



# The Markets in Financial Instruments Directive (and Regulation) 2.0

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# ECMI/CEPS Task Force Report



## MiFID 2.0: Casting New Light on Europe's Capital Markets



# The MiFID Review

- Extensive Review
- More prescriptive regulation

Mandatory areas	Other areas
<p>Data consolidation</p> <p>Systematic internalisers regime</p> <p>Tied agents</p> <p>Commodity derivatives exemption</p> <p>Requirements for authorisation</p> <p>Gold plating</p> <p>Best execution (data execution quality)</p> <p>Telephone recording</p>	<p>Pre-trade transparency waivers</p> <p>Transparency for non-equity asset classes</p> <p>Transaction reporting (with MAD)</p> <p>Trading venues classification and legal treatment</p> <p>Disorderly markets</p> <p>Selling practices (with PRIPs)</p> <p>Direct market access, algos and HFT</p> <p>Client categorisation</p> <p>Product classification (with UCITS Dir.)</p> <p>Special regime for SMEs</p> <p>Conflicts of interest and inducements</p> <p>Organisational requirements</p> <p>Investment advice</p> <p>Safeguards and asset segregation</p> <p>Post-trade transparency delays</p>



# Agenda

1. Consistency
2. Objectives
3. Timeline
4. Scope
5. Organised trading facilities
6. Financial market data
7. Open access, unbundling
8. Transparency
9. Investor protection
10. Surveillance
11. Efficiency and competition
12. Additional points



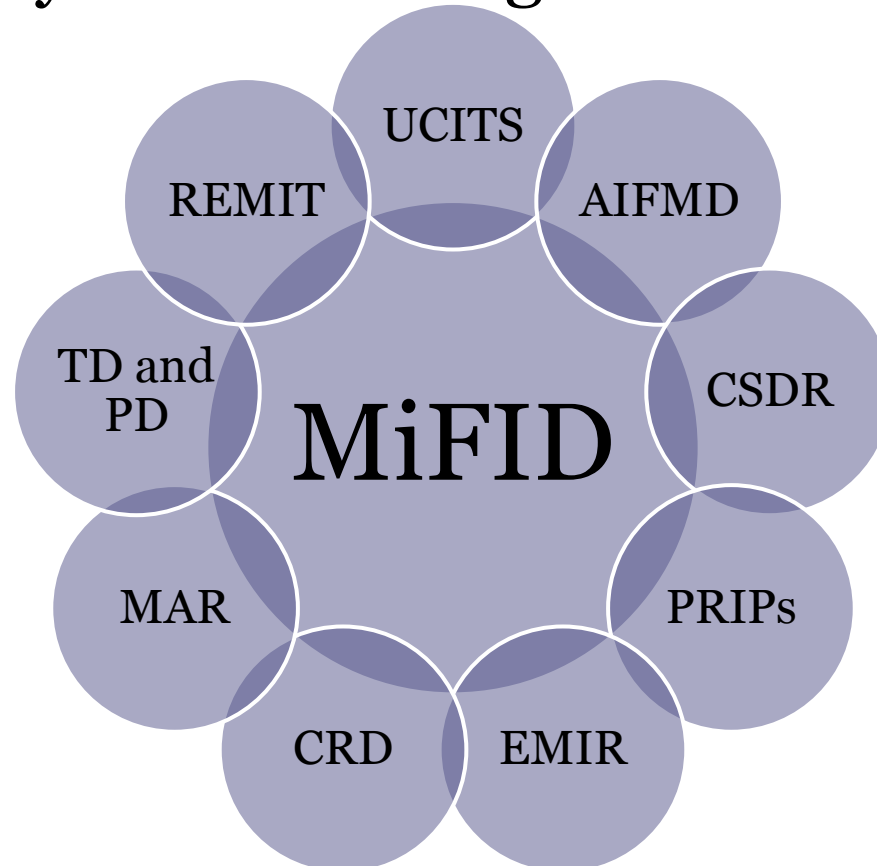
# Consistency

# MiFID 2 and MiFIR

- **MiFID 2**
  - Market structure (RMs-MTFs-OTFs)
  - Exemptions (e.g. commodity derivatives)
  - Investor protection
    - Execution quality
    - Client categorisation
    - Investment advice
  - SMEs regime
  - Organisational requirements
  - Third country regime (branch)
  - Data consolidation (APAs, CTPs)
  - Corporate governance (directors)
  - Supervisory powers (position limits and management; algo trading)
  - Sanctions
- **MiFIR**
  - Transparency (trade and transaction reporting)
  - Open access
  - Trading of OTC derivatives
  - Supervisory powers (coordination role for ESMA)
  - Third country firms without branch

# The MiFID Review (1)

- Consistency with other legislation...



