Counting the cost of MiFID II

Report highlights

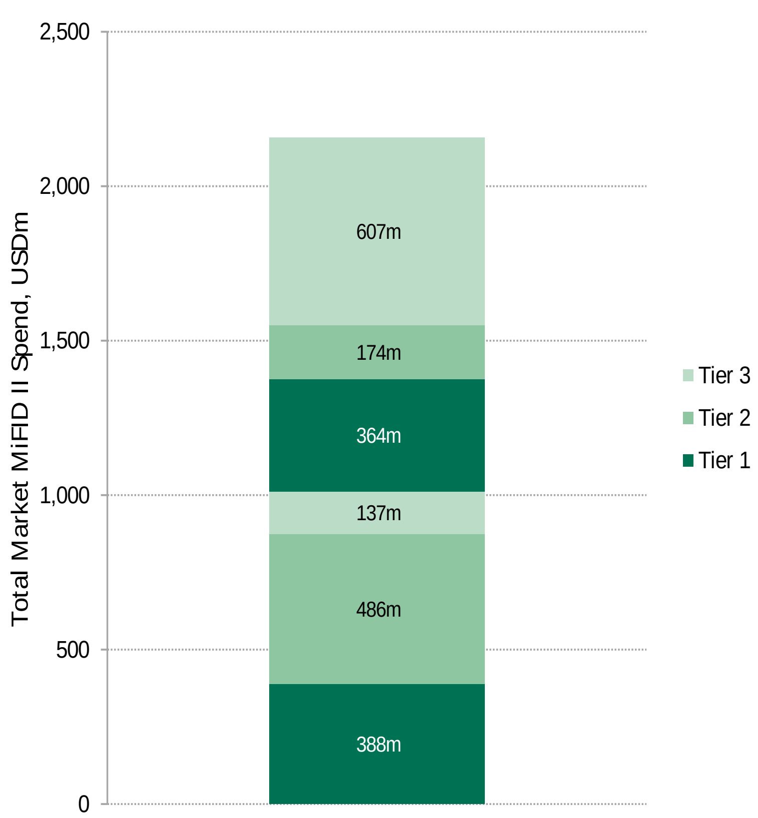
An introduction to MiFID II

The implementation of the second Markets in Financial Instruments Directive (MiFID II) in January 2018 means that firms will have to spend much of next year readying themselves for the new regulatory landscape. While there has been much discussion around what firms need to do to comply with the impending regulations, so far there has been little tangible information around the expected costs of complying with MiFID II.

Both Investment Banks and Asset Managers are expected to spend in excess of USD 1bn to comply. As the January 2018 deadline for implementation is fast approaching, firms are looking at 3rd party vendors in certain areas to help, with USD 633m expected to be spent by firms. The main focus of the buy side is trade reporting and transparency, with 52% of the MiFID II budget allocated to it, whereas Investment Banks are expecting to allocate 48% of the spend on Investor Protection.

To help firms across the buy and sell side prepare to meet these upcoming cost implications, Expand and IHS Markit have partnered to release this study, revealing details of the forecast IT costs to the financial services industry in 2017.

We forecast a total industry spend of USD 2.1 bn in order to comply with MiFID II



