

Robert Fuller, IT director, strategy at Dresdner Kleinwort Wasserstein discusses the IT implications of MiFID.

*The Joint Working Group's MiFID Readiness Survey found that 80% of respondents did not know if they had an appropriate technology strategy in place. Why have firms been so slow to react?*

There hasn't been a tremendous move to create implementation efforts at firms and this hasn't changed since the survey came out in October 2005. One of the major reasons has been the lack of a final Level 2 draft. The EU Commissioner for Internal Market and Services, Charles McCreevy, has said he wants much of Level 2 to be regulation, rather than directive. As a result it seems likely the text will be quite different from the initial draft. This uncertainty has been a huge brake on firms doing scenario analysis. But once the details are out, people will start to take it more seriously, I hope.

*What impact will these delays have?*

Firms will have less time to work out what they need to do. The JWG IT subgroup is becoming very concerned about the lack of time left. From an IT perspective, testing systems between organisations across Europe will take time and should be under way by the end of the first quarter of 2007. That leaves just over a year to go from thinking about MiFID to having all of the systems required in a format that enables industry-wide testing for trade and transaction reporting and potentially price dissemination and consolidation. That is not a long period of time.

*What will be the impact of MiFID on firms' IT strategies?*

There are some common themes to the changes. For example, buy-side and sell-side firms are all dependent on IT suppliers and on infrastructure players that provide the information that enables us to trade. Transaction reporting will change for everyone



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across Europe and that could require a significant re-engineering of operations infrastructure.

The more that infrastructure has to change, the more important it is that these suppliers are engaged early in the process. If banks don't provide a common set of requirements to their suppliers, they will have problems. Financial institutions need to work together with suppliers on a co-operative basis if they want to reduce the costs of change. Technology development needs to be more co-operative because at the moment it is very fragmented and can sometimes be argumentative.

MiFID isn't a point piece of legislation; it is laying down new ground rules for our industry moving forward. The changes that are put in train now could have repercussions in five to ten years, requiring further changes. It isn't going to be the case that once you have ticked a box you can forget all about it.



#### ***Will there be changes to the way firms trade?***

It is reasonable to assume that there will be a significant number of systematic internalizers. Maybe one year down the track some will decide they don't make any money at this and will pull out. The transparency MiFID will deliver is likely to bring down margins, push up volumes and reduced ticket size and this will be a great driver of change. The cost of complying with MiFID is likely to lead to firms co-operating at first, leading to consolidation and ultimately cross-border consolidation.

#### ***How can firms successfully manage the IT challenges of implementing MiFID solutions?***

People must understand the potential ramifications for their business. MiFID will affect IT, operations, compliance and business areas. I am not advocating that anyone spends millions on IT right now and that will solve the problem. They need to look at how the market will adapt to MiFID and where they want to position themselves in a post-MiFID world. This is not like Sarbanes-Oxley or Basel II – MiFID is about changing business practices and it needs active business involvement.

What people need to do now is discuss MiFID and come up with some scenario analysis. Financial institutions will only be able to contain their costs if they move quickly.



## BIOGRAPHY ROBERT FULLER



Robert Fuller is IT Director, Strategy at investment bank Dresdner Kleinwort Wasserstein (DrKW) in London.

He is also co-chair of the JWG-IT which acts as the IT sub group for the MiFID JWG which was set up by FIX Protocol Ltd, ISITC Europe, the Reference Data User Group and SIIA/FISD to evaluate the European MiFID legislation and its affect and cost across Europe.

He joined DrKW in May 1998 and is part of a small team responsible for IT strategy, with specific responsibilities for IT infrastructure. Among these responsibilities are exchange connectivity and Swift connectivity for the investment bank and centrally cleared products, including exchange-traded derivatives, equities and bonds.

During his career, he has been co-Chair of the GSTPA Technology Committee from 1999-2001. Other roles included Managing Director of a software company specialising in middleware and wholesale banking data warehousing.

Prior to this, he was director of Charterhouse Bank responsible for the middle office and IT development for complex financial engineering.

From September 1997 to April 1998 he was Deputy Head of IT at Pru Bache Securities (UK) Ltd and from April 1987 to August 1997 he was Vice President, Group at Chemical Bank various roles including Internal Audit, Deputy Financial Controller, Head of Off-Balance sheet systems and Head of Securities Settlement.

### *Who will benefit from MiFID?*

MiFID is there to create a harmonized view of life for the end investor; whether individual firms experience a positive or negative effect is not addressed by the European Commission. Some firms may find it p&I negative, because nearly all of the costs associated with MiFID are on the wholesale side, while the beneficiaries are the end investors on the retail side. Other firms may find new opportunities are created by MiFID and go from strength to strength.

