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Brief Round-up of Some Key Topics and Updates

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What is the 2018 ISDA Choice of Court and Governing Law Guide?

The International Swaps and Derivatives Association, Inc. ("ISDA") has published its 2018 ISDA Choice of Court and Governing Law Guide[1] (the "Guide") which contains substitute model clauses for the "Governing Law" and "Jurisdiction" provisions of Section 13(a) and (b) of the ISDA 1992 Master Agreement (Multicurrency – Cross Border) and the ISDA 2002 Master Agreement (each, an "ISDA Master Agreement") and guidance on the use of these new model 'choice of law' and 'choice of court' clauses. The new model clauses contained in the Guide have been developed in light of legal developments since these provisions were last formulated.

Model Choice of Court Clauses

Currently, Section 13(b) of each ISDA Master Agreement is drafted to provide that each party submits to the non-exclusive jurisdiction of (i) the English courts where the governing law is English law and (ii) the courts of the State of New York and the United States District Court located in the Borough of Manhattan in New York City where the governing law is the laws of the State of New York. However, in certain circumstances (which themselves differ between the 1992 and 2002 versions of the ISDA Master Agreement), exclusive submission to such courts will apply. Section 13(b), therefore, contains references to both English courts and New York courts (in each case, whereby submission may be exclusive or non-exclusive), depending on the governing law.

In providing alternative 'updated' versions of these jurisdiction clauses, the Guide proposes:

1. a separate exclusive jurisdiction clause in favour of the English courts where the governing law is English law;
2. a separate exclusive jurisdiction clause in favour of the courts of the State of New York and the United States District Court located in the Borough of Manhattan where the governing law is the laws of the State of New York; or
3. a non-exclusive jurisdiction clause in favour of (i) the English courts where the governing law is English law and (ii) the courts of the State of New York and the United States District Court located in the Borough of Manhattan where the governing law is the laws of the State of New York.

Additionally, each of the new model clauses clarifies the definition of "Proceedings" (i.e. the suit, action or proceedings falling within the ambit of the jurisdiction clause) to expressly include non-contractual rights and obligations.

The new model clauses are intentionally 'separated' to provide for either exclusive or non-exclusive jurisdiction, thus departing from the current formulation in the ISDA Master Agreements. This separation is intended (in the case of (i) and (ii) above) to bring any submission to exclusive jurisdiction more into line with the Hague Convention's[2] requirements, as the separation should reinforce the 'exclusive' nature of the clause and should remove scope for any argument to be presented that the clause is not an "exclusive choice of court agreement" for the purposes of Article 3 of the Hague Convention (which argument might undermine the exclusivity).

Model Governing Law Clause

The Guide also includes a model governing law clause covering the choice of law for non-contractual obligations.

AB Trading Advisors View and Comment

To include any of the model clauses set out in the Guide, parties will need to amend their existing ISDA Master Agreements or make appropriate changes in ISDA Master Agreements currently under negotiation, as the Guide does not automatically amend existing terms. As a general principle, we think it is prudent to move to one of the model clauses where possible, even though ISDA notes that (for the definition of "Proceedings") the drafting changes are for clarification purposes only.

It should be noted that the Guide is not related to the work that ISDA is currently undertaking in relation to governing law and jurisdiction issues for the forthcoming Irish law and French law versions of the ISDA Master Agreement which are being produced to allow for recognition of governing law within the EU/EEA, related to Brexit (see our November 2017 edition of Briefs for the Buy side[3]).

If the UK ratifies the Hague Convention in its own capacity upon Brexit (as the UK Government has indicated it intends to do), this will facilitate the enforcement of UK court judgments throughout the EU (i.e. the remaining EU 27 countries). In this scenario, it will remain prudent to adopt the exclusive 'court of choice' model clause, as the requirements of the Hague Convention will continue to apply.

It is important to emphasise as well that certain parties may prefer non-exclusive jurisdiction over exclusive jurisdiction, for various reasons including, obviously, not being constrained in having to bring an action in a specific location. However, we would expect most clients to choose an exclusive jurisdiction clause that would meet the criteria of the Hague Convention.

MiFID II: Best Execution 'Top 5' Disclosure Reports – 30 April 2018 Deadline

What must be disclosed?

