

## MiFID II

*The European Commission is preparing its revision of the Markets in Financial Instruments Directive (MiFID I) that provides harmonised regulation for investment services. MiFID II is due to be published in September 2011, slightly delayed from the earlier deadline of July.*

While the main objective of MiFID I, implemented in 2007, was to allow competition with traditional exchanges, its successor is all about transparency. When it comes into effect, possibly in 2014, it will apply to the equity markets and may be extended to commodities, bonds and derivatives markets.

The transparency push is in line with the G20's response to the financial crisis, especially in the otherwise opaque OTC derivatives markets. At a Brussels conference, Barnier's cabinet member, Paulina Dejmek, also took the pro-transparency line and supported the need to develop the consolidated tape system.

Addressing the meeting, organised by the Federation of European Securities Exchanges and the CFA Institute in March, she added that there was a need for "better granularity of post-trade data".

Philip Warland, head of public policy at Fidelity International, sees the new emphasis as following logically from the fact that pressure on the Commission for MiFID I was dominated by the investment banks. Now, lobbying pressure for its successor is from the buy side.

There is now better acceptance that the market has two sides and that both need to be heard. Pension funds, whether self-managed or

using third parties, are affected because their trades can be either on or off market. The major difference is transparency.

"We would like to know who we are dealing with," says Warland. "It might be the investment bank itself or one of its customers, or with a third party, not a customer. That means that we don't know the risk". He notes that pension asset managers can likewise trade in the dark.

Here, the transparency issue concerns OTC trades, which may be relatively opaque. Some non-bank groups put the volume at 30-40 % of trades, hence escaping MiFID I. Banks, speaking via the Association for Financial Markets in Europe (AFME), would like this to be more like 16%.

Rhodri Preece, director of capital markets policy, at the CFA Institute, says that while OTC business is acceptable for ad hoc, large, or non-standard transactions, there is little rationale for standard marketable order flow to be executed away from transparent exchanges.

He adds that the Commission's new rules that will strengthen post trade data quality by setting up "approved publication arrangements". This will bring consistency to the reporting of trades across different venues. They will also shorten the permissible time delays for reporting large trades, bearing in mind that currently some large deals are not disclosed for up to three days. In the US, disclosure would arrive within 30 seconds.

Strong objections to OTC trading are expressed by Hans-Ole Jochumsen, president of both Federation of European Securities Exchanges (FESE) and of NASDAQ

OMX Nordics, who refers to market abuse, and lists possible types of market manipulation.

Writing in Efinancelab, he mentions 'layering', where traders send multiple orders priced closely to the current best bid and offer to create the false impression of liquidity in a stock. Another market abuse is 'front running', where brokers trade ahead of a client's order and benefit from the price movement caused by this order.

Jochumsen mentions schemes that involve two different venues. They take advantage of the fact that it is impossible, under today's surveillance structure, to see the connection at the exchange level. He talks of market operators responding to high volatility in a single security by calling a trading halt in that stock and issuing a price query to the listed company.

This enables market participants to take in newly disclosed information and allows price discovery to occur through a call auction. Jochumsen notes the possibility of using multiple trading venues. He says that while each venue has responsibly for surveillance of its own marketplace, none has overall responsibility. Nor do they have a complete view of the transactions across all venues. This environment has made it easier for certain types of market manipulation to go undetected, he says.

MiFID applies across the 30-state European Economic Area (EEA), which is made up of the 27 EU countries plus associates such as Norway.