# MiFID II – not yet fully implemented and already under construction

The review of MiFID I was a very comprehensive project. It affects all institutions that act on financial markets and it got bigger than anybody would have ever expected. No wonder, as the review includes reactions to the financial crisis such as the introduction of the trading obligation for OTC derivatives. Legislators rightly acknowledged the essentially positive contribution of financial markets infrastructures for creating a safer, more transparent and efficient financial market of the future. Also, we see the extension of the transparency regime from equities to all financial instruments. Preserving and enhancing transparency is key for well-functioning markets as it provides the tools for a more stable and efficient financial market by setting the stage of a better understanding and supervision of markets. And, last but not least, there are adoptions due to technological developments such as algorithmic trading.

MiFID II/MiFIR has kept us busy and will continue to do so. After more than eight years of intensive discussions and planning for both the regulators and the financial industry, and more than 30,000 pages written, read, analysed, and implemented, MiFID II finally went live on 3 January 2018.

We at Deutsche Börse Group have always thought – and still do! – that all these efforts are worth it to achieve the legislators' objectives of further enhancing transparency, stability and investor protection. We do see merit in stressing this big picture of MiFID II given the general mood on both sides to grumble about the burden of implementing the new rules.

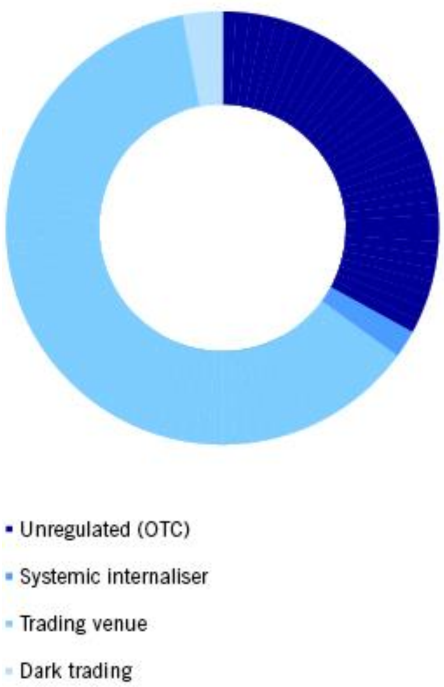
Admittedly, many aspects will require time. Still not all Member States have fully implemented MiFID II and many areas still require additional data to rightly calibrate thresholds and make rules applicable. However, we remain confident that these problems will be fixed over time.

## The new rules do finally apply – how do markets react?

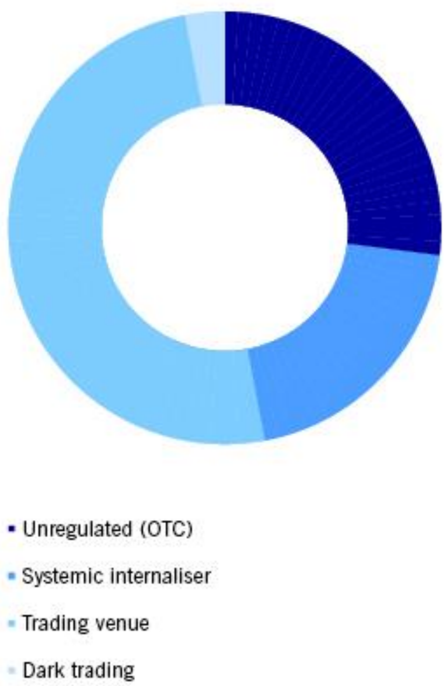
MiFID II/MiFIR have set in motion huge amounts of data streams. These data pools also provide us with opportunities to improve transparency and contribute to market quality. In this context, we should keep in mind that some provisions will phase-in over the course of this year, among others the public disclosure of execution quality in April, the liquidity assessment for corporate and sovereign bonds in May, and the need to authorise as a Systematic Internaliser (SI) in September.

