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MiFID Milestones

November 2007
Investment Services Directive replaced by implementation of MiFID

April 2010
CESR publishes MiFID II consultation papers

October 2011
European Commission publishes formal MiFID II legislative proposals

2007
2009
2010
2011
2015
2018

September 2009
Regulatory reform of the OTC derivatives market proposed by the G-20

December 2010
European Commission publishes MiFID II consultation paper

2015-2018?
Timetable unclear with implementation expected to occur at some stage between 2015 & 2018.
Bifurcated approach to the regulatory reform of the OTC derivatives market proposed by the G-20:

– Trading & Clearing

“All standardised OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end 2012 at the latest.” G-20 leaders, September 2009
5 Key Objectives

On 20 October 2011 the MiFID II proposals were published. These proposals consist of a Directive and a Regulation and aim to make financial markets more efficient, resilient and transparent, and to strengthen the protection of investors.

1. More robust and efficient market structures:
   - new trading venue - the Organised Trading Facility (OTF). This will result in the harmonisation of transparency rules across all trading venues and ensure that conflicts of interest are mitigated

2. Take account of technological innovations:
   - Introduction of new safeguards for algorithmic and high frequency trading activities

3. Increased transparency:
   - The new OTF category will help improve the transparency of trading activities in equity markets, including "dark pools"
   - Introduction of a new trade transparency regime for non-equities markets (i.e. bonds, structured finance products and derivatives)

4. Reinforced supervisory powers and a stricter framework for commodity derivatives markets:
   - reinforce the role and powers of regulators
   - stronger supervision of commodity derivatives markets
5 Key Objectives

On 20 October 2011 the MiFID II proposals were published. These proposals consist of a Directive and a Regulation and aim to make financial markets more efficient, resilient and transparent, and to strengthen the protection of investors.

5. **Stronger investor protection:**
   - stricter requirements for portfolio management, investment advice and the offer of complex financial products
   - In order to prevent potential conflict of interest, independent advisors and portfolio managers will be prohibited from making or receiving third-party payments or other monetary gains
   - Rules on corporate governance and managers' responsibility are introduced for all investment firms.
Objective 1: OTFs

Definition of the OTF platform is defined in a broad way to ensure that it captures all forms of organised trading not matching the existing categories

The objective of the creation of the OTF is the setting up of an appropriate regulatory framework for:

- Broker Crossing Systems (“BCNs”) present in the equities markets e.g. Goldman Sachs Sigma, Credit Suisse Cross Finder

- Trading systems currently not regulated as trading venues e.g. multi-dealer platforms. This will impact bond and derivative trading (currently estimated at 80-95% OTC)

- Trading systems & solutions that could emerge in the future
Objective 1: OTFs

Definition of the OTF platform is defined in a broad way to ensure that it captures all forms of organised trading not matching the existing categories.

Operating an OTF would be a new licensable activity under MiFID. OTFs would be subject to a certain number of core regulatory requirements notably in terms of notification and transparency:

- notification and description of the OTF to the competent authority and to ESMA
- post-trade transparency reports to the competent authorities and to the public
- adoption of access rules, rules to manage conflicts of interest and monitor trading activity for market abuse, conduct of business rules, and others
- ESMA shall establish a list of all OTFs (&MTFs) in the EU and shall publish and keep up-to-date that list on its website.
Objective 2: Take Account of Technological Innovations

Algo trading occurs where a computer algorithm automatically determines individual parameters of orders such as whether to initiate the order, the timing, price or quantity of the order.

- New requirements have been proposed for those asset managers engaged in algorithmic trading.

- As such the firms trading systems should:
  - Be resilient and have sufficient capacity;
  - Be subject to appropriate trading thresholds and limits;
  - Not be able to be used abusively or contrary to market rules; and
  - Prevent the firm’s trading systems creating or contributing to disorderly markets.

- Managers will also need to test and monitor their algorithmic trading systems, operate effective business continuity arrangements and report annually to the competent authority in their home member state on their algorithmic trading strategies (including their compliance and risk controls).
Objective 3: Increased Transparency

Current transparency regime applies only to shares admitted to trading on RM

- Pre and post-trade transparency rules to be extended to bonds and:
  - FDI when traded on an organised trading venue (incl. OTFs) and OTC.
  - FDI which are clearing-eligible or are reported to a trade repository (to be defined further in EMIR).
  This is to bring the transparency regime more in line with the scope of the Market Abuse Directive.

