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MiFID II: the EU's latest adaptations

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MIFID II: THE EU'S LATEST ADAPTATIONS

The EU has finalised the latest changes to its financial markets legislation arising out of the MiFID II Review. Many of these changes respond to the outcomes of the U.K.'s post-Brexit Smarter Regulatory Framework.

The MiFID II package, last subject to major revisions in 2018, is made up of the Markets in Financial Instruments Regulation (MiFIR)[1] and the Markets in Financial Instruments Directive (MiFID II)[2]. These aimed to promote investment activity, enhance transparency, remove unnecessary burdens, and deepen EU-level harmonisation. While harmonisation has occurred in many areas, the MiFID II regime has proven unwieldy and overly rigid, with unprecedented levels of prescription. Some estimate that, including secondary legislation, there are over two million legal provisions.

The U.K. "on-shored" MiFID II in whole into U.K. laws upon Brexit, with only minor amendments. Extensive changes are now being made across a number of areas, to remove unnecessary "red tape" and tailor the regime for the U.K. market. This follows HM Treasury's Wholesale Markets Review (discussed by A&O Shearman, in our previous notes "Wholesale Markets Review" and "UK wholesale markets review update: Financial Services and Markets Act 2023 and latest developments").

The EU and U.K. changes and approach often target the same areas and shortcomings in MiFID II. There is notable alignment in some areas, but in others, the reforms will differ in various respects. For example, the U.K. continues to expressly allow the provision of direct electronic access by third-country firms to U.K. trading venues, which is in stark contrast to the EU's closed-market approach. Areas where similar paths are being adopted by the EU and the U.K. include banning payment for order flow (PFOF), clarifying the regime for Systematic Internalisers and allowing investment firms to choose whether to apply separate or joint payments for research and execution services. This note sets out the latest developments in the EU MiFID II package, emphasising differences from the European Commission's original proposals. We also refer to related U.K. adjustments, highlighting where the U.K. and EU are on similar or different tracks. The table in the Annex to this note shows the main changes, indicating the degree of divergence or convergence between the EU and U.K. MiFID II packages.

We refer to the finalised MiFID II Review legislation as the "amending Regulation"[3] and the "amending Directive."[4] The amending Regulation has applied directly across the EU since 28 March 2024, except for certain provisions that are to be supplemented further by Commission Delegated Regulations, which will, according to the European Commission's (Commission) Notice,[5] only apply from the date that those Delegated Regulations take effect. Further clarification on timings has also been provided by the European Securities and Markets Authority (ESMA) in a Public Statement (ESMA's Public Statement).[6] The amending Directive must be transposed into Member States' national laws by 29 September 2025. ESMA is consulting on proposed new or changes to existing delegated regulated and technical standards covering a range of topics including consolidate tape providers, the commodity derivatives

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1 Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012.

2 Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU.

3 Regulation (EU) 2024/791 of the European Parliament and of the Council of 28 February 2024 amending Regulation (EU) No 600/2014 as regards enhancing data transparency, removing obstacles to the emergence of consolidated tapes, optimising the trading obligations and prohibiting receiving payment for order flow.

4 Directive (EU) 2024/790 of the European Parliament and of the Council of 28 February 2024 amending Directive 2014/65/EU on markets in financial instruments.

5 Commission Notice on the interpretation and implementation of the transitional provision laid down in Regulation (EU) 2024/791 of the European Parliament and of the Council amending Regulation (EU) No 600/2014 as regards enhancing data transparency, removing obstacles to the emergence of consolidated tapes, optimising the trading obligations, and prohibiting receiving payment for order flow (C/2024/2966), 2 May 2024.

6 Public Statement, "Transition for the application of the MiFID II/MiFIR review", ESMA, 27 March 2024 (ESMA74-2134169708-7163).

regime, transparency and transaction reporting requirements, Systematic Internalisers and organisational requirements for trading venues.

The EU is close to finalising further MiFID II amendments under the Listing Act package, which significantly relax the rules for investment firms on unbundling of research. That legislation has been provisionally agreed, and the timing of its application will not be certain until it is published in the Official Journal of the European Union. We refer to that near-final amending Directive as the "Listing Act Directive."[7] We do not cover other aspects of the Listing Act package in this note, and we do not cover other MiFID II legislative reforms, for example, those in scope of the Retail Investment Strategy.

PROHIBITING PAYMENT FOR ORDER FLOW

PFOF describes the situation where an investment firm sources liquidity and then receives commission both from its client (that originates the order) and from a non-client (for execution of the order). This can result in bad execution outcomes for clients because of the potential for misincentives and conflicts of interest. PFOF was previously allowed under some EU Member State interpretations of the inducements rules in the MiFID II Directive, subject to disclosure, although some countries did not allow it. Under the amending Regulation, PFOF is expressly banned. However, the final provisions have been narrowed since the initial proposals so as to apply only when an investment firm acts for a retail client or a retail client that has opted to be treated as a professional client. Investment firms acting for these clients are banned from receiving any fee, commission, or non-monetary benefit from any third party for executing orders from those clients on a particular execution venue or for forwarding orders of those clients to any third party for their execution on a particular execution venue.

The main intention is to stop the practice whereby high-frequency traders (HFTs) pay brokers/investment firms to direct their orders to the HFT for execution. It is expected that, without the incentive of PFOF, these orders will instead be sent to an exchange or multilateral trading facility (MTF) and lead to more transparency.

The ban does not apply to rebates or discounts on the transaction fees of execution venues, where permitted under the approved and public tariff structure of an EU or third-country trading venue, provided they exclusively benefit the client.

A Member State may exempt a local investment firm from this ban until 30 June 2026, provided that before 28 March 2024 the investment firm was receiving PFOF for services to clients established in that member state. The Commission had not included this derogation in its proposals.