Total Industry Spend

Asset Management — **USD 1.1bn**

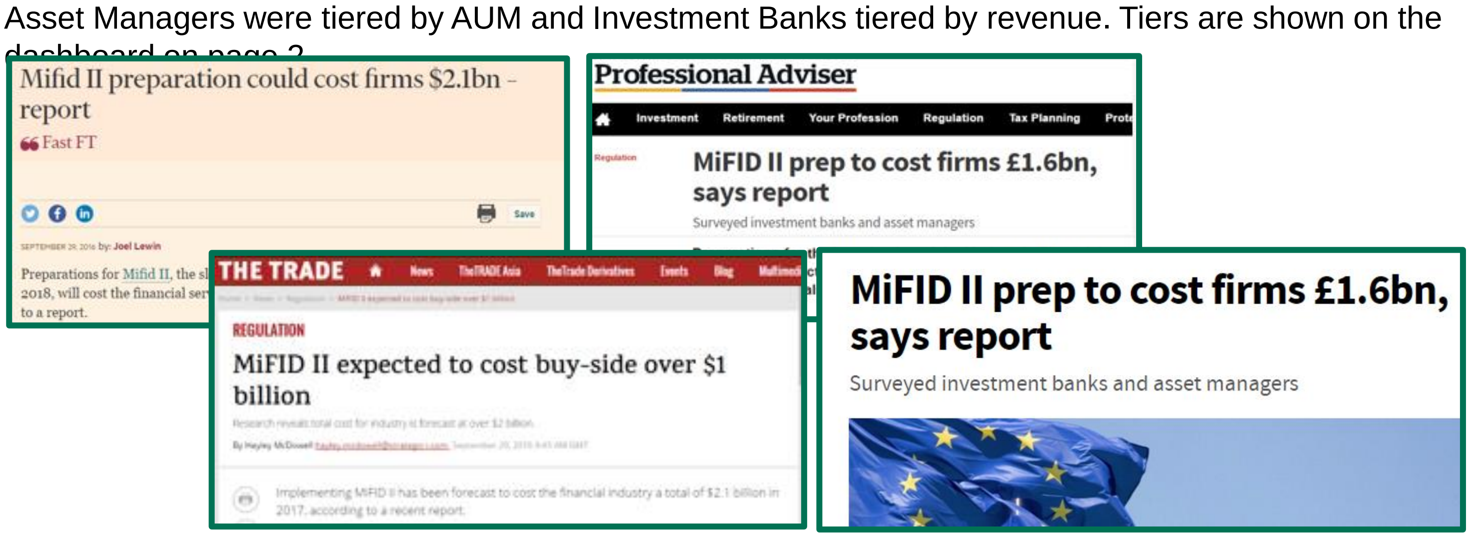
Estimation based on MiFID II spend ratio of the top 400 Asset Managers by AUM

Investment Banking — **USD 1.0bn**

Estimation based on MiFID II spend ratio of the top 40 global Investment Banks by revenue

Based on 2017 budgets and from the quantitative data captured through interviews, we estimate that the top 40 global Investment Banks and top 400 global Asset Managers will spend 2.1 bn on compliance with MIFID II: 1.1 bn by the Asset Management community and 1.0 bn by the Investment Banks.

Asset Managers were tiered by AUM and Investment Banks tiered by revenue. Tiers are shown on the dashboard on page 2.



Key Takeaways

USD 2.1bn
Total forecasted MiFID II industry spend

USD 633m
Allocated towards 3rd Party Vendor spend

Increase in CTB* budgets
Firms are expecting a significant uplift for Reg CTB budgets
*Change the bank

Trade Reporting & Transparency
The focus for Asset Managers

Investor Protection
The focus for Investment Banks

For more information

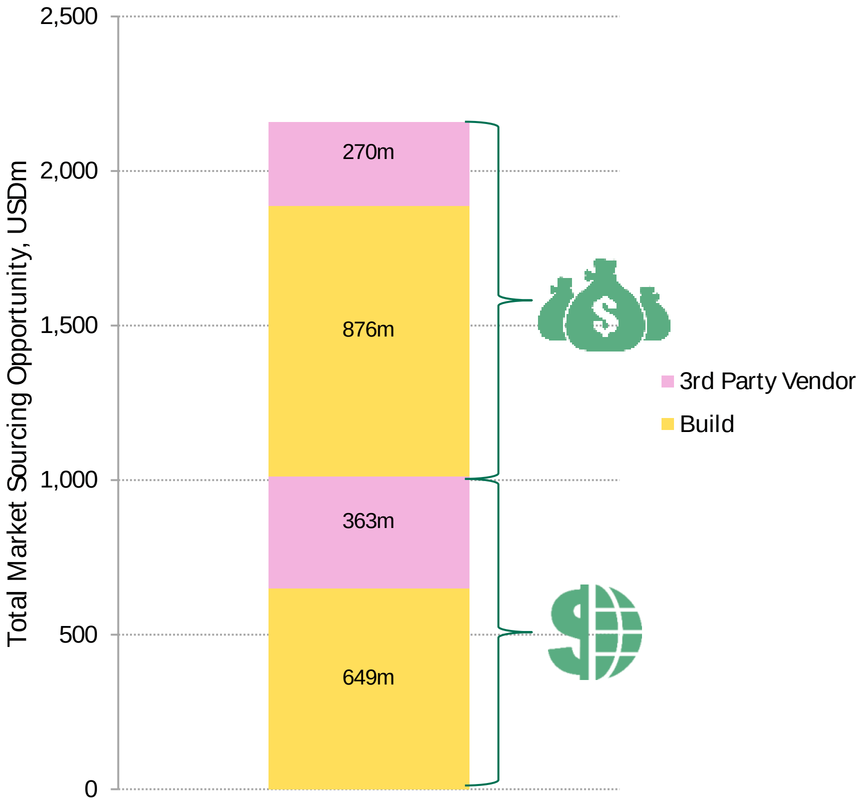
Raza Hussain
Managing Partner
+1 (212) 913 9269
raza.hussain@expandresearch.com

