



The Crisis and MiFID

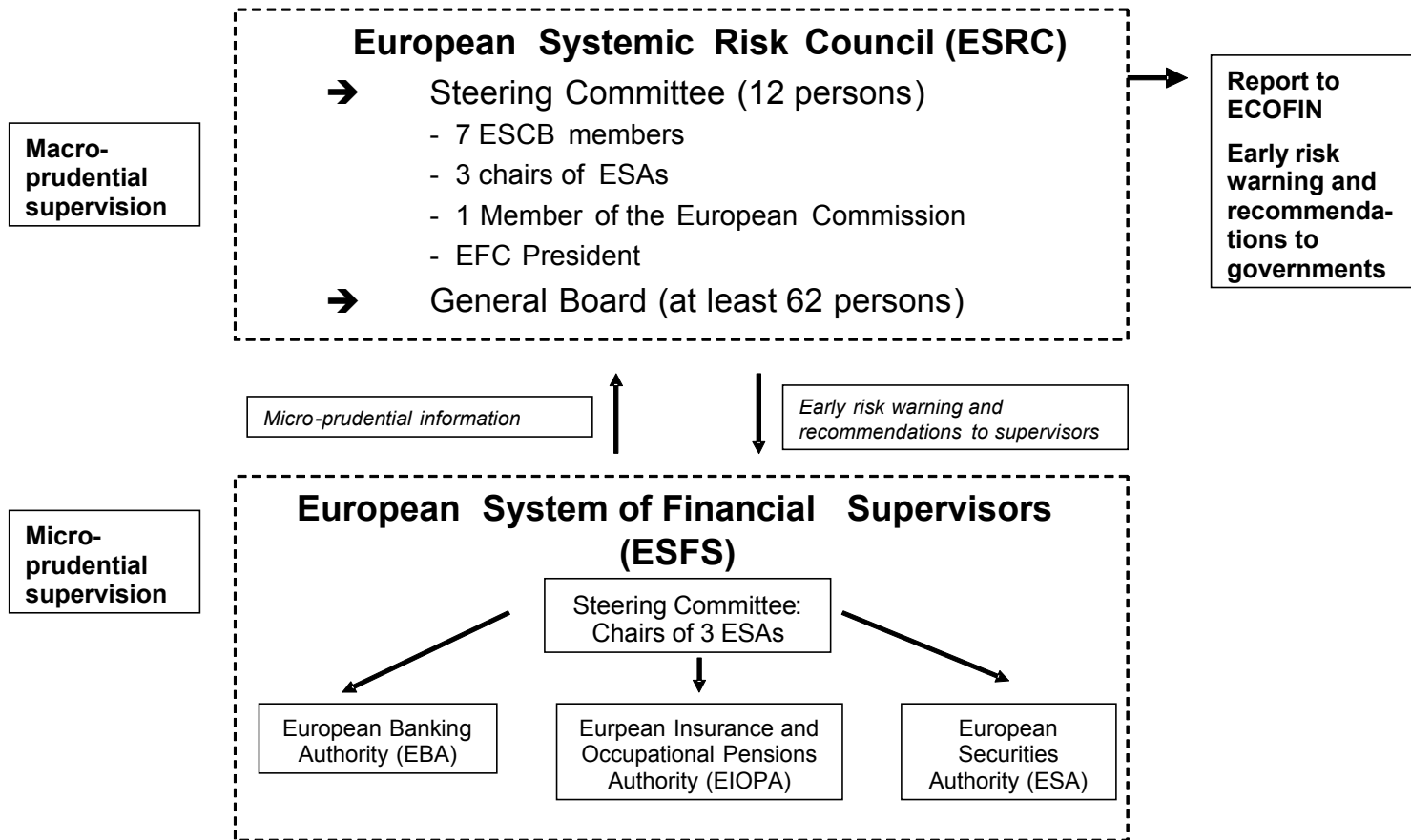
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Post-crisis EU policy agenda

