

Convergence Romania Financial Sector Modernization

Public-Private Special Projects Initiative



WORKSHOP

on

MiFID Transposition and Implementation in Romania

Bucharest, July 6, 2007

Romanian Banking Association

MINUTES

9:00-14:00

I. Background and Aims of the Workshop

The Markets in Financial Instruments Directive (MiFID) has been transposed in Romanian legislation with a series of NSC (CNVM) regulations.

MiFID introduces significant changes to the European regulatory framework. MiFID will increase significantly the competition in financial markets across EU. Intermediaries will come under pressure to match incoming firms' offers, cost structures and support services. At the same time investor protection will be harmonized at a high level of transparency requirements.

Financial industry players face opportunities and challenges. MiFID regulations will affect all internal processes and procedures, from an organization's IT and documentation, from order handling and execution to record keeping and marketing and promotional campaigns.

The directive provides a consistent regulatory framework that will recognize the existence of new forms of execution and the need to include all participants in the execution cycle. Its impact goes beyond equity markets and will affect all market participants, buy-side, sell-side and exchanges.

Participants will be liable and accountable for implementation failure. Those who have not even begun to address implementation should be aware of the serious prospects of legal action.

The Workshop objectives were:

1. to develop awareness among market participants of legal and operational implications from MiFID transposition;
2. to foster dialogue between authorities engaged in transposition and implementation process and recipient market participants;
3. to acknowledge how other European banking industries are getting organized to be ready to comply with MiFID as from November 2007;
4. to discuss about the implementation main steps of MiFID in Romania in order to ensure a smooth implementation.

II. Presentations

1. MiFID Transposition in Romania

The first presentation delivered by **Mrs. Florentina Boboc**, Director, General Directorate for Authorization and Regulation, **National Securities Commission**, described how the European Directive has been transposed in Romania and stressed the impact on investment firms and on credit institutions.

Mrs. Boboc outlined that **National Securities Commission is the competent authority in charge with MiFID implementation in Romania.**

MiFID has been transposed in the Romanian legislation as follows:

- **Directive 2004/39/EC:**
 - NSC Regulation no. 32/2006 on the financial investment services
 - NSC Regulation no.31/2006 for amending NSC's regulations in order to implement provisions of the European Directives
 - NSC Regulation no. 2/2006 on the regulated market and alternative transaction systems
- **Directive 2006/73/EC:**
 - NSC Regulation no. 32/2006 on the financial investment services

Regarding the national particularities of the MiFID regulations, the National Securities Commission didn't exercise the discretions foreseen by the European Directive on:

- exempting companies that receive and send the clients' orders and offer consultancy services;
- considering non-legal entities as investment companies;
- specifying the description of the risks associated to financial instruments;

but chose to exercise the discretions on:

- allowing investment firms to use delegated agents;
- observing the reporting requirements on the transactions with financial instruments that are not authorized to be transacted on a regulated market;
- excepting the investment companies from the reporting requirements for the transactions on a regulated market or on an ATS;

- expanding the post transacting requirements on other categories of financial instruments;
- recognizing the “pure” professional clients as eligible counterparts;
- recognizing the clients considered as professionals as eligible counterparts (on requirement);
- recording the phone conversations with clients (based on clients’ acceptance).

The new regulations brought new requirements for the investment firms, related to: conditions and procedures for authorization, organization, operations, integrity and transparency of the transactions.

The operational requirements for investment firms refer to:

- identifying and addressing the conflict of interest situations;
- conducting the relation with the clients;
- executing the clients’ orders;
- the minimum set of information to be provided to clients;
- matching the clients’ protection with the three client categories;
- reporting to clients;
- record keeping the transactions and archiving the documentation.

Regarding the free access on EU markets, the Romanian legislation has provisions on passporting that outline the obligation to notify the competent authority in the state of origin on the intention to deliver financial services in another member state, to prepare a detailed business plan in Romanian and in English, to indicate the persons ensuring the management of the branch and the address in the member state from where documents can be requested.

The provisions on the requirements on organizational and operational issues, on transparency and integrity of the operations with financial instruments and part of the provisions on the freedom to deliver investment services are applicable also to credit institutions.

