

MiFID: Operational Challenges

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Is the hellish list of MiFID requirements an opportunity for a firm to grow? Is it more of a challenge that must be overcome in the absence of guidance in certain areas and jurisdictions, and with a lot of self-interest at play? Two distinctly divergent views were emphatically expressed about what the monumental directive means to the industry as a whole, and sectors of it in particular.

Sikko van Katwijk reported that Citi believes regulatory change provides an opportunity to grow its business, changing its design and models along the way. In fact, he wryly complimented regulators as being the best innovators in the industry; unlike the one-off of Y2K, MiFID will radically change it over the next few years. Along with technology innovation, consumer expectations, operating efficiency, trade globalisation and other regulations, it will drive global change.

With about 100 working days at the time of the presentation until MiFID's November 1 implementation

date, van Katwijk stressed the need to think hard about compliance and how to make the date work. Those who operate in an environment such as the UK or Ireland that are better prepared than other countries and have a more liberal regime will, he thinks, benefit in business terms. He expects a wide variety of MiFID interpretation in the EU zone that will create some arbitrage within it.

Daniel Wiener reported that, like many firms, State Street has limited resources. Like others, November 1 is a challenging date, but one that it has to work through. It is striving for consistency across its businesses and is not looking for gold-plated solutions. The approach it has taken is to work with business units both individually and as a group, as well as with consultants, conducting gap analyses across all businesses. A few areas in the organisation also retained consultants to assist with project management and policies. On board as well are multiple legal firms to address a number of gray areas and arrive at consistent solutions for them.

Leading Wiener's list of challenges for the industry as a whole is lack of clarity, where suitability is a particularly thorny issue. What makes sense for a retail investor doesn't make sense for a professional investor, and there is confusion as to what information is to be used to assess distinctions. The area of investment advice is, he said, probably more of a sell-side issue, but can be one for the buy-side as well. Sales people will need to use caution about giving investment advice; if they do, they should document it. Wiener called consent as it relates to OTC transactions a total nightmare, especially for fixed income and foreign currency where there isn't a regulated market and every transaction is off-exchange.

Adding to this diabolic list are country variations and, especially, lack of information. Wiener emphasised the importance of documenting decisions rather than just assuming something doesn't apply. However, some assumptions as they relate to compliance must be made, otherwise

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regulators might not look too kindly if nothing is done by the implementation date because rules did not come out in time.

The sheer volume of documentation and communications to clients - already bombarded with information, and, now, two-way consent and the methodology and coordination of it - is overwhelming.

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- Sikko van Katwijk

In fact, there seem to be an almost limitless number of challenges. For instance, many firms look at their business across functional lines where some cross various legal entities; yet, regulators are not particularly interested in the functions but in how compliant the legal entities are in their jurisdiction.

Wiener disagreed with van Katwijk about opportunities spurred by MiFID. Perhaps there are some for firms involved in trading or which offer outsourcing services. Investment management firms, however, are not as blessed with opportunity, except for the ability to passport around Europe. He thinks it is a benefit for smaller firms in particular, but one that comes with increased compliance costs. Wiener also thinks that exchanges will remain the primary point of price discovery for equities, and that people will not be trading in a different way on November 1. The fragmentation of market data - both published and from the exchanges - will lead to increased costs.

He'd also love it if the ludicrous comments he's heard that investment banks will improve or generate huge amounts of profit by selling data are proved to be wrong. Wiener reported that the London Stock Exchange makes about \$200 million selling information; Goldman Sachs, about \$25 billion on trading. Anything the investment bank would make on data

selling would be the proverbial drop in the ocean.

Kim McFarland, following their presentations, asked panellists what approach they were taking as global firms operating both inside and outside MiFID.

Wiener replied that global coordination is difficult. Additional challenges arise because some State

Street businesses operate out of branches of US entities and, thus, are not regulated by UK regulators. Around Europe, some activities are captured by some regulators and some are not. Reconciling these issues will take a lot of engagement throughout the firm at all levels to establish common threads and generate consistency.

Van Katwijk added that at Citi, MiFID is not seen in isolation but in combination with other large pieces of legislation. It has taken a holistic approach to MiFID in the 23 European countries in which it operates, structuring it to benefit from

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passporting. Already a PLC has been in put in place in the UK and Ireland that will allow it to branch out to other countries.

For orders such as fixed income that are not executed on the exchanges, asked a participant, will brokers transactionreport on behalf of asset managers, or will asset managers have to build their own transaction reporting systems? Van Katwijk believes this area will have the most impact on the financial services industry in Europe. Investment managers will have to

broaden their scope of transaction reporting for off-exchange execution. Citi, he added, is one of nine investment banks that established a project called Turquoise, which is basically an alternative exchange that will facilitate transaction reporting across all available entities. To date, Turquoise accounts for 40 per cent of the Madrid Stock Exchange trading, which it does from London. This will change with MiFID, and the impact on the Madrid exchange will be fairly dramatic.

Wiener wanted to separate out transaction reporting from the trading side because he again disagreed with van Katwijk, except for the fact that there will have to be additional transaction reporting for fixed income, foreign exchange and derivatives for State Street as brokers. He believes that brokers can continue to be relied upon, although he is somewhat concerned with the difficulty of getting them to put in writing anything more than that they will transact in accordance with regulations.

