

MIFID, BOOM NOT DOOM?

White Paper

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As the deadline for the Market in Financial Services Directive (MiFID) approaches, the firms in pole position will be those that have clear client and market strategies allied to an understanding of the changes to their operating model. These firms will allocate budget and resources to business development that exploits the opportunities created by the directive. The losers will be those that are slow to react or seek only to tick the compliance box.

There will be clear winners that exploit the opportunities arising from the opening and restructuring of the markets and for some firms additional gains will come through the increased ease of passporting services. The winners will be the firms that adapt to the changing landscape and in doing so attract increased order flow/funds to manage.

A clear advantage will lie with those that are better prepared. Although achieving compliance will make demands on resources and budgets, for most firms the requirements are clear-cut. The real challenge is positioning the firm to exploit the changes that will occur.

The introduction of MiFID will be a stimulus that will prompt the European financial markets to examine their infrastructure and improve their overall efficiency.

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What will the future look like?

Using the experiences of New York and its reaction to technical and market events, it appears that MiFID will create the environment for a similar explosion in the volume of trading on the European markets.

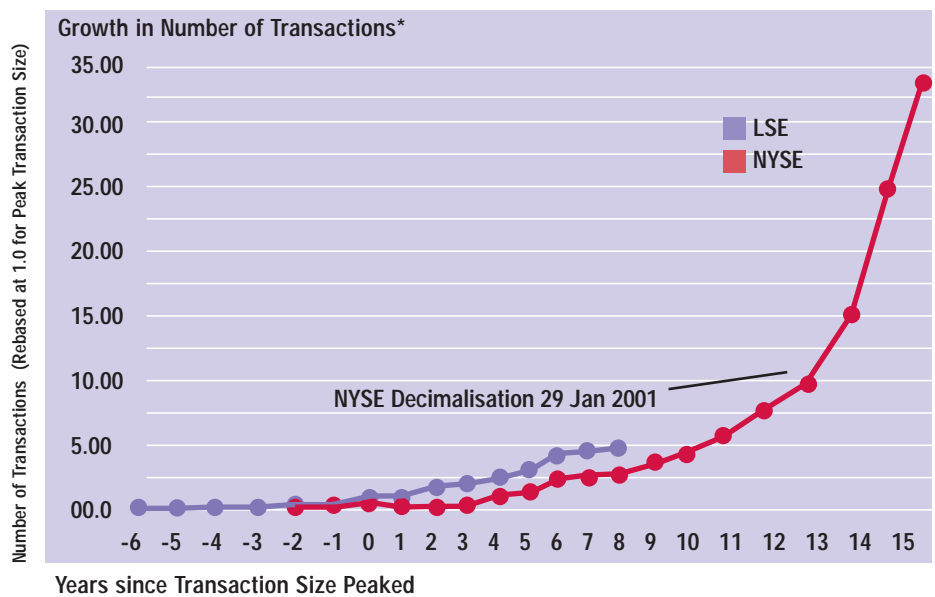
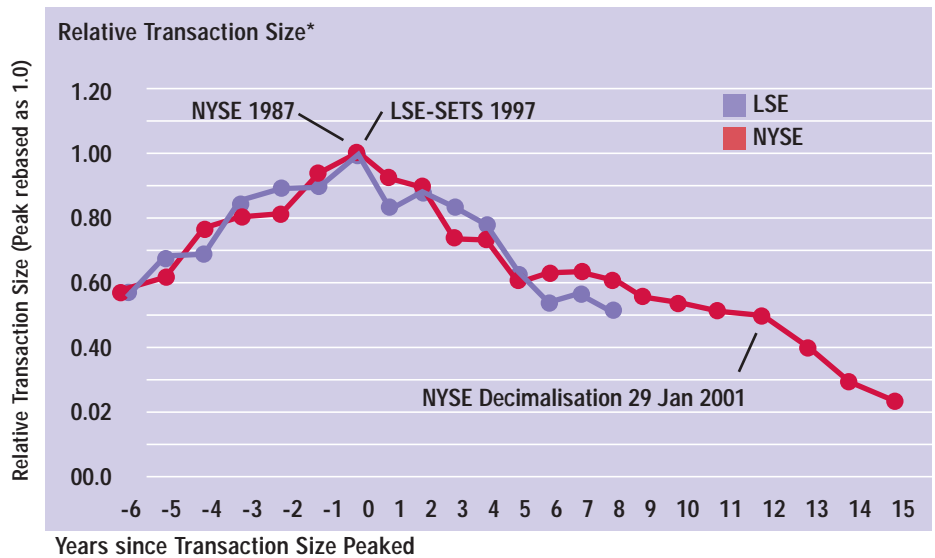
This could create significant business opportunities for those firms that treat the directive as something other than a nuisance with which they have to comply.

In recent years, the LSE and NYSE markets have had almost identical reactions to similar events.

