

FIN11 TERM PAPER

MiFiD II : Analysis of the impact of MiFID II on financial institutions

ABSTRACT

An analysis of the changes that MiFID II will bring and how this would impact financial institutions in European Union and also businesses that are currently trading with the European Union. We will measure the impact on the competition on small and big firms We would also consider what companies should do and consider in order to meet the new requirements and maintain their level of performance.

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1. Introduction to MiFID II

1.1 Markets in Financial instruments Directive (MiFID)

MiFID was adopted in April 2004, and took effect as of 1st November 2007, in replacement of the Investment Services Directives adopted by the European Parliament in 1993. MiFID is a European Union law that aims to provide harmonisation of regulation services within the 31 member states of the European Economic Area, ensuring all banks and financial services are following the same set of regulations. MiFID is a regulatory regime, involving 42 measures, that affected how firms participating in investment businesses and primary activities will organise their internal system and controls, as well as how carry out business with their customers across Europe. This is a key element of the European Union's Financial Services Action Plan which was crafted for the purpose of integration of Europe's financial markets, improvement of investor protections and the attraction of fresh investors within the EU capital markets.

MiFID will be focusing on three areas that will be elaborated on in the table below:

Basic Areas:	Rules Included:
Conduct of Business	best execution, client categorisation, suitability/appropriateness, inducements, investment advice, **commodity derivatives**, reporting requirements, client order handling, marketing and **transaction reporting**
Organisation	licensing, cross-border passporting, compliance arrangements, risk management, outsourcing, recordkeeping, client assets and client money, conflicts of interest, systems and controls, auditors, controllers and governance.
Equity Market Transparency	systematic internalisation, pre-trade transparency and post-trade transparency

MiFID applies to entities such as banks, investment service companies and asset managers providing investment services in relation to shares, bonds, units in collective instrument schemes and derivatives. This regulation is meant to be at the side of investors as it aims for firms to act in the best interest of their clients.

