MiFID II

Market infrastructure, trading venues and central counterparties

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
- Creation of a new category of trading venue: the organised trading facility ("**OTF**")
- Extension of the regime for systematic internalisers ("**SIs"**)
- Introduction of regime for small- and medium-sized enterprise growth markets
- 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

2016

Background

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.

MiFID I also introduced the category of *systemic internalisers* ("**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 the Markets in Financial Instruments Regulation ("**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, RMs, MTFs and OTFs 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

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

[2] MiFID II Directive, article 20(6).

[3] For MTFs, see MiFID II Directive, article 19(1).

[4] MiFID II Directive, article 20(4).

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**"). To do so, the OTF operator will need to explain its use of matched principal trading to its national competent authority ("**NCA**"), who will monitor the OTF's compliance and ensure that no conflicts of interest arise.[6]

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. The MiFID II definition of an SI requires SIs to deal on an organised, frequent, systematic and substantial basis.[7] 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:

- 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

- 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.[8]

ESMA has proposed quantitative thresholds for the criteria of "frequent and systematic" and "substantial". These thresholds will be based on the number, frequency and volume of transactions executed by the firm concerned.[9]

In addition, MiFID II will extend the SI regime from covering only shares traded on a regulated market to capture equity-like instruments (depositary receipts, exchange- traded funds, certificates and other similar financial instruments) and instruments. As a result, it is anticipated that, under MiFID II, more firms will be treated as SIs for a greater range of financial instruments.

Tighter governance requirements for trading venues

MiFID II introduces 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 CRD IV, and the operators of RMs will be subject under MiFID II to a similar regime.[10]

These include the following:

- The overall composition of the management body must reflect an adequately broad range of experiences.

- The management body should possess adequate collective knowledge, skills and experience to be able to understand the market's activities and main risks.

- 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:

[5] MiFID II Directive, article 20(1).

[6] MiFID II Directive, article 20(2).

[7] MiFID I Directive, article 4(1)(7); MiFID II Directive, article 4(1)(20).

[8] MiFID II Directive, article 4(1)(20).

[9] ESMA, Consultation Paper, 22 May 2014, chapter 3.3; and ESMA, Technical Advice, 19 December 2014, chapter 3.3.

[10] MiFID II Directive, article 9(1) for investment firms including MTF and OTF operators; MiFID II Directive, article 45 for RM operators.

- one executive directorship with two non-executive directorships; or

- 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. Also, the regulated body's regulator can authorise a person to hold one additional non-executive membership, subject to their having notified ESMA.

- Each member of the management body will be required to act with honesty, integrity and independence of mind.

- There will be a requirement to devote adequate human and financial resources to the induction and training of members of the management body.

- Significant market operators will be required to establish non-executive nomination committees.

- 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.

- Management bodies will be required to define and oversee the implementation of governance arrangements that ensure effective and prudent management.

ESMA is required to issue guidelines on the aspects of the governance regime for management bodies of RM operators by January 2016. ESMA and the EBA will issue similar guidelines on management bodies of investment firms generally.

Enhanced systems resilience

The MiFID II Directive will introduce new requirements for trading venues to:

(a) ensure their trading systems are resilient and have adequate capacity;

(b) reject orders that exceed volume limits or which are obviously erroneous;

(c) halt or limit trading if there is a significant price movement;

(d) carry out testing of algorithms to ensure that trading systems do not lead to disorderly market conditions;

(e) impose controls on direct electronic access; and

(f) use flags to identify algorithms and algorithmic traders.[11]

Organisational requirements for trading venues that enable or allow algorithmic trading through their systems

ESMA has produced draft technical standards that aim to set minimum requirements for trading venues that allow algorithmic trading on their systems.

In its Final Report published in September 2015, ESMA clarified that where a trading venue has trading segments that do not permit algorithmic trading, the requirements will not apply to those segments. In addition, certain trading systems which do not involve algorithmic trading activity, such as voice trading systems, will be outside the scope of the draft RTS.[12]

In addition, ESMA has proposed that trading venues which allow algorithmic trading should carry out a self-assessment of their compliance with the MiFID II organisational requirements at least once a year. A principle of proportionality should be applied when making this assessment; a trading venue whose business is particularly large in scale or complex may need to impose more extensive organisational controls compared with a smaller operation.[13] An Annex to the draft RTS sets out elements that the trading venue

[11] Articles 18(5) and 48(1), MiFID II Directive. Article 18(5) states that the requirements for RMs in articles 48 and 49 shall also apply to firms operating an MTF or OTF.

