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Mifid II: industry calls on Esma to improve FIRDS data quality

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Author: Lizzie Meager

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Market participants are calling on EU regulators to improve the quality of Mifid II reference data in its central database.

The Financial Instruments Reference Data System (FIRDS) is absolutely integral to Mifid II's transparency drive as it determines whether or not an instrument qualifies as 'traded on a trading venue' (TOTV) and thus, if it needs to be reported or not.

With such a confusing and far-reaching new framework, teething problems are to be expected. But market participants argue that incomplete or inaccurate data is undermining regulators' attempt at transparency.

"FIRDS was only ever going to be as good as its inputs – crap in, crap out is an old adage for a reason," said one transaction reporting head based in London. "A Europe-wide instrument database that relies on all contributors being correct in their understanding of the regulation was always going to be a challenge."

The very nature of EU rulemaking and the way it filters down to member states creates fertile ground for inconsistencies and confusion, which he thinks is a major obstacle to FIRDS actually being useful.

Every day, trading venues and platforms collect and submit so-called reference data to their national regulators, who pass the data on to the European Securities and Markets Authority (Esma). Esma then inputs the data in FIRDS and makes it available from 9am central European time the next morning, when firms begin trawling the data to establish their reporting and pre-trade transparency obligations for instruments to be traded that day.

"Mifid II was delayed by a year almost exclusively to allow Esma time to build its database and get it all working, yet they've made a dog's dinner of it," said one Mifid specialist. "The data is spotty and patchy at best, and incredibly untrustworthy."

What Esma can actually do about this is less clear, since the problems are arising as a result of inconsistent implementation and interpretations between national regulators and lawmakers, firms and trading venues.

KEY TAKEAWAYS

- **Market participants are calling on Esma to improve the quality of reference data in its centralised database FIRDS;**
- **Teething problems are to be expected but they argue that incorrect or incomplete data undermines Mifid's broader transparency drive;**
- **Many reports are getting rejected either because FIRDS is not released on time, the right instruments are not being reported, or for entirely unknown reasons;**
- **Regulators' opinion that a swap is a single instrument conflicts directly with the industry-wide view that each leg of the swap counts as a different transaction, which is causing both duplications and missing data;**

- **Many also criticised Esma's liquidity threshold tests for bonds, which they argue is wrong;**
- **Some are concerned inaccurate threshold tests resulting in excessive transparency obligations for illiquid instruments could have a real economic impact by allowing algorithms to undercut trades.**

A golden source?

Market participants suggest further clarification on certain reporting points would be helpful, as would a centralised error correction process. At the moment, if firms spot a mistake in FIRDS, they notify their national competent authority (NCA) who then goes to the venue to clarify, according to one transaction reporting head at a UK bank. "It's just impractical, so if there was some sort of internal flagging system that triggered a check from Esma itself rather than the NCA that would help," she said.

There are a lot of mistakes, too. "We have a growing list of instruments which we can see are in FIRDS and haven't expired, but are being rejected by the FCA ," said Mark Kelly, director of professional services at Nex. "We haven't had a clear response as to why this is yet, but we have been asked to notify the market data processor helpdesk when these situations arise." This is happening most frequently with the newly-reportable commodity derivatives and FX forwards, he added.

"Then there are some instruments that fail even our pre-FCA validation. The most common cause of that is FIRDS not being delivered on time – sometimes it's not until the early afternoon," said Kelly.

But while there are undoubtedly issues – the well-documented (https://www.iflrinsight.com/Articles/80) lack of legal entity identifier codes being particularly pertinent – it's not all bad. For CFI codes for instance, around 28% of the 68 operators that submit OTC derivative data to FIRDS are getting CFI codes wrong, according to Sassan Danesh of the management team at ANNA DSB, which generates Isins for the industry and cross-checks the data with its own golden source.

"That boils down to just under 10% of total submissions, which is not ideal but looking at how big Mifid II is, the industry has done a very good job at getting to grips with this," he said. "Compared to Dodd-Frank which was all over the place, I'd say we're in a good place – just not a brilliant one."

CFI codes are important to get right because Esma uses them to provide additional rules on product structure.

Swaps: confusing by design

The very nature of swaps is contributing to the confusion. "If you're buying a USD-GBP FX call option, to you that's what it is. But to the person on the other end, it can just as easily be a GBP-USD FX put option," said ANNA DSB's Danesh.

