

MiFID

Impact on US Operations

March, 2007

The logo consists of a solid black square with the word "capco" written in white lowercase letters inside it.

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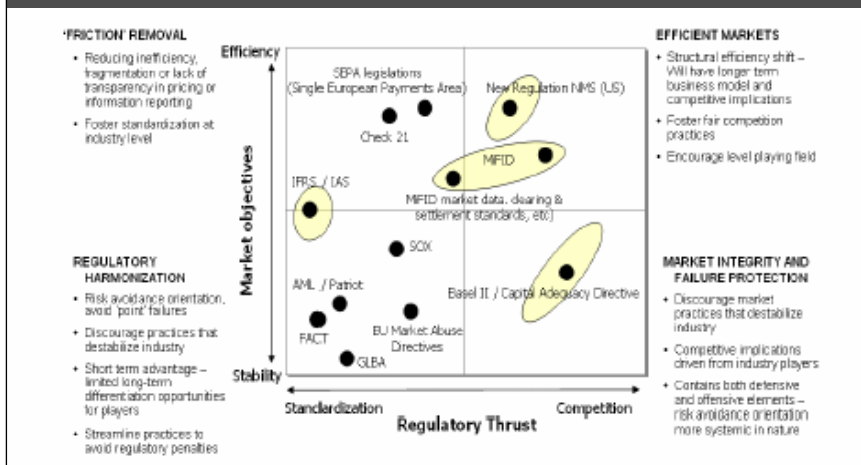
- What is MiFID?
- Impact of MiFID
- Considerations for US firms
- Response

What is MiFID?

MiFID comes into effect in Nov, 2007 and replaces the existing ISD

- MiFID promises to level the EU investment market while raising the bar on accountability to investors
- The **broad objective is to create a single financial services market**, for both retail and wholesale transactions in financial instruments, within the EEA countries through higher levels of compliance in the following areas:
 - **Conduct of business**, introduces a classification system for all clients along with investment suitability assessments, commission disclosure and other transactional information requirements.
 - **Market activities**, involves best execution, pre- and post-trading reporting, and allocation policies.
 - **Organizational standards**, governs senior management responsibilities, internal audits, and compliance and risk functions

MiFID is set to make the EU financial services landscape more efficient and competitive

