



ECMI Research Report

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MiFID Implementation in the midst of the Financial Crisis

Results of an ECMI Survey

Diego Valiante

& Bashir Assi

Abstract

This report summarises the main results of a survey conducted by the European Capital Markets Institute (ECMI) during the period December 2009 - July 2010. The survey aims to investigate the actual implementation of the Markets in Financial Instruments Directive (MiFID), two years after it came into force. A general finding of this survey is that MiFID rules have had a positive impact, in particular, through a greater competitive environment that promoted, most of all, cuts in trading fees and massive investment in technologies and infrastructure. The impact of the Directive, however, remains highly controversial in terms of data quality and implementation costs.

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MiFID Implementation in the midst of the Financial Crisis

Results of an ECRI Survey

Diego Valiante & Bashir Assi*

1. Introduction

This report presents the main results and conclusions of a survey conducted by the European Capital Markets Institute (ECMI) during the period December 2009-July 2010.¹ The survey investigated the actual progress achieved in the implementation of the Market in Financial Instruments Directive (MiFID),² two years after it came into force, with the aim shedding light on how MiFID is applied in practice by different market participants in the European financial sector.

In recent years, European financial markets have undergone significant changes, such as technological developments, new trading platforms and financial integration, which have had a major impact on their structure and competitive landscape. In addition to these factors, the 2008-09 financial crisis had major repercussions on European financial markets, thereby obscuring the effects of the MiFID implementation.

To this extent, there is no doubt that isolating the effects of distinct and disparate factors, and their contribution to the current state of European financial markets is a complex task. Moreover, European financial markets are in the midst of a (r)evolutionary process, and it is highly challenging to predict how the market will develop in the coming years. In this respect, any attempt to pinpoint the correlation between MiFID provisions and the current state of the European securities market is an uncertain exercise and must be undertaken with due care.

Therefore, this report highlights the main results of the survey without drawing conclusions on the role played by external factors. The approach taken is merely to present the reality as objectively and fully as possible, without offering firm policy conclusions. Nevertheless, on some topics – where appropriate and in line with the survey responses – the report may express support for certain policy options that are seen as fostering a better implementation of the MiFID framework.

There is a broad consensus that MiFID has been successful in the establishment of a comprehensive regulatory framework that has increased efficiency and competition in

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¹ The survey instrument can be downloaded at <http://www.eurocapitalmarkets.org/node/541>

² Directive 2004/39/EC and its 'implementing measures', Directive 2006/73/EC (hereinafter, "implementing Directive") and EC Regulation 1287/2006 (hereinafter, "implementing Regulation").

European financial markets. Before the Directive came into force, however, it was unclear how the markets would adapt to this new framework. Most notably, it is still unclear whether the current state of European financial markets is coherent with the MiFID framework, as was intended by the MiFID architects. To put it differently, while most market participants agree on the positive effects of these new rules, many argue that there is a lack of enforcement and fragmentation in the national implementation. In our view, two factors have contributed to the ambiguity of the actual implementation of MiFID provisions:

- i) the principle-based structure of the Directive, as was constructed at Level 1 according to the Lamfalussy procedure; and
- ii) the insufficiently coordinated action and control over the enforcement of the Directive by the competent national authorities, which led to divergent interpretations in its implementation and enforcement.

The new supervisory architecture designed by De Larosiere,³ however, will try to address these ambiguities.

Taking into consideration the abovementioned points, the implementation of the Directive has been largely based on: first, the interpretation of the Directive, by market participants; and second, the form and level of supervision and enforcement by the national regulatory authorities. Consequently, this has led, to divergent interpretations, implementation and enforcement of the Directive's provisions by different member states.

The European Commission is planning to review MiFID in 2011 (hereinafter 'the Review'), with a view to adopting implementing measures by 2012. The survey aims to contribute to and enrich the current debate on the implementation of MiFID.

2. Survey conclusions

This section presents the main conclusions that can be drawn from the responses we received from market operators to this survey. Overall, seven areas that can be highlighted: 1) business conduct rules; 2) data quality, consolidation and access; 3) pre- and post-trade transparency; 4) trade execution; 5) organisational requirements; 6) transaction reporting; 7) general views.

Business conduct rules. The results of the survey seem to confirm that overall this set of rules has been uniformly applied across Europe. However, some doubts remain on remuneration of compliance officer and best execution duties. Overall, the compensation and functions of compliance officer are not always entirely independent from the performance and the day-by-day activities of the company. It is unclear if this is the effect or the cause of the scarce influence of the compliance function over the commercial strategies of the operational one. Concerning best execution duties, from the responses it seems clear that firms applying best execution are *de facto* making sure they meet the minimum legal requirements (static view). There are only a few hesitant intentions to promote dynamic execution policies for clients, beyond the requirements set by MiFID. It would therefore seem crucial to assess the commercial grounds of specific decisions. For instance, limiting the choice of trading venues that clients can decide to execute their orders on.

³ See, in general, available documents on the European Commission's website on financial supervision at (http://ec.europa.eu/internal_market/finances/committees/index_en.htm).

Data quality, consolidation and access. In relation to quality, responding institutions seem to agree that the quality of some trade data is quite low (e.g. OTC trades). In addition, lack of standardised data formats and flags, plus the widespread use of potentially harmful selling practices (e.g. bundling pre- and post-trade data), seem to have deteriorated data quality and increased the costs of data consolidation on a pan-European level. Accessing these data solutions is thus still costly and use by retail investors and funds is not common.

Pre- and post-trade transparency. Respondents have highlighted major issues in the standardisation of formats and flags of post-trade data and quotes (for formats), which are impeding the actual delivery of a commonly affordable and meaningful consolidated pre- and post-trade data solution. The quality of data, therefore, is generally judged to be poor for OTC trades. However, there is a general feeling that MiFID has extended the range of products under transparency obligations, in line with the objective of a pan-European market. Besides quality, adjustments may be needed for waivers of pre-trade transparency, as thresholds may no longer be compatible with the evolution of the market. Other issues concern the use of cross-selling strategies to increase overall revenues, for example, the practice of bundling pre- and post-trade data solutions or promoting different formats to create an artificial non-homogeneity of products in order to help market segmentation in the distribution phase.

Trade execution. There are conflicting views on the effects of MiFID on trade execution. Some respondents argued that MiFID increased the volume of trades on dark books and/or off-order books. However, other entities replied that MiFID only made transparent something that was opaque and outside the legal regime before it became effective.

Organisational requirements. Conflict of interest procedures are widely and uniformly applied by market participants since many of them had already procedures in place that were in line with MiFID requirements. However, monitoring these policies may be costly for financial authorities, which usually apply different mechanisms of enforcement. This may affect the results of their action. Regarding compliance officers, all respondents have appointed one with the introduction of MiFID. However, compensation is not always independent from the economic performance of the firm and officers typically perform other functions and responsibilities within the firm. All relevant respondents have a system of record-keeping in place. Finally, not all IFs segregate assets with third parties or are ready to do so if the investor opposes the decision to deposit financial instruments with a specific counterparty.

Transaction reporting. Transaction reporting requirements have been fully applied and IFs keep records of them according to MiFID rules. The majority of IFs publish their transaction report through an external service provider.

General views. Overall, respondents' opinions on MiFID rules are positive, in particular for the more competitive environment that has promoted most of all reductions of trading fees and massive investment in technologies and infrastructure. This generated positive spill-over effects on the market as whole. Negative views are widespread on the actual quality of trading data, with particular reference to the OTC trades, and the costs that market participants have had to meet to fully implement MiFID rules.

