



making sense of

MiFID II

PMQs
By Anne Plested

What will MiFID II do to improve pre- and post-trade transparency?

The transparency regime under the original MiFID Directive only applies to shares admitted to trading on regulated markets (including when those shares are traded on an MTF or over the counter). It was designed to harmonise the available information, mitigate the potential effects of fragmentation of market liquidity, integrate EU equity markets in the eyes of issuers and investors, increase the potential number of active market participants in a security, and thus increase liquidity. The extent to which these aims have been achieved in the past three years is the subject of much debate but the general view is that they have been. It does seem likely, though, that MiFID II will herald some changes in this important area.

So, what kind of changes can we expect to see to the pre-trade transparency requirements?

In equity markets transparency is all about providing investors with access to information on current trading opportunities, facilitating price formation and helping firms provide best execution to their clients. In practice, pre-trade transparency is the obligation to publish real-time orders and quotes. With this transparency in place we operate a 'lit' market; orders that do not come under the rules for pre-trade transparency being 'dark' liquidity/traded in 'dark pools'.

The increased use of dark pools since November 2007 has been the focus of many discussions in 2010 and has raised regulatory concerns around the effect on overall price discovery. However, as this debate continues, no major change is proposed in the review. The use of dark pools will continue to merit 'ongoing observation by regulators'.

Sometimes pre-trade transparency can have an adverse effect on liquidity and, to counter this, the current pre-trade transparency regime has a number of waivers in place. These will remain in place with a few changes. For example, the Commission proposes more stringent regulatory monitoring of the use of the existing waivers and consistency throughout Europe.

Under the LIS (Large in Scale) waiver the proposal is that order stubs (remaining unexecuted quantity of an initially LIS order) which no longer meet the LIS threshold will not be allowed to remain in the dark. Under the Reference Price waiver a minimum order size is proposed.

These suggested changes would impact smart order routing (SOR) processing with potentially new requirements for broker crossing networks and other trading venues.

Actionable Indications of Interest (IOIs) are to be treated as orders under the pre-trade transparency rules, which would mean a change to IOI processing if routable IOIs are covered in the scope.

What are the post-trade obligations?

The Commission has proposed that post-trade information needs to be published as "close to instantaneously as is technically possible", reducing the deadline for trade reporting from 3 minutes to 1 minute.

Changes are proposed to the delayed publication regime that will see all reports published by the end of day. Only the largest trades that occur late in the day will be allowed to delay publication until the next day.



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Reducing these publication delays on block trades could give less protection to buy-sides, though, as more trades become immediately reportable. Changes to the transparency rules will mean more trades for publication.

Is it just equity markets that will be affected?

No, the rules for pre- and post-trade transparency are to be extended to non-equity markets (e.g. Depositary Receipts, Exchange Traded Funds, Preference Shares, Bonds, Structured Products, and Derivatives).

The commission proposes that all RMs, MTFs and OTFs offering trading in non-equity instruments should publish their pre-trade information (orders/quotes) continuously. For firms trading OTC in non-equity instruments their pre-trade quotes should reflect the current market value, similar to the rules for SIs. This approach does sound helpful for equity-like instruments but for other diverse financial instruments the extension of equity rules will need to be proportional to the structure of each market.

What about OTC trading?

Since 2007 concerns have been raised by some market participants about the levels of trading going on outside the RMs, MTFs and SIs. These OTC trades are currently subject to trade and transaction reporting but, while MiFID removed a whole raft of flags back in 2007, there are now calls for more granular information to enable the regulator to monitor OTC trading effectively. I would therefore expect new trade reporting flags to be introduced on OTC trades under MiFID II with standardisation across markets.

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