

Practical guide to Markets in Financial Instruments Directive ('MiFID II') and Markets in Financial Instruments Regulation ('MiFIR')

A. Introduction – Legal Framework

1. The Cyprus Securities and Exchange Commission has prepared this document with the aim to provide the industry with an outline of the new MiFID II and MiFIR requirements.
2. The Markets in Financial Instruments Directive (MiFID - Directive 2004/39/EC) has been in force since 2008 and is a cornerstone of the EU's regulation of financial markets. It aims to improve the competitiveness and integration of EU financial markets by creating a single market for investment services and activities and ensuring a high degree of harmonized protection for investors in financial instruments. It also allows investment firms to provide services throughout the Union, being an internal market, on the basis of the home country supervision.
3. Various events and market developments have demonstrated weaknesses in some of the underlying principles of MiFID and highlighted areas needing reinforcement or revision. The financial crisis has exposed weaknesses in the functioning and in the transparency of financial markets. The evolution of financial markets has exposed the need to strengthen the framework for the regulation of markets in financial instruments, including where trading in such markets takes place over-the-counter (OTC), in order to increase transparency, better protect investors, reinforce confidence, address unregulated areas and ensure that supervisors are granted adequate powers to fulfill their tasks.
4. Therefore, on 12 June 2014, the European Parliament and the Council adopted Directive 2014/65/EC ([MiFID II](#)) and Regulation 600/2014 ([MiFIR](#)). This new legislative package seeks to make financial markets more efficient, resilient and transparent, improve investor protection as well as address commitments made by the G20 on these topics. Both MiFID II and MiFIR entered into force on 3 July 2014.
5. MiFID II and MiFIR apply to:
 - a) Investment firms
 - b) Credit institutions when providing investment services and/or performing investment activities and credit institutions when selling or advising clients in relation to structured deposits
 - c) Market operators, including any trading venues they operate
 - d) Data reporting services providers

- e) All financial counterparties as defined in Article 2(8) of the European Markets Infrastructure Regulation (EMIR) and all non-financial counterparties falling under Article 10(1)(b) of EMIR
 - f) Central counterparties (CCPs) and persons with proprietary rights to benchmarks
 - g) Third country firms providing investment services and/or performing investment activities within the Union
6. MiFID II establishes requirements in relation to the following:
- a) Authorization and operating conditions for investment firms
 - b) Provision of investment services or activities by third-country firms through the establishment of a branch
 - c) Authorization and operation of regulated markets
 - d) Authorization and operation of data reporting services providers
 - e) Supervision, cooperation and enforcement by competent authorities
7. MiFIR establishes uniform requirements in relation to the following:
- a) Disclosure of trade data to the public
 - b) Reporting of transactions to the competent authorities
 - c) Trading of derivatives on organized venues
 - d) Non-discriminatory access to clearing and non-discriminatory access to trading in benchmarks
 - e) Product intervention powers of competent authorities, ESMA and EBA and powers of ESMA on position management controls and position limits
 - f) Provision of investment services or activities by third-country firms following an applicable equivalence decision by the Commission with or without a branch
8. Persons who fall within the scope of MiFID II and MiFIR will need to carefully read this document and the legislative package itself in order to have an overview of the obligations set out in MiFID II and MiFIR and the main changes introduced.
- B. Main changes introduced with MiFID II and MiFIR**
9. **Scope and Exemptions of MiFID II**
[Articles 2, 3 and 91, Annex I(A)(9) and Annex I(C)(11) - MiFID II]
- The current exemptions under MiFID I are redefined and new exemptions are introduced (Articles 2 and 3 – MiFID II).
 - Additional financial instruments are brought into the scope of MiFID II, such as emission allowances (Annex I(C)(11) – MiFID II).

- MiFID II extends some of the information to clients and conflict of interest requirements to insurance-based investment products (Article 91 – MiFID II).
- The operation of an Organised Trading Facility¹ is added as a new investment service (Annex I(A)(9) – MiFID II)
- Structured deposits are included in the scope of MiFID II.