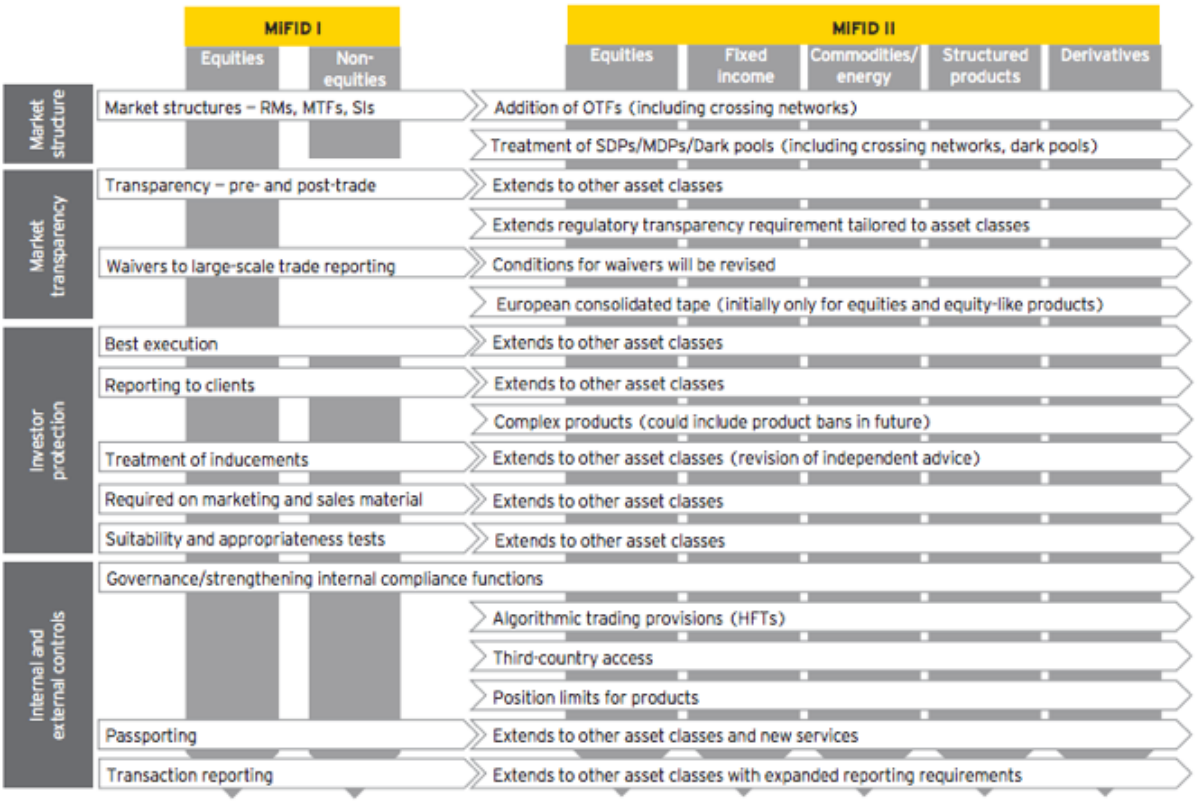
1.2 LIMITATIONS OF MIFID

MiFID was made effective on 1 November 2007, just before the financial crisis. MiFID had aimed not to control **financial instruments**, but to just create a common internal market to increase competition amongst trading platforms. This meant that MiFID birthed the idea of "**multilateral trading facilities**" (MTF) which were allowed to operate next to the "**regulated markets**" such as stock exchanges. Rules that turned to regulate competition by requiring all trades to be done on the **regulated markets** were removed. There was a large increase in the trading that took place on MTF. However, trading also flourished outside of any trading platform on the bilateral "over-the-counter"(OTC) markets. These markets were set up by banks and specialised investment firms, which led to "dark markets" or "**dark pool**" trading. "Dark Markets" refer to venues that do not display prices before the trade takes place. Five years ago, **dark pools** only accounted for 2.7% of European trading, according to data from Bats Chi-X Europe, but as of December 2015, it has risen to 7.5%. MiFID encouraged the rapid growth of such markets, but did not contain anything to prevent or negate the effects of the global financial crisis in 2008.

The failure of the Lehman Brothers, and the financial crisis that came after highlighted the shortcomings in the financial crisis that needs to be addressed. Additionally, the issue of "dark markets" and the lack of **transparency** in the financial industry has been of increasing concern to authorities. In response to this, the European Union has begun a wide-ranging and radical reform of its securities and derivatives markets through MiFID 2.

Additionally, MiFID II will be looking to increase its **asset classes**. In MiFID II, there will be the addition of fixed income, commodities, structured products and derivatives. Many of the regulations will also be expanded to include the new **asset classes**. This will be further elaborated on below.

The changes from MiFID to MiFID II can be seen from the diagram below.



1.3 MiFID II

After a long period of numerous discussions and procedures, there has been a revision made to MiFID. The implementation of MiFID II will present many strategic challenges and operational issues for both EU and many non-EU investment firms to consider in the coming year.

We will now look the core objectives of MiFID:

- Increased investor protection
- Corporate governance and organisational requirements
- Increasing competition across the financial markets
- Strengthening supervisory powers at the national and international levels
- Regulating market for 3rd country investment firms

1.3.1 Increased Investor Protection

One of the main emphasis of MiFID II is on improving investor protection. This extends to the introduction of robust controls to avoid conflict of interest, to encourage greater **transparency** both before and after execution and to ban any commissions payable for investment advice and portfolio management. In summary, MiFID II will be introducing

stricter requirements in terms of communication, disclosure and **transparency** that will work in favor of investors.

1.3.2 Corporate Governance and Organisational Requirements

Within the financial services sector MiFID II seeks to address perceived weaknesses in corporate governance within the sector. The aim of MiFID II is to strengthen the role of management bodies of investment firms, **regulated markets** and data reporting services providers. This is done by ensuring proper and prudent management of the firms as well as the promotion of market integrity and the investors interest. MiFID II includes measures which require management bodies to spend time and have sufficient collective knowledge, skills and experience to understand the firm's activities, such as the main risks facing the firms

1.3.3 Increasing Competition Across Financial Markets

In looking to increase competition across financial markets, there will need to be levelling of the playing field amongst the competitors. This would entail appropriate regulation of all market structures, factoring in the needs of smaller participants like SMEs, as well as new trading technologies. This would include various reinforcements of the regulatory framework of the current trading venues, authorisation requirements, and the creation of a new trading ground – **Organised Trading Facilities** (OTFs). OTFs would apply to the part of trading of equities currently done by **Broker Crossing Systems** (BCS) as well as for the trading of derivatives under different formats. To level out the playing field for SMEs, a tailored regime for them, or promote an industry led initiative to improve the visibility of these markets. On the technological side, there will be increased focus on controlling the users of new technologies, and how they access markets.