3. Survey on MiFID Implementation

3.1 Purpose of the Survey

The survey aims at giving a qualitative and objective analysis of the actual implementation of MiFID across European markets. The scope is, therefore, to provide an overall assessment of MiFID implementation by various market players, almost three years after the Directive came into force.

Among the numerous regulatory measures introduced by MiFID, the study focuses in particular on three pillars:

- Conduct of business (best execution, suitability and appropriateness, conflicts of interest, record keeping, compliance, remuneration, safeguard and depositing);
- Trading venues and transparency (e.g. pre-trade transparency waivers); and
- Trade reporting and data quality (e.g. consolidation of data).

The affected part of the industry has been discussing MiFID in relation to its effective and proper implementation. Concerns have been raised on detailed issues, such as best execution (e.g. measuring quality of execution, etc.), pre-trade transparency waivers, level-playing field between trading venues, etc. These issues have attracted even more attention as a result of the financial crisis. In this respect, the survey tries to shed light on potential issues that can be discussed by the MiFID Review.

MiFID had implications for a wide span of regulatory and market issues. However, the focus of this survey will only be limited to the issues mentioned above.

3.2 Survey Description and Methodology

For the survey, we selected the respondents with a view to assembling a representative sample of different participants in European capital markets. We split responding institutions into five target groups:

- Regulatory authorities (RAs)
- Regulated markets (or RMs)
- Multilateral trading facilities (or MTFs)
- Investment firms (IFs); and
- Data vendors (DVs).

The investment firms group include: investment firms, systematic internalisers, broker-dealer crossing networks.

We contacted a total of 86 entities, of which 43 (50%) responded to our questionnaire. The groups were divided as follows:

- Regulatory authorities: 4 out of 15 (26.7%);
- Regulated markets: 8 out of 16 (50%, representing 42.9% of EEA (European Economic Area) regulated markets' turnover;⁴

⁴ Authors' calculations based on figures reported by Thomson Reuters.

- MTFs: 11 out of 17 (64.7% which represents 96.6% of EEA MTFs’ turnover, 70.9% of EEA MTFs’ dark and hidden order books’ turnover, and 99% EEA MTFs’ lit order book’s turnover;⁵
- Investment firms: 16 out of 32 (50%); and
- Data vendors: 5 out of 6 (83.3%).

Figure 1. Breakdown of survey sample by type of institution

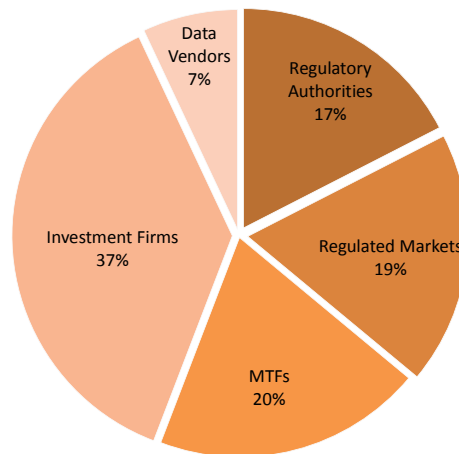
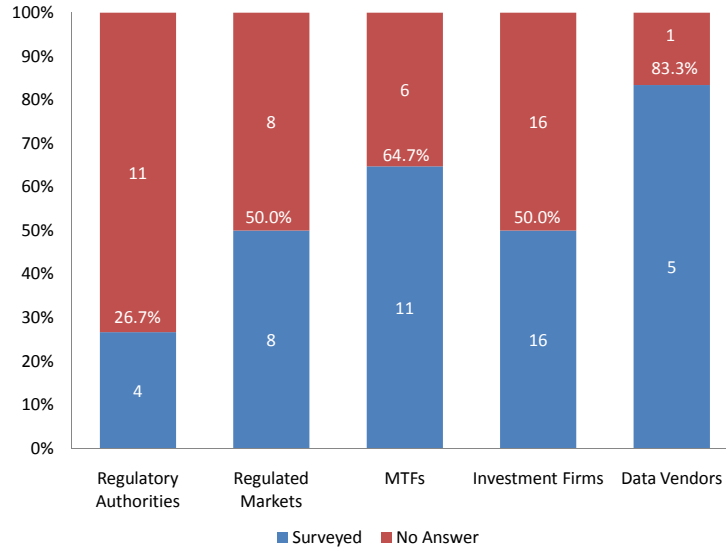


Figure 2. Response rate to the survey, by type of institution



The lowest rate of responses came from regulatory authorities, as they are more reluctant to deal with regulatory issues outside the umbrella of CESR. The complete list of responding institutions appears in Annex I.

⁵ Authors’ calculations based on figures reported by Thomson Reuters.

3.3 Research Questions

MiFID affects many areas of the market system and their participants. The survey, as mentioned above, focuses on three pillars and for each of these pillars we raised research questions that we would like to be implicitly answered by this survey.

3.3.1 Conduct of Business

Did investment firms change their practices with respect to conflicts of interests? Did firms adopt a comprehensive policy and organisational arrangements to deal with potential conflicts of interest?

Are the suitability and appropriateness tests applied in practice? Are they applicable from a cost-efficiency point of view?

Is best execution achieved? What is the level of legal certainty, clarity and implementation in the policies of best execution used by investment firms? What type of execution policy is more frequently applied (static or dynamic)? How does increased fragmentation post-MiFID (i.e. market structure and data transparency) affect order execution in general and the ability to achieve best execution?

Do firms keep records of their clients' orders and transactions?

Do firms safeguard their clients' assets? Where do they deposit their clients' financial instruments?

Do firms have a compliance officer, and assure the independence of the officer?

Do firms execute orders? How frequently do they do so? Between how many clients?

3.3.2 Trading Venues and Transparency

What are the major changes in practice to trading on equity markets?

How did MiFID legal classifications affect the structure of the market for trading venues? And what are the characteristics and share of different type of venues in the trading markets – RMs, MTFs, SIs and broker-dealer crossing networks – and their effects on market efficiency, integrity and price discovery?

How severe is the new phenomena of 'dark pools' and broker-dealer crossing networks (BCNs)? Do they fall outside the scope of MiFID? What are their effects on trading in general and particularly on market efficiency and price discovery?

Do dark pools execute trades only above standard market size?

Are pre-trade transparency waivers widely adopted? Which are the most used ones?

How does the current interpretation and use of waivers affect the price discovery and efficient order execution?

3.3.3 Reporting and Data Quality

Do firms comply with MiFID transparency obligations?

What is the effect of MiFID on data quality, provision and consolidation? Is the level of data quality provided by market data sources and vendors good enough from every source of reporting?

Is market data provided on a non-discriminatory basis? And under what terms?

Is the level of standardisation adequate?

Are reporting requirements implemented in practice? Do firms report on a frequent basis to competent authorities? Does the information reported enable the competent authorities to monitor investment firms' activities?

4. Survey Results

4.1 Analysis of the Responses

The analysis of responses will be firstly done by group of responding institutions, then -at the end of the chapter - results will be aggregated for a cross-section analysis, in order to draw some conclusions from the responses we processed at that time.

All questionnaires were submitted to these firms and public authorities during the same period, but responses were sent back at different stages. The period covers December 2009 – July 2010.

As agreed with respondents, the whole section will discuss aggregate results.

4.1.1 Regulatory Authorities

There are two reasons for including regulatory authorities (RAs) in this survey: first, to have an objective view from the competent authorities on the implementation of MiFID by private institutions, as a check to the responses received from them. Secondly, the questionnaire has tried to get a sense of what regulatory authorities actually do to apply MiFID provisions in their national markets. Therefore, the questionnaire included various sections that are relevant to the implementation of MiFID and are only directed to competent authorities or applying to other categories of market participants (investment firms, MTFs and regulated markets).

