



The Crisis and MiFID

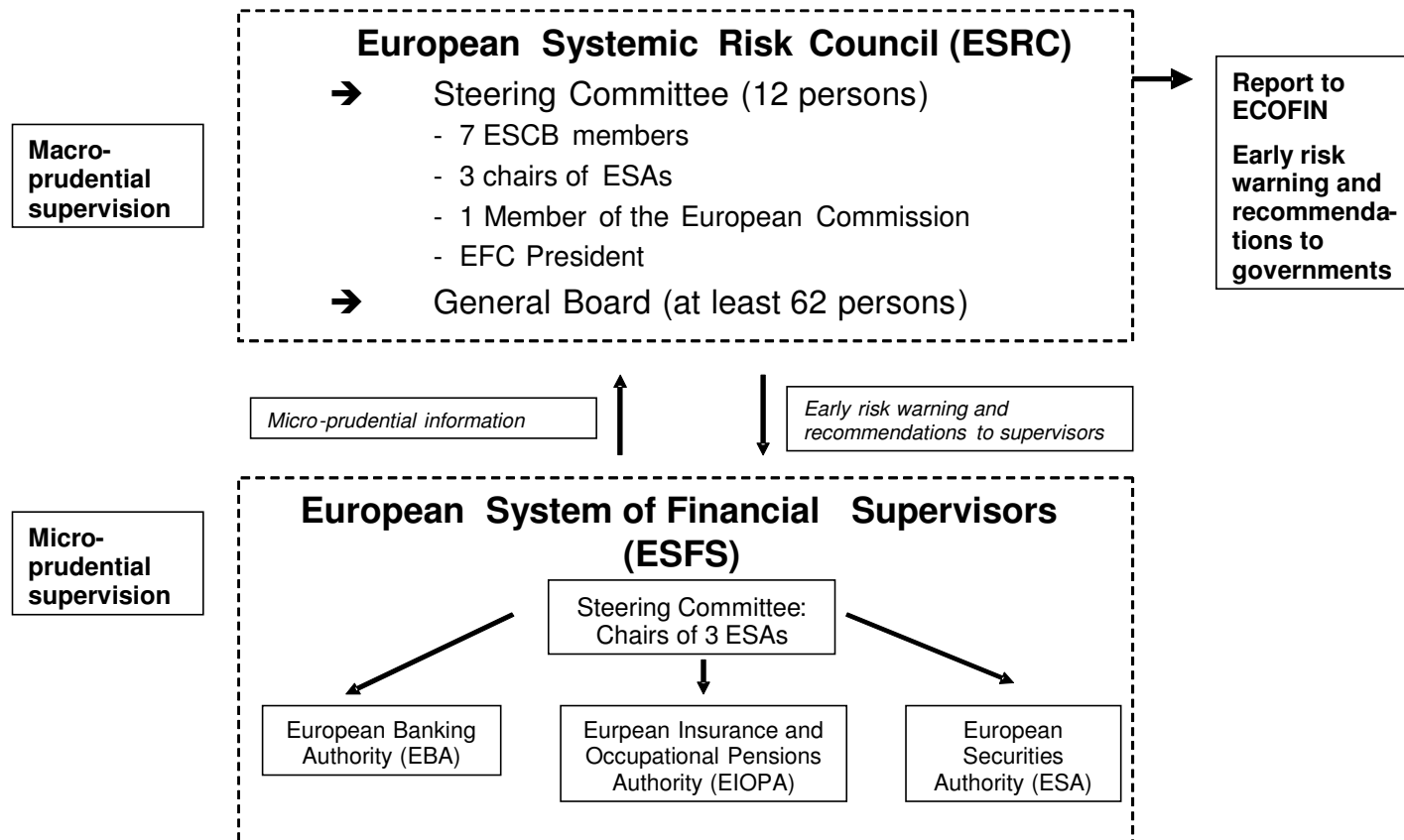
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● ● ● | Post-crisis EU policy agenda

