



Patrick Neary

Foreword by Patrick Neary, Chief Executive, Financial Regulator

It is a pleasure to introduce this special bulletin of Regulatory Connection which is dedicated to the Markets in Financial Instruments Directive ('MiFID'). This Directive, which will be implemented

in Ireland in November, contains a number of enabling provisions which should convey considerable benefits both to investors and industry, and thus to Ireland, if full advantage is taken of these opportunities. I would urge firms to look beyond the implementation of MiFID as just a compliance exercise and to think strategically about the new possibilities it can present.

MiFID aims to remove obstacles to the use of the passport by investment firms, foster competition and create a level playing field between Europe's trading venues. It will transform the landscape for the trading of securities, increase the source and drive down the cost of new capital and generate growth. It is good news for investors because it will both increase their level of protection and give them greater choice.

By substantially updating the so-called "single passport" for investment firms from November onwards it will mean that a firm will only be subject to supervision by one regulator - the home regulator when providing services on a cross border basis. The host state regulator's role in supervising branches in its

territory will only be in respect of conduct of business and transaction reporting. As a result of stimulating cross-border activity, the range of products and services that investors can access and of markets that firms can tap into will expand. The MiFID contains several technical innovations allowing for more coherent regulation of this new pan-European financial marketplace.

Perhaps most profoundly of all MiFID abolishes the so called 'concentration rule' which required investment firms in a number of Member States to route orders to the stock exchange. It will lead to a new relationship between investment firms, stock exchanges and other trading venues for the right to host transactions in shares. This greater choice of trading venue should bring about even more competitive standards of service to investors, lead to more investors using capital markets, and ultimately to deeper and more liquid markets. It will also lead to increased transparency of the whole European marketplace, not just the national stock exchange.

There is no reason why Irish firms should not rise to the strategic opportunities offered by MiFID to develop as a cross EU trading venue or to offer investment products to a greater consumer base than was hitherto possible.

I hope that this bulletin of Regulatory Connection will act as an early reminder of the new opportunities coming your way.

CONTENTS

Foreword by Patrick Neary	1	Conduct of Business	8
Message from the Prudential Director	2	Transaction Reporting	9
MiFID Implementation on Structure	3	Multi - Lateral Trading Facilities (MTF)	9
Impact and Scope of MiFID	4	Systematic Internaliser	10
CESR's Role in Relation to the MiFID	6	Glossary of MiFID Terms	10
Authorisations and Passporting	7		

Message from the Prudential Director



Con Horan

In this bulletin we provide information on the various impacts that MiFID will have as it comes into effect in areas such as authorisations, transaction reporting and conduct of business.

The MiFID, (formerly known as ISD2) is one of the most significant pieces of financial services legislation agreed in recent times and applies to both Investment Firms and Credit Institutions when providing investment services.

It incorporates a revision and an extension of the provisions of the Investment Services Directive (ISD) that had regulated the provision of investment services within the internal market since 1993. It also introduces some new provisions promoting transparency in the trading of financial instruments that are admitted to trading on a regulated market anywhere within the EU.

The MiFID was agreed in April 2004 by the European Council and the European Parliament. Shortly after the adoption of the MiFID the EU Commission granted a formal mandate to the Committee of European Securities Regulators (CESR) to provide technical advice. CESR provided this advice in both February and April 2005. Both the European Parliament and the European Council examined the draft advice and the final implementing measures were adopted in August 2006. The development of the legislation has involved no fewer than 19 separate consultations to date organised by either the EU Commission or CESR. CESR is the key forum for consultation on the MiFID. Further details of CESR's work on the MiFID are contained within this bulletin.

The Department of Finance is proceeding with drafting the legislation transposing the MiFID into Irish Law and this is scheduled to be completed by 31 January 2007. Firms have a further nine months, until 1 November 2007, to comply with the provisions of the legislation.

The Financial Regulator has established a joint forum with industry to work on the implementation of the MiFID in Ireland. As part of the implementation plan we have established a number of different workstreams to deal with various aspects of the MiFID. Contact details are contained within this bulletin. Industry representatives have been invited to participate in a number of these working groups in particular those dealing with Conduct of Business and Organisational requirements.

