

white paper

MiFID

**Markets in Financial Instruments Directive
2004/39/EC of the European Parliament and
of the Council**

A Smart Response



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Executive summary

Headlines

Scope and impact

- The directive brings a wider range of products and services under the umbrella of common European legislation.
- Investment firms will be able to conduct business in member states based upon “home market” regulation.
- The implications require business, operational, technology and compliance input to the program.

Timetable

- Implement in 2007 (April has been the working assumption, October is the newly proposed date).
- Budget must be reserved for MiFID projects now.
- Projects for 2006 need to be planned.

Response

- Ensure that sufficient awareness of the directive exists.
- Establish a broadly based program.
- Align with existing initiatives that have overlapping scope.

MiFID, the Markets in Financial Instruments Directive has been generating an increasing amount of press comment and interest during the latter part of 2005. Much of the comment has sensationalised the potential impact of this legislation with dire warnings of huge spend and infrastructure struggling under the burden of data generated. Whilst these headlines excite interest, this paper tries to take a more sober and measured assessment. We will review the main impacts of MiFID and how Investment Firms should formulate their plans to respond.

MiFID does have a number of significant impacts, notably:

- Increased scope incorporating more financial products.
- Increased rigour around client reporting and disclosure of fees and charges to clients.
- Significant requirements regarding order handling.
- Pre and post trade information publication obligations intended to increase market transparency.

In handling the changes required by MiFID we believe that the key to a **smart response** is to:

- Create awareness of MiFID across the business.
- Put a program governance structure in place with sufficient representation of business, operations, technology and compliance.
- Review projects that are already underway in such areas as KYC and align overlapping requirements to ensure effective focus of effort and budget.

Many of the current programs that investment firms have established are too low key and lack sufficient high-level representation. If not addressed quickly this is likely to result in duplicated effort, regret spend and missed opportunities as firms scramble to achieve “bare minimum” compliance once their MiFID implementation programs fully engage in 2006.

Understanding MiFID

1 Background

1.1 MiFID - a step in the development of European Financial Markets

The MiFID directive is the latest in a series of legislative changes that have been introduced by the European Union and a continuation in a process that has been going on for a decade or more.

EU Member states are committed to creating a more effective and integrated financial services market that will deliver **“the most competitive and dynamic knowledge-based economy in the world** capable of sustainable economic growth with more and better jobs and greater social cohesion”¹. Few could argue that the fundamental objectives of a single market will be of benefit both to investors and Financial Services firms within Europe. These objectives could be summarised as:

- Allow European retail customers to have access to a wider range of cost effective services and financial products.
- Give firms the opportunity to access markets in other member states within a common framework and to carry out cross border business effectively and on a level competitive playing field.
- Reduce the costs of doing cross border financial services business within Europe.
- Improve the accessibility of capital and enhance the allocation of capital across the whole of the European Union.

The ambition to create an integrated market has been embodied in the Financial Services Action Plan (FSAP) which was endorsed by the European Council in Lisbon in March 2000. The FSAP sets the overall direction and is effectively a framework for a host of other legislation. Some of this legislation pre-dates FSAP, including the original Investment Services Directive (ISD).

Introduced in January 1996 the ISD introduced the European Passport allowing firms to carry out a wide range of investment business across member states, opened up membership of exchanges in other member states and reduced local regulatory barriers. As part of the FSAP, ISD was reviewed resulting in ISD 2, the old name for MiFID. MiFID was formally adopted by the EU Council in April 2004.

¹ Presidency conclusions of the European Council Lisbon 23-24 March 2004

1.2 Key developments that MiFID introduces over ISD

MiFID extends the existing ISD, by establishing EU wide legislative harmonisation for:

- A wider range of Financial Instruments (for example including both financial and commodity derivatives).
- A wider range of investment services including the provision of advice.
- Alternative trading mechanisms and venues Multilateral Trading Facilities (MTF).

In addition the directive is more prescriptive than its predecessors, defining rules at a more detailed level than has previously been the case with European legislation. This will give less flexibility to individual member states when they come to translate the directive into national law and market practice.

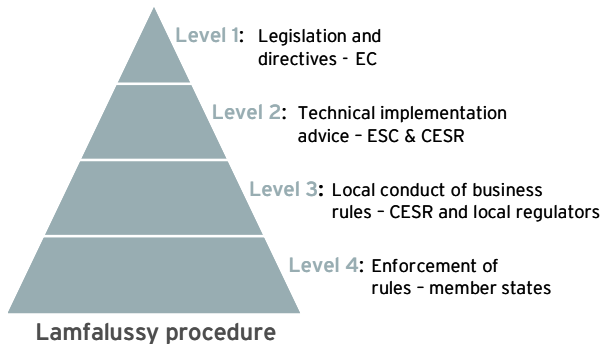
1.3 The objectives that the EU has for the MiFID directive

MiFID aims to increase the transparency of European Financial Markets and to ensure the protection of the interests of the investor (in particular the retail investor). At the same time the directive aims to increase efficiency allowing Investment Firms to benefit from opportunities that arise from their right to conduct business in other states based upon their existing home market authorisation.

