Insideview

MiFID II – Status Quo and Next Steps

INTERVIEW WITH ELISABETH ROEGELE

Elisabeth Roegele
Chief Executive Director for Securities Supervision / Asset Management
Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin)

The European Securities and Markets Authority (ESMA) has recently finalized its work on important draft regulatory technical standards (RTS) specifying MiFID II and MiFIR. When do you expect these RTS to enter into force?

ESMA has just sent its proposals to the European Commission. It is then up to the Commission to review the RTS. In a second step, the European Parliament and the European Council will be involved. Our estimate is that the RTS will not enter into force before early 2016.

The transparency regime for non-equity (i.e., bonds, derivatives, etc.) is completely new. The methodology for assessing liquidity has been the subject of rather controversial discussion within the industry. Could you tell us about the approach chosen?

Indeed, this was a major challenge for all parties involved. Since MiFID I, we have had a transparency regime for shares that will not change dramatically. This is different with regard to non-equities. Here, we as regulators are entering completely new territory. The task is to increase transparency without hurting liquidity. Some of the markets, e.g., those for bonds and many derivatives, are characterized by episodic trading patterns. Therefore, a variety of proposals has been discussed. For most instruments, a class-of-financial-instrument approach (COFIA) will be used. A class is considered liquid if it meets certain quantitative criteria. For most asset classes, COFIA will be dynamic, i.e., each class will be assessed on a yearly basis in order to take market developments into account. However, for bonds, an instrument-by-instrument approach (IBIA) will be applied, i.e., each single bond instrument will be assessed on a quarterly basis if it meets certain quantitative criteria with regard to days traded, nominal amount traded, and number of trades per day.

Another controversial discussion related to the calibration of the transparency waivers, i.e., the large-in-scale (LIS) and size-specific-to-the-instrument (SSTI) waivers. What is the purpose of these waivers and how are the waiver thresholds determined?

The waivers' aim is to protect market participants that provide liquidity or enter into large transactions. Getting the calibration correct is indeed no simple task. We expect a mix of static and, in most cases, dynamic thresholds. So, again, ESMA will have to run regular calculations, which will demand a major technical and financial effort of all regulators and ESMA. In general terms, the thresholds for pre-trade waivers will be lower than for post-trade waivers, and the SSTI will be lower than the LIS.

Market participants also held a lively debate about the organizational requirements for algorithmic traders suggested by ESMA. What is expected here?

BaFin places high demands on the risk and compliance management of banks and investment firms. In line with our current supervisory practice, the new RTS will require all algorithmic traders to systemically conduct sound self-assessments and validations. Moreover, there must be a system of different controls such as pre-trade controls, real-time monitoring, and an ex-post surveillance generating alerts on the next trading day. In some cases, the RTS is more granular than the existing BaFin Circular 06/2013 – for example, by specifying pre-trade controls and testing of algorithms. The requirements address several aspects of risk management such as testing procedures, business continuity arrangements, and kill functionalities as well as setting special requirements for the provision of direct electronic access. In addition, firms will have to implement effective IT security measures as safeguards against cyber-attacks, and conduct penetration tests and vulnerability scans. They will also have to implement an IT strategy and effective IT management processes to ensure the reliability and inherent stability of their trading systems. In my view, this is necessary to ensure orderly markets and to cope with the specific risks of an ever-increasing use of automated trading technology.

Thank you for this interesting conversation.