Julia: **Welcome to a DerivSource podcast. I'm Julia Schieffer, the Founder and Editor of DerivSource.com.**

In this podcast we discuss MiFID II and trade reporting. MiFID introduces new rules on pre- and post-trade transparency, and a final consultation report was recently published in December 2014, giving the financial market much more information to work with.

In this podcast I speak to David Farmery, Chief Operating Officer at Message Automation, who explains how financial organisations need to adjust trade reporting processes both operationally and strategically to meet new MiFID requirements. He also explains some of the challenges business-wise as well as operational, that firms may encounter as they work towards meeting this new requirement.

To start off, let's first remind our listeners as to what the trade reporting requirements are under MiFID II and who needs to comply with these rules. David, would you like to give us a little bit of background on this first?

David: Thanks, Julia. So, MiFID I, and indeed MiFID II, covers all registered investment firms operating in the European Economic Area, so that's not only EEA domiciled firms but it also includes branches of non-EEA entities who are operating in the EU. So that could be for example the London branch of an American bank.

In terms of what investments are in scope for MiFID II, and indeed were for MiFID I, it's effectively all investment products. However, for MiFID I the detailed reporting provisions applied to equities and equity-related derivatives only. So the big change for MiFID II is that it expands the reporting scope to cover a much wider asset class coverage, which doesn't just include equities and their derivatives, but it now includes things like securities, structured finance products and all flavours of derivatives, so rates, commodities, FX and credit.

I guess when we focus on the reporting requirements there are two flavours that we need to consider. The first one is transparency reporting which relates to orders, pricing and execution information. The second one is all-round post trade transaction reporting which is primarily designed to identify market abuse.

The transparency reporting will primarily impact venues and regulated markets and those investment firms who are systematic internalisers for certain liquid trades, and for those entities this is very much real-time reporting, both pre- and post-trade to what's called Approved Publication Arrangements (APAs).

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Post-trade transaction reporting on the other hand applies to all investment firms that are executing relevant investments. What is a relevant investment? It's basically an investment that could have been traded on a venue, or an investment that has an underlier that could have been traded on a venue, or has an index that includes items that could have been traded on venues. This transaction reporting will hit everyone; the buy side, the sell side, brokers, etc.

Finally on the transaction reporting, whereas under MiFID I there were 25 fields you needed to report, in the draft regulations for MiFID II there are now 81 fields, so quite a bit of expansion on the actual data that you need to report.

***Julia*: Derivatives trade reporting is well underway with both EMIR and Dodd Frank. So David how can firms leverage work completed already to support MiFID II?**

David: Thanks, Julia. That's an interesting question, and one would certainly hope that there are synergies between all the massive work that's been done on EMIR and Dodd Frank and for MiFID II. I guess the short answer is, yes there are ways you can leverage, up to a point.

Before we go into the specifics I think it's important to remember that EMIR and MiFID reporting are really addressing two different regulatory objectives. EMIR is primarily around market stability and MiFID, as we know, is more around investment protection and preventing marketing abuse, so whilst there is some commonality between those regimes, there is also some divergence. I guess my main point is, don't assume that if you've done EMIR and you've done Dodd Frank you are necessarily okay for MiFID.

If we look on the positive side, if a firm's reporting solution has been properly designed they should be in good shape to leverage what has already been done. What does properly designed mean? Well, firstly, do they have a robust solution that harmonises trades from all their multiple internal systems into a common format and that gets stored in a data store? Next point is, can their source systems and booking systems be easily amended to carry more transactional source data, because MiFID II will require more information about the trade and who did the trade, and that needs to be captured somehow. Once you've captured that data, actually can your harmonised data format be expanded to cope with this new information?

There will be a lot more static information that will be required, so I guess if you have a robust functioning static data service that might be separate from your trading systems and that can be expanded and easily accessed by the reporting system, that's good.