The diagram/data shows that in both the US and UK, average trade size was rising until technology changes intervened; average size then fell sharply before reaching a plateau. NYSE data indicates a second market driven stimulus from the decimalisation of share prices resulting in a further drop in trade size accompanied by a massive surge in transaction volumes; not yet seen in Europe.

MiFID should provide a similar stimulus to volume in the European markets by introducing increased transparency and strengthening competition.

*Data source LSE & NYSE



Technology changes such as those seen in the US market have significant consequences on the market's behaviour.

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What are the catalysts for change?

On the Buy-Side

- > MiFID will further encourage leaders to use client profiling for services better geared to individual investor needs
- > Best Execution will be the 'hallmark' for winners – not only will firms take more control over the execution of client orders, accelerating the use of automated links to directly access trading venues, but they will be value-leaders and gain market share compared to non-EU firms not obliged to provide the best deals to clients
- > Safeguarding of assets will be a strong plus for EU-based private bankers, compared to other, even lower-tax domiciles
- > Conflicts-of-interest are the subject of much closer scrutiny under MiFID
- > Some aggressive players, such as hedge funds, may use the availability of firm prices to arbitrage across and within the order books of Sell-Side institutions.

On the Sell-Side

- > The appetite of key players to give access to their order books could create additional pools of easily accessible liquidity
- > Firms may narrow spreads to improve their attraction as an execution venue and make a land-grab for order flow, potentially reducing spreads to zero in selected stocks
- > A further increase in the number of fills as the "value add" will be the ability to execute larger blocks whilst minimising the market impact and hence cost to the client
- > The extension of firm quotes to sizes above SMS resulting in an increase in automated execution of these larger sizes.

In the middle, brokers and other intermediaries will be squeezed and will increase their efforts to deploy a hybrid model, with voice driven value added services and increased automation of small orders.



The reactions of the buy and sell sides will dictate the scale, nature and timing of the changes instigated by MiFID. There are some potential catalysts that might accelerate market growth and change the dynamics.

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What could be the impact of these changes?

Opportunities

Atos Consulting foresees firms reacting to the probable reduction in average order size by additional automation of execution for small orders, reducing the cost per trade and promoting a virtuous circle for smaller trades. This will be allied to a steady increase in Algorithmic trading to further reduce cost by minimising market impact.

On the Sell-Side, automation will be used to offer a wider range of trading strategies, for both proprietary use and as a product offered to the Buy-Side. For example, more sophisticated order book management will result in additional growth in the automated execution of small trade sizes to fill block trades, minimising market impact of these orders.

The use of automated trading systems will also increase on the Buy-Side as more of these firms take control of their trading activity in-house and simultaneously execute small shapes across multiple Sell-Side venues.

On both sides of the market, Europe will follow the US lead in the adoption of smart routing systems, seeking the best price from the plethora of venues quoting firm prices that will emerge post-MiFID.

A further growth in automation will be increased use of dynamic Transaction Cost Analysis. On the Sell-Side such systems will provide a source of data on quality of execution and will be used to provide a marketing edge for the successful firms. On the Buy-Side MiFID will increase the propensity to actively monitor execution results by broker, by venue and other characteristics.

Challenges

The number of execution venues (Exchanges, Multi-lateral Trading Facilities and Systematic Internalisers) providing firm prices for small sizes will mushroom under MiFID. One risk is that this will fragment liquidity in the short term as the venues strive for market share. Consequently, many of the transparency provisions in the Directive seek to reduce the impact of this fragmentation. However, a possible outcome is a market that is initially flooded with data of limited use. Investment will be required to extract value from this data and to automate the decision on where to execute from the choice of venues that the firm has selected in its execution policy.

For those that choose to be Systematic Internalisers the growth in the number of trading facilities complicates the requirement that quoted prices are comparable to other execution venues. Data from competing venues will have to be accessed and action taken where required. Some firms may choose to react by dynamically adjusting spreads and the quoted price points in response to quotes from competing venues.

On both sides of the market, managing transaction costs will be critical as the number of transactions grows but the average value declines, reinforcing existing pressures on technology to support these higher volumes.

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What will the future look like?

First and foremost the firm has to know how it will react to MiFID and there are four key questions it should be asking:

1. How does MiFID change the business strategy?
2. Where should the firm compete, collaborate or just react?
3. What is the impact on the operating model?
4. When should it implement the changes?

Strategy

A key factor for all firms is the responsibilities that MiFID sets out for the various classifications of client. For example, a firm with very few retail clients may seek to

reclassify these as professionals, or in extremes be prepared to forgo their business. These responsibilities will also drive the firm to re-examine its interaction with the markets and its trading partners.

The firm with the initial client contact will always retain responsibility for 'Best Execution'. Such firms also need to re-consider the degree of control exercised over the management and execution of client orders. Firms will have to review the processes of selection and monitoring of the intermediaries and trading venues used and this will re-shape many existing commercial relationships.

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Compete, collaborate or react?

