EUROPEAN
COMMISSION

Brussels, 25.4.2016
SWD(2016) 139 final

COMMISSION STAFF WORKING DOCUMENT

EXECUTIVE SUMMARY OF THE IMPACT ASSESSMENT

Accompanying the document

COMMISSION DELEGATED REGULATION

supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive

{C(2016) 2398 final}
{SWD(2016) 138 final}

1. INTRODUCTION

MiFID II and MiFIR

The subject of this impact assessment is the delegated acts of 'MiFID II' and 'MiFIR'.

MiFID I entered into force in 2007. It contributed to more competition and integration for regulated markets and shares. The financial crisis and subsequent market developments made clear that the scope of the Directive was no longer appropriate and that investor protection had to be strengthened further. MiFID II and MiFIR accordingly broadens the scope to other financial instruments and trading venues. It extends to market participants and activities not regulated under MiFID I to even out the regulatory playing field. MiFID II and MiFIR aim to reinforce supervisory convergence across the single market.

The overarching aim of MiFID II and MiFIR can be summarised as enabling financial markets to work for the benefit of the economy, supporting jobs and growth through making them safer and more transparent and enhancing investor confidence.

2. PROCEDURAL ISSUES AND CONSULTATION OF INTERESTED PARTIES

In spring 2014, the European Commission requested technical advice from the European Securities Markets Authority and the European Banking Authority. The technical advice is based on 3-month public consultations by the authorities ESMA and EBA, hearings and extensive discussions with national supervisors. The Commission consulted the Expert Group of the European Securities Committee, experts from Member States, and the members of the ECON Committee of the European Parliament on the technical advice. In addition, Commission services held many bilateral meetings with stakeholders.

The impact assessment work was steered by an inter-service steering group composed of representatives from 11 Commission services and Directorates General.

3. PROBLEM DESCRIPTION

MiFID II and MiFIR address insufficiencies in three key areas:

(1) Transparency requirements are extended to equity-like and non-equity instruments and to market players that had previously not been regulated or only to a lesser extent;

(2) Market integration: requirements are amended to ensure a level playing field between trading venues and to take into consideration technological developments;

(3) Investor protection is reinforced in particular by strengthening the inducements regime and introducing additional safeguards concerning clients' assets and rules on product governance and intervention powers.

Many of the level 1 provisions in these areas require further specification at level 2 to ensure their precise application and implementation and to avoid differing interpretations of the level 1 provisions leading to different regimes on investor protection, market transparency and market integration.

Some of the matters to be addressed at level 2 have been identified as crucial as choices at level 2 will have a decisive impact on the overall ability of MiFID II and MiFIR to meet the stated objectives in an efficient and effective manner. These issues are addressed in more in detail in this impact assessment. The other issues either would not be expected to have a significant impact, or the empowerments in MiFID II and MiFIR leave only very limited discretion. These issues are only briefly explained and discussed in an annex.

Safeguarding of Client Assets: MiFID II requires that investment firms make adequate arrangements to safeguard investor's ownership and rights in respect of investor's securities and funds entrusted to the firm. However, there is considerable uncertainty as to how this has to be done. This could result in unintentional and/or intentional lawful or unlawful discrepancies in investor protection across Member States and across investment firms. Investors might not be aware of such differences and the consequences and take decisions on the basis of erroneous assumptions. Investment firms might reduce investor protection, e.g. by re-using client assets without the investors' consent or full understanding of the potential implications on their rights.

Inducements, quality enhancement: In principle, MiFID II prevents investment firms providing independent advice or portfolio management from accepting and retaining inducements. In all other cases, inducements may only be allowed where they are disclosed and designed to enhance the quality of the relevant services to the client and do not impair compliance with the investment firms' duty to act honestly, fairly and professionally in accordance with the best interest of clients.

Without further guidance divergent practices may carry on, leading to circumventions of the Directive with detrimental effects for investors. Inducements might bias investment firms to favour products or services which would provide them with higher inducements, without such products or services necessarily being the best choice for the investor.

Liquid markets: The definition or classification as a 'liquid market' under MiFID II/MiFIR has several consequences: it triggers different restrictions regarding the price at which a negotiated transaction can be executed; quantitative limits on the total volume of trading under the reference price waiver; and quoting obligations for systematic internalisers. The main requirement is to make firm quotes public on a regular and continuous basis for instruments for which there is a liquid market. Diverging interpretations could lead to discrepancies in the application across Member States and have adverse implications for the transparency regime applicable to shares, ETFs and other similar financial instruments. Transparency would suffer if the rules applicable to different instruments would deviate without obvious reasons. This could result in unjustified price differences for different players and hamper market integration and integrity.

