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SHEDDING LIGHT ON EU DARK TRADES

In 2007, the EU implemented the Markets in Financial Instruments Directive (MiFID) that revolutionized securities trading in Europe and created Multilateral Trading Facilities (MTFs) for the electronic trading of shares and derivatives. But as a by-product of this technological advance came "dark trading," a means of concealing volumes being bought and sold and their prices. Now, the European Council has approved the final text of MiFID2 — a corrective measure to light up Europe's dark trades.

Regulation and Transparency

The benefits of MiFID were rarely realized by the end-user investor — rather mainly by large institutional traders. The investment climate under MiFID was a complex one; it lacked transparency and allowed OTC-derivatives trading to proceed largely unregulated. MiFID2 corrects these deficiencies by offering greater protection to investors and making trades — and their related data — more transparent.

Part of a Package of Regulations

MiFID2 is not a stand-alone regulation, but rather it must be considered in conjunction with two parallel laws: the Markets in Financial Instruments Regulation (MiFIR) and the European Market Infrastructure Regulation (EMIR); the latter is sometimes regarded as the "EU's Dodd-Frank." While the directives allow for some modification by member states so as to conform more to local norms, the regulations must be implemented equally by all signatories.

Key Provisions of MiFID2

A main concern of MiFID2 is to ensure that all trading is transacted on regulated trading venues such as MTFs, Systematic Internalizers (SIs) and Organized Trading Facilities (OTFs). Special emphasis applies to the regulation of OTC derivatives, and technical standards are devised to establish the classes of derivatives subject to the trading obligation. The rules also provide for the suspension of certain instruments from regulated trading venues and for the exchange of data among the different venues.

Specific Transparency Disclosures

Among the required disclosures by regulated venues are the following: (a) annual free publication to the general public as to execution quality (i.e., orders canceled, speed of execution, pricing); (b) posting of post-trade information within 15 minutes after execution of a trade; (c) separate pre-trade and post-trade data availability; (d) statement of rules controlling access to the venue; and (e) disclosure of specific risk controls by firms engaging in algorithmic or high frequency trading.

Clamoring to Get on Board

The new rules — and the expectation of new opportunities — have led several U.S. exchanges to set up shop in Europe under MiFID2 and its related regulations. Last May, NASDAQ opened NLX, a derivatives exchange; an equity-trading platform launched in November bases its fees on a subscription basis rather than on a percentage of value traded; and the Midwest operator of the world's largest futures market opened a London-based exchange last month.

CONTACT US!

DAVID KINNEAR
O: 212.913.0500 x565
M: 917.886.3222
E: DAVID.KINNEAR@GREENPOINTGLOBAL.COM

WILLIAM H. ANDERSON, ESQ
O: 212.913.0500 x586
M: 914.672.4975
E: WILLIAM.ANDERSON@GREENPOINTGLOBAL.COM

PETER K. OVERZAT, ESQ
O: 212.913.0500 x557
M: 917.807.1321
E: PETER.OVERZAT@GREENPOINTGLOBAL.COM

WWW.GREENPOINTLEGAL.COM