1.3.4 Strengthening Supervisory Powers at the National and International Levels

MiFID II will see an increase in reinforced powers of supervision, coordinated with the European Securities and Market Authority (ESMA). Intervention will be allowed both before the execution, in terms of the products offered by each company, as well as after the execution, in relation to sales and services provided. There will be wider general powers to oversee governance processes and for intervention to be carried out wherever necessary.

1.3.5 REGULATING MARKET FOR 3RD COUNTRY INVESTMENT FIRMS

Changes to the third country regime will result in significant barriers to entry for firms outside the European Union. The Commission is looking to introduce a form of exemptive relief for those firms operating in third countries with a regulatory regime that is equivalent to that of the EU. The Commission will set the requirements for a third country to be considered equivalent. Third countries' regulatory regimes will need to be deemed equivalent to the European Union's by the European Commission before a it can apply to undertake investment services within the EU. This will need to be done before a third country firm can establish a branch in the EU, for the purpose of providing services to retail clients. To provide services to eligible counterparts, third country firms do not require a branch in the country, but will still require the go ahead from the European Commission before being able to do so.

1.4 WHICH FIRMS ARE SUBJECTED TO THE REQUIREMENTS?

The MiFID generally applies to **regulated markets**, investment firms and credit institutions in the provision of investment services or performing investment activities in the EU. This would include stock exchanges, investment banks, broker-dealers, investment managers and operators of MTFs.

However, the scope of the MiFD will increase under the new rules. Operating an OTF will be included in the list of activities that will be under the scope of MiFID 2. This means firms engaging in this activity will need to extend their authorisation requirements. More rules will also be applied to a wider range of **financial instrument**s. **Emission allowances**, derivatives of emission allowances and and physically settled derivatives traded on OTFs will also be included in the regulations.

Additionally, all firms employing **high-frequency algorithmic trading** techniques will also be under the regulations and will have to comply with stricter requirements. Some entities that trade **commodity derivatives** may also be brought into scope, depending on the firm's exact activities and what they may be exempted from.

Although not required to be authorized under the MiFID, Central Counterparties and individuals with proprietary rights to benchmarks, for example firms using their own data to establish benchmarks later used by trading venues to develop contracts, will have to comply with the rules on non-discriminatory clearing access for **financial instruments**.

2. Impacts on EU Capital Market's Trading Landscape

2.1 Overview

As aforementioned, MFID II is an extension and modification of the original MiFID framework, which was designed for the equities market and implemented in November 2007. Whereas MiFID I was aimed at creating a single European market in equities trading, MiFID II is a response to the financial crisis. The main objective of the MiFID II framework is to further the integration, competitiveness, and efficiency of the EU financial market. Its reforms are not incremental changes but rather changes that trigger a shift to a new trading landscape. There will be changes to the market structure, greater competition, **transparency** and financial stability, but effects on liquidity are questionable and there may be a risk of fragmentation in non-equity markets caused by introduction of OTFs. These impacts on the trading landscape will be elaborated in greater detail below.

2.2 Impacts

2.2.1 Shift from OTC to trading venues: End of OTC

Over The Counter (OTC) derivatives trading and its opaqueness was viewed as one of the primary drivers of the 2008 crisis. Michel Barnier, EU internal markets Commissioner, stated that MiFID II seeks to put "an end to the rule of opaqueness, and an end to the reign of over the counter transactions". In view of this, the biggest changes will be felt in derivative markets, where reforms seek to implement the commitments made by the G20 in 2009 to move OTC derivative trading to trading venues. (Dudhia, 2015) This is especially acute in the Fixed Income, Currencies and Commodities (FICC) market, which could shift from being predominantly OTC to become largely automated and venue-based. (Flatley, 2016) With significantly less OTC trades, more trading would hence take place on 1 of the 3 regulated trading venues, namely **Regulated Markets** (RM), Organized Trading Facilities (OTFs) and **Multilateral Trading Facilities (MTFs)**.