Extension of the systematic internaliser regime: Systematic internaliser means "an investment firm which, on an organised, frequent, systematic and substantial basis, deals on own account by executing client orders outside a regulated market, a multilateral trading facility or an Organised trading facility without operating a multilateral system". There are only very few investment firms registered as Systematic internaliser under MiFID I. They do not represent a large proportion of equity trading within the Union. MiFID II supplements the qualitative definition of Systematic internaliser by introducing quantitative criteria. It also extends the regime to equity-like and non-equity instruments. Without further technical specification this definition could lead to a non-level playing field in terms of transparency for instruments traded on different types of execution venues. Market integration and transparency could be hampered. Some investors and issuers might face losses or reduced profits due to a sub-optimal choice of investment products.

Fees for trade data publication: Trading data in the EU are provided in certain cases at elevated prices, partly because most of the data are only available in pre-set larger data bundles. These high prices create barriers to the provision and use of market data and the price discovery and formation process. This could adversely affect market integration and transparency. Investors might make poorer choices due to a lack of information and/or higher prices. Markets would not be as 'deep' as they could be.

SME growth markets: MiFID II introduces an “SME growth market” label which multilateral trading facilities that comply with certain conditions can benefit from. MiFID II could not specify these conditions in sufficient detail to ensure that all market participants would have the same, or a sufficiently similar understanding of what an SME growth market is. Transparency and market integration and integrity could suffer. Insufficiently transparent and understood SME growth markets would be more likely to fail. This would leave many SMEs without access to liquid markets for their capital needs and a perpetuation of the lack of access to finance for them with adverse impacts on their and the (national) economies' growth perspectives.

Core definitions: Without further specification certain definitions in MiFID II and MiFIR would not be precise enough to ensure sufficiently harmonised interpretations and applications. In some cases this could also lead to an inconsistent application under different pieces of EU law. This could hinder the efficient functioning of securities markets across the Union and undermine market integration. Inefficient markets usually result in less liquidity and transparency. This could have detrimental impacts on issuers/offers and investors as demand and supply would match less well.

4. THE EU'S RIGHT TO ACT AND JUSTIFICATION

The EU’s right to act follows from the respective empowerments in MiFID II and MiFIR.

5. OBJECTIVES

The general objectives of MiFID II were to reinforce investor confidence, reduce risks of market disorder and abuse, reduce systemic risks and increase the efficiency of financial markets and to reduce unnecessary costs for market participants. The specific objectives of the delegated acts are linked to these objectives:

– Reduce the risk of mis-selling of financial instruments to retail investors

– Improve protection of investor assets when firms place funds in group institutions

– Ensure fees for trade data publication are set at a reasonable commercial basis

– Establish a quality 'SME growth markets' label

– Ensure a level playing field with regard to transparency obligations across financial instruments, markets and players

– Ensure a common understanding of key definitions.

All these objectives are elements of the overall strategy to foster jobs and growth in the Union through an integrated legal and economic framework that is efficient and treats all actors fairly.

6. OPTIONS AND IMPACTS

Safeguarding of Client Assets: Where an investment firm deposits client funds at a third party within its own group, an intra-group deposit limit of 20% shall be imposed. However, an investment firm shall be allowed to exceed the limit if it is able to demonstrate that this is proportionate in view of the nature, scale and complexity of its business as well as the safety offered by the third parties considered. The 20% limit reduces considerably the risk of loss or diminution of client funds in the event of the insolvency of the group. Granting firms with a small balance of client funds under certain conditions the possibility to maintain the client funds with group entities is proportionate as it does not put clients' funds at excessive risks.

Inducements: The provision of investment research by third parties should not be regarded as an inducement if it is received in return for direct payments by the investment firm out of the firm's own resources or from a separate research payment account. Unbundling payments for research from payments for transactions should shift the focus from the number of transactions to the actual quality of the research. Investors could be confident that best execution requirements are complied with and that their portfolio managers do not 'churn' client portfolios to gain access to more research services for 'free'.

Quality enhancement: The preferred option singles out situations in which the benefit for the client is direct and tangible. The option favours open-architecture models while requiring investment firms to focus more strongly on the benefits to clients when receiving inducements. It provides incentives to competition in quality services which makes the costs transparent.