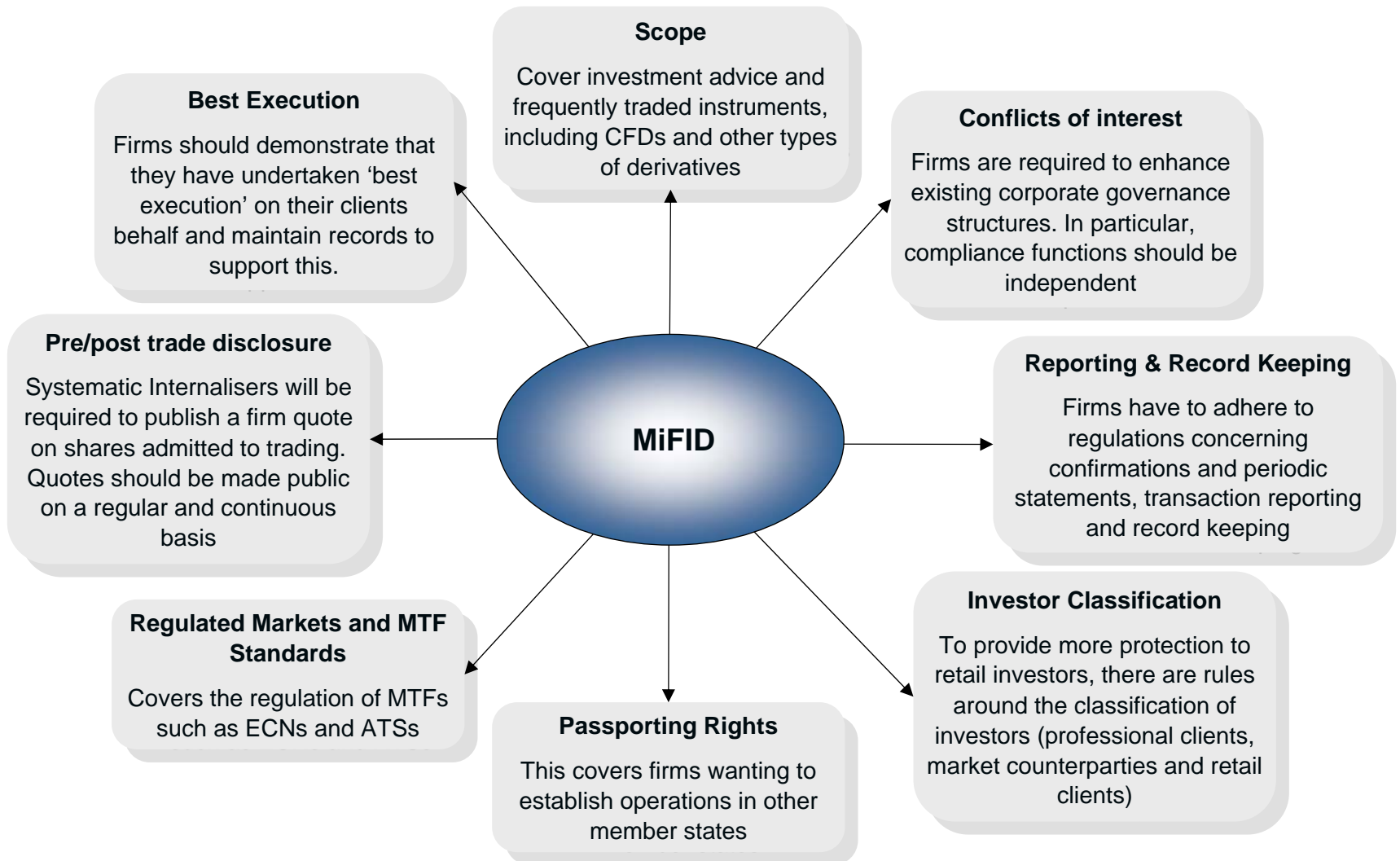


Essentially, **MiFID** was created to provide greater protection and transparency in a market where:

- Investors are more active in global markets
- There has been a greater use of a wider range of services and complex instruments
- Emergence of a plethora of market trading platforms alongside regulated markets

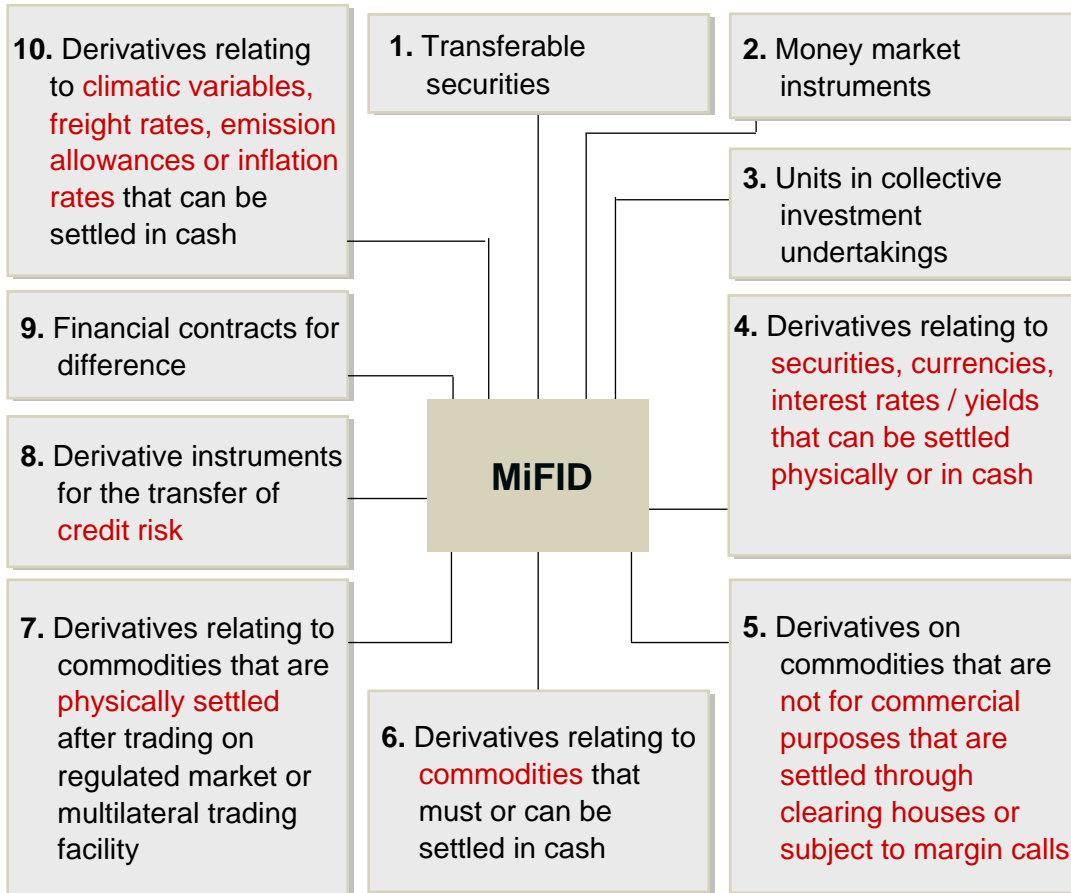
What is MiFID?

