

The FSA Approach to Implementation

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Agenda

- MiFID now transposed in the UK
- What has been our implementation approach?
- What are the costs and benefits of MiFID?
- The role of industry guidance
- What are the key changes to Markets?
- What will be the impact of those changes?

MiFID now transposed in the UK

- 31 January – transposition deadline met
- 26 January – PS07/2, “Implementing the Markets in Financial Instruments Directive” published
- 26 January – PS07/3, “Reforming the Approved Persons Regime” published
- 24 January – Treasury changes to FSMA and secondary legislation made

What has been our implementation approach?



- “Intelligent copy-out” of Directive requirements
- Not sought to “gold-plate” or introduce super-equivalent Rules unless justified and by satisfied cost-benefit analysis

Costs and benefits of MiFID

- One-off costs of some £900m - £1.2b for firms
- Ongoing costs of £100m per year
- Most sizeable MiFID-related compliance costs arising from client categorisation, best execution, introducing the appropriateness test, and systems changes required by market transparency provisions
- Benefits of up to £200m per year

Industry Guidance

- **DP06/05, FSA Confirmation of Industry Guidance published in November**
- **Proposals for ‘confirmation’ of guidance**
- **Three possible types of recognition:**
 - Safe-harbour
 - Sturdy breakwater (preferred option)
 - Implicit recognition
- **Sturdy breakwater:**
 - No FSA action against firm
 - No effect on rights of third parties
 - No legal need to follow statutory processes

Industry Guidance (2)

- MiFID Connect have published guidelines on:
 - Suitability/appropriateness
 - Outsourcing
 - Investment research
 - Conflicts of interest
 - Best Execution

What are the key changes to Markets?



- Rules for RMs and MTFs
- Transparency regime
- Systematic Internalisers
- Data consolidation
- Transactions reporting
- Best execution

- **Regulated markets (RMs)**
 - MiFID’s authorisation and ongoing requirements for RMs extend and deepen previous ISD requirements
 - Commodity derivatives exchanges will be eligible to be RMs
 - MiFID ends ability of MS to require certain transactions to be executed on an RM (the “concentration” rule)
- **Multilateral Trading Facilities (MTFs)**
 - Operating an MTF becomes a regulated and passportable activity under MiFID
 - MTFs can be operated by investment firms or RMs
 - Commodity MTFs are carved out until as late as 31 Dec 2010

Markets - transparency regime

- MiFID creates new comprehensive EU-wide pre- and post-trade transparency regime
- For trades in shares admitted to trading on an EU RM, whether executed on an RM, MTF or OTC
- Pre-trade details differ according to trading venue and methodology
- Post-trade details same across all venues

Markets - systematic internalisers

- Investment firms which, on an organised, frequent and systematic basis, deal on own account by executing client orders outside an RM or MTF
- FSA proposing direct “copy out” of Directive requirements
- Obligations in respect of liquid shares:
 - Publish a firm quote in respect of any share (admitted to trading on a RM) that is deemed to be liquid
 - SIs choose the size or sizes in which they quote
 - Quotes must reflect prevailing market conditions
 - N.B. the SI obligation to quote only applies when dealing for sizes up to SMS

Markets - systematic internalisers (2)



- **Liquid shares and standard market sizes:**
 - 500 European liquid shares (of which around 140 might be UK shares)
 - Shares to be divided into SMS bands from €7,500 to €80,000
- **Executing client orders:**
 - Ability to price improve for orders bigger than €7,500 if dealing with professional clients
 - Fully-matched back to back trading does not amount to dealing on own account; therefore falls outside the SI regime

Markets – data consolidation

- MiFID aims to increase competition between trading venues
- Also gives investment firms more choice over where to publish post-trade data
- Publication arrangements to meet certain criteria
- CESR has also agreed guidance in this area to promote data consolidation

Transaction reporting

- **Transaction reports play key role in detecting market abuse and protecting market integrity**
- **Under MiFID:**
 - all transactions in instruments admitted to trading on an RM to be reported. UK regime thus will extend to include commodity, interest rate and foreign exchange derivative contracts
 - reports to be made electronically and contain specified fields
 - firms will report to their local regulator rather than the regulator of the market

Transaction reporting (2)

- **To further underpin integrity of UK markets and strengthen ability to counter market abuse, FSA proposing additional requirements:**
 - To report other transactions, in particular OTC derivatives and CFDs
 - For the report to identify the client on whose behalf the transaction was executed

Best execution

- **FSA objective: to implement MiFID compliantly and with maximum flexibility for firms to operate their preferred business models**
- **Concerns about getting a sensible approach in quote-driven markets are well understood**
- **Awaiting feedback from the European Commission on scope, including in quote-driven markets**
- **Meanwhile, 2 February CESR consultation paper on common approaches to:**
 - the execution policy and arrangements;
 - relative responsibilities in a chain of execution;
 - review and monitoring of execution performance; and
 - disclosure
- **See http://www.cesr-eu.org/index.php?page=consultation_details&id=86**

Market impact

- **Main channels likely to be:**
 - Greater competition between trading platforms
 - Impact of new transparency regime on liquidity and spreads
 - Greater competition for trading data

Market impact (2)

• Trading platforms

- Limited implications for the competition between RMs, as the UK has a relatively, open and competitive environment for exchanges
- RMs may need to respond to competitive threats from MTFs and SIs
- MTFs may be able to compete more effectively with other trading venues, as EU-wide access facilitated
- Allowing investment firms to compete more directly as execution venues will impact those countries with concentration rules
- Less so for the UK which already has a relatively high degree of internalisation
- There are already signs that the exchanges are planning to respond to the challenge of more competition

Market impact (3)

- **Pre-trade transparency**

- Little change for trading on order-book, quote-driven and hybrid systems

- **Post-trade transparency**

- new block trading regime and requirement to publish non-UK share transactions
- New thresholds for block trade delays may decrease transparency

- **Impact on spreads and liquidity may be limited**

Market impact (4)

- **Costs of post-trade reporting will fall**
- **Effective consolidation arrangements should mean cost of data falls in medium term to long term**

Further information on MiFID implementation

- **FSA website:**
 - www.fsa.gov.uk
- **HM Treasury:**
 - www.hm-treasury.gov.uk
- **CESR**
 - www.cesr-eu.org
- **MiFID Connect:**
 - www.mifidconnect.com