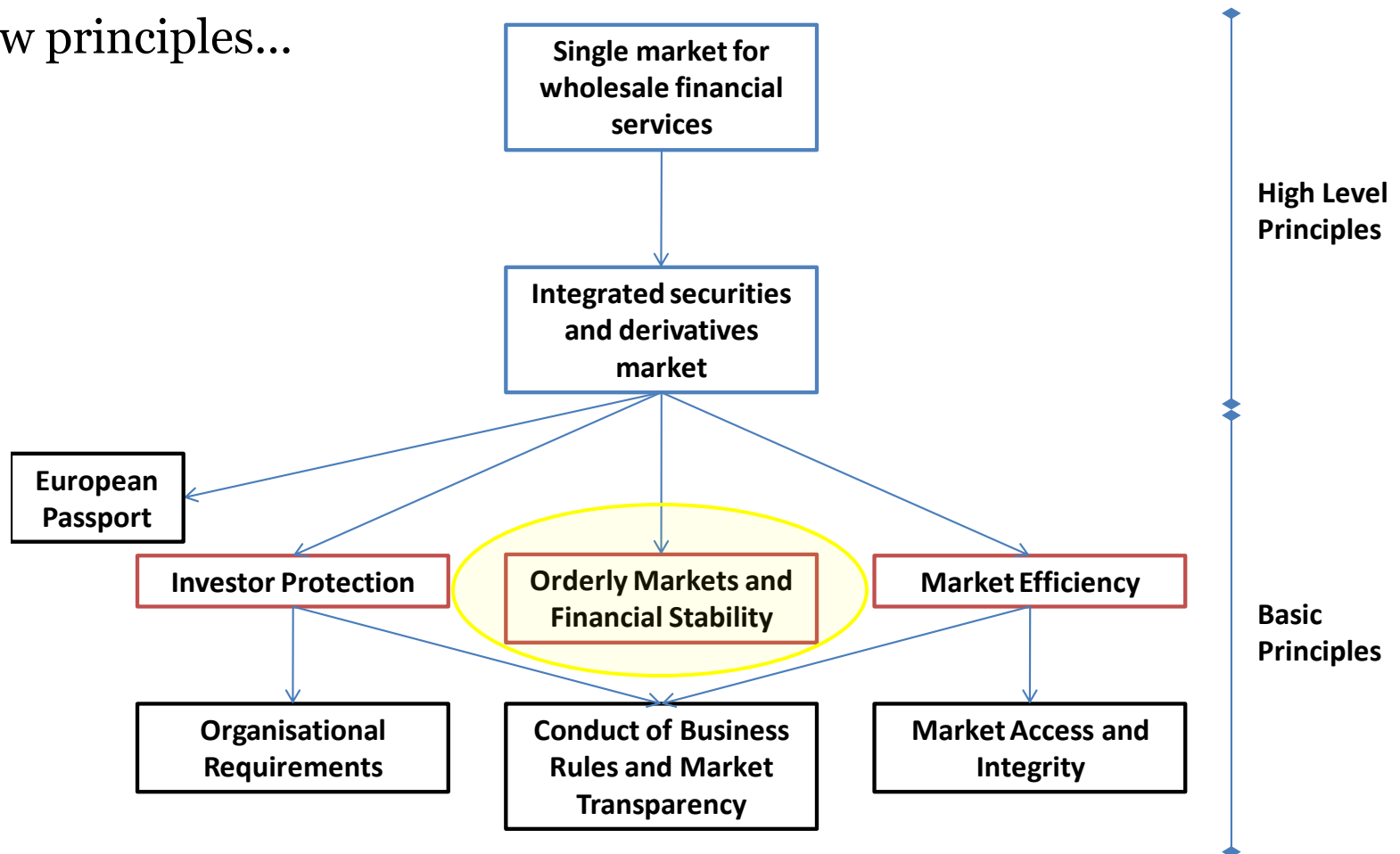


# Objectives



# The MiFID Review (2)

- New principles...





# Timeline



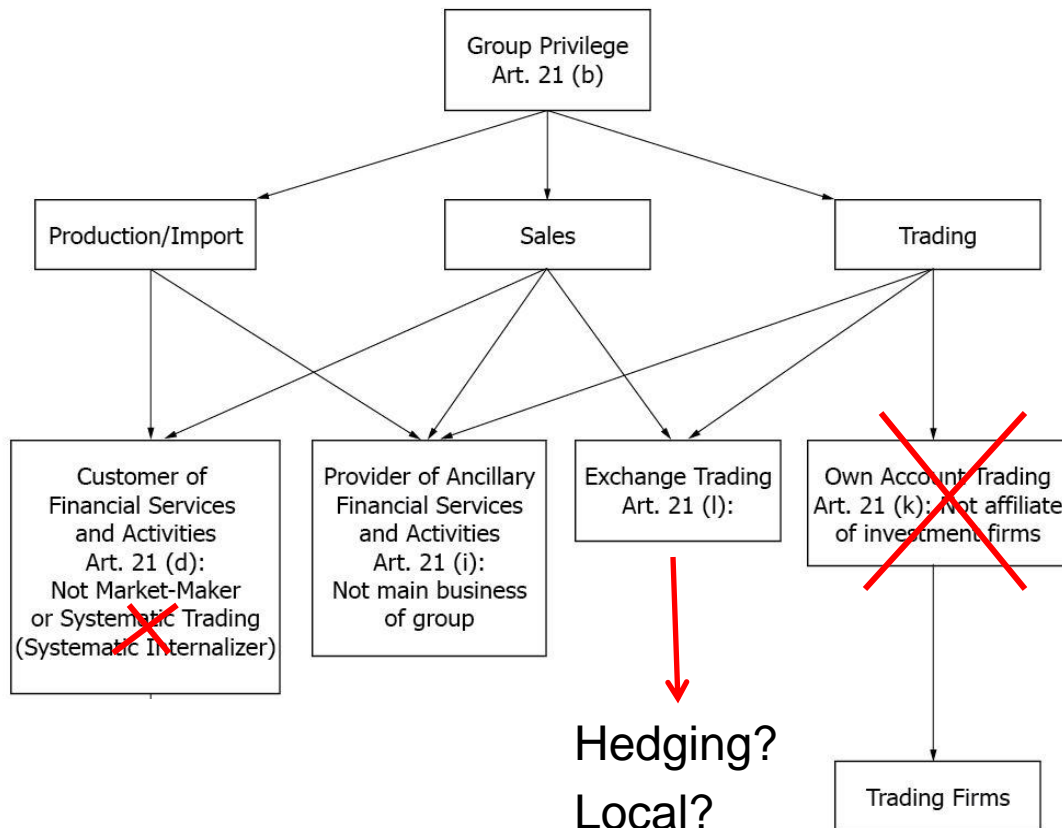
# Timeline

- Level 1 (end 2012?)
- Level 2 (end 2014?)
- Full transposition (end 2015?)