Firms have four options in responding to the changes brought about by MiFID:

1. Focus on compliance, treat the directive as business as usual and do the minimum necessary
2. Prepare contingency plans to react to the actions of other market participants, for example, how will the firm react if a Sell-Side firm slashes its spread
3. Collaborate with other players in the market on infrastructure programmes and similar projects
4. Make an aggressive play to reposition the firm or take a market lead.

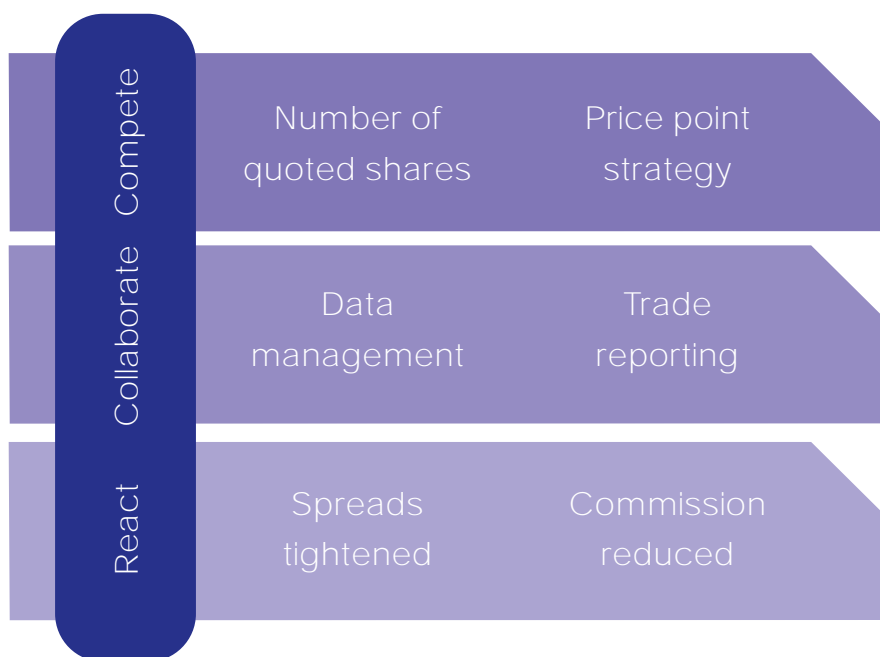
The winning firm will use a combination of these, a simple example is shown below.

Operating model

To grasp the opportunity offered by MiFID, the winning firm will review and refine its operating model in line with its revised strategy. The ensuing changes will have an impact on staff and processes, as well as the systems and software changes set out above.

All client-facing staff need a thorough grounding in the new requirements, not least to know when suitability and appropriateness tests are required and when a client instruction overrides the firm's policy and so mandates a warning to the client.

Example approach



Timing

Every firm needs to adjust the pace of its response according to its own circumstances. In some areas the pace will be fast, particularly where the firm is taking an aggressive or market leading stance. In other areas the pace will be more measured as there will be a need for standards to evolve and infrastructure providers to upgrade their products.

The successful firms will adjust their timing to use the provisions of the directive to its advantage. For example, a Systematic Internaliser may choose to trade report anonymously from day one and then ensure that it publishes quality statistics to allow this to continue.

Regardless of pace, the winning firms will have a coherent plan covering all activities and dependencies managed by a good programme office with strong business sponsorship.

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Clearly, not all changes can take place in isolation and a prerequisite for the increase in automation will be further standardisation of key data elements and resolution of the necessary changes to data formats and protocols.

What do the winners do now?

As the response to MiFID gathers pace, the firms in pole position will be those that actively:

- > Adopt a strategy that applies the regulatory rules smartly, maximising the opportunities to grow the business
- > Challenge the status quo to determine where to compete and where to collaborate
- > Drive down total transaction costs throughout the business by re-evaluation of the operating model
- > Establish a governance structure involving all aspects of the business (client facing, operations, IT, etc.).

In conclusion, the implementation of MiFID has started and, whilst different firms will require a different response, all need to act now.

The markets are changing and the winners will be those that do more than merely seek to tick the compliance box.

For further information please contact the Compliance team on compliance@atosorigin.com or call us on +44 (0)20 7830 5444.

About Atos Origin

Atos Origin is an international information technology services company. Its business is turning client vision into results through the application of consulting, systems integration and managed operations. The company's annual revenues are EUR 5.5 billion and it employs over 47,000 people in 40 countries. Atos Origin is the Worldwide Information Technology Partner for the Olympic Games and has a client base of international blue-chip companies across all sectors. Atos Origin is quoted on the Paris Eurolist Market and trades as Atos Origin, Atos Euronext Market Solutions, Atos Worldline and Atos Consulting. For more information, please visit the company's website at www.atosorigin.com

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Atos Consulting is a leading provider of business, process and technology consulting services. With more than 2,500 staff globally, it focuses on delivering proven, pragmatic solutions to the telecom, manufacturing, financial services and public sectors.