

MiFID II

**Market infrastructure, trading venues and
central counterparties**

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**Hogan
Lovells**

Market infrastructure

Key Points

- Creation of a new category of trading venue: the organised trading facility.
- Extension of the regime for systematic internalisers.
- Introduction of regime for small- and medium-sized enterprise growth markets.

Market infrastructure under MiFID I

MiFID I established a regulatory framework for the trading of financial instruments across the EU. Under MiFID I, trading venues are divided into:

- Regulated markets ("RMs"):** These are defined as multilateral systems operated and/or managed by a market operator that bring together multiple third-party buying and selling interests in accordance with non-discretionary rules and in a way that results in a contract. This category covers "traditional" exchanges such as the London Stock Exchange.
- Multilateral trading facilities ("MTFs"):** These are alternative trading venues that bring together multiple third-party buying and selling interests in accordance with non-discretionary rules and in a way that results in a contract. Typically MTFs involve electronic trading systems that are operated by investment banks or other market operators.

In addition, certain investment firms may provide trading facilities outside a trading venue:

- Systematic internalisers ("SIs"):** MiFID I also introduced the category of SIs, which are investment firms dealing on their own account by executing client orders outside a regulated market or an MTF on an organised, regular and systematic basis. This

category covers large investment firms that execute client orders outside trading venues by matching their clients' buy and sell orders in-house.

The MiFID I regime, however, contained a number of deficiencies which the MiFID II Directive and MiFIR are intended to address:

- Although the introduction of a lighter-touch MTF regime increased competition between trading venues, it also resulted in the fragmentation of the market.
- In particular, it has been suggested that the rules give a competitive advantage to MTFs due to their lighter regulatory burden compared with RMs.
- The SI regime has not been successful, as few firms have registered as SIs.
- In addition, alternative trading models, such as broker crossing networks, are not covered by the MiFID I framework.

MiFID II is intended to enhance the MiFID regime for trading venues through the measures set out below. MiFID II seeks to create a level playing field for trading venues, ensuring that similar activities are subject to a similar level of regulation. As such, the different categories of trading venue under MiFID II will largely be subject to similar transparency and organisational requirements.

Organised trading facilities

MiFID II introduces a new category of trading venue, the organised trading facility ("**OTF**"). This is intended to cover systems which currently operate outside the scope of MiFID. The OTF regime will capture broker crossing networks and other trading in non-equities (bonds, structured finance products, emission allowances or derivatives) outside RMs, MTFs and SIs.

OTFs are defined as multilateral systems which are neither RMs nor MTFs and in which multiple third-party buying and selling interests in bonds,

structured finance products, emission allowances or derivatives can interact in a way which results in a contract.¹

One of the main differences between RMs and MTFs compared with OTFs is that the OTF operator has discretion in executing orders, subject to their transparency and best execution obligations.²

Because OTFs are discretionary, MiFID II's provisions on investor protection, including suitability, best execution and client order handling rules, will cover transactions concluded on an OTF.

OTFs, along with RMs and MTFs, must establish transparent and non-discriminatory rules governing access to the facility.³ Where the OTF regime differs, however, is in the OTFs' ability to determine and restrict access based on the role and obligations that they have in relation to their clients.

OTF operators cannot be an SI or connect with an SI or another OTF in a way which will enable orders in the OTF and SI to interact.⁴ An OTF may engage market makers provided that such market making is carried out on an independent basis.

Like RMs and MTFs, OTFs cannot execute client orders against proprietary capital.⁵ However, an OTF may engage in matched principal trading in bonds, structured finance products, emission allowances and derivatives that are not subject to the clearing requirement under Article 5 of the European Market Infrastructure Regulation ("**EMIR**").⁶ To do so, the OTF operator will need to explain its use of matched principal trading to its competent authority, who will monitor the

OTF's compliance and ensure that no conflicts of interest arise.⁷

Extension of the SI Regime

MiFID II is intended to encourage greater take-up of the SI model by including additional objective criteria to determine when a firm is an SI. This is likely to lead to more firms becoming SIs for the first time.