Once implemented in the law and market practice of member states MiFID is intended to deliver the following:

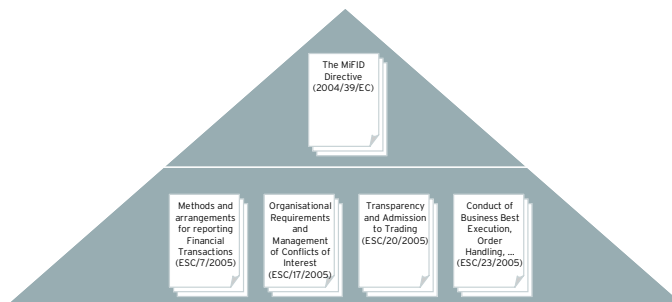
- Increased transparency on the depth of liquidity across all trading venues including trades in regulated markets, MTFs and internalised trades.
- Enhanced protection for the retail investor covering the whole spectrum of investment services from the provision of advice through to execution of orders where specific obligations exist regarding how the order is handled and best execution achieved.
- Greater competition between regulated markets and MTFs and removal of barriers to investment firms connecting with the trading venues in other states.
- Greater emphasis and clarity on the obligation for Investment Firms to take specific action to avoid any conflict of interest.
- Increased levels of disclosure to the retail investor including greater transparency in relation to charges and fees.

1.4 The process for the implementation of MiFID



European securities legislation is introduced following the **Lamfalussy arrangements**. This is a four level approach that starts with EU directives issued by the European Council, progresses into more detailed technical guidance before embracing the regulatory bodies in member states for the conduct of business rules. Finally the legislation becomes law and practice in the markets of the member states.

At the time of writing this white paper the level 2 and level 3 processes are under way. The European Commission has published a series of working documents that clarify a number of the articles of the directive. These working papers continue to be discussed and amended and there will be further revisions. This White Paper reflects information available in working documents published up to 31st October 2005.



1.5 The timetable for implementation

Key dates

Q4 2005

- Continued consultation for Level 2 and Level 3 process.
- Level 2 wording finalised.

Q1 2006

- Level 3 advice from member state regulators.

Q4 2006

- Rules finalised.

30th April 2007*

- Rules implemented.

*The date has not been finalised and a move to October 2007 has been proposed.

The normal timetable to transpose a directive to law would be 2 years. However the commission has proposed a year delay with a target to have the directive implemented by April 2007. This date has never been finalised however and a move to October 2007 is a strong possibility.

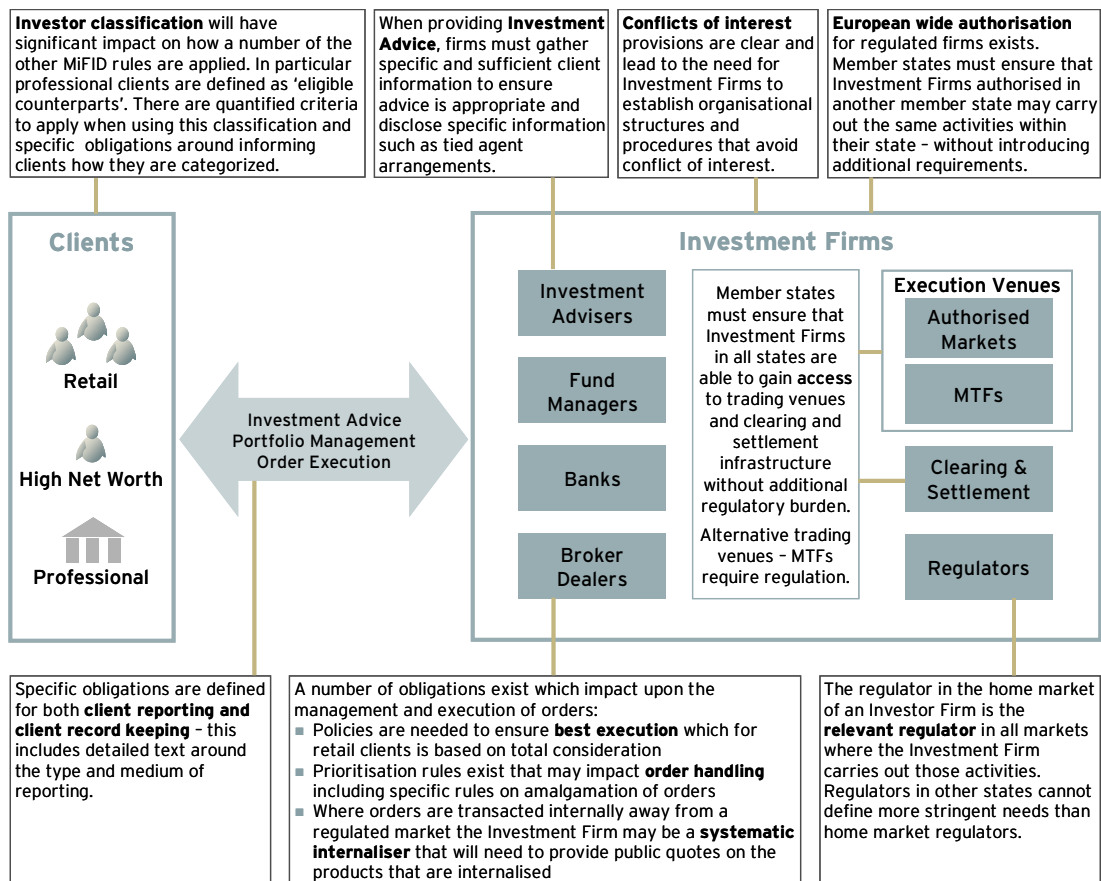
We believe that although the date may shift, the EU will now be determined to ensure that MiFID is implemented in 2007. As the panel opposite shows this will not leave investment firms much time to understand the impacts of the directive and make the required changes.