Marios Tziannaros
Project Leader
+44 20 7337 2541
+44 75 4072 1637
marios.tziannaros@expandresearch.com

Jonathan Bell
Analyst
+44 20 7337 2535
+44 77 1033 3689
jonathan.bell@expandresearch.com

Report highlights

The majority of firm's MiFID II budgets are being allocated towards building technology resources in house



Build	3rd Party Vendor
USD 1.5bn	**USD 633m**

Building technology in house to comply with MiFID II is the preferred solution across both the buy side and sell side. This preference means firms are having to increase Regulatory CTB headcount considerably, ultimately potentially resulting in a scarcity of Regulatory CTB resources in the lead up to implementation in 2018.

Some firms on the sell side are collaborating with vendors to mutualize costs amongst themselves and create a more consistent solution. In some exceptional instances, some tier 1 Asset Managers are ahead of the curve and are commercializing their tools to tier 2 and 3 Asset Managers to prepare for MiFID II.

MiFID II Asset Management & Investment Bank Dashboard

**Business Metrics are FY 2015, MiFID II is 2017 estimates*

		Asset Management			Investment Banking		
		Tier 1	Tier 2	Tier 3	Tier 1	Tier 2	Tier 3
Tiering	AuM (AM), Revenues (IB)	>500bn	200-500bn	<250bn	>5bn	2-5bn	<2bn
Business*	Revenues (USDbn)				12.0	3.9	0.9
	Operating Expense (USDbn)				8.2	2.4	0.4
	Assets Under Management (USDbn)	1,256.3	395.3	111.1			
	Application Development & Maintenance (USDm)	189.9	60.3	20.2	896.6	368.5	60.2
	of which Regulatory CTB	*11%*	*5%*	*6%*	*9%*	*12%*	*7%*
MIFID II	Overall MiFID II Spend (USDm)	13.7	5.9	4.1	38.0	36.0	13.6
	Investor Protection	*2.4*	*1.4*	*1.7*	*17.8*	*17.6*	*5.9*
	Trade Reporting & Transparency	*7.6*	*3.2*	*1.9*	*10.3*	*10.7*	*4.8*
	Market Structure	*3.7*	*1.3*	*0.4*	*9.9*	*7.7*	*3.0*
	of which 3rd party vendor spend	25%	39%	19%	11%	39%	25%
	of which technology	81%	75%	60%	93%	85%	67%
Metrics	MiFID II as bps of AUM	0.11	0.14	0.37			
	MiFID II as % Technology Budget	7%	10%	20%	4%	10%	23%
	MiFID II as % Regulatory CTB	64%	178%	343%	46%	83%	342%

MiFID II will re-define Regulatory CTB IT spend for firms with Tier 3 institutions (both Investment Banks and Asset Managers), expecting to allocate three times as much on MiFID II in 2017 compared to their entire 2015 Regulatory CTB IT budget.

Tier 1 Asset Managers will allocate 7% of their technology budget in 2017 on MiFID II related projects. For Tier 2 and Tier 3 firms this percentage reaches 10% and 20% respectively as firms are looking to comply to with one of their most demanding regulations to date.

Investment Banks are expecting to allocate a similar proportion of their IT budget on MiFID II compliance. Tier 1 firms are expecting their investment to reach 4% of their entire IT budget in 2017. This ratio increases again for Tier 2 and Tier 3 firms reaching 10% and 23% respectively.

The level of preparedness among Asset Managers varies considerably, with some firms choosing to keep the original 2017 deadline internally, while others are still at the planning stage. Some firms are approaching 3rd party vendors to ensure preparedness for MiFID II. Asset Managers are expecting to spend USD 270m on these 3rd party vendors solutions (or 24% of the overall Asset Management MiFID II spend).