MiFID I defined SIs by using qualitative criteria, which meant that many firms determined that they did not fall within the regime. MiFID II defines an SI as "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".⁸ In particular, MiFID II will introduce quantitative conditions to determine whether an investment firm is dealing on a "frequent and systematic" basis and on a "substantial" basis:

- (a) the "frequent and systematic" basis will be measured by the number of OTC trades in the financial instrument carried out by the firm on own account by executing client orders; and
- (b) the "substantial" basis will be measured by the size of the firm's OTC trading in a specific financial instrument in relation to the total trading of the firm or the total trading in the EU.

Firms must meet both criteria to fall under the SI category, though there will also be the possibility for firms to opt into the regime.⁹

The MiFID II Delegated Regulation contains quantitative thresholds for the criteria of "frequent and systematic" and "substantial". These thresholds are based on the number, frequency

¹ For the definition of an OTF, see Article 4(1)(23), MiFID II Directive.

² Article 20(6), MiFID II Directive.

³ For MTFs, see Article 19(1), MiFID II Directive.

⁴ Article 20(4), MiFID II Directive.

⁵ Article 20(1), MiFID II Directive.

⁶ Regulation 648/2012.

⁷ Article 20(2), MiFID II Directive.

⁸ Article 4(1)(7), MiFID I Directive; Article 4(1)(20), MiFID II Directive.

⁹ Article 4(1)(20), MiFID II Directive.

and volume of transactions executed by the firm concerned.¹⁰

In addition, MiFID II will extend the SI regime from covering only shares traded on a regulated market to capture:

- (a) equity-like instruments (depository receipts, exchange-traded funds, certificates and other similar financial instruments); and
- (b) non-equity instruments (derivatives, bonds, emission allowances, structured finance products).

As a result, it is anticipated that, under MiFID II, more firms will be treated as SIs for a greater range of financial instruments.

Small- and medium-sized enterprise ("SME") growth markets

MiFID II is intended to make it easier for small and medium-sized enterprises to access capital. Under MiFID II the operator of an MTF can apply to have that MTF registered as a specialised market for SMEs.¹¹ This is intended to allow growth markets (e.g. in small-cap stocks) to flourish under a looser regulatory regime. At least 50 per cent of issuers on SME growth markets must be SMEs. These SME markets will be subject to a simplified regulatory regime.

The MiFID II Delegated Regulation sets out certain key issues relating to SME growth markets, including:

- (a) the definition of an SME that may be admitted to the market;

- (b) conditions for registration as an SME growth market, including the requirement for 50 per cent of the issuers to be SMEs;
- (c) the requirement for an appropriate prospectus for securities admitted to the market; and
- (d) requirements for periodic financial reporting by issuers.¹²

¹⁰ Articles 12-16, Commission Delegated Regulation (EU) of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive (the "**MiFID II Delegated Regulation**"). For earlier drafts, see ESMA, Consultation Paper, 22 May 2014, Chapter 3.3; and ESMA, Technical Advice, 19 December 2014, Chapter 3.3.

¹¹ Recitals 132-135 and Article 33, MiFID II Directive.

¹² Articles 78-79, MiFID II Delegated Regulation. For ESMA commentary, see ESMA, Technical Advice, 19 December 2014, Chapter 6.1.

Trading venues

Key Points

- More intensive regulation of trading venues, with increased monitoring and regulatory reporting requirements.
- New governance, systems and controls, and technical requirements for all categories of trading venues.

This section contains matters relating to the impact of MiFID II on trading venues, including trading venues that allow algorithmic trading on their systems. For the impact of MiFID II on investment firms that engage in algorithmic trading, please see our separate briefing note on Algorithmic and High-Frequency Trading.