# Scope

# Exemptions



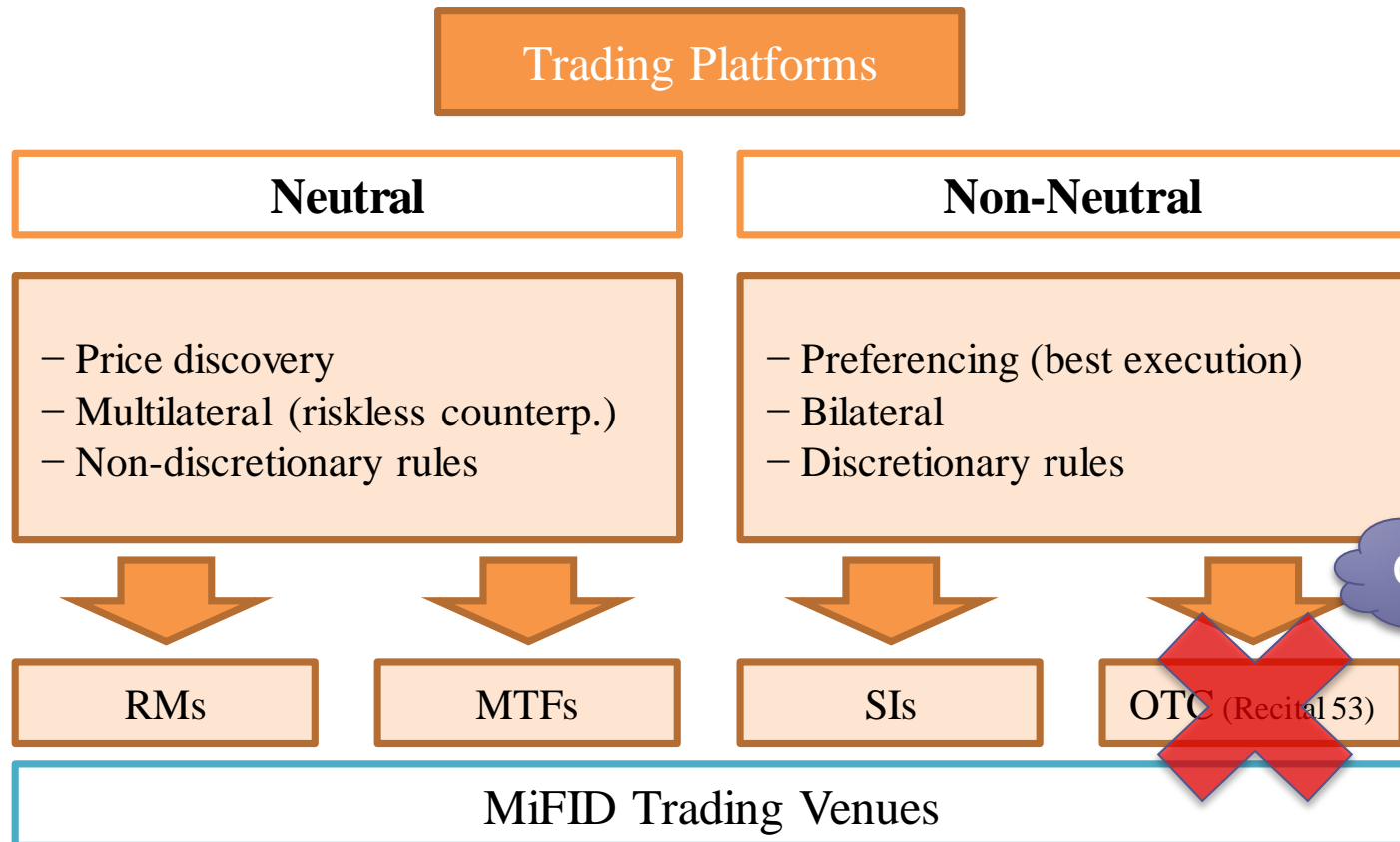
- ‘Trading on own account’ exemptions
  - Hedging (local)
  - Only if done on ‘ancillary basis’
    - Except if member of RMs or MTFs (e.g., some HFT), executing client orders, or market makers
  - ‘Only activity’
    - Except if...
  - Commodities derivatives (removed)
- US exemption for commodities firms?
  - Commodities financial instruments physically settled