The NSC representative outlined the impact of the new regulations on the investment firms, especially in respect of:

- re-organizing the activity
- re-drafting the internal procedures and rules
- recruiting qualified employees and specializing the existing personnel
- implementing know-your-customer rules and establishing policies for executing the clients’ orders
- re-configuring the IT systems.

Regarding the impact on the market, MiFID is removing the concentration rules, facilitating the competition and reducing the transaction costs.

2. Presentation on MiFID Project led by the Italian Banking Association

Mr. David Sabatini, Italian Banking Association (ABI) and **Mr. Enrico Di Leo, KPMG Italy**, jointly presented the implementation process in the Italian credit institutions under the Italian Banking Association co-ordination and with the support of KPMG Italy.

ABI launched a **Special Project on MiFID** to support banks in adequate and fast implementation of the MiFID Directive up to November 1st, 2007, with these **goals**:

- analysing the **main aspects of the legislative framework** and providing **guidelines and implementing strategies**;
- defining **ways to support banks** in making the adjustments necessary to meet the new regulatory requirements.

MiFID Special Project mobilized an impressive community of specialists from banks with a complex working, co-ordinating and decision structure. The organisational arrangements established for the MiFID Project comprise:

- a **Steering Committee**, composed by Members of the ABI Executive Committee, with these responsibilities:
 - i. to decide the strategies for the banking sector to achieve the project goals;
 - ii. to raise awareness of the whole banking sector about the necessary measures to implement the MiFID;
 - iii. to set goals, plans and priorities of the Project;
- a **Coordination Committee**, with these responsibilities:
 - i. to coordinate working groups;
 - ii. to evaluate proposals made by the various working groups;
 - iii. to draft proposals to submit to the Steering Committee for final approval;
- a **Technical Secretariat**, to support the Coordination Committee with the task of monitoring all activities, managing documents related to the Project as well as communications among Members;
- four **Working Groups**, each of them focussing on one of the principal investment services (**trading, placing, investment advice and portfolio management**), with the following responsibilities:
 - i. Performance of tasks assigned to them;
 - ii. Drafting operational plans;
 - iii. Providing expected *deliverables* within the agreed schedule;
 - iv. Providing the Technical Secretariat with the information necessary to regularly monitor all activities;
 - v. Supporting the Technical Secretariat in making SAL.

82 banks joined the initiative and are contributing to these working groups with experts from various departments: Marketing/Distribution network, Finance, Organisation/ ICT and Compliance / Audit / Legal.

Each bank has also appointed an **internal contact person** acting as liaison person with ABI in order to ensure dissemination of the information and the outputs of the Project.

- four **Drafting Groups**, composed of 3 or 4 people chosen among the members of the Working groups, with the task of reviewing the Project's semi-finished *outputs* before discussing them with other members.

- **Consultation Forums** aimed at creating interaction between the **banking sector** and **other sectors** equally impacted by the MIFID: above all, other *stakeholders* (consumers, financial operators, firms, markets), as well as *ICT Providers & Consulting companies*, which will support banks in implementing the new EC rules.

In particular, there is:

- a *forum* for **ICT providers** and **Consulting Companies**, organised in cooperation with ABILab;
- a *forum* for **associations representing firms, financial practitioners, issuers, markets**, etc..

Discussions within the working groups are centered on 19 matters:

1. *clients classification*
2. *adequacy – appropriateness*
3. *information to clients*
4. *tied agents*
5. *investment advice*
6. *investment researches and market communications*
7. *client order handling*
8. *best execution*
9. *execution only*
10. *systematic internalization*
11. *Alternative Trading Systems*
12. *reporting transactions*
13. *post-trade transparency*
14. *conflicts of interest*
15. *inducements*
16. *internal audit*
17. *personal transactions*
18. *organizational requirements*
19. *outsourcing of financial services*

The project was conceived to be accomplished in four stages:

- **STAGE I – “AS IS” Analysis Tool** – whose objective is to finalise a **GAP Analysis** tool for each of the 19 matters so to allow for the analysis of the gap between the bank’s actual arrangements and the new Directive requirements;
- **STAGE II – tools for the “TO BE” Model** – whose objective is to finalise an *Impact assessment tool* to help banks in collecting and organising information on how the new rules impact them. This assessment will be used in drafting an adequate action plan implementing the Project. The decision-making tree tool provides banks with an efficient tool in making business strategic choices;
- **STAGE III – Operational Guidelines** - banks will receive guidelines to perform most relevant activities in the best way in order to comply with the new rules;
- **STAGE IV –Finalising Templates** - aims at finalising templates for those documents that banks are commonly required to draft and provide to their clients.

