

Insight: Regulatory

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The review of the Markets in Financial Instruments Directive: the European Commission publishes legislative proposals

The Markets in Financial Instruments Directive (2004/39/EC) ("MiFID") and implementing legislation, in force since November 2007, sets out a framework for regulating investment services in financial instruments provided by investment firms and credit institutions. MiFID also provides a framework for the regulation of trading venues together with a pre- and post trade price transparency regime for equities. Its aim was to promote the integration, efficiency and competitiveness of EU financial markets while ensuring adequate protection for investors in financial instruments.

The review of MiFID launched by the European Commission (the "Commission") in 2010 resulted in the publication on 20 October 2011 of some very wide ranging proposals that have significant implications for market participants. The Commission cites a number of reasons to explain why these changes are necessary, including the failure of MiFID adequately to deliver its promised benefits, changes in technology and trading behaviours and the high level governmental responses to the financial crisis. Accordingly the proposals seek to address the objectives originally set for MiFID while responding to new regulatory challenges posed by changes in the financial markets and some aspects of the financial crisis. The proposals rely heavily on the role of the European Securities and Markets Authority ("ESMA") on which significant new powers and responsibilities would be conferred. The proposals would also require ESMA to develop advice on a very wide range of detailed technical and implementing measures.

The Commission's MiFID review proposals should be read together with the parallel proposals for the review of the Market Abuse Directive (please [click here](#) for a copy of our client alert on these proposals). The Commission's review of the regulation of market infrastructure as proposed in the draft European Market Infrastructure Regulation (EMIR)¹ is also relevant. Together these proposals contribute to the Commission's wider ambition to create a single European rule book for significant elements of financial regulation.

The timeline for the eventual adoption of the proposals is, in view of their length, complexity and radical nature, likely to be prolonged. There will now follow a 'trialogue' involving consideration of the proposals by the European Parliament, the Commission and the Council, a process of negotiation and discussion that could last until the end of 2012 or beyond. Once that process has been completed, the final texts of the instruments will be adopted and enter into law following their publication in the Official Journal and are expected to become effective in Member States two years later. Accordingly the timetable could stretch to the beginning of 2015. A number of the proposals also suggest the need for transitional provisions.



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¹ This is available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52010PC0484:EN:NOT>

It can be expected that the proposals will be the focus of intensive lobbying and it should be assumed that the final text will reflect a number of changes. Nevertheless clients will want to start considering the implications for their businesses.

We would in particular draw attention to the potential impact for financial firms that are established outside of the European Economic Area (EEA) but which may currently be providing investment services in the EEA under existing national laws, for example under the 'overseas persons exclusion' in the UK. The proposals would see those national regimes swept away and replaced by a potentially more restrictive approach which could exclude firms in countries that are not judged by the Commission to have equivalent regulatory regimes or to offer full reciprocity of treatment for EU based firms.

Other changes we headline which are likely to impact upon business models are the possibility of position limits for commodity derivatives, mandating the trading of standardized derivatives on trading venues and the application of pre- and post-trade price transparency for firms trading in bonds and derivatives.

The Commission's legislative proposals for amending MiFID consist of a new Directive ("MiFID II") and a Regulation ("MiFIR"). MiFID II sets out a number of changes, including scope extensions, a revised framework for the regulation of trading venues, additional requirements for algorithmic and high-frequency trading and enhancements to the organisational and conduct of business obligations of investment firms. MiFIR establishes harmonised requirements for the disclosure and publication of pre- and post-trade data (including in equities, bonds and derivatives) and the transmission of transaction data to competent authorities, the re-location of trading in standardised derivatives to regulated markets and non-discriminatory access to clearing services. The proposed new regime for access to EU markets for third country firms is split between MiFID II and MiFIR as are enhancements to the supervisory and enforcement powers of competent authorities and ESMA.

This note provides an overview of some of the main proposals.

Scope Extensions

Restricting exemptions in relation to dealing on own account

Dealing on own account is among the investment services and activities covered by MiFID. However, certain exemptions from the MiFID licensing and related requirements apply, notably in relation to dealing on own account as an exclusive activity, as an ancillary part of another non-financial corporate activity or as part of trading in commodities and/or commodity derivatives, subject to certain conditions. MiFID would eliminate the exemption for trading on own account in commodities and/or commodity derivatives. It would also narrow down the other exemptions, which would no longer cover dealing on own account by executing client orders.

