

oneworld

CORPORATE AND TRUST - TAX AND LEGAL - BUSINESS ADVISORY - ACCOUNTING - FINANCIAL MANAGEMENT

COMPLYING WITH MiFID

MiFID – the Markets in Financial Instruments Directive – will apply from 1 November 2007. Its implementation will significantly alter financial services regulation in the EU, how firms operate their businesses and the way they interact with their customers.

MiFID is probably the most significant piece of EU securities legislation to date. It is already changing market dynamics which will impact all investment sectors and could offer new opportunities. Market participants need to consider fundamental strategic options in order to establish an effective operating model in the post MiFID world.

As Cyprus is a member of the EU, Cypriot investment firms and banking institutions will also be affected by MiFID. The regulators are already taking steps towards adopting MiFID, the target date for implementation being 1 November 2007.

Contents

1. OVERVIEW
2. ORGANISATION REQUIREMENTS
3. CONDUCT OF BUSINESS
4. MARKETS AND TRANSPARENCY
5. CROSS BORDER BUSINESS

For further information on the topics of the issue please contact Savvas Shiatis or George Hadjipavlou

Tel +357 22495707 Fax +357 22493000
reception@oneworldweb.net

Potentially, there will also be new business opportunities. More services will be passportable. Its implementation across the EU may bring about significant changes in market structure. The precise impact will vary from sector to sector, firm to firm. Firms that are well prepared will be positioned to make the most of these changes.

Firms and financial advisors are urged to start planning now to meet the implementation challenge. To help clients get started, we have developed this document. Its purpose is to highlight the key impacts of MiFID and the types of compliance and business issues that are likely to arise, which should be considered in drawing up your plans.

1. OVERVIEW

What is MiFID

The Investment Services Directive (ISD) has been the most significant EU legislation for investment intermediaries and financial markets since it was implemented in 1995. It is now being completely replaced by MiFID which extends the coverage of the current ISD regime and introduces new and more extensive requirements to which firms will have to adapt, in particular in relation to:

- how they interact with their clients
- how they operate in financial markets
- their choice of products and investment services
- their organisation structure and business model
- how they report to clients, markets and to regulators

Which firms are affected

MiFID will directly affect those firms that fall within its scope. The position of any particular firm will also depend on the nature of that firm's business and whether it falls within any of the exemptions in the directive.

In general, MiFID will cover most if not all firms currently subject to the ISD, plus some that currently are not. It will include:

- investment banks
- portfolio managers
- stockbrokers and broker dealers
- corporate finance firms
- many futures and options firms, and
- some commodities firms

In some other areas, the position for firms will be less clear cut. Retail banks and building societies will be subject to MiFID for some parts of their business. For example, the sale of securities, or investment products which contain securities but not for others. And there is the prospect – particularly in the retail market – of firms competing for the same type of business being subject to different regulatory standards, depending on whether the firm falls within the scope of MiFID.

The types of firm that are likely to fall outside MiFID scope but nevertheless likely to be affected to some extent by changes associated with MiFID include:

- operators of collective investment schemes

- occupational pension scheme firms
- life companies and friendly societies
- financial advisers (FA) that do not hold client assets, and
- authorised professional firms

So, even if a firm's investment business is partly or wholly outside the scope of MiFID, this does not mean that you will be unaffected and not implement.

What MiFID does

One of the main purposes of the ISD is to give a "passport" to investment firms to enable them to provide investment services on a cross border basis or to establish a branch in another member state, in each case on the basis of home state authorisation. It sets out some basic high level provisions governing the organisational and conduct of business requirements that should apply to firms. It also aims to harmonise certain conditions governing the operation of regulated markets.

MiFID has the same basic purpose. But it makes significant changes to the regulatory framework to reflect developments in financial services and markets since the ISD was implemented.

Scope is wider

Firstly, MiFID widens the range of "core" investment services and activities that can be passported. In addition to the services covered by the ISD, MiFID:

- upgrades advice that involves a personal recommendation to a core investment service that can be passported on a stand alone basis
- clarifies that operating a multilateral trading facility (MTF) is covered by the passport, and
- extends the scope of the passport to cover commodity derivatives, credit derivatives and financial contracts for differences for the first time

A greater degree of harmonisation

Secondly, MiFID sets more detailed requirements governing the organisation and conduct of business of investment firms, and how regulated markets and MTF operate. It also includes new pre and post trade transparency requirements for equity markets, the



creation of a new regime for “systematic internalisers” of retail order flow in liquid equities and more extensive transaction reporting requirements.