As we explain in the remainder of the White Paper, Investment Firms need to take action in Q4 2005 to complete an initial assessment and reserve budget for 2006. In 2006 projects to handle MiFID requirements can then be organised in a "smart" manner.

2 The key provisions

2.1 Where the key provisions are focused

With 73 articles in the directive and almost as many again in the form of level 2 clarifications there is a significant amount for Investment Firms to take on-board. The good news, however is that the number of articles that will have significant material impact focus on a relatively small collection of key provisions. The majority of the key impacts are highlighted in overview in the diagram below. The most widely critical of these are then explained in more detail within the remainder of this section.



2.2 The key provisions: explained (briefly)

Regulatory scope

Key references

Directive articles

- 1 Scope
- 2 Exemptions
- 3 Optional exemptions
- 4 Definitions
- 5 Requirement for authorisation
- 6 Scope of authorisation

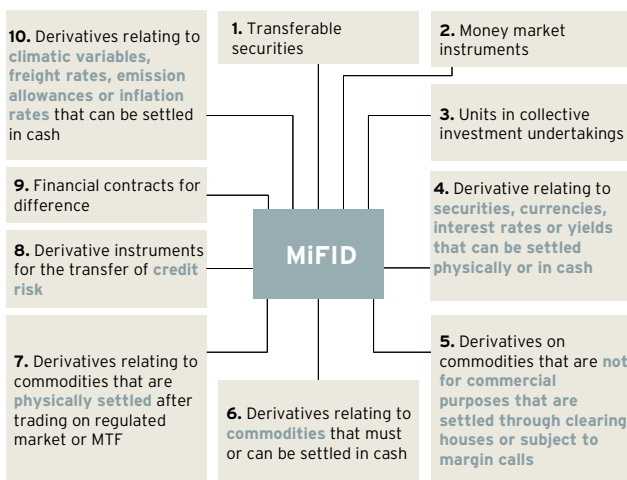
Directive annex 1

- a. Services in scope
- b. Ancillary services in scope
- c. Financial instruments in scope

Level 2 text

Esc/23/2005 - Definitions

- The scope of products brought under the regulatory umbrella will increase significantly as compared to the previous directive (see Illustration).



- Financial services firms transacting client business in these products will need to do so via an entity authorised in Europe.
- Certain derivatives contracts including commodity, credit, interest rates and even climatic variables and emission allowances are now included.
- The range of investment services for which authorisation is required has broadened.
- Firms may establish new European branches without having to satisfy any additional host country requirements.
- The new arrangements will further clarify the duties and responsibilities of home and host supervisors, which lends greater certainty as to how cross-border trades are supervised and reduces the risk of host supervisors placing undue restrictions on firms undertaking cross-border business.
- Commodity trading (for own account) organisations may be exempt.

Conflicts of interest

Key references

Directive articles

- 13 Organisational requirements
- 18 Conflicts of interest

Level 2 text

ESC/17/2005 - Article 24
Conflicts of interest and research

- Principles on managing conflicts of interest are specified and there are requirements for the segregation of areas of business.
- MiFID requires firms to have an independent compliance function and for there to be adequate senior management involvement in, and accountability for, the compliance of regulated firms. It has also been proposed that the compliance function's remuneration does not undermine its independence i.e. their bonuses should not be linked to a firm's financial performance.
- Any material conflict is required to be notified both to clients and the competent supervisory body.
- Firms will be required to set and maintain a Conflicts of Interest policy and maintain effective information barriers (i.e. Chinese walls).
- Where a firm creates and distributes research additional specific obligations are identified to ensure that the firm and the individual analysts are not conflicted.

Investor classification

Key references

Directive articles

- 19 Conduct of business obligations
- 20 Services through another firm
- 23 Tied agents
- 24 Eligible counterparties

Level 2 text

ESC/23/2005 - Eligible counterparty

- MiFID establishes a common EU framework for classifying trading partners as retail investors or professional clients (referred to in MiFID as **eligible counterparties** i.e. those who warrant less protection - comparable to intermediate customers and market counterparties under FSA rules).
- Much of the directive is focused on the retail client and the obligations of the investment firm to the client in respect of advice, execution, reporting and disclosure.
- A full suitability test on clients is required when they are provided with investment advice or portfolio management. Execution only business is exempt.
- Eligible counterparty classification has been clarified with quantified guidelines and specific notification requirements where a client is categorised as an eligible counterparty.

Record keeping

Key references

Directive articles

- 19 Conduct of business
- 25 Obligations regarding record keeping

Level 2 text

ESC/23/2005 - Defines Durable Medium

- The customers of investment firms must receive adequate information and reporting on transactions in a clearly comprehensible form, including details of costs.
- Confirmations must be provided within one business day of the transaction (with the exception of regular investment schemes).
- Firms must maintain transaction data for at least 5 years and also divulge daily, details of transactions on regulated markets to the relevant authority, by close of the following business day.
- Telephone records of client conversations may have to be retained for 1 year.
- Record keeping requirements for transaction reporting are increased (to include for example: venue, period of validity and dealer ID).
- Transaction reporting obligations may be met by the Investment Firm or by an authorised third party such as an MTF, Exchange or Trade Matching facility.
- The directive has been clarified to allow a web site to fall into the definition of durable medium.

