No time to rest

MiFID II: We've seen an orderly transition so far, but there's still plenty of work to be done by firms, says Peter Moss, CEO, SmartStream Reference Data Utility.

January 3rd came and went. No major disasters, no systemic failures. Trade volumes were light in the first week, so perhaps we shouldn't be surprised that the introduction of MiFID II/MiFIR proved more of a whimper than a bang. But that would be to ignore the huge amount of effort financial services organisations put into making sure that the advent of MiFID II passed off smoothly. Project teams across financial institutions laboured for many months, and even over the festive break, to make systems and processes ready for the MiFID II start date.

Although it is still early days, and so any assessment must be cautious, the financial industry appears to have made it through the introduction of MiFID II in reasonably good shape. The lead up to MiFID II was, however, anything but a walk in the park for the sector.

The industry faced delays in receiving information from regulators and so, at times, had to grapple with a lack of clarity as to how it should be preparing itself for MiFID II. ESMA's Financial Instrument Reference Database arrived in October, rather than the anticipated July to August. Clarification for RTS 1 and 2 only came in early December. Market participants had to cope with last minute changes; announcements from ESMA were still being made on the Friday before Christmas. And gaps still remain – the enforcement of the requirement for LEIs for every client has been postponed for six monthsand ESMA is only just starting to publish certain information, for example, the list of instruments subject to the double volume cap.

So where should organisations now be turning their attention? Prudent firms will avoid the temptation to rest on their laurels and instead consider which parts of their infrastructure are functioning efficiently and which are in need of remediation. MiFID II is highly demanding, requiring large amounts of data. Is data missing, inaccurate or has it been incorrectly interpreted? Is extra automation necessary? Are there new processes to be tested? Financial authorities will be fine-tuning regulation during coming months – market participants will need to be vigilant, keeping an eye out for regulatory announcements and responding, where necessary, with adjustments to their infrastructure.

In the scramble to meet the January 3rd deadline, firms may have taken shortcuts, adopting tactical fixes or sourcing data inefficiently. Organisations should now be reviewing the

frameworks they have put in place – are they resilient, cost-effective and sustainable? Do they provide sufficient control? Can they be relied on in other jurisdictions? MiFiD II looks set to have a profound, long-term effect – optimising existing systems and processes is vital if these are to stand firms in good stead not just now but for the foreseeable future.

Transaction reporting

One further but essential requirement – and an area to which relatively little time has been devoted by firms – is a control framework to ensure precise, transparent transaction reporting. Under MiFID I transaction reporting was primarily an issue for the sellside. Under MiFID II, however, all investment firms, including those on the buyside, are responsible for ensuring transaction reporting is correct – Regulatory Technical Standard 22, Article 15 makes plain the need for "investment firms" to have in place arrangements "to ensure that transaction reports are complete and accurate."

The buyside can no longer simply rely on a broker or trading venue to undertake transaction reporting but must have adequate oversight of this activity. The current bedding in phase of MiFID II provides an excellent opportunity for firms to take a good look at their control framework and ask some important questions. Can we independently verify that our reporting is correct? Do we need an independent data source? Are our reconciliations processes accurate enough to ensure that what we actually did is what we reported?

A further challenge on the horizon is the systematic internaliser (SI) regime, which will come fully into force in September 2018. From January 3rd 2018, firms have had the choice to opt in as SIs but as of September 2018, regulators will determine whether a company falls within this category, based on trade volumes. As rules are gradually clarified, sellside firms will need to keep a close eye on regulatory announcements to check if, when, and how they will be affected.

The incoming SI regime will have an impact not only on the sellside but on the buyside too. Under MiFID II, for post-trade reporting purposes, market participants must identify if counterparties are systematic internalisers for the financial instruments they are trading in – so the buyside will need to know whether it is dealing with an SI or not. Clarifying this matter is not a straightforward business, as regulatory protocols have failed to set out a mechanism which allows the easy identification of systematic internalisers for particular instruments.

One answer to this dilemma is a centralised database which lists systematic internalisers for each specific instrument. As financial authorities have not provided such a solution, the task of devising a suitable mechanism has instead fallen to the industry. The need to solve this problem has become particularly pressing, given the looming September 2018 deadline for the transition of the SI regime from a voluntary to compulsory basis.

An industry collaboration – between a number of Approved Publication Arrangements (APAs) and the SmartStream Reference Data Utility (RDU) – has been set up to plug this gap in the regulatory framework. The APAs collect the list of instruments for which their SI customers are providing SI services, and the RDU consolidates that data into a master file that can be shared with the APAs, the contributing SIs and other market participants. This centralised registry enables market participants to readily identify systematic internalisers for a particular financial instrument. The data the registry provides will bring greater clarity to the market but, more specifically, it should also enable the buyside to benefit from reduced compliance costs as firms will be able to select brokers that offer the required systematic internaliser services.

In conclusion, the MiFID II regime is bedding down. Financial authorities are giving the market some time to settle, as well as finessing certain aspects of the new regulation. This transitional phase will not last for long and, all too soon, regulators will begin to look in earnest at how closely firms are complying with the provisions of MiFID II. The next few months offer a breathing space and present an ideal opportunity for firms to review the infrastructure they have in place and to ensure that it is truly fit for purpose. ■