I urge all firms which may be impacted by the MiFID to examine the provisions of the Directive and assess the impact for their firms as soon as possible.

MiFID brings with it a number of opportunities for those that are prepared in time. Existing firms that at present do business only in the Irish market may wish to avail of the commercial advantages of operating in a much larger market. We may also see new firms enter the EU market to take advantage of the new freedoms. MiFID compliant firms stand to gain from the new framework as opportunities for business will grow while at the same time it should increase market efficiency through increased competition across the single market.

A handwritten signature in blue ink that reads "Con Horan". The signature is written in a cursive style.

Con Horan
Prudential Director

MiFID Implementation Structure

In recognition of the far-reaching nature of the MiFID, the Financial Regulator has involved four separate departments within the organisation in its implementation - Markets Supervision, Financial Institutions and Funds Authorisation, Consumer Protection Codes and Investment Service Providers Supervision.

Each of these departments within the organisation is charged with the implementation process of relevant parts of the MiFID. The Financial Regulator has also put measures in place seeking to insure that no provisions of the MiFID are overlooked and that implementation is carried out in a co-ordinated fashion. These measures include oversight of the overall project by legal and organisational advisers.

The Financial Regulator has established fourteen separate workstreams to deal with the implementation. The areas that each workstream covers plus contact details are set out below:

Workstream	Contact
CESR	downey.keegan@financialregulator.ie
Transaction reporting	jack.grehan@financialregulator.ie
Systematic Internalisation	downey.keegan@financialregulator.ie
Pre and Post trade Transparency	downey.keegan@financialregulator.ie
Regulated Markets	helen.ward@financialregulator.ie
Multilateral Trading Facilities	downey.keegan@financialregulator.ie
Transposition	michael.hennigan@financialregulator.ie
Client assets	niamh.lynn@financialregulator.ie
Organisational	noel.thompson@financialregulator.ie
Mapping of authorisations and passports	tim.mcdonagh@financialregulator.ie
Conduct of Business	deirdre.norris@financialregulator.ie
Client classification	deirdre.norris@financialregulator.ie
Authorisations	annemarie.pidgeon@financialregulator.ie
Registers	fiona.strain@financialregulator.ie

Impact and Scope of MiFID

The MiFID brings with it extensions to current investment service regulation. As a result, firms should consider the areas and implications for them where the ISD has been extended. We have detailed below the main implications for various activities. In conducting assessments of the implications of the MiFID, investment firms, banks and other credit institutions should bear in mind that elements of investment activity and business lines that were not formerly regulated may now fall within the scope of MiFID (and consequently the legislation that will transpose the provisions of MiFID into Irish law).

Extension and revision of the ISD

The extensions of the current investment services regulation will include the:

- extension of the list of regulated financial instruments;
- extension of the list of regulated investment services;
- provision of fully harmonised rules throughout the EU in relation to the organisation of the business of an investment firm and rules for the conduct of investment business;
- application of many of the MiFID rules to banks and building societies;
- regulation of market operators.

Market Transparency

MiFID imposes certain obligations on investment firms, credit institutions and regulated markets to provide greater transparency. These include:

- transactional records and data will have to be retained in relation to all transactions in financial instruments;
- investment firms will have to report all transactions in relation to any financial instrument admitted to trading on a regulated market whether or not such transaction was carried out on a regulated market. This information will also go to the competent authority of the most relevant market for those instruments in terms of liquidity;
- systematic internalisers must make public firm quotes in circumstances where they enter into trades within the concept of 'standard market size' (the Commission has set out criteria in the level 2 measures for determining standard market size);
- investment firms must make post-trade public disclosure in relation to transactions in shares admitted to trading on a regulated market where the transactions are concluded outside a regulated market or multi-lateral trading facility (MTF);
- in respect of shares admitted to trading on a regulated market, operators of an MTF must make certain pre-trade public disclosures in relation to prices and interests advertised through their systems and must publicly disclose the price, volume and time of any transactions executed on their systems.

Financial Instruments

MiFID extends the list of financial instruments to include for the first time: commodity derivatives; credit derivatives; derivatives based on exotic variables such as emissions allowances or economic statistics. MiFID will also include financial contracts for differences.