Key themes of the European directive



What is MiFID?

The scope of products governed by the regulatory umbrella is significantly increased



■ Additions with MiFID ■ Covered by ISD

Source: Norton Rose / Capco

- EU wide – the directive will apply to all regulated investment firms within the 25 member states
- Initially covers equities but will eventually encompass all asset classes (see diagram)
- Does *not* include Insurance Business
- Includes securities traded on regulated exchanges, multilateral trading facilities (ECNs) and systematic internalisers (pre-trade), other investment firms (post trade)

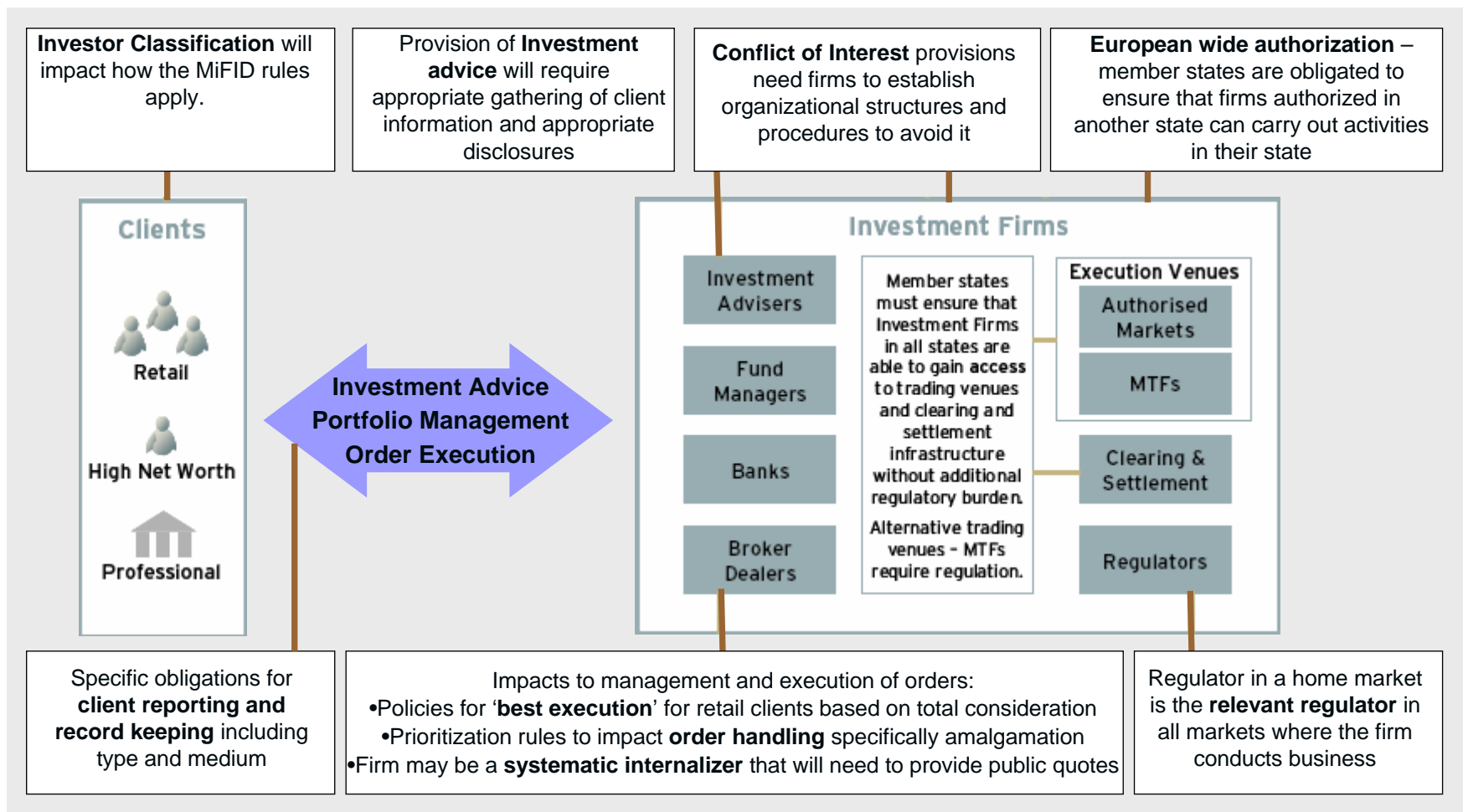
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Implications of MiFID