Tightening optional exemptions for some service providers

Member States may opt not to apply MiFID to firms providing investment advice (with or without the reception and transmission of orders) if they do not offer their services cross-border, do not hold client money and are regulated at national level. MiFID II would require Member States to apply authorisation and conduct of business requirements analogous to those under MiFID to such firms in order to benefit from this exemption.

Application of MiFID II to structured deposits

Structured deposits are not currently covered by MiFID. MiFID II would extend regulatory requirements to the advised and non-advised sales of structured deposits by credit institutions. A structured deposit would be a deposit with a rate of return that is determined otherwise than by an interest rate.

Treating emission allowances as financial instruments

Currently, emission allowances are not classified as financial instruments under MiFID, unlike derivative contracts on these allowances. MiFID II would extend the definition of financial instruments to include all emission allowances recognized under the Emissions Trading Scheme Directive (2003/87/EC). This would also bring such instruments within the scope of the proposed Market Abuse Regulation. As a result, professional traders in emission

allowances as well as trading venues specializing in spot trade in emission allowances would have to comply with a whole range of new regulatory requirements. While trading in emissions allowances is expected to grow and require enhanced regulation, the policy debate has centered on whether it could be subject to a tailored regulatory regime instead of MiFID II.

Clarification of treatment of issuance and sale of own securities

It is currently not clear whether MiFID applies where investment firms or credit institutions issue and sell their own securities without providing advice. MiFID II would cover such situations by extending the definition of execution of orders on behalf of clients to include the conclusion of agreements to sell financial instruments issued by a credit institution or an investment firm at the moment of their issuance, i.e. in the primary market.

The precise practical implications of this change would depend on the categorisation of the clients involved. We discuss the treatment of eligible counterparties under MiFID II below. We also draw attention below to a proposed restriction of the circumstances in which the execution only exception to the requirement to carry out suitability and appropriateness assessments in respect of other clients would apply. As a result, credit institutions and investment firms might not be able to publicly offer certain complex financial instruments, such as shares or bonds embedding derivatives, to these clients without suitability and appropriateness assessments. Distribution of such products via intermediaries who are able to comply with the restrictions on the execution only sale of complex products would continue to be possible. In any case, 'plain vanilla' shares and bonds would still be treated as non-complex financial instruments.

Classifying custodianship as an investment activity

MiFID II classifies the safekeeping and administration of financial instruments, including custodianship and related services such as cash/collateral management, as investment activities rather than as now as ancillary activities. They would therefore become activities that if carried out on a stand alone basis would attract the need for authorisation.

Changes Affecting Trading Platforms and Trading

Revised taxonomy of trading venues and activities

Shedding light on dark pools

MiFID currently distinguishes four categories of venue for securities trading: regulated markets, multilateral trading facilities (“MTFs”), systematic internalisers and everything else traded over the counter (“OTC”). Different regulatory requirements are imposed on trading in each category, including in particular in relation to pre- and post trade transparency. Developments in the market led participants to rely upon some fine distinctions between these MiFID categories of trading systems. For example, currently, a trading system may be ‘dark’ and not subject to the requirements for pre-trade price transparency because the operator is able to categorise its venue as one where the routing or execution of client orders remains subject to some element of operator discretion. Specifically, such a trading system would want to avoid categorisation as an MTF and be treated as OTC trading. MiFID does not however specify the nature or degree of discretion that is necessary if a trading system is not to be classified as an MTF. Another similar concern addressed by the Commission is the relatively low number of firms currently treated under MiFID as systematic internalisers and hence subject to a continuous quoting obligation. Also, MTFs and regulated markets have sought to take full advantage of the possibility of securing from national regulators waivers from pre-trade transparency (for example for trades that are large in size or referenced in some way to another market price). All of these market trends and developments have compounded the Commission’s view that pre-trade price transparency for equities is not working as well as it should.

In part to avoid fine distinctions being drawn between broker operated trading platforms and MTFs, MiFID II would introduce an additional third category of trading platform, so-called organised trading facilities (“OTFs”). An OTF is defined very broadly in order to ensure that all types of ‘organised’ trading are conducted in a venue that is subject to pre-trade transparency requirements and also market abuse protections. A broker crossing network is cited as an example of the kind of organised

venue that would become an OTF. Authorisation as an OTF would require an explanation why the system cannot operate as a regulated market, MTF or systematic internaliser. Unlike systematic internalisers, OTFs would not be allowed to execute client transactions against their own proprietary capital. The Commission appears to consider that executing orders against the venue’s own capital is incompatible with the discretions reserved to the investment firm operating the facility. Unlike MTFs, OTFs would not need to execute client orders in accordance with pre-determined, non-discretionary rules. Otherwise, OTFs would be subject to many of the same regulatory requirements as MTFs. Additionally, OTFs may not connect with other OTFs to allow orders to interact across OTFs.

