

The Regulation of MTFs under EU MiFID Directive

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Multilateral Trading Facility

Definition:

According to MiFID Directive, article 4, no. 15) a MTF is *“a multilateral system, operated by an investment firm or a market operator, which brings together multiple third-party buying and selling interests in financial instruments – in the system and in accordance with non-discretionary rules – in a way that results in a contract”*

Multilateral Trading Facilities in a nutshell

MTFs are trading systems (trading venues) that:

- are operated by regulated market operators or large investment firms
- bring together multiple third-parties buy and selling orders in a non discretionary way;
- are based on sophisticated electronic systems and matching softwares that allow a very quick orders execution (like US ECN)
- are less strict regarding the admission of securities (more exotic instruments traded)
- are meant to enhance competition within EU trading services market

Differences from other regulated trading venues

Regulated Market: “multilateral system operated and/or managed by a market operator, which brings together or facilitates the bringing together of multiple third-party buying and selling interests in financial instruments – in the system and in accordance with its nondiscretionary rules – in a way that results in a contract, in respect of the financial instruments admitted to trading under its rules and/or systems, and which is authorised and functions regularly” (*MiFID, article 4, no. 14*)

MTFs vs. Regulated Market

The definitions are similar, but:

- The MTFs can be operated by a market operator or an investment firm
- The operation of a RM is not considered an investment service and it's reserved to market operators only

MTFs vs. Systematic Internalisers

Systematic Internaliser: “an investment firm which, on an organised, frequent and systematic basis, deals on own account by executing client orders outside a regulated market or an MTF” (*MiFID, article 4, no. 7*)



Not a third party that matches orders, a SI can be a party in a transaction, which can be executed against its own book or against orders from other clients

Operating a Multilateral Trading Facility

Under Annex I, section A of MiFID:

The operation of Multilateral Trading Facilities is considered an **investment service**



investment firms that want to operate a MTF are required to obtain a *specific authorisation* issued by their home Member State Authority according to MiFID rules.

Entities operating MTFs

- MTFs operated by **investment firms**: must comply with investment firms requirements (*chapters I and II of Title II of MiFID*) plus the additional requirements concerning the MTFs (*articles 14, 26, 29, 30 of MiFID*)
- MTFs operated by **regulated market operators**: according to *art. 5.2 of MiFID*, RMOs must comply with the rules regarding regulated markets (*Title III of MiFID*) plus the requirements regarding investment firms applicable to RMOs (*chapters I of Title II of MiFID*), including additional requirements regarding MTFs (*articles 14, 26, 29, 30 of MiFID*)

Operating conditions for MTFs operated by investment firms

Authorisation to operate an MTF is issued by home Member State Authority and implies the compliance with the requirements provided for in art. 13 of MiFID and Directive 2006/73/EC:

- ensuring compliance with MiFID;
- prevention of conflicts of interest;
- continuity and regularity in the performance of investment services;
- avoidance of undue risks (third party risk);
- soundness of administrative and accounting procedures, and internal control system;
- safeguarding of clients ownership on financial instruments;

Operating conditions for MTFs

/2

Additional MTFs transactions requirements (art. 14 of MiFID):

- **Transparent and non-discretionary rules for fair and orderly trading and for the efficient execution of orders (14.1);**
- **Transparent rules regarding the criteria of determining financial instruments that can be traded under MTF system (14.2);**
- **Publicly available info to allow users to form an investment judgement (14.2);**
- **Objective criteria on access to its facility (14.4.);**
- **Arrangements to facilitate the settlement of the transactions concluded under its system (14.5).**

MTFs European Passport

Art. 31.5 of MiFID: “*Member States shall, without further legal or administrative requirement, allow investment firms and market operators operating MTFs from other Member States to provide appropriate arrangements on their territory so as to facilitate access to and use of their systems by remote users or participants established in their territory*”.

