



## Investment Management ADVISORY ■

**APRIL 23, 2014**

### European Parliament Adopts MiFID II/MiFIR Financial Service Regulations

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On April 15, 2014, the European Parliament approved two sets of revised rules designed to remedy perceived weaknesses in the functioning and transparency of financial markets in the European Union (EU). Because non-EU financial firms will need to register with the European Securities and Marketing Authority (ESMA) in order to conduct business in financial instruments with certain EU counterparties and will be subject to EU member state discretion in the case of other EU clients, these rules have implications beyond the borders of the EU. Since the rules provide that transactions between two non-EU counterparties may be subject to EU jurisdiction based on the circumstances of the trade, it is important that non-EU firms that transact business in the EU or whose financial instrument transactions have an EU connection seek legal advice as to whether these new rules might impact them or their respective businesses.

The first rule is in the form of an EU directive (often referred to as "MiFID II") and repeals prior legislation (commonly referred to as "MiFID"), which provided harmonized regulation for investment services in traditional financial instruments. The second is in the form of a regulation (MiFIR). MiFIR amends the European Market Infrastructure Regulation (EMIR) on over-the-counter derivatives, central clearing and trade repositories, which was adopted on July 4, 2012. Together, MiFID II and MiFIR represent the EU's new legal framework for EU-regulated markets, data-reporting service providers and investment firms, as well as for non-EU firms providing investment services or activities in the EU, whether such services relate to traditional financial instruments, derivatives, foreign exchange, certain structured investments or other types of contracts that are commonly traded.

MiFIR's principal objectives include the following:

1. Introducing a type of regulated trading platform, known as an organized trading facility (OTF), to trade certain types of derivatives contracts;
2. Increasing the availability and quality of trade transparency, both pre- and post-trade, on regulated venues;
3. Requiring financial counterparties and certain non-financial counterparties to execute standardized derivatives on an exchange. The European Commission and ESMA have the authority to determine which types of derivatives will be subject to this requirement, including whether any derivatives not subject to

an EU clearing mandate will be covered. This requirement covers standardized derivatives between an EU entity and certain non-EU counterparties, and in certain circumstances, may also apply to two non-EU parties if the derivative has a “direct, substantial and foreseeable” effect in the EU or if the execution on an exchange is necessary to avoid evasion of the rules. In addition, the term “exchange” includes an EU-regulated market (RM), multilateral trading facility (MTF) or OTF, or a non-European Economic Area trading platform that would fit any of the three foregoing categories if it were operated within the EU;

4. Expanding the scope of trade reporting and recordkeeping;
5. Allowing trading venues non-discriminatory and transparent access to central clearing counterparties in order to promote more competition;
6. Granting powers to member state regulators and ESMA to impose position limits on commodity derivatives, based on methodologies to be adopted by ESMA;
7. Requiring operators of RMs, MTFs and OTFs to monitor open positions and reduce or terminate such positions as necessary.

MiFID II updates the principles set forth in MiFID and adds further details to the predecessor directive by:

1. Conferring greater supervisory authority on home and host member states, particularly in the area of disclosure of positions and risk management controls in the commodity derivative and emission allowance markets. In addition, records of transactions have to be made available by investment firms to the competent governmental authorities, which can share such information with other member states if necessary to promote cross-border compliance with the rules;
2. Requiring the removal of financial instruments from trading in the event of suspected market abuse, a takeover bid or the nondisclosure of insider information about the issuer or the instrument;
3. Imposing requirements on market participants to provide information on demand to regulators about their algorithmic trading strategies and other uses of technological developments in financial markets, with the intent of curbing potential market abuses;
4. Recording telephone conversations and electronic communications involving client orders;
5. Mitigating perceived risks created by “dark pools” by imposing caps on their trading;
6. Adopting appropriate trade tick sizes in order to promote liquidity in the market; and
7. Protecting retail client assets by limiting title transfer collateral arrangements.

MiFIR is effective immediately and requires no further action on the part of the EU member states. MiFID II requires ratification by each EU member within a 30-month timeframe after the directive’s publication in the Official Journal of the European Union. Adoption of these new rules means that ESMA can begin the process of determining how to implement the rules; publication of formal discussion and consultation papers is expected by the end of June 2014.

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