Next point is quite important, and it's all around the business decisioning logic covering things like what to report, when to report. If the firm has designed this in a flexible, rules-

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based solution that allows new decisions to be inserted relatively easily then they're in good shape. On the other hand (and we have seen this in some of our conversations with prospects), if firms have effectively hard-coded business decisions in logic then I think they're going to struggle with that approach.

Next important point if you are going to be a systematic internaliser, if your current system handles real-time reporting, for example for Dodd Frank, then you will be in a good place to handle those transparency post-trade reporting items that I mentioned. If your system has been designed to be batched driven, end of day driven, then you might have a problem.

There's going to be a lot more focus, I believe, on product taxonomy and the more detailed way firms have to describe their different OTC derivatives, probably beyond… I mean, ISDA have mentioned that they will be extending their own taxonomy and I believe that will definitely happen. So, a system that properly identifies products at a low level of granularity is a key requirement.

I think MiFID II will lead to more standardisation of products and it will lead to in all likelihood a higher volume of transactions being processed in the OTC type market and so your system has to be scalable, both from an IT point of view, to cope with increasing volumes, but also from an end-user perspective. If you have manual processes or manual workarounds you may really struggle in the future. On the other hand, if you have a good level of automation then that puts you in good stead.

Last but not least, I think what we've seen, again in conversations with other people, is that the end-user facing view on what's been reported can often get missed, so having a good dashboard that's flexible, that's configurable, that can be used to view both your EMIR, Dodd Frank and your MiFID II reporting is pretty key.

***Julia*:** **David, you've already outlined how processes should already be working in practice to support trade reporting and MiFID II, but what do you think are some of the more common challenges, both operational and business wise, that firms are likely to encounter?**

David: Yes, there are loads of challenges that firms will face throughout their operations when looking at MiFID II, and obviously this podcast is around reporting related items so that's what I'm going to focus on but firstly I'll make some general points.

MiFID II is complex; the guidance, discussion papers and draft RTSs are over 1,500 pages long, and we saw it in EMIR and I believe it will be the same here, where there will be certain amounts of functional uncertainty over exactly what these regulations mean and those will be clarified throughout the course of 2015 and 2016, all the way up to January

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2017. I guess firms need to factor that in to their project planning, which is a project manager's nightmare but probably a consultant's dream. Lots of moving parts and lots of requirements for flexibility.

If your solution for EMIR was tactical, and that's fine, it probably is sufficing you for your current EMIR reporting. I would be very wary of trying to build further logic on top of a tactical solution because the complexity of what you're trying to achieve could vary the organisation and could become a real maintenance nightmare.

Those are a few general points. Turning to the business challenges that… and I'm only highlighting these, there are many more, but some of the main business challenges, I guess the first one is what products and activities are actually in scope for me and do I have those covered in my existing reporting solution? I guess what I'm referring to here: if I'm an EU domiciled entity then there's a strong chance that all the products I've had to report for EMIR are going to be catered for in MiFID, or the MiFID will be a subset of those. If, on the other hand, I'm the famous London branch of an American bank, it's possible that that branch had no EMIR reporting to do whatsoever. However, if an EEA registered investment firm now, all of that activity within the London branch could become reportable under MiFID, so there is a chance that some source systems that have never been mapped to EMIR or maybe to Dodd Frank, will need to be brought into scope for MiFID, so that's a key point.

The second key business challenge is for all of those firms that have adopted a delegated reporting model for EMIR, which is perfectly valid, I would suggest that they analyse whether that's going to do it for them for MiFID II. I'm not 100% sure as to the delegation capabilities in MiFID II but I would certainly investigate that, and it may well be that actually it's too complex to rely on that model.

Third business point is all around this systematic internaliser, which is essentially a market maker dealing off your own capital. If you believe you are a systematic internaliser, or indeed you *want* to be a systematic internaliser in the new landscape, then you have a number of new challenges all around this real-time pre and post-trade transparency reporting. That's quite key. It could well be that you're a systematic internaliser for a subset of products, so it could be quite a narrow focus but you still need to evaluate that.