MTF regulation

Key references

Directive articles

- 14 Trading process in an MTF
- 26 Monitoring an MTF
- 27 Obligation to make public firm quotes
- 29 Pre trade transparency for an MTF
- 30 Post trade transparency for an MTF

Level 2 text

ESC/20/2005 - Defines rules around the publication rules for different MTF order book systems

- Multi-lateral Trading Facilities (such as Electronic Communication Networks and Automated Trading Systems) will be included in the scope of EU regulation, comparable to national exchanges.
- MiFID will also eliminate the concentration rules practiced in France, Spain, Italy and Germany, allowing increased opportunity for cross-border trading via MTFs.
- Investment firms that internalise transactions are defined as **Systematic Internalisers with specific obligations** to make quotes public.
- MTFs will be able to utilize a central counterparty (CCP) or depository (CSD/ICSD) based in a different EU state.

Best execution and client order handling

Key references

Directive articles

- 21 Obligation to execute orders on terms most favourable to clients
- 22 Client order handling

Level 2 text

ESC/23/2005 - Clarifies best execution priorities and defines for a retail client that total consideration is key

ESC/23/2005 - Introduces rules for order handling aggregation

- Best execution obligations are to ensure the best possible deal for clients, taking into account multiple factors including price, cost, speed and likelihood of execution and settlement.
- Firms are required to maintain a formal Order/Execution policy and be able to demonstrate that this policy is followed.
- The elimination of concentration rules and the potential that this has for creating more pools of liquidity will create greater complexity in defining and meeting best execution obligations.
- Firms will need to be able to demonstrate that client business was executed in accordance with their policy.
- Under MiFID provisions, firms must understand their trading cost breakdown/analysis in order to be able to monitor best execution.
- There are specific rules regarding the aggregation of client orders and the prioritisation of execution of orders based upon the time of receipt of order.
- Firms that receive limit orders that cannot be executed immediately must make these public in order to increase the chance of executing the order.

Pre and post trade disclosure

Key references

Directive articles

- 28 Post trade disclosure - investment firms
- 29 Post trade disclosure - MTFs

Level 2 text

ESC/20/2005 - Scope on the quote publication obligations of Systemic Internalisers

- MiFID identifies the activities of Systemic Internalisers (firms that cross client orders against proprietary positions internally). They will be required to publish a firm quote on those shares admitted to trading on a regulated market on a regular and continuous basis during normal trading hours. It must be accessible to the market on a reasonable commercial basis.
- Such quotes are to be treated as firm for transactions up to standard market size.
- Post trade reporting by investment firms includes the obligation to make information public (as near to real time as possible) on a reasonable commercial basis.

Understanding the impact and developing a response

3 The implications

MiFID has important business and operational implications and is not solely a regulatory problem for the compliance function to handle. The impact of the legislative change touches upon the entire financial services ecosystem, and just like any ecosystem the way that each part reacts to change will have a direct bearing on the other parts of the industry. MiFID requires broad engagement from business, operations, technology and regulatory stakeholders within a firm. In addition, some firms will find that MiFID presents opportunities to expand their product offerings or achieve costs savings and is not merely a cost burden.

3.1 The business and operational implications

Regulatory requirement	Implication
<ul style="list-style-type: none"> ■ Increase of the regulatory scope to include additional services, and financial products, and to require that compliance be an independent function within the organization in order to ensure better “policing” of the regulations within the firm. 	<ul style="list-style-type: none"> ■ Increase controls framework where required to cover enhanced scope of the regulations. ■ If newly regulated due to the increased product scope then obtain necessary regulatory approvals. ■ Where not currently the case, establish compliance as a separate function. ■ Where not currently the case, establish investment research as an independent function and ensure research workflow processes that meet requirements.
<ul style="list-style-type: none"> ■ Enhancement of passporting to provide scope for licensing, with authorisation obtained in one country being applicable in other EU states, without further requirements. 	<ul style="list-style-type: none"> ■ Determine whether European Capital Structure can be optimised as a result of enhanced passporting provisions. ■ Determine whether enhanced passporting provisions offer an opportunity for increased pan-European business. ■ If newly regulated due to the increased product scope then determine the best country to obtain initial regulatory approval. ■ Determine whether there are opportunities to extend or introduce “hubbing” within European Operations rationalising the countries in which operations are carried out.

Regulatory requirement	Implication
<ul style="list-style-type: none"> ■ Reclassification of client types to distinguish between Retail clients or Professional clients and to manage the two differently. ■ Specification of the conditions that apply to “eligible counterparties” and a definition of a counterparty’s responsibilities. 	<ul style="list-style-type: none"> ■ Enhancement of Client/Counterparty Information Systems to support the data required for the additional information requirements. ■ Update of Client/Counterparty take-on processes to capture necessary information and perform the classifications required. ■ Categorisation of existing entities in Client/Counterparty Information Systems according to the additional requirements.
<ul style="list-style-type: none"> ■ Firms need to apply additional suitability and appropriateness tests to clients prior to providing a service or product. (Suitability test assesses the suitability of that client to be provided a particular service. Appropriateness verifies whether a particular product or service is appropriate for a client.) 	<ul style="list-style-type: none"> ■ Enhancement of Client/Counterparty Information Systems to support the data required for the additional information requirements. ■ Enhancement of sales processes and applications to support the flow and data capture required to meet suitability and appropriateness tests.
<ul style="list-style-type: none"> ■ Client order handling policies require additional detail and must include information about the different execution venues where the firm executes client orders and the factors affecting the choice of venue. Trading outside a regulated market or MTF requires specific client consent. ■ The concentration rules currently applicable to France, Italy, Germany and Spain are removed. ■ Firms will now have to establish a best execution policy and monitor that it is followed. They may need to keep records in order to prove to a client that the policy is followed. ■ The effectiveness of the order handling policy with regard to best execution must be monitored and in particular firms must regularly check whether the execution venues in the policy provide for the best possible results for the client. 	<ul style="list-style-type: none"> ■ Create an order handling policy that incorporates the considerations of the new regulations. ■ Update client documentation to include new provisions. ■ Enhance order routing/execution applications to adhere to the policy and to provide information required to prove best execution. ■ Update applications to obtain necessary information from execution venues. ■ Provide reporting necessary to demonstrate that the best execution policies are followed. ■ Implement control processes for best execution monitoring (including benchmarking against those execution venues not included in the order handling policy) and ensure that the policies remain valid.

