Mifid II FAQs

Overview of the research and best execution rules

ESMA has published its Final Technical Advice to the European Commission on some aspects of Mifid II.

This advice will help the EU Commission to translate Mifid II requirements into practically applicable rules. The new Mifid regime will go into effect in January 2017.

The rules increase scrutiny of research commissions and execution quality. Although not banned, clients' payments for research entails strict requirements, including the use of dedicated research payment accounts funded by research charges to the firm's clients. Mifid II also addresses the enforcement of best execution requirements and extends the application of best execution across asset classes.

Markit helps customers address these requirements. Customers can aggregate and manage CCA/CSA credits across trading partners on our Commission Manager platform. Using our Vote platform, customers can record and evaluate sellside services. Integration between Commission Manager and Vote allows firms to easily determine payment allocations based on their broker vote results. Analysis of execution, algorithmic, venue and smart order router metrics are offered through our Transaction Cost Analysis platform to support execution quality reporting.

RESEARCH COMMISSIONS

Mifid II imposes stringent conditions around clients' payments for research, including the required use of a dedicated research payment account and regular assessments of research quality.

What are the key requirements around clients' payments for research?

An investment firm will need to set up a research payment account funded by specific research charges billed to the firm's clients. Research charges to fund these accounts must be based on a research budget determined by the investment firm, and cannot be linked to the clients' transaction volumes or values.

What are the research budgeting requirements?

The amount and frequency of the research charge to fund the research payment account must be agreed between investment managers and clients. Research budgets may only be increased with a client's written agreement, and must be managed solely by the investment firm, with senior management oversight. Investment managers need to put in place certain controls, including a clear audit trail of payments to research providers and how the amounts were determined.

Investment managers need to regularly assess the quality of the research, including its ability to contribute to better investment decisions and the extent it benefits clients' portfolios, and have a written policy documenting this process.

What challenges could firms face around research budgeting?

The amount investment managers are willing to pay to each broker supplying research will need to be determined in advance. The aggregation of these budget figures will determine the research charges for the firm's clients. Increasing the research budget will require written agreement from clients. Research commissions will need to be tracked at the fund level. Broker votes can be used for allocating research charges, but do not address budgeting and client approvals.

What if investment managers choose to pay out of their own pocket instead of dealing with the added administrative burden?

Direct payment by investment managers only requires general disclosure and conflict management. Investment managers may account for their direct payment through an increase in their portfolio management or advice fees.

How do CSAs factor in with the new rules?

Asset managers may be able to use CSAs to pay executing brokers for trade execution while allocating part of the commission for a research provider. CSAs may become a mechanism adopted to implement research payment accounts. They help address conflict of interest issues between brokers and portfolio managers. However, CSAs alone do not meet Mifid II requirements as they allow research charges to be linked to transaction volumes.

How do the rules impact broker dealers?

Broker dealers may potentially benefit from the new guidelines as CSA brokers. However, ESMA states that research pricing should be unbundled and is calling for the European Commission to address conflicts between investment banking and research.

EXECUTION

Mifid II addresses the setup, measurement and enforcement of best execution. Best execution encompasses a broad range of factors, including the quality, speed and size of execution. Best execution should now also be applied across asset classes, including FX, equities, fixed income, derivatives and any contract-based instrument.

What are the key requirements around investment managers' execution policies?

Execution policies should be customised depending on asset class and type of service provided. Policies must include factors used to select an execution venue, such as price, costs, speed and likelihood of execution, and the relative importance of each factor.

Investment managers must also provide clients with information on how venue selection occurs, specific execution strategies employed, procedures used to analyse execution quality and how best execution is monitored and verified. The firms' top execution venues also need to be disclosed. Client requests for information about policies must be answered clearly and within a reasonable amount of time.

How does best execution apply to products that trade OTC?

Where they execute over-the-counter, investment managers must be able to check the fairness of the price proposed to the client. This shall be done by gathering market data used to estimate the price of the product and through comparisons when possible to similar products.

MARKIT

Markit's Commission Manager, Vote and Transaction Cost Analysis platforms can help firms address new disclosure requirements around commission allocations and best execution.

Contact us to learn more:

sales@markit.com

About Markit

Markit is a leading global diversified provider of financial information services.

Markit provides products that enhance transparency, reduce risk and improve operational efficiency. Customers include banks, hedge funds, asset managers, central banks, regulators, auditors, fund administrators and insurance companies.

Founded in 2003, Markit employs over 3,000 people in 10 countries. Markit shares are listed on Nasdaq under the symbol "MRKT."

For more information, please see **markit.com**