MiFID II also proposes, in the recitals, to broaden the definition of a systematic internaliser by means of implementing legislation. Systematic internalisers must deal on own account by executing client orders “on an organised, frequent and systematic basis” and the criteria for assessing what amount to an organised, frequent and systematic basis at present only capture a small number of firms. The intention appears to be to revise these criteria to widen the application of the systematic internaliser regime.

The Commission is proposing these changes to catch up with and also to counteract market developments. The net effect would be to considerably shrink the footprint of true OTC trading. The new category of OTF would perhaps serve to provide greater flexibility for standardised derivatives to be traded on organised trading platforms, although the OTF operator would not be able to trade with clients against its own capital.

The Commission also proposes to align a number of regulatory requirements across regulated markets, MTFs and OTFs, including in particular in respect of monitoring of compliance by their users with market abuse rules, the suspension and removal of instruments from trading where required and cooperation and exchange of information between trading venues, position limits in respect of commodity derivatives and transparency. Broker systems that were not previously subject to such obligations might need to make significant changes to their business models to comply.

Defining SME growth markets

MiFID II would allow MTFs to apply to be registered as an SME growth market if they meet certain conditions, including that the majority of issuers admitted to trading on the MTF are small and medium-sized enterprises. Registration as an SME growth market is without prejudice to compliance by the MTF with other obligations on MTFs under MiFID and also does not prevent the MTF from imposing additional requirements. At present it is not entirely clear what practical advantages the label “SME growth market” would bestow. However, the legislative proposals for a revised Market Abuse Directive already provide for tailored disclosure requirements for issuers admitted to SME growth markets. A possible example in the UK would be the Alternative Investment Market (AIM), which is an MTF operated by the London Stock Exchange (LSE) for issuers seeking an alternative to a full listing.

Additional regulatory requirements for algorithmic and high-frequency trading

The legislative proposals include a number of new requirements to address the perceived risks of algorithmic trading and high-frequency trading.

Currently, high frequency trading firms can sometimes avoid authorisation under MiFID by relying on an exemption for persons who exclusively deal on own account. As outlined above, this exemption would be restricted under MiFID II.

Investment firms engaging in algorithmic trading would have to establish systems and risk controls in relation to their trading system. Investment firms providing direct electronic access to trading venues and regulated markets would also have to enhance their risk controls.

In addition, investment firms engaging in algorithmic trading would have to make annual disclosures to their competent authority about their algorithmic trading strategies and systems. Post-trade transaction reports would also include details of the computer algorithms responsible for the investment decisions and the execution of the transactions. Investment firms are likely to be concerned about the risks to the confidentiality of their algorithmic trading strategies and systems inherent in these proposals. It is also unclear how useful the information

disclosed might be to competent authorities in practice and whether this would warrant the inevitable additional compliance costs for firms.

Finally, and perhaps most significantly, firms using algorithmic trading strategies would have to post firm quotes at competitive prices so that they would be required to provide liquidity on a regular and ongoing basis to trading venues they are using, regardless of prevailing market conditions. The requirement to provide liquidity could entail significant changes to the business model of such firms and might be akin to requiring any firm wishing to use algorithmic trading to act as a market maker. The Commission appears to consider that algorithmic and high frequency trading is a potential source of extreme volatility and that persons deploying such strategies should have a stake in the ongoing liquidity and stability of the markets they use. Further clarification on the application of this requirement is likely to be provided in implementing legislation.

Changes to the regulation and supervision of derivatives trading

Tightening of exemptions relied on by commodity derivatives trading firms

The tightening of exemptions in relation to dealing on own account described above would affect commodity derivatives trading firms.

Requirements for trading venues in relation to commodity derivatives

Trading venues would have to adopt position limits or other appropriate arrangements for commodity derivatives to support liquidity, prevent market abuse and support orderly pricing and settlement conditions. Trading venues would also have to publish information on the weekly aggregate positions held by different categories of traders in commodity derivatives (and emission allowances and related derivatives) and provide their competent authority with a breakdown of the positions held by different market participants upon request. Delegated acts by the Commission could harmonise these measures across Member States.