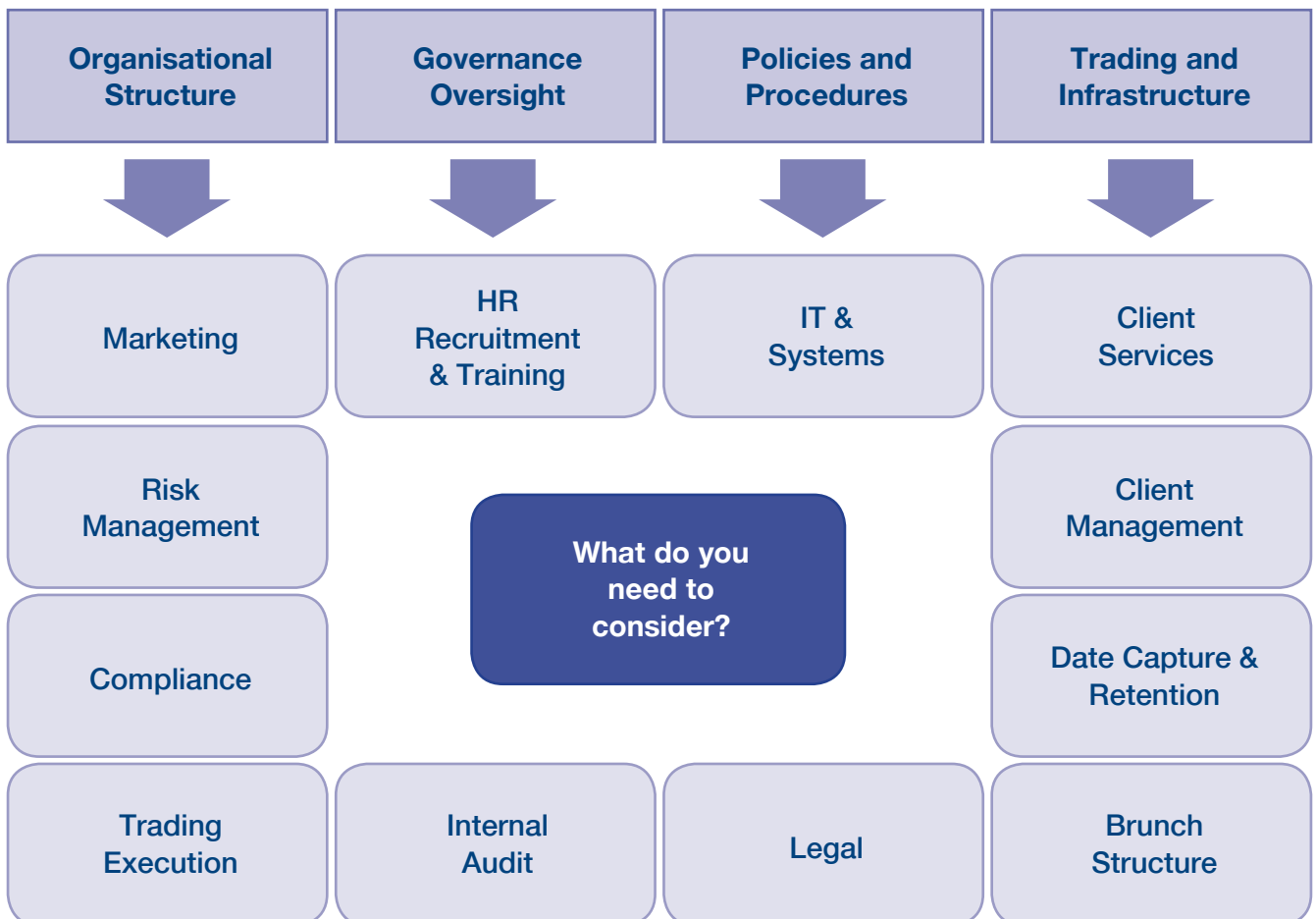
also more clearly recognises the concept of tied agents, who will be able to carry on some cross border business under the passport of their principal.

Doing business cross border

Thirdly, MiFID improves the operation of the “passport” for investment firms by more clearly delineating the allocation of responsibility between home state and host state for passported branches and generally clarifying some of the jurisdictional uncertainties that arose under the ISD. For example, going forward, it is clear that a firm will be subject only to home state requirements. MiFID

Capital Requirements Directive

Fourthly, most firms that fall within the scope of MiFID will also have to comply with the new Capital Requirements Directive (CRD) which will set requirements for the regulatory capital which a firm must hold. Those firms brought into regulation by MiFID will be subject to directive based capital requirements for the first time.



