ITC INFOTECH

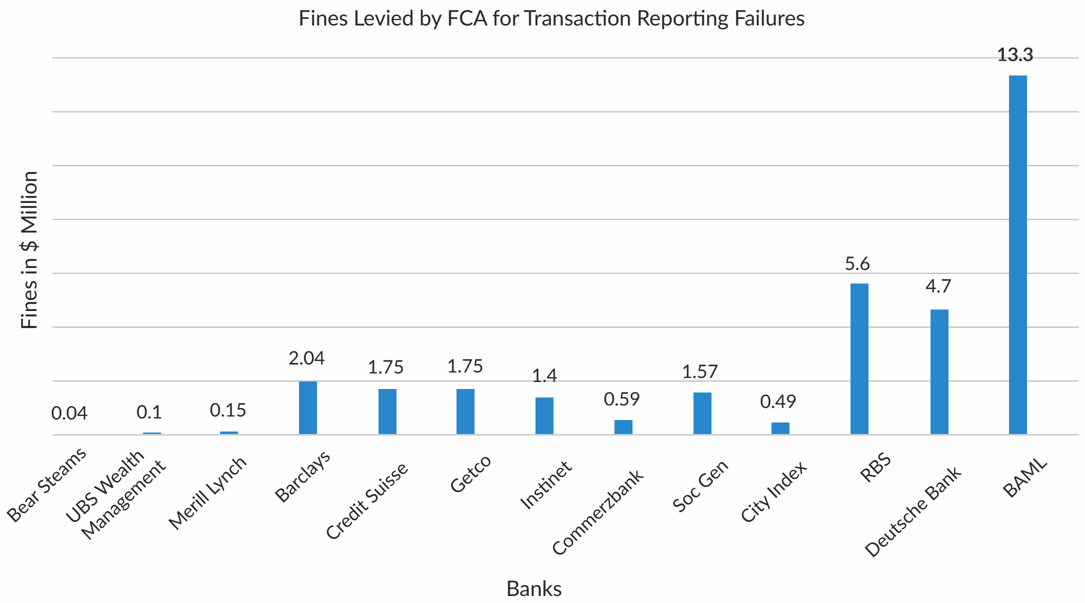
Business-friendly Solutions

MiFID II: TRANSACTION REPORTING

SUMMARY

Buy-side and sell-side firms have been working at a frenzied pace to ensure compliance with MiFID II by 3rd January 2017.Given this, the news of the deadline being pushed back by a year to January 2018 must have been sweet music to all involved. However, firms would do well not to take their feet off the pedal in implementing all that is required of them to fall in line with this all-encompassing regulation that has given banks, market makers and investment funds, the jitters.

Failure to report transactions or reporting them accurately could land investment firms in unwanted problems with the regulators. A quick look at the FCA figure reveals the below infographic.



Firms were fined heavily (totalling over £33 million to date) for non-compliance with MiFID I, not to mention the corresponding loss of standing that it bought along.

Transaction Reporting is important as non-compliance can lead to:

- Reputational Loss
- Financial Penalties
- Punitive actions including banning of trading activity, suspension of licences
- Loss of Investor confidence

But the complexity in reporting transactions to the regulatory authority in every member state is an onerous task and it is for the same reason that the implementation timeline was extended by another year. In the words of the EC, "Reason for the extension lies in the complex technical infrastructure that needs to be set up for the MiFID II package to work effectively. The European Securities and Markets Authority (ESMA) has to collect data from about 300 trading venues on about 15 million financial instruments. To achieve this result, ESMA must work closely with national competent authorities and the trading venues themselves."

The second iteration of MiFID has, in fact, widened the net of coverage, both in terms of instruments, as well as the data required to be reported.

TRANSACTION REPORTING DIFFERENCES BETWEEN MIFID I & II:

MiFID I	MiFID II
Fields to be Reported Reporting of 26 fields	Reporting of 65 fields. Additional fields consist of: • Client Information • Trader Identification Code (both for investment decision, execution) • Trading Venue details
Products Covered • Bonds • Cash Equities • Equity Derivatives (OTC & ETD) • Indexes	• Bonds • Cash Equities • Equity • FX, Indexes • IR & Commodity Derivatives (OTC & ETD)
Counterparty Details Counterparty ID (Business Identifier Code or internal code), No identification of primary client required	Counterparty ID (Legal Entity Identifier) Required to identify clients involved in a transaction and it must adhere to a prescribed format
Instrument Details Basic instrument data using standard codes for identification of underlying instrument	• Basic instrument data • Product Details • Delivery Type • Position Details
Execution Details • None in addition to basic • trade economics	• Details of investment decision maker and trader • Short sales flag • Waiver flag • OTC post-trade identifier flag • Commodity derivative flag

Things to look out for

- ESMA has introduced new rules for debt instruments issued by a non-EEA entity and derivatives where the ultimate underlying has no global identifier (for example commodities), is a basket or is a non-EEA index
- More challenging for OTC trades with fields like name of buyer/seller and the decision maker to be reported, it will be a big challenge for all asset managers
- Traders and decision makers are in the cross hairs as they have to assume responsibility for all positions entered into

MiFID II, like its predecessor, applies across the EU and EEA member states and, with limited exceptions, applies to firms providing "investment services or activities", as defined by the regulation. In addition to considering what sort of investment services or activities a firm undertakes, the regulation also considers the type and quantity of "Financial Instruments" a firm trades. MiFID II is intended to capture more commodity instruments,compared to the existing regulation, including physically settling contracts in some cases.