Regulatory requirement	Implication
<ul style="list-style-type: none"> ■ Increase of pre-trade transparency requiring the publication of applicable information in near real-time (within 3 minutes) to be available across all 25 member states. ■ Regulated markets must make public bid and offer prices for all instruments. ■ Systematic Internalisers (client orders matched against proprietary positions) must provide a firm quote for all shares that are admitted to trading on a regulated market. 	<ul style="list-style-type: none"> ■ Determine how pre-trade information will be distributed and enhance information distribution infrastructure as required. ■ Where a firm is a Systematic Internaliser determine the options for making information public and where appropriate begin work with partners to fulfil the obligation. ■ Where a firm is a Systematic Internaliser develop appropriate quoting applications to provide firm quotes for selected instruments. ■ Regulated markets may update systems and services.
<ul style="list-style-type: none"> ■ Client limit orders must be published if they cannot be executed. The limit orders should be available for viewing by the other market participants. 	<ul style="list-style-type: none"> ■ Determine how limit order information will be distributed including identifying potential partners where appropriate. ■ Enhance applications to provide for publication of limit orders.
<ul style="list-style-type: none"> ■ Post-trade disclosures must be made available to the relevant authority for all instruments that can be traded on regulated markets as soon as possible and by end of T+1 at least. 	<ul style="list-style-type: none"> ■ Determine what post trade information will need to be reported and to which authority. ■ Determine the appropriate mechanism for reporting. ■ Enhance trade reporting applications according to new reporting requirements. ■ Review the infrastructure requirements arising from increased distribution.
<ul style="list-style-type: none"> ■ Exchanges and MTFs will have to adhere to stricter rules regarding validation of issuers prior to admitting new instruments for trading. 	<ul style="list-style-type: none"> ■ Enhancement of static data systems to support the data required for the additional information requirements. ■ Update of new issues processes to capture necessary information.
<ul style="list-style-type: none"> ■ In the event that firms are unable to meet reporting and publication requirements they may be unable to trade. 	<ul style="list-style-type: none"> ■ Review and enhance business contingency plans if required.

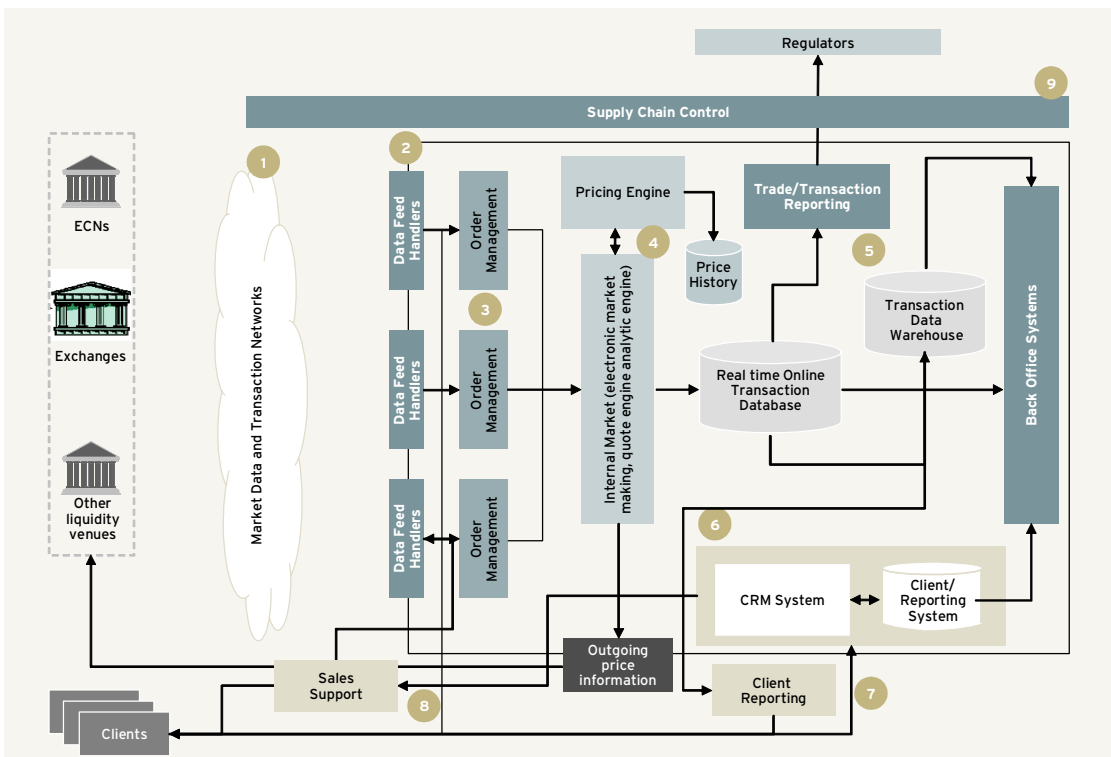
Regulatory requirement	Implication
<ul style="list-style-type: none"> ■ Depending upon detailed procedures, the amount of data to be retained may need to be increased (e.g. time series quotes, all prices used in validating best execution). ■ “Reasonable commercial basis” implies flexibility in how information can be distributed. Instead of being restricted to reporting to exchanges investment firms will now be able to use other methods: via regulated markets, via a 3rd party or via a proprietary arrangement. 	<ul style="list-style-type: none"> ■ Review the changed landscape, post MiIFD with respect to information creation, aggregation and distribution and formulate a strategic response. ■ Where an investment firm wishes to provide its own data service then specification and establishment of the service will be required. ■ Review changes proposed by Exchanges and Information Providers. ■ Determine partners that will be used in meeting requirements where appropriate. ■ Enhance information management applications (data warehouses, reporting applications, etc.) to handle increased data and retention requirements. ■ Determine how information will be distributed and enhance information distribution infrastructure as required.
<ul style="list-style-type: none"> ■ The trading operations of an investment firm will be subject to additional regulation if internal matching of client orders takes place. ■ Firms where crossing of client orders takes place will be regulated as an MTF. ■ Systematic Internalisers need to meet their quotation obligations and establish procedures to ensure that they monitor and achieve the required compliance level. 	<ul style="list-style-type: none"> ■ Determine if the firm is now an MTF or Systematic Internaliser and make strategic decisions regarding the continued operation of this business within the current structure. ■ Ensure that procedures are established to meet the obligations either of an MTF or a Systematic Internaliser and that the management structure of the organisation can monitor the compliance of the organisation appropriately.