The U.K. Financial Conduct Authority (FCA) has for many years held the view that PFOF arrangements create conflicts of interest between an investment firm and its client. The FCA maintains its view that PFOF arrangements are not in compliance with the MiFID II requirements on conflicts of interest, and present challenges for a firm to achieve best execution for clients. The FCA has stated that it will take supervisory action against firms for breach of compliance.[8]

DIRECT ELECTRONIC ACCESS

Under MiFID II, some activities are exempt from the requirement to be authorised as an investment firm or credit institution, so as to avoid non-financial corporates from being caught-up in the regulatory regime. For example, an energy company should be able to hedge its commercial risks using derivatives, or invest its own treasury assets

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7 Proposal for a Directive of the European Parliament and of the Council amending Directive 2014/65/EU to make public capital markets in the Union more attractive for companies and to facilitate access to capital for small and medium-sized enterprises and repealing Directive 2001/34/EC.

8 Financial Conduct Authority, Payment for Order Flow (PFOF), April 2019.

without being licensed as a financial institution. The own-account exemption is for firms that deal on own account only. That exemption had been curtailed for certain firms or activities, including those that "have direct electronic access to a trading venue." This means that EU clients accessing an EU trading venue through direct electronic access (DEA) were not eligible for the dealing on own account exemption and needed to be licenced as a credit institution or investment firm.

The amending Directive removes the DEA restriction so that EU clients accessing an EU trading venue through DEA are exempt from authorisation and are treated the same as third-country firms who have never required MiFID II authorisation for accessing an EU trading venue via DEA. Unlike the Commission's original proposal, the final provisions maintain and clarify the existing exclusion from the restriction for non-financial counterparties (NFCs) that are members or participants in a regulated market or MTF so that NFCs dealing on own account only and that are trading for hedging purposes or for liquidity management purposes do not require authorisation.

The amending Directive does not, however, remove or adjust the requirement that DEA must be provided by an EU credit institution or investment firm, nor provide clarification on the issue regarding the provision of DEA by third-country firms. These issues were discussed in detail by Shearman & Sterling, now A&O Shearman, in a note published in response to ESMA's Q&A on market structure[9] of November 2017 ("ESMA Sounds a Death Knell for Cross-Border Exchange Access, in Conflict with UK Legislation and MiFIR"). ESMA has not amended its Q&A response to date.

The U.K. continues to expressly permit third-country firms to provide DEA to U.K. exchanges where the firm falls under the "overseas persons exclusion,"[10] or the U.K. MiFIR equivalence regime. In practice, the latter is inoperable since one of the conditions is an equivalence decision, which HM Treasury has not yet issued for any country. As announced, HM Treasury has begun to assess the U.K.'s equivalence determination regime to ensure it works with the new deference accountability mechanism introduced by the Financial Services and Markets Act 2023 (FSMA 2023).

DERIVATIVES—EXEMPTIONS FOR POST-TRADE RISK REDUCTION SERVICES

Under MiFID II, the pre-trade transparency obligations require market operators and investment firms operating a trading venue to make public current bid and offer prices and the depth of trading interests at those prices which are advertised through their systems for equity and non-equity financial instruments. The post-trade transparency obligations require investment firms to make public as close to real-time as possible information on transactions in financial instruments traded on an EU trading venue. The EU's existing exemptions from transparency reporting for portfolio compression have been extended to encompass all post-trade risk reduction services (PTRR services) for OTC derivatives. None of these PTRR provisions were included in the Commission's original proposal. The amending Regulation provides that OTC derivatives formed and established as a result of PTRR services are exempt from the pre- and post-trade transparency requirements, the requirement to verify best execution, the requirement for multilateral systems to operate a MTF or Organised Trading Facility (OTF) and from the derivatives trading obligation (DTO). Providers of PTRR services must keep accurate records of these transactions, providing them to a regulator on request. The European Commission will specify in delegated acts what constitutes PTRR services, and the particulars of the transactions for which records must be kept.

The DTO requires investment firms to conclude transactions in certain derivatives on regulated markets, MTFs, OTFs, or third-country venues in jurisdictions benefiting from equivalence decisions. The European Market

9 ESMA, "Questions and Answers on MiFID II and MiFIR market structure topics" (ESMA70-872942901-38), 13 October 2023.
10 Article 72 of The Financial Services and Markets Act 2000 (Regulated Activities) Order 2001.

Infrastructure Regulation (EMIR)[11] imposes a clearing obligation on certain classes of derivatives. The PTRR exemption from the DTO links to the recently introduced PTRR exemption from the derivatives clearing obligation (DCO) in the latest revisions to EMIR. The DCO exemption will apply to OTC derivative contracts that are initiated and concluded as the result of an eligible post-trade risk reduction exercise, subject to certain conditions being satisfied. Shearman and Sterling, now A&O Shearman, discussed that exemption in "EMIR 3 and Clearing in the EU."

These amendments are similar to the changes being brought about through the U.K.'s FSMA 2023, discussed by Shearman and Sterling, now A&O Shearman, in "A Boost for UK Financial Services." FSMA 2023 empowers the FCA to make rules exempting certain PTRR activities or services or providers from the DTO, the best execution requirements and the requirement that operators of a multilateral system must operate a MTF or OTF. The Bank of England may also provide for an exemption from the DCO. The U.K. regulators have not yet consulted on their proposals.