The provisions in MiFID II relating to commodity derivatives aim to "improve oversight and transparency of commodity derivative markets in order to ensure their function for hedging and price discovery, as well as in light of developments in market structures and technology, in order to ensure fair competition and efficient markets". The changes also reflect the G-20 agreement to improve the regulation, functioning and transparency of financial and commodity markets to address excessive commodity price volatility.

PREPARING FOR MIFID II COMPLIANCE

As market participants work towards compliance with MiFID, we believe that they will have to confront a number of challenges. The first would be to make sure the right foundations have been put in place. The newer version picks up from where MiFID I left off, so it's of utmost importance that the existing transaction reporting capability is robust enough to handle the huge uptick in volume that would occur once MiFID II kicks in.

Irrespective of their nature, both buy-side and sell-side firms need to build capabilities into their existing systems that would enable them to adapt to the ever changing regulations.

Firms mustequip themselves with appropriate tools to handle the challenges posed in data cleaning and aggregation posed by MiFID's extremely vast scope. Mandatory data fields include natural person information, trader details and algorithm identification code. Sourcing, storing and maintaining reference data wouldinvolve significant effort and could prove to be cumbersome. Besides, data privacy issues will have to be addressed, including the threat of legal action from countries which have strict privacy laws protecting identity of the investors.

EXPECTED CHALLENGES TO BE FACED BY FIRMS:

- Errors and omissions due to manual entry
- Difficulty in understanding the implications of CRD IV
- Difficulty in setting up a team with developed methodologies
- Increased number of transaction reporting layers, apart from the existing regulatory requirements under EMIR, REMIT, MAD
- Unnecessary time consumption on account of reporting requirements preparation
- High possibility of reconciliation errors
- Need for the right systems, controls and documentation to be in place
- Higher risk of receiving fines for non-compliance

ITC INFOTECH SOLUTION APPROACH

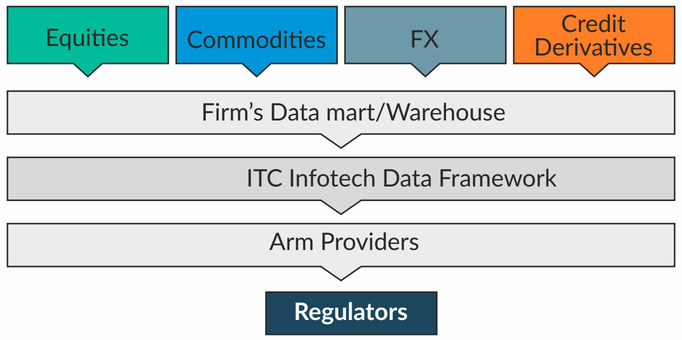
The above-mentioned challenges must be fully comprehended and addressed by all market participants. They should work towards aligning their systems with existing reporting regulations such as EMIR, MAD, REMIT and others. An attempt should be made to make full use of existing reporting systems and simplify reporting frameworks, so as to find synergies across reporting requirements.

ITC Infotech DATA FRAMEWORK

We have come up with a structure that makes it extremely easy for companies to report their requirements under not just MiFID II, but other regulatory regimes as well. The framework draws heavily from the expertise of ITC Infotech's in-house team of experts in a host of domains, ranging from capital markets, banking, digital technology and data warehousing to business intelligence, governance and risk compliance.

The data framework can be integrated into the existing data platforms of the banks and investment firms, as shown below. This arrangement works well when a proper data policy is in place and a certain degree of formalization is present. However, that might not be the case always. For such instances, ITC Infotech has an elaborate utility that pools data from across different system and aggregates the data into the requisite format, as specified by the regulators in the mandated templates by making use of the respective rule and context engines. Once the data has been gathered in the databases, a dashboard detailing the summary of the transactions undertaken is generated for supervisory review. The report hence generated can be shared with the ARM's which are entrusted with reporting on behalf of the firms to the respective regulator.