The DSB has now set its systems to recognise when this happens and provide the same Isin. "There's just so much work everyone's had to do, and at the DSB all we do is focus on this, so I understand why not everyone in the industry is getting these nuances straightaway," added Danesh.

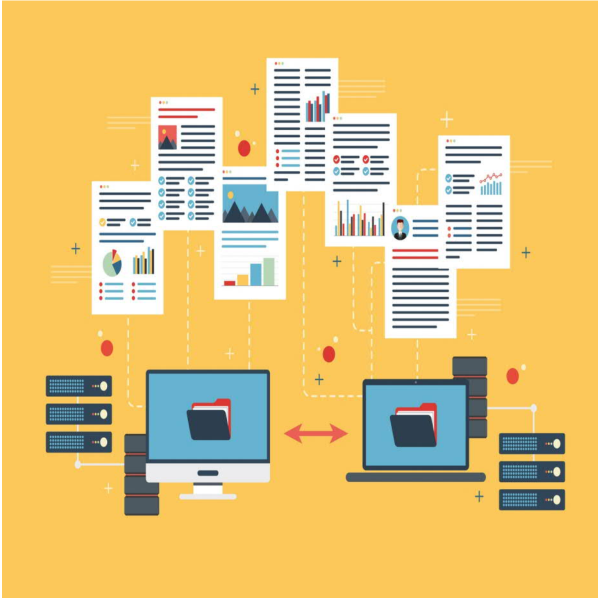
Swap curves are also causing headaches. Esma was clear in the level 2 text of Mifid II that it wanted the maturity date to be part of an instrument's definition. As highlighted by IFLR last summer (http://www.iflr.com/Article/3730441/Capital-markets/Mifid-IIs-traded-on-a-trading-venue-confusion-continues.html), that means that a 10-year interest rate swap would need a new Isin every day that it's traded, because the following day it's technically a 10-year-plus-one-day interest rate swap. This means the volume of Isins is far bigger than the market – which tends to view it as the same instrument regardless – would have expected.

Swaps: one report or two?

The transaction reporting head said that differing approaches to swaps between Esma and the market have caused a huge amount of confusion. While Esma views a swap as one transaction – warranting one Isin and one transaction report – the market, including all the firms that spoke to Practice Insight, views this as two forwards and is reporting them separately.

"Because banks are viewing one swap as two forwards it means they're not even looking for that swap-level Isin in FIRDS," she said. "That's causing problems with TOTV assessments as things are being missed out. How long are we supposed to spend checking these things?"

Both the FCA and Esma insist that if a report gets rejected or another error occurs then firms should report it immediately, but the reporting specialist said banks can't be expected to re-evaluate historical data for something that may have been missed forever. For now her firm is storing all rejections until further notice.



With so many different people submitting so much data, inconsistencies are to be expected

"This is just creating a potentially huge backlog of reports that firms will have to do in the future. The effort and analysis that needs to go into that is massive," she added. While her firm has an automated system that scans FIRDS, others are opting to do this both electronically and manually.

So far the DSB has created Isins for both the entire swap and its underlying legs, and is leaving it to the industry to decide which they use.

Bonds: liquidity threshold testing

One of the biggest gripes with FIRDS comes down to the liquidity threshold tests Esma used to calculate instruments' TOTV status throughout 2017. The idea is that only the most liquid bonds and derivatives qualify for the full suite of transparency and reporting obligations – but many in the market feel that an error was made here.

Sources explained that a number of secondary market bonds that were not traded at all in the assessment period last year (which caught around 65,000 fixed income instruments), so are decidedly illiquid, have ended up in FIRDS. That's because once a deal is traded, the current system flags them as new deals and, if they're over a certain size, automatically considers them liquid, which all transparency requirements apply.

Not only does this result in misleading and fundamentally inaccurate data, several firms voiced concerns about it making it easy for algorithmic traders to reverse engineer the data and take a position against them.

"Shifting illiquid securities to an overly transparent trading environment could easily see them get picked off by other players with smart algos, which could have big economic effects," said the source. "Over time we could see them trading those instruments less and less frequently, which would obviously reduce overall liquidity."

An Esma spokesperson declined to comment for this article.

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Get in touch with the author of this story (mailto:elizabeth.meager@legalmediagroup.com).

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