Some firms could be spending money to make less money – that's not an easy sell for an IT director. However, some of the larger firms may find a way to take a lot more market share, leveraging their costs over a bigger base and becoming more profitable as a result; hence our belief that industry consolidation is a likely outcome.

### *What is the JWG IT group focusing on?*

Right now we are heavily engaged with MiFID Connect, the joint program of UK trade associations. I co-chair the IT committee on that and we are looking at how these industry associations - APCIMS, BBA, FOA, LIBA, ICMA etc - will work together. It is good to see industry organisations co-operating like this but it brings challenges because they don't usually collaborate in this way – particularly the sellside and buy-side associations. We will provide IT information to retail and wholesale institutions but that's a huge task and not to be underestimated.

### *Is it important to discuss the ramifications of MiFID on a Europe-wide basis?*

A lot of the MiFID regulation will be applicable across geographic boundaries, so discussion with other countries is very important, or we'll end up with 25 different versions of the truth. Again, we are looking at a completely different way of working – it no longer matters which city will be the financial hub of Europe because we all need to co-operate.

The other issue is that all parts of Europe are not equal; everyone is starting from a different place. London is probably closest to MiFID compliance but still has a lot of work to do. For example, the Know Your Customer treatment here is different from that required by MiFID, so how do you explain that to your CEO? Conversely, some countries currently have a concentration rule, which will be repealed, as it is one of the fundamentals of MiFID – different countries have different challenges. ●



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Alberto Giovannini, author of the Fifteen Barriers to European Integration, speaks to SunGard about the forthcoming Markets in Financial Instruments Directive.

*Do you see MiFID as a complement in helping to overcome your 15 barriers to European Union (EU) integration?*

It is a complement in the sense that, by streamlining the trading environment and by making it easier to offer trading services remotely within the twenty-five EU member states, it will generate more demand for efficient post-trade processing and, in particular, a more efficient cross-border post-trade environment.

*There has been so much regulatory change in trying to implement the Financial Services Action Plan to create one European capital market; do you think this goal can realistically be achieved?*

Yes, since I believe that, fundamentally, in the EU there is a healthy interaction between markets and authorities, and that the EU Commission and the EU Parliament have very much in mind the importance of free and efficient financial intermediation. Because of these conditions, while I expect that the road to a truly efficient financial system in Europe will certainly be bumpy every now and then, the essential dynamics are of the right kind. One fundamental driver to reform is the economic motivation that the



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private sector has towards a barrier-free and efficient financial system: a barrier-free and efficient system multiplies opportunities for all market participants. Hence, there are congruent forces that are at work, both from authorities and the markets.

**Assuming that the goal of achieving one European capital market is attainable – what do we stand to gain by doing this?**

As I mentioned before, the gain is to market participants, essentially through a multiplication of business opportunities, and to society. One of the few propositions on which economists agree is the following: prosperous societies have always been associated with a healthy and well-functioning financial system. The financial system is the essential lubricant of economic activity.

**Some are sceptical about legislating for one European capital market. Member-states' appetite to enforce this kind of legislation is rather mixed and there seems to be plenty of opportunity to get out of certain parts. Will there be enough loopholes to make the legislation ineffective or toothless?**

These are the bumps that I was talking about before. Healthy scepticism is warranted on these issues, but I think that this process is becoming more efficient over time. Recently, I read in the Wall Street Journal that Commissioner McCreevy is considering issuing level 2 regulations for MiFID. This is a perfect illustration of the fact that weaknesses in the production of rules - and I want to stress, in particular, rules aimed at liberalising markets - are well known to the players, and that they know what to do about them.

***Are there any contentious issues in how each member state will interpret MiFID that may cause problems with implementation, normal market size for example?***

I think "contentious" may not be the appropriate word here. Certainly "normal market size" has been a topic of discussions among the different member

states, who consider the threshold size for pre-trade-transparency obligations an important parameter in this reform. But my impression is that this and other issues have not reached political stature (despite the efforts of organized private interests) and therefore should not be considered as contentious.

#### **Who will actually benefit from MiFID?**

No question in my mind: MiFID will benefit all market participants that will be able to see the opportunities created by liberalization. Symmetrically, MiFID will hurt those whose business model makes sense only in a less than competitive environment. On identifying the beneficiaries, the candidates are many, so it is hard to pinpoint specific names or classes of market actors.

#### **Will MiFID create a US broker-dealer model in Europe?**

The potential for well-organized and high-quality broker-dealer businesses is enhanced by MiFID. Certainly the nature of broker-dealer business will be determined by the regulatory environment: however it is not clear to me whether the market liberalization that is being envisaged will on itself have a profound effect on the way the broker-dealer business will be conducted in the future, and whether it will induce such significant differences with, say, the United States.