The number of responses that have been collected is fairly low, due to a general commitment by these authorities to provide detailed information on the application of European Directives only in a general framework led by the Committee of European Securities Regulators (CESR). Therefore, only four national authorities have responded to our questionnaire. Surveying the competent authorities was meant to serve two purposes: to check whether competent authorities have been complying with their role and duties in supervising and enforcing MiFID provisions in their national territory; and to verify the reliability of the other market participants responses to our questionnaire.

The questionnaire was constructed to cover the main pillars of MiFID and to enable us to answer some research questions of this survey. The questionnaire was divided into 15 themes as follows: 1) conflicts of interest, 2) suitability and appropriateness, 3) best execution, 4) transaction reporting, 5) record-keeping, 6) safeguard and depositing, 7) compliance officer, 8) trade execution, 9) data provision, 10) data consolidation, 11) transparency (pre- and post-trade), 12) waivers, 13) publication, 14) cooperation and 15) general questions (optional).

Conflicts of interest. Overall, regulatory authorities apply the framework of rules on conflicts of interest designed by MiFID with a sufficient degree of detail. They seem to confirm that not much is changed in the terms of conflicts of interest policies after the introduction of MiFID. The Directive, in effect, built in many cases on already existing national rules. All

Regulatory Authorities (RAs) checked that conflicts of interest policies have been implemented, not only when they grant authorisation to perform investment services and activities. However, methods of law enforcement may diverge. One authority relies on the control done by an auditor once year – which fills an examination report for the authority – while the other three authorities opted for a direct supervision with ‘on-site’ inspections, which is limited to a sample of firms. Finally, one RA does not check links between remuneration of relevant persons,⁶ which may undermine the independence of their activities.

Suitability and Appropriateness. Along with received responses, suitability and appropriateness requirements have been applied uniformly. Procedures seem to have been put in place with no major issues but it does not seem to be diffused practice to keep information on clients regularly updated, even though there exists record-keeping infrastructure for client details across investment firms. In addition, only some investment firms review suitability and appropriateness policies and procedures regularly.

Best Execution. RAs have put in place specific procedures to examine whether investment firms apply best execution. They confirm that investment firms are legally applying best execution. However, some responses cast doubts on how best execution is effectively applied. In effect, in the four countries included in this section on RAs: i) not all venues have separate best execution policies for retail and professional investors; ii) not all firms take into account – when deciding best execution for professional clients – parameters that are not related to price and costs; iii) in general, only some firms have a system able to select a venue across all execution currently available for that financial instrument; iv) all authorities confirmed that some investment firms have a predetermined execution venue; and v) finally, execution policies are generally reviewed once a year and one authority replied that in its jurisdiction firms do not request the consent of the client specifically for the execution policy.

Transaction-Reporting and Record-Keeping. RAs explained that the transaction-reporting and record-keeping systems are working and have been fully applied. One authority, however, highlighted the presence of overlapping information, as trades in some cases are double counted.

Safeguard and Depositing. According to responses, a big part of investment firms segregate clients’ financial instruments with a third party.⁷ If the firm is not a credit institution, other potential depositories are central banks, banks authorised in a third country and/or (international) central securities depositories {(I)CSDs}.

Compliance Officer. All RAs – in these four markets – confirm that firms have a compliance officer and rules in place. However, a fairly high part of the market allows compliance officers to be involved in a firm’s other activities, which should be the object of their monitoring task.⁸ In addition, RAs seems to agree that firms have procedures in place in order to preserve the independence of their remuneration (detached from the performance).

⁶ Art. 22.3 (c), Implementing Directive.

⁷ According to Arts 13.7 and 13.8, MiFID, the investment firm can hold the instruments for its own account if there is a clear agreement with the client or the firm is a credit institution as defined by the Directive 2000/12, Art. 1.1.

⁸ Art. 6.3 (c) and (d), Implementing Directive, require that compliance officers should not be involved in activities they are supposed to monitor. However, the Directive also states that investment firms may waive these

Trade Execution and Reporting. Some of the firms under RAs' supervision execute clients' orders in-house, crossing them or trading on their own account. Most of the firms in these four countries do not comply with pre-trade transparency obligations or other transparency requirements (e.g. quarterly reports) since they are not registered and do not execute trades as systematic internalisers.

Data Provision and Consolidation. Two RAs recognise the difficulty in the consolidation of data, because the market is highly fragmented (hence consolidating is costly). Therefore commercial-led solutions have not yet clearly emerged in their respective countries yet. One authority also envisages an increase in data quality in the near future (e.g. OTC post-trade data quality) and emphasised the fact that pre-MiFID it was possible to acquire all the information from one market player (RMs), which upheld the overall data quality.

Transparency. Concerning pre-trade data, regulated markets and MTFs are providing this data to the market with a common or similar format of publication and equal access. However, some of them discriminate between client profiles and there is a fixed income MTF that provides pre-trade information only to its Members (for this Authority it seems to be a concern even though it is not an obligation under MiFID). These trading venues also apply waivers of pre-trade transparency, mainly for large-in-scale orders. The other three waivers apply as well, and the reference price one typically uses is the price from a regulated market. In relation to post-trade data, except for the quality of OTC data; the quality for equities is fairly high, while authorities claim that non-equity markets are rather opaque.

General views. The surveyed RAs are rather positive on the overall effects of MiFID on European capital markets. However, their positions diverge on specific aspects of the market. Contestability (competition) and transparency of markets is undoubtedly increased, while RAs agree that quality of data (especially OTC) is worsened. RAs take conflicting positions on the improvements of IT infrastructures for investment firms and trading venues with the Directive. According with the responses, there are two plausible reasons to see no or negative changes in IT for trading venues and investment firms with MiFID: 1) the country of reference has not a competitive enough market to stimulate investment in technologies; and 2) a RA, in particular, judges these changes as 'probably not linked to MiFID'. Other areas in which they see further improvements have been pointed out:

- Quality and standards of post-trade data;
- Harmonisation of transaction reporting;
- Extension of MiFID to other financial instruments and (for business conduct rules) to insurance and banking products; and
- Extension of trade reporting to non-equity markets.

obligations, if they demonstrate that duties are not proportionate to the scale and nature of the investment services and activities they perform.

4.1.2 Investment Firms

As mentioned above, investment firms (IFs) represent a diverse group of financial institutions – e.g. banks, institutional investors, brokers – as defined by Art. 4.1.1, MiFID.⁹ 50% of the IFs surveyed replied to our questionnaire.

The questionnaire was devised to cover the main pillars of MiFID for the activities of investment firms that are most challenging for the implementation process. We divided the questionnaire into 13 themes, as follows: 1) conflicts of interest; 2) suitability and appropriateness; 3) best execution; 4) transaction reporting; 5) eligible counterparties; 6) record keeping; 7) safeguard and depositing; 8) freedom to provide investment services; 9) compliance officer; 10) trade execution; 11) data provision; 12) data consolidation; 13) general questions (optional).

Conflicts of interest. One of the main pillars of the ‘conduct of business’ rules for investment firms, for which MiFID imposed a more stringent and harmonized legal obligation than its predecessor ISD,¹⁰ are the rules on conflicts of interest. According to MiFID organisational requirements, investment firms have to take “*all reasonable steps*” (art. 13.3) “*to identify conflicts of interest between themselves*” (art. 18.1). If “*organisational or administrative arrangements*” are not effective “*the investment firm should disclose the general nature and/or sources of conflicts of interest to the client before undertaking business on its behalf*” (Art. 18.2). Further details of how to comply with these provisions, are provided in Section 4, of MiFID Level 2 – Implementing Directive 2006/73/EC, Arts 21-25. Most importantly, investment firms, must have a clearly defined and written policy for conflicts of interest (Art. 22, Implementing Directive). Moreover, investment firms must have a record of such conflicts of interest situations (Art. 23, Implementing Directive). The section of the questionnaire on conflicts of interest measures can be summarised in the points below.