DERIVATIVES—ALIGNING THE TRADING AND CLEARING OBLIGATIONS

The amending Regulation aligns the DTO with the DCO according to the revised scope set out in EMIR. EMIR Refit exempted smaller Financial Counterparties from the DCO and limited the scope of the DCO of NFCs to only apply to the contracts in the asset classes in which they exceed the clearing threshold for the particular asset class (as opposed to being obliged to centrally clear all their derivatives contracts if they exceed one of the prescribed thresholds for any asset class). This was one of the Commission's original proposals to implement ESMA's recommendations of February 2020. The final amending Regulation also specifically clarifies that transactions that are not subject to the DCO are not subject to the DTO.

The U.K. aligned the DTO and DCO via changes made by the FSMA 2023, which change took effect on 29 August 2023.

DERIVATIVES—REMOVING THE OPEN ACCESS OBLIGATION FOR EXCHANGE-TRADED DERIVATIVES

Under MiFID II, trading venues had been required to provide open and non-discriminatory access to a CCP, with a reciprocal requirement for CCPs to provide access for trading venues, when clearing transferable securities, money market instruments, and exchange-traded derivatives (ETDs). This potentially resulted in the EU becoming unattractive for investment and innovation in this sector, since those trading venues which successfully develop new products or become a trading venue of choice for the market would have to essentially give free access of their IP to competitors. Numerous papers have been published by market associations over the years on the open access obligation.[12]

That obligation has now been removed as regards ETDs by the EU's amending Regulation. This is in line with the original proposals made by the Commission.

The U.K. removed the open-access obligation for ETDs in October 2021, as one of its first post-Brexit reforms.

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11 Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties, and trade repositories.

12 See for example, FMLC, "Issues of legal uncertainty arising in the context of provisions on non-discriminatory access to central counterparties and trading venues: Response to Consultation Paper (2014/1570) by the European Securities and Markets Authority on MiFID II and MiFIR", May 2015; FIA and ISDA, "Joint response to MiFID II Review", May 2020; and FESE, "MiFIR "Non-discriminatory" Access to derivatives clearing & trading: Putting EU27 financial stability & competitiveness at risk.", 1 July 2019 and again on 9 October 2020.

COMMODITY DERIVATIVES POSITIONS REGIME

The position management controls requirements are extended to trading venues providing trading for derivatives of emission allowances, and the position reporting obligations are clarified so that they apply only to derivatives of emission allowances, and not to spot trading of emission allowances.

FSMA 2023 has already made several reforms to the U.K.'s commodity derivatives regulatory regime. In particular, it revoked the MiFID II requirement for commodities position limits to be applied to all exchange-traded contracts and OTC contracts that are economically equivalent to exchange-traded commodity derivatives. Instead, the FCA will decide the scope of the commodity derivatives to which position limits will apply. In addition, the powers for setting position controls were transferred from the FCA to the operators of trading venues. The FCA has consulted on proposals for reforming the commodity derivatives regulatory framework, including for example, narrowing the application of the position limits regime to a set of identified "critical" contracts and certain sufficiently related contracts, requiring trading venues to establish accountability thresholds as a position management control, enhancing position reporting requirements and introducing a new exemption for liquidity providers and the introduction of a pass-through hedging exemption for financial firms. The FCA has not yet published its final rules.

The FCA also consulted on proposed guidance on the regulatory perimeter for the "ancillary activities" test, which is an exemption from the regulated activity of dealing as principal, when a company deals in financial instruments only in a way ancillary to its main business. The U.K. government decided, as part of the Wholesale Markets Review, to remove the "ancillary activities" test from legislation so that the FCA could instead develop guidance for firms to determine when their activities would require authorisation. Initial legislation[13] provided that the removal from legislation would occur on 1 January 2025. However, following feedback to the FCA's consultation, that legislation has been delayed,[14] with the intention of implementation occurring in January 2027. The EU MiFID II "Quick Fix" amended the ancillary activities test to enable EU national regulators to combine a quantitative and qualitative assessment, based on guidance to be issued by the Commission.

UNBUNDLING OF RESEARCH

MiFID II requires payments for research and trading commissions to be unbundled. The research that investment managers typically receive from brokers is, under MiFID II, generally classified as a prohibited "inducement," unless the investment manager pays for the research either: (a) directly from its own resources; (b) from a "Research Payment Account" (RPA) funded, with the client's prior approval, with the client's money; or (c) a combination of the two methods. In 2021, the EU introduced an exemption from the inducements rule for research on SME issuers with a market capitalisation below EUR 1 billion, which is available subject to the EU firm having: (i) notified its clients of the joint payments for research and execution services; and (ii) entered into an agreement with the research provider identifying the part of any combined charges or joint payments for execution services and research that is attributable to research. The U.K. currently has a similar exemption for research on companies with a market capitalisation below £200 million.

This is an area where MiFID II has had a negative effect. The size of the research market in Europe has been negatively impacted, with consequences for jobs. Many issuers now lack research coverage entirely and, for those which are covered, there are fewer providers.[15] The EU's reforms also made cross-border execution and research arrangements difficult, including for U.S. brokers or fund managers.

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13 The Financial Services and Markets Act 2000 (Commodity Derivatives and Emission Allowances) Order 2023.

14 The Financial Services and Markets Act 2000 (Commodity Derivatives and Emission Allowances) (Amendment) Order 2024.

15 ICMA's response to the European Commission's consultation on the review of MiFID II sets out figures from independent surveys conducted over the years since the rules took effect in 2018. See ICMA response to the public consultation on the review of the MiFID II/MiFIR regulatory framework.

The Commission originally proposed that the SME research exemption should be extended to cover companies with a market capitalisation below EUR 10 billion, with the same conditions attached. Instead, the provisionally agreed Listing Act Directive removes the market capitalisation threshold entirely, making it possible for investment firms to choose whether to apply separate or joint payments for research and execution services.

EU firms choosing joint payments will be subject to new conduct obligations aimed at ensuring that conflicts of interest are managed, such as:

(a) Entering into an agreement with the third-party provider of research and execution services, establishing a methodology for remuneration.