Material impacts are centered on a relatively small collection of key provisions

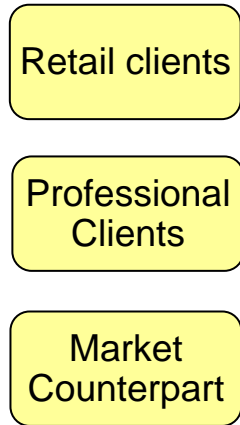
- 73 articles in the directive require action, however the number of articles that have a material impact are from a smaller group of provisions:



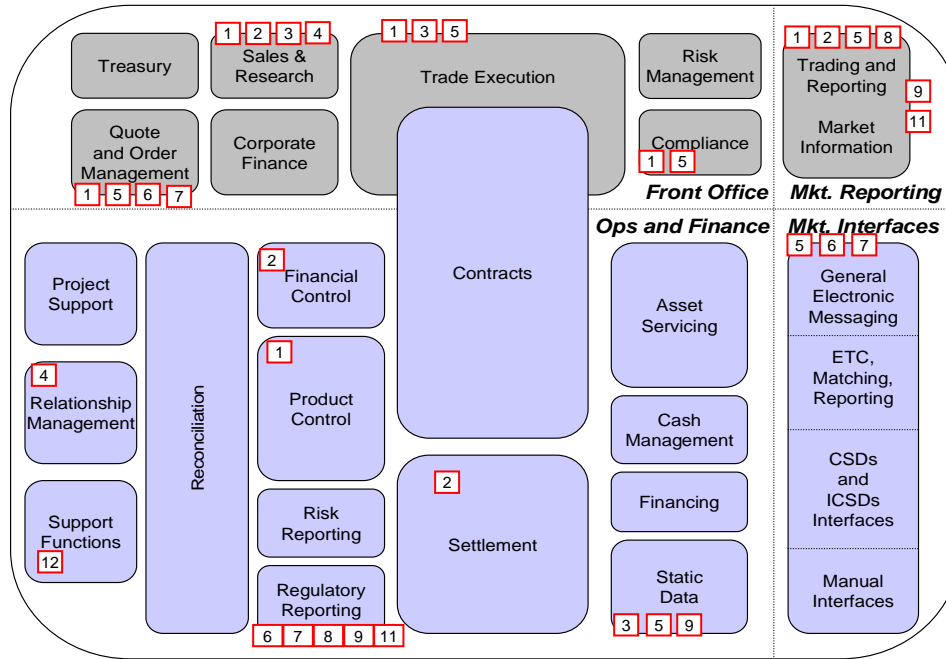
Implications of MiFID

A view of business and operational impacts on the overall landscape

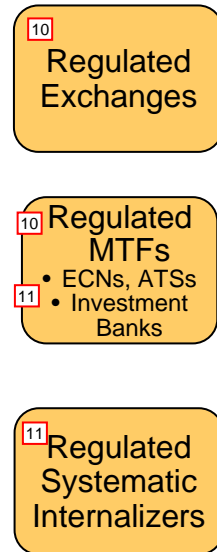
Clients / Counterparties



Broker / Dealer

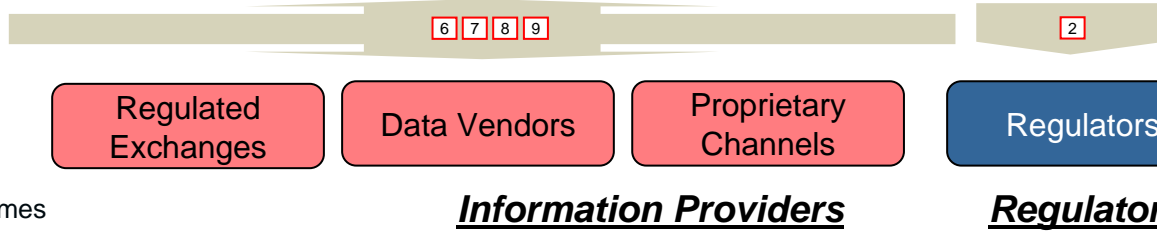