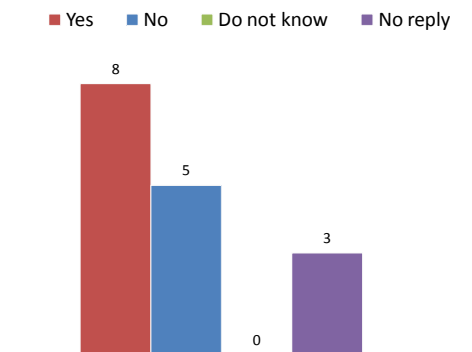
All responding firms have a written conflict of interest policy and specific procedures and measures to manage such conflicts.

Only half of responding firms have adjusted their conflicts of interest policies to cope with new MiFID requirements (see graph below).

⁹ “Investment firm” means any legal person whose regular occupation or business is the provision of one or more investment services to third parties and/or the performance of one or more investment activities on a professional basis; see Art. 4.1.1, MiFID.

¹⁰ See Jean-Pierre Casey and Karel Lannoo (2009), *The MiFID Revolution*, Cambridge: Cambridge University Press, Ch. 6, pp. 98-99. The authors state that – in comparison to the ISD (Investment Services Directive- 1993) – MiFID introduced a stricter ‘conflicts of interest’ regime in three aspects: 1) the provisions are placed under MiFID’s organisational requirements (Art. 13, MiFID), which leaves no discretion to host countries to impose their national regime on conflicts of interest; 2) ISD Art. 11 wording instructed firms to “try to avoid conflicts of interest”, while MiFID explicitly requires firms to “take all reasonable steps” to prevent conflicts of interest; and 3) MiFID defines the types of conflicts of interest that should be avoided, and actions to be taken to manage such conflicts.

Q: If your firm was established prior to January 2007: Did you change any of its practices to cope with the MiFID requirements with regard to conflicts of interest?



Eight firms (50%) have updated their conflicts of interest policies and introduced new procedures, for instance on inducements or a new conflicts of interest matrix. Five firms (31.25%) have not changed their conflicts of interest policies post-MiFID, basically because previous policies and procedures were judged to be already in compliance with MiFID provisions.

Conflicts of interest policies do not differentiate between retail, professional and eligible counterparties (hereinafter, ECP). There are two possible reasons for this: 1) firms are running the business only for retail or professional; or 2) relevant policies are addressing internal procedures, so there is no need to distinguish between different types of clients.

All firms seem to have a system to record conflicts of interest that may arise in their business activities. However, there is one firm that does not have specific procedures to “ensure independence between relevant persons” and “prevent exchange of information between relevant persons”, while another firm does not have procedures to “prevent direct links between remuneration of relevant persons”.

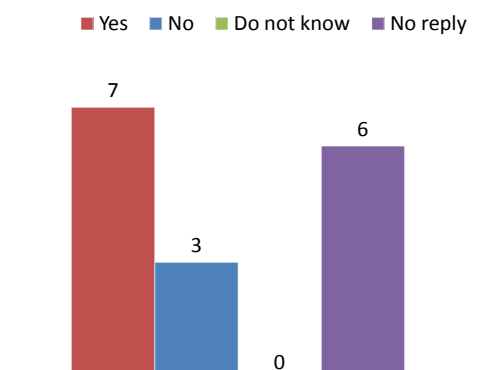
Suitability and appropriateness. The suitability and appropriateness tests (the so-called ‘know your customer’ rules) are articulated in Art. 19, MiFID.¹¹ As mentioned in §1.1.1, on the one hand, the suitability test requires that investment firms assess clients’ knowledge and experience, financial situation and investment objectives when they provide advice or portfolio management services. On the other hand, when investment firms provide other investment services they should evaluate the appropriateness of the product or service on the basis of the information received about the client’s knowledge and experience. A warning should be sent to the client in case he does not provide enough information to define the appropriateness of the service or product. Nevertheless, eligible counterparties have the right to request to be treated as clients (Art. 24.2, MiFID), either on a general form or on a trade-by-trade basis. In this case, the firm must apply the tests when offering the services to such eligible counterparties. The questionnaire results are quite homogenous and there is no indication that the legislation has not been implemented in practice.

All responding firms apply suitability and appropriateness tests to retail and professional clients when they provide advice or portfolio management services, and/or other investment services, and if they are not dealing with ECPs.

¹¹ An extensive overview of the suitability and appropriateness regime is provided in Casey & Lannoo, op. cit., ch. 3.

Firms seem to comply with the requirement to warn clients when the product is not appropriate, but only a few of them use a standardised format for warnings (see graph below).

Q: ... do you have a standard format warning for this purpose?

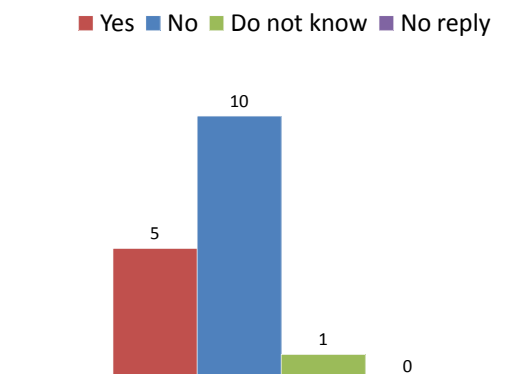


Firms review their suitability and appropriateness policies and procedures; and record client details next to any relevant communication with clients.

Best Execution. The best execution obligation (Art. 21, MiFID) is considered to be the most significant and innovative regulatory measure introduced by MiFID. It may produce a double impact: on market structure (it may support a competitive environment); and on investor protection (it assures a minimum level of protection to investors in the provision and quality of execution services).

All respondents legally apply best execution. Some of them have a separate execution policy for retail and professional investors (see graph below)

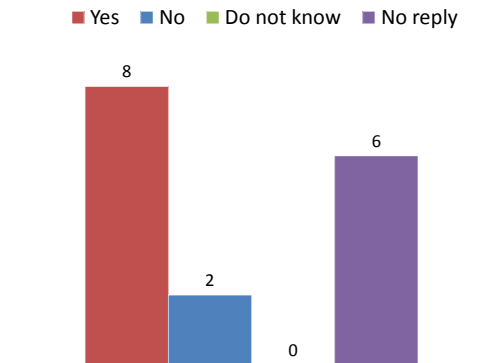
Q: Do you have a separate best execution policy for retail and professional clients?



In effect, some of the firms make the distinction 'retail/professional investor' in the same execution policy, or they do not provide best execution as they only deal with ECPs (which have not 'opted in' to get best execution).

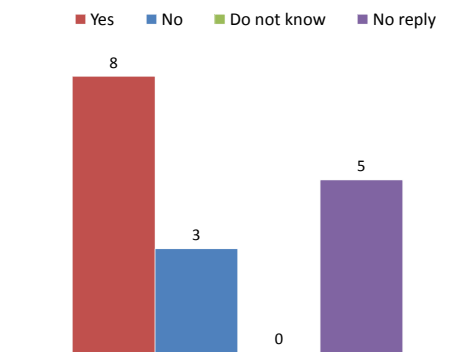
Two IFs apparently do not specify parameters taken into account for the selection of the execution venue (see graph below).

Q: Do you specify the parameters taken into account, for the choice of the execution venue, in your best execution policy?