- More integrated supervisory structure
- Enormous regulatory agenda (single market or g-20 driven):
 - **Credit rating** agencies regulation
 - Review of **Basel rules**: 5% for securitisation, more capital for trading book, leverage ratio dynamic provisioning, liquidity requirements
 - Tighter **conduct** regulation (e.g. short selling, executive remuneration, trading rules)
 - More **product** regulation (hedge funds, private equity, OTC derivative markets)
 - Regulation of **CCPs** and **CSDs**

The new European supervisory structure



European Systemic Risk Board

- Governance:
 - Steering Committee (12 persons): 7 central bankers, 3 chairs of ESAs, 1 Commissioner, 1 Finance Minister delegate
 - General Board (> 62 p)
 - **Consultative only**
- Tasks:
 - define, identify and prioritise all macro-financial risks (e.g. excess credit growth, asset inflation);
 - issue risk warnings and give recommendations to policy makers, supervisors and public;
 - monitor follow-up of the risk warnings;
 - liaise with international counterparts;
- Based within ECB, but not formally part of it

European Supervisory Authorities

- 3 sectoral authorities with separate legal personality: EBA, ESMA, EIOPA
- Tasks:
 - single **rulebook**;
 - **enforcement** of rules;
 - harmonise supervisory practices, **peer review** of national authorities;
 - strengthen the oversight of cross-border groups (participate and **mediate** in colleges) and supervise pan-European entities (CRAs, CSDs, CCPs);
 - establish a central European **supervisory database** and ensure exchange of information



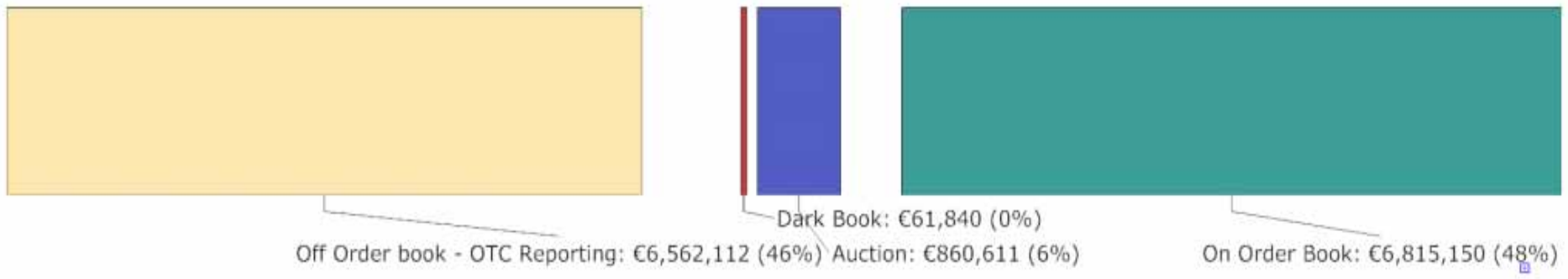
What is MiFID?

- Drastic change in the regulation of van financial markets, liberalisation of networks
- Liberalisation of trading venues, abolition of the monopoly of exchanges. 3 possible “venues”:
 - Regulated Markets
 - MTF’s
 - Systemic Internalisers
- Higher protection of investors
 - “Best execution” in the execution of orders
 - “Client suitability” and “appropriateness” or requirement to know your customer
 - Stricter regulation of pre- and post-order price transparency
 - Rules on conflict of interest and inducements
- Very detailed, but principles-based regulation