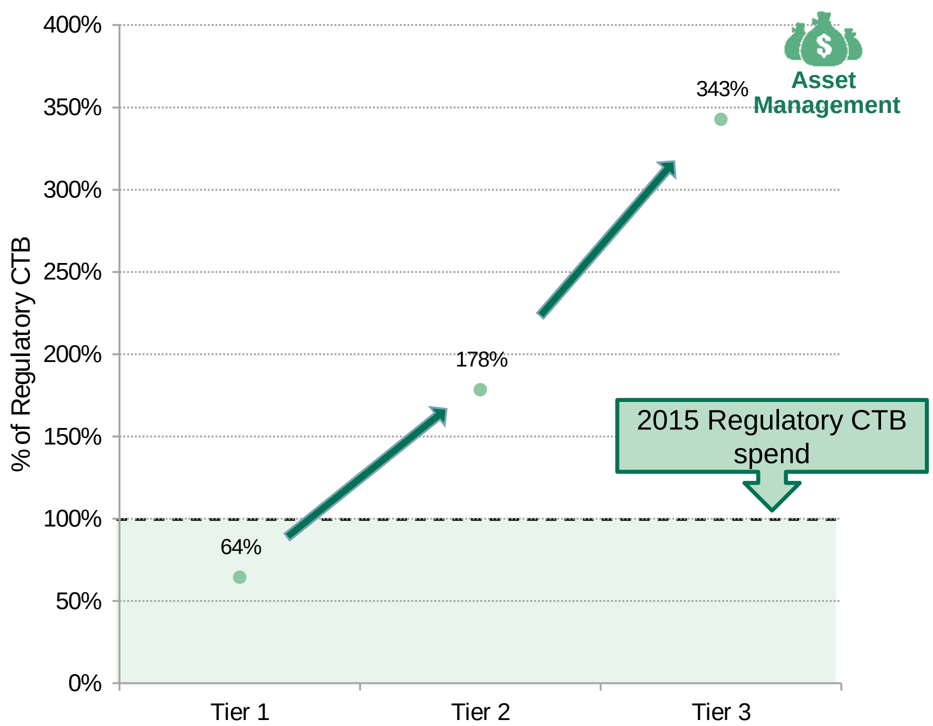
Trade reporting and transparency measures are expected to take up the majority of the Asset Management spend as firms are looking at vendors to ensure they remain compliant with all transactions and new reporting guidelines.

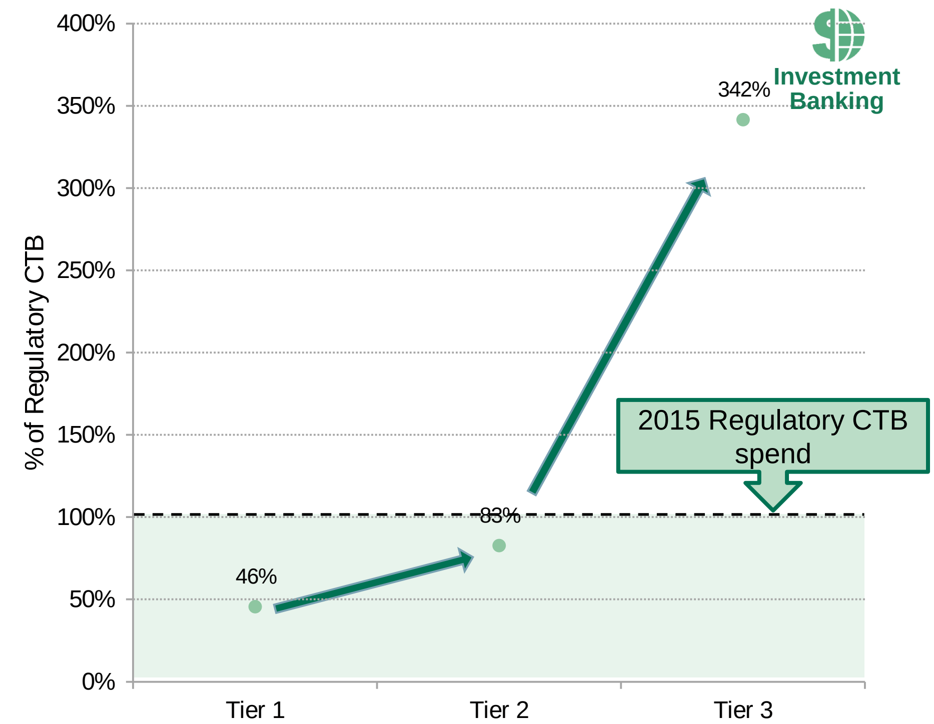
Investment Banks are planning to undertake the majority of their MiFID II work in 2017 with minimal work commencing earlier then September 2016. Third party vendors are expected to provide some MiFID II solutions to Investment Banks, with firms expecting to allocate on average 36% of their MiFID II spend on 3rd party products and services.