2. ORGANISATION REQUIREMENTS

What is changing

The requirements cover:

- compliance arrangements, including measures governing personal transactions
- internal systems and controls, particularly in relation to:
 - business continuity
 - staff
 - risk assessment, management and regulation
 - internal audit
 - administrative and accounting procedures, and
 - IT systems and processing
- outsourcing of “critical and important” functions and investment services
- record keeping, particularly in relation to transactions undertaken for clients
- management of conflicts of interest to prevent the interests of clients being adversely affected, and
- safeguarding of client financial instruments or money held by the firm

What you need to consider

It is already clear that firms will need to pay particular attention to:

- the efficiency and effectiveness of their arrangements for compliance and risk management
- the general integrity of their systems and controls, including internal audit and business continuity management, and
- their arrangements for identifying conflicts of interest and the resilience of the organisational arrangements caused to manage them

There is likely to be an increased focus on the “functional independence” of compliance and risk management controls. As a consequence, firms will need to review the adequacy of their:

- internal organisation
- reporting lines, and
- allocation of senior management responsibility

MiFID is likely to introduce new requirements to be satisfied in the outsourcing of “critical and important” functions and investment services.

Who is affected

The organisational requirements will apply to:

- all investment firms within MiFID scope
- all credit institutions doing MiFID business
- UCITS management firms
- firms or market operators running MTF





3. CONDUCT OF BUSINESS

3.1 Client classification

What is changing

The MiFID client classification regime has similarities with the current classifications and it differs in three key respects:

- firstly, although MiFID distinguishes between three types of client: retail client, professional client and eligible counterparty (ECP), these are not exactly the same as current categories of private customer, intermediate customer and market counterparty. For example, not all intermediate customers under current rules will be professional clients under MiFID
- secondly, whilst there is some flexibility for clients to move between categories to obtain more, or less, regulatory protection, the criteria for doing so are not identical to those applying under our current rules
- thirdly, the regulatory protection afforded to each category of client under MiFID will not be the same as that provided for under the current classification regime

What you need to consider

Under MiFID, both ECP and professional clients will be able to request regulatory protection either generally, on a trade by trade basis, or in relation to a “particular investment service or transaction, or types of transaction or product”. Firms will need to consider how they would administer such a system. Clients may fall into different categories in respect of different products or services.

MiFID also contains transitional provisions which allow firms to continue treating professional clients as such, provided certain conditions are satisfied.

Who is affected

The client classification requirements will affect all MiFID scope firms. However, the impact is likely to vary, depending on the nature of the firms’s business and the size and breadth of its existing client base.

3.2 Marketing

What is changing

Implementation of the MiFID requirements on “market-

ing communications” relating to MiFID instruments or services is likely to have an impact on the existing UK financial promotions regime.

What you need to consider

Firms will need to review their financial promotions and marketing functions, particularly to consider whether their procedures for approving financial promotions will satisfy the expectations of the new regime.

Who is affected

Proposals will be relevant to all firms - both MiFID and non MiFID scope firms – that promote their investment products and services to retail investors. This will include, for example, life insurance companies and other current “non ISD” investment firms.

3.3 Information about the firm and its services

What is changing

MiFID will establish requirements governing information about the firm and its services that must be provided to a client, whether retail or professional, including:

- the nature and detail of the information that must be provided
- when it must be given
- the form in which it must be provided
- when it must be updated

What you need to consider

Firms will need to consider the adequacy of:

- procedures for capturing and generating required information and for getting it into the relevant form in relation to the services offered by the firm to its clients
- existing mechanisms for delivering information to the range of clients with whom they do business, and the circumstances in which it will be required
- procedures for updating information to clients

Firms will also have to consider whether, in the period running up to MiFID implementation, they should start to give existing clients’ additional information on the basis of the above requirements.

Who is affected

The MiFID requirements will apply to all MiFID scope business carried on by MiFID firms, with more extensive requirements for business with retail clients.

3.4 Client agreements

What is changing

The directive requires firms to keep a record of the document or documents agreed with their clients effectively covering the terms on which they provide investment services.