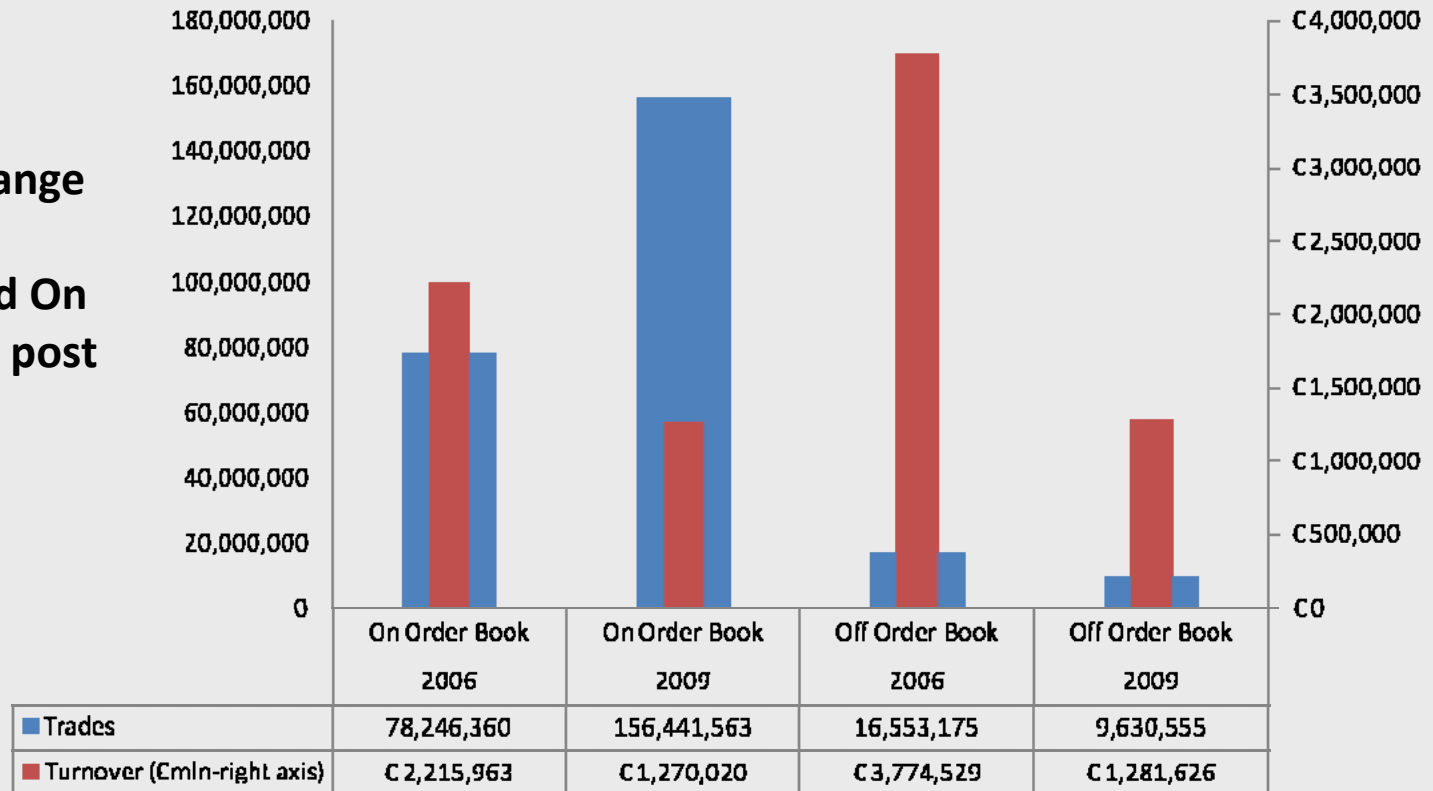
Effects so far

- More competition – liberalisation worked (between exchanges and with MTF's)
- Growth of 'dark pools' and crossing networks
- More fragmentation: has it reduced liquidity, price formation on exchanges?
- Reduction in trading fees on exchanges
- But what about respect of conduct of business rules?
- Lack of single data feed?
- MiFID 2010 Review?