- More integrated supervisory structure
- Enormous regulatory agenda (single market or g-20 driven):
 - **Credit rating** agencies regulation
 - Review of **Basel rules**: 5% for securitisation, trading book, dynamic provisioning, leverage ratio
 - Tighter **conduct** regulation (e.g. short selling, executive remuneration, trading rules)
 - More **product** regulation (hedge funds, private equity, OTC markets)
 - Deposit protection schemes review (end 2009)

The new European supervisory structure



European Systemic Risk Board

- Governance:
 - Steering Committee (12 persons): 7 central bankers, 3 chairs of ESAs, 1 Commissioner, 1 Finance Minister delegate
 - General Board (> 62 p)
 - **Consultative only**
- Tasks:
 - define, identify and prioritise all macro-financial risks (e.g. excess credit growth, asset inflation);
 - issue risk warnings and give recommendations to policy makers, supervisors and public;
 - monitor follow-up of the risk warnings;
 - liaise with international counterparts;
- Based within ECB, but not formally part of it

● ● ● | European Supervisory Authorities

- 3 sectoral authorities with separate legal personality: EBA, ESMA, EIOPA
- Tasks:
 - single **rulebook**;
 - **enforcement** of rules;
 - harmonise supervisory practices, **peer review** of national authorities;
 - strengthen the oversight of cross-border groups (participate and **mediate** in colleges) and supervise pan-European entities (CRAs, CSDs, CCPs);
 - establish a central European **supervisory database** and ensure exchange of information

What is MiFID?

- Drastic change in the regulation of van financial markets, liberalisation of networks
- Liberalisation of trading venues, abolition of the monopoly of exchanges. 3 possible “venues”:
 - Regulated Markets
 - MTF’s
 - Systemic Internalisers
- Higher protection of investors
 - “Best execution” in the execution of orders
 - “Client suitability” and “appropriateness” or requirement to know your customer
 - Stricter regulation of pre- and post-order price transparency
 - Rules on conflict of interest and inducements
- Very detailed, but principles-based regulation