Under the trading obligation, the main regulatory change is the move to a multilateral environment, specifically the establishment of a new alternate trading venue called OTFs, which is similar to the introduction of MTFs by MiFID I. In contrast to RMs and MTFs, OTF is a new category for non-equity instruments that allows operators to have discretion over order execution. However it has restrictions on the use of its own capital

for principal trading, with the exception of highly illiquid fixed income instruments like sovereign debt on a case-to-case basis. (Deloitte, 2014)

The exact volume of derivatives trading that will move to trading venues is still unknown as it will depend on the number of derivatives that meet the ESMA 2-pronged test. According to the European Securities and Market Authority (ESMA), under the European Market Infrastructure Regulation (EMIR) framework, MiFIR foresees two tests to determine the trading obligation which is closely linked to the clearing obligation:

- Venue test: a class of derivatives must be admitted to trading or traded on at least one admissible trading venue; and
- Liquidity test: whether a derivative is 'sufficiently liquid' and there is sufficient third-party buying and selling interest.

However, it is certain that over time, a significant proportion of OTC derivatives will be eligible for clearing and it is expected to be around 70%.

On the other hand, under MIFID I, a systematic internaliser (SI) is an investment firm which, on an organised, frequent and systematic basis, deals on its own account by executing customer order flow in liquid shares outside a regulated market or a multilateral trading facility. SIs will become increasingly important as the regime is extended to a wider range of **asset classes** and other **financial instruments** including bonds, OTC derivatives, commodities, and emissions. It is expected that a significant proportion of bond trading and some OTC derivative trading that is not subject to the trading obligation will be captured by the SI regime in future. (Deloitte, 2014)

2.2.2 Overhaul of market structure

Under the new rules, all organised trading is due to take place on regulated trading venues or **Systematic Internalisers** (SIs). Equities subject to the trading obligation will no longer be able to trade on broker crossing networks, thus to accomplish this, OTFs have been proposed to capture broker crossing networks and other multilateral trading in non-equity instruments which does not currently take place on **regulated markets** (RMs), MTFs or SIs. (Linklaters, 2014) These new trading venues will be able to exercise discretion in execution, trade on a proprietary basis on their own platform in illiquid **sovereign bonds** and trade on a matched principal basis in all bonds. Moreover, by structuring multiple kinds of financial products for trading and ensuring their adherence to the same broad **transparency** requirements, regulators and investors are able to monitor markets and track prices more easily.

For now, it still remains unknown whether the reclassification of single dealer platforms, broker crossing networks, MTFs and third country platforms, such as SEFs, will represent greater opportunity for flow or impact the liquidity in non-equity markets. (Dudhia, 2015)

2.2.3 Increased transparency

MiFID II will provide adjustments to pre-trade and post-trade **transparency** requirements. The new regulation extends the scope of **transparency** requirements from just shares to non equity instruments and other 'equity-like' ones such as depositary receipts, exchange-traded funds and certificates that are traded on **regulated markets**, MTFs and OTFs. All trading venues (RMs, MTFs and OTFs) are required to publish bid-ask spreads and depth of trading interest. SIs are obligated to make public their firm quotes on the instruments. Waivers have been narrowed and use of some waivers will be subject to a volume cap which limits the extent of its usage. (Deloitte, 2014)

As **transparency** is set to increase significantly, it would enable investors to make more informed investment decisions, facilitate price formation, allow verification of best order execution, and most importantly reduce the adverse impacts which fragmentation in EU equity markets, resulted from MIFID, bear on the quality of price discovery. .

2.2.4 Risks posed to financial stability and orderly markets

High frequency algorithmic trading is one of MIFID II's key provisions designed to avoid flash crashes, promote financial stability and ensure orderly markets. While it has arguably improved market liquidity and asset pricing consistency, its growing use has also resulted in higher risk of systemic risk amplification, where the "Flash Crash" in May 2010 served as a prime example of this risk. It refers to the 5%-6% plunge and rebound in major U.S. equity indices within the span of a few minutes. Repeated episodes of unusual market volatility like the Flash Crash could erode investors' confidence in market integrity. Other risks include errant algorithms which may cause millions in losses since HFT **algorithmic trading** takes place at a high speed; and possibility of worsening volatility swings which could result in huge investor losses as well. (Picardo, 2016)

2.2.5 Increased competition in trading and clearing markets

In line with the policy focus on competition, the European Commission proposed rules on open access to trading, clearing and index licences as part of MiFID II. Open access allows users to process trades through a clearing house of their choice, irrespective of where they traded. This non-discriminatory access regime also applies to benchmarks

for trading and clearing purposes. (Dudhia, 2015) Thus, it is expected to drive competition and limit **vertical silos**, which may improve services to market participants and reduce fees in both trading and clearing. However, due to concerns from some Member States wishing to protect their domestic interests and clearing houses seeking to maintain their revenue streams, it is possible that these regulations will have to be reinforced to ensure competition.