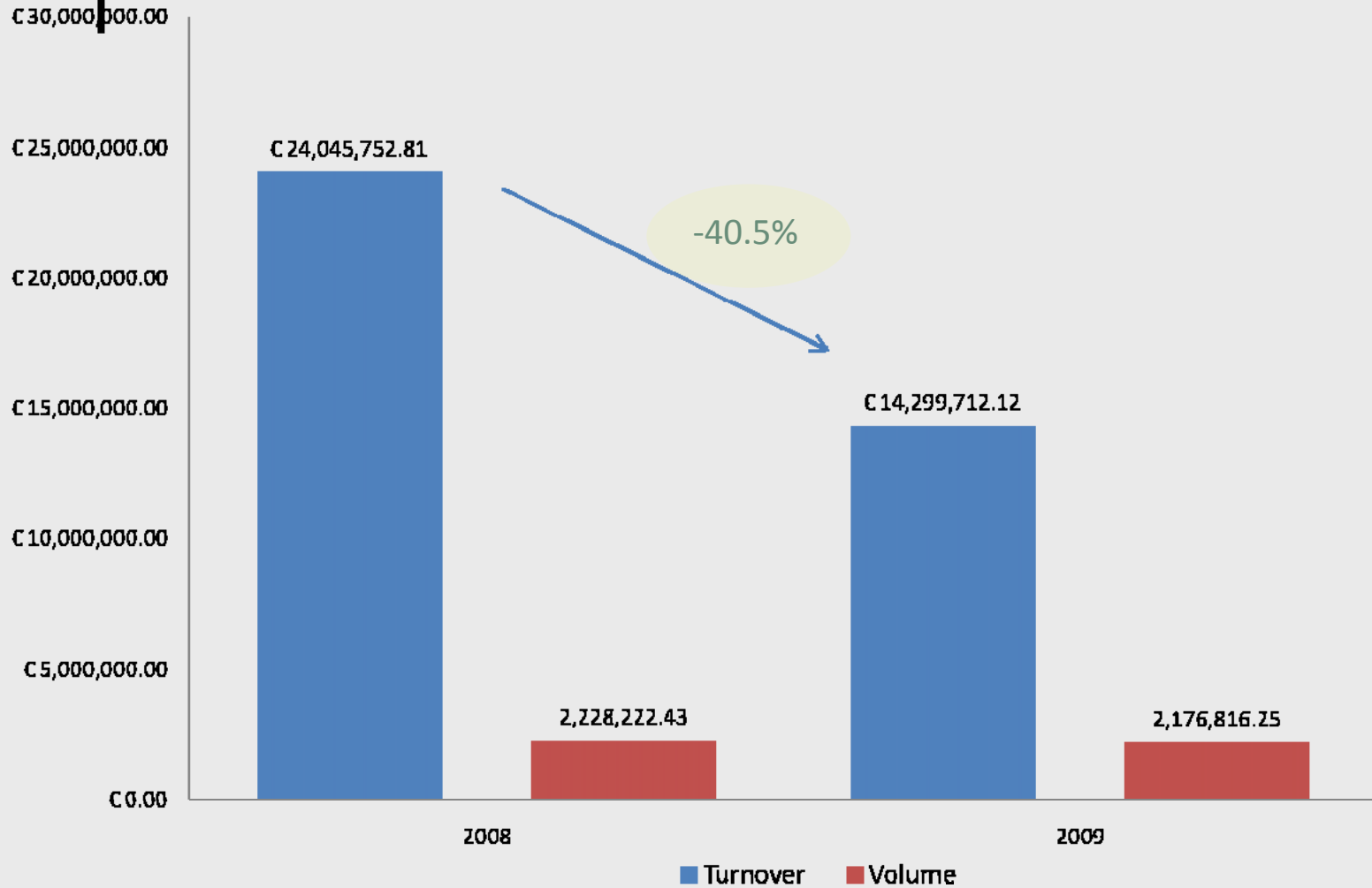
Source: Thomson Reuters – 2009 Annual Report (€mln)