[12] ESMA, Final Report: Draft Regulatory and Implementing Technical Standards (the "**Final Report**"), 28 September 2015, chapter 3.2.

[13] RTS 7 in ESMA, Regulatory and Technical Implementing Standards: Annex I, 28 September 2015, article 2.

should when making the self-assessment.[14] In its September 2015 draft RTS, ESMA maintained this proposal for self-assessment and the list of factors to be considered by trading venues.[15]

Systems resilience

Trading venues are required by the MiFID II Directive to ensure that their trading systems are resilient and have adequate capacity.[16]

ESMA is required to further specify requirements in relation to this rule. In its draft RTS, ESMA has set out requirements for trading venues that allow algorithmic trading on their systems in relation to the following issues:

- the need for clear and formalised governance arrangements;
- the role of the compliance function;
- staffing;
- outsourcing;
- due diligence and periodic reviews of members; and
- testing of the trading system.[17]

In September 2015, ESMA clarified the following points:

- ESMA expects all trading venues to put in place adequate segregation between their functions to ensure effective supervision of compliance with legal and regulatory obligations;
- in some trading venues, the compliance function may be in charge of operating the kill functionality (i.e. the ability to halt trading on that venue);
- ESMA has reduced the reporting requirements for trading venues in relation to outsourcing; and
- ESMA has revised the requirement for trading venues to carry out due diligence on their members to clarify that this should not duplicate any due diligence already performed as part of the general organisational requirements for investment firms.[18]

Direct electronic access

MiFID II requires trading venues to impose controls on direct electronic access. To properly assess the suitability of users, a trading venue should have procedures in place to ensure that:

- all users using direct electronic access are authorised under MiFID II or CRD IV;
- criteria are in place to assess the suitability of all users using direct electronic access; and
- the user is responsible for its orders executed by direct electronic access.[19]

ESMA is required to specify the details for these controls in relation to trading venues that allow algorithmic trading. In its draft RTS, ESMA sets out requirements for systems and controls and particularly, due diligence of direct electronic access clients, on-going review of direct electronic access clients, and pre- and post-trade controls.

In addition to these minimum requirements, ESMA recommends that trading venues establish further requirements where necessary. A person providing sponsored access must have equivalent controls in relation to sponsored access users.

ESMA recommends that unique identification numbers are assigned to all users of direct electronic access, to allow a trading venue or firm to identify a user, and subsequently suspend or terminate the user's direct electronic access where there is a risk of disorderly trading. This should then be reported to the relevant NCA.[20]

[14] Annex of RTS 7in ESMA, Regulatory and Technical Implementing Standards: Annex I, 28 September 2015.

[15] ESMA, Final Report, 28 September 2015, chapter 3.2.

[16] Article 48(1), MiFID II Directive.

[17] RTS 7 in ESMA, Regulatory and Technical Implementing Standards: Annex I, 28 September 2015.

[18] ESMA, Final Report, 28 September 2015, chapter 3.2.

[19] Article 48(7), MiFID II Directive.

[20] RTS 7 in ESMA, Regulatory and Technical Implementing Standards: Annex I, 28 September 2015.

Testing of algorithms to avoid disorderly trading conditions

MiFID II requires trading venues to ensure testing of algorithms so that their trading systems cannot create or contribute to "disorderly trading systems".[21]

ESMA has provided draft RTS on such testing. In its latest RTS, the requirements are that trading venues should:

- require investment firms to certify that algorithms have been tested prior to trading;
- not be required to validate the test themselves;
- provide members with (i) a "live simulation environment" to allow testing in conditions similar to actual trading, or (ii) access to a testing "symbol" provided by the trading venue; and
- ensure that the testing environment is kept separate from the production environment.[22]

In addition, ESMA noted that it had received criticism regarding the problem of reproducing market conditions in a testing environment. On this basis, ESMA has proposed that trading venues may either offer access to a facility simulating their markets or provide a dedicated fictional "symbol" to allow testing in a live trading environment with other algorithms.

Orders generated by algorithmic trading should be flagged by internal risk management,[23] so that an individual member or participant can be identified where the member or participant has engaged in disorderly trading.

Circuit breakers

Trading venues will be required to maintain systems, procedures and arrangements to reject orders that exceed pre-determined volume and price thresholds, or which are clearly erroneous.[24]

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.[25] In exceptional cases, the trading venue must be able to cancel, vary or correct the transaction.[26]

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 NCA.