Until now, the gap analysis and the impact assessment tools for all the 19 matters and 5 decision-making trees have been delivered.

The ***GAP Analysis Tool*** works as following:

Topic: main sub-matters to be analysed under each of the 19 matters;

Scope: investment services, financial instruments and types of clients affected by the new rules will be identified with respect of each of the 19 matters,

Legislation: under each matter, EC and regulations in force as well as the new ones (not yet in force) will be identified;

GAP Analysis: for each sub-matter, an analysis of the gap between the bank's actual arrangements and the new Directive requirements will be carried out to identify the necessary adjustments.

The ***Impact Analysis Tool*** consists of **4 matrices**:

1. **The Gap Matrix** describes all the areas where there is a gap between the actual arrangements (AS-IS situation) and the new MiFID requirements, providing a qualitative analysis of the impact (high/medium/low/n.a.) according to the four areas of analysis identified (Organisation, IT, Legal & Compliance and Business). Each bank decides whether it wants to describe the gap or simply indicate the title;
2. **The Matrix for Organizational Impacts** describes, for each of the area where a gap has been identified, the changes to the procedures of the Bank and the *effort* to implement them;
3. **The Matrix for impacts on IT** describes, for each area where a gap has been identified, the changes to the procedures of the Bank and the *effort* to implement them;
4. **The Matrix for Legal & Compliance** describes, for each area where a gap has been identified, the necessary changes to comply with the new rules, specific *templates*, and the *effort* to implement them.

There is not a matrix specifically describing impact on the *business* as the impact on business has been analysed in connection with the finalisation process of the Decision-making trees. The *Impact Analysis Tool* must be filled in by each bank of the same group and indicate the name of the contact person responsible for the analysis of the gap and the implementation of the adjustments.

The ***Decision-Making Trees*** provide banks **with efficient tools** in deciding business strategies in order to comply with the MiFID Directive requirements. They have been developed in connection with the following **5 MiFID matters**:

- **Clients Classification**
- **Best execution**
- **Execution only**
- **Systematic Internalization**
- **Alternative Trading Systems (SSO)**
- **Inducements**

The ***Operational Guidelines*** aim to assist banks in implementing the requirements of the new Directive. In the beginning, Guidelines (so-called ***Position Paper***) will be developed on the following MiFID matters: ***Client Classification, Investment Research and Market Communication, Best execution, Conflict of interests*** and ***Inducements***.

ABI performed a bank survey on the level of preparation for the MiFID in order to measure how banks are getting prepared to meet the new requirements, which enter into force on November 1. The questionnaire, prepared by ABI in cooperation with KPMG, illustrates the threats and the opportunities of the MiFID Directive and shows how the Italian banking industry is preparing itself to cope with this change in the regulatory framework.

Some findings of the survey

*As for implementing measures, more than half the banks surveyed consider **streamlining structures** as a priority. Almost equally as important is the need to **externalise systems and infrastructure and to make the network services more efficient.***

*Almost all the banks surveyed envisage the **delay in defining regulatory aspects** as the principal obstacle in adjusting their business. Moreover, more than 70% of the sample is uncertain on how to apply the new requirements and almost half envisages the risks related to possible **delays** in implementing the required **compliance/organisation measures.***

*70% of the sample states that there will be a Committee in charge of implementing the MiFID Directive and this person will report to the **CEO.***

Less than 20% of banks state that the Finance Department will be in charge of implementing MiFID.

About 70% of the sample agrees that adjusting to MiFID constitutes a separate object, which is not integrated with the other ongoing initiatives.

3. Implementing MiFID in UK

Mr. Robert Cain, Senior Associate, Clifford Chance outlined that implementing MiFID in UK wasn't a revolution, but an evolution – given the development of the financial market – and FSA did a very good job in transposing MiFID.

