



MiFID: an opportunity for reform

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This presentation reflects the author's views on the MiFID review. Though they are naturally in line with CESR's positions, CESR is not liable for comments and opinions conveyed. Moreover, certain issues were not the object of CESR's formal positions. Where comments are made on such issues, they are printed in grey.

MiFID: three years on

Time to look backwards and forward

- **Implementation during an extremely severe crisis**
- **Could MiFID have prevented risks that triggered the crisis?**
 - Probably not alone and in its current shape
 - Probably so with appropriate reform and if combined with other reforms
- **Crisis also contributed to drawing lessons for MiFID's review**



MiFID's central objectives

- **To promote competition between trading venues**
- **To foster markets' transparency and efficiency**
- **To strengthen investors' protection**



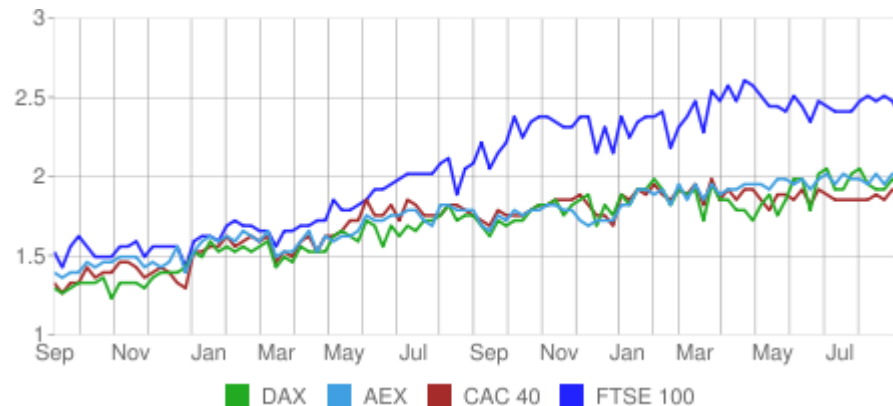
MiFID's central objectives (cont'd)

- **Means to achieve these objectives entailed risks that were to be mitigated through several mechanisms.**
- **Some anticipated risks did materialize and were not sufficiently addressed by mitigating mechanisms.**

Market fragmentation did increase

- **Rapid emergence of alternative trading platforms and growth of broker crossing systems (OTC-like trading).**
- **Regulatory arbitrage: non-harmonized requirements between regulated markets and MTF.**

Fidessa Fragmentation Index (Sept 08-10)



Source: Fidessa



Did fragmentation increase liquidity?

Some observations may point into that direction, however:

- **Prices of alternative venues often referred to regulated market prices (which are based on decreasing trading volumes).**
- **Mitigating mechanisms for fragmentation [full and consolidated information for investors and regulators] are far from being fully in place:**
 - **No consolidated tape, thus no integrated view of transactions and difficult to assess best execution;**
 - **Transaction reporting requirements still have a limited scope and results are not yet fully reliable.**

Did fragmentation benefit investors?

- Execution prices have decreased
- Regulated markets adjusted fee structure

But

- Apparently not always conveyed to the final investor
- Efficiency of price discovery is not ensured
- Best execution principle requires further clarity, objectivity and appropriate mechanisms for its implementation and monitoring.



Divergence across markets is a reality

- **Broad waiver regime for trade transparency**
- **Too many options and discretions leading to significant regulatory divergence, as demonstrated by CESR's Review Panel works.**
- **Significant divergence of sanctions (nature and levels) across member states, as evident in the published Review Panel report.**

Divergent treatment of financial instruments

- **Equities vs. bonds and derivatives (in pre- and post-trade transparency)**
- **PRIP and some “new” complex products (e.g. ETF, ETN, retail HF, if not UCITS, are not covered by MiFID investor protection rules)**

Non anticipated risks also emerged

- **Emergence of new non transparent modalities of trading, some of them also drawing liquidity out of regulated markets (e.g. dark pools, crossing networks);**
- **“Retailization” of complex products not covered by MiFID**

Crucial points to consider in the review

Concrete points to mitigate or eliminate risks and achieve MiFID's original objectives:

1. Make transaction reporting a really useful tool:

- **Extend its scope (e.g. instruments admitted to trading only on MTF and to certain OTC derivatives)**
- **Define “transaction” unambiguously**
- **Require reporting of clients' ID for all the transaction chain**

Crucial points to consider (cont'd)

2. Urgently implement the “consolidated tape”:

- So far the “industry” was not able to provide it
- How can it be made available soon?
(the US SRO is not replicated in the EU)

Crucial points to consider (cont'd)

3. Revisit the concept of “best execution” and adopt the necessary mechanisms for its implementation and monitoring:

- **Relative concept?**

Close to the existing one - ex-ante definition of trading venues used by IF – it does not ensure that ex-post the investor effectively gets the best available conditions; not easily enforceable: trading venues required to produce reports demonstrating execution quality.

- **Absolute concept?**

It requires interconnectivity between markets (as in the US), smart order routing systems and consolidated market data.

Crucial points to consider (cont'd)

4. Reduce opportunities for regulatory divergence:

- **Move to a more “rule-based” regime for pre-transparency waivers and provide ESMA with powers to monitor and review them and develop BTS**
- **Reduce most options/discretions**
- **Eliminate regulatory divergence regarding PRIP and complex products currently not covered by MiFID**
- **Reduce divergence of sanctions for infringements across member states**

Crucial points to consider (cont'd)

5. Strengthen investors' protection in the relationship with investment firms (IFs):

- **Make the recording of orders (phone/electronic means) mandatory**
- **Introduce a risk-based approach to the distinction of complex vs. non-complex financial instruments; need for a consistent approach with PRIIP**
- **Clarify the definition of investment advice (account for new distribution channels);**
- Revisit the implementation of the appropriateness tests
- Accountability of IFs for mis-selling (appropriateness requirements for IF's employees who distribute complex products?)

Crucial points to consider (cont'd)

6. Extend (with due adaptations) pre- and post-trade transparency obligations to other financial products and markets:

- extend transparency obligations for equity-like instruments (i.e. depositary receipts, ETF, certificates)
- Introduce pre-trade transparency requirements for non-equity financial instruments traded in RM and MTF (and consider regime for OTC)
- post-trade transparency regime to bonds (corporate and public)
- post-trade transparency regime for structured finance products (CESR suggests a phased approach)
- post-trade transparency regime for clearing eligible CDS
- post-trade transparency of derivatives markets

Crucial points to consider (cont'd)

7. Regulate the new trading modalities:

- **HFT / algorithmic trading: supervisory conditions [“flash-crash” lessons];**
- **Broker crossing systems: identification; disclosure by ESMA; post-trade transparency; limit to the amount of business above which BCS should be required to become an MTF;**
- **Systematic internalizers: thresholds, information to the market, trading obligations (i.e. two-sided quotes and minimum quote sizes).**



Crucial points to consider (cont'd)

8. Bring, whenever possible, OTC bond and derivatives trading into organized trading venues (CESR to issue technical advice soon).

Who shall do all this?

- **The “new” MiFID should leave room to ESMA to implement its principles through BTS**
- **Markets have proved to be dynamic and creative in building new solutions**

Therefore,

regulation must be flexible and agile.