(b) Informing its clients of its payment choice, and making available its relevant policy.

(c) Assessing, on an annual basis, the quality, usability and value of the research used, and the ability of the research used to contribute to better investment decisions.

A firm that chooses to pay separately for execution services and third-party research will be required to ensure that research is received in return for either: (i) direct payments by the investment firm out of its own resources; or (ii) payments from a separate RPA controlled by the investment firm.

A new exclusion is also being introduced such that it is made clear that trading commentary and other bespoke trade advisory services linked to the execution of a transaction in financial instruments is not considered to be research.

The draft Listing Act Directive provides that investment firms distributing to clients or potential clients research that is paid for, fully or partially, by an issuer, is labelled as issuer-sponsored research. Only research that is prepared in accordance with an EU code of practice may be labelled issuer-sponsored research. ESMA is tasked with developing draft regulatory standards to establish the code of conduct for issuer-sponsored research.

These significant EU changes reflect the same policy changes that are being implemented in the U.K. following the recommendations of the U.K. Investment Research Review.[16] The FCA recently consulted on its proposals to introduce the option for bundled payments for third-party research and execution services, which would be available alongside the existing methods of direct payments out of a firm's own resources or from a separate RPA. Similar requirements to the EU's would need to be satisfied by firms opting to pay for research with bundled payments.

While the new optionality around payment approach in the U.K. and the EU reforms is to be welcomed, it may come too late in the sense that clients have become used to the lower execution fees and so may not easily accept a reversion to previous fee structures. Also, for U.S. broker-dealers, the reforms come too late, because the temporary relief that allowed brokers to provide execution and research services on a MiFID II-compliant basis without being regulated as an investment adviser expired on 3 July 2023. The impact of the removal of the SEC's relief as well as potential solutions for U.S. broker-dealers was discussed by Shearman and Sterling, now A&O Shearman, in "MiFID II and the U.S. Investment Adviser Regime: The Latest U.K., EU and U.S. Developments on Inducements and Research Unbundling." However, the reforms may allow for a broader diversity of pricing models and a more competitive U.K. and EU backdrop for research as a product and industry. The changes would also mitigate in part the impact of the expiration of the SEC's relief.[17]

16 R Kent, UK Investment Research Review, 10 July 2023.
17 See U.K. Finance and AFME, "Response to the Investment Research Review Call for Evidence", April 2023.

PRE-TRADE TRANSPARENCY REQUIREMENTS FOR TRADING VENUES: NON-EQUITY INSTRUMENTS

MiFIR imposed pre-trade transparency requirements for trading venues for non-equity instruments, requiring venues to make public current bid and offer prices, and the depth of trading interests at those prices, including actionable indication of interests. The amending Regulation reduces the scope so that this pre-transparency obligation applies only to central limit order book and periodic auction trading systems, and no longer to voice trading and request-for-quote systems. The related waivers are also so limited in their scope.

The product scope of the EU obligation remains the same for bonds, structured finance products, and emission allowances. There is clarification that the obligation applies for package orders "composed of bonds, structured finance products, emission allowances or derivatives." For derivatives, there is clarification that the requirement applies to ETDs (as opposed to "derivatives traded on a trading venue") and to certain interest rate swap (IRS) and credit default swap (CDS) OTC derivatives that are denominated in euro, Japanese yen, U.S. dollars, or pounds sterling and, in summary, that are subject to the clearing obligation in EMIR and centrally cleared. This excludes derivatives not suitable for clearing, such as intra-group transactions. There is also the exemption, described above, from the pre- and post-trade transparency obligations for OTC derivatives formed and established as a result of PTRR service.

The U.K. pre-trade transparency rules for non-equities are expected to change in 2024 in line with FCA proposals. Following the Wholesale Markets Review, FSMA 2023 grants powers to the FCA to make rules which will replace the current pre-trade and post-trade disclosure rules for bonds, structured finance products, emission allowances, and derivatives. The FCA's rules must ensure efficient price formation and the fair evaluation of financial assets. It is proposed that non-equities will be split into two categories. Category 1 will consist of bonds traded on a U.K. trading venue and certain OTC derivatives subject to the clearing obligation. Category 2 will be derivatives or structured finance products not in category 1, as well as emission allowances and emission allowance derivatives. Pre-trade transparency would apply depending on the characteristics of the market model. The waivers regime will be simplified and would be available for large in scale orders, packages, and negotiated transactions.

The FCA is also proposing a transitional period for firms to implement the new rules, which will be one year from finalisation of the rules. The implementation of the new rules, which will be housed in a new part of the FCA's Market Conduct Sourcebook, will be synched with changes to the U.K. MiFIR and related legislation. The FCA expects to finalise the rules in 2024, and that they would apply in 2025 before the consolidated tape for bonds goes live, which is anticipated to occur in the second half of 2025, following the publication in December 2023 by the FCA of its final policy statement on a CT framework for bonds.

POST-TRADE TRANSPARENCY REQUIREMENTS FOR TRADING VENUES: NON-EQUITY INSTRUMENTS

MiFIR provides that trading venues must make public the price, volume, and time of the transactions executed in non-equity instruments—bonds, structured finance products, emission allowances, and derivatives. Member States have a discretion to allow trading venues to defer such publication for large-in-scale transactions, for transactions in illiquid instruments, and for transactions below the size specific to instrument threshold. There are very specific formulae for calculating these thresholds, which have had unintended consequences.

The amending Regulation clarifies that the requirement applies to ETDs (as opposed to "traded on a trading venue") and to certain IRS and CDS OTC derivatives that are denominated in euro, Japanese yen, U.S. dollars, or pounds sterling and, in summary, that are subject to the clearing obligation in EMIR and centrally cleared. Package transactions are also explicitly brought into scope.

