

## EPFSF Briefing “MiFID implementation”

On 1 November 2007, the Markets in Financial Instruments Directive, the so-called MiFID<sup>1</sup>, along with its European implementing provisions<sup>2</sup> and national implementing measures, entered into force in the 30 EEA States, replacing the Investment Services Directive (ISD). The ISD, adopted in 1993, was the first piece of legislation which sought to develop a European regulatory framework for investment services.

MiFID goes further in advancing the integration and development of EU financial markets by setting up a more comprehensive and homogeneous regulatory framework. It aims to cope with, and further enable, the increased level of cross-border investment transactions. It is one of the most important and challenging reform projects in the financial sector set to overhaul regulation of EU financial markets with a view to enhancing the competitiveness of EU investment services industry in today's increasingly globalised markets and boosting the EU's economy.

### **The difficult path to MiFID's implementation**

MiFID introduces a wide spectrum of new and innovative requirements oriented towards three major objectives: fostering competition, increasing market efficiency and improving investor protection. The resulting new framework implies in practice a double-faceted reality for the financial industry. On the one hand it introduces more opportunities by allowing new competition among financial intermediaries at all steps of a security's transaction cycle, from the provision of investment advice to the practical execution and settlement of the transaction. On the other hand, it imposes more constraints on firms by providing for increased transparency and information requirements as well as for a strengthened investor protection regime.

This overhaul has required a considerable mobilisation of time and resources both by Member States to transpose the MiFID provisions into national legislation and by the financial industry to comply with the new rules. MiFID has entailed important changes in the way markets players conduct business, involving significant financial investments. To put into place the procedures and processes required by MiFID, banks and investment firms had to substantially review their organisational and reporting structures as well as to adapt and upgrade their IT systems as MiFID requires an incremental storage of data. Moreover they had to devote extra resources for retraining staff and testing their MiFID compliance programmes.

In view of the scale and complexity of the changes involved, and delays in finalising implementing measures, the Commission decided in June 2005 to modify the original timetables, delaying the deadline for transposition of MiFID by Member States from April 2006 until January 2007. Similarly, firms and markets have had an extended period until November 2007 (originally April 2007) to make their organisation and procedures compliant.

### **MiFID's implementation complicated by transposition delays**

Despite the deadline extension - as shown by the European Commission's 'MiFID transposition state of play' table<sup>3</sup> - only three Member States were able to meet the new transposition date of 31 January 2007 and, on 1 November 2007, still five Member States had not fully complied with their transposition obligations.

<sup>1</sup> Directive 2004/39/EC of the European Parliament and the Council of 21/04/2004 (OJ L 145, 30.04.2004).

<sup>2</sup> Commission Directive 2006/73/EC of 10/08/2006 implementing Directive 2004/39/EC with regard to the organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive (OJ L 241, 2.09.2006) and Commission Regulation (EC) No 1287/2006 of 10.08.2006 implementing Directive 2004/39/EC as regards record-keeping obligations for investment firms, transaction reporting, market transparency, admission of financial instruments to trading, and defined terms for the purposes of that Directive (OJ L 241, 2.09.2006).

<sup>3</sup> [http://ec.europa.eu/internal\\_market/securities/isd/mifid\\_implementation\\_en.htm](http://ec.europa.eu/internal_market/securities/isd/mifid_implementation_en.htm)

Today, transposition is still awaited from two Member States. These delays in transposition have considerably shortened the time span available to firms to adapt to MiFID new requirements, putting additional pressure on the financial industry. They have also resulted in potential difficulties, legal uncertainties and competitive disadvantage for firms located or operating in these Member States.

Nevertheless, on the whole, the effects of these delays on the wider market should be minimal since the Member States that are most active in financial markets have all transposed the Directive. Furthermore, to ensure business continuity and minimal disruption in cross-border business to be possibly caused by late transposition of MiFID, a number of measures<sup>4</sup> were set out by CESR<sup>5</sup> aimed at smoothing MiFID's implementation. In this vein, CESR issued amongst others practical arrangements allowing firms from late transposing countries to continue using 'passports' granted under the ISD.

### **Major changes following MiFID implementation**

**Abolition of the "concentration rule":** Member States can no longer require investment firms to route orders only through regulated markets. Exchanges are now exposed to competition of two additional types of trading venues: Multilateral Trading Facilities (MTFs) and Systematic Internalisers (SIs). MTFs and SIs – of which so far not many exist - are subject to separate rules intended to meet similar pre- and post-trade transparency requirements as the exchanges. In choosing among trading venues, the intermediary is obliged to comply with a new set of best execution rules. These measures are intended to ensure a level playing field between the exchanges and their new competitors that should favour the emergence of a more integrated and competitive trading infrastructure. The MiFID leaves the consolidation of data to market forces.