Execution Venues



IMPLICATIONS:

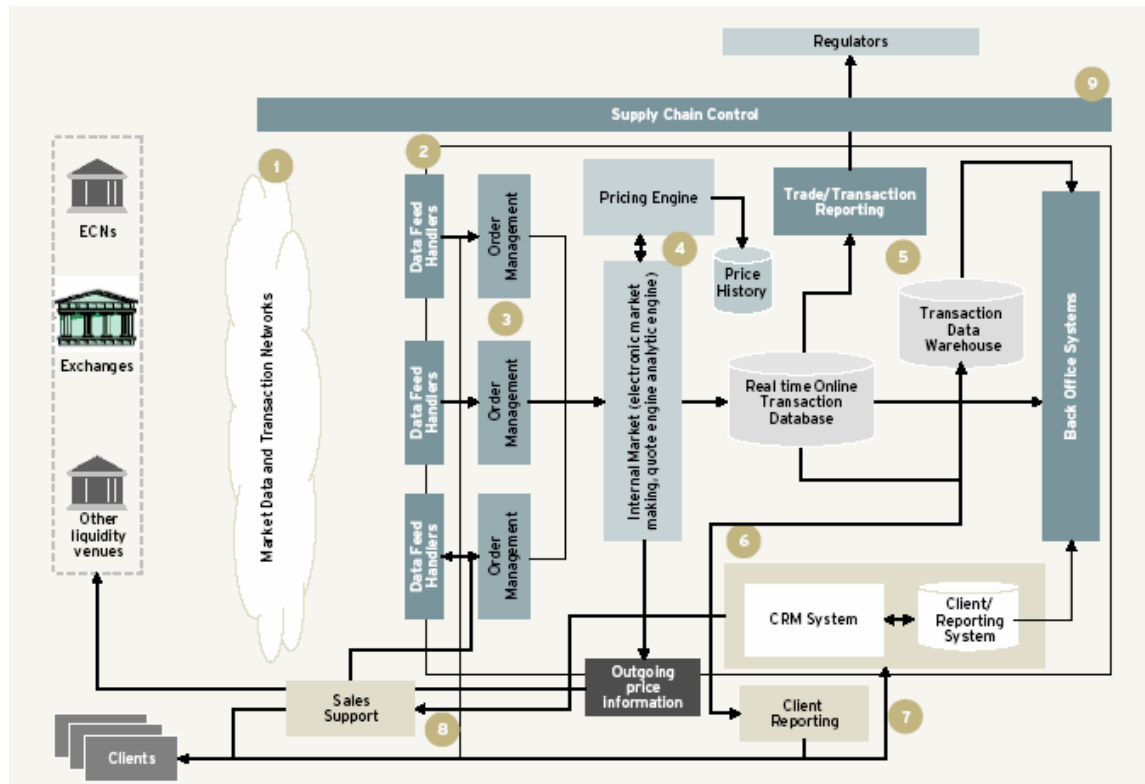
- Scope
- Passporting enhancement
- Change in client types
- Suitability test
- Client order handling policies
- Trade transparency
- Publish client limit order
- Post trade disclosures
- Reporting & record keeping time frames
- Issue validation for exchanges & MTF's
- Internal matching of client orders
- Business continuity



Implications of MiFID

Technology impacts should be considered in conjunction with business and operational impacts