Tighter governance requirements for trading venues

MiFID II will introduce stricter requirements on the management bodies of trading venues. The management boards of MTF and OTF operators will be subject to the governance requirements imposed on the boards of credit institutions under the Capital Requirements Directive ("**CRD IV**"), and the operators of RMs will be subject under MiFID II to a similar regime.¹³

The governance requirements include the following:

- (a) The overall composition of the management body must reflect an adequately broad range of experiences.
- (b) The management body should possess adequate collective knowledge, skills and experience to be able to understand the market's activities and main risks.

- (c) All members of the management body must commit sufficient time to perform their functions. There will also be limits on the types of other directorships that can be held by directors of significant market operators. Members of the management body of a significant market operator cannot hold positions exceeding one of the following combinations:
 - (i) one executive directorship with two non-executive directorships; or
 - (ii) four non-executive directorships.

It should be noted that directorships held with companies within the same group are counted as a single directorship, and directorships in non-commercial organisations are exempt. In addition, the regulated body's regulator can authorise a person to hold one additional non-executive membership, subject to their having notified ESMA.

- (a) Each member of the management body will be required to act with honesty, integrity and independence of mind.
- (b) There will be a requirement to devote adequate human and financial resources to the induction and training of members of the management body.
- (c) Significant market operators will be required to establish non-executive nomination committees.
- (d) Market operators and their nomination committees will be required to engage a broad set of qualities and competences when recruiting members to management body. They will be required to put in place policies promoting diversity.
- (e) Management bodies will be required to define and oversee the implementation of governance arrangements that ensure effective and prudent management.

¹³ Article 9(1), MiFID II Directive for investment firms including MTF and OTF operators; Article 45, MiFID II Directive for RM operators.

ESMA issued a consultation paper in October 2016 which contained draft guidelines on the aspects of the governance regime for management bodies of RM operators.¹⁴ ESMA and the EBA will issue similar guidelines on management bodies of investment firms generally, which will include operators of MTFs and OTFs.

General requirements for trading venues

The MiFID II Directive introduces the following requirements for trading venues:¹⁵

- (a) **Systems resilience.** Trading venues must ensure their trading systems are resilient and have adequate capacity. They must be able to ensure orderly trading, carry out testing of systems, and have business continuity arrangements in place.¹⁶
- (b) **Market making.** Trading venues must have written agreements with investment firms pursuing a market-making strategy on the market (that is, firms that provide liquidity by quoting buy and sell prices for financial instruments).

Trading venues will need to ensure that a sufficient number of investment firms participate in agreements to provide liquidity to the market on a regular and predictable basis. The agreements with market-makers must specify the obligations of the investment firm and any incentives offered by the trading venue to the firm.¹⁷

A Commission Delegated Regulation, RTS 8, sets out trading venues' obligations in respect of market making schemes.¹⁸

- (c) **Trading controls.** Trading venues must maintain systems to reject orders that exceed pre-determined volume and price thresholds, or which are clearly erroneous.¹⁹
- (d) **Trading halts and suspensions.** Trading venues must be able to temporarily halt or constrain trading if there is a significant price movement in a financial instrument on the market, or a related market during a short period.²⁰ In exceptional cases, the trading venue must be able to cancel, vary or correct the transaction.

The parameters used by a trading venue for halting trading must be properly calibrated to avoid significant disruptions to orderly trading and shall take account of the liquidity of differing asset classes and sub-classes, the nature of market models and the types of users. Those parameters must be reported to the trading venue's competent authority.

If a trading venue is a "material market in terms of liquidity" it will also need to have in place procedures to notify its competent authority if the trading venue puts a halt to trading in order that the competent authority can co-ordinate a market-wide response.²¹ RTS 12 contains a definition of "material market in terms of liquidity".²²

Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards specifying the requirements on market making agreements and schemes ("**RTS 8**"). For an earlier draft, see RTS 8 in ESMA, Regulatory and Technical Implementing Standards: Annex I, 28 September 2015. See also ESMA, Final Report, 28 September 2015, Chapter 3.3.

¹⁹

Article 48(4), MiFID II Directive.

²⁰

Article 48(5), MiFID II Directive.

