th>Operator</th>
<th>RMStrMs</th>
<th>MTFs</th>
<th>OTFs¹</th>
<th>SIs</th>
<th>OTC</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-discretionary execution</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>Where quotes binding</td>
<td>No</td>
</tr>
<tr>
<td>Conduct of business rules</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Operator can use own capital</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Access to facilities</td>
<td>Transparent, non-discriminatory rules, objective criteria</td>
<td>Transparent, non-discriminatory rules, objective criteria</td>
<td>Transparent, non-discriminatory rules, objective criteria</td>
<td>Commercial policy (in objective, non-discriminatory way)</td>
<td>Commercial policy</td>
</tr>
<tr>
<td>Admission to trading</td>
<td>Clear, transparent rules (+ other criteria)</td>
<td>Transparent rules (+ adequate PAI²)</td>
<td>Transparent rules (+ adequate PAI²)</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Resilience, circuit breakers, tick size</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Surveillance required (MAR)</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
</tbody>
</table>

¹: Non-equities only; ²: Publicly available information
### Market structure under MiFID2 (continued)

<table>
<thead>
<tr>
<th></th>
<th>RM</th>
<th>MTFs</th>
<th>OTFs¹</th>
<th>SIs</th>
<th>OTC</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Pre-trade transparency</strong></td>
<td>Yes (incl. non-equities)</td>
<td>Yes (incl. non-equities)</td>
<td>Yes</td>
<td>Yes (incl. non-equities)</td>
<td>No</td>
</tr>
<tr>
<td><strong>Pre-trade waiver available</strong></td>
<td>Yes (incl. non-equities)</td>
<td>Yes (incl. non-equities)</td>
<td>Yes</td>
<td>No</td>
<td>N/a</td>
</tr>
<tr>
<td><strong>Post trade transparency</strong></td>
<td>Yes (incl. non-equities)</td>
<td>Yes (incl. non-equities)</td>
<td>Yes</td>
<td>Yes (incl. non-equities)</td>
<td>Yes (incl. non-equities)</td>
</tr>
<tr>
<td><strong>Publish execution quality data</strong></td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td><strong>Eligible OTC derivs platform</strong></td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td><strong>Authorities can suspend trading</strong></td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td><strong>Record orders</strong></td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
</tbody>
</table>

¹: Non-equities only
Clearing mandate
## Completing the clearing mandate

### Exchange traded derivatives (ETD)

Operator of a regulated market must ensure that all transactions in derivatives concluded on that market are cleared by a CCP

- EMIR requires EU CCP to be authorised and non-EU CCP to be recognised

For ETD, indirect clearing arrangements are acceptable if:

- Do not increase counterparty risk and
- Ensure equivalent protection to EMIR rules

RTS to specify arrangements, consistent with EMIR

Definition of ETD covers contracts executed on regulated markets and equivalent third country markets

### All cleared derivatives

**Requirement for effective procedures to ensure submitted and accepted for clearing:**

- As quickly as technologically practicable using automated systems
- To be specified by RTS

**Scope of obligation:**

- CCPs and trading venues
- Investment firms acting as clearing members of CCPs

**Cleared derivatives**

- Derivatives concluded on a regulated market
- OTC derivatives subject to clearing mandate
- All derivatives agreed to be cleared

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**Relevant articles:** MiFIR Articles 29 and 30

MiFID2/MiFIR – the new framework for derivatives
Derivatives execution
Derivatives – mandatory trading obligation

OTC derivative subject to the clearing obligation under EMIR

- Not an intragroup transaction under Article 3 EMIR
- Not subject to transitional provisions under Article 89 EMIR

Declared subject to mandatory venue trading obligation

In order to become subject to mandatory trading, derivatives must be:
- Admitted to trading on at least one relevant trading venue;
- Sufficiently liquid

ESMA to take into account anticipated impact on liquidity of relevant derivatives and commercial activities of end users

ESMA also to consider whether derivatives only sufficiently liquid in transactions below a certain size

Must be traded only on:

- Regulated market
- MTF
- OTF
- Equivalent third country market

Relevant Articles
MiFIR Articles 28 and 32,
### Mandatory trading process

#### “Bottom up” process

1. Class of OTC derivatives is declared subject to mandatory clearing under EMIR
2. ESMA consults on whether to impose mandatory trading on that class or a subset of that class
3. ESMA proposes draft regulatory technical standards (RTS) to Commission within fixed period after adoption of RTS on clearing under EMIR
4. Mandatory trading may be phased-in for some counterparty types

#### “Top down” process

1. Where a class of OTC derivatives has not been declared subject to mandatory trading
2. ESMA shall regularly monitor activity in those derivatives to identify cases where this may pose systemic risk and to prevent regulatory arbitrage
3. ESMA shall, on its own initiative, identify and notify to the Commission derivatives that should be subject to the trading obligation but which no CCP is authorised to clear under EMIR or which are not admitted to trading.
What venues qualify?

<table>
<thead>
<tr>
<th>OTC derivative subject to the clearing obligation under EMIR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Not an intragroup transaction under Article 3 EMIR</td>
</tr>
<tr>
<td>Not subject to transitional provisions under Article 89 EMIR</td>
</tr>
</tbody>
</table>

Declared subject to mandatory venue trading obligation

Must be traded only on:

| Regulated market | MTF | OTF | Equivalent third country market |

- Commission decision that there are equivalent legally binding requirements:
  - Authorisation and supervision;
  - Venue has clear and transparent rules on admission to trading;
  - Issuers are subject to periodic information requirements;
  - Market abuse rules

- Effective equivalent recognition for EU trading venues for derivatives

- Commission decision only for purposes of determining eligibility as a trading venue for these purposes, and may be limited to a category or categories of trading venues

- Also need to address licensing issues for third country firms
Who is subject to mandatory trading?

**FC or NFC+**

**OTC derivative**

**EU**

**FC or NFC+**

**Non-EU**

**Third country financial institution or TCE**

**OTC derivative**

**EU**

**Non-EU**

**TCE**

- **FC** = financial counterparty
- **NFC+** = non-financial counterparty over the EMIR clearing threshold
- **TCE** = non-EU entity which would have been subject to the trading obligation if established in the EU
- **Third country financial institution** = non-EU entity authorised to carry on any of the activities listed in BCD, MiFID 2, Solvency II, UCITS, IORPs, AIFMD

Note: Exemption for duplicative or conflicting obligations.

Treatment of entities exempt under Article 1(4) or 1(5) EMIR?

Treatment of branches of non-EU entities and EU branches of non-EU entities?

Only if transaction has a direct, substantial and foreseeable effect in the EU or if necessary or appropriate to prevent evasion

Where possible and appropriate, ESMA’s technical standards shall be identical to those under EMIR
## Duplicative and conflicting rules

### Requirement for equivalence?

<table>
<thead>
<tr>
<th>Avoiding duplicating or conflicting rules (Article 33 MiFIR)</th>
<th>Criteria for equivalence?</th>
<th>Who decides?</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>A counterparty to a derivative will be deemed to have complied with the mandatory derivatives trading and clearing obligations under MiFIR where:</td>
<td>The legal, supervisory and enforcement arrangements of the relevant third country:</td>
<td>European Commission</td>
<td>The European Commission (together with ESMA) is required to monitor the laws of any jurisdiction declared equivalent, and report on at least an annual basis to the European Parliament and Council</td>
</tr>
<tr>
<td>■ at least one counterparty is established in an equivalent non-EU jurisdiction and</td>
<td>■ are equivalent to the requirements resulting from Articles 28 and 29 MiFIR</td>
<td>Implementing act on equivalence</td>
<td>The equivalence decision may be withdrawn</td>
</tr>
<tr>
<td>■ the counterparties are in compliance with the relevant rules in that jurisdiction</td>
<td>■ ensure protection of professional secrecy that is equivalent to that set out in MiFIR</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>■ are being effectively applied and enforced in an equitable and non-distortive manner so as to ensure effective supervision and enforcement in that third country</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Transparency rules for derivatives