Investment Services

The list of investment services that can be provided throughout the EU using an authorisation obtained in the home Member State has been extended to include, for example, investment advice; the operation of a MTF; and traditional investment services in relation to the new financial instruments. MiFID also includes the service of what is termed "systematic internalisation" whereby an investment firm concludes transactions in financial instruments for its clients on its own account on an organised, frequent and systematic basis.

The investment activity of dealing on own account has been more clearly defined in MiFID and it also includes new ancillary services of investment research and financial analysis.

Maximum Harmonisation

MiFID introduces in the area of investment services a harmonised set of rules governing the organisation of the business of an investment firm necessary to obtain an authorisation and rules governing the conduct of an investment firm's investment business. These measures have been introduced in a detailed directive issued by the EU Commission (2006/73/EC) which may only be added to by Member States in limited circumstances.

Importantly, unlike the ISD, investment firms providing investment services from one Member State to another under MiFID will be subject to the supervision of their home Member State competent authority for prudential purposes.

Application to Banks and Building societies

Many of the harmonised rules of MiFID will for the first time apply to banks and building societies when they provide services covered by MiFID, although such entities will not require any further authorisation to provide such services.

Market operators

MiFID provides for a harmonised regime for the regulation of market operators of what will be known as 'regulated markets'. MiFID provides that investment firms must have equal access to membership of regulated markets throughout the EU, and that the regulated markets themselves must be able to avail of clearing and settlement systems in other Member States on terms equal to markets in those other Member States.



MiFID Implementation Forum which was attended by key representatives from the industry and Financial Regulator in November 06.



CESR's Role in Relation to the MiFID

In early June '06 the Committee of European Securities Regulators (CESR) established its level 3 Expert Group, chaired by Arthur Phillipe of the CSSF, Luxembourg. Two separate sub-groups - one on markets issues and the other dealing with intermediary issues were subsequently established. The Financial Regulator has been very active in all of these groups since their inception. The workplan (comprised of the workplan of both of the sub-groups) for this expert group for the first six months of 2007 was issued for public consultation in August 2006. One of the main concerns of industry participants was the timing of the guidance by CESR on key aspects of the Directive. CESR took these views into account and prioritised these key areas in finalising its workplan.

The markets sub-group will deal with the following aspects of the Directive:

- Transaction reporting
- Required calculations and estimates concerning liquid shares
- Publication and consolidation of market transparency information

The intermediaries sub-group will address the following aspects of the MiFID over the same period:

- Passporting
- Inducements
- Best Execution
- Outsourcing
- Internal Governance

The detailed workplan is available on CESR's website www.cesr.eu

CESR will be very active over the coming months in providing non binding guidance and common interpretations on various aspects of the MiFID. One of the Financial Regulator's principles in its implementation of the MiFID is that it will follow CESR's guidance on the aspects of the Directive and in that regard firms should be cognisant of the fact that CESR is their forum for consultation on such issues.

CESR has issued six level 3 consultation papers to date on the MiFID as follows:

- Level 3 workplan - This was agreed in October 2006.
- Minimum list of records in Article 51(3) of the Directive - the consultation period for this paper closed on 27 November 2006.
- The publication and consolidation of MiFID Market Transparency - the consultation period for this paper closed on 15 December 2006.
- The practical and operational aspects relating to the functioning of the passport for investment firms - consultation period closes on the 9 February 2007.
- The use of reference data standard codes in transaction reporting - consultation period closed 15 January 2007.
- Consultation on Inducements under the MiFID - consultation period closes on 9 February 2007.

CESR is currently preparing a consultation paper in relation to the best execution requirements. This paper is due to be issued in early February 2007.

Authorisations and Passporting

The approach taken by us in relation to authorisations and passporting post-MiFID will be broadly similar to the current approach we take in this regard. However, the MiFID introduces new investment services and new financial instruments that were not included in the ISD. If your firm's activities did not fall within the remit of the Investment Intermediaries Act, 1995 (IIA) or the Stock Exchange Act, 1995 (SEA) but do fall within the scope of the MiFID your firm is a new applicant.

What does an existing IIA or SEA firm have to do?