- Extension of transaction reporting regime to cover instruments admitted to trading on RM, MTFs or OTFs/instruments whose value is dependent on instruments traded on these venues/instruments which have or are likely to have an effect on a financial instrument admitted to trading or traded on an MTF or OTF

- Exemption for bespoke, bilateral, ad-hoc contracts specifically built to address specific hedging concerns
Objective 3: Increased Transparency

Dark Pools of liquidity are trading facilities which anonymously match large and small orders

- Pre-trade transparency requirements apply to Regulated Markets (“RMs”), Multilateral Trading Facilities (“MTFs”) & Systematic Internalisers (“SIs”) – pre-trade waivers exist for MTFs & SIs

- Trading venues such as Broker Crossing Network (BCN) Dark Pools are not captured by MiFID

- BCN dark pools likely to be forced to classify as an SI, MTF or OTF under MiFID II
# MiFID Venue Stats

## Market Shares of Trading Venues by Type of Financial Instrument

<table>
<thead>
<tr>
<th>EU (MiFID)</th>
<th>Equities</th>
<th>Fixed Income</th>
<th>Derivatives</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regulated Markets</td>
<td>49%</td>
<td>5%</td>
<td>20%</td>
</tr>
<tr>
<td>MTF</td>
<td>8%</td>
<td>3%</td>
<td>0%</td>
</tr>
<tr>
<td>OTC including dark pools</td>
<td>41%</td>
<td>89%</td>
<td>80%</td>
</tr>
<tr>
<td>SI (for equities only)</td>
<td>2%</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Other</td>
<td>0%</td>
<td>3%</td>
<td></td>
</tr>
</tbody>
</table>

| United States               |          |              |             |
| Exchanges                   | 64.20%   | <1%          | 20%         |
| OTC (including ATS/dark pools) | 35.80%  | >99%         | 80%         |

Source: FESE, Xtrakter (http://www.xtrakter.com/ye2008fi.aspx), FINRA, European Commission and BIS (for Derivatives)  
EU Equities trading as of May 2009, fixed income as of Dec. 2008  
U.S. equities as of July 2009 in exchange listed stocks, fixed income as of July 2009 (TRACE).
Objective 4: Reinforced Supervisory Powers

Additional powers bestowed upon regulators

- Product intervention powers – national regulators, such as the Central Bank of Ireland, and ESMA will be permitted to ban or restrict products in certain circumstances. Position limits for products such as commodity derivatives will also be introduced.
Objective 5: Stronger Investor Protection

The provisions relating to the scope of MiFID, the conduct of business rules and the authorisation and organisational provisions are under review

- **Inducements**
  - In the case of portfolio management, bans third party inducements altogether.
  - Bans third party inducements for a firm providing *independent* advice
  - Reporting to clients on performance of investments on which advice has been given

- **Best Execution**
  - Requirement to publish annually the top 5 execution venues for each class of financial instrument

- **Appropriateness Test**
  - Updated to ban intermediaries from selling structured UCITS on an execution-only basis by removing them from the list of “non-complex” financial instruments for which there is an exemption
Other - 3rd Country Provisions

The EU Commission is proposing to permit third country firms that wish to provide cross-border investment services across the EEA to do so on the basis of a "passport".

Under the proposals, the passport will be exercised:

- by establishing a physical branch presence in the EEA when providing services to retail & professional clients;
- by registering with ESMA when providing services to eligible counterparties

- In each case the non-EEA firm must pass an equivalency test to be devised by ESMA.

- persons within the EEA will be able to receive services cross border from non-EEA firms that are not authorised in the EEA where requested at their "own exclusive initiative", i.e. on an unsolicited basis. Presumed rewrite of "safe harbour" rule in Regulation 8 of MiFID and the introduction of a formal "unsolicited business" exemption.

- More onerous than the equivalent third country provisions in AIFMD?
Questions & Answers

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