# Markets in Financial Instruments Directive

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## Impact on Commodities Business

# Outline

- What is MiFID?
- Key dates
- Financial regulation of commodities today
- Patchwork of national regimes
- Scope and application of MiFID
- MiFID for authorised firms
- Practical issues with MiFID framework
- MiFID review

# What is MiFID?

- Markets in Financial Instruments Directive
  - Adopted April 2004
  - Key part of EU Financial Services Action Plan
  - Replaces 1993 Investment Services Directive (ISD)
  - Framework for regulating securities/derivatives business in EU
- Aims to improve single market by:
  - More effective ‘passport’ for EU investment firms/banks
  - Greater harmonisation of organisational/conduct of business rules
  - Enhanced competition between exchanges, multilateral trading facilities (MTFs) and investment firms/banks
- Linked to Capital Requirements Directive (CRD)
  - Investment firms/banks regulated by MiFID subject to regulatory capital rules established under CRD

# Key dates

- 2 September 2006:
  - EU implementing measures published
- 31 January 2007:
  - Deadline for member states to adopt national implementing legislation/rules
- 1 November 2007:
  - National implementing legislation/rules to come into force
  - Likely slippage in national implementation schedules
- 30 April 2008:
  - Commission to report on application of MiFID/CRD to firms trading commodity and new derivative products
- Parallel timetable for implementing CRD:
  - From 1 January 2007

# Financial regulation of commodities today

- Commodities business outside the scope of:
  - Mandatory EU authorisation requirements
  - EU passport regime
  - EU consolidated supervision requirements
  - EU market abuse regulation
- But:
  - Banks/investment firms carrying on commodities business subject to capital rules on that business
  - Member states can impose national authorisation requirements on commodities firms (and many do)
  - Member states can extend market abuse regulation to commodities derivatives business

# Patchwork of national regimes

- National authorisation requirements
  - Focus on regulation of commodity derivatives not physical business
  - Differing definitions but narrow scope/broad exemptions mitigate practical impact on firms
  - E.g. UK, Germany, France, Netherlands
- Impact of authorisation also reduced by:
  - Modified capital/business conduct rules
  - E.g. UK, Germany, Netherlands
- However, practical issues remain e.g.
  - Authorisation barriers for cross-border business, including non-EU firms
  - Obstacles to exchanges, MTFs
  - Difficulties with enforceability of close out netting

# Scope and application of MiFID

- Extends authorisation requirements to cover:
  - Investment services/activities, including dealing for own account
  - Relating to derivatives on commodities, weather, emissions certificates and other specific underlyings
  - If contract cash settled, traded on a regulated market/MTF or closely linked to a regulated market/MTF contract
- Exemptions apply e.g.
  - Firms whose main business is dealing on own account in commodities/commodity derivatives
  - Firms whose dealing or services ancillary to main business
  - If group's main business not banking/investment services
- Member states may:
  - Adopt broader scope or narrower exemptions
  - Apply restrictions to non-EU entities doing cross-border business

# MiFID for authorised firms

- Prudential/organisational framework
  - Regulatory capital requirements set under CRD
  - Client money/assets segregation rules
  - Systems/controls e.g. outsourcing, separate compliance/risk/audit functions
  - Conflict of interest management rules
- Conduct of business
  - Client classification: retail, professional, eligible counterparties
  - Client information, documentation requirements
  - Suitability requirements for advice
  - Broad best execution requirement
- Market integrity rules
  - Transaction reporting requirements
  - Extends scope of market abuse regime

# Practical issues with the framework

- Restrictions on cross-border business
  - EU entities within EU, non-EU entities into EU
  - Patchwork of differing national rules remains
- Lack of recognition of wholesale nature of markets
  - Practical difficulties with client classification regime
  - Different rules for derivatives vs physical transactions
- Forces subsidiarisation of regulated activities
  - Loss of business alignment, natural hedges
  - Reduces netting between regulated/unregulated transactions
  - Costs of restructuring, uncertainty of outcome of review
  - Business with non-EU counterparts better located outside EU
- Issues with netting and collateral remain

# MiFID review

- Evaluation of MiFID exemptions and prudential regime
  - Report deadline 30 April 2008
  - but legislation changes unlikely before 2010
- Need to identify regulatory risks, intended objectives
  - Investor protection, systemic stability, market integrity
  - Application in global, competitive wholesale markets
  - Identification of appropriate regulatory tools
  - Role of authorisation requirements/regulation of market participants vs market regulation
  - Application
  - Cost/benefit analysis for regulatory options
  - Need for common EU approach to authorisation requirements that limits superequivalent national licensing rules
- Industry involvement in review process

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