Investor protection will attract 48% of the MiFID II market spent for Investment Banks, with firms looking to third party vendors to provide them with solutions in this space. Best execution within fixed income will attract a big portion of the investor protection budget, with Tier 2 firms looking to spend more than half of that on 3rd party solutions.
MIFID Spend was categorized into the following categories:
Investor protection, this includes; Inducements & Commissions, Suitability and Best Execution
Trade reporting and transparency, this includes; Transaction Reporting, Post-Trade Transparency and Post-Trade Reporting
Market Structure, this includes; Product Governance and Electronic Trading

Report highlights

Preparing for the implementation of MiFID II will redefine firms regulatory CTB budgets in 2017



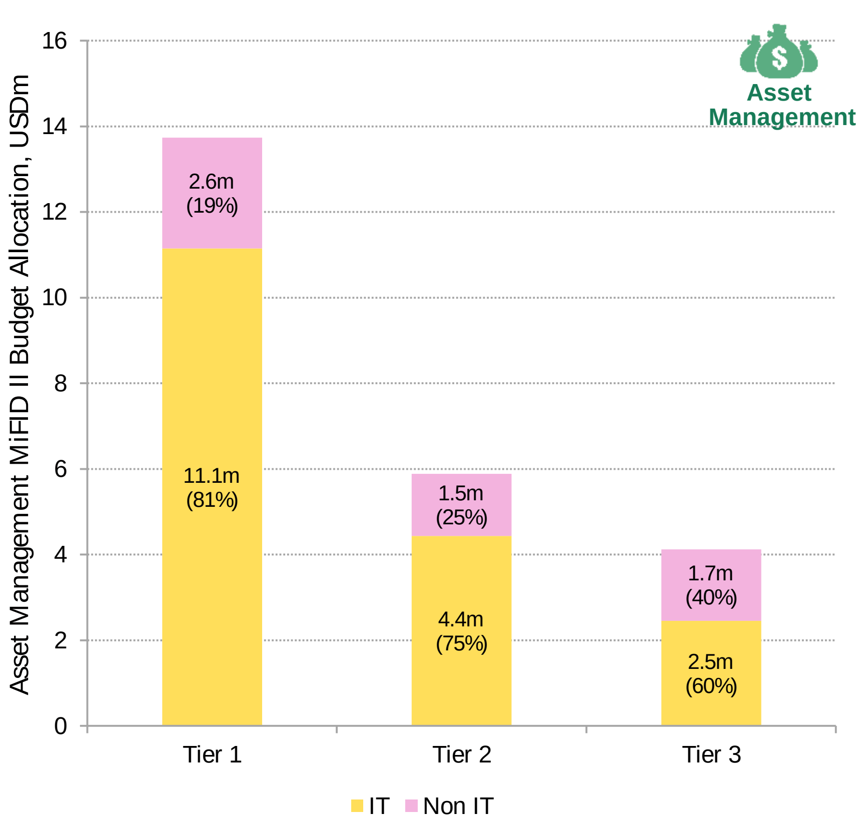


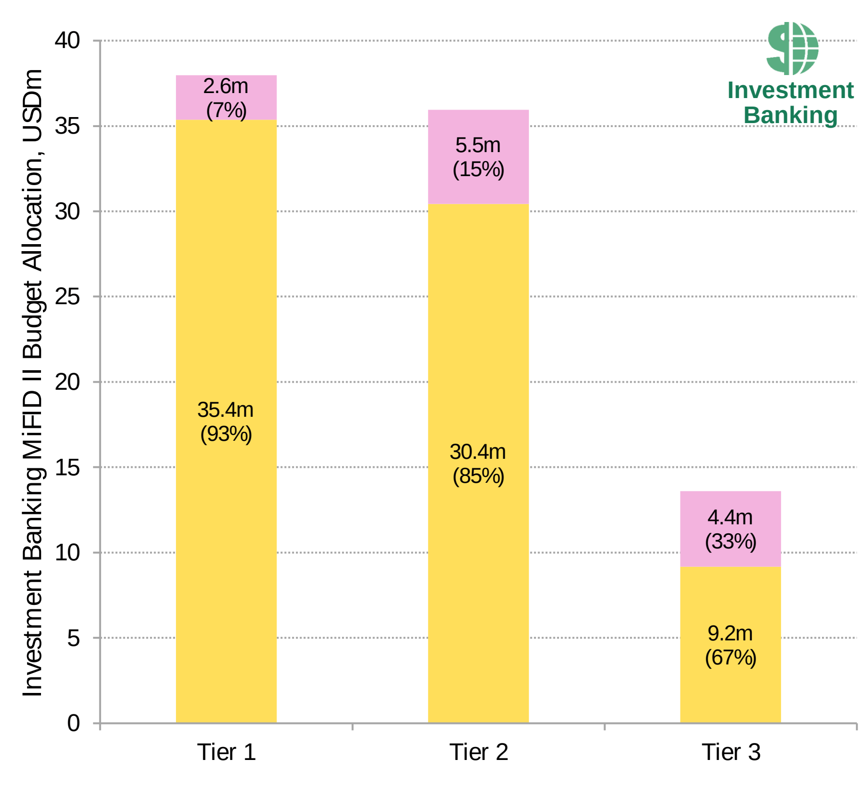
With the impact of MiFID II increasing the lower the tier, it was evident through both the conversations and quantitative analysis that sell side tier 3 institutions were less prepared than their tier 1 and 2 peers.

Relative to 2015 total regulatory CTB spend, we expect tier 2 & 3 firms in Asset Management to be spending considerably more on MiFID II alone. Specifically, for tier 2 Asset Managers we are expecting a 178% increase whereas for tier 3's a 343% increase. This trend is also evident in tier 3 firms in Investment Banking, where the expectation is to spend in excess of 340% of their entire 2015 regulatory CTB budget.

Tier 1 and 2 institutions have typically been able to leverage existing technological solutions from other regulations to assist with MiFID II requirements. Additionally, tier 1 and 2 Investment Banks have always had large regulatory CTB budgets when compared with their tier 3 peers.