2.2.6 Reduced liquidity

Firstly, increased **transparency** can be positive for investors, but one potential downside is that it may have a negative effect on liquidity as the publication of trade data due to **transparency** may undesirably impact the execution of trades entered into after execution. (Dudhia, 2015) Also, many participants are not interested in making public policy; hence they are not involved in the market. This could hurt price formation and neglect execution objectives pursued by the **transparency** requirements.

Secondly, MiFID II's proposal for pre-trade price **transparency**, which includes greater quote dissemination and equal access of actionable quotes to all clients, may harm liquidity as well. As less-liquid debt trading deviates from more standard offerings and becomes tougher to sell, market makers will be forced to lower the prices to entice buyers, increasing the costs to trade and provide the necessary capital requirement to cover exposures. Such adverse pricing will eventually create a negative loop of decreasing trading activity and subsequent market liquidity, which in turn increases market volatility. (Healey, 2012)

3. Impact on Players in the European Financial Markets

From the section above, it is apparent that MiFID II would result in major changes in the European financial markets. This has led to the emergence of winner and losers.

The impact that MiFID II will have on players would be determined by their strategic responses and the nature of the firm.

3.1 Winners of MiFID II

The following firms would benefit from the implementation of MiFID II:

3.1.1 Large Asset Managers

According to MIFID II,it fund managers from using trade commission to pay for these research and these managers could choose to pay for the research out of their own pockets or set up a separate research payment account for their clients (Markets Media & Bloomberg, 2015). This would mean that asset managers would be required to come up with a proposal for research budget that is specific to the asset owners' investment. Although the client may reject the proposal, managers can still choose to pay for the research cost out of its own pocket.

Moreover, large asset managers such as Aberdeen, BlackRock and Schroders, have the ability to pay for the research costs from their own pockets while smaller fund managers would not have the ability to do so. This would also be easier for large asset managers as they have greater scale hence making it easier for them to conduct the research and taking on the costs itself. Thus, niche and smaller fund managers would not be able to access the research and are at risks of losing the businesses to large asset managers since the large asset managers are able to charge at a lower cost.

Furthermore, it is also possible for these large asset managers to take over the accounts of the small fund managers as they struggle to keep afloat with the increase in costs (Mayhew, 2015). Hence, large asset managers would able to increase their market share significantly.

However, this may lead to a reduction in the production of research for European financial markets and reduce the competitiveness of EU globally.

3.1.2 Asset Owners

Historically, asset owners were being charged a significant amount of money in terms of equity commissions for the external research used by their investment managers. Hence, it seems that these commissions were not efficiently used by the managers.

Thus, MIFID II's proposal of using of Research Payment Accounts (RPAs) will help to manage the commissions of the asset owners more efficiently. This helps to add fiduciary layer for asset owners as under MIFID II, asset owners will only pay for research they need for their investments (Baert, 2016).

However, we must also note that asset managers may also increase the management fees due to the incurring of extra costs and time from setting up RPAs.

3.1.3 Independent Research Providers

Non-Bank Research Providers such as Morningstar and exchanges providers such as London-Stock Exchange (LSE) would also benefit as they have a higher chance in competing with the banks in the investment research market (Bloomberg, 2015) due to the MiFID II proposing to separate payment for research from dealing commissions.

Portfolio managers would no longer need to only obtain research from the banks due to the unbundling of research fees from dealing commission. Hence, portfolio managers would now have greater options to purchase research from other sources such as independent research providers. Moreover, in the long run, independent research provider would do better than investment banks since they already had experiences in pricing their research services on an unbundled basis.

This would mean that the independent research providers as mentioned above would be able to gain access to the equity research market that were once dominated by investment banks and brokers.

3.2 Losers of MiFID II

However, the implications that MiFID II could also result in losers in the European financial landscape.

3.2.1 Small and Mid-Sized Asset Managers

MiFID II regulations **may not be as beneficial** to small and medium sized firms. Asset managers would have to incur additional costs such as financial and administrative costs due to MiFID II. This would definitely reduce profit margin for all asset managers but the impact of these costs on smaller asset managers would definitely be more

significantly since they would not have the scales and resources that larger asset managers have.

In response, these small and mid-sized asset managers would spend less on research (Bloomberg, 2015) and choose to increase their management fees and this may drive clients to the large asset manager. Hence, this may result in the closing down of its operations and also deter many managers from starting up a business in this industry.