What you need to consider

There are likely to be a number of specific information provision, notification and consent requirements. Where firms usually incorporate such provisions in client agreements, it would be advisable to plan for a review of the agreement content and consider amendments for existing clients.

Who is affected

The MiFID requirements will apply to MiFID scope business carried on by MiFID firms, with more extensive requirements for business with retail clients. We shall be considering to what extent it may be appropriate to adopt any MiFID standards for similar business carried on by non scope firms with retail clients.

3.5 Suitability and know your customer

What is changing

Like current rules, MiFID contains “know your customer” and suitability requirements which apply when a firm provides investment advice and discretionary portfolio management. These are broadly similar to current requirements, but the MiFID requirements will apply to both retail and (in more limited form) professional clients.

What will you need to consider

In order to be able to meet these requirements firms will need to review:

- the comprehensiveness and adequacy of procedures for capturing and recording “know your client” information and providing it as appropriate to the individuals who provide advice or make discretionary management decisions

- the adequacy of arrangements for ensuring suitable recommendations are given and investment management decisions taken
- whether current standardised fact finding processes (for example, for retail clients) capture all the information required by MiFID, and
- their arrangements for business with professional clients

Who is affected

The MiFID requirements will apply to all MiFID scope firms providing investment advice and portfolio management to retail or professional clients. We shall be considering whether, and if so how, the fact finding and suitability requirements for retail clients of non MiFID firms should be aligned with the MiFID standards.





3.6 Appropriateness and execution only services

What is changing

MiFID will require changes to the current position under current rules where most investment products can be provided on an execution only basis. Under MiFID, an execution only service can be provided only where:

- it relates to “non complex” instruments including shares admitted to trading on a regulated market (or equivalent third country market), money market instruments, bonds and other securitised debt (but excluding bonds that embed a derivative) and UCITS
- it consists only of execution of orders and reception and transmission
- it is provided at the initiative of the client
- the client is warned by the firm that the firm has not assessed suitability

For other investment products, MiFID introduces a new requirement for firms to obtain information from clients about their relevant knowledge and experience, and assess whether the service is appropriate for that client. If the firm assesses the product or service to be inappropriate it must warn the client of that. If the client does not provide sufficient information then the firm must warn the client it has not been able to carry out the assessment. This is not a test of suitability which applies only to the provision of investment advice and portfolio management. Appropriateness, therefore, does not relate to the making of a personal recommendation.

What you need to consider

Firms providing relevant services will need to assess and decide the basis on which to provide them post MiFID, and whether this entails any organisational or other business change.

Firms offering services under the appropriateness test will need to:

- consider the adequacy of systems for obtaining information from clients and for setting and operating controls over client activity
- develop systems and procedures for assessing appropriateness and carrying forward the outcomes in the ways required by MiFID

Firms offering services on an execution only basis will need to:

- assess the adequacy of procedures for making the assessments implied by MiFID (or, ensuring the conditions are met) and providing the required warnings

Who is affected

The appropriateness requirements will primarily affect firms that provide “execution only” dealing services in more “complex” financial instruments for retail clients.

Covered warrants, options and contracts for differences are among the investments traded by retail customers that may need to be considered.



3.7 Best execution

What is changing

The MiFID requirements on best execution will mean some important changes to the current regime. An investment firm will be required to take all reasonable steps to obtain the best possible result for its clients including taking into account relevant considerations such as price, cost, speed and the likelihood of execution and settlement when executing orders.

In doing so, the firm must:

- establish and implement effective arrangement and an “order execution” policy designed to obtain the best possible results in executing client orders
- disclose “appropriate information” to clients about its “order execution” arrangements and policy, including the execution venues it uses
- obtain prior client consent to its policy
- monitor the effectiveness of its execution arrangements and policy and update them as necessary, and
- at their clients’ request, demonstrate that their orders have been executed according to the firms’ policy

What you need to consider

Firms will need to develop an execution policy, or review

any existing policy, and obtain client consent to the policy before undertaking any transactions.

The policy will need to cover selection of execution venues that will enable the firm to secure the best results for clients on a consistent basis and firms will need to keep that selection under review.

Firms will need to consider how they will monitor execution performance by the venues included in their policy, and their processes for determining which execution venues to use. They will need to consider the extent to which their existing trading strategies enable them to deliver on these obligations.

Who is affected

These requirements apply to an investment firm (all brokers and broker dealers) executing client orders in both wholesale and retail markets and to all MiFID financial instruments. They are also likely to apply to portfolio managers and order receivers and transmitters.