The amending Regulation removes the Member State discretion for deferrals and provides for the deferral regime to be supplemented in regulatory technical standards (RTS). National competent authorities will have powers to defer sovereign debt transactions where the instrument is issued by a Member State; ESMA will have this power where the instrument is not issued by a Member State. ESMA's Public Statement clarified that these provisions will not apply until the revised RTS applies.

See above on the U.K. FCA's proposed changes to the transparency regime for non-equities.

REMOVING OBSTACLES TO THE EMERGENCE OF AN EU CONSOLIDATED TAPE

MiFID II promoted the development of a "consolidated tape" for all transactions in equity and non-equity instruments. It envisaged a consolidated tape provider (CTP) to collect post-trade information published by trading venues and Approved Publication Arrangements (APAs), and to consolidate this into a continuous live data stream made available to the public. No consolidated tape has yet been set up in either the U.K. or the EU.

Under the EU amending Regulation, trading venues and APAs (collectively referred to as "data contributors") are required, as close to real time as possible, to submit market data directly and exclusively to the entities appointed by ESMA as the CTP for each asset class. The asset classes are shares, exchange-traded funds, bonds, and derivatives. ESMA is responsible for authorising and overseeing CTPs. Small trading venues and SME Growth Markets are exempt from the requirement to submit data to a CTP but may opt into the regime (this exemption was not included in the Commission's original proposals).

FSMA 2023 (discussed by Shearman and Sterling, now A&O Shearman, in "A Boost for UK Financial Services") gave the FCA rule-making powers for Data Reporting Service Providers, enabling the U.K. to set a framework for the development of a consolidated tape. The FCA's rules and guidance for a consolidated tape for bonds entered into force on 5 April 2024, the same date that the related legislation—the Data Reporting Services Regulations 2024[18]—came into force. The Data Reporting Services Regulations 2017 were revoked on the same day. The tender process for the bond CTP will progress through 2024. The bond CTP is expected to go live in the second half of 2025.

SYSTEMATIC INTERNALISERS—QUANTITATIVE CRITERIA

Systematic Internalisers are firms which regularly execute transactions against their own capital, rather than externally on trading venues. Under EU MiFID II, an investment firm is considered to be a Systematic Internaliser if it performs its activities on an organised, frequent, systematic, and substantial basis, or if it opts into the Systematic Internaliser regime. The criteria for a "frequent, systematic, and substantial basis" are quantitative. As with the U.K.'s approach, the amending Directive will remove the quantitative criteria. This change will apply once the amending Directive has been transposed into national laws, which must occur by 29 September 2025.

SYSTEMATIC INTERNALISERS—PRE-TRADE TRANSPARENCY REQUIREMENTS FOR NON-EQUITIES

On the EU side, Systematic Internalisers will, under the amending Regulation, no longer be within the scope of the pre-trade transparency requirements for non-equity instruments. Firms will still be able to opt into the Systematic Internaliser regime. The Commission had not proposed these changes. The U.K. FCA is proposing the same exclusion and final rules are expected this year.

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18 SI 2024/107.

SYSTEMATIC INTERNALISERS—PRE-TRADE TRANSPARENCY REQUIREMENTS FOR EQUITIES

The amending Regulation provides for changes to the minimum quote size requirements for equity instruments. Currently, a Systematic Internaliser must make public all quotes in equity instruments if it deals in sizes up to the standard market size. A Systematic Internaliser may decide at which sizes they quote, subject to having to quote at a minimum size of ten percent of the standard market size. The Commission had proposed a minimum size of twice the standard market size. Under the amending Regulation, the minimum quote size will be set out in RTS developed by ESMA, and these changes will only apply once those RTS apply. The U.K. is making similar changes, giving responsibility to the FCA to make the change.

As originally proposed by the Commission, the amending Regulation allows Systematic Internalisers to match orders of any size at midpoint. This change took effect on 28 March 2024. This change is similar to that implemented by the U.K. under FSMA 2023, effective 29 August 2023. Amendments to the Systematic Internaliser reporting regime will be made by FCA rules. HM Treasury will be considering further whether conflicts of interest would be manageable if a Systematic Internaliser and an OTF are operated within the same legal entity.

REPLACING THE DOUBLE VOLUME CAP

The double volume cap (DVC) limits the amount of shares a market participant can trade using a pre-trade transparency waiver, thus restricting the extent of dark trading that can occur for each financial instrument. There are two main waivers: the reference price waiver and the negotiated trade waiver. The cap consists of two elements: a venue specific cap and an EU-wide limit. The DVC will be replaced by a single EU-wide volume cap set at seven percent of trades that are executed under the reference price waiver only. The Commission had proposed that both waivers would be restricted by the new cap. The provisions in the amending Regulation take effect from 29 September 2025. ESMA has confirmed it will continue publishing the DVC results until the single volume cap takes effect.

Effective 29 August 2023, the DVC was removed from U.K. MiFIR by FSMA 2023.[19] Instead, the FCA is tasked with monitoring trading and has new powers to direct that transparency waivers should be suspended if the ongoing use of the waiver would impact market integrity.