Procedure

- Investment firm or RMO operating an MTF **communicate** to its home member State Authority **the host State in which it intends to provide arrangements;**
- The home Member State Authority **communicates this info** within 1 month **to the host Member State Authority;**
- In case of request by the host SA, the home SA **communicates** within a reasonable delay **the identity of the members or participants of the MTF;**

Problem

What exactly means “providing arrangements”?

→ *There's need for a common criterion to define MTF “passportable” services...*

MTF passport

According to CESR:

If the MTF comprises an **automated IT trading platform**, the MTF operator authorised in a Member State needs to notify to the home State Authority where the platform is **providing direct access to users or participants in the territory of a Member State other than its home Member State**



"connectivity test":

the placing of trading screens, the delivery of software so as to facilitate access to the platform, the physical presence of IT-infrastructure and the facilitation of direct access via Internet in general.

MTF passport/2

In case of **no trading platform**, an MTF needs to notify when it **facilitates the conclusion of transactions by users** or participants established in another Member State **under the rulebook of the MTF**.

CESR considers that “facilitating” means **providing the participants** into the territory of the other Member State **with the necessary information and material services** in such a way that it enables the participants **to accept the rulebook of the MTF and to start trading on the MTF** from the host Member State.

MTFs rules

MTFs implement MiFID requirements concerning their internal organization and their functioning through their Rulebooks, which set the rules regarding:

- Trading activities;
- Securities eligible for trading;
- Transactions settlement;
- Access to its facilities;
- Membership/participation.

(following rules collected surveying Turquoise, Chi-X and NYSE Arca Europe Rulebooks)

MTFs Trading Rules

The part of an MTF Rulebook concerning trading usually specifies:

- Trading calendar and trading hours;
- Particular tick size structure (a peculiar one or the commonly used in primary market);
- Limit orders infos (price/quantity display, Price Control Band, etc.);
- Policy regarding dark orders and iceberg orders;
- Volatility Rejections;
- Policies followed in case of erroneous trades (definition, conditions to cancel them, etc.);
- Policy adopted in case of regulatory suspension of trading regarding a security (pending orders amendment, cancellation, execution, etc.)
- MTF emergency powers.

Securities eligible for trading

The Rulebook specifies whether the MTF:

- Lists **the specific securities** that can be traded; or
- Sets **criteria to identify them** (by type, by market, by trading currency, etc.); or
- Determines **at its absolute discretion** which securities are eligible and communicates from time to time relevant changes to its members.

MTF usually do not trade every security but rather specialise in some specific types

Transactions settlement rules

- Members must have adequate settlement arrangements in place prior to joining the MTF;
- When a member is acting on behalf of a client, in case of failure to deliver security or cash due to the client, it's bound as principal with the transaction counterparties;
- MTFs do not take any responsibility in any event of default concerning clearing and settlement rules

Rules on access to MTFs facilities

MTFs must comply with *art. 42.3 of MiFID* regarding the admission of members and participants, which must:

- Be fit and proper;
- Have sufficient level of trading ability and competence;
- Have adequate organizational arrangements;
- Have sufficient resources for the role they perform according to MTF rules established to guarantee the settlement of the transactions.

MTFs membership rules

In implementing art. 42.3 MTFs set some criteria regarding prospective members, they must:

- Be EEA regulated investment firms/credit institutions

OR

- Be able to demonstrate sufficient experience in trading securities (e.g. being member of other trading venues);

- Have adequate internal control systems, expertise and financial resources sufficient for its own functioning;

- Be responsible for all orders and actions taken on their user account by their officers, employees and agents;

- Retain records of their transactions and communications for a given period of time.

Financial Requirements

- Art. 12 of MiFID: investment firms operating MTFs must have sufficient initial capital according to the provisions of Capital Adequacy Directive (2006/49/EC)
- According to art. 9 of CAD, an investment firm who performs the investment service of operating an MTF falls under a minimum capital requirement equal to 730.000 Euros
(may vary under member states law: UK 730k, IT 1Mil.)

Financial Requirements/2 : MTF operated by RM operators

Must RMOs comply with investment firms' initial capital requirement?