²¹

Article 48(5), MiFID II Directive.

²²

Commission Delegated Regulation (EU) of 26 May 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards for the determination of a material market in terms of liquidity in relation to notifications of a temporary halt in trading ("**RTS 12**"). For an earlier draft, see RTS 12 in ESMA, Regulatory and Technical Implementing Standards: Annex I, 28 September 2015. See also ESMA, Final Report, 28 September 2015, Chapter 3.7.

¹⁴ ESMA, Consultation Paper: Guidelines on specific notions under MiFID II related to the management body of market operators and data reporting services providers (5 October 2016) (ESMA/2016/1437).

¹⁵ Article 48 of the MiFID II Directive states the requirements for operators of RMs. Article 18(5) states that the Article 48 requirements also apply to firms operating an MTF or OTF. Article 48(1), MiFID II Directive.

¹⁶ Article 48(1), MiFID II Directive.

¹⁷ Article 48(2), MiFID II Directive.

¹⁸ Commission Delegated Regulation (EU) of 13 June 2016 supplementing Directive 2014/65/EU of the European

- (e) **Testing and managing algorithmic trading.** Trading venues must have in place effective systems to ensure that algorithmic trading cannot create disorderly trading, and to manage any disorderly trading that arises. In particular, trading venues must carry out testing of algorithms, and must have systems to limit the ratio of unexecuted orders to transactions.²³ RTS 9 sets out the obligation for trading venues to calculate this ratio, and the methodology for the calculation.²⁴
- (f) **Direct electronic access.** A trading venue should have procedures in place to ensure that:
- (i) all users using direct electronic access are authorised under MiFID II or CRD IV;
 - (ii) criteria are in place to assess the suitability of all users using direct electronic access; and
 - (iii) the user is responsible for its orders executed by direct electronic access.²⁵
- (g) **Co-location.** A trading venue should have in place rules on co-location. "Co-location" is the location of user-owned computers on the same premises as the trading venue's computer servers, which enables the user to access prices before other users.²⁶ RTS 10 sets out requirements for fair and non-discriminatory co-location services.²⁷
- (h) **Fee structures.** Trading venues must have fee structures that are transparent, fair and non-discriminatory. RTS 10 sets out detailed requirements for the fee structures that trading venues must have in place.²⁸
- (i) **Identification of algorithmic trades.** Trading venues must use flags to identify orders generated by algorithms and the traders who have initiated such orders.²⁹
- (j) **Record-keeping.** All trading venues must keep a record of transactions, and upon request, the trading venue must provide the competent authority with access to its order book.³⁰

Specific requirements for trading venues which allow algorithmic trading by members

The Commission has adopted a Regulatory Technical Standard, RTS 7, that sets detailed requirements for trading venues that allow algorithmic trading on their systems.³¹ In particular, RTS 7 sets out organisational requirements in relation to the following issues:

- (a) **Self-assessment.** Trading venues must carry out a self-assessment of their compliance with the organisational requirements at least once a year, covering the criteria in the Annex to RTS 7.
- (b) **Governance.** Trading venues must have clear and formalised governance arrangements.

²³ Article 48(6), MiFID II Directive.
²⁴ Commission Delegated Regulation (EU) of 18 May 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards for the ratio of unexecuted orders to transactions in order to prevent disorderly trading conditions ("**RTS 9**"). For an earlier draft, see RTS 9 in ESMA, Regulatory and Technical Implementing Standards: Annex I, 28 September 2015.

²⁵ Article 48(7), MiFID II Directive.

²⁶ Article 48(8), MiFID II Directive.

²⁷ Articles 1 and 2, Commission Delegated Regulation (EU) of 6 June 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards on requirements to ensure fair and non-

discriminatory co-location services and fee structures ("**RTS 10**").

²⁸ Articles 3-5, RTS 10.

²⁹ Article 48(10), MiFID II Directive.

³⁰ Article 48(11), MiFID II Directive.