3.2.2 Investment Banks

MiFID II regulations will bring about significant changes in the internal crossing systems that were operated by the investment banks. These internal crossing systems would have to be regulated and turn into an Organised Trading Facility (OTF) or a **Systematic Internaliser (SI)**.

Moreover, all eligible **Over The Counter** (OTC) derivative contracts will need to be centrally cleared by European Market Infrastructure Regulation (EMIR). The EMIR is a body of European legislation and its aim is to regulate and provide the requirements for reporting of OTC derivatives and risk management standards. This would help to increase **transparency** and reduce systematic risk. Furthermore, there are also changes to the trading requirements for both pre-and-post- trade. It will not widen its scope to include more **financial instruments** and increase intensity of **transaction reporting** (KPMG, 2012).

Hence, these changes would affect investment banks negatively since it would lead to increase in the costs of capital that firms would need to incur. The regulation for OTC derivative contracts to be centrally cleared by EMIR would also mean that both the firms and their clients would need to incur higher cost from managing risk. Furthermore, the restructuring of OTF would affect the bank's operations by complicating the processes and may impede the bank to carry out the best deals for their clients.

Therefore, the shifts from OTC to becoming more automated would result in many firms being driven out of the market. This could potentially be detrimental to the liquidity and the markets resulting in investors incurring more costs due to the increase in cost of capital (KPMG, 2012).

Furthermore, the implementation of new regulations regarding research payments would also affect the revenue that the investment bank would get from buy-side. This is due to the unbundling of research fees from dealing commission, increasing competition

since there are more options in terms of firms for portfolio managers to choose from instead of Investment bank in the area of equity bank research.

However, not all investment banks would be affected by the new regulation to a great extent. For boutique investment banks who are specialised in key sectors, they would be less affected by the increase in competition since they are niche in the areas that would be hard to replicate. For instance, boutique investment banks such as Ambrian Capital, London boutique Investment bank, specialised in Mining, Oil & Gas, Cleantech and Life Sciences, would stand to gain from this new regulation (Ambrian, n.d.) . This would also mean that the research revenue generated for these firms would not be significantly affected.

3.2.3 Retail Investors

Due to the MiFID II's proposal of separating payment for research from dealing commissions, retail investors would benefit from reducing the cost of research on their assets.

However, in 2013, an academic study by Chartered Alternative Investment Analyst Association conducted on nearly 3000 long-short equity hedge funds had found that smaller asset managers typically outperformed the larger asset managers by an average of 220 basis point at a year during the preceding decade(Stefanova, Teten, Beardsley, 2016).

MiFID II's research payment rule would have meant that smaller firms account being taken over by larger firm's and this may lead to lower investment returns for the retail investor. Moreover, it also important to note that this would also lead to lesser intensity of competition which would result in the ability of asset management managers charging higher fees to the retail investors.

4. Preparation For MiFID II

What Companies Should Do And Consider In Order To Meet The New Requirements And Maintain Their Level Of Performance

Since the changes MiFID will bring affects all participants in the trading landscape, every company has to adapt their business model or at least certain parts of it according to the new rules. The extent to which companies have to adjust their strategy and operations depends on the extent to which they are affected by MiFID II, because the impacts of it relate to the respective business models. Thus, every participant is affected but the impacts in terms of time, effort and costs will vary. Furthermore, it is important to understand that even companies which are not residential in the EU but participating in trading at EU are affected by the new rules. This part gives advice for **independent advisors** and **discretionary asset managers**, fund distributors, product providers, third-country companies and afterwards general advice for CEO´s and COO´s.

1. Independent advisors and discretionary asset managers

These players are heavily affected by the new rules MiFID will set, because it banns inducements for independent and discretionary asset management. Thus the new rules will eliminate a significant source of income. The ban leads to the need of increasing advisory and discretionary asset management fees which are charged to their clients.
Furthermore, an increase of a minimum portfolio size is recommended in order to stay able to offer services to a range of investors while simultaneously staying able to operate efficiently. In case of **discretionary asset managers**, they should promote in-house instruments instead of third-party funds to avoid losses of the profit due to third-party involvement.

2. Fund Distributors

Fund distributors need to diversify their sources of revenues. One way would be to provide extra services like advice, transaction management, risk reporting and analytical services which can be charged separately.