Early market observations since the go-live date show us that markets successfully opened on 3 January: the vast majority of participants were well prepared and markets functioned without major distortions. New trading venues, SIs and data service providers have been authorised successfully. The most notable development can be observed in the area of SI – under MiFID I we had less than 20, now we already have 109 authorised firms, although the authorisation requirement will kick in not before September this year. We can already observe a significant decrease of unregulated trading for equities, which is a positive outcome. At the same time, the share of trading on SI has increased from around 2 per cent to over 20 per cent of daily trading volumes.  This increase in fragmentation may contravene the transparency objectives of MiFID II if more trading moves to private pools of liquidity controlled by SI that have the ability to choose who they are trading with and adapt their prices depending on the type of client. This could further hinder European price formation and the ability for companies to raise finance on the public market.

Trading of DAX values, 29 December 2017




Trading of DAX values, 9 March 2018




Moreover, we can see that too much trading takes place in the dark. This becomes obvious from the fact that ESMA has just published first data on the usage of waivers thatare subject to the Double Volume Cap mechanism, which restricts the amount of trading benefitting from pre-trade transparency exemptions. The outcome is that for more than 700 values these waivers will be banned on a temporary basis to ensure that more trading happens transparently and contributes to price formation.

### The big picture

Stability, market integrity, transparency or access to capital markets are not just some buzzwords from economic theory. They have a very practical relevance when it comes to decide how we would like to see our markets work – particularly in times when politics and paradigms change dramatically. Nowadays more than ever, we have to ensure stability, transparency and efficiency of our financial markets.

The European Union needs a true level playing field. The principle of "same business, same rules" is the prerequisite of fair markets. Competition should be based on how good you are at serving your clients' needs, and not on discriminatory rules. Policy makers and regulators clearly understood the importance of that topic when designing the new transparency-based market structure in MiFID II.

We strongly welcome their current efforts to monitor how markets adapt to the new set of rules and their willingness to close any remaining loophole to ensure that a maximum of trading volumes contributes to enhancing price discovery and fair competition. Transparency forms the very basis of any informed investment decision, which is still the most "natural" and intuitive way to protect investors. Moreover, competent authorities need the full picture of market activity to do their job of ensuring the stability of markets as well as investor protection.

### Brexit as a game changer

However, fixing Brexit will be the true challenge for policy makers, regulators and the whole financial industry. MiFID II/MiFIR was originally designed for 28 EU countries, including the UK. Once the UK will have left the EU, it will loose its EU passporting rights for financial services and become a third country. The existing regime will reach its limits given the volumes of EU trading taking place in the UK and vice versa. Many thresholds that are essential parts of MiFID II/MiFIR for determining transparency and trading obligations will need to be recalibrated as the biggest financial centre will not be part of the sample anymore. In addition, we will need to develop third country regimes that are able to cope with the relevance of the UK for the EU financial markets.

UK's withdrawal from the European Union also reminds us that the overarching principle of all financial legislation is stability. In the light of Brexit, we should not risk financial stability by dealing with access requests at a time when the legislative set-up of some of the entities requesting access is completely unknown. Both events occurring cumulatively and condensed in a short timeframe definitely poses challenges. When dealing with the cumulative effect of these fundamental regulatory changes and the disruptions possibly caused by Brexit, we should not compromise on the stability and efficiency of CCPs, which are at the heart of the financial plumbing.

## Looking ahead

At the same time, due to Brexit and the largest financial centre leaving the EU, the Capital Markets Union (CMU) project becomes more important. It will be crucial to develop attractive and competitive EU capital markets. The CMU is a key catalyst for the jobs and growth agenda and needs a solid foundation of financial stability. Furthermore, the CMU needs to be completed as it is a core element to strengthen the EU's ability to withstand future crises. Capital markets with deep pools of liquidity across different market segments will act as a strong stabilisation force in times of crisis by diversifying sources of finance and by ensuring a second strong leg next to bank financing.

Achieving the MiFID II objectives of transparency, stability and investor protection will keep us busy also in future, but it is worth it.

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*An edited version of this article has been published in the Börsen-Zeitung/Rules and Regulations on 20 March 2018.*