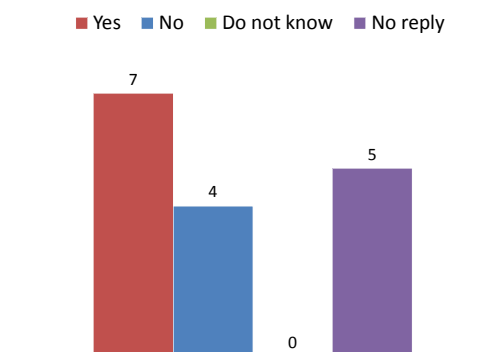


Overall, IFs seem to be compliant with formal procedures and legal requirements (yearly review, etc.), but how these firms apply this legal obligation significantly changes from one investment firm to another (see graphs below).

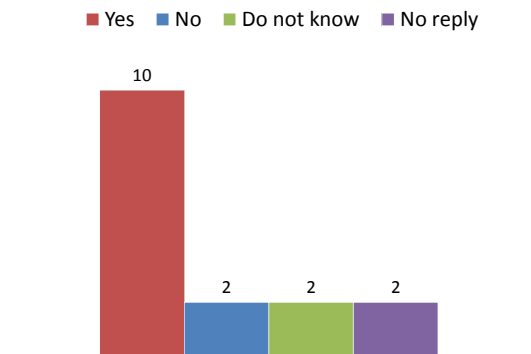
Q: Do you specify in detail in your best execution policy how orders are executed?



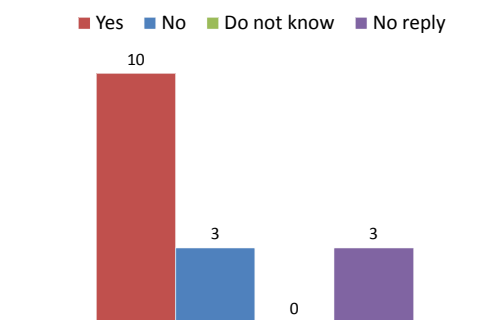
Q: Did you add any execution venue to your list of execution venues since January 1st, 2007?



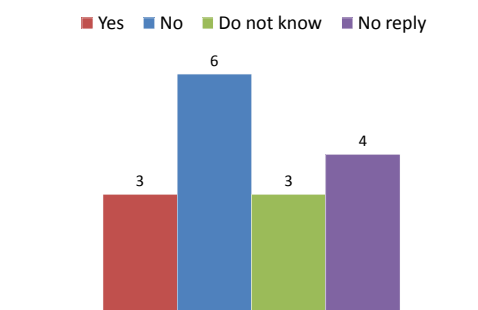
Q: Do you have a specific procedure or technology for selecting the execution venue?



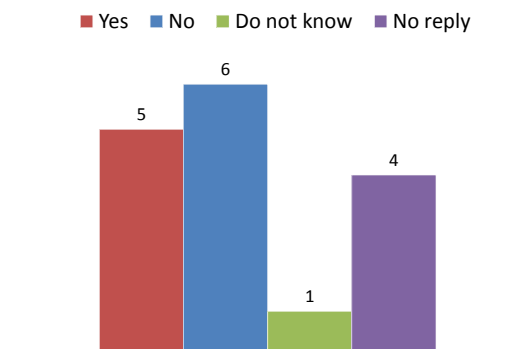
Q: Do you have a system able to select the venue across all execution venues on which the financial instrument is traded (smart-order routing system)?



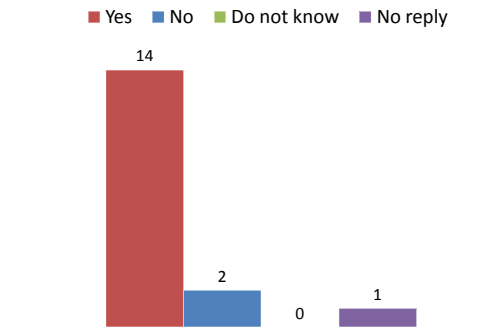
Q: Do you have a predetermined execution venue?



Q: Do you see major obstacles in achieving best execution (e.g. fragmentation, and accessibility to market data)?



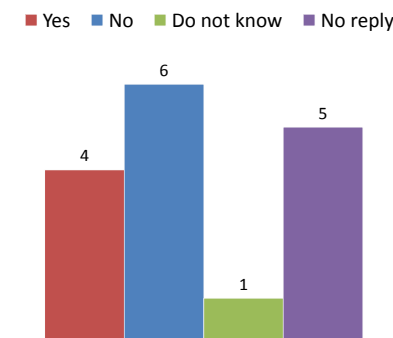
Q: Do you ask for the consent of the client for your execution policy? And for the client's particular consent when an order is executed outside regulated exchange or MTF? (There was only one 'no' response to the second question)



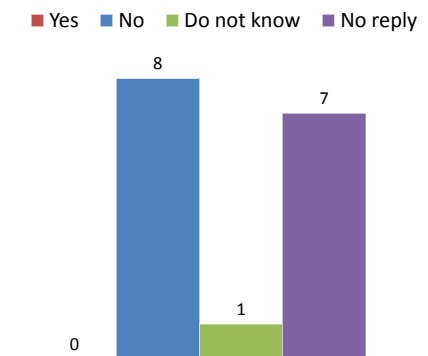
IFs, finally, review their execution arrangements once a year, in compliance with MiFID rules. Generally, investment firms are applying MiFID rules for execution policies, but overall they seem to interpret the design of execution policies as a 'static' and formal legal procedure. Only one respondent reviews execution arrangements more than once a year.

Transaction reporting. The vast majority of IFs publish their transaction reports through external service providers. Some of them have different timing in publishing post-trade data, while no one has experienced any particular problems (e.g. time lagging).

Q: Do you have different timing in publishing post-trade data?



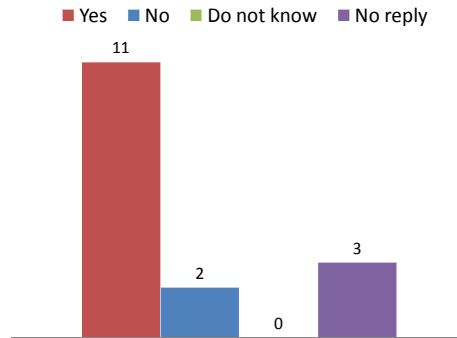
Q: Did you experience any particular problem repeatedly, e.g. time lagging, with respect to post-trade data publishing?



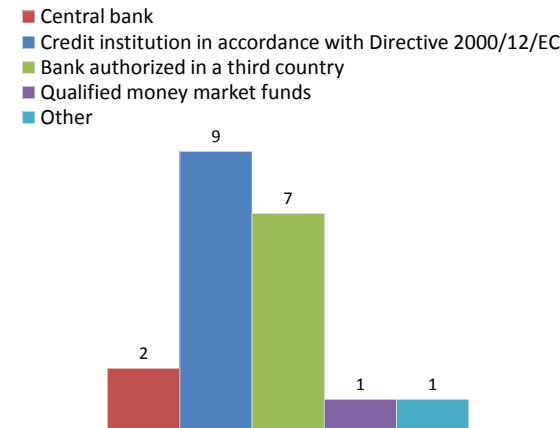
Record-keeping. All responding IFs have systems in place for record-keeping of orders and transactions.

Safeguard and depositing. The vast majority of IFs deposit clients' financial instruments into an account with a third party (usually a credit institution authorised in accordance with Directive 2000/12/EC).

Q: Do you deposit your clients' financial instruments into an account with a third party (hereinafter: "the third party")?