The majority of MiFID II budgets are allocated towards improving technology





Buy side budgets are lower than their sell side peers with an average spend in 2017 predicted to reach just under USD 14m in tier 1 and under USD 6m in tiers 2 and 3. Whereas sell side budgets are expected to reach in excess of USD 35m for tier 1 & 2 firms.

A common theme amongst all three tiers and across both industries is the allocation of MiFID II budget on technology, even though sell side institutions are looking to leverage existing solutions where possible to cover certain requirements. The remaining budget is consumed primarily by the legal and compliance departments' staffing requirements.

"We have allocated the majority of our MiFID II budget towards the technology department, we are still in 'proof of concept' stage with several vendors"
– Tier 1 Investment Bank, CIO

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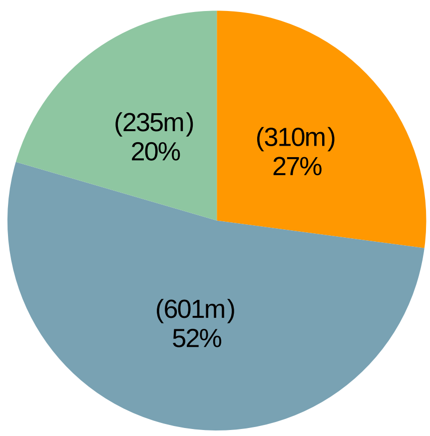
MiFID II budgets vary between industry with both sides of the market focusing on different aspects of the regulation

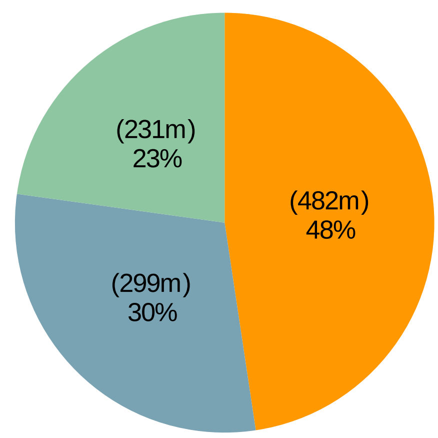
Asset Management



Buy Side Budget Allocation (USDm)

Over half the average buy side MiFID II budget is allocated towards enhancing trade reporting & transparency

Investment Banking



Sell Side Budget Allocation (USDm)

With increased focus on best execution, sell side budgets are primarily focussed on allocating resources to improve investor protection

Investor Protection · Trade Reporting & Transparency · Market Structure

On the buy side the area of trade reporting & transparency is receiving the greatest attention, with firms on average allocating 52% of their budget towards this.