# Organised trading facilities

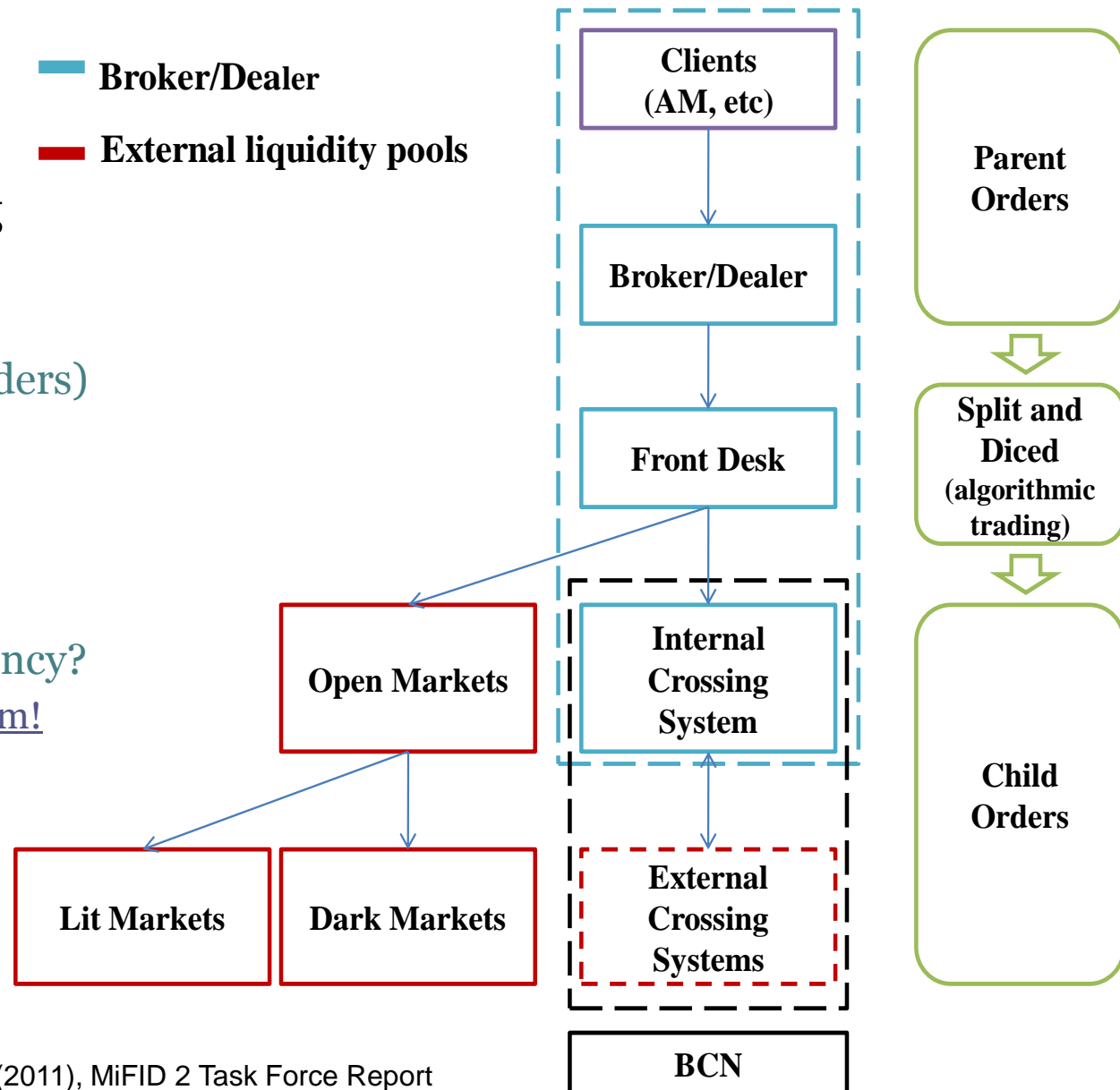
# OTFs

- Venues classification (Recital 6, now 12, New MiFID)



•Source: Valiante (2011), MiFID 2 Task Force Report

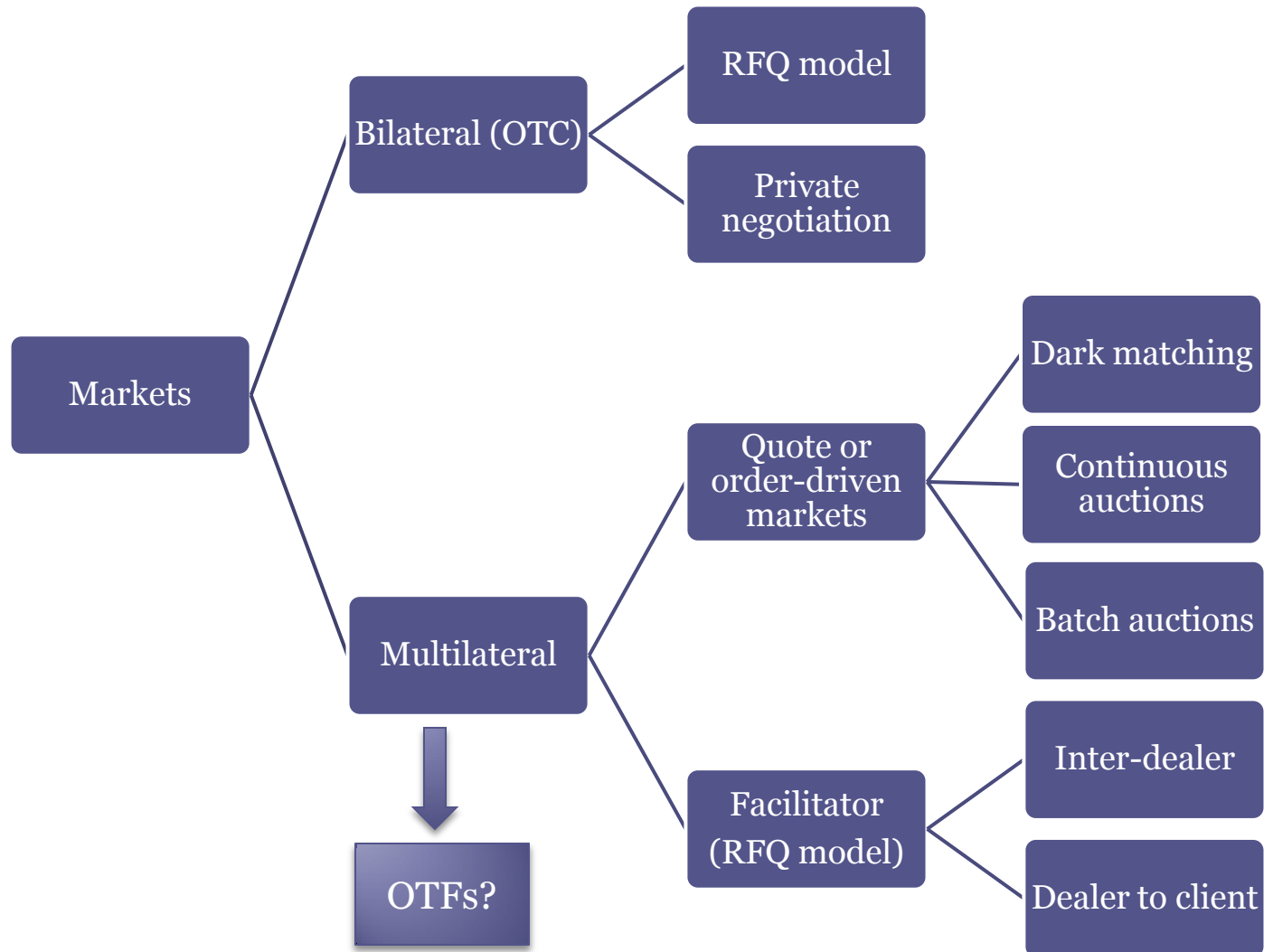
- Broker-dealer crossing networks (BCNs)
  - Below/above SMS ('parent' vs 'child' orders)
  - Data quality and size (1.5% Q1, 2010)
  - Organised platform?
    - Systemic relevance?
  - Pre-trade transparency?
    - Not an auction system!