3.8 Clients order handling

What is changing

MiFID requires investment firms to execute client orders promptly, fairly and expeditiously and follows the general thrust of existing rules.

Among other things, the measures are likely to require investment firms to:



- ensure that orders executed on behalf of clients are promptly and accurately recorded and allocated
- allocate aggregated orders promptly, accurately and fairly
- refrain from front running
- ensure that any client assets received in settlement of an executed order are promptly and correctly delivered to the account of each relevant client, and
- make public client limit orders that are not immediately executed under prevailing market conditions.

What you need to consider

Some review of existing systems and processes is advisable, though we do not expect that their overall impact will be substantial for most firms. The requirement to make public client limit orders that are not immediately executed is a new requirement. Firms will need to consider the details of their contracts with clients and the venues they would use to make limit orders public.

Who is affected

These requirements apply to all brokers and dealers when executing client orders in any MiFID financial instrument. They are also likely to apply to portfolio managers and order receivers and transmitters, such as introducing brokers.

3.9 Reporting information to clients

What is changing

MiFID requires a firm to provide to its clients adequate information on the service provided. In particular it sets out requirements to ensure that clients are promptly advised of the essential details of a transaction and receive a regular statement with essential information on their investment portfolio.

What you need to consider

The main difference is that the flexibility under existing rules for private customers to vary the content or frequency of contract notes for reporting on transactions and periodic information for portfolio management is not replicated in MiFID.

Who is affected

These requirements apply to all firms when they carry on MiFID business, although detailed requirements are likely to apply only to retail clients. They are generally similar to existing conduct of business rules.

4. MARKETS AND TRANSPARENCY

4.1 Pre and post trade transparency

MiFID introduced comprehensive pre and post trade transparency regimes for trading in shares on the three main types of execution venues:

- Regulated Markets (RM): these include stock exchanges such as the London Stock Exchange (LSE) and virt-X
- Multilateral Trading Facilities (MTF): these cover alternative execution venues (currently referred to as alternative trading systems in the UK), and
- Over the Counter (OTC) – OTC trading refers to trades undertaken by firms outside a RM or MTF including those acting as systematic internalisers

Pre trade transparency

What is changing

While there are currently no set requirements about pre trade transparency as specific as the MiFID requirements, stock exchanges have trading systems and rules that provide transparency levels tailored to the type of share being traded and the method of trading. MiFID will introduce more extensive pre trade transparency requirements, particularly for trades below specified size thresholds and for trades that take place outside the order book.

MiFID introduces a completely new transparency regime for investment firms that are systematic internalisers in shares. MiFID defines a systematic internaliser as an investment firm which, on an organised, frequent and systematic basis, deals on own account by executing client orders outside an RM or MTF.

Systematic internalisers have no obligation to quote in all liquid shares. They can quote for a subset of liquid shares and this subset can change over time. The list of liquid shares will be defined on the basis of criteria.

The following activities will not be subject to the quoting obligations:

- dealing above “standard market size”
- dealing in on liquid shares
- dealing in other asset classes (eg bonds)

What you need to consider

RM and MTF will have to consider what modifications they need to make to their rules and trading systems to comply with the MiFID requirements. They will need to consider in particular the requirements relating to trading below the pre trade block thresholds (which will apply across the EU) and changes they need to make to ensure that the use of request for quote systems fall within the new regulations.

Firms executing trades outside RM or MTF will have to decide whether any part of what they currently do fits the definition of “systematic internalisers” under MiFID and, if so, whether the quoting obligations apply to them. Compliance with the pre trade obligations may involve the development of a new business model as well as significant system changes.

Who is affected

The new requirements directly affect RM, MTF and those firms that are deemed to be systematic internalisers in liquid shares. Indirectly, the way in which these bodies respond to the new requirements will impact on all other firms in meeting their best execution obligations.

Post trade transparency

What is changing

MiFID extends the scope of post trade transparency requirements from RM to MTF and investment firms trading outside RM or MTF. All trading venues will have to make public specified information about completed transactions in shares as close to real time as possible (with delays for large risk trades) and on a reasonable and non discriminatory commercial basis. Investment firms can choose the disclosure channel – RM, MTF, third party or proprietary arrangement – through which they make the details of each transaction public. The information will have to be checked for accuracy and meet the other criteria described above.

What will you need to consider

RM, MTF and investment firms will need to consider their internal controls for applying the new block trading provisions. Investment firms that trade outside a RM or MTF will need to consider the method by which they publish details of their trades and the steps they will need to take to ensure the accuracy and timeliness of publication.



