

# How to implement MiFID

*As the deadline for MiFID approaches, firms should now be considering the logistics of their implementation plans. PJ Di Giammarino of JWG-IT outlines some priorities*

It has been an exciting summer in Europe. Amongst the news articles proclaiming a new era for Italian football and record heat, you may have missed one of the most significant events in Europe's capital markets for a decade: the Level 2 Markets in Financial Instruments Directive (MiFID) was passed by the European Commission and the European Securities Council in June 2006. For all of the negative press last summer, it is quite remarkable that not much was made of this next big step on the road to a new capital markets regime across 28 member states. If you would like to understand how MiFID introduces changes to the way Europe and your firm will operate, read on.

Perhaps one of the reasons that the MiFID implementing measures were not big news is that many of the provisions were clear as early as April 2004, when Level 1 was passed into law. Although MiFID will apply to almost all asset classes, it initially affects equities more than any other financial instrument. Whatever your position in the capital markets value

chain, however, it requires that you better understand your customer, clarify the products and services on offer, define the way in which you will transact business and ensure transparency. This also applies to the way in which you run your institution and also how you involve third parties and outsourcers in conducting your day-to-day business. The more complex your business model is and the greater number of jurisdictions and legal entities involved, the more detailed the planning required for your organisation to comply.

There will be new market forces introduced across Europe which will begin to change the financial services value chain and the complex, inefficient and expensive operating model which underlies it. We will still be far from the "United States of Europe" as arbitrage opportunities of language, national discretion, market tradition, regulatory approaches and gold plating will continue to exist. However, the playing field will be substantially levelled and the barriers to consolidating market practices and infrastructure greatly reduced. Those that have a flexible and



scalable platform across Europe will be the real winners as MiFID is not just an issue about how to spend the least amount of money on compliance. In many ways, MiFID merely accelerates a number of changes that technology enabled trading strategies have brought the industry.

All that remains between now and MiFID implementation in November 2007, are the January transposition deadlines in each member state. Some “consultation periods” have begun and the regulators are now struggling to specify the requirements at the 3,000 metre level. Some of these debates have been quite lively indeed; the FSA’s suggestion that a benchmark price for price comparison in best execution might be appropriate has pushed the UK market to the point of revolution. It is rumoured that certain member states are now actively discussing the effective elimination of the eligible counterparty. And predictably, some member states have declared that they will not be able to have MiFID on their books within the required time frames.

The biggest difference between the MiFID of summer 2005 and that of 2006 is that we are now on the cusp of testing perhaps the most intensive period of IT systems changes ever simultaneously introduced to a single industry. Those that have responsibility for running the bank have (hopefully) by now acknowledged the inevitable increase in awareness volume levels and completed their gap analyses - demonstrating how much ground needs to be covered. In many organisations the conversation has rightly moved well beyond the question of “what does MiFID mean?” to “what do I need to do to get ready for MiFID?” This is not just a question of compliance; it involves fundamental issues of where each participant in the capital markets value chain perceives its greatest sources of competitive advantage to be. For example, it is nearly impossible to separate a discussion about cross-asset class or algorithmic trading strategies from the likely impact of MiFID.

If you are part of an organisation which has established a programme

governance structure which works across your asset classes and back-office functions to define the impact and determine how you will go forward, you are on the right track. Across Europe, however, there are many who are not in this position. Are some taking it all too literally and agitating the market with scare-monger tactics? Absolutely, but it is important to separate fact from fiction. Are there those who are attempting to defend their rapidly eroding market positions with their heads well in the sand? Yes. Be sure to ask the appropriate questions of even your most trusted suppliers.

The bottom line is that the market is not prepared for change. Making a large and complex move from familiar turf without control over the resources is a scary prospect for most bankers. Anecdotally, the contract labour market is already reflecting this as anyone who can spell MiFID and who has a programme management or business analyst background has seen their daily rate rise 30 to 50 per cent in the past six months.

**Five MiFID implementation priorities:**

- Complexity: The number of functions or businesses involved in MiFID discussions can be very large. This can be complicated by the number of initiatives in progress. Those discussions which can be owned by a single senior stakeholder are, by definition, less complex. Solution: Find the right group of stakeholders and make them accountable for your MiFID response.

- Lead time: Change will not happen overnight. Package vendors can only move so fast, no matter how much you shout. The larger the number of teams involved and the greater the number of dependencies, the less likely your teams will have short implementation

lifecycles. Solution: Start now; do not listen to those that would wait until 100 per cent certainty has been achieved before launching your implementation programme.