# Definition

- Organised Trading Facility
  - *“Organised trading facility (OTF)’ means any system or facility, which is not a regulated market or MTF, operated by an investment firm or a market operator, in which multiple third-party buying and selling interests in financial instruments are able to interact in the system in a way that results in a contract in accordance with the provisions of Title II of Directive [new MiFID]” (art.2.7, MiFIR);*
    1. ‘Residual category’ (Rec. 7, MiFIR)
    2. ‘Multilateral trading’/’Neutral’ → riskless counterparty → no matching against proprietary capital...
    3. ...but ‘discretionary execution’ (Rec. 8 MiFIR) and application of fiduciary duties ...
      - Execution services = Matching services (operation)





# OTFs

1. What does 'discretion' really mean?
  - Is 'discretion' referring to membership rights, so 'discriminatory access'?
  - SEF≠OTF
2. Bad OTC equity trade reporting
  - Double counting and misreporting
  - Size?
    - 38-40% (FESE) or 15-20% (AFME)
  - APAs?
    - Parent/child orders ambiguity in MiFID I
3. 'High quality of execution' principle (recital 5, MiFID I)? → choice!
  - Upstairs Trading → MTF dark trading or SI + MTF?
4. Derivatives and bond trading platforms → OTFs?
  - Can current MTF definition capture their business model?
  - What should the role of brokers be?



# Financial market data

# Financial market data

- Consolidated tape providers
  - Data vendors and exchanges
  - Intellectual property rights?
- Ban of cross-selling practices (CSPs)?
  - To reduce costs?
  - Are CSPs always bad? → per se prohibition?
  - Beyond transactions concerning financial instruments!
  - Supervisory issue (competition policy)?



# Open access, unbundling and interoperability

# Open access, unbundling and interoperability

- Access to infrastructures (after the Code)
  - Competing networks (accessibility)
- Unbundling (cross-selling practices; art. 11-12, MiFIR)  
→ ESMA?
- Interoperability in derivatives clearing? → EMIR?
- (Reverse) Open access (complementary to EMIR; art. 29-30, MiFIR)
  - For listed derivatives too?
    - Trading and clearing
  - How do you define 'benchmarks'?
- Who is the competent authority?
  - National financial/competition authorities
  - DG COMP and MARKT interaction



# Transparency



# Transparency

- **Waivers**
  - ‘Calibration needs to be improved’
    - Qualitative definition and quantitative application
    - ESMA already issued its opinion
    - Disagreements among authorities
- **Non-equity asset classes**
  - ‘Liquidity measures’ (frequency of trades, etc.)?
  - Waivers?



# Investor protection

# Investor protection

- Best execution
  - Obligation of ‘results’ or ‘means’? (art. 24, MiFID II)
  - Execution quality data
    - Trading venues (quality of execution)
    - Investment firms (top 5 venues)
  - Execution policy
- Investment advice
  - ‘Independent’
- Product classification



# Surveillance

# Surveillance (1)

- Algorithmic trading
  - Algo trading does not include routing and confirmation systems → proprietary trading
  - HFT is a subset of algo trading (Rec. 44, MiFID II)
    - Always ‘automated’?
  - Automated trading?
- Surveillance on algorithmic trading (art. 17.2, MiFID II) → ex ante
  - Are regulators able to supervise algos?
    - Can ex-ante control work for disorderly markets? (e.g., flash crash)
  - Market makers? (art. 17.3, MiFID II)
    - ‘Continuous operation’ for RMs/MTFs/OTFs members

## Surveillance (2)

- Harmonised emergency procedures → ex post
  - Circuit breakers (art. 51, MiFID II) → only RMs and MTFs? (Rec. 48, MiFID II)
    - OTF, only if algo trading
  - Slow down trading and minimum tick size