With Asset Managers now taking full responsibility of ensuring all transactions are reported to an appropriate standard to the regulator, many are paying increased attention to this requirement. In addition, as MiFID II requires details of all transactions in financial instruments that are listed on trading venues to be made public in as close to real time as possible, many Asset Managers do not have this level of capability so are investing in doing so.

On the sell side Investor Protection makes up the predominance of MiFID II budgets. This is primarily due to the focus on best execution, specifically with regards to fixed income.

Whilst budgets do vary throughout industry, the general budget trends amongst different tiers remains consistent

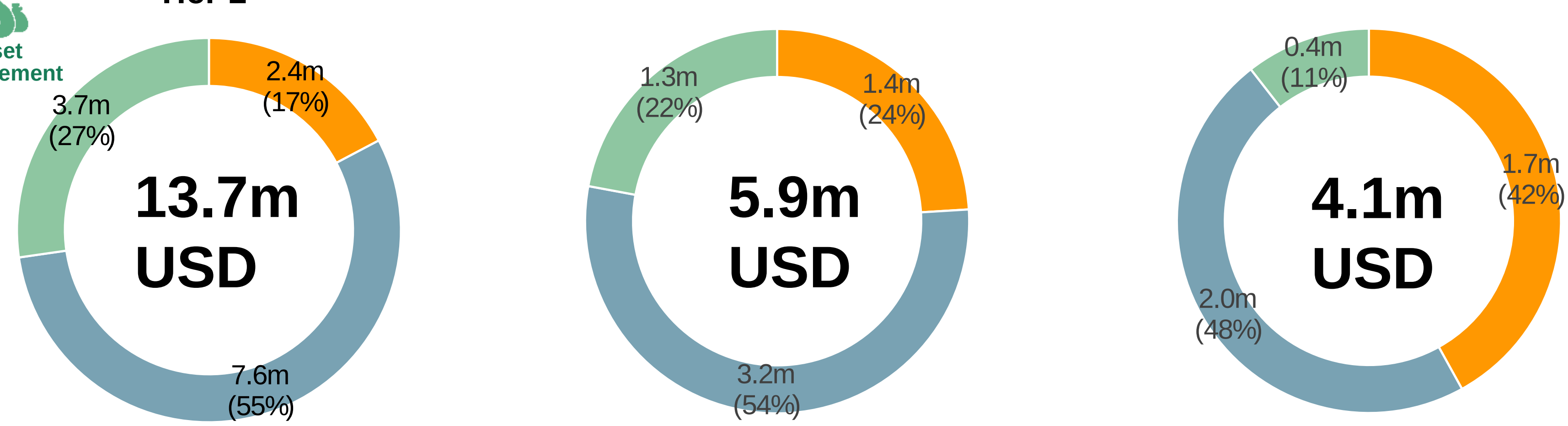
Additional Analysis

Across all three tiers in Asset Management the focus remains on trade reporting and transparency. Regardless of the size of the Asset Manager, the onus is still with them to ensure timely transaction reporting.

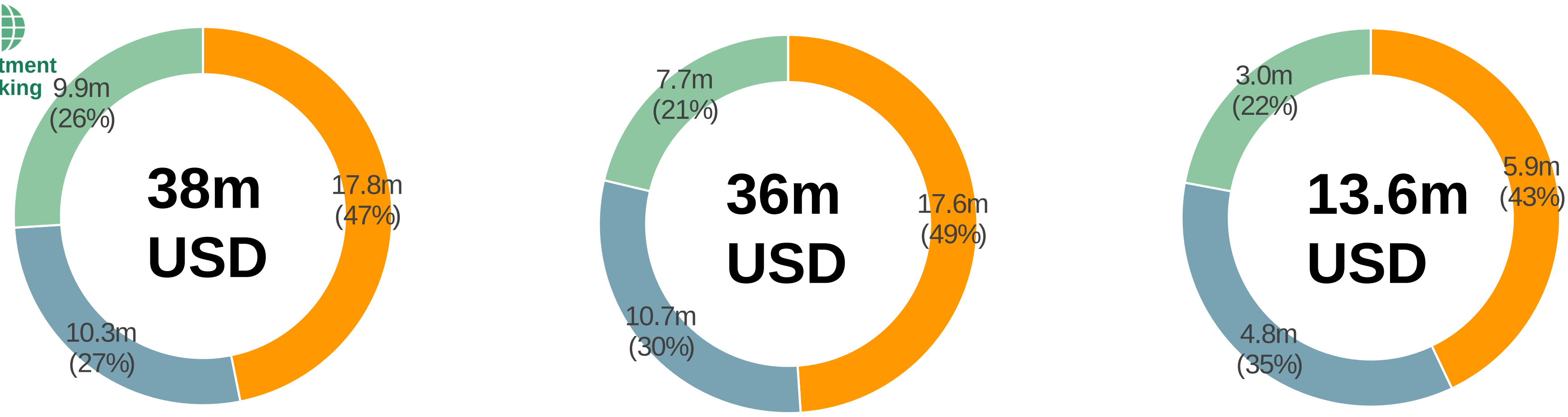
It appears the sell side allocation to improve best execution for Fixed Income is mirrored across all three tiers and is represented by the proportionally large allocation towards investor protection.