10. Corporate Governance and Organizational Requirements

[Articles 4, 9, 16, 45 and 63 – MiFID II]

- A new concept of management body is introduced. The role of the management body and the corporate governance requirements are strengthened (Articles 4(1)(36), 9, 45 and 63 – MiFID II).
- Product governance requirements arrangements will apply to firms who manufacture products and to those selling them (Article 16(3) – MiFID II).
- A requirement to record telephone conversations or electronic communications is introduced (Article 16(7) – MiFID II).
- A prohibition of title transfer collateral arrangements with retail clients is added (Article 16(10) – MiFID II).

11. Conduct of Business and Investor Protection Rules

[Articles 24 and 25 – MiFID II]

- The conduct of business rules are being strengthened, such as an extended scope for the appropriateness test and reinforced information to clients (Articles 24 and 25 – MiFID II).
- Independent advice is clearly distinguished from non-independent advice and additional restrictions are imposed on the receipt of third-party payments i.e. inducements by portfolio managers and providers of independent advice (Article 24 – MiFID II).
- There will be stricter control of the remuneration of staff advising or selling to clients in order to ensure that it complies with the obligation to act in the best interest of clients (Article 24(10) – MiFID II).
- The definition of non-complex instruments is amended and excludes structured UCITS. Therefore, an assessment of appropriateness will be required before selling any structured UCITS since the execution-only regime will not be possible for structured UCITS regardless of the product's risk profile (Article 25(4)(iv) – MiFID II).

12. Algorithmic Trading² and High Frequency Trading³

¹ An organized trading facility means a multilateral system which is not a regulated market or an MTF and in which multiple third-party buying and selling interests in bonds, structured finance products, emission allowances or derivatives are able to interact in the system in a way that results in a contract in accordance with Title II of MiFID.

[Articles 2 and 17 – MiFID II]

- Firms engaged in algorithmic trading are required to comply with specific systems and control requirements designed to ensure that their trading systems are suitably resilient and include appropriate risk controls (Article 17 – MiFID II).
- A requirement for all algorithmic traders to be properly regulated and to provide liquidity when pursuing a market-making strategy is introduced (Article 17 – MiFID II).
- Investment firms which provide direct electronic access to a trading venue will be required to have in place systems and risk controls to prevent trading that may contribute to a disorderly market or involve market abuse (Article 17 – MiFID II).
- Persons dealing on own account and applying a high-frequency algorithmic trading technique fall within the scope and need to be authorized under MiFID (Article 2 – MiFID II).

13. Market Structure Framework

[Articles 4, 20 and 33 MiFID II, Articles 14, 18, 20, 21, 23 and 28 MiFIR]

- A new multilateral trading venue, the Organized Trading Facility (OTF), alongside the existing categories of Regulated Markets (RM) and Multilateral Trading Facilities (MTF), is introduced. OTFs will only be able to trade non-equity instruments (bonds, structured finance products, emission allowances or derivatives) and will be able to exercise discretion in their execution policy. OTF operators will be able to engage in matched principal trading in non-equity instruments other than clearing eligible derivatives and in dealing on own account other than matched principal trading in illiquid sovereign debt instruments (Article 20 – MiFID II).
- Firms will be identified as Systematic internalisers (SIs) on the basis of quantitative criteria based on the frequency and scale of their trading. In addition to the pre- and post-trade transparency requirements for trading in liquid shares, the revised MiFID introduces a pre- and post-trade transparency regime for SIs in other liquid financial instruments (Article 4(1)(20) – MiFID II, Articles 14, 18, 20, 21 - MiFIR).
- Derivatives which are sufficiently liquid and eligible for clearing under the European Market Infrastructure Regulation (EMIR) will need to be traded on RMs, MTFs or OTFs (Article 28 – MiFIR).
- Where a share is admitted to trading on a trading venue, it will be required to be traded on a RM, MTF or SI, unless certain criteria apply, such as the transaction does not

² Algorithmic trading means trading in financial instruments where a computer algorithm automatically determines individual parameters of orders, with limited or no human intervention.