FSA performed an “intelligent copy out” on the European Directive, but added also implementation regulations such as parameter guidance on exemptions, interpretation of definitions, harmonization with the Directive on capital adequacy. FSA run three large consultations in May, July and October 06 covering systems and controls, markets issues and conduct of business and issued three FSA feedback statements setting out the FSA's final new rules.

FSA will be flexible with the market players as the implementation process was delayed due to some clarification discussions with the Commission and CESR, therefore market players will be allowed some time for adjustment after November 1st, 2007.

Clifford Chance representative pointed out some key topics in MiFID implementation:

- **Best execution** – the big one out of the critical issues. CESR has produced a very good document on this. This is the issue which caused most debate in the UK. For best execution the main problem has been how to apply “best execution” concepts to privately negotiated deals, e.g. in OTC bond and derivatives markets. The FSA

originally proposed that firms should try to measure themselves against “benchmarks”, but this was widely criticised and has been dropped;

- **Repapering of clients**
- **Cross-border issues**
- **Investment advice**
- **Systematic internalisers and MTFs**
- **Inducements**
- **Investment research**
- **Record-keeping**
- **Customer categorisation** – FSA helped this approach by providing an interpretation of the rules. the UK has traditionally had a 3-tier system but the MiFID categories do not map precisely to the old ones. The FSA has taken a very useful approach to grandfathering of existing client categorisations. Issues include: chains of counterparties and fact that some clients may have different categories for different types of business and between different firms – this is not a UK specific problem. Some professional clients will want to be treated as retail clients while equivalent counterparts will opt down to professionals. Brokers who have retail clients could ask to be treated as retail clients;
- **Conflicts of interest** – how to manage the conflict situation, not only to recognize and disclose it. The issue is how to improve practices and describe them to clients. Some conflicts are obvious but others can arise only in certain (possibly unusual) circumstances. Firms generally have procedures to manage conflicts.
- **Suitability and appropriateness**- for **suitability**, the debate has been about record-keeping, particularly in the context of “investment advice” which might be given incidentally by a trader over the phone. Also firms need to consider whether the client’s information remains up-to-date. For **appropriateness**, one solution is to rely on the presumptions which apply to professional clients (art 36 Level 2 Directive).
- **Organisation and compliance** - for organisational issues, the UK has had onerous “personal registration” requirements, which are being partly removed by MiFID. The UK regulator also expects firms to have a “compliance monitoring programme” to ensure its compliance procedures remain effective. MiFID also reinforces other existing practices. In general, not much change in UK.
- **Outsourcing** – its definition is very large and almost anything can be considered as outsourced;
- **Transaction reporting**

Mr. Cain shared with participants his views on the implementation planning and execution. Firms often ask on the best way to design a MiFID implementation project. There is no uniform template. Answers to these questions may help a firm designing a project which works for it. MiFID shouldn’t be seen as a “compliance” project. It will have strategic significance on profitability and the lines of business that a firm wants to develop and where it wants to do business. Getting business people to buy in is essential – compliance cannot take the decisions. For example, a client I am advising has had to consider whether to build a system to cope with a small number of retail clients or to cease providing services for those clients. Worrying about the undeveloped legislation is pointless. Most of the detail is already there in the EU Level 1 and Level 2 measures.

The collective initiatives are heavily important in designing and running the implementation at an individual level and Mr. Robert Cain spoke about “MiFID Connect”, the UK financial industry initiative, under which Clifford Chance has produced two guides (and another one is under preparation) that are endorsed by FSA.

4. MiFID – Romanian experience

Mr. Radu Ropota, Associate in Badea Clifford Chance, outlined some of the issues that are not very clearly defined by the current Romanian regulations transposing MiFID, such as competences and responsibilities in passporting (NBR and NSC roles). It was emphasized that the new regulations have a powerful impact on the investment activities, such as:

- **extension of scope**
 - investment advice
 - commodities, complex derivatives
 - multilateral trading facilities
 - own account dealing
- **new organisational rules**
 - compliance, other systems and controls
 - management of conflict of interest
 - new record keeping rules
 - client asset rules
- **new client documentation**
 - new client classification scheme
 - marketing rules
 - information about firm and its services
- **New conduct of business rules**
 - new suitability, appropriateness rules
 - best execution rules
 - order handling rules
- **Equities trading, market structure**
 - new quote rules for systematic internalisers
 - post trade transparency
 - **IT, operations**
 - transaction, trade reporting
 - client confirmations, reports
 - record keeping
 - client documentation

Romanian investment firms have to comply with a very tight implementation schedule:

- transparency requirements and market integrity – 1st of June 2007
- changes in internal rules and regulations in order to comply with Financial Services Regulation – 30th of June 2007
- notification to the National Securities Commission of the internal rules and procedures, organizational chart, operating rules, etc – 15th of July 2007.