- Examine the firm's current and proposed activities and match them to the MiFID services and instruments.
- Examine the firm's current passporting permissions and match them to the MiFID services and instruments.
- If an extension to your firm's authorisation is required please contact us. Contact details are available on page 3.
- If your firm is passporting investment services to other EU Member States and you are seeking an amendment to the firm's authorisation a revised passport notification will be required.

What work are we undertaking in relation to existing authorisations and passports?

We are currently developing a matrix to map the investment services and instruments under the IIA and SEA to the MiFID services. Upon its completion we will provide this matrix to firms to assist them in their matching exercise.

What does a new applicant have to do?

- Seek legal advice for a definitive understanding of the scope and application of the MiFID if in doubt as to whether the firm's activities may fall within the scope of the MiFID.
- Notify us by 30 April 2007 if the firm is likely to require authorisation by 1 Nov 2007.
- Submit a pre-application submission in order that we can identify and deal with any potential policy issues that may arise - this should speed up the application process.

What work are we undertaking in relation to new authorisations under the MiFID?

- We have established an authorisation workstream in our implementation structure; contact details are set out on page 3.
- The current application forms and related documentation are being updated and target completion date is 30 June 2007.

Conduct of Business

The conduct of business requirements set out by MiFID and the implementing Directive 2006/73 EC cover areas such as client classification, best execution and client order handling, assessment of suitability and appropriateness, provision of information to clients, inducements and conflicts of interest.

- *Client classification*: there are three categories of client, i.e., retail, professional and eligible counterparty, with different levels of protection afforded to each category, e.g., there are more obligations on firms when dealing with retail clients.
- *Best execution and client order handling*: firms must take all reasonable steps to obtain the best possible result for their clients, taking into account factors such as price, costs, speed, likelihood of execution and settlement, size, nature or any other relevant consideration, when executing orders and must establish an execution policy. Firms must also implement procedures and arrangements for the prompt, fair and expeditious execution of client orders.
- *Assessment of suitability and appropriateness*: when providing advice or portfolio management services, a firm must obtain certain information from clients in order to enable the firm to recommend services and products that are suitable. When providing other services, firms must determine whether the service or product is appropriate. In certain circumstances, firms may provide execution only services or receive and transmit orders without obtaining information from clients or assessing appropriateness, e.g., services related to non-complex instruments.
- *Provision of information to clients*: information must be fair, clear and not misleading, and must be provided in such a form that clients are reasonably able to understand the nature and risks of the service or product offered.
- *Inducements*: firms must act honestly, fairly and professionally in accordance with the best interests of their clients. MiFID sets out criteria in relation to the acceptance of fees, commissions and non-monetary benefits.
- *Conflicts of interest*: firms must identify and manage conflicts of interests and must establish a conflicts of interest policy.

One of the workstreams that has been set up will consider these issues and will also consider how firms that deal with MiFID and non-MiFID business can manage the overlapping requirements of MiFID and the Consumer Protection Code, for example in relation to client classification and suitability requirements. An industry working group has been set up to highlight issues of concern to industry where it may be necessary for the Financial Regulator to issue guidance. The working group met in December 2006 and some issues have already been highlighted, including the meaning of prior express consent, client documentation and client classification.

Transaction Reporting

Article 25 of the MIFID will require investment firms (including credit institutions when providing investment services) who execute transactions in financial instruments, to report such transactions to the Financial Regulator in respect of financial instruments admitted to trading on EU regulated markets. In addition, the Financial Regulator is considering seeking reports in respect of transactions in derivatives linked to such financial instruments and transactions in financial instruments admitted to trading on IEX.

This is a very broad requirement, particularly since it includes 'off-market' transactions. The obligation to trade report will fall on both firms that are members and non-members of the Irish Stock Exchange (ISE) who execute orders. For firms that currently trade report to the ISE there will be a need to amend their systems to meet the new requirements under the MiFID. We have identified this transaction reporting requirement as a priority area of work for us and have established a consultative forum to consider the impact on regulated entities. We will be advising that forum of the information we will require to be reported on each transaction. We encourage firms who believe they may be required to provide transaction reports to us to participate in this forum. The next meeting of the forum is on 23 January 2007.