3.2 The technology implications

MiFID will have a significant technology impact, both within Investment Firms and more widely in the marketplace to which they connect. The technology implications will only become fully apparent once the details around how the rules impact each firm are crystallised. This section defines general architecture guidelines for MiFID and beyond and highlights 9 key technology considerations.

Architecture guidelines for MiFID and beyond

- Business service management and monitoring capabilities for efficient and effective management support of the Firm's operations.
- An enterprise message bus providing guaranteed point-to-point and publish & subscribe message delivery built on fault tolerant, low-latency, high bandwidth network architecture.
- Light-weight application middleware to construct on-line applications that tie directly to the data messaging architecture.
- Computer grid architecture to create scaleable solutions for risk management, pre-trade analytics, portfolio analysis and market opportunity discovery.
- Caching capability to quickly synchronize and share common information, such as market data, across grid architectures.
- A well managed overall Information Lifecycle Management (ILM) strategy to ensure that information is where it is needed and easy to find.
- Highly scaleable archiving solution that complies with regulatory retention policy. This includes extensive indexing for accurate and fast search performance to comply with regulatory demands.
- The system must scale beyond terabytes of information, operating in a hardened operational environment with fault-tolerance and disaster recovery manageability across all components.



No	Implication
1	<p>Network Capability</p> <p>Fast, reliable connectivity will continue to have prominence in the overall market architecture of Europe. Firms will need to increase their network capacity to handle higher volumes of market and transaction data as they send out and receive more pre-trade indications of interest, market limit orders (to test the various liquidity pools for depth and price) and post-trade transaction data. In addition, those firms who are and decide to remain Systematic Internalisers will need to support the requirement to publish price quotations to the market. Network infrastructure providers will introduce low-latency services that enable market users to host their algorithmic and program trading applications adjacent to major execution venues. They will offer other value-added services to examine and analyse counterparty and service provider network traffic types and response times at a message level.</p>
2	<p>Data Feed Handlers</p> <p>Already firms are introducing feed handlers with much lower latency of data throughput - the difference between 5/10 milliseconds of latency and 50-100 milliseconds is substantial in a trading environment where speed is essential. Firms will continue to innovate in this area as the increase in market data traffic and transaction volumes, low-latency trading requirements and liquidity fragmentation all place pressure on the messaging infrastructure and technology. Firms are looking at all components of the 'stack' (software, firmware and hardware) to solve the latency problem. In addition to low latency architectures firms are now sourcing their data direct from the liquidity pool whether this is a traditional exchange or MTF, with a view to further cutting out the inherent latency introduced by data aggregators. This further complicates the front-end data feed environment as the in-house systems have to make decisions on which data elements to source from which feeds etc.</p>
3	<p>Order Management/Order Routing</p> <p>The order management and order routing systems of firms will require substantial changes. As the number of possible execution venues increases (depending on the number of firms who decide to become Systematic Internalisers under the new rules) the interaction of these external venues with the internal order matching and algorithmic engines will require faster transaction processing and access to consolidated transaction databases to assist with real-time decision making across product lines. Order management software vendors and in-house bespoke applications will need to be updated with new execution venue identifiers, order management and process logic and compliance rule enforcement modules.</p>