**Updated and expanded "single passport":** To keep pace with new market realities, MiFID extends the list of services and financial instruments that can be 'passport' across the EU on the basis of a single authorisation from the home Member State. These include for instance the provision of investment advice, the new activity of operating an MTF, or investment services and activities relating to derivative instruments, including commodities-related products. Moreover the use of the passport is further facilitated by the more thorough application of the principle of the exclusive application of home country regulation in the free provision of services and by the ban on host country regulators to impose additional requirements on EU foreign financial services providers.

**New investor protection regime:** Investor protection rules are strengthened and harmonised at high level so that investors can feel confident that they enjoy the same level of protection in using the services of investment firms, wherever those services originate in the EU. The elimination of overlapping requirements from the country of the investor gives investors access to a broader choice of investment service providers and, consequently, to a wider range of services and products. In return, investment firms are expected to comply with conduct of business rules on suitability, appropriateness, best execution, and acting in the best interests of the investor. Altogether this should attract new investors to EU capital markets and, more particularly, increase the participation of retail investors in capital markets.

### **Challenges following MiFID implementation**

Since its entry into force, MiFID's implementation appears to be a source of concerns for the industry on two major grounds: first, delays in adopting MiFID Directive have left some firms ill-prepared forcing them to quickly adapt to the new rules; second, firms which are making important efforts in order to be compliant with the new framework, may be now facing new difficulties due to Member States' possible different interpretations, or gold-plating, of some provisions. The Commission's role in this context will be of utmost importance in enforcing proper implementation of the Directive, as will CESR's promoting regulatory convergence.

<sup>4</sup> CESR's Statement of 22.10.2007.

<sup>5</sup> CESR – Committee of European Securities Regulators.

Indeed, a major challenge in tackling MiFID implementation comes from the fact that MiFID consists of a mixture of both fixed rules and more general principles. On one hand, MiFID seeks to ensure maximum harmonisation of transposition provisions<sup>6</sup>. On the other hand, it leaves firms a certain room for manoeuvre to meet their compliance obligations. Terms such as 'adequate', 'effective', 'sufficient' or 'appropriate' give firms the proper flexibility to design solutions that best fit their business and organisation. It is important that firms can do this without being constrained by Member States possibly diverging and restrictive interpretation of these terms, that would put MiFID's level playing field at risk.

Today however, eight months after MiFID's entry into force, it is still premature to assess possible significant discrepancies in Member States interpretation of MiFID's provisions. So far, the main challenge seems to be the profoundly innovative character of MiFID, which introduces a wide range of new requirements in many Member States - such as "best execution" and post-trade transparency rules - that require some time to be fully digested by firms as well as properly embedded in their culture. The degree of consistency in the supervision of these rules also remains to be seen. Another challenge lies in MiFID's complexity that has prompted the Commission as well as CESR to create a MiFID Q&A facility to address the numerous practical questions arising in MiFID implementation and help firms integrating as easily as possible the new complex rules in their daily business. In this respect, a clarification of the status of CESR's MiFID Q&A as well as its interaction with the Commission's MiFID Q&A is urgently needed.

## **Conclusion**

MiFID is far from being a "one-shot" reform, but rather a lengthy and complex process. Adapting to new regulatory requirements is never easy and MiFID implementation is particularly challenging given its wide-ranging scope and numerous innovative provisions.

Likewise the full impact of MiFID on the architecture of European financial markets and the financial services industry will only become tangible over time and so will the real consequences and changes in the market dynamics.

Today, there are still lots of details to work out and implementation will require continued efforts, especially to examine the impact of any discrepancies and inconsistencies in national interpretation and application of the MiFID.

There is no doubt however that MiFID has the potential to create new opportunities for markets players and to significantly foster financial market efficiency by injecting fresh competition as well as to yield substantial progress in market integration and transparency. In this respect, the ability to reap the full benefits from MiFID will clearly depend on its effective and homogeneous implementation. To that end, it is crucial to ensure consistency of approach by Member States as well as increased cooperation between securities regulators and continuing convergence of supervisory practices.

This is also important from the perspective of broader transatlantic and international capital markets integration. MiFID will be a central directive in the comparability assessment of trading and investment rules between Europe and the US in the context of the discussions on mutual recognition. A consistent approach to MiFID implementation will play a significant role in the successful outcome of these discussions.

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<sup>6</sup> Art. 4.1 of Dir. 2006/73/EC provides that "Member States may retain or impose requirements additional to those in this Directive only in those exceptional cases where such requirements are objectively justified and proportionate so as to address specific risks to investor protection or to market integrity that are not adequately addressed by this Directive (...) and subject to two conditions."

Briefing notes are prepared by the Financial Industry Committee to the European Parliamentary Financial Services Forum. For further information on the subjects raised in the briefs please contact the Chairman, Members or Secretariat of the Financial Industry Committee.

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