Badea Clifford Chance's representative detailed on some **hot topics** on which efforts should be concentrated:

- **client classification** – need to review all the clients' classification, to check clients' home state classification regime and more formal requirements as to classification, including notifications and risk warnings;
- **client documentation** (information on the firm/services; instruments/risk warnings; costs/charges; client assets/client money; suitability risk warnings; client classification notification; classification opt-up/downs; best execution policy, conflicts policy etc.) that makes re-papering unavoidable. The issue of regulated agreements was raised;
- **suitability/appropriateness** – a questionnaire is to be conceived and fact-finding performed with clients.

III. Summary of the discussions

- Regarding the provisions of Art. 5 and 6 of Directive 73 on the **implementation of the control** for ensuring conformity – the control is seen as a function, not as a system. NSC could make a better distinction when revising Law no. 297/2004 on the capital market.
- In respect of the **execution of transactions on the OTC market** – the Romanian regulations do not forbid expressly the execution of transactions on other markets and they gave up the concentration rule, so it is allowed, but the problem is with the settlement of these transactions. Transactions on regulated market are settled through Depozitarul Central, therefore is up to this institution to provide rules for settling also the other transactions.
- NSC intends to issue implementation guidelines as a **package of instructions**.
- Regarding **the competencies and responsibilities** on authorizing and supervising the credit institutions falling under Romanian regulation on MiFID – NSC outlined that NBR should be in charge with these, and NBR representatives expressed their contrary opinion. In Italy there is a permanent interaction between CONSOB and Bank of Italy, the co-operation being foreseen by the law. There is a clear distinction in the law by function: CONSOB has to regulate and supervise conduct of business and Bank of Italy has to look for stability objectives. The two institutions will issue a common regulation on MiFID.
- As for **passporting in Romania**, there is a protocol in place between NSC and NBR on the procedures to be followed
- NBR didn't issue regulations for implementing the Romanian regulations on MiFID in the banking system.
- On **the market players' awareness on MiFID implications** – there is a low level of awareness among Romanian credit institutions. In Italy, the Central Bank asked banks' top management on the implementation status and the Governor initiate a high level meeting in this respect. ABI also sent a letter to all its member banks.

- The **definition of the client** – in Romania, the existence of a written agreement is the base to consider the counterpart a client. In UK, the definition covers also the potential clients (for which an activity is performed, not a service), although the Directive doesn't make distinction between activities and services. This is a very important aspect for dealing on own account, for operating an MTF and for the best execution requirements.
- Romanian regulations don't detail on the **client's consent** issue; in UK the regulation stipulates that the prior consent is not to be given in writing, can be general and continued dealing is treated as consent, while the prior express consent is given through signature, by email or by phone.
- Regarding the **clients' right to sue banks for non-complying with MiFID** after November 1st, 2007 – there is this risk.
- At the bank level, **responsibility** falls on the senior management.
- Banks could be **sanctioned** by authorities for non-complying with MiFID requirements.

IV. Conclusions

The objective of the workshop was to raise awareness on the MiFID implications and to foster dialogue between authorities and market players in order to create the synergies for a rapid and a proper implementation.

MiFID is for the capital market what Basel II is for the banking market. MiFID will introduce new competition in the system and Romanian market is going to change completely. Romania is one of the few countries that transposed MiFID, but there is room for improvement.

The competent authorities (NSC and NBR) and market players have to join forces in a sustained and structured effort to implement MIFID in Romania. The role of the relevant authorities doesn't end when a regulation is released.

Italy represents a very relevant example of organizing a structured approach in order to provide banks with helping tools for implementation.

UK has found interesting ways to tackle certain issues and FSA efforts in providing the financial industry with clear and explanatory regulations represents an example to be followed.

Attachment (List of Participants)