The impending requirement for in-scope firms (see "Who Must Publish such Reports", below) to make public information in respect of their top five execution and broker venues, together with certain qualitative information on execution ("Top 5 Reports"), is driven by two separate provisions (relating to direct and indirect execution) in the panoply of MiFID II:

- Article 27(6) of MiFID II[4] requires investment firms who execute client orders to summarise and make public on an annual basis, for each class of financial instruments, the top five execution venues[5] in terms of trading volumes on which client orders were executed (this will include circumstances both where the firm executes directly on the venue as a member / participant and where it trades on an OTC basis directly with a counterparty) in the preceding year and information on the quality of execution obtained (the "Direct Execution Top 5 Report"); and

- Article 65(6) of the MiFID II Delegated Regulation[6] requires that when the investment firm selects other firms to provide order execution services, it shall summarise and make public, on an annual basis, for each class of financial instruments, the top five investment firms in terms of trading volumes to whom it transmitted or with whom it placed client orders for execution in the preceding year and information on the quality of execution obtained (the "Indirect Execution Top 5 Report").

Those in-scope firms which engage both in executing orders directly and transmitting to or placing orders with third parties for execution will be required to produce separate Top 5 Reports in relation to these two activities[7]. ESMA notes[8] that: "It is important that these

reports are distinct so that investment firms disclose on one hand the top five execution venues and on the other hand the top five entities (brokers) to which client orders were routed during the relevant period. To note, this does not preclude firms from, in addition, providing a single consolidated report on the execution venues and entities the firms uses most frequently to execute client orders.".

By When Must the Reports be Published?

As confirmed in the MiFID II Q&A[9], such reports should be made public on or before 30 April following the end of the period to which the report relates. Therefore, the first set of Top 5 Reports will cover execution and/or order transmission or placement during 2017 and must be published by 30 April 2018.

Who Must Publish such Reports?

The obligation to publish attaches to certain EU firms, meaning that non-EU investment managers are out of scope even where they place orders with EU counterparties or trade on EU execution venues.

In respect of firms regulated in the UK, the position is as follows:

- MiFID II investment firms: in-scope;
- UCITS management companies: in-scope for all of its business;
- Registered or authorised alternative investment fund managers ("AIFMs"):
  - if the AIFM has no MiFID top-up permissions (e.g. in respect of managed accounts), then out of scope; and
  - if the AIFM has MiFID top-up permissions, then in-scope in respect of MiFID business but only in respect of the order transmission and order placement element of such business (i.e. indirect execution). Therefore, such an AIFM would only be required to publish an Indirect Execution Top 5 Report and not a Direct Execution Top 5 Report.

What Must be Included in the Top 5 Reports

The detail of the Top 5 Reports is found in RTS 28[10] which applies to direct execution, but Article 65(6) of the MiFID II Delegated Regulation makes it clear that the information to be reported in respect of the transmission or placement of client orders for execution should be consistent with the information reported in respect of direct execution. The Top 5 Reports will list the 'top 5' in terms of trading volumes, along with an assessment of the quality of execution.

Identity of the 'Top 5'

Identifying the 'top 5' venues / brokers in terms of trading volumes is an exercise that must be carried out separately in respect of each of the 22 sub-classes of financial instrument listed in Annex I of RTS 28. For each sub-class of financial instrument, three separate 'top 5' lists must be identified and published as follows:

- one list relating to execution / order transmissions for retail clients (if any), excluding securities financing transactions ("SFTs"): there is a prescribed format for this part of the report set out at Table 1 of Annex II of RTS 28;
- one list relating to execution / order transmissions for professional clients, excluding SFTs: there is a prescribed format for this part of the report set out at Table 2 of Annex II of RTS 28; and
- one list relating to execution / order transmissions in respect of SFTs only: there is a prescribed format for this part of the report set out at Table 3 of Annex II of RTS 28.

In respect of the non-SFT lists, the following information will need to be provided for each venue / broker: (i) proportion of volume traded as a percentage of total in that class; (ii) proportion of orders executed as a percentage of total in that class; (iii) percentage of passive orders; (iv) percentage of aggressive orders[11]; and (v) percentage of direct orders. For the SFT list, just limbs (i) and (ii) are required. In respect of the Indirect Execution Top 5 Report, ESMA has noted that it is unlikely that limbs (iii) and (iv) would be relevant unless the portfolio manager / transmitter of orders attaches a corresponding specific instruction relating to the order to the broker[12].

ESMA has also confirmed[13] that where an order is placed by a direct electronic access ("DEA") arrangement (i.e. an arrangement where a member or participant of a trading venue permits a client to use its trading code), then it is the DEA provider that is executing the order. As such, in-scope firms using DEA services to specifically direct an order to a particular venue should list the intermediary firm providing that service for the purposes of the Indirect Execution Top 5 Report (and not the Direct Execution Report).