No	Implication
4	<p>Internal Market and Pricing Engines</p> <p>Internalisers will need to enhance or create “smart” trading engines which link the various parts of the business (such as retail brokerage, asset management, wealth management, etc) to enable them to “see” the firm’s internal order flow and compare this to client orders. This order flow interaction will require complex compliance logic built in the application to ensure that certain client orders can only be matched with other appropriate client orders and orders which are not matched internally are not delayed in being disseminated to other execution venues. In addition, Systematic Internalisers will be required to publish quotes for equities which they internalise.</p>
5	<p>Transaction History</p> <p>Firms must maintain a 5 year history of all customer trades, including information about the execution venue for the trade and information on the trade (price, size, time, etc), they are also required to maintain a history of their own quotes. Firms must be in a position to demonstrate that the executed orders complied with the firm’s order execution policy and that best execution requirements were fulfilled. All of this will lead to the need for enhanced data storage and storage management functionality.</p>
6	<p>CRM Systems</p> <p>Firms will need to ensure their KYC and related data repositories comply with the new requirement - this is likely to require the addition of some new customer related fields and some new work-flow practices to ensure this data is maintained and that they remain compliant with Conduct of Business requirements.</p>
7	<p>Client Reporting</p> <p>Firms must increase the completeness of client reporting, ensure timely reporting to comply with the T+1 confirmation rule. Firms will need to track client communication within their overall CRM applications. It will be necessary to show a clear paper trail around, client classification and the notification of status to those clients that are treated as eligible counterparties.</p>
8	<p>Sales Process</p> <p>MiFID targets sales process transparency and introduces additional internal rules. Additional automation around the sales process will help ensure quality and that order handling procedures are followed.</p>

No	Implication
9	<p>Supply Chain Control</p> <p>Demands for low latency, high process quality and business contingency planning are increased due to MiFID. Focusing on the overall end-to-end process will help all players to comply with the rules using a policy based strategy. Business Service Management concepts can help to achieve this by providing the integration of multiple heterogeneous legacy platforms. The requirement for resilience and the demands of increased loading will require that Firms increase focus on operations management and automated support, utilising control dashboards and Business Activity Monitoring (BAM).</p>

4 Smart response

A smart response to MiFID positions the organisation to comply with regulatory change, at the minimum incremental cost, by leveraging existing change programs and simultaneously being alert to the market opportunities which result from the legislation. Whilst most organisations have established initiatives to begin assessing MiFID, many programs lack the urgency, visibility and focus to properly deal with such far reaching legislation. The two primary dangers of insufficient focus now lie in the lost opportunity to exploit the potential benefits of MiFID and in increased expenditure and higher risk when the implementation program is fully mobilised.

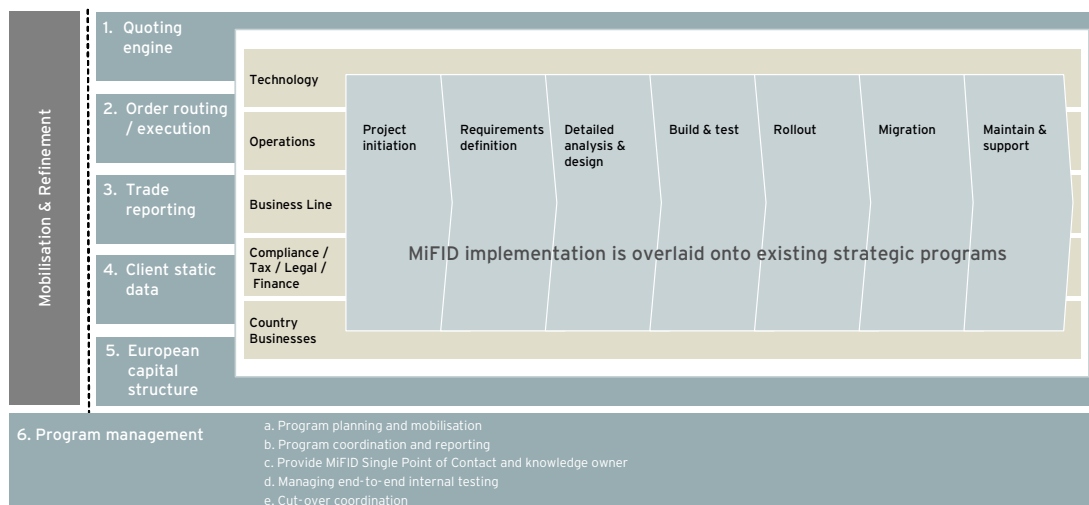
4.1 Five key actions - for immediate consideration

- **Initiate a MiFID Impact Assessment ASAP** in order to shape the program, align it within the existing change portfolio and to establish a realistic mandatory program budget figure for 2006. Ensuring sufficient budget is set aside for the program will help avoid your MiFID initiative getting off to a rocky start.
- **Evaluate opportunities** - the impact of MiFID is not simply cost, such fundamental change will result in opportunity for some organisations. Identifying this early will result in potential "first mover" advantage.
- **Align MiFID with other programs** i.e. determine how MiFID changes can be aligned to existing strategic programs. This will allow you to leverage existing or planned and funded initiatives and provide the additional governance overlay necessary. It is important to minimise the need for duplicate "regret spend" and maximise the effective use of scant skilled resource.
- **Identify an internal champion** who is able to keep up to date with developments in terms of national rulebooks, timing of new regulations, and who is able to participate in - or even lead - the market consultation and industry-wide debate.
- **Establish the governance structure** to provide the forum to which MiFID issues will be brought. This forum must include sufficient representation from the business, operations, technology and compliance. MiFID implications will need to be discussed and decisions taken which impact upon all of these stakeholders.