³ High-frequency algorithmic trading technique means an algorithmic trading technique characterized by infrastructure intended to minimize network and other type of latencies, system-determination of order initiation, generation, routing or execution without human intervention for individual trades or orders and high message intraday rates which constitute orders, quotes or cancellations.

involve a retail client and does not contribute to the price formation process (Article 23 – MiFIR).

- Within the MTF category, a new sub-category of Smaller and Medium-sized Enterprises (SME) growth Market is created (Article 33 – MiFID II).

14. Transparency Requirements

[Title II – MiFIR]

- New pre- and post-trade transparency requirements are introduced, and these requirements are extended beyond equities to cover equity-like instruments, bonds and derivatives. The requirements also apply to a broader range of trading venues (Title II – MiFIR).
- A double volume cap mechanism is introduced for orders placed in systems which are based on a trading methodology by which the price is determined in accordance with a reference price and for certain negotiated transactions, in order to limit the use of the reference price waiver and the negotiated transaction waiver (Article 5 – MiFIR).

15. Trade Reporting and Transaction Reporting

[Title V – MiFID II, Article 26 – MiFIR]

- Enhanced consolidation and disclosure of trading data are introduced.
- Requirements for authorization and operation of the newly-introduced data reporting services providers are established, i.e. Consolidated Tape Providers (CTPs), Approved Reporting Mechanisms (ARMs) and Authorized Publication Arrangements (APAs) (Title V - MiFID II).
- The scope of the transaction reporting regime is extended to cover financial instruments which are admitted to trading or traded on a trading venue or for which a request for admission to trading has been made, financial instruments where the underlying is a financial instrument traded on a trading venue and financial instruments where the underlying is an index or a basket composed of financial instruments traded on a trading venue (Article 26 - MiFIR).

16. Commodity Derivatives

[Articles 57 and 58 – MiFID II]

- Positions limits will be applied on the size of a net position which a person can hold at all times in commodity derivatives traded on trading venues and economically equivalent OTC contracts. There will be exemptions for non-financial entities on positions which are objectively measurable as reducing risks directly related to their commercial activity (Article 57 – MiFID II).

- A position reporting obligation is introduced by categories of position holders which will help regulators and market participants to have better information on the functioning of these markets (Article 58 – MiFID II).

17. Competition in trading and clearing

[Title VI - MiFIR]

- A harmonized EU regime is established for non-discriminatory access to trading venues and central counterparties and to benchmarks for trading and clearing purposes. Transitional measures will ensure the smooth application of those provisions.

18. Product intervention

[Title VII - MiFIR]

- MiFIR gives EU and national regulators new powers to temporarily or permanently prohibit or restrict the marketing, distribution or sale of certain financial instruments and structured deposits, financial activities and practices in case of significant investor protection concern or a threat to financial stability or the orderly functioning and integrity of markets and subject to a number of legal conditions to be fulfilled (Articles 40, 41, 42 and 43 – MiFIR).
- ESMA is given a facilitation and coordination role on position management measures and position limits applied by competent authorities and is also given position management powers (Articles 44 and 45 – MiFIR).

19. Third Country Regime

[Articles 39 and 42 - MiFID II, Title VIII - MiFIR]

- A harmonized regime for third country firms is introduced.
- When offering services to retail or professional clients on request in the EU, member states may require that third country firms will have to establish a branch in each member state where they operate. Branches will be subject to authorization and supervision in the member state (Article 39 – MiFID II).
- When retail or professional clients initiate at their own exclusive initiative the provisions of services by third country firms, there is no requirement for authorization (Article 42 – MiFID II).
- When providing services to eligible counterparties or per se professional clients in the EU, third country firms will directly register with ESMA. The registration will be subject to the third country receiving a positive equivalence assessment from the European Commission. No EU branch is required and the EU passport will be available (Title VIII – MiFIR).