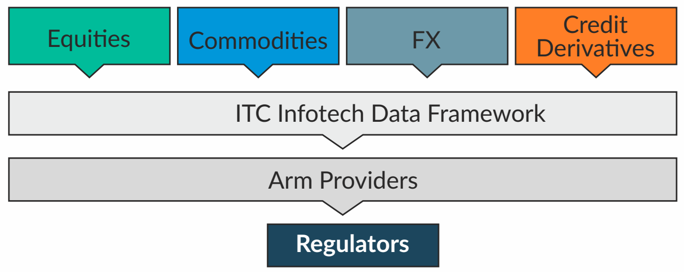
Plug-in Integration with DW



The framework integrates on to the existing data warehouse structure of the firm to collate requisite data for generating reports

VS

Stand-alone Data Platform



In the absence of any datamart, the framework is capable of generating meta data and further process it to derive reports

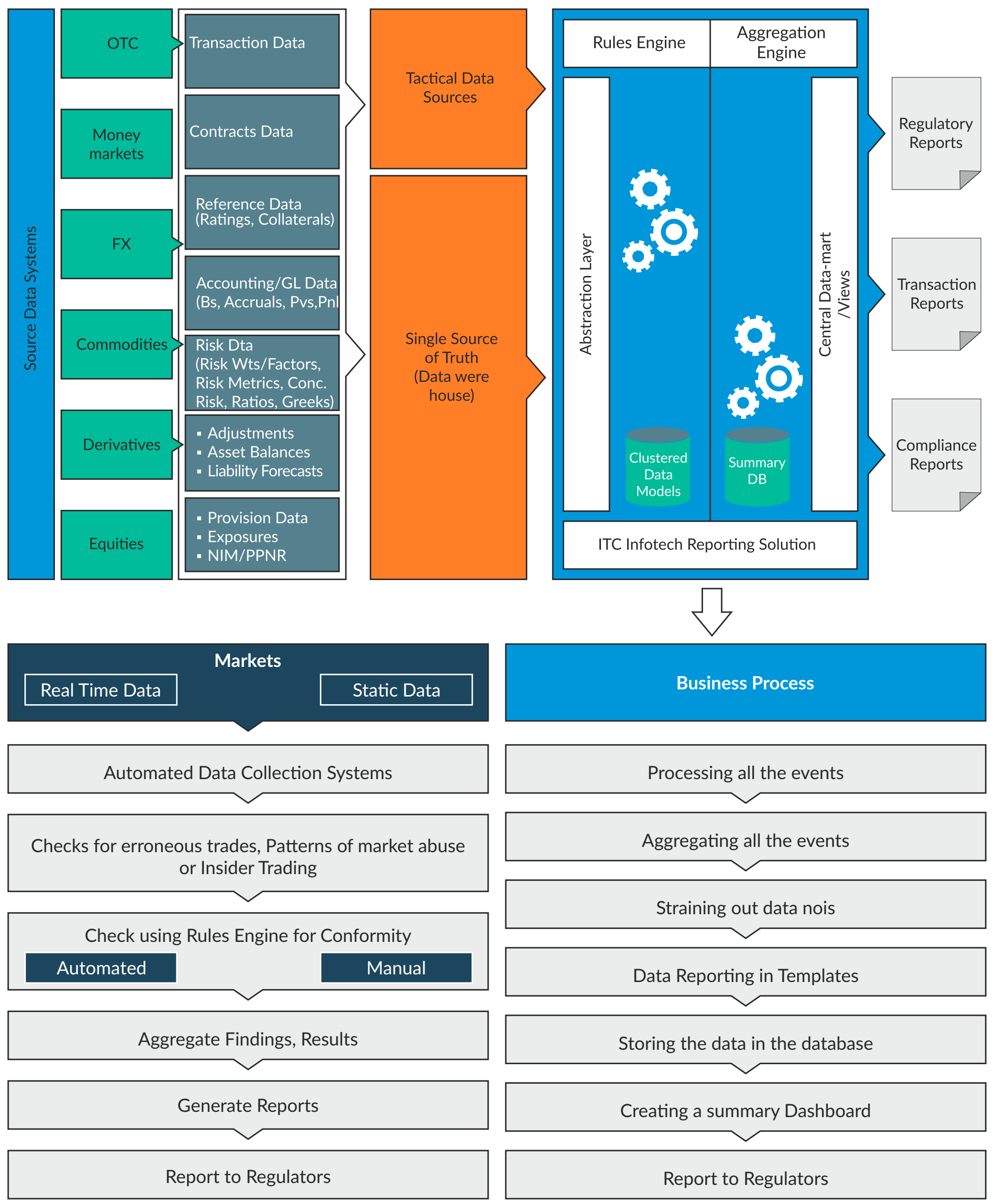
PLUG-IN INTEGRATION VERSUS STAND-ALONE PLATFORM

It is recommended that firms follow the plug-in alternative as it would make use of already existing data. This is especially true if one has earlier implemented measures to adhere to MiFID I. This alternative would involve incremental changes to be carried out, as some form of configuration would already have been put in place for the earlier version of MiFID. However, in cases where firms are working towards implementing a transaction reporting system for the first time, they can make use of a stand-alone data platform for carrying out the compliance tasks.