CLARIFYING THE SHARE TRADING OBLIGATION

EU MiFIR requires EU investment firms to ensure that the trades they undertake in shares admitted to trading on a regulated market or traded on a trading venue take place on an EU-regulated market, MTF, Systematic Internaliser, or equivalent third-country trading venue. As originally proposed by the Commission, the amending Regulation will enshrine into law ESMA's post-Brexit interpretation[20] that the share trading obligation (STO) only applies to shares that have an EEA ISIN and which are traded on a trading venue. ESMA is to maintain a list of such shares. The STO exemption for trades in shares which are non-systematic, ad hoc, or irregular and infrequent is removed because it had caused uncertainty as to when it applied. There is a new exemption for shares traded on a third-country venue in the local currency or in a non-EEA currency. One of the pre-existing exemptions is carried through, so the STO

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19 The Financial Services and Markets Act 2023 (Commencement No. 1) Regulations 2023 (S.I. 2023/779). Various industry associations supported the removal of the U.K. DVC; for example, AFME states: "AFME does not believe that enforcing increased lit trading necessarily improves price formation and, conversely, may impact the ability for firms to provide best execution for their clients. For these reasons, AFME has consistently called for the removal of the DVC, which has resulted in no beneficial outcomes for end-investors and has resulted in unhelpful complexity in equity market structure." AFME, "consultation response: HM Treasury Wholesale Markets Review Consultation", 1 September 2021.

20 ESMA, "Brexit: Impact of the end of the transition period on 31 December 2020 on the trading obligation for shares (Article 23 of MiFIR)", (ESMA70-155-7782), 26 October 2020.

still does not apply to shares traded between eligible counterparties, between professional counterparties, or between eligible and professional counterparties and that do not contribute to the price discovery process.

Effective 29 August 2023,[21] the STO was deleted entirely from U.K. MiFIR by FSMA 2023.

SME GROWTH MARKETS

SME Growth Markets were a new sub-category of MTF introduced in January 2018 to facilitate access to capital for SMEs. The proposed Listing Act Directive aims to further facilitate the development of those markets by allowing a segment of an MTF to become a SME Growth Market and extending to other trading venues the possibility of trading a SME financial instrument, provided there is no objection by the issuer. These provisions mostly reflect the Commission's original proposals.

In the U.K. Wholesale Markets Review, HM Treasury proposed to introduce a new type of trading venue (or additional segment for existing trading platforms) tailored to the requirements of smaller SMEs. As an example, SMEs with a market capitalisation under £50 million was proposed as a category. Most respondents did not support the idea of a new SME specialist trading venue type, as it would potentially overlap with the existing SME Growth market category. In response, HM Treasury stated that it would explore this issue further, including in the reforms to the listing regime.

WHAT NOW?

The operational, markets, and commercial impacts resulting from emerging divergences and differing timetables between the now parallel EU and U.K. regimes will be monitored intently by firms, policy makers, and regulators. We at A&O Shearman continue to track the evolving frameworks, and our financial services regulatory experts would be delighted to discuss any of these issues with you further.

21 The Financial Services and Markets Act 2023 (Commencement No. 1) Regulations 2023 (S.I. 2023/779).

Annex: EU MiFID/MiFIR Review—divergence emergence?

Our table covers the main EU MiFID/MiFIR Review changes and focussed changes from the near-final Listing Act Package and flags any relevant U.K. changes or developments on the same issues. This table does not cover all changes made to the EU and U.K. MiFID rules since Brexit.

Please note that this table does not cover Level 2 and Level 3 developments or prospective changes and does not take into account any changes as a result of other legislative developments impacting MiFID (for example the Retail Investment Strategy and the Listing Act Package).

Key

(red)	EU and U.K. have made substantively similar changes/there is otherwise no material divergence
(amber)	Some overlap between the EU and U.K. changes
(green)	Clear divergence between the EU and the U.K.

TOPIC	MATERIAL DIVERGENCE?	EU MIFID/MIFIR CHANGE	RELEVANT U.K. DEVELOPMENT
Trading venues: pre-trade transparency for equities—double volume cap	Yes[22]	DVC is being amended to a single EU-wide seven percent cap.	DVC was removed on 29 August 2023.
Trading venues: pre-trade transparency for non-equities	Potentially in future[23]	Application is being limited to trades in a central limit order book or a periodic auction trading system. For derivatives, the scope of application is clarified so that it applies (in summary) (i) ETDs; and (ii) certain IRS and CDS OTC derivatives denominated in euro, Japanese yen, U.S. dollars, or pounds sterling that are subject to the EMIR clearing obligation and which are centrally cleared. For package orders, the limitation to central limit order book and periodic auction trading system trades applies, but the general	The FCA has consulted on changes to the transparency regime for bonds and derivatives. Final rules are expected in 2024. The proposed framework will divide non-equities into two categories—category 1 (bonds traded on U.K. trading venues and certain OTC derivatives subject to the clearing obligation) and category 2 (derivatives or structured finance products which are not in category 1, plus emission allowances and emission allowance derivatives). Under the proposals, pre-trade transparency would apply

[22] Note that pre-trade transparency changes for equities have also been made both in the EU and U.K. by way of changes to RTS 1 (Commission Delegated Regulation (EU) 2017/587).

[23] Note that pre-trade transparency changes for non-equities have also been made both in the EU and U.K. by way of changes to RTS 2 (Commission Delegated Regulation (EU) 2017/583).