- MiFID will have significant technology impacts both within the investment firms and more widely in the marketplace to which they connect. There are 9 key considerations:



TECHNOLOGY CONSIDERATIONS:

1. Network capability
2. Data feed handlers
3. Order management / order routing
4. Internal market and pricing engines
5. Transaction history
6. CRM systems
7. Client reporting
8. Sales process
9. Supply chain control

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Consideration should be given to MiFID

The impact of MiFID will vary depending on the US firm business model

- US firms will have to **comply with MiFID to participate in European Markets**
- US firms should decide if they are going to **exploit the regulation for commercial purposes or merely check a few boxes**
- **MiFID will improve the EU's competitiveness in the global economy:**
 - European investors will expect the **protections afforded by MiFID** when dealing with the US and eventually US investors may consider taking advantage of the protections offered by MiFID
 - **New business models** will crop up to capture revenue from systematic internalization and market-data distribution, firms that cannot adapt will inevitably fade away.
- **The following questions should be considered to determine the impact of MiFID:**

Current Business Operations:

- Do you have EU domiciled branches or subsidiaries?
- Do these deal with domiciled counterparts and clients?

Future Business Operations:

- Does your non-dollar growth strategy include the EU?
- Does your business plan to exploit the regulation for commercial purposes?

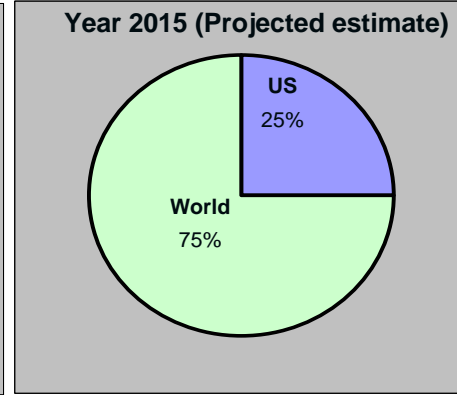
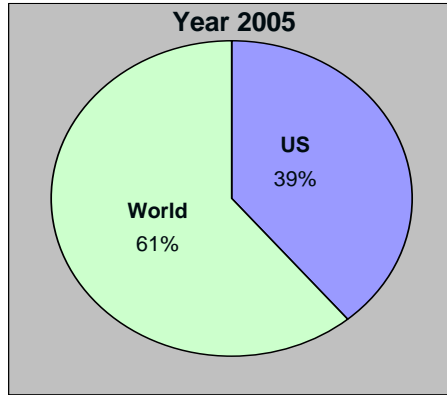
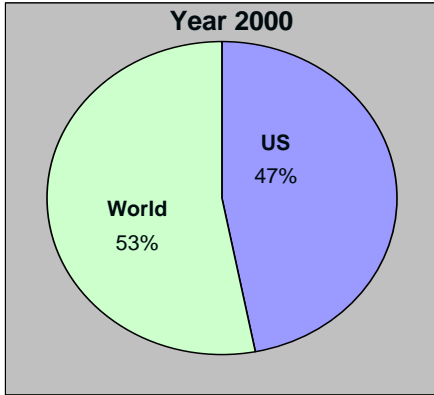
If the answer to these questions is YES then MiFID is a major consideration

MiFID will change the way that organizations do business globally

Market Trend

Non-US instruments are becoming an increasing and substantial part of US investors' portfolio

Global Stock Markets Capitalization (market value in \$ Billions)