London Stock Exchange Evolution of Off and On Order Book pre and post MiFID



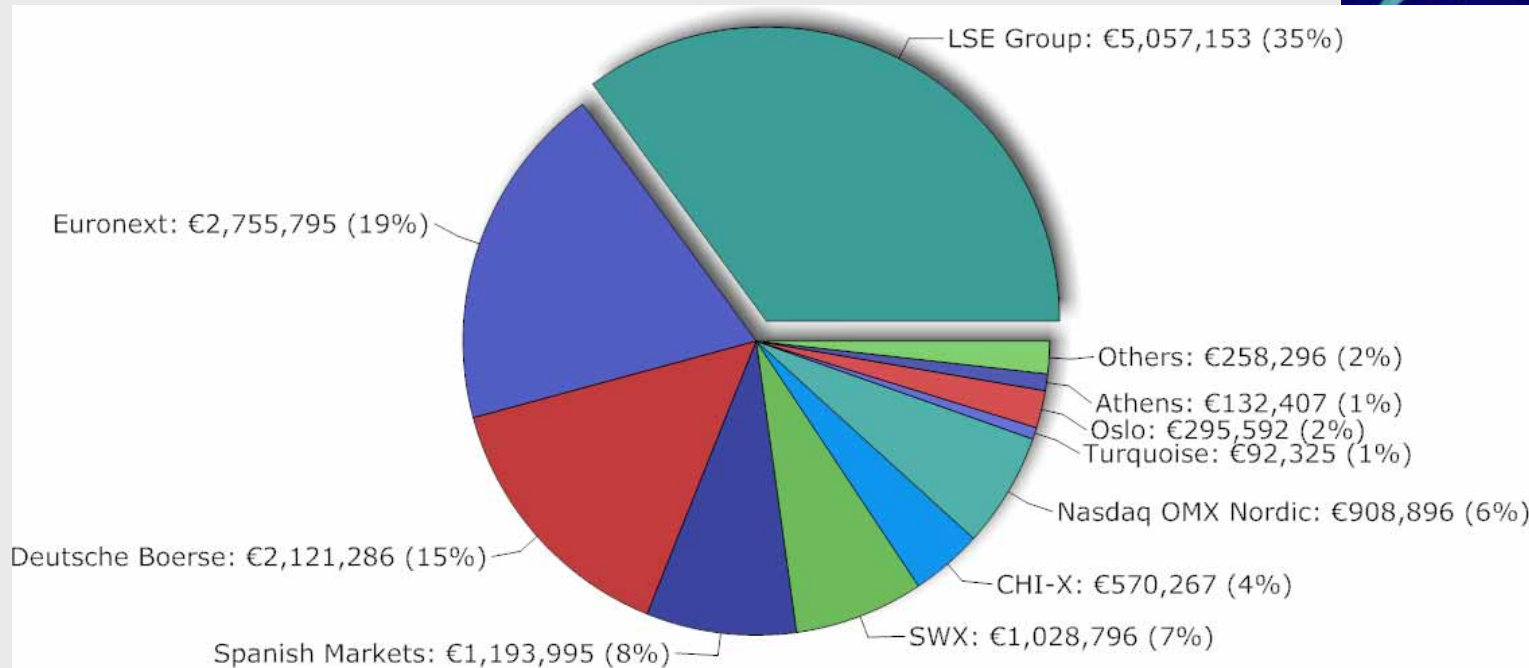
Source: FESE, Off Order Book may not include all OTC reporting (Markit BOAT)

