

MiFID

**M**iFID's draft 'Level 2' implementing measures were released on 6 February. The tone adopted by its authors in Brussels surprised some market commentators: "We weren't expecting the guidance to be quite so prescriptive," comments Tony Kirby, analyst at Accenture, although he points out that much of the detail is contained in the background notes and ponders what legal weight, if any, will be attached to these.

For traders, the question that remains to be answered is whether the Level 2 measures shed any more light on execution policy, specifically what constitutes 'best execution' – a part of MiFID that has been criticised as being too vague and containing a "higher level of generality than the rest of the directive." (see *The TRADE*, Issue 6, page 15.)

The most recent step along the Lamfalussy process for enacting EU legislation, Level 2 provides the financial services industry with a draft set of legislative measures to consider before MiFID is finalised this summer, culminating in new legislation to replace the Investment Services Directive in the summer of 2007. In outlining the Level

# The level best for execution

—MiFID Level 2 implementing measures strive for a clearer view of best execution

2 draft measures, the EU Commission was restricted to areas where the Level 1 measures explicitly allowed them to undertake further review. This applied to 18 of the 73 provisions. Among the areas covered in the new draft proposal are conduct of business requirements for firms, focusing on areas such as best execution and client categorisation, and organisational requirements for firms and markets, including risk management and outsourcing, transaction reporting and transparency requirements.

### Best execution revisited

Whilst the new draft measures are written within the framework of Level 1, they do shed new light on a number of MiFID's key issues. In the section on best execution, a further attempt has been made to outline a firm's responsibility to provide best execution and how this can be achieved. The draft notes make it clear that firms will not be expected to connect to all



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execution venues in order to provide best execution – good news for most traders.

Furthermore, the Level 2 draft implementing measures recognise that, "Due to differences in market structures as well as the nature of certain financial instruments, it is not possible to apply best execution obligations in the same manner in all cases." However, it is quick to point out that, "The lack of a precise or wholly reliable benchmark comparison does not relieve an investment firm of its duty to act in the best interest of the client and hence its best execution obligations."

While the section on best execution is helpful, it still leaves some questions unanswered. Although Level 2 provides a step-by-step guide to what it describes as "the cycle of best execution", uncertainty remains as to how best execution will be applied in practice. "It's extremely difficult to see a time, even after MiFID becomes law, where there is complete agreement about

the application and the evidencing of best execution for every member state for every asset class,” says Kirby. “However, I do see a pathway towards a degree of convergence for the more liquid investments,” he continues.

It is still too early to expect everyone in the industry to have fully digested Level 2 and its implications. However, by next summer, when many of the provisions including best execution are formalised, “firms will start to see the writing on the wall and be taking appropriate measures, including training their front office staff on changes to the conduct of business rules,” says Kirby.

**Buy-side view**

For members of the buy-side trading community, currently engaged with unbundling under the auspices of CP176, while the implications of MiFID need to be taken account of, it is thought unlikely to require a major reappraisal of their execution policy. Notwithstanding the rigours of MiFID, best execution is already considered a given. “We are still very much at the early stages of the process and it currently appears that the dealing

**Buy-side speaks as one on MiFID**

—A buy-side focus group on MiFID has been set up to encourage the buy-side community to engage more openly in the issues surrounding implementation of the impending directive.

“The MiFID Joint Working Group (JWG) has been saying that they have very little representation from the buy-side,” notes Clare Vincent-Silk, consultant at Investit.

In discussions with the JWG, Investit realised that it would be much easier to implement MiFID if there was a clear voice from an informed buy-side group. “We are hearing a great deal about MiFID at conferences, but it tends to be relatively sell-side specific. The focus group aims to address buy-side only issues. Any developments can then be fed back to the JWG,” explains Vincent-Silk.

In conjunction with the JWG, Catherine Doherty, principal at Investit, and Vincent-Silk co-chaired the first buy-side focus group on 24 February. The purpose of the first meeting was to define the role of the buy-side group, how it would complement MiFID Connect and feed buy-side views to the JWG. There were 34 attendees at the first meeting with 25 others watching the outcome of the group, those present included heads of compliance, heads of dealing, operations and project management.

“We have been working with clients on the operational and IT implications of MiFID so have a detailed understanding of the likely implications,” said Doherty. The baton has now been passed to the fund managers who will take on the running of the group.

aspects [of MiFID] are going to concentrate far more on processes involving the less informed investor than they will towards the professional investor,” observes Tony Whalley, investment director, head of derivatives and dealing at Scottish Widows Investment Partnership. He believes that the net effect

of MiFID on the trading community will be far less pronounced than the impact of unbundling, for example. “It is clearly something that we will need, and intend, to comply with fully, but I think it will be a lot less demanding and time consuming from a dealing perspective than unbundling.” ■