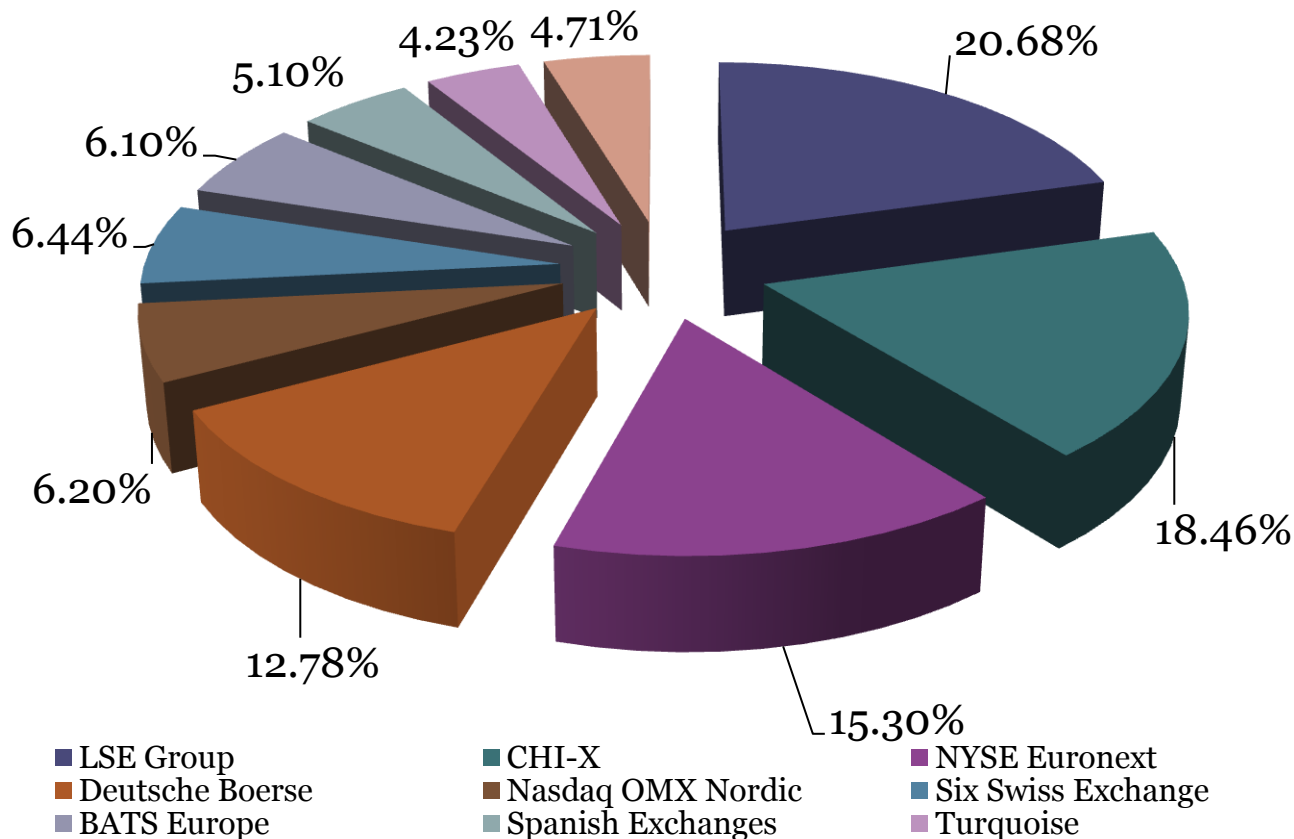


# Efficiency and competition



## Greater competition...

- Roughly 30% is pan-European trading...



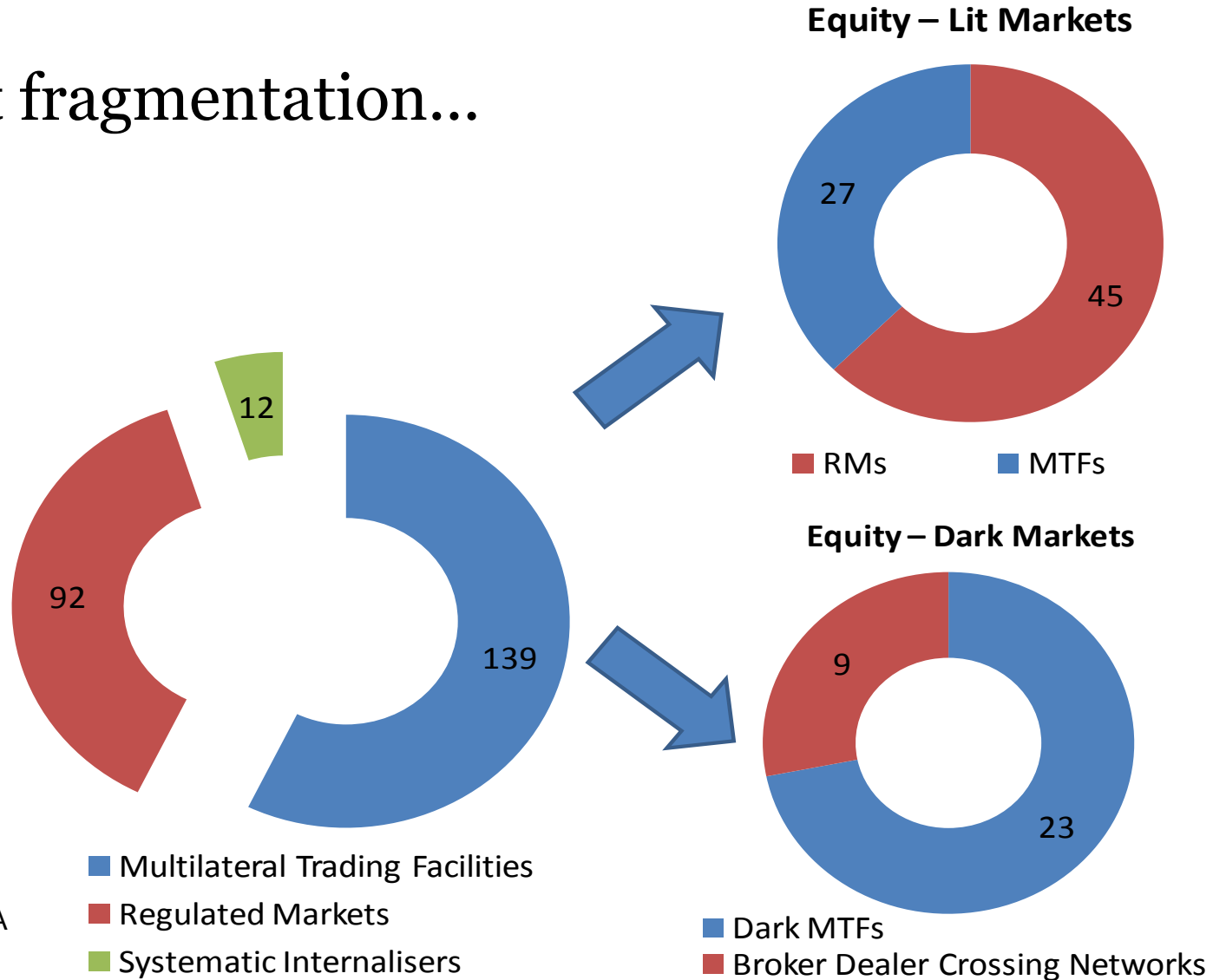
London	22.385%
Frankfurt	16.474%
Paris	15.646%
Milan	9.652%
Zurich	8.443%
Madrid	6.752%
Amsterdam	6.318%
Stockholm	5.409%
Oslo	2.377%
Helsinki	2.065%
Copenhagen	1.128%
Brussels	1.119%
Lisbon	0.467%
Vienna	0.366%
Others	1.399%

