

EPFSF Lunch Discussion

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MiFID Implementation

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Good Afternoon Ladies and Gentlemen

Introduction

I am very pleased to have been invited here today to speak about some aspects of MiFID implementation we at Citibank have found either interesting or challenging, or both. In the time allotted I should like to concentrate on the impact of MiFID on post trade transaction services, and in particular, the clearing and settlement industry. As well as taking a look at how MiFID has changed the clearing and settlement landscape, I should like to dwell also on the new outsourcing regime and the impact it has had on the provision of post-transaction services.

Before I begin I should perhaps say a few words about my role at Citibank and the particular business area I cover.

I am the head of legal for the EMEA region of the Global Transaction Services division of Citi - known as GTS.

GTS provides a full range of post trade transaction services, including: custody, clearing, cash management, securities financing, funds administration and trustee and fiduciary services. We provide these services on a multi-jurisdictional basis and have a presence in 22 EEA States. It is probably worth mentioning that many of our clients are themselves regulated as investment firms, and have themselves been engaged in major MiFID projects.

Citi's approach to MiFID compliance

First, it may be helpful if I set the scene by briefly explaining the approach we took to ensure that we were MiFID compliant by the transposition deadline. Our MiFID campaign commenced about a year and a half before the Directive was due to come into force. We began by identifying the areas of the firm's business which would be affected by MiFID. Citi was committed to investing in the exercise and the project, chiefly led by the Legal Department, devoured man-hours, legal and technology spend and cross border co-ordination. The remarkable features I would highlight are:

- How we had to approach MiFID from the perspective of principally 1 or 2 regulators' contributions to the exercise. Had we worried about local issues and gold plating we would not have been able to develop the pragmatic approach we ended up with – this was an exercise in arriving at Pan-EU best practices and financial institutions HAD to cross borders and harmonise.

- We end up with no major issues with any of the production charges for technology, process or policy.
- The project involved a major communication effort across the firm with its clients. It was completed but I wonder how much of a tit-for-tat paper trail this actually became as institutions simply swapped paper with each other.
- The task was complicated by late transposition of MiFID in some jurisdictions local businesses insisted on “reserving their rights” became to revisit issues and as such once country legislations became clearer. There is still no way of knowing whether a “late Member State” will impose obligations different from or additional to MiFID. We take comfort in the fact that we had done our utmost to ensure that in Member States where MiFID had been transposed our contracts and procedures were fully compliant. We now await further information from the “late Member States” before finalising a position on any new detailed country-specific changes.

Impact of MiFID on the clearing and settlement landscape

Looking at how MiFID has affected the clearing and settlement landscape on a macro level, one particular point of interest for us is the development of new trading platforms such as Turquoise and Chi-X. These new platforms have taken advantage of a new MiFID animal - the multilateral trading facility. A leaner and less burdened beast which can take on the established exchanges. This is one area where you can see MiFID actually succeeding in opening up the market and encouraging competition between the old guard exchanges and the new MTFs.

These innovations have also had a real knock-on effect on the services which our broker-dealer clients require. The new MTFs have led to new central counterparties (CCPs), which have in turn created a need for new settlement and clearing services for clients accessing these platforms. Our clients who are trading on these new MTFs may need to engage a general clearing member who can clear their trades when they are novated to these new CCPs. And for settlement, we have developed our services to accommodate clients self-clearing through these CCPs.

These innovations have increased the demand on Citi to provide liquidity and credit to consumers of post-trade services - which is an interesting prospect in these times.

Outsourcing

I believe the most challenging aspect of the new regime for us as providers of transaction services has been the new outsourcing rules. The GTS business identified the MiFID outsourcing regime as an influencer on the way we did business in future. We therefore carried out a review of all our service contracts and we have developed a principles based best practice approach to outsourcing. Issues have arisen where our customers have identified certain services as outsourcing where we do not. This is a significant issue due to the additional regulatory requirements imposed on outsourced services. MiFID has actually introduced uncertainty about when a transaction is an outsourcing and this can slow the negotiation stages and adds to the costs of doing business.

For example, I do not think that anyone would contend that every single service contract is an "outsourcing", but where do you draw the line? Is the provision of custody services, or clearing, or settlement services, an "outsourcing"? We don't think so. But it is unfortunate that MiFID does not contain a clear definition of what is an outsourcing, as this would limit possible confusion and unnecessary cost on both the providers and recipients of services which may be misinterpreted as outsourcing.

The MiFID Legacy - will it bring down costs of post-trade services?

As you know, there is a good deal of concern about the costs of post-trade services in Europe. Now the dust has settled and we can stand back and take stock of the MiFID legacy for clearing and settlement - what difference has the Directive made? It has certainly opened up the availability of more trading platforms, and this will have a knock-on effect on the cost of trading services, but we do not see that the Directive is likely to deliver a significant cost reduction in post-trade services.

MiFID is not, nor was it intended to be, a directive to revolutionise clearing and settlement services. There is other legislation in the pipeline which may have some effect - in particular, you will be aware of the proposed changes to the Settlement Finality Directive and the Financial Collateral Directive - but these are likely to have only minimal impact. Rather more important are the so-called "soft law" developments.

These may well have greater impact on post-trade costs. By soft law we mean developments which are not based on national or international legislation, but developments and rules stemming from industry organisations and codes of conduct. These include the Code of Conduct for clearing and settlement which addresses price transparency, market access and unbundling in the equities markets.

Also of significance, once it finally gets off the starting block, will be the Unidroit Code of laws to establish the rights of investors whose securities are held indirectly. We think this is a very important measure. Many of the barriers identified by the Giovannini reports are legal in nature and stem from the differences between national laws on securities held in accounts. We believe that harmonising these laws will go a long way towards reducing legal uncertainty and thereby reducing cost for customers.

And of course we shouldn't forget Target-2 Securities, which is a step in the right direction towards harmonising the too fragmented settlement infrastructures throughout Europe.

Together, these measures, provided they can be effectively implemented, may actually bring down the Giovanni barriers, and if MiFID is the catalyst to get this going, then good for MiFID - outsourcing issues notwithstanding!

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