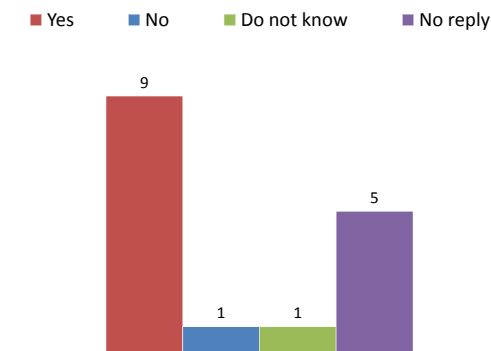


Q: If yes, please specify the type of this third party.

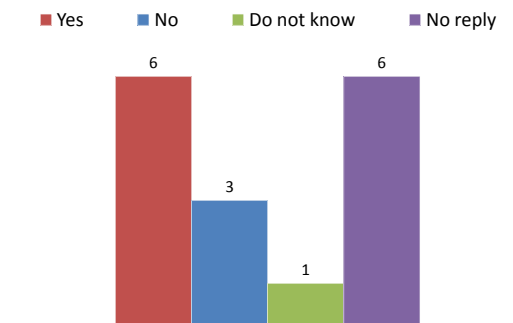


Most IFs review the selection of the third party, while some of them do not provide solutions in case the client objects to a specific depositary institution as 'third party'.

Q: Do you review periodically the selection of the third party?

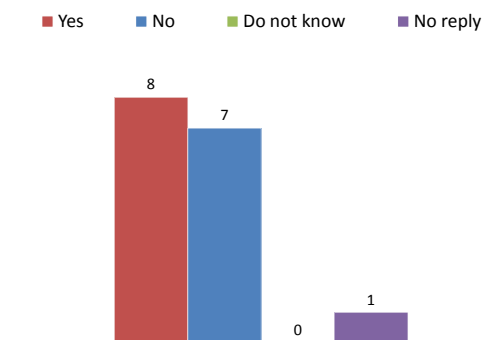


Q: Do you provide solutions in case the client opposed a particular third party as a depositary institution?

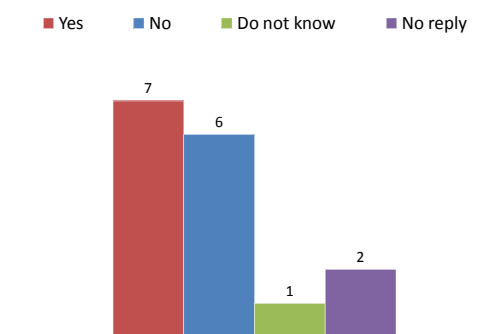


Compliance officer. All responding IFs have a compliance officer, but almost half of them have other responsibilities in addition to the compliance function and a majority of them has remuneration linked in some way with the performance of the firm.

Q: Does the compliance officer perform any other responsibility for the firm, apart from the compliance function i.e. monitoring and assessing the adequacy and effectiveness of measures and procedures?

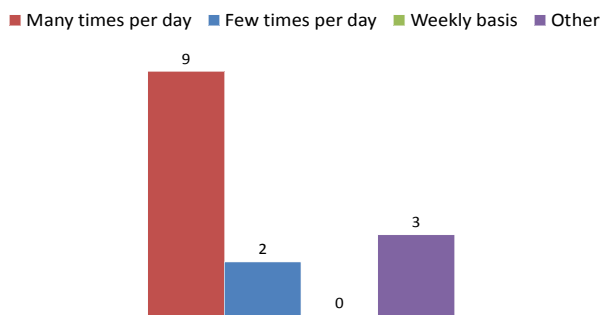


Q: Is the compliance officer's remuneration related in some way to the performance of the firm (or one of its departments)?



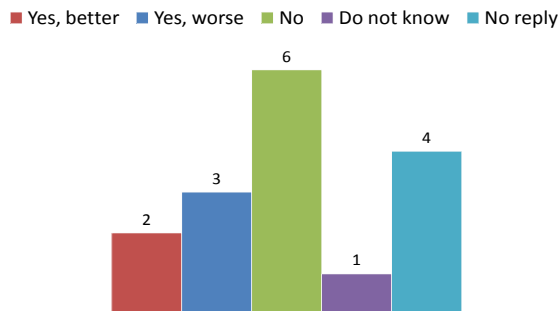
Trade execution. A majority of IFs execute orders on their own account, match clients' orders on a multilateral basis or send them to RMs and MTFs for execution following specific trading strategies. More than half IFs execute orders in-house many times per day and a few of them execute a sizeable share of orders below the standard market size. Only two of the responding IFs publish quarterly reports.

Q: How frequently do you execute orders in house, on average?



Data provision and consolidation. IFs do not agree on the differences in the offer of data services prior versus post-MiFID, however a vast majority sees no changes or negative changes with the introduction of MiFID.

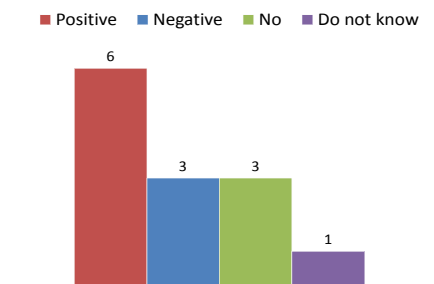
Q: Are there differences in the offer of market data services prior v. post MiFID implementation?



Only two IFs experienced problems to access data services and only a few respondents noticed big differences between data services offered by current data providers. Four IFs do not use consolidated solution and the majority of them do not see particular issues with the quality of data provided by data sources, and only a few of them have difficulties to acquire consolidated data.

General views. IFs do recognise the positive role of MiFID in promoting competition, transparency and investments in IT infrastructures (also for trading venues). They do not agree on the quality of trading data and almost half of responding IFs declare that there have been no changes or negative changes in the quality of data with the introduction of the MiFID.

Q: Do you estimate there has been a significant change after the introduction of MiFID in the quality of trading data and transparency?



Few IFs doubt the overall positive impact of the MiFID. However, there are also high costs due to the fragmentation of the trading environment, in particular in terms of liquidity and transaction costs, even if the cost per transaction has gone down drastically. Specifically, liquidity fragmentation increased the risk of market impact and pushed down the average size of trades, thus the number of transactions skyrocketed after the implementation of the Directive. However, these issues may be explained by the deterioration that IFs see in the quality of trading data, which in their view have not kept up with the evolution in the market structure.

In conclusion, two IFs claimed the risk of unfair benefits in favour of arbitrageurs and proprietary orders. In their view, some trading platforms are de facto discriminating against certain users (proprietary versus agent orders) creating unfair advantages and harming competition.

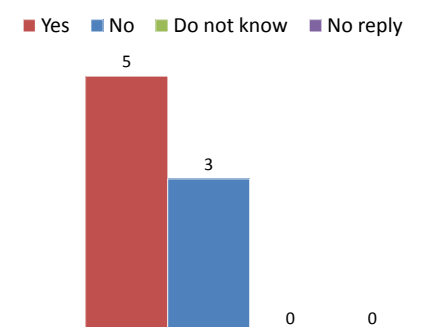
4.1.3 Regulated Markets

Half of the surveyed regulated markets (RMs) replied to our questionnaire. The sample covers roughly 42.9% of EEA regulated markets' turnover (see paragraph 2.2).

The questionnaire covers the following areas: 1) pre-trade data and waivers, 2) post-trade data, 3) data provision and consolidation, 4) transaction reporting, 5) conflicts of interest, 6) compliance officer, 7) monitoring and 8) general questions.

Pre-trade data. All RMs provide pre-trade data, but the data format for some of them is not standardised or commonly used by other trading platforms.