If a trading venue is a material market in terms of liquidity it will also need to have in place procedures to notify the NCA if the trading venue puts a halt to trading in order that the competent authority can co-ordinate a market-wide response.[27] The draft RTS contains a definition of "material market in terms of liquidity".[28]

Market making

Trading venues will be required to have agreements with liquidity providers; that is, investment firms pursuing a market-making strategy on the market. Trading venues will need to have arrangements in place to ensure that a sufficient number of investment firms participate in agreements to provide liquidity to the market on a regular and predictable basis.[29] These agreements must specify the obligations of the investment firm and any incentives offered by the trading venue to the firm. ESMA has provided RTS on such a market making scheme and the responsibilities

[21] Article 48(6), MIFID II Directive.

[22] RTS 7 in ESMA, Regulatory and Technical Implementing Standards: Annex I, 28 September 2015.

[23] Article 48(10), MiFID II Directive.

[24] Article 48(4), MiFID II Directive.

[25] Article 48(5), MiFID II Directive.

[26] RTS 7 in ESMA, Regulatory and Technical Implementing Standards: Annex I, 28 September 2015.

[27] Article 48(5), MiFID II Directive.

[28] RTS 12 in ESMA, Regulatory and Technical Implementing Standards: Annex I, 28 September 2015; ESMA, Final Report, 28 September 2015, chapter 3.7.

[29] Article 48(2), MiFID II Directive.

of the trading venue.[30] The trading venues will be expected to enforce compliance with those liquidity agreements.

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 regime[31] which will be adapted for each category of financial instrument[32] and will apply to each trading venue.

In the draft RTS released in September 2015, ESMA largely maintained its previous proposals[33] in relation to the MiFID II requirement for tick sizes to be adopted for shares, depositary receipts, and certain exchange-traded funds.[34] ESMA proposes that the tick size should be based upon:

- the liquidity of the instrument; and
- the price of the order.

However, ESMA has revised its previous proposal in some respects, in particular in relation to the tick size for exchange-traded funds ("**ETFs**").

Ratio of unexecuted orders to transactions

Under Articles 48(6) and 18(5) of MiFID II, trading venues must have in place effective systems, procedures and arrangements to ensure that algorithmic trading systems cannot create or contribute to disorderly trading conditions on their market, and to manage any disorderly trading that arises, including systems to limit the ratio of unexecuted orders to transactions. To meet this objective, ESMA has produced draft RTS which set out the obligation for trading venues to calculate this ratio, and the methodology for the calculation.[35]

Fee structures and co-location

A trading venue should also have in place fair, transparent and non-discriminatory fee structures[36] and rules on co-location.[37] "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. ESMA has issued a draft RTS on fair and non-discriminatory co-location services and fee structures.[38]

Monitoring and reporting requirements

Trading venues must inform NCAs immediately of:

- significant infringements of their rules;
- disorderly trading conditions;
- conduct that may indicated market abuse; or
- systems disruptions in relation to a financial instrument.[39]

ESMA has developed a non-exhaustive list of the circumstances that would require a trading venue to issue a notification to its NCA.[40]

Record-keeping

All trading venues must keep a record of transactions, and upon request, the trading venue must provide the NCA with access to its order book.[41]

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[30] RTS 8 in ESMA, Regulatory and Technical Implementing Standards: Annex I, 28 September 2015; ESMA, Final Report, 28 September 2015, chapter 3.3.

[31] Article 49(1), MiFID II Directive.

[32] Article 49(2), MiFID II Directive.

[33] RTS 18 in ESMA, Consultation Paper – Annex B, 19 December 2014, in accordance with Articles 49(3) and 49(4), MiFID II Directive..

[34] ESMA, Final Report, 28 September 2015, chapter 3 (page 253); RTS 11 in ESMA, Regulatory and Technical Implementing Standards: Annex I, 28 September 2015.

[35] RTS 9 in ESMA, Regulatory and Technical Implementing Standards: Annex I, 28 September 2015.

[36] Article 48(9), MiFID II Directive.

[37] Article 48(8), MiFID II Directive.

[38] RTS 10 in ESMA, Regulatory and Technical Implementing Standards: Annex I, 28 September 2015; ESMA, Final Report, 28 September 2015, chapter 3.5.

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

[40] ESMA, Technical Advice, 19 December 2014, chapters 6.4 and 6.5.