- Requirement certainty: In some areas your compliance or legal function may have very clear views on what is required. In others, you may be entirely dependent on the development of industry market practices and issue resolution. The level of iterative development in the latter cases will be much higher. Solution: Identify and risk-weight your assumptions, recognise that they could change and monitor them carefully during the implementation lifecycle.

- Ability to deliver: Good teams are not built in a day. Where your teams

are trained and ready to go you will have an advantage. Where there are no teams, the IT supply markets need to be locked-in at the appropriate time and price points – often sooner and higher than you would like.

Solution: Start committing to good people now; accept that the most cost effective implementation outcome will require experience up front.

- Commercial advantage: As MiFID is not all about regulation, it cannot be considered with a single lens. Opportunities are there for those that look.

Solution: “War game” your options now. Even once budgets are set keep a close watch on the opportunities as they present themselves.

### JWG-IT's 10 Commandments for MiFID implementation programmes

1. Thou shalt collaborate internally: If you haven't already done so, it is time to engage Compliance, IT and Operations in a real discussion with the front office about the requirements of MiFID.

2. Thou shalt collaborate externally: The operational complexities being introduced are extremely difficult to analyse independently. The forums which bring relevant parties together to share ideas and develop common approaches and practices should be leveraged.

3. Think, do, deliver: Prior to deploying your implementation teams, the gap analyses that have been conducted should be reviewed in a

strategic forum which takes account of commercial and regulatory plans.

4. Prepare for thy regulator: It is no longer appropriate to wait for the results of any one regulator. Teams need to be engaged in meaningful discussion of how they would like to see level 3 operational issues resolved.

5. Think "many to many": Common approaches to solutions should be discussed in the appropriate forums.

6. Scope and develop iteratively: To determine the appropriate implementation strategy, front and back offices need to consider potential solutions and costs in parallel.

7. Be European: MiFID will not create the "United States of Europe", but it will help to harmonise Europe. Current and potential business models

that cross jurisdictions should be evaluated at the European level.

8. Align partner interests: Suppliers of internal IT and operational services will need to collaborate closely with their external counterparts.

9. Implement across asset classes: Internal boundaries and barriers within your institution will need to be examined as the parallel requirements of increasing performance whilst reducing costs are introduced.

10. Know thy new marketplace: MiFID does not use the term "buy side" or "sell side". It does, however introduce new animals such as systematic internalisers and multilateral trading facilities. Changes to future roles, responsibilities and behaviours need to be considered carefully.

If you have been steadily investing in the appropriate processes, partnerships and technologies to manage the trade lifecycle then you need not be too concerned. However, if you have pursued independent single asset class-based operating platforms you will struggle to meet the new requirements.

To date, hundreds of implementation issues, many of which cannot be solved unilaterally by any one firm have surfaced. For example, can a branch which reports to its home regulator rely on them to report to the host regulator? What if additional information is required by the host such as stock loans which are outside the scope of MiFID? Will the host faithfully pass the information on to their colleagues? Does one stop being a System Integrator (SI) in a German stock during a German national holiday? How long can a firm knowingly remain in the market if an IT infrastructure failure will prevent them from reporting within three minutes of the trades? To complicate matters

the Committee of European Securities Regulators (CESR), the regulators with 1/400th of the resources of the SEC and little budget or operating expertise will have their work cut out for them to introduce the necessary guidance in a timeframe acceptable to the industry.

At JWG-IT Ltd we have already spent over 700 hours this year in think-tank workshops with senior practitioners defining and documenting the detailed operating models, scenarios and issues which MiFID implementers face across the trade lifecycle. By mapping the new model requirements with over 60 individuals in 12 top tier firms, we have achieved a good view of common implementation challenges, but at least twice the level of effort we have expended to date will be required to get to 80 per cent common solutions.

MiFID is not a problem which can be outsourced to someone who does not run your financial institution. However you look at it, the key to a successful

MiFID implementation programme is to have the right resources analysing the right problems at the appropriate time. So what are your priorities?

For most firms, these factors mean that large infrastructure changes like transaction reporting and pre and post trade transparency should be well understood by now. Process restructuring intensive work like best execution and customer reclassification should also be thought through. "Heavy lifting" requirements like proving record retention or managing conflicts of interest changes should be top of the agenda for the autumn.

We estimate the IT supply chain affected by MiFID to be approximately €100 billion per annum across hundreds of thousands of individuals. Few have the information they require to deliver market changes in a timely manner. Fortunately, now that the heat of the summer has been replaced by that of the budget season we can begin to have the right discussions. ■