³¹ Commission Delegated Regulation (EU) of 19 July 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the organisational requirements of investment firms engaged in algorithmic trading ("**RTS 7**"). For an earlier draft, see RTS 7 in ESMA, Regulatory and Technical Implementing Standards: Annex I, 28 September 2015, Article 2. For ESMA commentary, see ESMA, Final Report, 28 September 2015, Chapter 3.2.

- (c) **Compliance function.** Compliance staff must have a general understanding of algorithmic trading, and be able to advise on related legal obligations. They must also at all times have access to persons who have the ability to halt trading on that venue (the "kill functionality") or be able to exercise the kill functionality themselves.
- (d) **Staffing.** Trading venues must employ a sufficient number of staff to manage algorithmic trading, and those staff must be knowledgeable about the use of algorithms and the venue's legal obligations.
- (e) **Outsourcing and procurement.** There must be controls on the outsourcing of functions relating to algorithmic trading, including a written outsourcing agreement with the service provider.

Trading venues that permit algorithmic trading are required by RTS 7 to ensure that their trading systems are resilient and have adequate capacity:

- (a) **Due diligence and periodic review for members.** The RTS requires trading venues to assess the suitability of members, and to carry out an on-going review of the members' suitability at least annually.
- (b) **Testing of the trading systems.** Trading venues must test their systems prior to use and before any update.
- (c) **Conformance testing.** Members of trading venues must also carry out testing to ensure that their trading system, algorithm or trading strategy is compatible with the trading venue.
- (d) **Testing of members' algorithms.** Members must certify that their algorithms have been tested to avoid creating "disorderly trading systems".

Trading venues have to provide a testing environment to allow members to carry out such testing. The testing environment may

consist either of access to a facility simulating the market or a dedicated fictional trading "symbol" to allow testing in a live trading environment with other algorithms.

- (e) **Trading venue capacity.** Trading venues must have sufficient capacity to avoid systems failures, and cope with increased message flows if needed.
- (f) **General and on-going monitoring.** Trading venues must conduct real-time monitoring of algorithmic trading and take appropriate action where required.
- (g) **Periodic review.** Trading venues must carry out stress testing that simulates adverse conditions to check how their systems perform under pressure.
- (h) **Business continuity.** Trading venues must have effective business continuity arrangements in place, including a business continuity plan. The arrangements must be subject to periodic review.
- (i) **Prevention of disorderly trading conditions.** Trading venues must be able to prevent disorderly trading by suspending a member's access to its systems, operating a kill functionality, cancelling orders, and "throttling" orders so that order executions are staggered over time.
- (j) **Mechanisms to manage volatility.** Trading venues must ensure that mechanisms to manage volatility are operational throughout their trading hours, and that they are appropriately tested and resourced.
- (k) **Pre- and post-trade controls.** Trading venues must have the following pre-trade controls in place for members' orders:
 - (i) price collars, which block orders outside pre-set limits;

- (ii) maximum order value; and
- (iii) minimum order value.

Trading venues may also establish post-trade controls depending on the risk posed by members' activities

- (l) **Conditions for direct electronic access.** Trading venues must publish rules under which they will provide direct electronic access to members. A person providing sponsored access must have equivalent controls in relation to sponsored access users.
- (m) **Security and limits to access.** Physical and electronic security of trading venues should be ensured, and any misuse or unauthorised access must be notified to the regulator.

Tick sizes

Tick sizes are the mandatory minimum sizes in which a particular instrument can be traded. Member states are required by MiFID II to adopt a tick size regime³² which will be adapted for each category of financial instrument³³ and will apply to each trading venue.

RTS 11 sets out detailed requirements for tick sizes to be adopted for shares, depositary receipts, and certain exchange-traded funds.³⁴ The RTS specifies that the tick size should be based upon:

- (a) the liquidity of the instrument; and
- (b) the price of the order.

³² Article 49(1), MiFID II Directive.

³³ Article 49(2), MiFID II Directive.