[41] Article 48(11), MiFID II Directive.

Admission, suspension and removal of financial instruments

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.[42] 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.

ESMA's latest draft regulatory technical standard ("**RTS**") in September 2015 contains the following provisions:

- The draft RTS specify the characteristics of financial instruments to be taken into account by a regulated market when assessing whether:

    - the instrument is capable of being traded in a fair, orderly and efficient manner; and

    - in the case of transferrable securities, the instrument is freely negotiable.

    In its December 2014 consultation, ESMA proposed that, for an exchange-traded fund to be capable of being traded in a fair, orderly and efficient manner, it must offer market making arrangements and appropriate alternative arrangements for investors to redeem units, at least in cases where the value of the units significantly varies from the net asset value. This has been carried forward in the September 2015 RTS.

- The RTS clarify arrangements to be put in place by regulated markets for ensuring that issuers comply with disclosure obligations under the Prospectus Directive, Transparency Directive and Market Abuse Directive. Regulated markets will be required to:

    - adopt a policy to verify compliance with these Directives, and to publish it on their websites; and

    - check compliance with the policy.

- The RTS clarify arrangements by regulated markets for facilitating access of members or participants to information being made public under the Prospectus Directive, Transparency Directive and Market Abuse Directive and under transparency requirements under MiFIR. ESMA maintained the requirement previously proposed in December 2014 that regulated markets shall facilitate access to the relevant information, and should ensure that a description of how they facilitate such access is freely accessible, free of charge and published on their websites.[43]

Suspension and 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, unless this would be likely to cause significant damage to investors' interests or the orderly functioning of the market.[44]

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:

- suspected market abuse;

- a takeover bid; or

- non-disclosure of inside information,

unless this could cause significant damage to investors' interests or the orderly functioning of the market.[45]

ESMA has proposed a non-exhaustive list of circumstances that would constitute damage to investors' interests or to the orderly functioning of the market.[46]

ESMA has issued further technical standards on when and how trading venues will suspend or remove

[42] Article 51(6), MiFID II Directive.

[43] ESMA, Final Report,, 28 September 2015, chapter 5.1. See also ESMA, Consultation Paper, 19 December 2014, chapter 6.1.

[44] MiFID II Directive, article 52 (in relation to RMs); article 32 (in relation to MTFs and OTFs).

[45] MiFID II Directive, articles 32(2) and 52(2).

[46] ESMA, Technical Advice, 19 December 2014, chapter 6.2.

financial instruments from trading under the MiFID II regime. ESMA states 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.[47]

Cooperation between home and host NCAs 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 NCAs must put cooperation arrangements in place.[48] ESMA has proposed criteria for determining the substantial importance of a trading venue.[49]

Access between central counterparties and trading venues

Under MiFIR, trading venues must have access to central counterparties ("**CCPs**"), and vice versa.[50] 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 NCA and the trading venue's NCA.

An NCA 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.

ESMA's proposals on open access between trading venues and CCPs

In its latest draft RTS released in September 2015, ESMA elaborated on the grounds on which a CCP or trading venue may deny access.[51] ESMA stated that it considers that access should be granted if, after reasonable efforts to manage the risks arising from access, no "significant undue risks" remained.[52] It is clear that ESMA regards this as the guiding principle by which open access should be interpreted.

Denial of access by a CCP to a trading venue

According to the draft RTS, a CCP may deny access to a trading venue on the following grounds:

- anticipated volume of transactions;
- increased operational risk and complexity; or
- other factors that may create significant undue risks.

In September 2015, ESMA's Final Report considered the following issues in relation to the denial of access by a CCP to a trading venue:

- ESMA stated that in order to deny access on the basis that the CCP's systems or capacity would be inadequate to cope with the anticipated volume of transactions, a CCP must be able to demonstrate why and how it is unable to acquire the needed capacity.
- ESMA restated its position that it does not consider an increase in the number and type of users to be grounds for denial of access.

[47] 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).

[48] MiFID II Directive, article 79(2).

[49] ESMA, Technical Advice, 19 December 2014, chapter 6.4.

[50] MiFIR, articles 35-36.

[51] RTS 15 in ESMA, Regulatory Technical and Implementing Standards – Annex I, 28 September 2015.

[52] 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.