#### **Will MiFID cause fragmentation of liquidity as more execution venues - exchanges, systematic internalisers (SIs) and multilateral trading facilities (MTFs) compete to match order flow?**

Again, it is important to make a distinction between the initial and long-term effects of MiFID. There could be fragmentation on impact, but this fragmentation would be a sign of higher competition, and the fact that competition will be played out on a different playing field. After this impact, I expect that the value of pooling will re-emerge. But this will likely change the relative importance of different market participants. One rather natural phenomenon to watch will be consolidation of exchanges, which I think MiFID will accelerate.

#### **If so, how will this impact the way that firms trade?**

Increased competition will induce tremendous demand on systems. Effective real-time comparison will be needed to make full use of the opportunities that competition brings. Suppliers will also need to provide sound systems to back up compliance. As far as back office technologies are concerned, the demand for cross-border transactions that will result from MiFID will accelerate the adoption of systems that support post-trade transaction services. ●

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## **BIOGRAPHY** **ALBERTO GIOVANNINI**



Alberto Giovannini is Chief Executive Officer and a founding shareholder of UNIFORTUNE SGR SpA, an asset management company based in Milano, Italy, and Chief Executive Officer and a founding shareholder of

Unifortune Investment Management Ltd, an asset management company based in London.

Giovannini is also Chairman of the Consultative Group on the Impact of the Euro on European Capital Markets (the so-called Giovannini Group) and Principal Policy Advisor of the Commission's Clearing and Settlement Advisory and Monitoring Group (CESAME).

He has been Deputy General Manager of Banca di Roma, the parent company of the fourth-largest banking group in Italy, from 1999 to 2001. In addition, he was a member of the board of Borsa Italiana SpA (the Italian stock exchange), Montetitoli SpA (the Italian central security depository) and the vice-chairman of MTS SpA (the premier government bond electronic platform in Europe).

From 1995 to 1999, Giovannini was senior advisor and senior strategist at Long-Term Capital Management, LP, a private investment management firm based in Greenwich, Connecticut. Previously, he was the Jerome A. Chazen Professor of International Business at Columbia University, where he taught and conducted research from 1983 to 1995.

While a professor at Columbia, Giovannini was also a Research Associate of the National Bureau of Economic Research in Cambridge, Massachusetts and a Research Fellow of the Centre for Economic Policy Research in London, United Kingdom. He is currently a member of the Euro 50 Group, Honorary Professor and Chairman of the Academic Committee of the Center for the New Economy, Zhongshan University in Guangzhou, China, and Advisor of the Institute of Contemporary Finance, Jiao Tong University in Shanghai.

From 1992 to 1994 Giovannini was Co-Chairman of the Council of Experts at the Ministry of the Treasury in Rome, Italy, in charge of the Republic of Italy's international debt program. He was also Co-Chairman of the Government Borrowers' Forum, an organization of the government debt managers of industrial and developing countries, and a director of ENEL, the Italian electric utility. He had been consultant to the IMF, the World Bank and the Commission of the European Communities.

Mr. Giovannini received a Laurea summa cum laude from the University of Bologna in November 1978, and a Ph.D. in Economics from the Massachusetts Institute of Technology in 1984.



**Dermot Turing, partner at law firm Clifford Chance, talks to SunGard about the legal ramifications of MiFID.**

***How much legal interpretation remains before MiFID regulations and directives are finalised?***

There is still a long way to go. MiFID is a “Lamfalussy Directive” so there will be Level 2 legislation (which covers implementation technicalities) from the European Commission, which is expected to take the form of a further Directive and a Regulation. Regulations have direct legal effect in the member states but directives need national laws or regulatory rules in order to implement them. So there will be a further local legislative phase before all the written legal material is in place. That is supposed to be completed by the end of January 2007.

But even that is not the end of the story. In the UK, for example, the industry is used to seeing “rules” from the Financial Services Authority (FSA) and “guidance” which helps interpret the rules. MiFID is a maximum-harmonization directive, which restricts the FSA’s freedom to interpret its own rules. Where the rules are imposed through Level 2 Regulation they will be European, rather than UK and even where the FSA is implementing a Level 2 directive it will have to conform to whatever is agreed about implementation at Level 3 of the Lamfalussy process – the consistent transposition and implementation by EU member states. So we are likely to see rather less volume of FSA material, but the price of this might be greater uncertainty.

