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# MiFID II Transaction Reporting Challenges for the Buy-Side

*Slated for implementation on 3 January, 2018, the revised Markets in Financial Instruments Directive (MiFID II) and the Regulation on Markets in Financial Instruments (MiFIR) will impact every stage of the buy-side investment process, and all asset classes aside from spot FX. MiFID II provides some latitude for EU member states to amend and interpret requirements before codifying them into national law. In contrast, MiFIR allows little room for interpretation or amendment and will be implemented consistently across the EU. Transaction reporting is arguably the most disruptive MiFID II requirement in terms of technology and compliance. Notably, the expanded transaction reporting requirements are contained in MiFIR.*

*This article discusses several key buy-side impacts of the MiFID II transaction reporting requirements. These requirements apply to all EU investment managers and any non-EU firms with a branch located in the EU. Only Alternative Investment Fund (AIFs) and European-based mutual funds (UCITS) are exempt from reporting themselves, though they still are impacted by transaction reporting requirements imposed on any Multilateral Trading Facility (MTF) where they are a participant.*

## Reportable Transactions

MiFID I defined transactions to be the purchase or sale of a reportable financial instrument within a narrow scope. MiFID II includes transactions from a much larger set of instruments and scenarios, in particular around OTC derivatives. Increases to the notional of a contract outside pre-determined contract terms, closing a contract, or the simultaneous acquisition and disposal of an asset, even without any change of beneficial ownership, are all reportable events under MiFID II. A number of exclusions have also been published. These include repurchase agreements, stock lending, derivative novations, and the expiration or redemption of instruments resulting from mandatory events that don't involve an investment decision.

Understanding transaction reporting obligations in a geographic context is also critical, in that MiFID reporting obligations extend beyond EU borders. For example, a derivative traded on a non-EU venue, where the underlying instrument is traded on an EU venue, must be reported.

## Expanded Reporting Requirements

MiFID II expands the definition of a reportable transaction to include significantly more data elements than those codified in the MiFID I requirements. Most notably, transaction reporting will have to incorporate personal identifiers such as a national client identifier or passport number for all individuals associated with the transaction:

- Any individual making a decision to buy or sell a reportable financial instrument or modify existing contracts (e.g., the portfolio manager).
- An individual (e.g., trader) responsible for executing a transaction or unique ID for automated processes, such as an automated routing rule within an OMS.
- The client or an individual acting on their behalf. Where this is an individual, details include date of birth and personal identifiers. Funds and managed accounts will require a Legal Entity Identifier (LEI)

## Data Privacy and Protection

Capturing this level of data granularity and transmitting it securely from the point of trade through to the National Competent Authority (NCA) presents significant operational, legal and compliance challenges for buy-side firms. Storing personal identifiers is especially problematic. These requirements have raised concerns about data privacy statutes in several national jurisdictions in relation to client details.

Further concerns are also raised by requirements placed on MTFs, which must provide transaction reports for "participants" that fall outside the MiFID reporting obligation. This raises the prospect that non-EU firms subject to stringent national data privacy laws must either disclose personal identifiers to the MTF, allow the MTF to default values which may not be correct, or forgo trading. Additionally, MTFs have recordkeeping obligations that may require them to obtain data elements for participants such as the execution and investment decision makers even where these firms have their own reporting obligation. As this data travels across entities in the MiFID II reporting chain, the possibility of data breaches rises, exposing firms to regulatory fines and client lawsuits.

## Additional Complications

Firms trading in both MiFID and non-MiFID jurisdictions need to ensure that only MiFID-eligible trades are reported. Regulators have voiced little tolerance for either under- or over-reporting. This requires far more systematic tracking of the branch and affiliates associated with portfolio managers, traders, and the desks responsible for the receipt of client orders. Within the report itself, the supervising branch country for each stage of the order lifecycle needs to be tracked and reported, and the reporting obligation itself arises from the involvement of an EU branch with the transaction. Similarly, firms where multiple affiliates with different legal entities share a single Order or Execution Management system need to maintain careful track of the individuals involved in the lifecycle to avoid over-reporting details where they do not have to, or under-reporting required transactions.

Block orders further complicate transaction reporting, in that they can be allocated across multiple trading books. Parsing out these important details from the voluminous MiFID/MiFIR publications is a daunting challenge, and many buy-side firms are grappling with how the regulations apply to their asset class mix and geographic footprint.

## Buy-Side Reporting Options

Buy-side firms can either transmit reportable transactions to their brokers, if the client is comfortable passing personal data and the broker is willing to perform transaction reporting (through a transmission of order arrangement), or to an Approved Reporting Mechanism (ARM). ARMs provide clear advantages for firms trading with a non-MiFID broker or with brokers outside of the European Economic Area (EEA). Reporting all transactions to a single ARM streamlines reporting obligations and removes the liability of transmitting personal data to a broker. Tracking investment and execution decision makers also benefits venues subject to stringent audit requirements.

## Communicating Data

Technology vendors, trading venues and ARMs are working closely with their buy-side clients to develop solutions that address the challenges around transmitting data associated with transaction reporting. In a parallel initiative, the FIX Protocol is being expanded to support transmission of MiFID II transaction reports to ARMs as well, and the facilitation of sending and receiving data within the execution workflow that needs to be reported.

To mitigate data protection and privacy concerns, personal identification information is typically mapped to a “short code” when transmitting transaction details either to an MTF or an ARM. Mapping files would be transmitted via secure FTP among buy-side firms, ARMs and venues for translating short codes to the corresponding national identifier when needed. Short codes would also be used for communicating information between a firm’s OMS and its Execution Management Systems.

Although the industry has coalesced around this plan, it is far from perfect. To ensure translatability, mapping files have to be shared with multiple parties, increasing the potential for data breaches. For firms without a direct reporting obligation, it may be expedient to default the investment and execution decision maker when dealing with MTFs that require this; however, this could open up liability concerns if these defaults are not captured accurately or personnel changes make the defaults invalid.

## Meeting the Challenge

Transaction reporting presents one of the biggest MiFID-related data management challenges. Massive data quantities need to be sourced, normalized and reconciled from a variety of internal and external databases. Technology solutions must integrate the required 65 required transaction reporting fields from disparate OMS/EMS, legal entity, H.R. and reference databases, along with the executing counterparty or trading venue, while ensuring data security safeguards are in place at each touchpoint. Additionally, technology vendors certify connectivity to new and existing ARMs, and help buy-side clients design firm-appropriate workflows for submitting initial and amended transaction reports.

The looming MiFID II implementation deadline is forcing institutional investment managers, private banks and hedge funds to rethink their operating models and technology platforms. Partnering with the right vendor can alleviate many of the challenges that lie ahead.

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