Mandatory trading of eligible derivatives on organised markets

The proposed EMIR includes clearing and reporting obligations for eligible derivatives. MiFIR would additionally require counterparties that meet certain conditions to trade these derivatives on trading venues rather than OTC. The list of eligible derivatives would be set out in technical standards. The combined impact of EMIR and MiFIR would be a shift of derivatives business away from OTC trading to trading platforms where different regulatory standards such as pre- and post-trade price transparency would apply.

New supervisory powers in relation to derivative positions

MiFID II would allow competent authorities to demand information about the size and purpose of derivative positions, reduce their size and/or limit the ability of persons to enter into the derivative contracts ex ante. ESMA would have a coordinating role in this context. Subject to certain conditions, it would also have derivatives position management powers of its own. The Commission would specify the criteria and factors to be taken into account when determining whether these position management powers should be exercised.

There has been concern, particularly in the US, that underlying commodity prices for energy and foodstuffs have been strongly and adversely influenced by the related derivatives markets. This proposal would confer on the Commission a potentially important European role in any future dialogue with the US and other authorities on this important topic.

Reinforcements to best execution obligation

Under MiFID, investment firms have to provide appropriate information about their execution policy to their clients. MiFID II requires that information to explain clearly, in sufficient detail and in a way that can be easily understood by clients, how orders will be executed for clients. Investment firms would also have to annually publish the top five execution venues where they executed client orders in each class of financial instruments in the preceding year. MiFID II would also place an obligation on execution venues to publish data relating to the quality of execution of transactions on an annual basis.

Removal of barriers to access to clearing services

MiFID already regulates access to central counterparties, clearing and settlement arrangements. MiFIR would add provisions for the non-discriminatory and transparent access of trading venues to central counterparties. Conversely, MiFIR would require trading venues to provide trade feeds to central counterparties on request. The aim is to remove commercial barriers to competition between markets infrastructures. This reflects a policy concern about the effects on competition of the vertical integration of trading and clearing facilities.

Enhanced and extended transparency requirements

Upgraded pre- and post-trade transparency

The MiFID pre- and post-trade transparency requirements apply only to shares and only if admitted to trading on a regulated market (including where they are actually traded on an MTF or OTF).

MiFIR would extend the scope of these transparency requirements to cover a wider range of financial instruments. These would include not just shares, but also other equity instruments, for example depositary receipts and exchange-traded funds, even if traded only on an MTF or OTF. Indeed, the proposed new transparency requirements would also apply in relation to a wide range of non-equity instruments, i.e. bonds and structured finance products admitted to trading on a regulated market or for which a prospectus has been published and emission allowances and derivatives admitted to trading or which are traded on an MTF or OTF. In addition to offers, actionable indications of interest would also be caught.

The transparency requirements would be aligned across regulated markets, MTFs and OTFs in respect of qualifying financial instruments. A more tailored transparency regime would be introduced for investment firms trading OTC, including systematic internalisers.

Competent authorities could still grant waivers from the pre-trade transparency requirements to regulated markets, MTFs and OTFs based on certain characteristics of the relevant market and in accordance

with criteria to be specified by the Commission. However, they would have to notify ESMA and ESMA would then issue an opinion on the compatibility of the waiver with MiFIR.

These proposals will no doubt be controversial given the considerable costs they would impose on firms whilst arguably yielding only limited benefits in predominantly professional markets. The extension of pre-trade transparency to the bond markets would be particularly significant for banks that trade on own account against their own capital. It seems very likely that their trading desks would fall to be treated as systematic internalisers, with the result that such banks would have to provide firm quotes on request in relation to, for example, bonds admitted to trading on a regulated market or for which a prospectus has been published. Banks will be interested therefore in seeing how the detail of this proposal develops, particularly as to the waivers that would be available and the scope for price improvement for professional customers and market counterparties.

Better transaction reporting

Under MiFID, firms executing trades in financial instruments admitted to trading on regulated markets need to make transaction reports to their competent authority on a T+1 basis.

MiFIR extends this to all financial instruments, except those (i) which are not admitted to trading nor traded on an MTF or OTF, (ii) whose value does not depend on that of a financial instrument admitted to trading or traded on an MTF or OTF and (iii) the trading of which cannot have an impact on an instrument admitted to trading or traded on an MTF or OTF.

The content of transaction reports would be enhanced, particularly as to disclosing the identity of the end client. Investment firms and the operators of regulated markets, MTFs and OTFs would be required to keep data records for at least five years.

