FX & MIFID

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FX & MIFID

- Introduction
- MiFID Overview
- What FX instruments are within scope of MIFID ?
- What are the applicable MIFID requirements ?
- Internal impact on the organisation
- Consequences for the market ?

MiFID = Markets in Financial Instruments Directive

MiFID revises and replaces the 1993 Investment Services Directive, which created a "passporting" regime to allow EEA investment firms to carry out business throughout the EEA.

The new rules are intended to create:

- a more harmonised regime for transactions in financial instruments

throughout the EEA. Commodities now included.

- greater efficiency
- greater transparency

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How MiFID will be applied in the UK

- Directive “copied out” into FSA Handbook
- Little UK super-equivalence (gold-plating)
- FSA concurrently moving towards “principles-based regulation”
  - Some detailed rules and guidance deleted
  - Some requirements enhanced
- Many firms’ arrangements and procedures will require review and possible alteration
- Increasing emphasis on senior management responsibility and discretion
  - Room for individual flexibility
- Will require more internal vigilance because there will be fewer bright line rules

How will MiFID be implemented elsewhere in Europe?

- Each country has its own timetable and implementation plan
- Varying degrees of readiness
- Many uncertainties as a result
- In theory, should not be an issue as intention of Directive is to standardise regulation
- However, it is clear that investment firms will be dealing with MiFID implementation issues well into 2008 and beyond.

What is Citi’s approach to MiFID implementation?

- UK centric approach
  - Most major activities based in London
  - Branch network in EEA
- Best approach
  - Enables us to move forward and to take necessary business decisions
  - Will adjust and amend as individual country implementation becomes clear

Citi Communications to Clients on MiFID Implementation

- First letter to 4,000 parent accounts in June
  - Summary of MiFID
  - Requests for consents to authorise OTC trades for instruments normally traded on exchange or MTF
  - Explanation of second communication
- Second letter to 23,000 second level accounts in September
  - Client classification
  - New terms
  - Execution policy

What FX instruments are MiFID instruments?

Is FX covered under MIFID?

Yes - if it is a Financial Instrument :-

Financial instruments under MIFID Annex 1 Section C of MIFID:-

4. Options futures swaps, FRAs and any other derivative contracts relating to securities , *currencies,* interest rates or yields…which may be settled physically or in cash..

9. Financial contracts for differences

What FX instruments are MiFID instruments?

- Spot and Commercial FX forwards *excluded* from MIFID scope

  Caveat If FX Service is an ancillary service " connected to" provision of investment services

- Forwards for Investment purposes, FX Options, Rolling Spot contracts *within* scope

- Interpretation by other member states ?

Impact of MiFID

Element of MiFID	Does it Impact FICC Sales and Trading & Markets?	If So…How?
Best Execution	**Yes**	Applies when we execute orders on behalf of a client e.g. futures (rather than acting as principal) or when we agree to achieve the best price.
Investment Advice, suitability, Appropriateness	**Yes**	In majority of cases FICC will not be giving advice. This will be communicated to our clients. Where it is intended to give advice, a number of obligations must be complied with prior to giving the advice.
Governance and Internal Controls	**Yes**	New requirements for Senior staff and their responsibilities. Training and competence more onerous than before.
Outsourcing	**Yes**	Need to determine which outsourced functions are critical. May result in general tightening up of outsourced arrangements. We will not be able to pass on regulatory responsibility.
Conflicts of Interest	**Yes**	Firms need to identify, record and manage conflicts, resulting in greater transparency. Specific rules also relating to PA trading, gifts/inducements and allocation of orders.
Client Classification	**Yes**	There are new classifications (Eligible counterparties (EC), professional clients and retail clients). Most clients will be professional with other dealers being EC's. Professionals will get best execution and advice where applicable.
Communications to Client	**Yes**	All communications (written and oral) must be clear, fair and not misleading. Greater detail now required re. Fees and charges.
Systematic Internalisers	No – equities only	
Trade and Transaction Reporting	**Yes**	Reporting extends to all MiFID covered instruments admitted to trading on a regulated market. Timely booking of these instruments paramount.
Client Assets	No	
Training and Competence	**Yes**	All relevant personnel must have necessary skills, knowledge and expertise and be aware of all procedures they should follow.

Best Execution - Introduction

Under MIFID, investment firms which execute client orders on behalf of a client in relation to financial instruments covered by MIFID must comply with the best execution requirements of the directive.

When providing investment services to clients, investment firms are expected to act honestly, fairly and professionally in accordance with the best interests of the client. Best execution focuses on the way client orders should be executed by an investment firm.

Citi has implemented a Best Execution Policy to address those situations where we are providing order execution services.

The Policy applies when:

(i) Citi acts on behalf of a client; and

(ii) Citi agrees to achieve the best price or other terms for the client in the market.

Best Execution – have you received an order?

The Best Execution Policy will not apply when we are not executing an order on a client's behalf, or where we transact with a client but not on the basis of having received an order. This would be the case:

- Where we act as a dealer and enter into a transaction with a client as a principal.
- Where we act as a counterparty to a client for our own account.
- When a client transacts with us as principal on the basis of a published quote or a request for quote.
- Where we follow a client's specific instructions to execute an order in a specific manner.
- When the client is classified as an "Eligible Counterparty".

Best Execution – what if it does apply?

Where Citi does provide order execution services, the best execution rules are likely to apply and we must ensure that:

- we consider appropriate factors to achieve best execution for the client (e.g. price, costs, size, speed of execution, liquidity, type of instrument, characteristics of execution venue);
- we follow any specific instructions received from the client on order execution (to the extent that it is possible for us to do so); and
- we can demonstrate that we have executed the order in accordance with our Best Execution Policy – this will necessitate us maintaining appropriate records of the order received and the factors we have considered to achieve best execution.
- Since most of the FICC businesses trade in a proprietary capacity, providing prices for Citis own book to clients, there are only a couple of areas where on occasion transactions may be executed on behalf of a client in the market. For these areas detailed processes have been have been drafted. No other business areas are considered to owe best execution

Investment Advice under MiFID

- Citi' view is that in general, sales and trading staff in Markets & Banking do not provide personal recommendations,
    - Reliance is a key factor
    - Sales and trading staff in wholesale businesses do not have the kind of detailed information about clients and their overall and long-term objectives that a private banker or retail banker may have
    - Terms of business can make it clear that we are doing business on the basis that we are not providing personal recommendations
- If you do not have sufficient information to be able to assess the client's suitability, then you are not permitted to make a personal recommendation or make any trading decisions for them
    - Being informed of a client's short term objectives does not constitute sufficient information
    - Sending specific trade ideas to a group of investors with an interest in that sector does not constitute a personal recommendation

Internal Impact on organisation

- Little change to way Front Office does business
- One off Increased Compliance costs for training etc
- Operationally – client classification

Impact on FX market

•Gold plating and interpretive disputes as MIFID implementation spreads throughout EEA

•Regulators communicate a great deal but co-operate rather less

•Constant threat of complaint by customers ?

•Concern of contagion – one decision cited by another regulator

•Wait and see

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