MiFID only requires the RMO to demonstrate “*to have available, at the time of authorisation and on an ongoing basis, sufficient financial resources to facilitate its orderly functioning, having regard to the nature and extent of the transactions concluded on the market and the range and degree of the risks to which it is exposed*” (art. 39, f) .

RM Financial Requirements

Unlike investment firms, which can also perform other investment services beside operating an MTF, a RMO does not take any risk and act solely as a third party



No specific initial capital requirements (even though *art. 5.2 of MiFID* seem to extend investment firms requirements to RMs)

(IT: from 5mil. to “sufficient resources”)

Code of Conduct

Art. 26 of MiFID: Investment firms and market operators operating an MTF must:

- establish and maintain effective arrangements and procedures for the regular **monitoring of the compliance by its users** with its rules.
- monitor the transactions undertaken by their users under their systems in order to **identify breaches of those rules, disorderly trading conditions** or conduct that may involve **market abuse**.
- **report significant breaches of its rules or disorderly trading conditions** or conduct that may involve **market abuse** to the competent authority;
- supply the **relevant information** to the authority competent for the **investigation and prosecution of market abuse** and provide full assistance in investigating and prosecuting market abuses occurring on or through its systems.

Rulebook implementation

MTFs include in their rulebooks provisions regarding their members, specifically aimed at implementing art. 26, such as:

- prohibition of committing any act that is unlawful or that could simply harm MTF reputation (even if executed on behalf of a client);
- Prohibition of engaging in any transactions that may result in a conduct sanctioned by the Market Abuse Directive 2003/6/EC (*trade based, information based and action based market manipulation and even fake testing orders placing*);

Rulebook implementation/2

Cooperation between MTF and its Members:

- Duty to promptly inform the MTF about every breach of its rules committed by one of its members;

Cooperation between MTF and Authorities:

- MTF power to require its members to provide documents and specific informations on their transactions and to share them with Authorities;

Sanctionatory Procedure

MTFs' Rulebooks usually include a **sanctionatory procedure** in order to investigate any alleged rules violation, it may include:

- preliminary investigations;
- examinations of records;
- hearings of members' top management;
- precautionary suspensions;
- right of appeal.

Sanctions

Once the violation has been proved the MTF may decide to apply:

- Official warning;
- Temporary suspension;
- Publication of the details of the breach and the identity of the Member;
- Termination of the membership;
- Monetary sanctions (the max. is usually specified ex ante);
- Legal actions.

Supervision by National Authorities

According to *art. 48 of MiFID* each member state designates a **competent oversight authority**, that will exercise **regulatory powers** provided for in *art. 50 of MiFID*, among which the rights to:

- have access to any document and to receive a copy of it;
- demand information, summon and question a person to obtain information;
- carry out inspections or allow MTFs' auditors to carry out investigations and provide information;
- require existing telephone and existing data traffic records;
- require the cessation of any practice contrary to MiFID implementation and adopt measures to ensure that MTFs operators compliance;
- request the freezing and/or the sequestration of asset or the temporary prohibition of professional activity;
- require the suspension of trading in a financial instrument and the removal of a financial instrument from trading;
- refer matters for criminal prosecution;

Supervision by National Authorities/2

Member States Authorities have the duty to:

keep every information regarding the oversighted entities confidential, except under particular circumstances (e.g. bankruptcy) (*art. 54*)

Cooperate with other member State Authorities in supervisory activities and exchange information (*art. 56-62*)

Accounts auditors of investment firms must promptly report to the authority every fact resulting in a breach of the law, in the malfunctioning of the firm or in the refusal to certify the firm accounts (*art. 55*)

MTFs cooperation

MTFs rulebooks specify the competent oversight Authority and set rules to cooperate with it by:

- Sharing information about the members;
- Providing Authority with the records of the transactions and the communications performed by the members;
- Suspending or otherwise sanctioning the members when required;
- Making available to the Authority the records and the document regarding the audits performed by MTFs internal control officers;
- Promptly comply with any Authority suspension order regarding a traded security.

Thanks for your attention!

Comments, questions and remarks are welcomed!

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