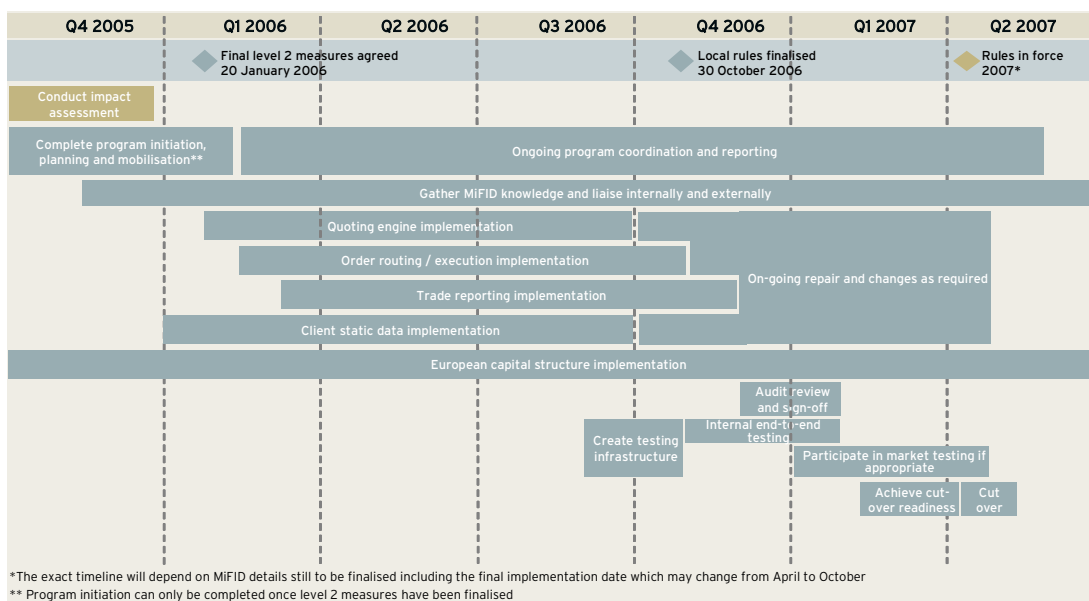
4.2 Five key workstreams

Going further, we can suggest the likely shape of the MiFID program in terms of five critical workstreams. Clustering the regulatory requirement and market opportunity into functional groups is a smart means by which to align mandatory change to existing change programs.

The final organisation of the workstreams may vary in different organisations but is likely to include some of the elements illustrated in the diagram below.



From a timeline perspective, there exist a number of understood external milestones which are important to factor into the 2006 plan. If we overlay these external dates onto a strawman delivery plan based on the five workstreams suggested above, a summary timeline emerges:



4.3 Mapping MiFID to current initiatives

Most major firms will have key programs in play which will either interact or overlap with MiFID requirements. Aligning the MiFID requirements with these programs will help to avoid duplicate spend and will ensure the best use of scant skilled resource. Potential programs to consider include:

- Know your Client (KYC) and Anti Money Laundering (AML) programs
- Reference Data rationalisation and quality programs
- Operations rationalisation and introduction of hubbed operating models
- Research Workflow automation/control (in response to Spitzer initiatives)
- Internalisation of order flow
- Booking name simplification
- Market links rationalisation/Infrastructure refresh
- Storage strategy
- Quoting engine
- Algorithmic trading and client portal
- Initiatives to deal with US regulation *Reg NMS*

These are just some examples of the types of internal program which should be synchronised with MiFID to ensure that the value received from expenditure and effort are maximised. US banks should note that work that they have done to become compliant with US initiatives may also be relevant to MiFID (for example Investment Research control and compliance in response to the Spitzer report) and that they may have the opportunity to utilise common solutions.

Conclusion

5 Final thoughts

Contrary to what some market commentators would have you believe - there is no need to panic.

However, MiFID is far reaching in its consequences and will result in the requirement for mandatory change for Investment Firms. MiFID also creates opportunities as it impacts on multiple parts of the financial services ecosystem and triggers demand for new cross border service offerings. There will be losers as well as winners.

MiFID requires mandatory work during 2006 to meet a 2007 compliance date; the working assumption should remain that this date will not slip any further and that MiFID will be implemented in 2007.

Timely assessment and planning requires broad representation from the business, operations, technology and compliance in order to understand the far reaching impacts of MiFID. This assessment will allow firms to exploit opportunities, influence the implementation into local market practice and proactively work with suppliers to understand their strategy. Most importantly this allows firms sufficient time to plan and to maximise the synergy with other initiatives so that MiFID compliance is achieved at a manageable incremental cost.

MiFID is a front to back business issue, not an isolated regulatory or compliance issue. Although most firms have mobilised initiatives we believe that many of these are too low-key and lack urgency and focus. The Smart Approach requires sufficient representation from across the organisation to allow decisions to be taken and the groundwork to be laid for when the main implementation effort can begin. Failure to do this is likely to result in duplicated effort, regret spend and missed opportunities as firms scramble to achieve "bare minimum" compliance.

Working smart demands expending sufficient effort now to avoid MiFID becoming a hard problem in 2006.

Appendix

Links and references

Capco

- www.capco.com
- Award winning Journal | 14th Edition "Market Imperfection"
(<http://www.capco.com/journal14.html>)
 - Page 31 Best Execution
 - Page 80 European financial exchanges
 - Page 145 European regulation
 - Page 157 Financial supervision
- Award winning Journal | 9th Edition "Transformation"
(<http://www.capco.com/journal9.html>)

HP

- www.hp.com
- <http://www.hp.com/go/FSI>

External links

MiFID Joint Working Group

- www.mifid.com

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