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MiFID II / MiFIR

Implementation Challenges for the Bank of Tomorrow

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Introduction

A review of MiFID I in 2007 was long overdue. The financial crisis made MiFID I's weaknesses apparent, as did the adoption of new trading platforms and activities that were not included in MiFID I's regulatory scope. The review and revisions adopted were designed to close existing loopholes, improve investor confidence and create a more robust regulatory framework. The Commission's goal in its review was to "Improve the competitiveness of EU financial markets by creating a single market for investment services and activities and to ensure a high degree of harmonised protection for investors in financial instruments, such as shares, bonds, derivatives and various structured products." The new rules came into force in July 2014 and firms must begin complying by early 2017.

The key elements of these sweeping Level 1 reforms include new and expanded requirements related to:

- Market Structure
- Transparency and Transaction Reporting
- Conduct of Business, Supervision and Product Scope
- Commodities
- Third World Countries

This paper covers changes to market structure, transparency and transaction reporting, and conduct, supervision and product scope.

Market Structure

The key objective of MiFID reforms is to address perceived failures in market regulation leading up to the first financial crisis by addressing four specific areas:

- Organised Trading Facilities
- Systematic Internalisers
- Equities Trading Obligation
- Aligning Requirements for Regulated
- Markets' Multilateral Trading Facilities

Market Transparency and Other Reforms

Equities market transparency was included in the scope of MiFID I, but MiFID II expands that scope to include new pre-trade and post-trade transparency requirements for equities and equity-like instruments, such as ETFs and depository receipts, while redefining transparency waivers currently applicable to equities' business. In response to the problems posed by fragmentation of trade data that followed from the introduction of venue competition under the original MiFID, the new rules also address the introduction of a consolidated tape for equities and equity like instruments.

Fixed income and derivatives market transparency are new additions to the regulation under MiFID II. Liquidity and fragmentation pose special implementation challenges that will need to be addressed in Level 2 measures and Level 3 guidance. Generally, MTFs, OTFs and firms that operate such trading venues, would need to publish bid and offer prices 'depth of trading interest' information and disclose actionable indications of interest. Such data must be published continuously during normal trading hours, which potentially creates a significant implementation challenge.

Transaction reporting obligations are expanded under MiFIR, significantly increasing the volume of reportable data that investment firms executing transactions in financial instruments must report. Specifically, investment firms would need to provide complete and accurate details of the transactions to the competent authority quickly, no later than the close of working day following trade.

Reforms for algorithmic trading stem from the 2010 US "flash crash" and are designed to address systemic risks posed by algorithmic trading. Among these reforms are licensing requirements, information requirements and reporting, systems and controls regarding liquidity and rules related to circuit breakers and controls.

Conduct of Business, Supervision and Product Scope

Changes relating to conduct of business, supervision and product scope are a direct result of a number of financial scandals that occurred in between the adoption of MiFID I and the revisions finalised in MiFID II. These changes encompass:

- Extending conduct of business rules to include structured deposits
- Product design
- Title transfer with retail clients
- Conflicts of interest
- Execution only business
- Best execution

Structured deposits were not included in the scope of MiFID I. Protections under MiFID II apply when firms sell or advise on these products, which are linked to indices, MiFID instruments, commodities, other non-fungible assets or FX rates.

Product design requirements are related to sales practices for firms that create investment products. Specifically, these requirements encompass:

- Pre-sale internal approval processes
- Identifying target markets to ensure that all relevant risks are identified and addressed
- Distribution strategies must be consistent with the identified target markets
- Requirements for periodic reviews by the investment firm
- Distributors must have information about product design and intended markets

These requirements are intended to reduce the number of sales practice violations and abuses of investor confidence.

Title transfer requirements are directed at firms that hold client funds and assets. These firms must make adequate arrangements to safeguard client ownership rights, especially in instances of insolvency by the investment firm.

The most sweeping changes for retail investors are the expansions made to existing rules relating to conflicts of interest. These changes include the following requirements (but not limited to) relating to remuneration and third party inducements:

- Ensuring that remuneration and third party inducement do not constitute conflicts of interest
- Providing disclosures to clients about inducements
- Disclosures regarding whether investment advice is independent
- Aggregating and providing cost information to clients

Implementation Challenges for Technology

Changes in reporting and transparency, as well as tracking information relating to business conduct, supervision and conflict of interest are going to require significant investments to add, upgrade or replace technology. In particular, where there are new requirements, firms may need to build or buy brand new technology to meet them.

Meet the MiFID II / MiFIR Challenges with NextAngles

Using the same technologies to address increasing regulatory and compliance burden is not a sustainable solution. NextAngles takes advantage of advances in technology to meet evolving regulatory challenges. It's a new breed of disruptive, enterprise technology that can meet the challenges presented by MiFID II and MiFIR head on.

NextAngles is a smart platform. In other words, it's an expert system that knows, learns and reasons as people do. It is fuelled by cognitive models, smart data and enterprise application expertise in a knowledge base. NextAngles' expert system interprets directions and executes compliance processes, resulting in decisions, actions, reporting, explanation and self-documentation.

About NextAngles

Reimagining Financial Regulatory Compliance

NextAngles is an Mphasis venture developing a new breed of disruptive solutions for regulatory compliance and risk management. Our vision is to make compliance easy through a highly automated and knowledge centric approach that provides a centralised and integrated view of data. Our NextAngles solution suite can be applied across diverse risk and compliance areas, such as AML Alert Investigations, Retail Sales Practice Compliance Management, Master Trade Surveillance and Liquidity Risk Management, to create a smart compliance experience. This disruptive approach not just reduces compliance burden, but also increases the speed of response to business and regulatory changes significantly. In addition, it scales to meet the most demanding enterprise-class financial regulatory requirements.

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