



MiFID – fail to prepare; prepare to fail

MiFID is a big priority for the heads of investment management companies - and many are already putting preparations in place to be compliant with this directive by November 2007. At a recent Investit conference for senior business heads of investment management companies, 88% of delegates ranked MiFID as a top priority for 2006. MiFID (markets in financial instruments directive) is regulation aiming to uphold the integrity and transparency of the EU markets.

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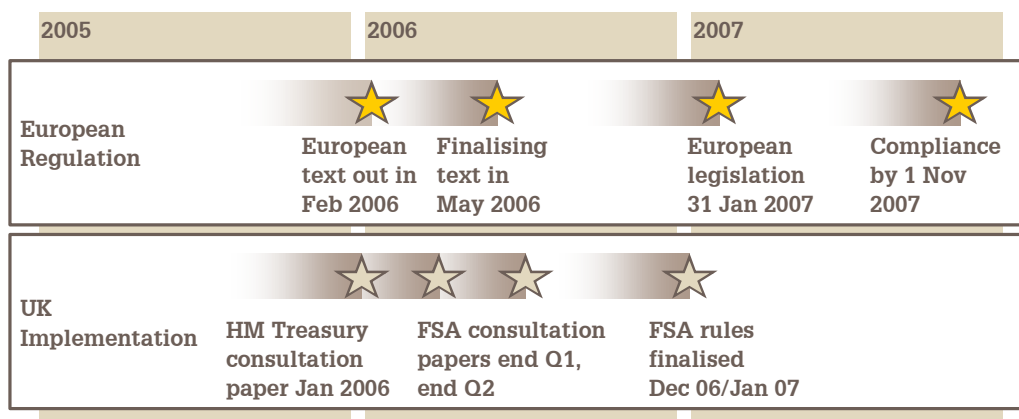
Is MiFID as big an obstacle as many make out? It will be if buy-side firms don't prepare. Many of the current MiFID regulations mean the scope of any changes will be greater for sell-side firms and their systems and data vendors. But this does not mean buy-side companies can be complacent or ignore MiFID. They will have to make some fundamental changes. In addition, buy-side firms will be affected by the changes that sell-side and system vendor firms are implementing.

Nothing's finalised, but this doesn't mean ignore MiFID

There's a growing awareness of MiFID in the buy-side community, and understanding of the preparations to be made. However, there's still some uncertainty over the likely interpretation of MiFID by the FSA and the Treasury – and the subsequent regulatory impact. MiFID's level one principles have already been published and level two MiFID has recently been published. And, while providing further detail, it has not made available some of the clarity investment management firms were looking for. This will be provided when the FSA publishes its implementation paper.

So, with detail yet to be finalised, there is little that investment management companies can actually implement. However, investment managers should not sit on their laurels – they can and should start to assess the probable impacts of MiFID on their businesses and prepare the projects and budget to comply with the forthcoming legislation. While MiFID legislation in the UK will not be finalised until 31 January 2007, the directive is to be implemented by November 2007. This is only a nine-month period. If investment managers leave this to the last minute, implementing projects to comply with MiFID could prove costly.

The probable MiFID Timeline



So, what are the key issues that will affect investment management companies?

Proving best execution

Proving best execution and transparency are MiFID's key aims. But how does this translate to an investment manager's business? Firstly, there's the best execution policy; MiFID requires that investment management

firms have one, although many managers already have this in place in some form. And managers need their clients to agree to this policy – not always an easy task to administer.

New unbundling of commission regulation, which separates the payment for deal execution and payment for broker research, means the amount of execution only business is likely to grow. The growing complexities involved in dealing and the pressures from MiFID for best execution may lead some investment management companies to outsource their dealing functions and let someone else worry about it. Once best execution policies are in place, investment managers will need the ability and processes to review them annually.

MiFID will also require investment managers to prove their systems and internal processes are consistent with their best execution policy. For example, managers might need extra systems to conduct pre and post-trade analysis. If investment managers already have transaction cost analyses 'provided free' (through execution commission) again, these services could start to cost because of unbundling of commission regulation - investment managers will need to pay for them out of their own pockets.

Investment managers may also need to be able to monitor and trade at more venues to provide best execution. Some of these venues will require investment managers to be FIX-enabled and to connect to alternative trading systems. This could cause some issues. With a multitude of trading venues, multi-lateral trading facilities (MTFs) and systematic internalisers also publishing prices, there will be a dramatic increase in apparent liquidity and transparency. Some industry commentators are speculating that large trades not usually published will be open for all to see – and may adversely affect market movements.

Reclassifying clients

Buy-side firms will need to reclassify clients. MiFID already sets out client criteria, whether clients are eligible counterparties, professional clients or retail clients. Investment managers can check this definition against their current client split. Buy-side firms need to review the level of information they receive from their clients to make sure it is sufficient to classify clients appropriately to comply with MiFID. Investment managers will need significantly more information for retail clients. And be aware, under MiFID, clients can themselves choose to move from one client classification to another, in order to gain more or less protection.

Also, if investment managers have to review and change their best execution policies because of MiFID, they will need to inform clients. This may require a completely new investment management agreement (IMA), although this will depend on the client. Again, this is something managers can prepare to do now – they should not wait until the last minute. If there are any other IMA changes forecast, then managers should plan to do MiFID checks at the same time to save costs and client irritation.

Reporting trades

In the UK, under MiFID, it won't be sufficient to report transactions through the London Stock Exchange, only to the FSA. So, it becomes the investment manager's responsibility to publish the traded price to the market using either a data vendor or exchange, or by publishing it directly themselves. This could create a certain amount of fragmentation in published transaction information – making it harder for investment managers to see a clear picture of what's happening in the market. The web of data aggregators and data distributors may change, requiring changes to dealers' market data purchasing. This could mean increased data costs for investment managers.

Investment managers - get involved!

So, what's the best way for investment management companies to find out more about the likely impact of MiFID? They should get involved! The MiFID Joint Working Group has recently created a Buy-side Focus Group that will concentrate on helping buy-side firms internationally to address the technology-related impacts of MiFID. And managers shouldn't forget, the IMA is offering full support and practical advice to all its members.

There's still a lot of MiFID detail to be agreed before it becomes legislation. However, this debate and delay will mean investment management companies will have less time to implement any necessary changes before the MiFID deadline of November 2007. If managers fail to prepare.... It's an old adage.

About the author

Clare Vincent-Silk is a Consultant at Investit. Clare has worked in front office IT for 23 years. Coming from a technical background, the first half of her career was spent developing front office system solutions for broker dealers. In 1993, Clare moved over to the buy-side where she designed order management systems and provided front office pre-sales support and general consultancy.

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