3. Product providers

The new rules MiFID will establish lead to the necessity for product providers to assess their products according to the new requirements and adapt their fee structure. Furthermore some products will disappear, because they will not generate sufficient income anymore, while new products have to be developed that fulfil the requirements and provide opportunities for sufficient income.

4.1 THINGS THAT CEOS SHOULD CONSIDER

CEOs should study the changes that are about to come and how they will affect their business. According to the necessary changes, the business model and strategy should be aligned with the new rules and the company thus be prepared for the new trading landscape. First of all, MiFID II sets new rules for internal organization. It defines qualifications managers need to have and their responsibilities in the trading context.

There are two questions to be answered in order to prepare for MiFID II.

1. **Which products and services to be offered?**

According to the new requirements concerning investment advisors, investment firms must specify their advice as independent or non-independent.

This results in the question which advisory model should be chosen. To answer the question of the best fit between company resources/business model and advisory role, there are key criterions which can be used as qualifiers.

The first criterion is the availability of in-house products. **Independent advisors** need to assess and offer a range of different products. Regarding the products, it is recommended to link the amount of in-house products proportionally to the total amount of assets. Thus, there have to be enough in-house products in order to offer independent advice.

Furthermore, the ban of inducements on independent advisory services should be taken into account, because inducements for non-independent advisory services are allowed as long as they are clearly disclosed to investors.

2. **Which clients to be served and which distribution strategy to choose?**

First of all, in the investment firm industry it can possibly happen, that fund distribution platforms skip current distribution network and serve end-customers on their own behalf, instead of involving their network. Thus, the investment firms have to find ways, not being bypassed but included in business without offering financial inducements. This requires strong relationships between product manufacturers and distributors. Furthermore, it requires an evaluation of the pricing structure to assess if it is still appropriate in the new landscape.

Another point that should be considered here, is the fact, that retail customers will not be willing to pay for advisory services, thus these processes have to be optimized in order to achieve reasonable costs for these services while not losing customers.

4.2 THINGS THAT COOS SHOULD CONSIDER

The COOs main task is to achieve operational and organizational efficiency. This means, that COOs are heavily involved in the change and adaption process regarding the MiFID changes.

First of all, MiFID comes along with several new and stricter documentation and operational changes. This requires companies to improve their databases.

According to Deloitte, product databases must be enriched by information like costs and charges, target market definition, product complexity and product performance related information. Additional characteristics for client database like clients ability to bear losses and their sensitivity to risk need to be implemented in order to meet the new requirements.

Transaction databases need to include all data required to meet MiFIDs new reporting requirements. Furthermore, important IT developments will need to be performed. MiFID investor protection regime requires investment companies to offer only products that suit the customer and are appropriate regarding the customer's risk tolerance level. Thus, new tests and control mechanisms need to be developed and implemented, which ensure that the appropriate products are sold to the respective customers.

MiFID also requires additional reporting. This includes **transaction reporting**, top five execution venues, pre- and post trade **transparency** obligations.

In addition to these technical tasks, the COOs need to keep attention to other regulation activities in order to avoid multiple effort of alignment. They need to ensure that the alignment process moves smoothly and the costs of operations remain reasonable after the implementation. Thus, they need to find ways to minimize operational costs. This can be achieved through efficiency projects.

5. Conclusion

In conclusion, compared to MiFID, MiFID II introduces and addresses new issues such as increasing transparency, increasing investor's protection and increasing competition among financial markets.

Hence, this has led to significant changes to the financial institutions in European Union and this also affects companies that are not residential in the European Union but participating in trading at European Union. MiFID II will affect the competition between the firms in this industry. The impact that MiFID II will have on players in the financial industry differs greatly and this resulted in the emergence of winners and losers. Some of the winners include large asset managers and asset owners while losers would include investment banks.

Hence, it is important for companies to adjust their strategies and operations to meet these new regulations.

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7. Glossary

1. **Algorithmic Trading:** Trading done using computer programmes applying algorithms, which determine various aspects including price and quantity of orders, and most of the time placing them without human intervention.

2. **Asset Class:** A group of securities that exhibits similar characteristics, behaves similarly in the marketplace and is subject to the same laws and regulations. The three main asset classes are equities, or stocks; fixed income, or bonds; and cash equivalents, or money market instruments.