- ESMA previously called for examples of increased operational risks that would constitute grounds for denial. In its final draft RTS, it has settled on two: incompatibility of IT systems and lack of staff qualified to deal with the introduction of new financial instruments

- By and large, ESMA maintained its previous proposals in relation to other factors creating significant undue risks. It stated that:

  - a CCP should be able to deny access where it would not be able to launch a clearings service for the new instruments that is compliant with the European Markets Infrastructure Regulation ("**EMIR**");

  - access may be denied if granting it would threaten the economic viability of the CCP, but costs should not otherwise be taken into account;

  - access may be denied due to certain legal risks arising due to conflicts of law between different jurisdiction; and

  - the incompatibility of CCP rules and trading venue rules is also be a ground for denying access.

Denial of access by a trading venue to a CCP

The draft RTS has stated that trading venues may deny access to CCPs on the following grounds:

- the use of incompatible IT systems would lead to operational risk and complexity; or

- other factors may create significant undue risks.

ESMA's Final Report considered the following issues in relation to the denial of access by a trading venue to a CCP:

- Based on the feedback received to the previous consultation, ESMA does not believe that the anticipated volume of transactions or the number of users are sufficient grounds for a trading venue to deny access to a CCP.

- ESMA considers that, as for CCPs, lack of IT compatibility should be a ground for trading venues to deny access,

- In terms of other factors creating significant undue risks:

  - As with CCPs, trading venues should be able to deny access if granting it would make the trading venue economically unviable.

  - Incompatibility of trading venue rules and CCP rules is another ground to deny access.

  - However, ESMA is not convinced that risks arising from conflicts of law constitute sufficient grounds for a trading venue to deny access.

Systemic risk

A CCP may only grant access to a trading venue if a relevant national competent authority considers that this would not threaten the smooth and orderly functioning of the markets.

In the latest draft RTS, ESMA has considered the conditions under which granting access would threaten the smooth and orderly functioning of the markets or would otherwise adversely affect systemic risk. It has revised its approach to confirm that the following factors would each fall into this category:

- the risk of liquidity fragmentation; and

- 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.

Other ESMA proposals

The draft RTS also contains:

- mandatory terms to be included in an access agreement between the CCP and the trading venue; and

- requirements for CCPs and trading venues to charge non-discriminatory and transparent fees for access..[53]

In general, ESMA has noted with respect to open access that differences in asset classes may need to be taken into account, and in particular the fact that managing the risks arising from derivatives is likely to be complex and challenging than those arising in relation to securities.

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:

- relevant price and data feeds;
- information on the composition, methodology and pricing of the benchmark for the purposes of clearing and trading; and
- licences.

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.

ESMA's latest draft RTS released in September 2015 state that a person with proprietary rights to a benchmark must:

- provide the information about a benchmark that CCPs and trading venues need in order to be able to clear or trade instruments;
- apply identical rights and conditions to each licensee within a category of licensees;
- apply specified conditions for access to CCPs and trading venues.[54]

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.[55] 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.

ESMA has published technical advice on certain key issues relating to SME growth markets:

- the practical application of the requirement for 50 per cent of the issuers to be SMEs;
- criteria for the admission to trading of securities on the market;
- the requirement for an appropriate admission document for securities admitted to the market;
- requirements for periodic financial reporting;
- issuers, their management and associates must comply with the Market Abuse Regulation;
- a light regime for disclosure of information;
- compliance with the market abuse regime in terms of systems and controls to prevent and detect market abuse.[56]

Timescales for implementation

The MiFID II Directive and MiFIR came into force on 3 July 2014. At present, the texts state that most of their provisions will come into effect in member states from 3 January 2017.

However, uncertainties regarding the timetable for MiFID II mean that this date may be postponed. Following discussions between ESMA and the

[53] RTS 15 in ESMA, Regulatory Technical and Implementing Standards: Annex I, 28 September 2015.

[54] 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.

[55] MiFID II Directive, Recitals (132)-(135) and article 33.

[56] ESMA, Technical Advice, 19 December 2014, chapter 6.1.

European institutions, it is now expected that the implementation of MiFID II will be delayed until January 2018.

ESMA submitted draft technical standards to the Commission on 28 September 2015. In principle, the Commission had three months to consider whether to endorse the technical standards (i.e. by 28 December 2015). However, in the context of ongoing uncertainty regarding the legislative timetable, the Commission did not meet this deadline.

The European Commission is also drafting delegated acts on the basis of the Technical Advice received from ESMA in December 2014. The date of publication has not been announced but, according to recent comments from the FCA, the Commission is expected to publish these delegated acts in January 2016.

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