Q: Do you share a common (standard) format of data publication with other market data providers?



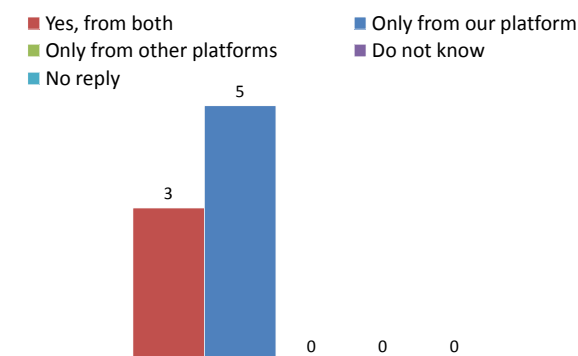
Two of them do not have a single set of terms and conditions, and for at least one of them conditions may change according to the client's profile.

Three of them are also running 'dark books', two directly and one through a subsidiary company recently acquired.

Finally, four responding RMs apply pre-trade transparency waivers and the most diffused is apparently the Large-in-scale orders (LISO) waiver.

Post-trade data. RM's also provide post-trade data of their platform and three of them even provide data coming from other platforms operated by market operators.

Q: Do you provide access to market data coming from trading platforms operated by yourself and/or other market operators?



Costs to acquire this data have not changed, except for one RM, which sees an increase of 10-15% after MiFID came into force. In addition, they offer equal access to all members that subscribe to these data services, and data is usually published in real time or at the latest within 3 seconds. Half of the respondents do not publish quarterly reports.

In conclusion, from their data, responding RMs confirm that the average size of orders has gone down drastically in the post-MiFID environment.

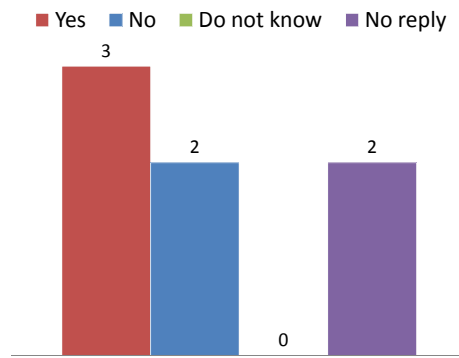
Data provision and consolidation. All responding institutions also act as data providers by selling their data feeds. However, consolidation of data is usually done by external data vendors.

Transaction reporting. All responding firms have a system to ensure the security and confidentiality of the reported data, as well as mechanisms to identify and correct errors in a transaction report.

Conflicts of interest. All responding RMs have a written implemented conflicts of interest policy, with specific procedures and measures to manage such conflicts. However, only one firm has changed these practices to cope with MiFID, after its introduction. Someone responded that their policies did not need changes. Finally, one firm does not keep record of conflicts of interests that may arise between the firm and its client.

Compliance officer. From the responses we received, only one firm does not have a compliance officer. Some of these compliance officers also have other responsibilities within the firm, apart from the compliance function. No RM seems to tie the remuneration of compliance officers to the performance of the firm.

Q: Does the compliance officer perform any other responsibility for your institution, apart from compliance function i.e. monitoring and assessing the adequacy and effectiveness of measures and procedures?

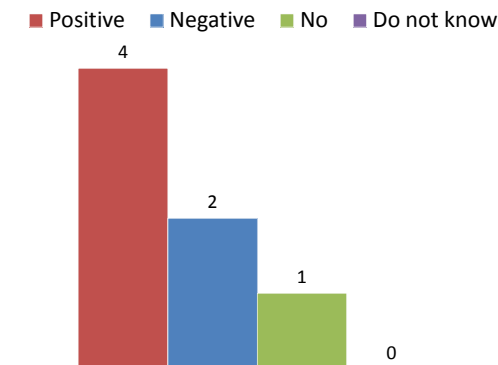


Monitoring. All answering firms have specific arrangements and procedures to monitor the compliance of their members and participants with their rules. Breaches of rules are immediately reported to the competent national authority.

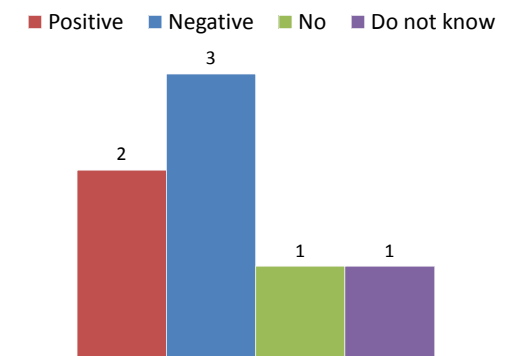
General views. Surprisingly, the majority of responding institutions welcome changes brought about by MiFID in terms of more competition between trading venues and incentives for trading venues to invest in technologies. A prevailing negative position concerns the level of transparency and quality of trading data – which they see as insufficient.

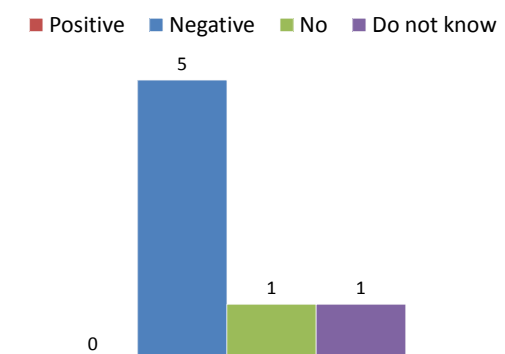
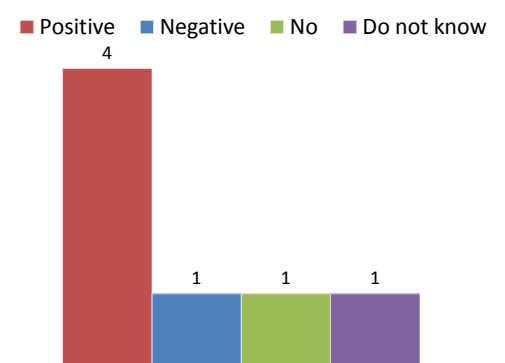
Q: Do you estimate there has been a significant change after the introduction of MiFID in the following:

a. *Competition between trading venues?*



b. *Transparency of European equity markets?*



c. *Quality of trading data and transparency?*d. *IT infrastructure of trading venues?*

Almost all respondents have experienced a negative impact of the MiFID on their business, in terms of higher costs and the uneven approach to regulation between RMs and direct competitors. These differences may have generated, in their view, unfair advantages for differently-classified trading venues.

Overall, the impact of the MiFID on European capital markets has been negatively judged and concerns have been raised about the size of over-the-counter equity trading; the unlevel playing field with other trading venues; the quality of post-trade data; the legal classification for broker-dealer crossing networks; the monitoring and enforcement of best execution duties; and issuer protection from market crashes.

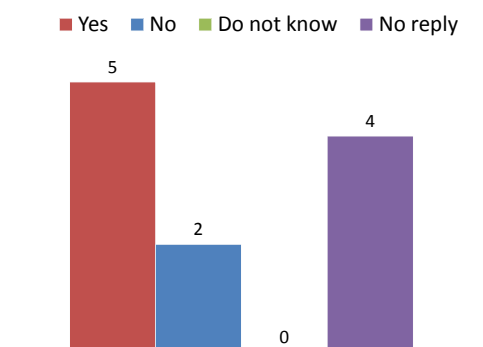
4.1.4 Multilateral Trading Facilities

The response rate of Multilateral Trading Facilities (MTFs) has been fairly high with 11 out of 17 MTFs (64.7%) replying to our questionnaire. As mentioned above, the sample represents 96.6% of EEA MTFs turnover, 70.9% EEA MTFs dark and hidden order books turnover, and 99% EEA MTFs lit order book turnover.