TOPIC	MATERIAL DIVERGENCE?	EU MIFID/MIFIR CHANGE	RELEVANT U.K. DEVELOPMENT
		definition of derivatives is retained.	depending on the characteristics of the market model. Waivers would be available for large in scale orders, packages, and negotiated transactions.
Trading venues: post-trade transparency for non-equities	Potentially in future	For derivatives, scope of application is clarified so that it applies (in summary) (i) ETDs; and (ii) certain IRS and CDS OTC derivatives denominated in euro, Japanese yen, U.S. dollars, or pounds sterling that are subject to the EMIR clearing obligation and which are centrally cleared. For package orders, this requirement is now explicitly included. On deferral, ESMA is mandated to draft RTS detailing technical requirements for bonds, structured finance products, and emission allowances. Bond and derivative requirements will be separated according to five categories of transactions: (i) medium-size liquid-market; (ii) medium-size non-liquid market; (iii) large-size liquid-market; (iv) large-size non-liquid market; and (v) very large size. ESMA will have emergency powers to extend deferrals. Competent authorities will have powers to defer sovereign debt transactions where the instrument is issued by a Member State; ESMA will have this power where the instrument is not issued by a Member State.	The FCA is currently consulting on improving transparency for bonds and derivatives. Please see comments above in relation to **Trading venues: Pre-trade transparency for non-equities**. For category 1 instruments, real-time reporting would apply to trading venues. For category 2 instruments, trading venues would set/calibrate transparency requirements in line with criteria set by the FCA. On deferral, the FCA proposes a framework for deferrals for large trades with the largest trades able to benefit from an extended deferral or permanent deferral where a cap applies. This framework will apply to both bonds and derivatives (but different calibration for different markets).
Availability of trade data	Potentially in future	The bar for what comprises a "reasonable commercial basis" when making available pre- and post-trade information is being raised. A "reasonable commercial basis" includes unbiased and fair contractual terms, and the level of fees. The level of fees must be determined by reference to the cost of producing and disseminating the information, plus a reasonable margin. Data	The FCA is currently consulting on a bond CT framework, which includes provisions on data being made available on a reasonable commercial basis, and in particular deleting the requirement for a CTP to price on a reasonable commercial basis. Additionally, in the U.K., the FCA has been looking at the availability and quality of trade data and has published its

TOPIC	MATERIAL DIVERGENCE?	EU MIFID/MIFIR CHANGE	RELEVANT U.K. DEVELOPMENT
		policies must also be made freely available. ESMA is mandated to draft RTS. The new requirements will bring into law the substance of the 2021 ESMA guidelines[24] on this.	Wholesale Data Market Study Report.[25]
Investment firms/Systematic Internalisers: pre-trade transparency for equities	Potential technical divergence in future[26]	The Systematic Internaliser requirements (i) to apply a minimum quote size; and (ii) to publish quotes of a certain size, will be updated. ESMA is mandated to draft RTS on these. It is expected that not only will there be changes to the minimum quote size threshold (making it higher), but there will be a reassessment of what is the "standard market size." Systematic Internalisers will be allowed to match orders at midpoint (not just large in scale orders as is currently the case).	The U.K. government found that there was industry appetite for the minimum quote size to be changed, but no changes have been implemented yet. The limitation on order-matching at mid-point to large in scale orders was removed as of August 2023.
Investment firms/Systematic Internalisers: pre-trade transparency for non-equities	Not materially (on the basis of current U.K. consultation)	Systematic Internaliser pre-trade transparency requirements for non-equity instruments are being removed.	The FCA is currently consulting on improving transparency for bonds and derivatives. The new proposals do not envisage any Systematic Internaliser-specific requirements for pre-trade transparency, and the new proposals do not envisage any pre-trade obligations in relation to investment firms.
Investment firms/Systematic Internalisers: post-trade transparency for equities—designated reporters/publishing entities	Yes—on timing and scope	There will be a new designated publishing entity regime for investment firms. Such entities will be responsible for making a transaction public, without needing to be Systematic Internalisers. ESMA is mandated to publish the register of designated publishing entities by 29 September 2024. In terms of the scope, the EU regime will apply at asset level. The exact meaning of "asset level" is yet to be prescribed.	There will be a new designated reporter regime for investment firms. This will apply at legal entity level. The regime came into force in April 2024, ahead of the EU regime.

24 ESMA, "Final Guidelines on the MiFID II/ MiFIR obligations on market data", 18 August 2021, (ESMA70-156-4263).
25 FCA, "Wholesale Data Market Study", February 2024, (Market Study MS23/1.5).
26 Note, however, that both the U.K. and the EU have removed the large-in-scale limitation on order-matching at mid-point.

TOPIC	MATERIAL DIVERGENCE?	EU MIFID/MIFIR CHANGE	RELEVANT U.K. DEVELOPMENT
Investment firms/Systematic Internalisers: post-trade transparency for non-equities	Potentially in future	For derivatives, scope of application is being limited to (in summary) OTC trades in respect of (i) certain derivatives subject to the EMIR clearing obligation which are centrally cleared; and (ii) certain CDS which are centrally cleared. For deferral, the same categories and technical standards will apply as for trading venues (see above).	The FCA is currently consulting on improving transparency for bonds and derivatives. Please see above in relation to **Trading venues: Post-trade transparency for non-equities**. The consultation proposals appear to anticipate that the Systematic Internaliser regime will not be relevant for non-equity transparency. The new proposals envisage investment firm real-time reporting requirements for category 1 instruments, unless the trade is above the large in scale threshold. The new proposals do not envisage any reporting obligations for investment firms for category 2 instruments.
Systematic Internalisers—quantitative criteria	Potentially in future	Removal of the quantitative criteria of “frequent, systematic, and substantial” for an investment firm to be considered a Systematic Internaliser, which will take effect on 29 September 2025.	FSMA 2023 provides for the quantitative criteria to be removed from the definition of a Systematic Internaliser. Legislation bringing that change into force has not yet been made.
Consolidated tape	Potentially in future	Trading venues and APAs will be subject to new requirements to submit data which has to be of a certain quality to CTPs. An adapted version of the requirements applies in the case of SME growth markets.[27] ESMA is mandated to draft RTS in respect of the above.	The U.K. set out a legislative framework for the regulation of CTPs (and APAs and ARMs) which came into force on 5 April 2024, along with FCA rules and guidance. A consolidated tape for bonds is expected to be developed during 2024.
Share trading obligation	Yes	Scope of the obligation applies to shares which have an EEA ISIN and which are traded on a trading venue, except where those shares are traded on a third-country venue in the local currency or in a non-EEA currency, or those shares are carried out between eligible/professional counterparties and do not	The STO was removed on 29 August 2023.

