



MiFID – Why Testing Lies at the Core of its Success?

Last Updated: 7th May, 2007



As the deadline for MiFID looms large, with companies directed by the FSA to comply by 1st November 2007, many organizations operating in the financial markets are compelled to start thinking about the systems they will need in place for them to adhere to this new legislation.

Technology underpins the MiFID (Marketing in Financial Instruments Directive) concept and will ensure that companies fall well within the compliance limits. However, in implementations of this nature, many often fall short due to inefficiencies in quality assurance and testing. But if holes appear in MiFID strategies due to inadequate testing procedures, serious problems will occur for financial organizations – failure to adhere to this legislation could result in legal consequences for the business. Fall out could extend to financial penalties, damage to the company's reputation and the start of a problematic relationship with the FSA.

So what exactly is MiFID? In a nutshell, MiFID is a more highly developed version of ISD (Investment Services Directive), as it introduces more extensive requirements relating to the conduct of business and the internal organization of financial companies. It is part of the European Union's Financial Services Action Plan, which has been designed to create a single European market in financial services.

So how does MiFID benefit UK organizations and how will it affect them? One of the key aims behind MiFID and indeed ISD before it, was to give a "passport" to investment firms to enable them to provide pan-European services and establish operations in other member states. This will allow them to provide services across the EU and establish branches in other European member states. The "scope" of MiFID is wider than ISD as it broadens the range of core investment services that can be passported. For example, MiFID extends the scope of the passport to cover commodity derivatives, credit derivatives and financial contracts for differences for the first time. Therefore, from a new business perspective for financial service investment firms, MiFID could prove very beneficial indeed.

MiFID also aims to harmonize certain conditions governing the organization and conduct of business at investment firms and how regulated markets operate. In addition, most firms that have to adhere to MiFID will also have to comply with the new Capital Markets Directive which will set requirements for the regulatory capital which a firm must hold. MiFID also does away with the idea that all

share trading has to be conducted through exchanges. A lot of financial organizations deal "off book" meaning that they can shift shares they are already holding between the customers that want to buy and sell, which is easier than going through exchanges – MiFID makes this possible.

There is no doubt that MiFID will have considerable impact on the IT systems in many financial organizations. One of the most difficult parts in the implementation of MiFID will be defining the requirements – it will be difficult for organizations to grapple with the requirements of a concept they are unfamiliar with. It is therefore extremely important that financial organizations do not underestimate the time and resource it will take to build and rigorously test the systems to identify all defects before rolling the systems out.

With its 73 articles, MiFID is a very complex beast compared to its 1993 ISD predecessor. The FSA has already warned companies that they need to start preparing for MiFID so they are ready for the implementation deadline. The responsibility for MiFID lies with senior management, who will need to get to grips with the issues and challenges that their organizations may face in the run up to MiFID. However, with the 1st November 2007 deadline looming, there is very little time remaining to work out what changes to business processes need to be made, what hardware requirements they may have and what software is needed to ensure smooth and trouble free implementation.

So from an organizational perspective and ultimately, from a testing perspective, how can firms get their houses in order to guarantee compliance to MiFID once the deadline comes around? New technology and revamped systems and processes will underpin the majority of initiatives that are geared towards MiFID compliance.

Good planning is essential in order to ensure that the coverage and prioritization of testing meets the needs of the business and reduces the inherent risks involved in making high-impact changes on IT systems. With this in mind, financial organizations need to take the following into account:

[Understanding the Scope of MiFID Testing Requirements](#)

A key stage of any project has to be in understanding the scope of the testing requirements for implementing MiFID changes and the impact on existing IT systems. This will enable planning of the required workload to ensure sufficient coverage of systems and applications.

Working with Partner Organizations

A considerable amount of time will be spent working with other organizations, carrying out interface and integration testing for matters such as publishing 'firm prices', getting data for the best execution and transaction reporting etc. Firms should identify which organizations they are likely to get involved with as soon as possible and agree on joint working practices and relevant standards.

Test Management - Audit Trails

As with good testing practice, managing the test process and testing against requirements will be essential in order to provide clear evidence of tests completed. The audit trail will be necessary in order for organizations to ensure system changes that they have made comply to MiFID's IT related requirements.

The operational changes that will have to be made within businesses are likely to arise from the organizational conduct of business, transparency and transaction reporting requirements of MiFID.

The requirements as outlined by the FSA are geared around: compliance arrangements, including measures governing personal transactions; internal systems and controls in relation to business continuity; staff, risk management; internal systems; and IT systems and processing, amongst other things.

Firms will need to consider a number of factors, including the efficiency and effectiveness of their arrangements for compliance and risk management, as well as the integrity of their systems and their arrangements for identifying conflicts of interest. According to the FSA, it is likely that there will be an increase of firms' functional independence of compliance and risk management controls – this will lead to reviews of companies' internal organization; their reporting structures and the allocation of responsibility to management. This would all be catered for if thorough requirements analysis was conducted and all processes were properly documented and mapped.

So with MiFID set to fundamentally change the way firms operate in the finance space, a number of trends will emerge. Industry watchers predict that MiFID might kick start consolidation in the marketplace of smaller providers, with firms believing that banding together will ease the load when it comes to meeting the stringent requirements of MiFID. Testing and integration is perhaps the most important part of the development cycle as it aims to assess each system's suitability, stability, usability and its ability to interact with other systems. A formal organized approach is needed to ensure no holes appear in a company's MiFID strategy – failure to adhere to this legislation could result in serious legal consequences for the business.

Adam Ripley is Senior Vice President, Marketing at AppLabs, the largest independent global provider of quality management, testing and certification services. For more information go to AppLabs.com