Source: BATS Europe, Thomson Reuters (Jan-Dec 2010, % turnover; lit and auction books).

•Source: BATS Europe, Thomson Reuters, FESE (August 2011 [YTD]); % total turnover, lit, auction, and dark order books and hidden orders).

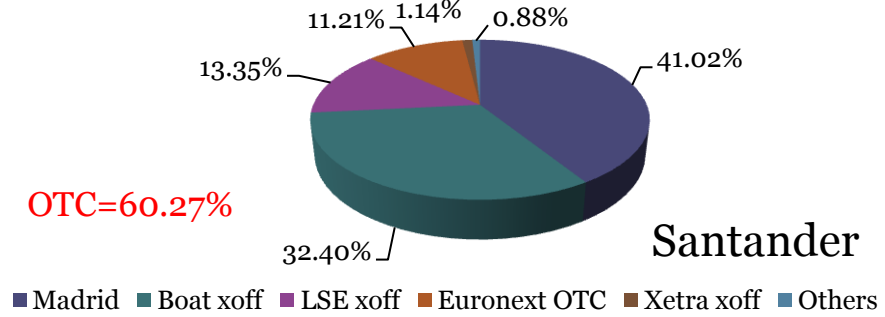
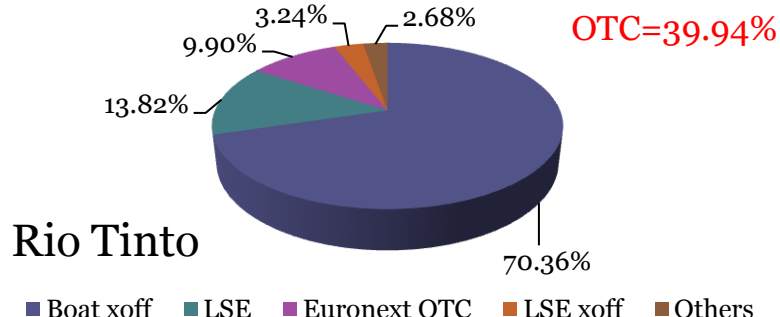
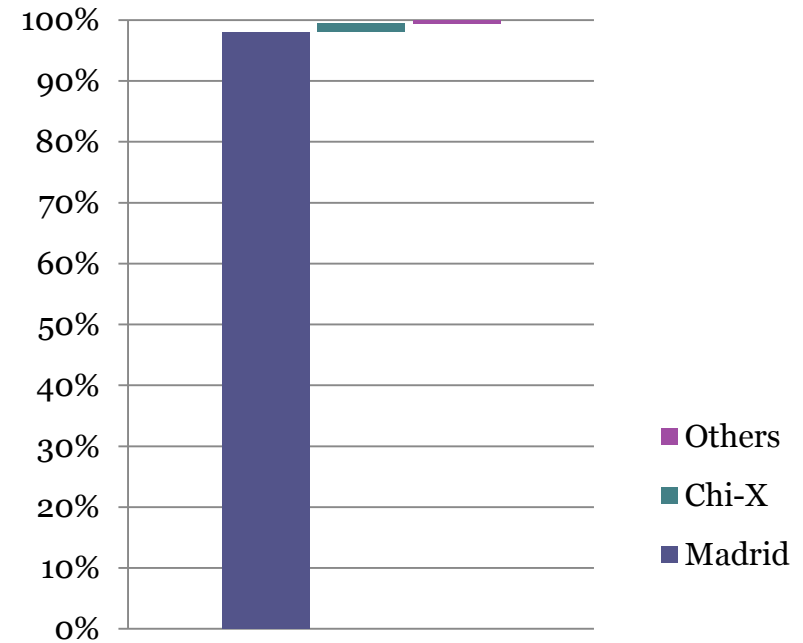
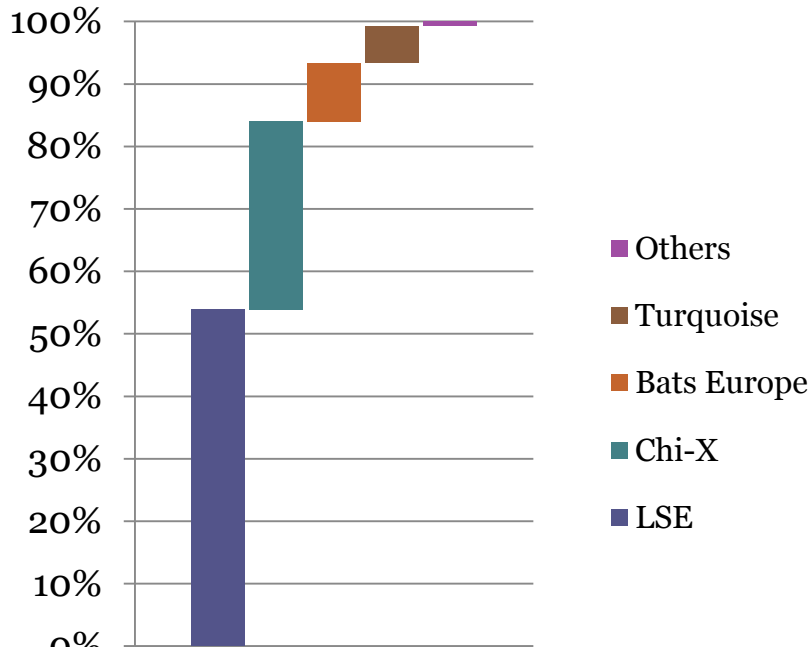