Tier 1 **Tier 2** **Tier 3**

Asset Management



Investment Banking



Investor Protection · Trade Reporting & Transparency · Market Structure

Report highlights

Cost Type & MiFID II Definitions

Cost Type			Definition
Application Development and Maintenance (ADM)	Development (CTB)	Discretionary CTB	Strategic change projects such as developing a new in-house platform to deliver new functionality to the business or implementing new 3rd party software
		Non-discretionary CTB	Projects driven by regulatory changes, MiFID, Basel, SOX, Dodd-Frank and market initiative, CCP, SEFs, clearing
	Maintenance (RTB)	Level 1/Level 2 Support	Costs of direct desktop maintenance and troubleshooting
		Bug Fixes & Upgrades	Costs of Technical (Level 3) support services, compulsory software upgrades and enhancements not driven by change initiatives
		3rd Party Software Licenses & Maintenance	Annual rental, maintenance and license costs of application vendors (e.g. Murex, Fidessa, Calypso, etc.)
IT Overhead	IT-driven CTB		Non-business aligned projects for internal IT consumption
	IT Management		Costs of the CIO / COO office allocated to the IT budget including central and regional IT management
	Architecture & Strategy		Costs of Central Architecture group allocated to the IT budget
	IT Risk and Security		Costs of IT Risk Management and Security allocated to the IT budget
Infrastructure	Application Hosting		Infrastructure service costs billed directly to applications. In particular this includes the servers, associated storage and DBMS systems on which applications sit, well as any embedded connectivity costs
	End User Technology		Infrastructure service costs billed as a unit rate to end users which cover desktops, telecoms and associated connectivity where not embedded in application hosting items (EUT costs for IT users are embedded in the relevant cost areas)

MiFID II	Rule	MiFID II Aim
Investor Protection	Inducements & Commissions	MiFID II establishes strict rules around conflicts of interest, commissions and inducements, with the goal of increasing transparency around the use of client dollars to pay for research.
	Suitability	To include periodic communications to the client on the service provided, taking in to account the type and complexity of financial instruments and nature of the service provided.
	Best Execution	Establishes additional rules around best execution for equity and non-equity asset classes, including stricter disclosure measures and processes
Trade Reporting and Transparency	Transaction Reporting	Enhances the requirement to report transactions to the regulators
	Post-trade transparency	Details of all transactions in financial instruments (both equity and non-equity) that are listed on trading venues need to be made public as close to real time as possible
	Post-trade reporting	Supporting reference data will need to be retrieved from repositories quickly and accurately, and will require near real time reporting
Market Structure	Product Governance	Explicit arrangments are to be in place for product governance to ensure that firms understand the products and those that are suitable for the ultimate client
	Electronic Trading	All organised trading will take place either on regulated trading venues or by systematic internalisation

Perimiter Definitions		Definition
Corporate & Investment Banking	Capital Markets	Fixed Income, Equities, FX, Credit etc…
	Corporate Finance	Equity/Debt Capital Markets, M&A etc…
	Lending	Vanilla and Structured/specialised lending
	Transaction Banking	Payments and Cash Management, Trade Finance, Trade Services, Securities Services
Asset Management		The company will invest on behalf of its clients and give them access to a wide range of traditional and alternative product offerings that would not be to the average investor. Asset Managers service governments, corporations and financial intermediaries. This includes such products as equity, fixed income, real estate, agriculture and international investments.

More Information on Expand Research

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