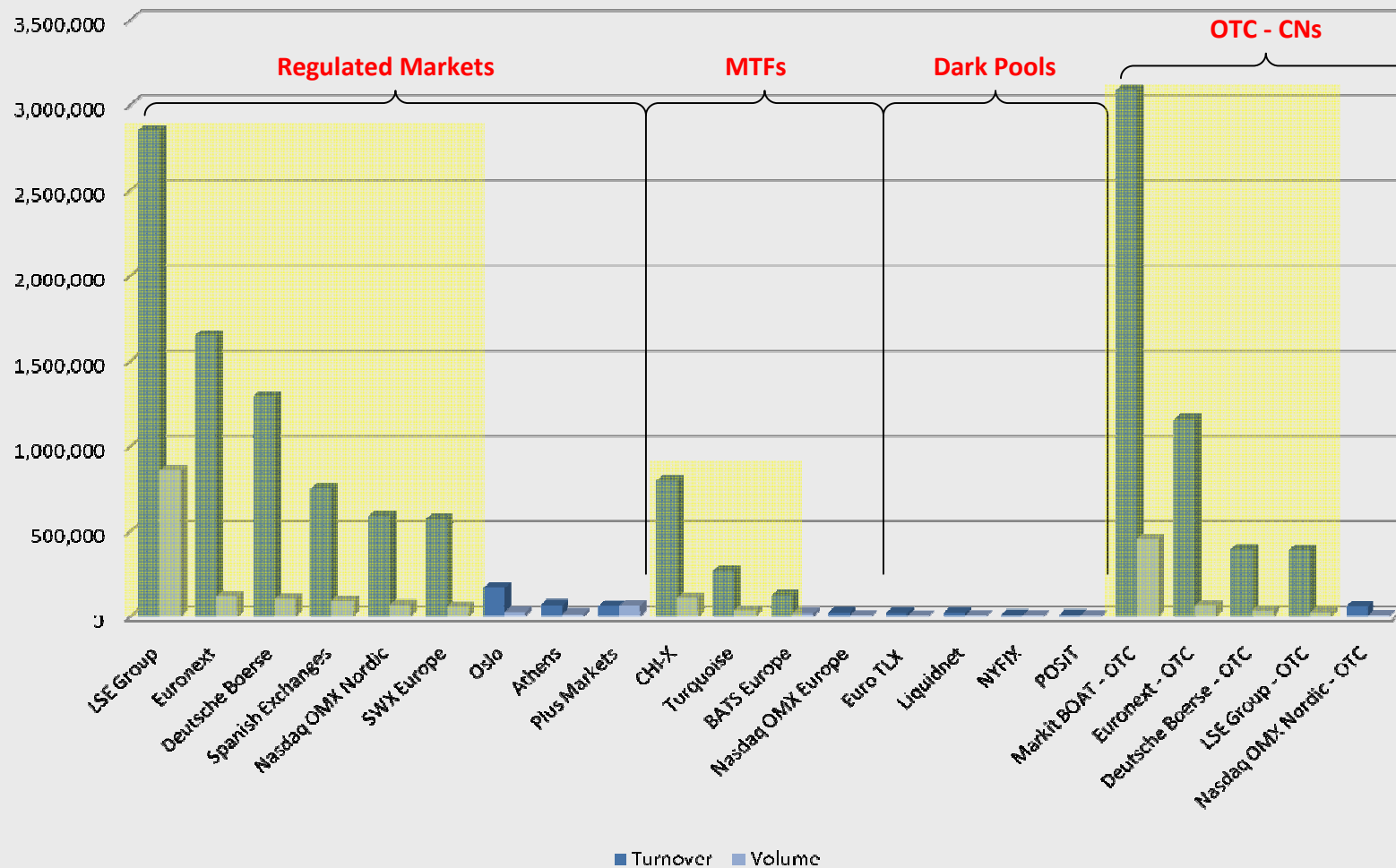


Effects so far

- More competition – liberalisation worked (between exchanges and with MTF's)
- Growth of 'dark pools' and crossing networks
- More fragmentation: has it reduced liquidity, price formation on exchanges?
- Reduction in trading fees on exchanges
- But what about respect of conduct of business rules?
- Lack of single data feed?
- MiFID 2010 Review?