Quality of Execution

For each of the 22 sub-classes of financial instrument, in-scope firms must publish a summary of the analysis and conclusions they draw from their detailed monitoring of the quality of execution during 2017 obtained (i) on execution venues, (ii) from brokers through which execution is carried out and (iii) through transmitted client orders. There is no prescribed form for this analysis in respect of each sub-class, but Article 3 of RTS 28 sets out the information which must be included. The qualitative aspect of the Top 5 Report must be differentiated for the 22 sub-classes (although there is some scope for consolidation of common information).

Where Must the Reports be Published?

Article 4 of RTS 28 states that the Top 5 Reports must be published on an in-scope firm's website – depending on the type of information being reported, either in a machine-readable version of the relevant template Table in the RTS 28 or in an electronic format – and be available for downloading by the public (therefore, not hidden behind firewalls or other password protected sections). ESMA has stated[14] that the Top 5 Reports must remain publicly available for at least two years. The requirement for reports to be available on a firm's website may cause some consternation, given that some firms may have only a 'placeholder' website, or no website at all.

AB Trading Advisors View and Comment

These Top 5 Reports will make for interesting reading for the brokers to the reporting entities and will likely result in some difficult discussions for some firms. Given that firms are forced to make available information showing which brokers they use the most by trading volume (thereby likely generating the greatest commissions), future negotiations with brokers may be prejudiced – or enhanced – depending on where that broker lies in the report.

The first set of Top 5 Reports will cover a period of time during the pre-MiFID II era. As such, some of the data and information that in-scope firms may need in order to complete parts of the Top 5 Broker Reports may be unavailable (for example, trading venues will not have published their best execution data for that period pursuant to RTS 27[15]). ESMA does recognise this[16], stating that: "… for the first set of [Top 5 Broker Reports], investment firms may not be able to report on information which is not available or applicable in relation to the previous year e.g. where it is tied to new provisions stemming from MiFID II or MiFIR". Therefore, in those respects, the Top 5 Reports will have to be prepared on a best endeavours basis for this first reporting period.

The requirement to report on 22 sub-classes of financial instruments, three separate tables of 'top 5' data per sub-class (professional / retail clients (both excluding SFTs) and SFTs) as well as the qualitative assessment – means that this is a significant requirement and will

necessitate resourcing or assistance from third party analytics providers. As a starting point, a firm will need to be able to identify where it has executed directly on an execution venue and where it has transmitted / placed orders for a third party to execute – an analysis that may not always be straightforward, or for which the relevant classification is not captured.

For those in-scope firms which execute only on a single venue or transmit orders to single broker for the broker to execute (e.g. where an in-scope firm transmits an order to an affiliate for the affiliate to execute), ESMA has noted that[17]: "… MIFID II does not prohibit firms from selecting only one execution venue to execute client orders in a given class of financial instruments where they are able to demonstrate that such a choice enables them to consistently get the best results for their clients". However, ESMA goes on to warn that: "… using a single venue should not lead firms to be "over-reliant" on the single venue. Using a single venue does not diminish a firm's responsibility to monitor the quality of execution. Nor does it mean that merely executing client orders on that venue will allow the firm to discharge its best execution obligations". As such, in-scope firms will need to ensure that their best execution policy is robust in terms of qualitative and quantitative factors used to choose that sole venue or broker, given the requirement to "… regularly assess the market landscape to determine whether or not there are alternative venues that they could use… [and that such assessment] … will benefit from the new metrics available under RTS 27 and from any other relevant source of data"[18].

Note also that, with respect to full-scope AIFMs being outside the scope of the Top 5 Reports publication regime, the UK Financial Conduct Authority ("FCA") has previously stated that it is keeping the position under review pending "… the outcome of the European Commission's review of AIFMD … which could propose enhancements to the best execution standards for AIFMs. However, we may still consider extending the MiFID II standards at an earlier stage if we detect evidence of poor outcomes in this sector linked to execution practices that could be addressed by such reforms"[19].

ESMA Publishes Double Volume Caps

As noted in the January edition of the Briefs for the Buy side[20], ESMA had delayed publication of the required data on the double volume cap (the "DVC") until March. Very briefly, the DVC mechanism: (i) limits the availability of the reference price waiver and the negotiated price waiver from the enhanced pre-trade transparency rules of MiFIR[21]; and (ii) operates by restricting trading under those waivers as follows: (x) the trading volume of a financial instrument carried out on a single trading venue under those waivers must not exceed 4% of the total trading volume in that financial instrument across all EU trading venues over the previous 12 months (the "4% Volume Cap"); and (2) the trading volume of a financial instrument carried out across all EU trading venues under those waivers must not exceed 8% of the total trading volume in that financial instrument across all EU trading venues over the previous 12 months (the "8% Volume Cap").