³⁴ Commission Delegated Regulation (EU) of 14 July 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards on the tick size regime for shares, depositary receipts and exchange traded funds ("**RTS 11**"). For earlier commentary and a draft, see ESMA, Final Report, 28 September 2015, Chapter 3 (page 253); RTS 11 in ESMA, Regulatory and Technical Implementing Standards: Annex I, 28 September 2015.

Synchronisation of business clocks

Trading venues and their members are required to synchronise their clocks in order to ensure that the recording of the time and date of reportable events is identical.³⁵ RTS 25 sets out the use of Coordinated Universal Time (UTC) for these purposes, and the level of accuracy that trading venues must achieve.³⁶

Admission of financial instruments to trading on RMs

MIFID II expands on the MiFID I requirements for the admission of securities to trading on regulated markets.³⁷ Although Article 40 of MiFID I provided for the development of draft technical standards on some of these matters, the majority of the requirements were never implemented in the secondary legislation. MiFID II is intended to develop the requirements fully.

RTS 17 specifies the following provisions in relation to admission to trading on RMs:

- (a) **Conditions for admission to trading.** The RTS sets out conditions which RMs must take into account when assessing whether the following financial instruments can be admitted to trading:
 - (i) transferable securities;
 - (ii) units or shares in collective investment undertakings;
 - (iii) derivatives; and
 - (iv) emissions allowances.
- (b) **Disclosure requirements.** RMs must ensure that issuers comply with disclosure

³⁵ Article 50, MiFID II Directive.

³⁶ Commission Delegated Regulation (EU) of 7 June 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards for the level of accuracy of business clocks ("**RTS 25**").

³⁷ Article 51(6), MiFID II Directive.

obligations under EU law (for example, the Prospectus Directive, Transparency Directive and Market Abuse Directive). RMs will be required to:

- (i) adopt a policy to verify compliance with EU disclosure requirements, and publish it on their websites; and
 - (ii) check compliance with the policy.
- (c) **Access to information.** RMs must facilitate access for members to information being disclosed under EU law. RMs should ensure that a description of how they facilitate access is freely accessible, free of charge and published on their websites.³⁸

Suspension or removal of financial instruments from trading

Trading venues may suspend or remove a financial instrument from trading where the instrument no longer complies with their rules. However, trading venues must not suspend or remove instruments if this would be likely to cause significant damage to investors' interests or the orderly functioning of the market.³⁹

If a trading venue suspends or removes an instrument, other trading venues will be required to do the same, where the suspension or removal is due to:

- (a) suspected market abuse;
- (b) a takeover bid; or
- (c) non-disclosure of inside information,

unless this could cause significant damage to investors' interests or the orderly functioning of the market.⁴⁰

The MiFID II Delegated Regulation contains a non-exhaustive list of circumstances that would constitute damage to investors' interests or to the orderly functioning of the market.⁴¹

RTS 18 clarifies that if a derivative has a single underlying which consists of a financial instrument that has been removed or suspended from trading, then that derivative should also be removed or suspended.⁴²

Following proposals from ESMA, an Implementing Technical Standard, ITS 2, is being prepared by the European Commission to clarify when and how trading venues will suspend or remove financial instruments from trading. ESMA has proposed that trading venues should announce the suspension or removal of an instrument "immediately after" the decision has been taken regarding that instrument. The announcement should be made on the trading venue's website in a standardised format. The trading venue will have to notify the regulatory authorities at the same time.⁴³

Monitoring and reporting requirements

Trading venues must inform their competent authorities immediately of:

- (a) significant infringements of their rules;
- (b) disorderly trading conditions;

³⁸ Commission Delegated Regulation (EU) of 24 May 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards for the admission of financial instruments to trading on regulated markets ("**RTS 17**"). For earlier commentary, see ESMA, Final Report, 28 September 2015, Chapter 5.1; and ESMA, Consultation Paper, 19 December 2014, Chapter 6.1.

³⁹ Article 52, MiFID II Directive (in relation to RMs); Article 32, MiFID II Directive (in relation to MTFs and OTFs).