The Commission would have an opportunity, two years after the entry into force of MiFIR, to submit proposals for transactions reports to be transmitted to a system appointed by ESMA rather than to competent authorities.

Mitigating data fragmentation

MiFID II provides for the authorisation and regulation of 'approved reporting mechanisms' for transaction reports to the competent authority, 'approved publication arrangements' for the publication of post-trade transparency data by investment firms trading over-the-counter and 'consolidated tape providers' for, as the name suggests, the consolidation of post-trade transparency data, albeit only in respect of equities. The aim is to help to address concerns about data fragmentation. However, the relevant provisions in the legislative proposals are quite basic and we would expect to see further work on this issue.

Other Changes to the Investor Protection Framework

Improvements to corporate governance

MiFID II would strengthen corporate governance requirements, with particular attention to the role of the management body of an investment firm or a market operator. Its members would have to commit sufficient time to perform their functions, possess adequate collective knowledge, skills and experience and to act with honesty, integrity and independence to ensure that the firm is managed in a sound and prudent way to promote the interests of clients and market integrity. Diversity would need to be taken into account when selecting the members. These requirements would be clarified by means of technical standards.

Enhancements to suitability and appropriateness assessments and reporting to clients

MiFID requires investment firms to carry out an assessment of suitability and appropriateness when providing investment advice or portfolio management.

This is subject to an exemption for execution only investment services in relation to non-complex instruments. MiFID II would clarify the criteria for non-complex instruments, excluding shares in non-UCITS collective investment undertakings or shares embedding derivatives, bonds and money market instruments embedding derivatives or incorporating any structure which would make it difficult for clients to assess the risk involved and structured UCITS.

MiFID II would also strengthen obligations on investment firms. They would have to specify how the advice given meets the personal characteristics of the client. They would also have to indicate whether clients will be provided with an ongoing assessment of the suitability of financial instruments recommended to them. In any case, firms would have to make periodic communications to their clients in relation to the services provided.

Restrictions on inducements

Under MiFID and the MiFID Implementing Directive (2006/73EC), investment firms may only accept incentives from third parties ("inducements") in relation to the provision of their services to clients where specific conditions are met. MiFID II would require investment firms to specify whether their investment advice is provided on an independent basis. Where advice is provided on an independent basis or portfolio management services are offered, inducements could not be accepted in any circumstances. The aim is to mitigate the potential for conflicts of interest for such investment firms. This proposal could have a significant impact upon bank distribution networks.

Tied agents and clients' assets

MiFID II would require Member States to allow investment firms to appoint tied agents, for example for purposes of promoting the services of the investment firms. However, tied agents would be prohibited from handling clients' assets.

No title-transfer collateral arrangements with retail clients

Under MiFID II, investment firms could not conclude title transfer collateral arrangements with retail clients for the purpose of securing or covering clients' present or future obligations. This change is consistent with changes already made by the Financial Services Authority (FSA) in the UK.

Records

Under MiFID, investment firms already need to keep records of services and transactions undertaken. MiFID II clarifies that these would include records of telephone conversations and electronic communications. These would need to be retained for three years.

Heightened protection for eligible counterparties

MiFID II would require investment firms to act honestly, fairly and professionally in their relationship with eligible counterparties and communicate in a way which is fair, clear and not misleading. Investment firms entering into specified transactions with eligible counterparties, including the execution of orders on behalf of clients, dealing on own account and/or receiving and transmitting orders and ancillary services, would continue to be exempted from many investor protection requirements. However, in respect of such transactions, eligible counterparties would benefit, like other clients, from better information on whether advice is provided on an independent basis, whether an ongoing assessment of suitability will be provided, how advice received meets their 'personal characteristics' and periodic communications in relation to the services provided. It is questionable whether all of these requirements are appropriate for eligible counterparties, the most sophisticated clients.

Re-classification of local authorities and municipalities

Local authorities and municipalities would be excluded from the list of eligible counterparties but could request treatment as professional clients, subject to certain criteria. This reflects the Commission's concern about how a number of local authorities and municipalities have been affected by the distribution of complex financial instruments.

Establishing Harmonised Conditions For Market Access For Third Country Firms

MiFID does not harmonize access of third country firms to EEA markets and the arrangements put in place vary across EEA States.

MiFID II and MiFIR envisage a preliminary equivalence assessment of third country jurisdictions by the Commission. Only if the Commission has adopted a decision that (i) the legal and supervisory arrangements of the third country are equivalent to requirements in MiFID II, MiFIR, the Capital Adequacy Directive and

their implementing measures and that (ii) the third country provides for equivalent reciprocal recognition of the prudential framework applicable to investment firms authorized under MiFID II could a firm from that third country request access to EEA markets.