On 7 March 2018, ESMA published such data for January and February 2018[22]. In summary, because of the DVC, dark trading in equity and equity-like instruments has been limited in respect of:

- 17 instruments for January 2018 and 10 instruments for February 2018 pursuant to the 4% Volume Cap; and
- 727 instruments for January 2018 and 633 instruments for February 2018 pursuant to the 8% Volume Cap.

ESMA notes that national competent authorities should suspend, within two working days, the use of waivers in those financial instruments where the caps were exceeded (the "DVC Prohibition") (the restriction on use of the waivers is applied on an ISIN basis – therefore, the waivers are suspended for financial instruments with the specific ISINs only). Hence, the DVC Prohibition for these instruments will apply for a period of six months starting from 12 March 2018.

The DVC data for March 2018 is expected to be published by 9 April 2018.

AB Trading Advisors View and Comment

This first wave of suspension of the use of waivers will (according to at least one report[23]) cover 80% of the most heavily traded shares. Unsurprisingly, the day the DVC Prohibition came into effect Cboe Global markets set a new one day record of €582.8 million traded on its periodic auction book[24].

Contact Us

If you have any queries in relation to the above, or would like to discuss any related aspects more generally, please contact Antony Bryceson or Richard Chapman.

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[1] Available at: https://www.isda.org/a/7YsEE/180130_ISDA-Choice-of-court-and-governing-law-guide-prepublication-fina.._02262018.pdf

[2] In brief, the Hague Convention requires that effect be given by contracting states to exclusive choice of court agreements (and to recognise and enforce judgments of those courts) provided that the agreement is an 'excusive choice of court agreement'. The contracting parties to the Hague Convention are currently the European Union ("EU") Member States, Singapore and Mexico; however, more States are expected to ratify in future (including the UK upon Brexit).

[3] Available at: https://abderivs.com/client-news/november-2017-round-up-of-some-key-topics/

[4] 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 (recast).

[5] For this purpose, an "execution venue" means a trading venue (i.e. a regulated market, multilateral trading facility and an organised trading facility), systematic internaliser, market makers or other liquidity providers or entities that perform a similar function to those performed by any of the foregoing in a third country.

[6] Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing MiFID II as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive. Available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017R0565&from=DA

[7] See Section 1, Answer 7 of the European Securities and Market Authority's ("ESMA") Questions and Answers on MiFID II and MiFIR Investor Protection and Intermediaries Topics ("MiFID II Q&A"). Available at: https://www.esma.europa.eu/press-news/esma-news/esma-updates-mifid-ii-mifir-investor-protection-qa

[8] Ibid.

[9] See Section 1, Answer 5 of the MiFID II Q&A.

[10] Commission Delegated Regulation (EU) 2017/576 of 8 June 2016 supplementing MiFID II with regard to regulatory technical standards for the annual publication by investment firms of information on the identity of execution venues and on the quality of execution. Available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017R0576&from=EN

[11] As defined in Article 2 of RTS 28, a passive order is an order entered on the order book that provides liquidity (e.g. a bid below the offer price or an offer above the bid price is entered – where the order is not matched against a resting order) whereas an aggressive order is an order entered on the order book that takes liquidity.

[12] See Section 1, Answer 14 of the MiFID II Q&A.

[13] See Section 1, Answer 17 to the MiFID II Q&A.

[14] See Section 1, Answer 4 of the MiFID II Q&A.

[15] This is the regulatory technical standard requiring execution venues to publish information relating to the quality of execution of transactions.

[16] See Section 1, Answer 6 of the MiFID II Q&A.

[17] See Section 1, Answer 3 of the MiFID II Q&A. (References to 'execution venues' and 'execution' should be construed as transmission of orders to a third party for execution.)

[18] Ibid.

[19] See page 95 of the FCA Policy Statement PS17/14 of July 2017 headed "Markets in Financial Instruments Directive II Implementation – Policy Statement II". Available at: https://www.fca.org.uk/publication/policy/ps17-14.pdf

[20] Available at: https://abderivs.com/client-news/february-2018-brief-round-up-of-some-key-trading-related-issues-2/

[21] 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.

[22] Available at: https://www.esma.europa.eu/press-news/esma-news/mifid-ii-esma-publishes-double-volume-cap-data

[23] See https://uk.reuters.com/article/us-eu-markets-regulator/eu-regulator-rolls-out-trading-caps-for-bulk-of-stock-market-idUKKCN1GJ2UA

[24] https://www.thetradenews.com/cboe-periodic-auction-sees-record-day-on-day-mifid-ii-dark-pool-rules-came-into-force/