⁴⁰ Articles 32(2) and 52(2), MiFID II Directive.

⁴¹ Article 80, MiFID II Delegated Regulation. See ESMA, Technical Advice, 19 December 2014, Chapter 6.2.

⁴² Commission Delegated Regulation (EU) of 24 May 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards for the suspension and removal of financial instruments from trading ("**RTS 18**").

⁴³ ESMA, Final Report: Draft Implementing Technical Standards under MiFID II, 11 December 2015 (ESMA/2015/1858), Chapter 3, ITS 2. See also ESMA, Consultation Paper: Drafting implementing technical standards under MiFID II, 31 August 2015 (ESMA/2015/1301).

- (c) conduct that may indicate market abuse; or
- (d) systems disruptions in relation to a financial instrument.⁴⁴

The MiFID II Delegated Regulation sets out non-exhaustive lists of the circumstances that would require a trading venue to issue a notification to its competent authority.⁴⁵

Cooperation between home and host competent authorities of a trading venue

MiFID II provides that, when a trading venue has become "of substantial importance" for a host member state, then the home and host competent authorities must put cooperation arrangements in place.⁴⁶ The MiFID II Delegated Regulation sets out criteria for determining the "substantial importance" of a trading venue.⁴⁷

⁴⁴ MiFID II Directive, article 54(2) (for RMs), and 31(2) for MTFs and OTFs.

⁴⁵ Articles 81 and 82, MiFID II Delegated Regulation. See also ESMA, Technical Advice, 19 December 2014, Chapters 6.4 and 6.5.

⁴⁶ Article 79(2), MiFID II Directive.

⁴⁷ Article 90, MiFID II Delegated Regulation. See also ESMA, Technical Advice, 19 December 2014, Chapter 6.4.

Central counterparties

Key Points

- Trading venues must have access to central counterparties, and vice versa.
- Trading venues and central counterparties must also be permitted non-discriminatory access to benchmarks and licences.

Access between central counterparties and trading venues

Under MiFIR, trading venues must have access to central counterparties ("CCPs"), and vice versa.⁴⁸

A CCP is required to clear financial instruments on a non-discriminatory and transparent basis, regardless of the trading venue on which a transaction is executed. The CCP may however require the trading venue to meet particular operational and technical requirements.

In order to have access to a CCP, the trading venue must submit a formal request to the CCP, the CCP's competent authority and the trading venue's competent authority.

A competent authority can only allow access to a CCP where such access would not:

- require, in relation to certain derivatives, an interoperability agreement; or
- threaten the smooth and orderly functioning of the markets, or adversely affect systemic risk.

A trading venue is required to provide trade feeds on a non-discriminatory and transparent basis, upon request to any CCP authorised or recognised under EMIR that wishes to clear transactions in financial instruments on that venue.

Denial of access by a CCP

In recent commentary on the principle of open access, ESMA stated that access should be granted if, after reasonable efforts to manage the risks arising from access, no "significant undue risks" remained.⁴⁹

Nevertheless, RTS 15 confirms that a CCP may deny access on the following grounds:

- Anticipated volume of transactions.** According to ESMA commentary, a CCP must be able to demonstrate why and how it is unable to acquire the needed capacity.⁵⁰
- Increased operational risk and complexity.** Examples include incompatibility of CCP and trading venue IT systems, and lack of staff qualified to deal with the introduction of new financial instruments.
- Other factors creating significant undue risks.** A CCP can also deny access if:
 - The CCP would not be able to launch a clearings service for the new instruments that is compliant with the European Markets Infrastructure Regulation ("EMIR").
 - Granting access would threaten the economic viability of the CCP.
 - Granting access would give rise to legal risks arising due to conflicts of law between different jurisdictions.
 - The CCP's rules and a trading venue's rules are incompatible.⁵¹

⁴⁹ ESMA, Final Report, 28 September 2015, Chapter 4.3. For ESMA's previous proposals, see ESMA, Discussion Paper: MiFID II / MiFIR, 22 May 2014, Chapter 5.7; ESMA, Consultation Paper, 19 December 2014, Chapter 5.5.