The conditions under which such a request may be granted would depend on whether services are to be provided to retail clients, professional clients or eligible counterparties.

If the firm wishes to provide investment services to retail clients in the EEA, it would have to establish a branch in the relevant EEA State. This would require prior authorization by the competent authority in accordance with criteria set out in MiFID II. It is possible that the same requirements would apply where investment services are to be offered only to professional clients, although, oddly, this scenario is not addressed by MiFID II or MiFIR.

A third country firm only seeking to provide specified investment services (execution of orders, dealing on own account and/or receiving and transmitting orders) to eligible counterparties in the EEA would have to apply to ESMA for registration under MiFIR. ESMA would need to be satisfied that the firm is authorized in its home jurisdiction to provide the relevant investment services and effectively supervised by its competent authority and that cooperation arrangements between ESMA and that competent authority have been established.

MiFIR provides for an exemption from the new requirements for specified services provided to eligible counterparties (including the execution of orders on behalf of such clients, dealing on own account and/or receiving and transmitting orders and ancillary services) on an unsolicited basis. However, this exemption is very limited and would not necessarily allow third country firms to effectively maintain even their existing business relationships with clients in the EEA.

Under transitional provisions, existing third country firms could continue to provide services in the EEA for four years after the entry into force of MiFID II and MiFIR. Thereafter, they would need to comply with the new access requirements.

These new requirements would be quite onerous. Firms based in third countries that do not pass the equivalence test – presumably including, but not necessarily limited to, some important emerging markets – could no longer provide any investment services in the EEA. Other third country firms could request access to EEA markets. However, authorisation and establishment of a branch in an EEA State would involve significant compliance costs. ESMA registration would hopefully be a cheaper process but sufficient only for third country firms exclusively targeting EEA eligible counterparties in the circumstances envisaged by MiFIR. This could make access to EEA financial services markets less attractive for some third country firms and drive up the price of their services. A further concern is that some third countries might respond to the proposed equivalence regime by restricting access to their own financial services markets for EEA firms.

The impact is likely to be particularly marked in the UK. Conscious of the advantages for London as an international financial services centre, the UK currently operates some flexible access regimes for third country firms. Where a person can take advantage of the overseas persons exclusion in the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001, it can provide financial services without authorisation. The likely removal or narrowing of this exemption could reduce the geographical spread of financial services on offer in London.

Strengthening Supervision and Enforcement

Product intervention powers

MiFIR would allow competent authorities to restrict or prohibit the sales, marketing or distribution of financial instruments and types of activities where this is necessary and proportionate for addressing significant investor protection concerns or a serious threat to the orderly functioning and integrity of financial markets or the stability of the financial system and after consultation with other competent authorities and ESMA. ESMA could make similar but temporary interventions in certain circumstances where competent authorities have not taken action.

Powers over derivative positions are discussed above.

Effective sanctions

MiFID requires Member States to impose sanctions for breaches which are effective, proportionate and dissuasive. MiFID II would require Member States to take into account certain criteria when determining these sanctions, such as the profits gained or losses avoided as a result of the breach. Competent authorities should have a wide range of possible sanctions at their disposal, including "naming and shaming", withdrawal of authorisation, temporary prohibition on exercising management functions in investment firms and fines. Fines could be up to twice the amount of profits gained or losses avoided because of the breach where this can be determined or, in any case up to 10% of the annual turnover in the preceding business year for a legal person or up to EUR 5 million for a natural person. Criminal sanctions are not covered in the working draft.

Next Steps

The legislative proposals will now pass to the European Parliament and the Council for negotiation. This process provides some scope for changes to MiFID II and MiFIR. It is likely that governments and industry groups alike will continue to lobby intensively for modifications to some of the more controversial provisions. Indeed, our analysis suggests that a more thorough analysis of the costs and benefits of some elements of MiFID II and MiFIR could add value to this ongoing debate.

It is too early to predict precisely when MiFID II and MiFIR might be adopted. MiFIR would presumably become directly applicable in Member States two years² after its adoption. MiFID II would need to be implemented by Member States but it is not apparent from the legislative proposal when this process would have to be completed. Our current best estimate is that the combined proposals will not become fully effective until early in 2015.

² This timeline appears in square brackets in the legislative proposal and may be subject to change.