MiFID II

Transparency in the context of Secondary Markets Bond Trading

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Introduction

- G20 and the mandate for greater market transparency
  - EMIR requirements to submit data to a Trade Repository (TR)
    - OTC Derivatives
  - MiFID II mandatory transparency requirements
    - pre-trade reporting requirements
    - post-trade reporting requirements
  - MiFIR Recital 8 – to make EU markets more transparent and efficient, create a new trading venue category: OTF “broadly defined so that now and in the future it should be able to capture all types of organized execution and arranging of trading which do not correspond to the functionalities or regulatory specifications of existing venues” (i.e. RM and MTF)
  - MiFIR Recital 18 – pre-trade transparency requirements should apply to systematic internalisers (widened definition)
MiFIR - Scope

• MiFIR generally applies to all of the following entities:
  • Investment firms authorized under MiFID II
  • Credit institutions authorized under CRD IV
  • Investment Firms and Market Operators operating trading venues (including Systematic Internalisers)
Material Changes from the MiFID Transparency Regime

- Expansion of transparency requirements from “equity” instruments, to “equity-like” and “non-equity” financial instruments including:
  - Corporate bonds
  - Structured finance products
  - Emissions allowances
  - Derivatives
- Could too much transparency further impact the liquidity in the EU corporate bond markets?
- Distinction between “appropriate transparency” and “full transparency” (MiFIR Recital 16 – calibrate transparency requirements for different types of financial instruments (interests of investors, issuers and market liquidity) and for different types of trading (transaction size, turnover, other relevant criteria)

NB: We have not gone into the details of the various waivers to the obligation to make public pre-trade information nor the authorizations for deferred publication of post-trade information set out in Articles 9 and 11 of MiFIR in respect of transactions that are large-in-scale, above a size specific to that bond, or that relate to bonds for which there is not a liquid market.
• Recital 1, MiFIR
  • … a new framework establishing **uniform requirements** for the transparency of transactions in markets for financial instruments
  • …comprehensive rules for a broad range of financial instruments
  • It should complement requirements for the transparency of orders and transactions in respect of shares [in MiFID]

• Article 1, MiFIR
  • The establishment of **uniform requirements** in relation to
    • disclosure of trade data to the public
    • reporting of transactions to competent authorities

• Articles 8-11, MiFIR – transparency for non-equity instruments
• Articles 18 and 21, MiFIR – transparency for systematic internalisers
• Recital 3, MiFIR
  • … The need to establish a single set of rules for all institutions in respect of certain requirements and to avoid potential regulatory arbitrage as well as to provide more legal certainty and less regulatory complexity for market participants warrants… a Regulation.

• Recital 5, MiFIR reinforces the anti-evasion language by emphasizing that transparency was included within the framework of the Regulation to “prevent diverging national requirements.”
Recital 6, MiFIR

“It is important to ensure that trading in financial instruments is carried out as far as possible on organized venues and that all such venues are appropriately regulated”

Recital 8, MiFIR

New trading venue category – Organized Trading Facility or “OTF” (broadly defined)

Products including bonds, structured finance products and derivatives

Must comply with transparency rules “…which support efficient price discovery…”
• Recital 10, MiFIR
  • “All organized trading should be conducted on regulated venues and be fully transparent, both pre- and post-trade.”
• Recital 18, MiFIR
  • “Pre-trade transparency requirements should apply to investment firms dealing on own account in financial instruments OTC in so far as it is carried out in their capacity as systematic internaliser in relation to … bonds… which are traded on a trading venue and for which there is a liquid market”
• Therefore, transparency requirements for bonds have been imposed on investment firms and other operators of trading venues (impacting participants and users) and on systematic internalisers
Pre-trade Transparency Requirements for Trading Venues in respect of Bonds

- Article 8, MiFIR
- Who does the obligation apply to
  - Market operators, and
  - Investment firms operating a trading venue
- What does the obligation entail?
  - making public current information regarding
    - bid prices
    - offer prices
    - the depth of trading interests
    - actionable indications of interest
- Information on a continuous basis during normal trading hours
- Subject to Regulatory Technical Standards by ESMA
Post-trade Transparency Requirements for Trading Venues in respect of Bonds

- Article 10, MiFIR
- Who does the obligation apply to
  - Market operators, and
  - Investment firms operating a trading venue
- What does the obligation entail?
  - making public information as close to real-time as is technically possible regarding
    - price
    - volume
    - time of trade execution
- Subject to Regulatory Technical Standards by ESMA
Obligation for Systematic Internalisers to Make Public Firm Quotes in respect of Bonds