Who will the requirements affect

The new post trade transparency requirements will affect providers and users of equity trade data – RM, MTF, their members and firms trading OTC (buy side and sell side firms), as well as equity trade data disseminators.

4.2 Transaction reporting

What is changing

MiFID transaction reporting requirements will shift the reporting emphasis to the competent authority of the home/host state of the firm and not to the competent authority of the regulated markets on which the instrument is traded. Transaction reporting refers to post-trade reporting to regulators and does not refer to the publication of trades. Following MiFID implementation the transaction reporting obligations of some firms will be affected as follows:

Increase in the types of instruments covered

While current reporting requirements extend to debt and equity related products, MiFID required transaction reports for any instrument admitted to trading on a regulated market – including commodity instruments admitted to trading on exchange.

What you need to consider

MiFID may have a significant impact on commodities firms which will now have to report transactions in any instruments traded on those commodities exchanges that are regulated markets. We are exploring the possibility of collecting MiFID compliant transaction reports from those exchanges that have commodity derivatives admitted to trading. If these exchanges cannot provide us with reports that satisfy MiFID requirements, then commodities firms will need to find alternative means for ensuring that their transaction reports are received by us.

EU firms that are remote members of overseas exchanges will have to report transactions to us as the qualifying exchange exemption no longer applies. Authorised firms which currently submit transaction reports to other EU exchanges will have to decide how they will report transactions to us once MiFID is implemented. Under MiFID, trades on non EU exchanges will still need to be transaction reported by firms if the subject instrument is also traded on a regulated market

in the EU. For example, a transaction in IBM common stock on the NYSE will still need to be reported to us as the instrument also has a London quote.

It is unlikely that UK firms will have to report transactions in instruments that are not admitted to trading on any exchange within the EU.

Finally, we believe that, similar to the current rules, firms that conduct discretionary investment management business can satisfy their MiFID reporting requirements if they can guarantee that their sell side brokers report the trades to us. These investment firms will be required to transaction report electronically if they trade instruments caught under MiFID with counterparties that are not authorised brokers eg other investment firms or overseas brokers.

Who is affected

Potentially all firms, depending on the nature of their business.





5. CROSS BORDER BUSINESS

What is passporting

Currently, firms that are authorised in one member state can provide ISD services in other EU states either cross border or through a branch without having to be authorised separately in each EU state in which they wish to do business – this is known as the “passport”. MiFID extends the range of activities and instruments covered by the passport and clarifies the home/host supervision of passported firms. In particular, MiFID:

- upgrades advice that involves a personal recommendation to a core investment service that can be passported on a stand alone basis
- clarifies that operating a MTF is covered by the passport, and
- extends the scope of the passport to cover commodity derivatives, credit derivatives and financial contracts for differences for the firms time

Responsibility for supervising passported firms

Under MiFID, a passported firm’s home state regulator has supervisory responsibility for both conduct of business requirements and organisational requirements, except in some circumstances where the relevant host state regulator takes responsibility for conduct of business requirements. So, where a firm provides services on a purely cross border basis only home

state requirements will apply. Where a firm establishes a branch in another EU state, under MiFID the branch must comply with home state requirements relating to organisational requirements. And it must comply with host state requirements on conduct of business insofar as its activities are within host state territory. Where a passported branch provides services outside the territory of its host state, only home state requirements should apply.

Use of “tied agents”

MiFID introduces a discretionary tied agent regime and sets out obligations for investment firms if they decide to use tied agents. This regime is largely similar to the current UK appointed representative regime. Tied agents will be able to provide certain activities cross border and to establish branches in other EU states under the passport of their principal. MiFID provides a way for firms to provide some services through the use of tied agents (by allowing them to use tied agents to provide cross border services and establish branches.)

What you need to consider

Firms may want to review how they currently conduct business throughout the EU, how this business is structured, and whether any change to their arrangements is desirable.

Oneworld Ltd

70 JF Kennedy Avenue

1st floor, PO Box 27171

CY 1641 Nicosia, Cyprus

Tel +357 22495707

Fax +357 22493000

E-mail reception@oneworldweb.net

Our Services:

- Corporate and Trust
- Tax and Legal
- Accounting and VAT
- Business Advisory
- Corporate Finance
- Estate Planning
- Internal Audit and Risk Management
- Corporate Governance
- Specialised Services