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Issues related to MiFID II

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Issues related to MiFID II

- **On 20 October 2011, the European Commission published its proposed revision of the Markets in Financial Instruments Directive (MiFID)**

- **The European Parliament and Council are in the process of negotiating the draft text as part of the European legislative process (as yet, no adoption date has been scheduled)**

- **MiFID II hinges around two texts: a regulation and a directive**

- **The current MiFID I will be repealed and replaced by these new texts. As a result, the implementing texts for the current directive should also be repealed and replaced by new provisions (reiterating some or all of their current content, amended where applicable)**

Issues related to MiFID II

- **Observations following the implementation of MiFID I**

  - **More fragmented markets**
  - **Less transparent markets**
  - **To the detriment of investors**

- **The revision of MiFID: an opportunity to be seized**

  - **To rethink market structure**
  - **For all financial instruments**
  - **By providing increased transparency**

Issues related to MiFID II

- **MiFID II proposes some good steps forward in principle**
  - **Desire to improve investor protection**
  - **Desire to regulate OTC trades**
  - **Introduction of pre-trade transparency requirements for securities other than equities (including in particular bonds and securitised products)**
  - **Introduction of post-trade transparency requirements (via “consolidated tapes”)**
  - **Desire to limit high frequency trading (HFT)**
  - **Call for equivalence and mutual recognition of investment services providers and trading platforms with third countries**

Issues related to MiFID II

- **"The devil is in the details"**

A few examples:

- **The definition of a market maker has still to be clarified by ESMA**
- **Emission allowances are now included in the list of financial instruments**
- **MiFID II introduces no major changes to the list of pre-trade transparency waivers, which is still far too wide**
- **MiFID II introduces the need for European "consolidated tapes". It remains to be defined how information can be exhaustively centralised and consolidated (cf. arrangements in the United States) and by which entity**
- **MiFID II introduces a new category of trading venues: OTFs (organised trading facilities). However, the order execution rules applicable to OTFs are less restrictive than those that apply to other trading venues (RMs and MTFs).**

- **There are too few references to ESMA's new powers ("binding technical standards")**

Issues related to market structure

- **Two major areas of concern within MiFID II in terms of market infrastructure**
  - **The concept of OTFs**
  - **The treatment of HFT**

Issues related to market structure: The concept of OTFs (1/2)

- **MiFID II is heading in the right direction**
  - **A desire to improve trade transparency**
  - **A framework for OTC platforms**

- **However, the concept of OTFs raises concerns**
  - **A catch-all category that covers a broad range of platforms with highly diverse characteristics**
  - **Discretionary order execution rules**
  - **Less prescriptive rules than for RMs/MTFs**

Issues related to market structure: The concept of OTFs (2/2)

- **OTFs must be clearly differentiated from RMs/MTFs**
  - **OTFs should not be qualified as trading venues, since the rules governing them are less prescriptive than those governing RMs/MTFs**
    - This would lead to unfair competition
    - Between platforms with the same label
  - **These rules will not provide for genuine pre-trade transparency**
    - Discretionary order execution rules
    - This means that different prices or order execution terms may be offered to different clients

- **MiFID II must promote trading on "trading venues"**
  - **For all standardised and sufficiently liquid financial instruments**
  - **By establishing a principle that these instruments must be traded on RMs or MTFs**
  - **Or by limiting trading volumes on OTFs**

Issues related to market structure: The treatment of HFT (1/2)

- **In an environment of market automation, HFT has grown considerably**
  - **30-40% of all EU trades**
  - **Significantly higher order volumes**
  - **Very low execution rates**
  - **High concentration**

- **The growth of HFT raises questions**
  - **For market integrity, efficiency and stability**
  - **Operators, investors and issuers are expressing concerns**

- **Legislative/regulatory action is now needed**
  - **Regulatory work (IOSCO/ESMA)**
  - **MiFID II needs to address the issue of HFT**

Issues related to market structure: The treatment of HFT (2/2)

- **Supervision must be tightened**
  - **A consolidated register of orders is needed**
  - **Cross-market supervision must be put in place**
  - **Regulators must have the resources to manage high volumes of orders**
  - **Appropriate controls must be put in place to reduce the risks generated by speed and automation**

- **More specific rules need to be drawn up on algorithmic trading**
  - **To put a stop to the never-ending race towards ever more speed**
  - **To lay down rules on tick sizes, fee structures, order execution/cancellation ratios, etc.**
  - **To ensure that co-location and fee structures do not undermine fair competition between market participants**
  - **By giving ESMA the power to adopt BTSs in these areas**

- **MiFID II must be coordinated with the Market Abuse Regulation (MAR) to control these financial "hackers"**

Issues related to investor protection

MiFID II proposes:

- **Reinforced rules of conduct**
- **Supplemented organisational rules**

Issues related to investor protection (1/2)

- **Reinforced rules of conduct**
  - **Obligations to eligible counterparties**
  - **Marketing rules**
    - Rules on “independent” advice (products proposed/remuneration)
    - Ban on collecting shared fees in connection with portfolio management
    - Requirement to inform clients about the performance of their investments and the criteria used to determine product suitability
  - **A reduction in the scope of “non-complex” products**
    - Harmonised UCITS will no longer systematically fall into the category of non-complex instruments
    - The AMF holds that it must be possible to determine a product’s complexity using a few simple criteria that are applied uniformly to all financial instruments marketed to retail investors. This means that the definition of complex/non-complex products needs to be covered by binding technical standards defined by ESMA.
  - **The possibility for ESMA and domestic authorities to ban overly complex products where they significantly harm investor protection or impede the smooth operation of the markets**
  - **Tightening “best execution” rules by requiring improved client information and introducing a new obligation for execution venues to periodically disclose information about execution quality**

Issues related to investor protection (2/2)

- **Supplemented organisational rules**

  - **Tighter rules on authorisation and the “fitness and properness” of ISPs’ management (with the concept of “management bodies” broader than the previous concept of “senior management”)**

  - **Implementation of specific organisational rules for multiple clearers**

  - **Obligation to record telephone calls and electronic communications about the transmission of orders, including the orders issued by ISPs trading on own account**

  - **Implementation of numerous legally restrictive technical standards drawn up by ESMA and adopted by the Commission to harmonise the implementation of texts**

  - **Removal of the option for Member States to allow authorities to delegate authorisation and monitoring of certain activities carried out by ISPs (financial investment advisors or “CIFs” in France)**

Issues related to commodity market regulation

- **MiFID II seeks to control**
  - **Price volatility and security of supply**
  - **Systemic risk, opacity, market abuse and regulatory effectiveness**
- **Various options have been put forward**
  - **Improved market monitoring, greater powers for regulators and the requirement to report large positions to the regulator**
  - **Disclosure of large positions aggregated by type of participant and the power to manage positions, including <u>position limits</u>**
- **Fewer exemptions for specialist commodity trading firms**
  - **Furthermore, the draft MAR clarifies various points in relation to the commodity derivatives market (insider dealing/cross-manipulation)**
  - **These provisions must be transposed and implemented by each country.**

Q&A

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