Scope
Derivatives traded on a trading venue
RM, MTF, OTF, SI, firms

Exemptions
Pre-trade waivers
Post-trade deferral

Key variables
Liquidity definition (Art 2(1)(17a) MiFIR)
ESMA RTS to calibrate waiver and deferral regimes

Relevant articles
MiFIR articles 2, 8, 9, 11
## Transparency rules for derivatives (trading venues pre-trade)

### Obligations
- All RMs, MTFs, OTFs to publish bid/offer and depth of trading interest
- Applies to actionable indications of interest
- Continuous basis during normal trading hours
- Give access to publication arrangements on reasonable commercial terms and non-discriminatory basis to firms subject to the obligation to make public firm quotes relating to bonds, structured finance products, emission allowances and derivatives

### Waivers
- Granted by NCAs following ESMA opinion
- 1. Orders large in scale relative to normal market size
- 2. Indications of interest in RFQ and voice trading systems above a specific size that would expose liquidity providers to undue risk
- 3. Derivatives not subject to trading obligation / other instruments without liquid market.
- NCA can temporarily suspend the obligations relating to publication of bid offer and depth of trading if liquidity drops (3 month rolling period)
- ESMA RTS to cover variables (size and liquidity thresholds)

### Relevant Articles
- MiFIR Articles 8, 9,
## Transparency rules for derivatives (Trading venues post-trade)

<table>
<thead>
<tr>
<th>Obligation</th>
<th>Deferral</th>
</tr>
</thead>
<tbody>
<tr>
<td>Publish price, volume and time of trade</td>
<td>Granted by NCAs following ESMA opinion</td>
</tr>
<tr>
<td>As close to real-time as reasonably possible</td>
<td>1. Orders large in scale relative to normal market size</td>
</tr>
<tr>
<td>Give access to publication arrangements on reasonable commercial terms and non-discriminatory basis to firms subject to the post-trade disclosure obligation relating to bonds, structured finance products, emission allowances and derivatives</td>
<td>2. No liquid market</td>
</tr>
<tr>
<td></td>
<td>3. Size of trade would expose liquidity providers to undue risk</td>
</tr>
<tr>
<td></td>
<td>Limited publication during deferral period / volume omission during extended deferral period possible</td>
</tr>
<tr>
<td></td>
<td>NCA can temporarily suspend the post-trade transparency obligation for trading venues if liquidity drops (3 month rolling period)</td>
</tr>
<tr>
<td></td>
<td>ESMA RTS to specify what data to be published and conditions/criteria for deferral</td>
</tr>
</tbody>
</table>

Relevant Articles
MiFIR Articles 10, 11
## Transparency rules for derivatives (SIs and OTC pre-trade and post-trade)

### Pre-trade
- SIs must publish firm quotes for liquid derivatives traded on a trading venue and make those quotes available to other clients if prompted for quote by client or agree to quote.
- For other derivatives traded on a trading venue, SIs must disclose quotes to clients on request if agree to quote.
- Undertaking to transact with other clients to whom quote made available where trade below a specified size.
- SIs can set non-discriminatory limits on number of transactions per quote and the clients they permit to access the quotes.
- No obligation to make public firm quotes if trade above specified size threshold as will be stated in ESMA RTS.

### Post-trade
- SIs and investment firms must publish volume, price and time of trades in derivatives traded on a trading venue via APA.
- Scope and time limits for deferral (and temporary suspension of obligation) analogous to Trading Venues post-trade transparency rules for non-equities (deferred publication, limited publication, volume omission, etc.).
- ESMA RTS will specify disclosable data and application of the obligation to transactions not determined by current market valuation.

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**Relevant Articles**
- MiFIR Articles 18, 21
Conclusion
Key issues

What venues will trade OTC derivatives?
Calibration of which firms are SIs
Scope of the trading mandate and phase in requirements
Equivalance assessments for non-EU venues and licensing issues for operators of those venues
How the regime deals with duplicative and conflicting rules
Calibration of liquidity thresholds and deferral arrangements for pre- and post-trade transparency
Coherence with US and other non-EU regimes
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