



SPECIAL REPORT: ESMA BEGINS CONSULTATION ON MiFID II

3 June 2014 - On 22 May 2014, the European Securities and Markets Authority ("ESMA") published a Discussion Paper (ESMA/2014/548) and Consultation Paper (ESMA/2014/549), which together herald the launch of its consultation process for the implementation of the recast Markets in Financial Instruments Directive ("MiFID II") and Markets in Financial Instruments Regulation ("MiFIR"). The publication of these two documents represents the first step in the process of translating the recently agreed texts of the MiFID II and MiFIR requirements into practical rules and regulations.

In light of the importance of this step, FIA and FIA Europe will be issuing a series of special reports throughout the month of June, each summarizing a specific area of focus in the context of the consultation. This introduction to the forthcoming special reports provides an overview of the two papers and the process to finalization of rules and regulations.

Put together, the two papers run close to 1,000 pages. The Consultation Paper poses 245 questions and the Discussion Paper has 615 questions, all of which are posed for public input. Responses are due 1 August 2014. ESMA has also committed to holding three public hearings addressing secondary markets, investor protections and commodity derivatives issues. The texts of the Directive and Regulation were approved by the European Parliament on 15 April 2014 and by the Council of the European Union on 13 May 2014. They will enter into force 20 days after their publication in the *Official Journal of the European Union*, which is expected in June.

The Discussion Paper covers proposals for the draft Regulatory Technical Standards ("RTS") and Implementing Technical Standards ("ITS"), which set out the detail required by the high-level provisions in the Directive and Regulation. Both MiFID II and MiFIR contain over 100 requirements for ESMA to draft RTS and ITS. The contents of the Discussion Paper will form the basis of a further consultation paper on the draft RTS and ITS, which is expected to be issued in the final quarter of this year or in early 2015. The Consultation Paper proposes the technical advice which the European Commission will need in order to adopt the RTS and ITS, and which ESMA intends to deliver to the Commission by December 2014. The consultation process is short, hence the closing date for responses to both papers is 1 August 2014.

Click [here](#) for the full text of the Discussion Paper
Click [here](#) for the full text of the Consultation Paper

BACKGROUND

The recast MiFID and MiFIR are the European Commission's attempt to reform the capital markets, following the effects of the financial crisis, as well as to update the original Markets in Financial Instruments Directive, published in 2007, to take account of new features in the marketplace, such as fragmentation, increasing use of algorithms and the predominance of high frequency trading, and the rise of dark pools. Steven Maijor, ESMA Chair, said that the consultation process "is an important step in the biggest overhaul of financial market regulation in the EU for a decade."

CONTENTS OF THE PAPERS

While both the Discussion Paper and Consultation Paper cover many of the same topics, the focus of each is markedly different.

Discussion Paper: In the Discussion Paper, the headline topic of investor protection looks at issues such as the authorisation of investment firms, the freedom to establish a branch and provide investment services across borders and the data reporting elements of best execution. In relation to transparency, the Discussion Paper covers pre and post-trade transparency for equities and non-equity instruments as well as the proposed liquid market definition for non-equity instruments. It also looks at the regime in relation to Systematic Internalisers. Systematic Internalisers are firms that deal on their own account by executing client orders outside of a Regulated Market, Multilateral Trading Facility or Organised Trading Facility on an organised, frequent and systematic basis.

On micro-structural issues, the Discussion Paper covers matters such as the organisational requirements for investment firms on testing and monitoring of trading systems, algorithms and strategies, as well as the organisational requirements for trading venues and market making strategies. It also discusses the micro-structural issues of requirements for co-location services, ensuring that fee structures do not create incentives for disorderly trading conditions or market abuse and tick size regimes.

The Discussion Paper sets out ESMA's more detailed proposals on data publication and access including information on data reporting services, consolidated providers, data disaggregation and access to central counterparties and trading venues. In relation to trading venues, areas of discussion include admission to trading of financial instruments, together with their suspension and removal from trading.

On commodity derivatives, the Discussion Paper reviews the criteria for establishing when activities connected to commodity derivatives are to be considered ancillary to the main business at a group level, and thereby fall outside the requirements of the regime, as well as position limits and position reporting.

The Discussion Paper then proceeds to analyse market data reporting requirements including the obligation to report transactions, to supply financial instrument reference data and to maintain records of orders and the synchronisation of business clocks. Finally, the Discussion Paper looks at post-trading issues such as the obligation to clear derivatives traded on regulated markets and any indirect clearing arrangements.

Consultation Paper: The Consultation Paper covers different ground in relation to similar topics. It looks at investor protection issues such as complaints handling, record keeping, product governance, investment advice, safeguarding of client assets, management of conflicts of interest, suitability and appropriateness of investment advice provided, best execution and reporting to clients. It also covers rules surrounding inducements and information on costs and charges for clients. The Paper proposes technical advice on transparency, including increasing the pre and post-trade transparency for many categories of instruments (shares, exchange traded funds, bonds and derivatives). Limitations to trade shares over the counter and new obligations to trade derivatives on trading venues are also discussed.

On data publication matters, the Consultation Paper discusses proposed technical advice on issues relating to the development of data standards, formats and technical arrangements for tape providers, approved publication arrangements and reporting mechanisms, as well as the definition of a reasonable commercial basis for data sales. It proposes arrangements with regard to access to central clearing counterparties, trading venues and benchmarks.

Micro-structural issues are also covered in the Consultation Paper, with proposed technical advice on algorithmic and high frequency trading, rules around direct electronic access for members, participants or clients of trading venues, requirements applying to trading venues with regard to monitoring compliance. On commodity derivatives, it proposes technical advice relating to the definition of derivatives covered by MiFID (as specified in Section C of Annex I of MiFID II), position reporting thresholds and the management powers of ESMA in relation to such derivatives. The final topic in the Consultation Paper relates to the rules that should apply to investment firms when providing portfolio compression services.

PREPARATION FOR IMPLEMENTATION

These two papers together set out a vast number of policy proposals for parties within scope to review and digest in a relatively short period of time. In forming any responses to the questions posed within the two documents, parties should consider the interaction of the proposals with the new U.S. rules contained within the Dodd-Frank Act as well as how such proposals will fit in and work with other EU Directives and Regulations, in particular the European Market Infrastructure Regulation ("EMIR").

UPCOMING SPECIAL REPORT SERIES

In the coming weeks, FIA and FIA Europe will issue special reports on the following topics addressed in the two papers:

- 1) **Commodity Derivatives** (including position limits)
- 2) **Open Access** (access to central counterparties, trading venues and benchmarks)
- 3) **Market Infrastructure** (requirements for organisation of new trading venues and impact of the new obligation to trade on those venues)
- 4) **Investor Protection**
- 5) **Algorithmic and High Frequency Trading** (defining terms and regulating activities)
- 6) **Third Country Access** (treatment of third country firms accessing EU customers)
- 7) **Reporting of Instruments**
- 8) **Transparency Requirements for Instruments**

For more information about these reports contact Will Acworth at FIA (wacworth@fia.org) or Emma Davey at FIA Europe (edavey@fia-europe.org)

Additional MiFID II/MiFIR documents are available [here](#).

Disclaimer: This report was drafted by the London office of Covington & Burling LLP on behalf of FIA and FIA Europe. The report is part of a series of reports intended to provide factual summaries of MiFID/MiFIR on certain topics of interest to the members of FIA and FIA Europe. The reports are provided for general informational purposes only. They do not constitute legal or regulatory advice and should not be relied upon for this purpose.

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