Moving on to operational challenges, the key one that I've alluded to is that the data that you need to report for MiFID II is similar to EMIR but also with some important differences. For example, EMIR reportable events are different from MiFID reportable events, so you need to analyse that. The data that you need to report for MiFID, some of it is similar to MiFID I, some of it is similar to EMIR, and some of it is completely new. The sort of

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completely new data items are around identifying who the trader was who actually made the decision to do the investment, and who the trader was who made the decision to do the execution or, if it was a committee, which committee did the investment decision, or if it was an algorithmic routine what's the idea of an algorithmic routine? These are new transactional related stats that will need to be captured. There's also fields that called the same as in EMIR, but I believe their detailed interpretation may be slightly different to that in EMIR. Things like price notation quantity. The devil is in the detail.

Second operational challenge is that the transactions that need to be reported in MiFID II may be different from the transactions that were reported in EMIR, and the real challenge here is that you need to report those that could have been traded on a venue. So let's take an example: I'm dealing in an interest rate swap bilaterally, I haven't dealt it on a venue, I've dealt it bilaterally. I need to work out that for that particular taxonomy, that flavor of that swap, is it being traded anywhere else in the EEA on a venue, because if it is I need to report it. If it isn't, I don't need to report it. That's quite a detailed level of complexity there.

That leads on to the next point which I've mentioned before, which is about the ability to handle detailed product taxonomies.

Couple more final operational challenges: who do I report to? I'm reporting to one or more TRs at the moment for Dodd Frank and EMIR, will those TRs actually support MiFID II? The indication is that, yes, the main TRs will indeed support MiFID II so you need to evaluate how will those TRs ease my burden? In other words, if I'm reporting for EMIR will they do a lot of the logic to take a subset for MiFID? Will they be ready? This is a big challenge for them as much as for the investment firms. Even if they are supporting MiFID II you absolutely need to plan for some heavy regression testing on what you already report for EMIR and Dodd Frank if they are amending their core processes to cope with MiFID II.

Final point: under MiFID you are meant to ensure the completeness and accuracy of your reporting, and obviously it's a similar situation for Dodd Frank and EMIR, so again how good are your reconciliation routines, because I believe that aspect will come to the fore.

***Julia*:** **Those are some good points to look out for in terms of both business and operational challenges. In terms of advice, David, what can you offer our listeners, as to what they should be doing to tackle MiFID II trade reporting requirements strategically and to ensure greater operational efficiency and timely compliance?**

David: When we've spoken to banks about EMIR and Dodd Frank, we are often confronted with people that say they bemoan the fact that they were rushed in to achieving compliance for

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those jurisdictions and therefore they're paying the price now with, you know, maybe some inefficiencies within their current solutions. So, I guess the first piece of advice is let's try not to make the same mistake, we have two years, and we have the opportunity to do something strategic.

I think firms really need to make a decision now as to whether their existing reporting solution has the attributes and capabilities that they need for both EMIR but also MiFID II, and maybe other reporting regimes that are in the future, and can the system cope with the challenges that we've talked about in the previous questions? If the answer is 'no', then they really should be looking at initiating projects to commence a strategic solution that could handle MiFID II and that could obviously migrate their other reporting requirements over at a subsequent time or as part of a big bang project.

If they think the reporting solution is partially okay, then they need to look at the aspects of the solution that might need upgrading. We talked about having all your business decisions in one place, we talked about validation layers, we talked about taxonomy handling. They need to look at the weaknesses they have and fill those gaps.

Finally, if you've done a valuation and you think you're in good stead, then congratulations frankly, you can leverage your platform for MiFID II. I would say you still have a massive project ahead of you but you have a good chance of success.

Julia: **Now that's a very positive note to end on. Thank you David Farmery of Message Automation for sharing your expertise with us on this topic.**

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