3. **Broker Crossing Systems (BCS):** A number of investment firms in the EU operate systems that match client order flow internally (for example Citigroup, Credit Suisse, Deutsche Bank, JP Morgan, Morgan Stanley and UBS). Generally, these firms receive orders electronically, utilise algorithms to determine how they should best be executed (given a client‘s objectives) and then pass the business through an internal system that will attempt to find matches. Normally, algorithms slice larger 'parent' orders into smaller 'child' orders before they are sent for matching. Some systems match only client orders, while others (depending on client instructions/permissions) also provide matching between client orders and house orders. Broker crossing networks do not show an order book, and as noted above, simply aim to match orders; due this nature they are sometimes compared to **Dark Pools**, which have similar characteristics

4. **Commodity Derivatives:** A financial instrument the value of which depends on that of a commodity, such as grains, energy or metals

5. **Dark pool:** Not accessible by the investing public and lack transparency. They came about primarily to facilitate block trading by institutional investors, who did not wish to impact the markets with their large orders and consequently obtain adverse prices for their trades.

6. **Discretionary asset managers:** Discretionary asset managers manage a client's account on their own discretion

7. **Emission allowances**: An allowance to emit one tonne of carbon dioxide equivalent during a specified period, as more specifically defined in Article 3(a) of Directive 2003/87/EC.

8. **Financial Instruments:** A financial instrument is an asset or evidence of the ownership of an asset, or a contractual agreement between two parties to receive or deliver another financial instrument.

9. **High Frequency Trading**: High frequency trading is a type of electronic trading that is often characterised by holding positions very briefly in order to take advantage of short term opportunities in terms of price rises and falls. High frequency traders use algorithmic trading to conduct their business.

10. **Independent advisors:** Investment banks that offer strategic and financial advice for customers on behalf of the customers.

11. **Multilateral Trading Facility (MTF):** A system, or "venue", which brings together multiple third-party buying and selling interests in financial instruments 11 in a way that results in a contract. MTFs can be operated by investment firms or market operators and are subject to broadly the same overarching regulatory requirements as **regulated markets** (e.g. fair and orderly trading) and the same detailed transparency requirements as **regulated markets**; in this sense they are more like a traditional regulated market than a broker crossing network or a systematic internaliser.

12. **Organised Trading Facilities (OTF)**: Any facility or system operated by an investment firm or a market operator that on an organised basis brings together third party buying and selling interests or orders relating to financial instruments. It excludes facilities or systems that are already regulated as a regulated market, MTF or a systematic internaliser. Examples of Organised Trading Facilities would include broker crossing systems and inter-dealer broker systems bringing together third-party interests and orders by way of voice and/or hybrid voice/electronic execution.

13. **Over the Counter(OTC)**: A method of trading that does not take place on an organised venue such as a regulated market or an MTF. It can take various shapes from bilateral trading to via permanent structures (such as systematic internalisers and broker networks).

14. **Regulated market**: A medium for the exchange of goods or services over which a government body exerts a level of control. This control may require market participants to comply with environmental standards, product-safety specifications, information disclosure requirements and so on.

15. **Sovereign bond:** Debt security issued by a national government. Sovereign bonds can be denominated in a foreign currency or the government's own domestic currency; the ability to issue bonds denominated in domestic currency tends to be a luxury that most governments do not enjoy. The less stable of a currency denomination, the greater the risk the bondholder faces.

16. **Systematic Internalisers (SI):** Introduced by MiFID in 2007 Systematic Internalisers (SIs) are institutions large enough to match client orders internally, or against their own books (unlike a broker crossing network, which may route orders between a number of institutions). They are defined in MiFID 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 an MTF". A firm does not need specific authorisation from its competent authority to carry out systematic internalisation; however similar to MTFs and RMs, they are required to conform to some transparency requirements, such as providing public quotes. Only a few (generally large) firms have set up SIs and, currently, there are 12 registered.

17. **Transparency:** The disclosure of information related to prices quoted (pre trade transparency) or transactions (post trade transparency) relevant to market participants for identifying trading opportunities and checking best execution and to regulators for monitoring the behaviour of market participants.

18. **Transaction Reporting:** Investment firms are required to report to competent authorities all trades in all financial instruments admitted to trading on a regulated market, regardless of whether the trade takes place on that market or not. It covers all transactions on these instruments, including OTC trades. Transaction reporting is not public, and contains more details about the transaction than pre and post trade transparency.

19. **Vertical Silo:** A structure whereby an exchange owns its own clearing house in one integrated business, allowing the exchange to lock in clearing revenue that otherwise would go to an external provider.