CLASSIFYING AND ORGANIZING

Transaction reporting across asset classes is a task filled with quite a few challenges. Our experience has shown that despite putting in necessary mechanisms in place for reporting, firms often end up sharing the data which regulators haven't asked for and miss out on the critical ones leading to punitive actions being imposed. The rule engine in ITC Infotech's data framework defines the trade characteristics like trading area, company, book, event type and counterparty group/class, which identifies whether a trade qualifies to be reported. Based on the criteria being fulfilled, the trade is moved to the requisite job file from where the reporting is carried out.

Besides, trades aren't just initiated;they are also modified, rolled over, settled and merged.So it is quite possible that a single trade can give rise to multiple transactions during the course of its lifecycle, which would have to be reported as well. Firms should ensure that all such modifications are also accounted for while performing their reporting activity. Our frame work allows for inclusion of all such modifications.



ITC INFOTECH FRAMEWORK FEATURES

The framework from ITC Infotech lays out a well-defined roadmap that enables firms to adhere to the regulatory environment with minimal re-work and disruption in day to day activities.

Automated Data Collection: Data from multiple trading systems for various asset classes is pooled in, so as to initiate the process of reporting. This data will be subjected to a wide range of procedures before finally being handed over to the regulatory agency as part of the new legislation. Automation with a data refresh capability at the required frequency desired by the firm is built in to smoothen the process.

Checks: Checks are carried out for erroneous trades and patterns of market abuse, insider trading; so as to ensure that there are no unfair methods being put into action

Rule Engine: ITC Infotech's proprietary rule engine ensure that data noise is eliminated and only the relevant details are captured to enable accurate reporting. Data taxonomy is standardized to streamline the data management for compliance reporting. Also, intelligent data extraction capabilities from multiple non-standardized data sources have been provided for.

Aggregation: All the captured data fields in accordance with the regulation are aggregated for the purpose of data reporting. The pertinent fields are stored in the database as well as used in creating a dashboard for the purpose of review.

Report Generation: The database is queried for the generation of reports, which are passed on to the ARM's, who route these reports to the respective regulator. Report generation at the frequency mandated by the regulators can be configured into the system to minimize manual intervention.

Domain-based approach: The extracted data can be leveraged for regulatory reporting for delivering business value. Thus, monitoring and trend analysis can be set up for on-going governance, as appropriate.

Transaction reporting is to be performed by all the firms that would be affected by the regulation. However, commodity trading firms would not be required to report their numbers in cases where the overall market size is determined on the basis of trading activity undertaken in the European Union. The said trading activity has to be in relation to each asset class: metals, oil, coal, emission allowances and derivatives thereof, gas, power, agricultural products and other commodities. As commodity markets differ significantly in terms of size, number of market participants, level of liquidity and other characteristics, different thresholds apply for different asset classes in relation to the test on the size of the trading activity in the European Union.

REFERENCES

These are the following references links

- http://www.fca.org.uk
- https://www.esma.europa.eu/policy-rules
- https://fia.org
- http://ec.europa.eu

AUTHORS

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Glossary of Terms

CRD	Capital Requirements Directives for the financial services industry have introduced a supervisory framework in the European Union which reflects the Basel Iland Basel III rules on capital measurement and capital standards.
EEA	European Economic Area is the area in which the Agreement on the EEA provides for the free movement of persons, goods, services and capital within the internal market of the European Union
EMIR	European Market Infrastructure Regulation is a body of European legislation for the regulation of over-the-counter derivatives.
EU	European Union is a politico-economic union of 28 member states that are located primarily in Europe.
FCA	The Financial Conduct Authority is a financial regulatory body in the United Kingdom
MAD	Market Abuse Directive seeks to implement an EU-wide market abuse regime
MiFID	Markets in Financial Instruments Directive is a European Union law that provides harmonised regulation for investment services across the 31 member states of the
OTC	Over-the-counter trading is done directly between two parties, without any supervision of an exchange.
REMIT	Regulation on Wholesale Energy Market Integrity and Transparency is an EU regulation designed to increase the transparency and stability of the European energy markets while combating insider trading and market manipulation.

About ITC Infotech

ITC Infotech is a specialized global scale - full service provider of Domain, Data and Digital technology solutions, led by a strong business and technology consulting focus. The company caters to enterprises in Supply Chain based industries (CPG, Retail, Manufacturing, Hi-Tech) and Services (Banking, Financial Services and Insurance, Airline, Hospitality) through a combination of traditional and newer business models, as a long term sustainable partner.

ITC Infotech is a fully owned subsidiary of USD 8bn ITC Ltd – one of India's most admired companies.

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