The questionnaire focused on the following areas: 1) pre-trade data and waivers; 2) post-trade data; 3) data provision and consolidation; 4) transaction reporting; 5) conflicts of interest; 6) compliance officer; 7) monitoring; 8) general questions.

Pre-trade data. Six MTFs regularly provide pre-trade data, thus they run lit order books with no regular use of waivers. Market operators also confirm the use of similar data formats; only two of them use non-standardised formats. The majority also has single terms and conditions for the provision of pre-trade transparency data.

Q: Do you share a common (standard) format of data publication with other market data providers?



Finally, waivers are widely adopted but there is no clear preference for one of the four. Reference price and large-in-scale orders waivers seem to be the most commonly occurring ones.

Post-trade data. 9 MTFs out of 11 provide only post-trade data of their own platform – usually free of charge – while 2 MTFs also publish data from other sources. Data is almost simultaneously published or sent to a third party for publication. Many of them do not publish quarterly reports but in many cases they offer data downloadable from their own website on a daily, weekly or monthly basis.

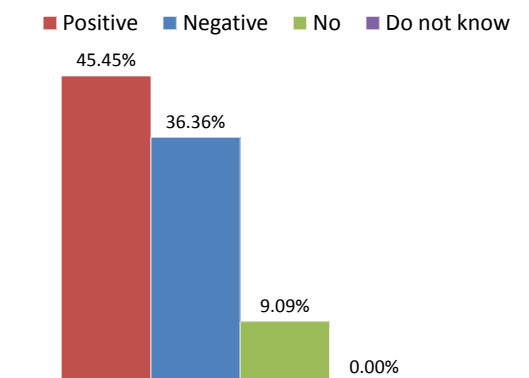
Data provision and consolidation. MTFs offer data, often free of charge. Only few of them offer consolidated data solutions and claim redistribution costs being too high in order to design consolidated solutions.

Conflicts of interest. 10 out of 11 MTFs have a written, established and maintained conflicts of interest policy. In general, these policies specify procedures and measures to manage such conflicts. The majority of the MTFs thus keep a record of conflicts of the interest that arise between the firm and its clients.

Compliance officer. All MTFs have a compliance officer and only in three cases does he/she perform other activities or has remuneration related in some way to the performance of the institution.

General views. Since all MTFs exist due to MiFID, all of them judge positive the introduction of the Directive and its impact on their business. They also see positive effects in terms of increased competition, transparency and investments in infrastructure for trading venues and investment firms. However, MTFs are split on the quality of trading data and nearly half judge the effects of the Directive to be negative, especially on the quality of OTC data.

Q: Do you estimate there has been a significant change after the introduction of MiFID in the quality of trading data and transparency?



A majority of them claim that the implementation of the Directive has brought unfair advantages to some market operators or has not been effectively implemented in some countries. The opening to competition of equity markets, in their view, raises questions around related services where incumbents are still monopolists, giving unfair advantages to them. They also raise the risk that bundled commissions may affect the quality of execution services.

In conclusions, MTFs judge positive the impact of the MiFID on EU financial markets as being positive and expect further improvements in specific areas: the quality of OTC data; the quality of best execution for retail investors; a partial revision of waivers; and a real opening-up of market infrastructures (clearing and settlement) to allow pan-European competition.

4.1.5 Data Vendors

Five out of six surveyed data vendors (DVs) replied to our short questionnaire. The questionnaire included three sections: 1) data provision, 2) data consolidation and 3) general questions.

Data provision. Not all DVs cover all trading venues; 2 out of 3 only cover some venues. All have improved their services in order to cope with the growing number of trading venues and the new trading strategies post-MiFID. DVs confirm the poor quality of some of the market data that MiFID requires to be publicised – in some countries for the first time. Some data vendors explain that this issue is caused by a lack of standardisation for new published data (often insufficient data is published) and trade flags do not seem to provide sufficient granularity. In addition, trade reporting obligations raise doubts about their consistent application, which creates potential space for double and triple counting, in particular with OTC market data.

- DVs, in their view, have tried to overcome these issues and to improve the accessibility to market data. In effect, new consolidated data services have been provided to market participants.
- All responding firms confirm that different data formats and identifiers make it difficult to compare data from different data vendors. This may create difficulties to build customised data solutions and eventually increase costs for final users. The industry is working to reduce these differences, but there are structural and competitive obstacles to make them effective.

Data consolidation. All vendors provide consolidated data solutions and they claim to experience difficulties in processing consolidated data due to several factors. Two reasons seem to explain these difficulties: different data formats and delivery methods; and high data fees (mainly due to bundled offers).

General views. DVs judge as positive the overall impact of MiFID on capital markets and their institutions. There is disagreement on the quality of trading data, even though they agree that further improvements are needed for the OTC reporting. In addition, they ask for standardised formats and identifiers, as well as more granular and common flags. They also seem to welcome the extension of post-transparency requirements to non-equity markets.

ANNEX I Surveyed Institutions

Regulatory Authorities

BaFin- Bundesanstalt für Finanzdienstleistungsaufsicht

CNMV- Comision Nacional del Mercado de Valores

FI- Finansinspektionen

Finantsinspektsioon

Regulated Markets

Athens Stock Exchange

Bolsas y Mercados Espanoles (BME)

Borsa Italiana

Oslo Bors

Prague Stock Exchange

London Stock Exchange

Nordic Growth

Warsaw Stock Exchange

Multilateral Trading Facilities

BATS Europe

Block Cross

Burgundy

CHI-X Europe

Equiduct Systems

ICAP Electronic Brokerage

ICAP Energy Instinet

Instinet

Nasdaq OMX Europe

SmartPool

Turquoise

Investment Firms

APG

Banco Santander

BBVA

CA Cheuvreux

CA Calyon Citadel

Citibank

Commerzbank

Danske Bank

Deutsche Bank

Fortis NL (and ABN Amro Bank)

Goldman Sachs International

HSBC Private Bank

JP Morgan Chase Securities

Morgan Stanley

Schroders

Unicredit

Data Vendors

Bloomberg

Fidessa

Interactive Data Corporation

Markit

Thomson-Reuters

About ECMI

The European Capital Markets Institute (ECMI) was established as an independent non-profit organisation in October 1993, in a collaborative effort by the European Federation of Financial Analysts Societies (EFFAS), the Federation of European Securities Exchanges (FESE) and the International Securities Market Association (ISMA), now the International Capital Market Association (ICMA). ECMI is managed and staffed by the Centre for European Policy Studies (CEPS) in Brussels. Its membership is composed of private firms, regulatory authorities and university institutes.

European capital markets have experienced rapid growth in recent years, corresponding to the gradual shift away from relationship banking as a source of funding and at the same time, have had to absorb and implement the massive output of EU-level regulation required to create a single market for financial services. These developments, combined with the immense challenges presented European financial institutions by the globalisation of financial markets, highlight the importance of an independent entity to undertake and disseminate research on European capital markets.

The principal objective of ECMI is therefore to provide a forum in which market participants, policy-makers and academics alike can exchange ideas and opinions concerning the efficiency, stability, liquidity, integrity, fairness and competitiveness of European capital markets and discuss the latest market trends. These exchanges are fuelled by the publications ECMI regularly produces for its members: quarterly newsletters, annual reports, a statistical package, regular commentary and research papers, as well as occasional workshops and conferences. ECMI also advises European regulators on policy-related matters, acts as a focal point for interaction between academic research, market sentiment and the policy-making process, and promotes a multidisciplinary and multidimensional approach to the subject.



European Capital Markets Institute

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