***Is MiFID a regulation that can be addressed by having compliance officers tick boxes – or are there changes to underlying business processes and systems required?***

In my view the biggest challenges posed by MiFID are the changes to business and systems processes. It couldn’t be further from a tick-box exercise. Every aspect of a firm’s



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processes and procedures will need to be looked at. This again is because MiFID is a maximum-harmonization measure: all member states have to change their regulatory regimes to conform to a single pan-European model. It may sound like a scare story, but the truth is that firms will find every department is affected in some way – the obvious ones are IT and compliance, but marketing and human resources are also involved. Each change will have a knock-on effect into other parts of an organization. This will differ according to the business profile of the firm in question, but it is unavoidable that there is a lot to do.

***There has been so much regulatory change in trying to implement the Financial Services Action Plan to create one European capital market; do you think this goal can realistically be achieved?***

I agree with Alberto Giovannini that it will happen but I think it is unrealistic to expect it to happen overnight on 1 November 2007. We also have to remember that the EU is not an island, and many of the influences on our markets come from outside Europe. This means that the agenda itself changes all the time. So even when we have achieved a "single capital market" there will still be more to do.

***Some are sceptical about legislating for one European capital market. Member-states' appetites to enforce this kind of legislation is rather mixed and there seems to be plenty of opportunity to get out of certain parts. Will there be enough loopholes to make the legislation ineffective or toothless?***

There is plenty of scope in MiFID for member states to gold plate the directives, or interpret them creatively, or retain pre-existing super equivalent regulatory rules and thereby preserve national differences. Having said that, this is a start; and you have to recognise that going any further than MiFID already does would mean even more upheaval for firms. The more harmonization, the more changes firms have to cope with.



## BIOGRAPHY DERMOT TURING



Dermot Turing is a Partner in the financial services and markets practice of Clifford Chance in London. He specialises in bank and

investment firm regulation including: regulatory capital, operational risk, controls, Basel II; licensing, conduct of business rules, the EU passport, market abuse and bank/investment firm structure; risk management, counterparty risk and insolvency; and clearing and settlement systems.

He led the Futures and Options Association's "MiFID survival" project and is partner in charge of the Association's standardized documentation. He is also chair of the FOA's Prudential Regulation and Risk Committee.

Other MiFID work includes assisting EU trade associations led by London Investment Banking Association on the Committee of European Securities Regulators' proposed Level 2 MiFID measures, including client assets.

Turing has also advised Banco Santander on its acquisition of Abbey National plc, undertaken a major corporate governance review for an international bank, driven by FSA requirements and worked on the proposed acquisition of asset management, foreign exchange bureau and other businesses by private equity investors.

He has provided legal advice on the establishment of joint ventures in foreign exchange broking, bond trading, equity research data and other areas and advised Citigroup on clearing and settlement infrastructure issues. He has advised an oil market participant on its systems and controls.

During his career, Turing has been repeatedly instructed to carry out cross-border reviews of regulatory issues. He also carried out a regulatory review of the effectiveness of business processes applicable to a unitized product created and distributed by a leading investment bank.

He is author of Risk Management Handbook (2000) and chapters on operational risk, set-off, insolvency of banks, and settlement finality in other recently published books.

***Are there any contentious issues in how each member state will interpret MiFID that may cause problems with implementation, normal market size for example?***

There are certainly a few areas where people are sceptical that member states will operate consistently with the "one Europe" spirit of MiFID but it is probably too early to speculate as to whether these will prove problematic in practice. My view is that, like the Investment Services Directive, issues will come out of the woodwork as we begin to operate under the MiFID framework.

***Who will benefit from MiFID?***

MiFID should make cross-border business easier because it abolishes the need to check for local conduct-of-business rules when targeting clients in other European countries.

Being a multilateral trading facility or a systematic internalizer becomes quite burdensome under MiFID. So a question that interests me is whether equities houses providing internalised trading functionality will feel that this activity is worthwhile under MiFID.

***Will MiFID create a US broker-dealer model in Europe?***

I doubt it: the differences between the way the US and the EU regulate investment business are still too great. The study done by a group of trade associations last year on the differences between the EU and the US in the equities field highlighted a whole list of issues where differences are very practical and relevant.

***How prepared are firms for MiFID?***

Generally the industry is divided into two groups: the large and sophisticated ones and the smaller players. The larger firms have more to do; their task is more complex but MiFID has been on their radar screens for some time. Most of these firms have MiFID implementation projects that are in varying stages of development.

More worrying are the number of firms that are less well resourced. MiFID will be less complex for these institutions but there is concern that they don't realise what they need to do. In the UK, the MiFID Connect joint program of industry associations, which has been set up to reduce legal risk and simplify MiFID implementation, will help these smaller firms to deal with the detail of MiFID. ●

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