We will be advising industry of the formats and content of the reports that we will require and participants will have an opportunity to comment on the proposed reports. The reporting requirements cannot be finalised until CESR has completed its work in respect of the codes to apply for the inter-change of data between regulators. CESR opened a public consultation on this issue on 15th December and this consultation period closed on 15 January 2007.

If you wish to participate in the forum or have any queries please e-mail jack.grehan@financialregulator.ie.

Multi - Lateral Trading Facilities (MTF)

One of the main reasons for the MiFID was to take significant changes to the regulatory framework of financial markets into account. There was a need to encourage competition between the various types of trading venues and create a level playing field between such venues. It was identified that there were three separate types of trading venues in competition - Regulated Markets, MTF's and Systematic Internalisers.

In broad terms an MTF is a platform (other than a regulated market) that permits trading between participants. An MTF can be operated by an investment firm which requires authorisation to carry out this activity - or by regulated markets. MTF's were formally known as Alternative Trading Systems (ATS)

It is likely that there will be a number of MTF's operating in Ireland post MiFID.

If a firm falls to be an MTF what does the firm need to do?

All MTF's will have to consider the changes they need to make to their rules and trading systems to comply with the MiFID requirements. MTF's will also have to comply with the pre-trade and post-trade transparency requirements set out in Articles 29 and 30 of the Directive.

If you consider that the operations of your firm may necessitate authorisation to operate an MTF contact us by emailing downey.keegan@financialregulator.ie to organise a bilateral meeting.

Systematic Internaliser

A systematic internaliser is defined as an investment firm which on an organised, frequent and systematic basis deals on own account by executing client orders outside a regulated market or multi-lateral trading facility (MTF). The MiFID has introduced a new transparency regime for investment firms that are systematic internalisers in shares.

If a firm falls to be a systematic internaliser what are the implications?

A systematic internaliser will be subject to the pre-trade transparency requirements as set out in article 27 of the framework directive 2004/39 EC and the associated articles of the implementing regulation 1287/2006 EC.

In summary systematic internalisers must provide firm bid or offer quotes in liquid shares on a continuous basis. Systematic internalisers do not have to quote in all liquid shares they can quote for a subset of liquid shares and they can change this subset over time. When a systematic internaliser deals above standard market size; deals in non-liquid shares or deals in other classes of assets the quoting obligations do not apply.

Firms which are dealing on a significant scale on their own account with clients need to consider whether they are systematic internaliser. In particular all brokers and any investment firm or credit institution engaged in this type of activity need to consider its position. Firms which are also market makers should take this into account. Where a firm has a doubt, it should seek legal advice and if it is still uncertain of its position it should then contact us to discuss the matter. As the most reasonable approach to adopt will depend on the particular details of a firm's business, we will deal with firms on a bilateral basis in relation to this matter.

If you have any queries in relation to 'Systematic Internalisation' please email downey.keegan@financialregulator.ie

Glossary of MiFID Terms

Commodity - Any good of a fungible nature that is capable of being delivered, including metals and their ores and alloys, agricultural products, and energy such as electricity.

Durable medium - Any instrument which enables a client to store information addressed personally to that client in a way accessible for future reference and which allows the unchanged reproduction of the information stored.

Eligible Counterparty - Includes investment firms, credit institutions, insurance companies, UCITS and their management companies, pension funds and their management companies.

Financial Contract for Difference - An agreement to exchange the difference in value of a particular share or index between the time at which a contract is opened and the time at which it is closed. It includes financial spread bets but does not include sports spread bets.

Liquid shares - Shares admitted to trading on a regulated market if traded daily with a free float of €500 million or more, the average daily number of transactions is 500 or more and/or the average daily turnover is €2million or more.

Market Operator - A person who manages operates the business of a regulated market.

Multi- Lateral Trading Facility (MTF) - A multilateral system, operated by an investment firm or a market operator, which brings about multiple third party buying or selling interests in financial instruments - in the system and in accordance with non-discretionary rules.

Systematic Internaliser (SI) - is an investment firm which on an organised frequent and systematic basis , deals on own account by executing client orders outside a regulated market or MTF.

Trading venue - A regulated market, MTF or systematic internaliser.

The above definitions are not legal definitions but are rather a useful guide for firms.