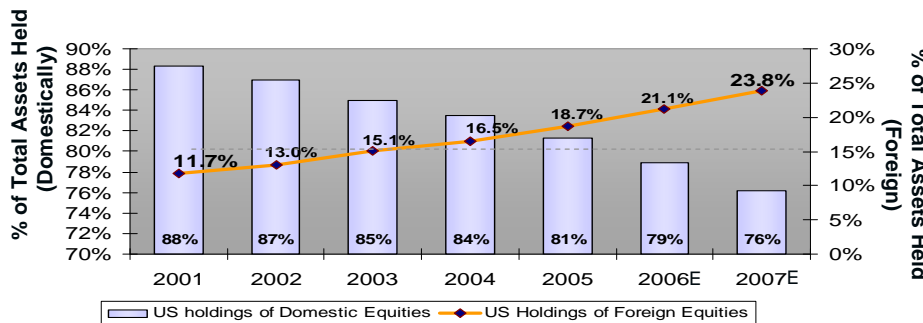
Year	US	World
2000	\$ 15,104	\$ 17,084

Year	US	World
2005	\$ 16,998	\$ 26,644

Year	US	World
2015 (est.)	\$ 21,528	\$ 64,807

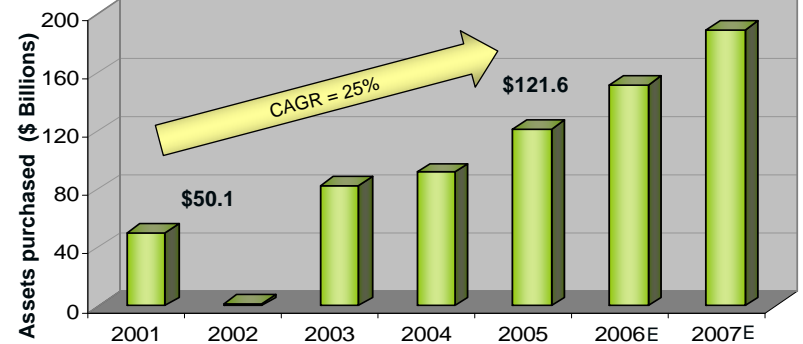
From 2000 to 2005, world stock markets capitalization grew at a 9.3% compounded annual growth rate (CAGR) while the US increased by only 2.4%

Equities Holding by US Investors



- US holdings of domestic equities grew by 1.6% (CAGR) from 2001 to 2005
- US holdings of foreign equities grew by 16.5 (CAGR) from 2001 to 2005

US Net Purchases of Foreign Equities



- Net purchases of foreign equities by US investors have grown at the rate of 25% CAGR between 2001 and 2005
- Net purchases of foreign securities estimated to cross \$151 billion by 2006 year end

The Operations Radar

US businesses will need to understand key operations impacts

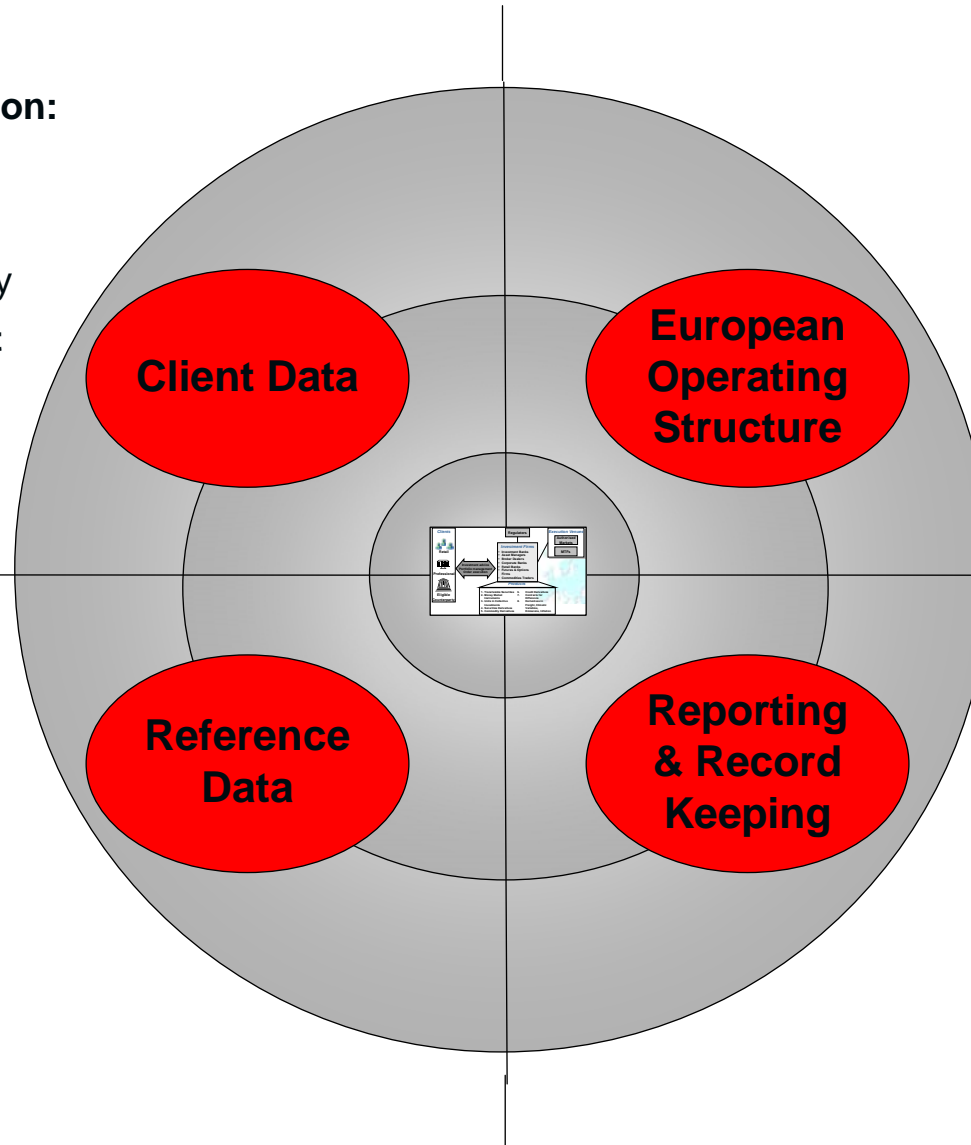
KEY IMPACTS:

1. Investor classification:

- Retail Clients
- Professional clients
- Eligible counterparty

2. Classification effort

3. Suitability and appropriateness



KEY IMPACTS:

1. Key transaction reporting proposals

KEY IMPACTS:

1. Instrument and country scope

- Review branch structures & booking names

2. Passporting

- Rationalize how business is conducted in Europe
- Hub operating models

KEY IMPACTS:

1. Trade Reporting

- Publish information
- Systematic internalization

2. Scope of Transaction Reporting

3. Client reporting

Implications

US businesses will need to change

- **EU passporting arrangements** will facilitate the opening of new activities across the 28 EEA countries and therefore new entities and booking models will be established, back to backs and network issues
- **Liquidity fragmentation**, if it occurs, will result in higher transaction volumes, lower ticket size and operations capacity challenges



- Companies should be looking to **augment systems** and not start from scratch
- US based firms should **dovetail MiFID compliance efforts with similar Reg NMS** compliance efforts e.g. best execution is consistent across both Reg NMS and MiFID although is more prescriptive in Reg NMS
- **Collaboration across the supply chain**, buy side, sell side and IT suppliers will allow quicker compliance and lower costs to comply

Only 3 countries (of a total 28 EEA members) will be fully compliant by the regulation implementation timeframe Nov, 2007

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Smart Response

Key principle: do not respond in isolation

- **Consider potential “big picture” impacts in formulating a response. Some of the major ramifications may include: fragmentation of liquidity, exchange consolidation, new competition, opportunity to expand cross border.....**
- **Consider the response of suppliers who might help :-**
 - Data vendors for consolidated price information
 - Exchanges/MTFs looking to provide new services
 - Connectivity routing providers looking to simplify best execution obligations
 - Data vendors looking to provide aggregator/publisher services
 - Outsource service providers (..care with possible additional obligations)
- **Consider common non-competitive issues and consider cooperation with peers** (consortia approach e.g. Project Boat; Project Turquoise)
- **Engage with industry consultation process, e.g. with FSA, JWG, LSE...** (consultation process nearly completed)

Smart Response

6 health check points for your firm

1. **Broad representation:** MiFID requires input from business, operations, IT and legal and regulatory; it cannot be dealt with as a narrow compliance issue
2. **“Big Picture” first:** the first assessment should look across all of the activity of the firm to identify where the main impacts are before going into detail
3. **Proactive approach to suppliers:** identify key suppliers and understand their plans, interact to influence them
4. **Proactive approach to regulators:** be prepared to seek guidance early and to interact with the local regulators to clarify specifics
5. **Clearly identified champion:** that will ensure the firm keeps up to date with developments and will participate in, or even lead, the market consultation and potential cooperation with peers. An internal single point of contact.
6. **Alignment with other programs:** leverage existing or planned initiatives that align with MiFID requirements (e.g. AML & KYC, reference data initiatives, workflow implementation and, potential synergies with Reg NMS). Aim to minimise the need for duplicate “regret spend” and maximise the effective use of scarce resource