[27] As a technical point, the existing requirement on synchronising business clocks is being moved from article 50 of MiFID to MiFIR.

TOPIC	MATERIAL DIVERGENCE?	EU MIFID/MIFIR CHANGE	RELEVANT U.K. DEVELOPMENT
		contribute to the price discovery process.	
Transaction reporting (including reference data also relevant to transparency obligations)	Potentially in future	On derivatives, the scope of the obligation applies to OTC derivatives transactions either where those derivatives (i) are executed on venue; or (ii) are executed off venue and are subject to transparency requirements (see above); or (iii) have an underlying which is traded on a trading venue (or is an index or basket composed of instruments traded on a trading venue). Additionally, OTC derivatives' instrument reference data (which also applies in the case of transparency requirements) will be based on globally-agreed standards. The Commission is empowered to adopt delegated acts specifying this. Changes are also made with a view to synchronising data included in transaction reports under other EU regulation.	There has not yet been any amendment to the U.K. MiFIR text on this, save for including a reference to the new legislative framework for data reporting (see **Consolidated tape**) above. On reference data, the FCA's consultation on improving transparency for bond and derivatives markets proposes introducing a UPI field, which is in line with the work being conducted by the Bank of England on U.K. EMIR. The U.K. FCA said in its consultation paper on improving transparency for bond and derivatives markets that, where possible, it would try to be consistent in using UPIs across U.K. EMIR and U.K. MiFIR reporting. Final rules have not yet been published.
Derivatives trading obligation	No[28]	Scope of the obligation is aligned with the scope of the EMIR clearing obligation (including the possibility for ESMA to request suspending the DTO when the CTO is suspended). There is also a new power for the Commission to suspend the obligation.	The DTO was aligned with the U.K. EMIR clearing obligation in August 2023.
Post-trade risk reduction services	Potentially in future[29]	The portfolio compression carve-out from transparency, transaction reporting, and trading rules is being expanded. Going forward, OTC derivative transactions resulting from PTRR services will benefit from this carve out.	The government proposed that the portfolio compression carve out should be expanded. FSMA 2023 provides a framework for the FCA to make rules on this, but no consultation has yet taken place.

28 This summary table focusses on the EU MiFID/MiFIR Review and does not take into account changes made under the EU's EMIR 3.0 amendments in respect of the clearing obligation or changes that may occur following the U.K. EMIR Review which is expected as part of Tranche 3 of the U.K.'s Smarter Regulatory Framework reforms.

29 Note that IOSCO has recently consulted on post-trade risk reduction services, including seeking input on services this includes in addition to portfolio compression and counterparty risk optimisation.

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		Delegated act(s) will be adopted specifying what PTRR services comprise.	
Non-discriminatory access to CCPs and trading venues	No	These requirements will no longer apply for ETDs.	ETDs removed from scope in October 2021.
Payment for order flow	No	PFOF is explicitly prohibited as being incompatible with MiFID best execution and inducement requirements.	No material changes—the FCA's position has been consistent since it published its PFOF publication in April 2019.
Execution venue reports (RTS 27)	No	The requirement for execution venues to publish RTS 27 reports has been removed. For financial instruments subject to the share and derivatives trading obligations, investment firms must still inform a client of the venue where the order was executed.	The U.K. RTS 27 requirements fell away in December 2021.
Regulated market suspension powers	No (not yet)[30]	Regulated markets will be required to publicly disclose the circumstances that lead to trading being halted or constrained and on the principles for establishing the main technical parameters used to do so. ESMA is mandated to draft RTS on this. Where a regulated market fails to exercise its suspension powers, an NCA now has powers to step in so as to re-establish normal functioning of the markets.	No material changes yet that directly track the EU development.
Commodity derivatives and emission allowances	Potentially in future	Derivatives of emission allowances will be in scope of the position limits rules. ESMA is consulting on amendments to the RTS and ITS position management controls and position reporting.	The U.K. government has amended aspects of the commodity derivatives positions regime, including the ancillary activities test. The U.K. FCA has consulted on proposals for the new regime covering (among other things) the methodology and calibration of position limits and accountability thresholds. Final rules have not yet been published.

[30] Note that the U.K.'s Wholesale Markets Review considered proposals in relation to market outages, and other provisions in relation to regulator suspension powers are relevant to other elements of the EU MiFID/MiFIR Review changes.

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Exemption from authorisation for firms only dealing on own account in financial instruments other than commodity derivatives, emission allowances, or emission allowances derivatives	Yes	The DEA restriction is removed so that EU clients accessing an EU trading venue through DEA are exempt from authorisation. The existing exclusion from the restriction for NFCs that are members or participants in a regulated market or MTF is maintained and clarified so that NFCs dealing on own account only and that are trading for hedging purposes or for liquidity management purposes do not require authorisation.	No prospective changes yet to MiFID Article 2(1)(d) as onshored in the U.K. Regulated Activities Order.
Unbundling of research	Potentially in future	Allows investment firms to choose whether to apply separate or joint payments for research and execution services. EU firms will be subject to new conduct obligations aimed at ensuring that conflicts of interest are managed.	The FCA has consulted on proposals to introduce the same payment optionality for investment firms, including the conditions that would need to be met where a firm selects joint payments (which are different from the EU's conditions, but aim to meet the same outcome of managing the conflict of interest). Final rules have not yet been published.
SME Growth Markets	Yes, although may align more in future	Changes to permit a segment of an MTF to become a SME Growth Market and extending to other trading venues the possibility of trading a SME financial instrument, provided there is no objection by the issuer.	HM Treasury continues to explore how to enhance the markets for SMEs.

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