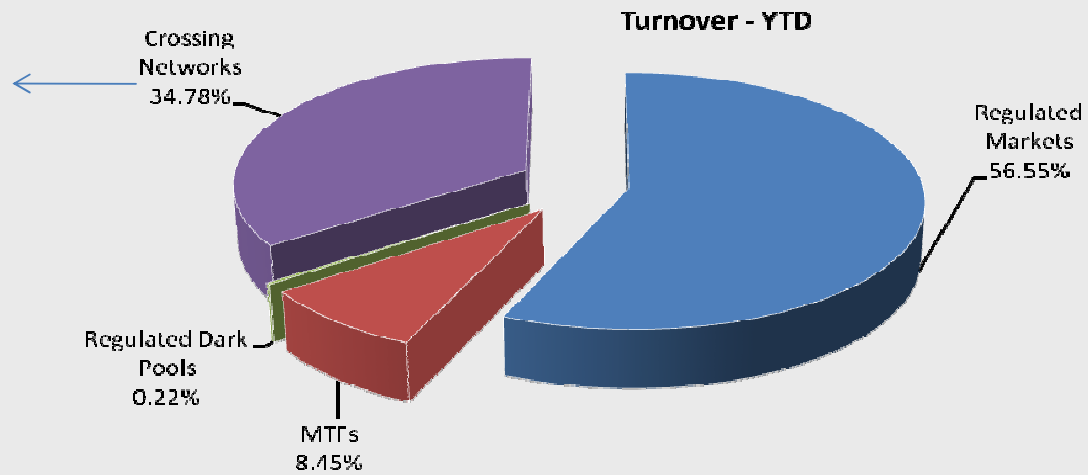
Turnover - Volume



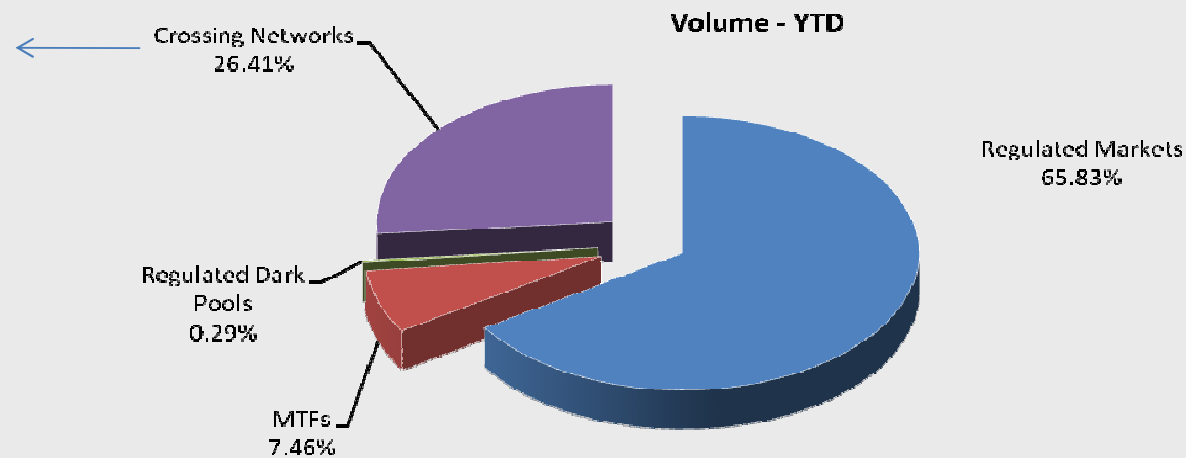


Market shares

Non-exchange owned CNs 21.14%

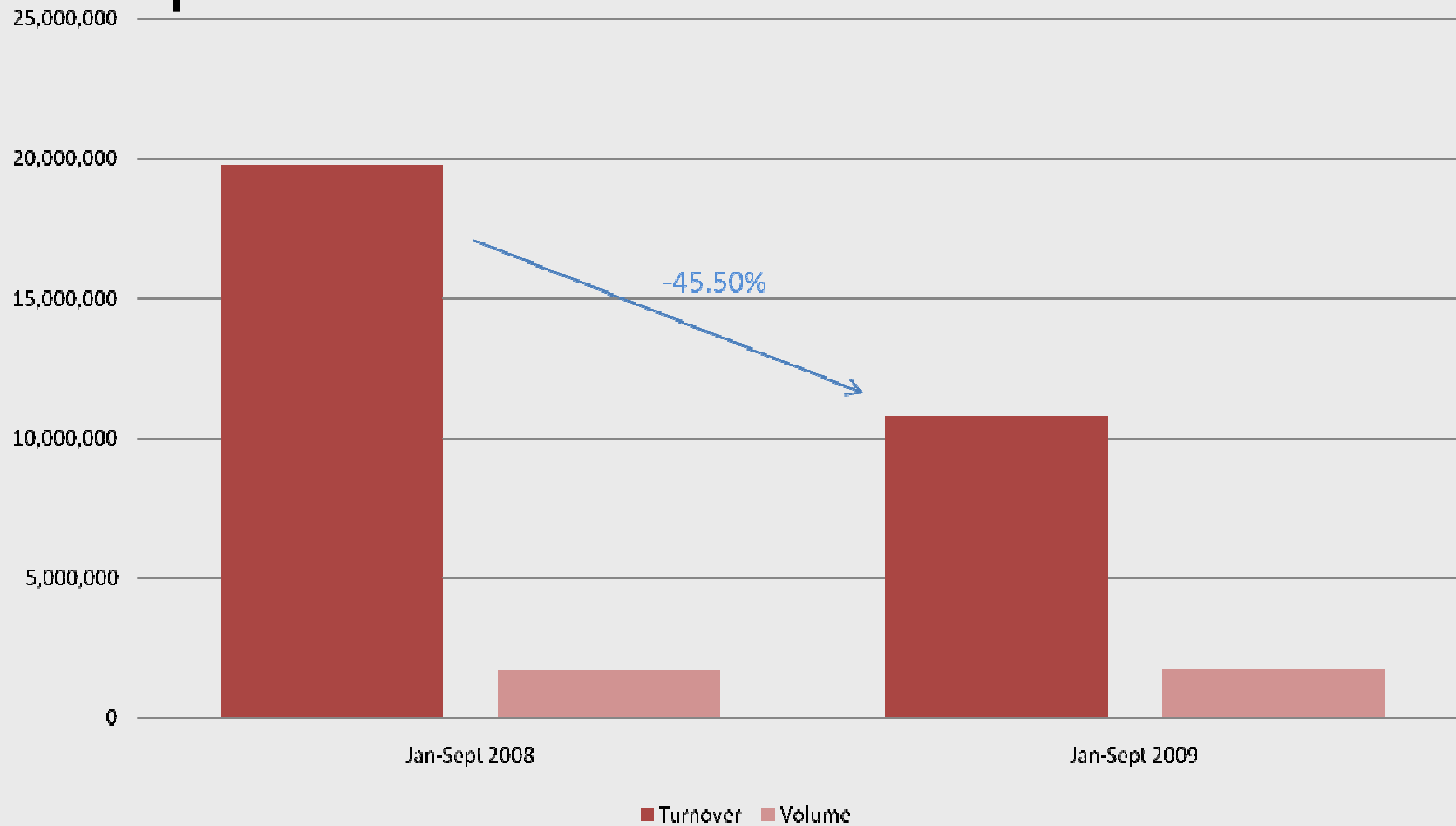


Non-exchange owned CNs 21%





Turnover – Volume EU (Jan-Sept 08/09)





MiFID: adapted to post crisis world

- much stricter conduct regulation for banks, investment firms
- but enforcement leaves much to be desired (to the extent we know)
- and may need to be extended
 - Price transparency (for equity, debt and derivative securities)
 - Sector-wise (AIFM, insurers' fund business)
 - Penalties on non-compliance
- but too much off exchange? Need to bring OTC back on exchange?

Best execution: not enforced?

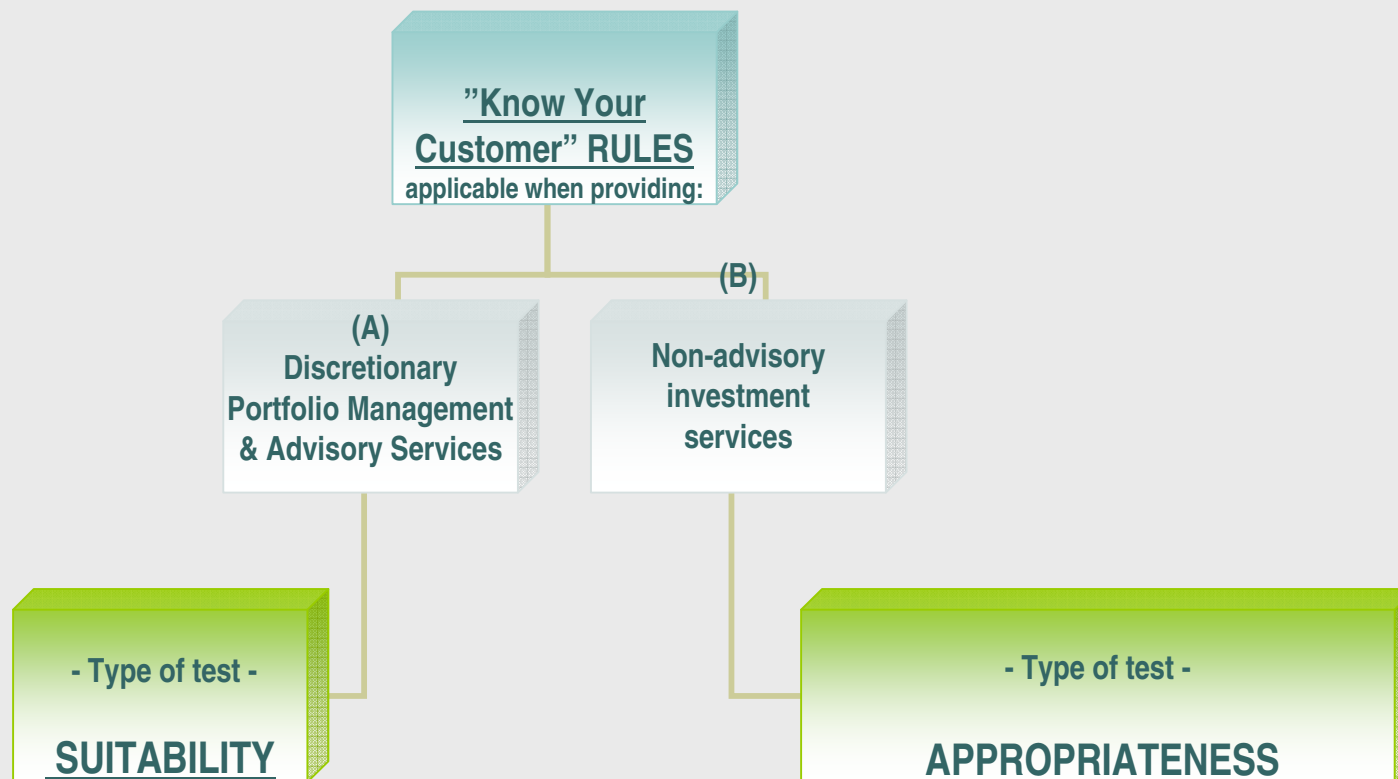
- Art. 21.: broad set of criteria (as compared to price only in US Reg NMS rule). It defines best execution as not only a matter of the price of a trade, but also “**costs, speed, likelihood of execution and settlement, size, nature or any other consideration relevant to the execution of the order**”. Investment firms are required to establish and implement order execution policies, including the factors affecting the order execution venue. These policies will be assessed by investment firms on a regular basis.
- Mostly price only for retail investors (and eligible counterparties who ask for this)
- Equiduct found that 33% of the trades could have achieved a better price (or extra cost of € 30 million in one month)!
- What do we know about enforcement???