2008 vs. 2009 Turnover and Volume (€mln) The effect of the financial crisis

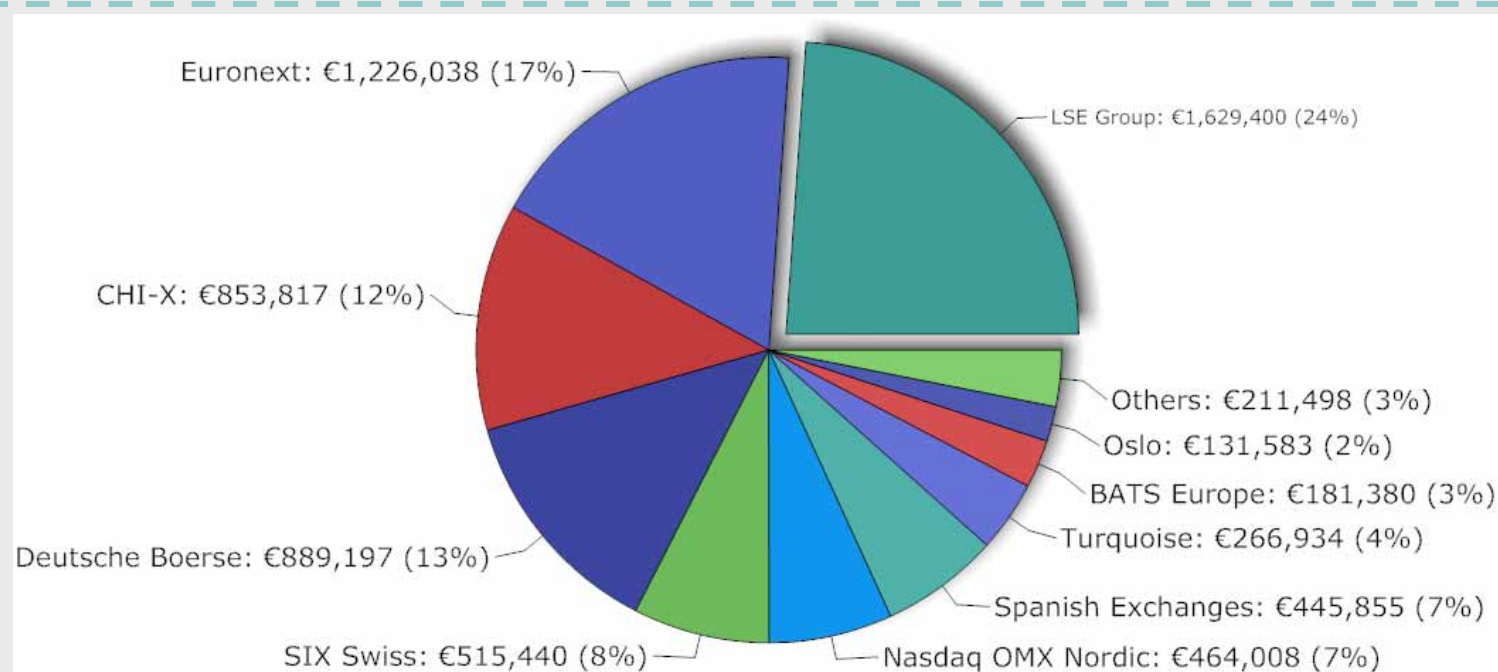




2008 Turnover (€mln)



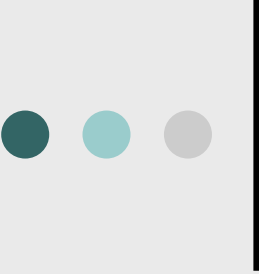
2009 Turnover (€mln)





MiFID: adapted to post crisis world

- much stricter conduct regulation for banks & investment firms
- but enforcement leaves much to be desired
- and may need to be extended
 - Price transparency (for equity, debt and derivative securities)
 - Sector-wise (AIFM, insurers' fund business)
 - Penalties on non-compliance
- but too much off exchange? Need to bring OTC back on exchange?



Price transparency: limited application

- Pre- and post-order price transparency
 - Only applicable to equity, not to fixed income and derivative markets
 - For liquid shares
 - And within low thresholds (standard market size trades)
 - Will these definitions be reviewed?
- How to apply to debt markets? Are market initiatives enough?

Conflict of interest rules: toothless

- Firms need to identify, prevent, disclose conflicts of interest
- And disclose them
 - Need for a written policy
 - Procedures
 - Internal supervision
 - Chinese walls for remuneration
- Up to authorities to enforce
- Stronger action on non-compliance?



ECMI MiFID survey

- Positive overall effect of MiFID on businesses and European securities markets
- Revision of waivers and thresholds
- Better and more transparency for OTC trades
- Increase of data costs and deterioration of data services (lack of uniform standards, granularity, delays, etc)
- Consolidated data (quote and tape) solutions to improve best execution and stimulate fair competition
- Need for more coherent and uniform implementation and enforcement across the EEA
- General feeling that **more clarity is needed** from market participants and regulators!



Conclusion

- MiFID provisions are largely adapted to the post-crisis world, with some updates
- Time to start much stricter enforcement, as a signal that EU regulation was prepared
- New supervisory framework (ESMA) should allow rapid coordinated action on e.g.:
 - Short selling
 - Flash orders
 - Waivers
- MiFID Review will extend application



More reading

- Jean-Pierre Casey and Karel Lannoo. The MiFID Revolution, xii and 228 p. Available from Cambridge UP, www.cambridge.org
- Policy briefs and articles on ECMI website: www.eurocapitalmarkets.org