

Industry Seminar – 6 December 2013

**Investment Supervision and Policy Division Presentation:
Markets in Financial Instruments Directive II – Importance to the Bailiwick**

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This time around it's bigger

The Markets in Financial Instruments directive (MIFID) originated in 2007 as a plan to facilitate cross-border equity trading in Europe as part of the larger scheme to create a single market in the EU. It removed the “concentration rule” that in many countries only allowed securities to be traded on the national exchange, enabling new trading venues to compete for secondary market trading in equities which had until then held monopolies.

It is probably true to say that – so far – this Directive has had only a limited impact on Bailiwick investment businesses. When we amended our licensee conduct of business rules back in 2009 we took account of comments from firms that it would be useful to make reference to MIFID in relation to the explicit determination of client classification. This inclusion was specifically made in order that rules did not present difficulties for firms that had to comply with MIFID provisions through, for example, parent and/or group policies.

So why MIFID II now?

MIFID II, the revision of the original 2007 MIFID, and its sister regulation MIFIR is a mandated review that is intended to expand on the original directive to encompass all asset classes, with the exception of foreign exchange, and to shore up MIFID's weak points.

MIFID II was announced by the European Commission in October 2011 and is widely considered to be the European response to US Dodd-Frank Act.

The MIFID II package is highly complex, diverse and aims to deal with trading related issues as well as consumer protection.

The scope of the directive in terms of firms/institutions affected is broad.

It is likely that the rules on “investment services” may override those of AIFMD for certain fund administration functions.

We remain to be convinced that the European Commission really understood what it was getting into when it embarked on the review. This is possibly reflected in the time it has taken for the various parties to agree the way forward. In October 2012 the EU Parliament adopted the revised version of MIFID II.

After eight months of negotiations, the Council reached an agreement under the Irish presidency.

The Trialogue phase commenced in July of this year during which the EU Commission, the EU Parliament and the Council have to reach an agreement on the final text.

The final vote is imminent and we expect to hear next week as the Directive and Regulation are due to be discussed at the EU Parliament Plenary session scheduled for 9-12 December.

We are, of course, aware that the European Securities and Markets Authority (ESMA) has already commenced work on the implementing measures – both the technical standards and technical advice to the EU Commission. As with AIFMD, there is some concern about how much work has been deferred to the Level II text, and therefore ESMA.

The proposed text we have seen suggests that the MIFID II proposals will mirror AIFMD in terms of their requirements regarding third countries particularly in relation to regulatory co-operation, tax information exchange and third countries not being considered as non-cooperative for anti-money laundering purposes. We expect that the work we have already undertaken in relation to AIFMD will greatly assist Guernsey with regard to these areas.

So how do we anticipate that the proposals in MIFID II affect us?

Well, probably the most important aspect of the current proposals which is likely to affect those firms outside of the EU which are intending to provide investment services to retail clients in the EU, is the proposal to require the establishment of a branch operation in the Member state where the retail clients are situated as the branch operation will be subject to certain provisions of the Directive.

Based on the success of the model of interaction with stakeholders used for AIFMD, we have established a working party – or perhaps a think tank would be a better description. It includes representatives from Commerce & Employment and a number of firms across the Investment, Insurance and Fiduciary sectors as it is anticipated that the Directive will impact beyond what would be considered as traditional investment licensees.

We commenced this dialogue between Regulator, Industry and Government prior to finalisation of the Directive in order to start considering its potential impact, not just on the Investment sectors, but other sectors as well, because it is going to be critical to ensure all firms are informed, at the earliest opportunity, of the possible implications for their business models in the future.

To date two meetings have been held and a further meeting is planned post 12 December after the final vote in the EU Parliamentary Plenary session.

Last month, we circulated a survey asking those licensees across the three sectors, likely to be affected, a number of questions which were aimed at providing the Commission with information on whether they had considered how the Directive would impact their business model, whether they provide investment services to retail clients in the EU and what, if any, preparations they had made. The deadline for submission is 16 December and I would encourage every firm that received a survey to complete it and email it to mifid@gfsc.gg.

As things become clearer and our thinking crystallises, you can rest assured that we will use various fora and communications, including road shows and FAQs on our website, to inform you of the possible issues and implications affecting us.