- Article 18, MiFIR
- Who does the obligation apply to
  - Investment firms in respect of the relevant product for which they are systematic internalisers, provided that there is a liquid market
- Scope of the obligation
  - When they are prompted for a quote by a client, and
  - They agree to provide a quote
- What does the obligation entail?
  - make public firm quotes to other clients in a manner which is easily accessible to other market participants on a reasonable commercial basis
  - undertake to deal at that price for trades below a specified size threshold
  - can decide the clients to whom they give access to their quotes (on the basis of their commercial policy and in an objective, non-discriminatory way)
  - beyond threshold deal sizes calibrated for a particular fixed income instrument, the pre-trade transparency requirement will not apply
Post-trade “Disclosure” by Investment Firms including Systematic Internalisers, in respect of Bonds

- Article 21, MiFIR
- Who does the obligation apply to
  - Investment firms
  - Including systematic internalisers
- Scope of the obligation
  - When trading on own account on a trading venue, or
  - When trading on behalf of clients on a trading venue
- What does the obligation entail?
  - making public current information regarding
    - volume of the transaction
    - price of the transaction
    - time of execution of the transaction
- Subject to Regulatory Technical Standards by ESMA
Recital 10, MiFIR

“Appropriately calibrated transparency requirements therefore need to apply to all types of trading venues, and to all financial instruments traded thereon”

- Distinction between “appropriate…transparency” and full transparency

Recital 48, MiFIR

- Principle of proportionality

Recital 51, MiFIR

- Regulatory Technical Standards or RTS to be developed by ESMA
Operating an OTF is an investment activity requiring authorization if provided in the E.U.

OTF is widely defined so organized trading arrangements by a third country firm offered to E.U. clients would be caught within scope of investment activity

No express wording on extra-territoriality as in EMIR

Extra-territoriality finds expression in the regulation of third country firms that provide investment services (as listed in Annex I, Section A) in the E.U.

Two regimes:
- MiFID II Articles 39 - 42 – retail clients and clients who may be treated as professionals on request
- MiFIR Articles 46 - 49 – eligible counterparties and professional clients
Third Country Firms, Cont. – MiFID II regime

- MiFID II Articles 39 - 42 – retail clients and clients who may be treated as professional clients on request
- Member states may request the establishment of a branch; such branch must be authorized by the relevant competent authority
  - Conditions for authorization
  - Informational requirements when requesting authorization
  - Authorization only for provision of services in that MS (no E.U. passport)
  - Equivalence process does not apply
  - Reverse enquiry – Article 42, MiFID II – initiation/request by an E.U. client for the provision of an investment service or action by a third country firm does not require authorization and is not subject to MiFID II / MiFIR requirements
Third country Firms, Cont. – MiFIR regime

- MiFIR Articles 46 – 49 – eligible counterparties and professional clients
- Relies on equivalence decision
- Third country firms can provide investment services to such E.U. clients without the establishment of a branch or obtaining any authorization, provided that such firm is registered in the ESMA register
- Registration depends on whether the European Commission has adopted an ‘equivalence decision’ under Article 47, MiFIR
- Reverse enquiry – Article 46.5, para 3 – If an E.U. professional client “initiates at its own exclusive initiative” the provision of the investment service, the above equivalence and registration regimes do not apply
Options available to E.U. investment firms, market operators and investment firms operating a trading venue
  - depend on their specific concerns, MiFID II status of their bond trading arrangements, operational and practical feasibility and legal/regulatory risk

Regulators are keen to plug any loopholes which go against the spirit of MiFID II: transparency and minimization of regulatory arbitrage
  - Articles 40-42, MiFIR on regulators’ powers to intervene to change practices in certain circumstances, including a threat to orderly functioning and integrity of markets and to stability
  - Market Abuse Directive – applies to OTFs and systematic internalisers
  - Other jurisdictions are likely to adopt similar pre- and post-trade transparency requirements (i.e. USA, Switzerland etc.)
Case Study: U.S. Fixed Income Transparency

- No pre-trade transparency for Fixed Income products
- Post trade transparency achieved via TRACE (introduced in 2001)
  - Trade Reporting And Compliance Engine
  - 15 minute delayed publishing
  - Trades at $5 million and above not published
- SEC initiative to improve transparency in the markets
  - SEC Chair Mary Jo White’s comments for more public information on private negotiated prices in the bond markets
- Recent comments by the SEC
  - Stephen Luparello, SEC Director of Trading and Markets
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