INTEGER WEALTH GLOBAL

Markets in Financial Instruments Directive (MiFID) Definition

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What is the ‘Markets in Financial Instruments Directive’ or (MiFID).? The Markets in Financial Instruments Directive (MiFID) is a European regulation that increases the transparency across the European Union's financial markets and standardizes the regulatory disclosures required for firms operating in the European Union.

MiFID implemented new measures, such as pre- and post-trade transparency requirements, and set out the standards of conduct to be followed by financial firms. MiFID has a defined scope that primarily focuses on stocks. The directive was drafted in 2004 and has been in force across the European Union (EU) since 2007. MiFID was replaced by MiFID II in 2018.

Key Takeaways

- The goal of the Markets in Financial Instruments Directive (MiFID) is to increase transparency across EU financial markets and to standardize regulatory disclosures for firms.
- MiFID is part of the regulatory changes sweeping the EU and impacting the compliance departments of all financial firms that operate there.
- MiFID has been in force across the European Union since 2007.
- MiFID was replaced by an updated regulatory directive, MiFID II, in 2018.
- Stocks are the primary focus of MiFID but the product scope has been expanded under MiFID II.

Understanding the Markets in Financial Instruments Directive (MiFID)

The stated aim of MiFID is for all EU members to share a common, robust regulatory framework that protects investors. MiFID came into effect a year before the 2008 financial crisis, but changes were made in light of the crisis that took shape in MiFID II. One issue in the original drafts was that the regulatory approach in dealing with countries outside of the European Union was left up to each member state. This meant that some firms outside of the EU could have a competitive advantage over firms inside the union because of the easier regulatory oversight.

This issue was addressed through MiFID II, which was implemented in January 2018 and harmonized the rules for all firms with EU clients. MiFID focuses primarily on stocks, which was seen as a limitation, because it did not include the vast amount of financial products available in the market, such as over-the-counter (OTC) derivatives.

OTC transactions are done between two parties without any exchange being in the middle to act as a supervisor. As a result, there was less regulatory oversight and much less transparency for the parties engaging in an OTC trade. Implementing MiFID II brought many more financial products under its purview. The Markets in Financial Instruments Regulation (MiFIR) works in conjunction with MiFID and MiFID II as a regulation rather than a directive to extend the codes of conduct beyond stocks to other types of assets.

Client Classifications Under the MiFID
One of the key aspects of MiFID is the classification of clients into specific client types. There are three types of client types: professional clients, retail clients, and eligible counterparties. The goal for the classifications is that the regulatory protection for the clients should reflect the different levels of risks for each client type.

The idea is that different types of clients, or investors, will have different levels of financial knowledge, and so should be given different levels of protection when dealing with a financial body, such as a bank. Eligible counterparties are provided the least protection and retail clients are provided the highest.

Depending on the client type, the client is provided with different levels of information, which are necessary for their understanding of the specific risks of a transaction as well as the overall explanations and details of that transaction.

European Union Regulatory Harmonization
MiFID is just one part of the regulatory changes sweeping the EU and impacting the compliance departments of all the financial firms, e.g., insurers, mutual fund providers, and banks operating there. Taken together with other regulatory initiatives, like the General Data Protection Regulation (GDPR) and MiFIR, the EU is following through on its vision of a transparent market with clear rights and protections for EU citizens.

As with any regulatory framework, many of the rules are tweaks to existing regulations, such as the requirements for disclosure where a conflict of interest exists. However, several best practices, like the appointment of a single officer to protect client interests from inside the firm, are now explicit requirements for firms that want to access the EU market.

MiFID II
In 2018, the European Commission enacted a revised directive called MiFID II. First proposed in 2012, the revised directive was intended to restore confidence in the markets following the 2008 market crash.

While MiFID was limited to equity stocks, MiFID II extended the requirements to issuers of all types of securities, including debt securities, derivatives, and structured instruments. The new regulation enhanced the transparency and reporting requirements of securities trades, reducing the use of dark pools and OTC trading. It also extended investor protection for all types of securities trades, whether the investor was located inside or outside of the European Union.

How Did MiFID II Affect Investment Banks.?
For banks that provided asset management or investment services, MiFID II requires financial instruments to be traded only in multilateral and regulated trading platforms, or those that adhere to the transparency requirements of OTC trading. These rules are intended to protect investors and eliminate dark trading of securities.

What Is the Difference Between MiFID and MiFID II.?
MiFID II enhanced the transparency and reporting requirements of the older MiFID regulation. One key difference is the expansion of its scope: while MiFID applied largely to equities markets, MiFID II applies to all types of securities and derivatives.

How Does Brexit Affect MiFID II.?
After the United Kingdom left the European Union, the two economies had two substantially similar regulatory regimes, although they lost their ability to trade easily with one another. This meant that British firms lost their license to provide financial services to EU clients, and vice versa. It also created duplicate reporting requirements for the two areas.

The Bottom Line
MiFID, or the Markets in Financial Instruments Directive, was a set of European regulations governing equities markets in the European Union. It was intended to enhance transparency and reporting requirements to protect European investors. These rules were replaced by the revised MiFID II regulation in 2018.