Seeking harmony

Joe Turso, Vice President of Product Management for the SmartStream Reference Data Utility spoke to Best Execution about the data challenges posed by MiFID II.

What do you perceive as the greatest challenge associated with MIFID II?
As a reference data utility (RDU) we are very focused on the harmonisation of data. We have seen several significant differences in the classifications of data that cause challenges in meeting pre- and post-trade reporting.

Can you give us some examples?
The European Securities and Market Authority (ESMA) has adopted three-tier taxonomy to drive transparency-reporting requirements: asset class, asset sub-class and sub-class. Although the first two levels are similar to many existing industry taxonomies, the third level is more granular, specific and challenging. It was originally anticipated that existing classifications schemes such as the Classification of Financial Instrument (CFI) Code could be used to derive the ESMA classifications, but it has become apparent that such mapping exercises lead to major gaps.

For example, securities where we find differences between ESMA and CFI include:

- Interest Rate Derivatives – IR Futures, IR Options, Swaptions;
- Equity Derivatives – Swaps, Portfolio Swaps;
- Commodity Derivatives – Energy Future, Options, Swaps;
- Credit Derivatives – Single Name CDS, CDS Index Options;
- Financial Contracts for Differences (CFDs) – Commodity CFDs.

RDU has adopted a methodology to derive the ESMA classifications based on both sourced and manually entered data. Data provided in the ESMA RTS 23 Financial Instruments Reference Data System (FIRDS) feed will be the primary source as this includes many of the necessary fields including the CFI Code. However, there are data points not covered in this feed, which we will source directly from the trading venues.

The ability to reconcile data across CFI codes, ESMA and trading venues is an example of harmonisation of data.

A key element of MiFID II is the concept of Trading On a Trading Venue (TOTV). Is there clarity on how TOTV should be supported?
ESMA has recently provided new guidance on this concept of TOTV, which requires using RTS 23 fields to reconcile an OTC security to a security trading on a listed venue. Implementation of this approach though has some significant challenges, such as the recommended fields are CFI codes and free form text fields. The RDU, as well as other industry participants, has commented to ESMA that using these fields for reconcilement can dramatically reduce the number of securities that match and this can lead to under-reporting. We expect ESMA to provide further guidance and refine their TOTV methodology.

We are six months away from this regulation being implemented and it appears there are still open requirements. How are you and your clients managing change?
We had been very committed to providing clients with a working service and a test environment

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Joe Turso, SmartStream

by June. Our clients understand that ESMA requirements are still evolving and there is still no test data. In the meantime, we have been working with our clients to develop a set of "test" data that can be used to exercise the functionality of our service. We have also built our services based on assumptions, which we constantly refine as we receive more clarity from regulators. A good example is TOTV, where we have defined a logic set to calculate "Best Fit" ISINs (International Securities Identification Number)

I think clients are fine with this incremental approach because it builds confidence in our solution and helps progress their internal build.

What role do you see the utility model playing in MIFID II?

As I mentioned before I believe that there is a need for a utility function to harmonise and integrate data across sources. It also supports pre and post trading reporting, which requires a combination of sources including ESMA, the Association of National Numbering Agencies (ANNA), Global Legal Entity Identifier Foundation (GLEIF) and trading venues. The same challenges related to classifications between ESMA and CFI code also exist between ESMA and ANNA regarding OTC transactions.

ANNA has created the Derivative Service Bureau (DSB), which has been designed to provide ISINs for OTC securities. The fundamental problem is that ESMA classifications don't align with ANNA, which is based on the International Swaps and Derivatives Association (ISDA). This makes it difficult to enrich an OTC product with ESMA liquidity and threshold values. A utility can play a role in the alignment of CFI code, ESMA and ANNA as these regulatory agencies try to align their data standards. We have invested significantly to build rules to manage these discrepancies and to provide clients with a working service they can test.

You mentioned before the need to harmonise data across with trading venues as well. Can you please explain that requirement?

The requirement relates to derivatives. Essentially, ESMA will be providing its FIRDs data on a T+1 basis. In calculating TOTV it is important to have a complete universe of products to be able to reconcile against OTC products to determine pre and post trade reporting on a T+0 basis. As a result, we are sourcing data directly from trading venues to ensure that clients have a complete universe of listed derivative securities to match against their OTC securities.

Aside from the issues of timeliness, we are concerned about the data quality associated with derivatives, including those listed on exchanges. Historically, the industry has struggled with complete and accurate data for derivatives given the complexity and lack of standards for this asset class. Therefore, we have gone directly to trading venues to ensure our clients have a comprehensive set of cleansed derivatives to support their MIFID II reporting requirements.

What do believe the current state of readiness is within the industry?

We anticipate that open requirement issues will be addressed by the regulators over the next few months. However, our concern is the lack of test data and plans for a co-ordinated industry test. We think the industry could benefit from co-ordinating testing across systematic internalisers (SIs), approved publication arrangements (APAs), approved reporting mechanisms (ARMs,) ESMA and market data suppliers. This approach would help build confidence in the process. Irrespective of testing, the wild card is still whether the industry as a whole can manage the volume and performance required to maintain liquidity in MIFID-regulated markets once the new reporting rules go into effect. ■