- ● ● | Price transparency: limited application

- Pre- and post-order price transparency
 - Only applicable to equity, not to fixed income and derivative markets
 - For liquid shares
 - And within low thresholds (standard market size trades)
 - Will these definitions be reviewed?
- How to apply to debt markets? Are market initiatives enough?

Know your customer rules: applicable?

- Client suitability” and “appropriateness” test: burdensome but not necessarily consistent



- ● ● | Conflict of interest rules: toothless

- Firms need to identify, prevent, disclose conflicts of interest
- And disclose them
 - Need for a written policy
 - Procedures
 - Internal supervision
 - Chinese walls for remuneration
- Up to authorities to enforce
- Stronger action on non-compliance?

MiFID and fund business

MiFID Provisions that apply to UCITS management companies (and soon AIFM)

- Dealings as counterparty to public authorities (art. 2.2)
- Cross-border takeover of a company (art. 10(4)) if it leads to a qualifying holding in that firm
- Capital requirements (art. 12)
- Organizational requirements (art. 13) (in particular conflicts of interest)
- Conduct of business obligations (art. 19) (in particular suitability and best execution)

These MiFID provisions only apply to UCITS management companies when the latter provide the following services:

- Discretionary portfolio management
- Investment advice
- Custody and administration

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MiFID and inducements

- Inducements are banned, unless they meet the strict criteria laid out in Article 26 MiFID Level 2 Directive
 - when the commissions/benefits are paid or provided to or by the client (or by a person acting on his behalf);
 - when the commissions/benefits are paid or provided to or by a third party (or by a person acting on his behalf) if two cumulative sub-conditions are fulfilled: disclosure of such commissions/benefits to the client plus need for enhancing the quality of the service through the payment of the commission.
 - when the commissions are necessary for the provision of the services and cannot give rise to conflicts of interest for ensuring acting in the best interests of the client.
- How to apply to fund business, e.g. retrocession fees?
- EU Commission said to publish guidance

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Conclusion

- MiFID provisions are largely adapted to the post-crisis world, with some updates
- Time to start much stricter enforcement, as a signal that EU regulation was prepared
- New supervisory framework (ESMA) should allow rapid coordinated action on e.g.:
 - Short selling
 - Flash orders, IOIs in 'grey pools'
- MiFID Review will extend application

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More reading

- Jean-Pierre Casey and Karel Lannoo. The MiFID Revolution, xii and 228 p. Available from Cambridge UP, www.cambridge.org
- Policy briefs and articles on ECMI website: www.eurocapitalmarkets.org