
The Effect of MiFID on Trade, Portfolio and Client Relationship Management

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Deadlines for the Markets in Financial Instruments Directive (MiFID) are still not set in stone, but it is imperative that planning for MiFID is undertaken immediately. This article looks at the effect on trade management, portfolio management and client relationship management.

With so much discussion about the forthcoming MiFID legislation, it's now getting very confusing and unfortunately there is no magic wand to help us make sense of it all. One certainty however is that it should not be seen as a waiting game or in fact a moving target. Deadlines for final measures may well shift again and the exact criteria is likely to change and evolve, but regardless, investment firms will have to accommodate the requirements of MiFID, and should be making preparations to do so now.

Private client investment firms are going to be affected in three areas in particular: client relationship, portfolio and trade management. Firms have to start making some changes to lay the foundations for the coming legislation and avoid a rush to the finish line.

However, it's not all doom and gloom and more red tape. MiFID is actually as much an opportunity for business development as it is about compliance. It must not be forgotten that the political objective of MiFID is to create a huge market that is able to compete with the US and the evolving Asian markets. By creating such a market, the EU will be offering a number of business opportunities; the structure of the new EU market offers more depth and breadth to the investors that in turn will generate more liquidity for international investment.

Further business opportunities lie in the elimination of cross-border barriers of different local market rules or legal boundaries. The opening up of so many markets will increase competition and develop keener pricing for both trading and subsequent clearing and settlement. Already, the Euroclear harmonisation project is well on its way to supplying a more efficient and cheaper settlement system with LCH Clearnet also developing their services and systems to mirror the market changes introduced by MiFID.

Whether perceived as a business opportunity or unwanted burden, private client investment firms must recognise the changes that need to occur to survive and begin to make those changes now. As mentioned earlier, private client investment managers (PCIMs) will see most disruption and, conversely, most opportunity in the three areas of portfolio management, trade management and client relationship management.

Best Execution

Perhaps the biggest effect on trade management will be on order execution. The unbundling of costs in MiFID best execution will provide transparency of sell side

pricing for the first time. This is a terrific opportunity for the buy side to negotiate what best execution policy suits them.

It used to be that best execution was simply about getting the best price for the client. Now, it will no longer be solely based on price and companies will be expected to provide far greater transparency on how they execute orders than previously, in addition to being expected to publish to clients its execution policy. Firms will also have to store all quotes during the execution process and monitor order flow via the multiple retail service providers (RSPs) that they use and given that clients will have up to a year to query the execution of an order, this will have big implications on the company's audit trail. All this could prove enormously time consuming, complex and costly to the business, so forward thinking firms are recognising the value in investing in order management and routing systems to take the pain out of best execution and auditing, allowing the PCIMs to concentrate on clients.

Client Relationship Management

Transparency on the order execution side carries over into the increasingly service defining area of client relationship management. In a market and environment dominated by legislation and compliance issues, differentiation in the market becomes ever harder and keeping and nurturing new client relationships is paramount. So, there is an argument that firms should be addressing ways of storing and retrieving client information anyway if they are to remain competitive in the market, and should have systems in place that can provide them with consolidated information at their fingertips. That said, MiFID does touch this area with specific requirements for the storage and retention of standing data, specifically 'know your client' information. A key requirement for any client relationship management system must be its usability, so any systems based on familiar desktop applications make the most sense.

Firms will also have to look at reporting, although the FSA has confirmed that MiFID has been watered down with respect to repapering client agreement letters. While firms will welcome this, it might equally prove to be a perfect marketing opportunity.

The reclassification of client types is another requirement, but similarly to storing client data, this presents another opportunity to provide a better service and in this case possible new European business development for portfolio rebalancing - also what better way to rekindle old dormant relationships with the offer of new and improved services and possible new products to sell.

Portfolio Management

One single European market in financial services is the design for MiFID and with this will come an investment management process with new facets and complications. Clients are also likely to grow in sophistication as their interest in overseas markets increases and different asset classes emerge but of course this will be tempered by the insistence on private clients only investing in 'non-complex' instruments. Under the MiFID regulation, client 'suitability' and risk profiling will involve new criteria, to ensure that the products and services which PCIMs provide are 'suitable' or 'appropriate' for their clients. The firm must obtain sufficient information regarding the client's knowledge and experience, financial situation and investment objectives - under the new regulation, suitability criteria will relate primarily to retail clients, but professional clients, including eligible counterparties will also need to be tested for appropriateness. Where more sophisticated investors who, after the necessary risk warnings have been issued, hold uncovered instruments, the firm will need to agree a loss percentage with the client. Should this loss be breached, the firm must report to the client that day to warn them of this occurrence.

This will result in firms having to perform a time-weighted performance calculation on these securities to accurately calculate the true profit or, more pertinently, loss position.

MiFID is coming and nothing bar the breakdown of the European Parliament can stop it, so it's vital that financial services firms in both wholesale and retail markets make business decisions immediately. A thorough understanding of MiFID is needed before any sensible decisions and planning can take place, but the impact will be great whether you are a small or large investing firm acting for private clients or large institutions, or in the wholesale market selling services to professional intermediaries or direct to large institutions. It's imperative that planning for MiFID is undertaken with immediate effect and budgets established for any system changes to meet your new business requirements and comply post November 2007.

There is no doubt MiFID will bring associated costs. But, there are also significant returns to be earned for complying, provided firms are able to make the correct business decisions and turn MiFID to their advantage. A single European market will be the world's biggest securities market of an incalculable size, offering financial benefits from the issuers through intermediaries to the end investors alike - an opportunity for all that should not be missed.