Delineation of liquid markets: The preferred option consists in lowering the existing thresholds for shares (except for shares that are only quoted on multilateral trading facilities, i.e. mainly SME shares) and applying them cumulatively to all equities. Where a Member State would have less than 5 liquid shares in its jurisdiction, it may specify up to 5 additional shares to be liquid. The criteria applicable to shares would not simply be applied to other equity and equity-like instruments but adapted to the specific instrument. This should ensure that the SMEs listed on regulated markets are not affected. The lowering of thresholds leads to enhanced transparency.

Extension of the systematic internaliser regime: ESMA's technical advice did not provide unique values to define 'thresholds for 'frequent and systematic' and 'substantial basis" for non-equity instruments, but only ranges. The impact assessment had to discuss where in these ranges to fix the thresholds. Using the mid-point in the ranges provided avoids extremes in view of the high level of uncertainty and takes due care of ensuring proportionality and a level-playing field amongst market participants. It will ensure an appropriate level of transparency and investor protection and help best price discovery by minimising the administrative burden for the proportionate number of investment firms that would have to comply with these rules.

Fees for trade data publication: Trading venues would be required to ensure transparency of fees charged for transaction data and to provide for fees that are cost-based. Costs should be transparent to market participants or at least towards competent authorities so that it can be verified whether prices are reasonable. It is essential that there is a "substantial test", i.e. criteria which clarify what 'reasonable commercial basis' is. This avoids the significant costs of an outright cost regulation but incorporates some well-defined guiding principles. It creates incentives for the development of best practices by data providers and increases the transparency of the mark-ups charged by data vendors.

SME growth markets: The preferred leaves it up to the operators of SME growth markets – under the supervision of their respective national competent authority – to establish their own admission and disclosure rules. This option is the least costly option for the operators of multilateral trading facilities, and it maximises the chances that existing markets will adopt the label. Given the diversity in operating models of existing MTFs with a focus on SMEs in the Union, and to ensure the success of the new category of SME growth market, it is appropriate to grant SME growth markets an appropriate degree of flexibility in evaluating the appropriateness of issuers for admission on their venue.

Core definitions: The preferred options for these definitions are based on clear concepts in order to avoid legal uncertainty and diverging interpretations in different markets and jurisdictions. By taking into account the specificities of certain markets and products or financial instruments they try to limit compliance costs for the market participants concerned without compromising the objectives set out above.

(1) Definition of high frequency trading: A participant or member of a trading venue who has the qualifying infrastructure and submits on average at least 4 messages per second with respect to all instruments across a venue or trades 2 messages per second with respect to any single instrument traded on a venue would be deemed to have a “high message intraday rate”. This option limits the definition not to one instrument only and avoids relative measures which could lead to different classifications of the same trading frequency in the same instrument in different trading venues.

(2) Definition of foreign exchange (FX) spot vs. derivative contracts: FX contracts with a settlement of more than T+2 would be considered as FX derivative contracts and hence qualify as financial instruments in scope of the MiFID II requirements. To ensure that the definition does not include contracts which by their nature are payments rather than financial instruments a number of qualifications would be introduced.

(3) Definition of commodity derivatives: The core task is to define wholesale energy product contracts which "must be physically settled" (C6) and commodity contracts "for commercial purpose" (C7). Therefore, derivative contracts referred to in Section C.6 of Annex I of MiFID II, so-called 'C6 contracts', ‘must be physically settled’ if it, amongst others, contains provisions which ensure that parties to the contract have proportionate arrangements in place to be able to make or take delivery of the underlying commodity. Other commodity derivative contracts will be deemed financial instruments under C7 if they are standardised and traded; however, physical forwards used in agriculture should not be captured by these definitions.

7. CHOICE OF LEGAL INSTRUMENT FOR ALL LEVEL 2 MEASURES

The main aim of the level 2 measures is to specify provisions in MiFID II and MiFIR to ensure consistent implementation and application across all Member States. This is important to ensure that the objectives of level 1 can be achieved. The best legal instrument to ensure such consistency is a regulation. A regulation guarantees full harmonisation and provides all stakeholders with full legal certainty and ensures market integration.

8. MONITORING AND EVALUATION

The impact assessment for the MiFID II Commission proposal already outlined a detailed monitoring programme which should provide indicators and information to evaluate both level 1 and level 2 provisions.