From a trading perspective, Wiener thinks there will be some opening up in the way people trade, particularly in markets like Madrid. However, there is no requirement to

internalise on the LSE or Xetra. He added that the way people trade in Europe has been changing since the mid-1980s and will continue to do so. He doesn't that trading desks will be doing anything radically different on November 1. MiFID is part of the evolutionary process here and not a major catalyst. We will see, Wiener added, if a bunch of nine investment banks with different motives can get a trading platform off the ground.

McFarland wanted to know what panellists viewed as the biggest impact

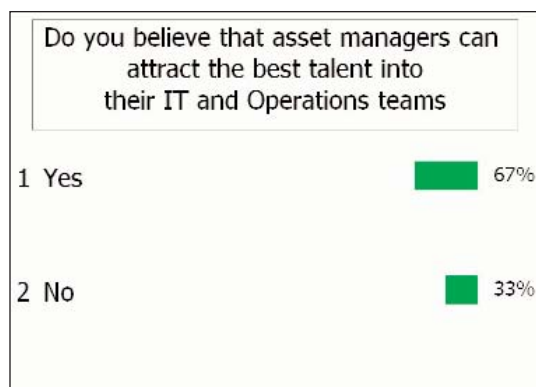
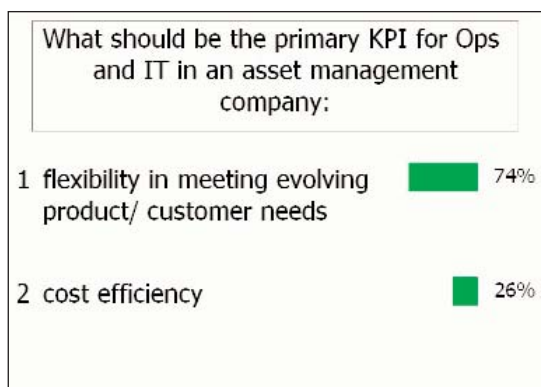
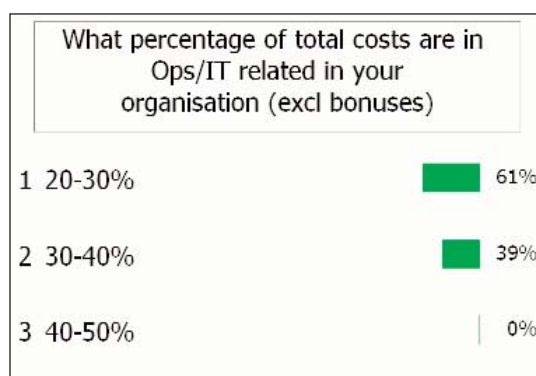
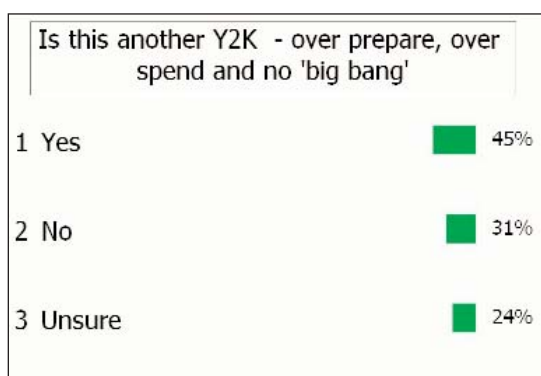
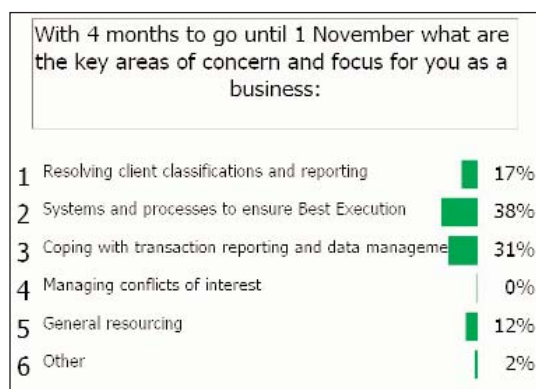
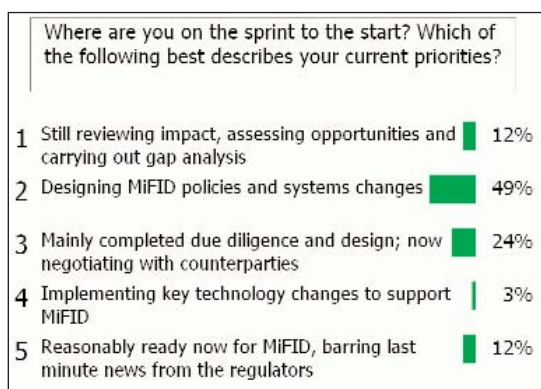
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of regulators acting more in concert, considering that banks appear to predominate with continental regulators, whereas more influence seems to come from securities dealers in the UK. To Wiener, regulators have gone from total *carte blanche* pre-MiFID to an environment where their hands are significantly tied. All are interpreting MiFID in different ways which seems to go against its objective of a pan-European, harmonised

regulatory structure. He thinks the best course is to follow the Commission's intent as expressed by CESAR and to communicate with the regulators. It will be interesting, he added, to see how this plays out with US regulators who - unlike the principles-based approach of the FSA - take a rules-based one, which Wiener is not convinced is the right one.

The reasons put forth by Wiener are why van Katwijk believes the

markets will drive harmonisation. Firms will want to passport service under a regulatory-light regime while those under a heavier regime will suffer. Here, the lead role by the FSA makes sense. Harmonisation will also be driven by some firms first becoming FSA-compliant, and then looking at other countries. ■



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