# Market fragmentation...

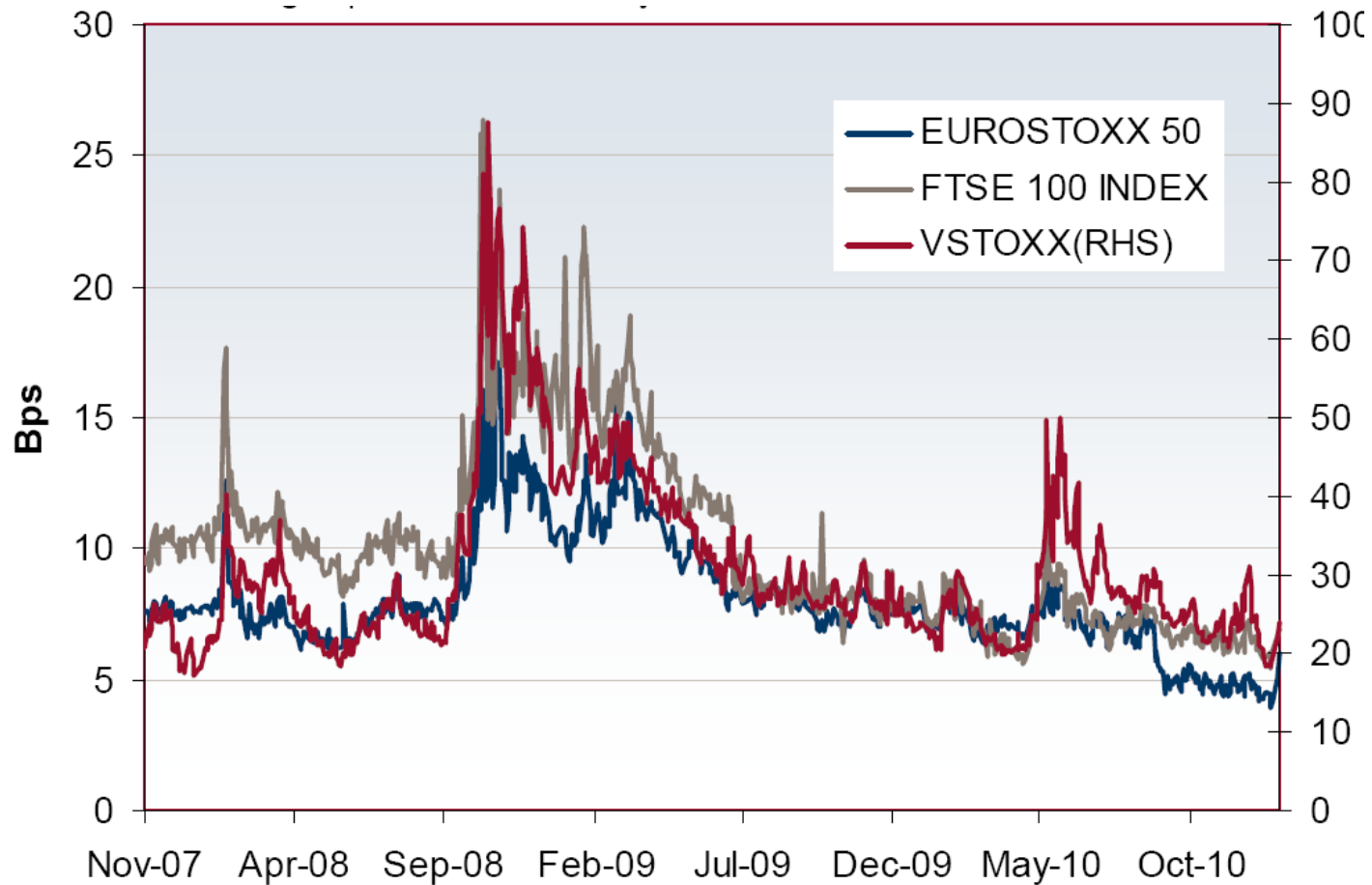


# UK vs. Spain (Sept. 2011, YTD)

•Source: Fidessa Fragulator



## • Declining spreads?



Source: Credit Suisse AES Analysis, Nov 1, 2007 to Dec 30, 2010; Credit Suisse (2011).



# Additional points



# Additional points

- SMEs growth markets
  - What are they?
- Trading obligation for derivatives
  - If exceeding clearing threshold
  - Eligibility criteria?
- Third country equivalence?
  - Retail and eligible counterparties
- Position limits and management
- Ban of financial instruments
  - By ESMA too (Treaty?)
  - MiFIR!
- Sanctions
  - Harmonisation through ESMA guidelines?
- Corporate Governance

# Thank you!

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# Definitions - Liquidity

- A market is liquid when ‘is almost infinitely tight, which is not infinitely deep, and [...] resilient enough so that prices eventually tend to their underlying value” (Kyle, 1985, p. 1317). Three aspects emerge from this definition:
  1. (i) **Tightness** (which is the possibility to turn over a position at the fastest speed technically possible, when needed);
  2. (ii) **Depth** (which refers to the ability of the market to absorb quantities without having a large effect on price; it is usually not constant over time in some asset classes); and
  3. (iii) **Resiliency** (which is the speed to which prices return to their fundamental value after a move due to regular trading or – with more intensity – to external shocks).