⁵⁰ ESMA, Final Report, 28 September 2015, Chapter 4.3.
⁵¹ Commission Delegated Regulation (EU) of 24 June 2016 supplementing Regulation (EU) No 600/2014 of the European Parliament and of the Council with regard to regulatory technical standards on clearing access in

Denial of access by a trading venue

RTS 15 states that trading venues may deny access on the following grounds:

- (a) **Operational risk and complexity.** A trading venue may deny access if the use of incompatible IT systems would lead to operational risk and complexity.
- (b) **Other factors creating significant undue risks.** Other factors creating significant undue risks comprise:
 - (i) As with CCPs, trading venues should be able to deny access if granting it would make the trading venue economically unviable.
 - (ii) Incompatibility of trading venue rules and CCP rules is another ground to deny access.

However, as ESMA has confirmed in its commentary, risks arising from conflicts of law are not sufficient grounds for a trading venue to deny access.

Denial of access due to disorderly markets or systemic risk

The competent authority of a trading venue or a CCP may deny access if it considers that this would not threaten the smooth and orderly functioning of the markets or affect systemic risk.⁵²

RTS 15 confirms that the following factors would each fall into this category:

- (a) the risk of liquidity fragmentation; or
- (b) the risk management procedures of one or both parties are insufficient to prevent the

access agreement from creating significant undue risk that cannot be remedied.⁵³

Fee requirements and mandatory terms for open access

RTS 15 also contains:

- (a) mandatory terms to be included in an access agreement between the CCP and the trading venue; and
- (b) requirements for CCPs and trading venues to charge non-discriminatory and transparent fees for access.

Non-discriminatory access to licences and benchmarks

Under MiFIR, a person with proprietary rights to a benchmark is required to ensure that trading venues are allowed non-discriminatory access to:

- (a) relevant price and data feeds;
- (b) information on the composition, methodology and pricing of the benchmark for the purposes of clearing and trading; and
- (c) licences.⁵⁴

Access must be permitted at a reasonable commercial price, taking into account the price at which access to the benchmark is granted or intellectual property rights are licensed to other CCPs or trading venues. Different prices for different CCPs and trading venues is only allowed where it can be objectively justified.

RTS 16 states that a person with proprietary rights to a benchmark must:

- (a) provide the information about a benchmark that CCPs and trading venues need in order to be able to clear or trade instruments;

respect of trading venues and central counterparties ("RTS 15"). For an earlier draft, see RTS 15 in ESMA, Regulatory Technical and Implementing Standards – Annex I, 28 September 2015.

⁵²

Article 35(4)(b) and 36(4)(b), MiFIR.

⁵³

Article 8, RTS 15.

⁵⁴

Article 37(1), MiFIR.

- (b) apply identical rights and conditions to each licensee within a category of licensees; and
- (c) apply specified conditions for access to CCPs and trading venues.⁵⁵

⁵⁵ Commission Delegated Regulation (EU) of 2 June 2016 supplementing Regulation (EU) No 600/2014 of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards on access in respect of benchmarks ("**RTS 16**"). For an earlier draft, see RTS 16 in ESMA, Regulatory Technical and Implementing Standards – Annex I, 28 September 2015. For earlier proposals, see ESMA, Discussion Paper, 22 May 2014, Chapter 5.8; ESMA, Consultation Paper, 19 December 2014, Chapter 5.6.

Timescales for implementation

The MiFID II Directive and MiFIR came into force on 3 July 2014, and most of their provisions will come into effect in member states from 3 January 2018. Member states have until 3 July 2017 to transpose the MiFID II Directive and the Delegated Directive into national law.

The changes to the MiFID Implementing Directive will be made by way of the MiFID II Delegated Regulation which will become effective by 3 January 2018. The MiFID II Delegated Regulation will have direct effect and the member states will not need to implement these changes into national law.

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