International Securities Services

Mifid II revisited

International Securities Services Virtual Roundtable

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The texts of the long awaited update to the November 2007 Markets in Financial Instruments Directive (MiFID II) and the accompanying Markets in Financial Instruments Regulation (MiFIR) were published in June 2014. Details of the twin measures are long and complex. The discussion paper, in which the European Securities and Markets Authority (ESMA) sets out its proposals, is 533 pages long. The consultation paper, in which ESMA sets out its advice to the European Commission adds a further 311 pages. Yet it is crucial that fund managers and their service providers understand the objectives of the proposed legislation. That is because MiFID II and MiFIR aim not only to update MiFID I but to regulate and re-regulate many of the issues which European regulators believe were to blame for the great financial crisis: lack of transparency, especially in OTC derivatives; "dark pools" and other opaque trading venues; high frequency trading (HFT); and the perceived information asymmetries between financial intermediaries and investors.

Analysis of the regulation has been done to death, but the recent announcement of the postponement of the implementation of MiFID II until January 2018 has provided fresh scope for discussion.

This is in one of the popular series of ISS virtual round tables, in which we gather the thoughts of **David Nowell**, Head of Industry Relations and Regulatory Compliance, UnaVista, **Adam De Rose**, Associate Director, Product Management, Eze Software Group and **Richard Frase**, Partner, Financial Services and Investment Management, Dechert LLP

ISS: Why has the implementation of MiFID II been postponed by a year?

Richard Frase, Partner, Financial Services and Investment Management, Dechert LLP: The timetable for implementation was overambitious and the Commission was under considerable pressure to acknowledge this. In particular the implementation of the new transactions reporting regime requires extensive technical design and development, but other areas such as transparency and commodity position limits were also problematic. The problems extended beyond firms themselves to include market operators and national regulators, who were unable to provide the necessary reporting and publication systems within the original timetable.
There was some discussion as to whether the bulk of MiFID II could still be implemented in 2017. This would have included the new client protection regime which mostly needs to be implemented by legal documentation rather than systems redesign. However, the elements of MiFID II are so interrelated that separating it into two discrete tranches would have been impractical, as well as subjecting firms to two implementation processes rather than one.

Adam De Rose, Associate Director, Product Management, Eze Software Group: Quite simply, the size of the effort required to build the infrastructure necessary is gargantuan, and it was very clear that neither the regulators nor the industry participants would be ready by the initial proposed implementation date.

David Nowell, Head of Industry Relations and Regulatory Compliance, Unavista at London Stock Exchange: MiFID II has been postponed by a year due to the exceptional technical implementation challenges faced by the regulators and market participants. The complexity of this exceptional technical implementation arises from the fact that ESMA has to collect data from about 300 trading venues on an estimated 15 million financial instruments. ESMA informed the European Commission during Q3 2015 that neither competent authorities nor market participants would have had the necessary systems ready by 3 January 2017, the date by which the MiFID II package was supposed to be readily deliverable. The one-year extension was formally approved by the European Commission during Q1 2016.

ISS: What are the implications of the postponement for institutional investors?

Richard Frase: The practical implications are relatively small in the medium to long term. Even in the short term, the benefits to investors are uncertain, with many of the planned changes based on fairly abstract theory rather than actual empirical research and evidence.
The new investor protection provisions of MiFID II will not come into force for another 12 months. A large part of this consists of extending the MiFID I retail disclosure provisions to professional investors. However such investors normally conduct their own due diligence and the formulaic disclosures required by MiFID II look to be of limited value.
One area which may be of real benefit is the new aggre-

gate costs disclosure requirement. For the first time firms are required to disclose all the costs associated with a particular investment or service aggregated into a single figure, and where possible basing this on client-specific information.
The biggest change is in the organisation of EU markets and the trading information which they are required to disclose. This is designed to bring increased transparency, but quite possibly at the price of a reduction in market liquidity.

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Adam De Rose
Associate Director, Product Management,
Eze Software Group

Adam De Rose: I think institutional investors were as relieved as everyone else. We all appreciate the goals of MiFID II -- increased transparency and investor protection - but imposing a tight time-frame on implementation doesn't afford participants the time they need to think through the complex implications. Implementing MiFID II quickly, but without careful thought and structured change management, could very easily mean that investment managers waste time and money pursuing the wrong solutions, which in the end only undermines the objectives of MiFID II.
In short, the postponement allows everyone to do this properly.

David Nowell: I believe this is positive for many firms as they have more time to run internal business assessments and long term risk analysis with the view to strategically invest in the best software capabilities, in order to meet the MiFIR reporting obligations. It also allows firms to make better informed decisions on the selection of their service providers, and to consider their internal tactical and strategic decision making process for the longer term. However, regulators may expect full compliance following the extra year to prepare.

ISS: What are the implications for their service providers?

Richard Frase: Brokers, dealers, asset managers, custodians and the like have gained a much-needed breathing space to develop their compliance and operational systems to meet the extensive new requirements under MiFID II. At the same time there may be a risk of regulatory fatigue, with some firms using the postponement merely as an opportunity to put everything on the back burner.
For UK investment firms, the postponement means that MiFID II is now scheduled to be implemented at the same time as the new UK senior managers and certification regime (SMCR). This could prove to be a bottle-neck. On the other hand, if firms coordinate the introduction of the SMCR with the organisational requirements of MiFID II, this might reduce the need to carry out two separate governance reviews and provide some economies of scale.

Eze Software Group

Eze Software Group is a premier provider of global, multi-asset class investment technology to support the front, middle and back office.

Eze Software was launched in 2013 by combining Eze Castle Software, RealTick, and Tradar, bringing in more than 20 years of expertise from each of the entities under one roof. The combined EzeSoft Investment Suite addresses the core business needs of the asset management community, including Order Management, Trade Execution & Analytics, Portfolio Analytics & Modeling, Compliance & Regulatory Reporting, Commission Management, Data Management and Portfolio Accounting.

Eze Software partners with more than 2,000 buy - and sell-side institutions in 30 countries across North and South America, EMEA, and Asia Pacific. The majority of the clients are hedge funds, as well as institutional asset managers, mutual funds, pension funds, endowments, family offices, wealth managers, and broker-dealers across a range of strategies, investment products, and asset classes. Headquartered in Boston, Eze Software employs more than 1,000 associates in 13 offices worldwide.

For more information, visit www.ezesoft.com.

Adam De Rose: Service providers all have their own roadmaps that extend out over multiple years. With any new regulations, it's tough to predict what the end result will look like, especially as compromises are made and objectives and deadlines shift. In a world of finite resources, tough decisions sometimes have to be made in order to build solutions for regulation over other client commitments.
The postponement has afforded us the time to analyse, plan, design, validate and schedule development in an organised, thoughtful manner, which is exactly how things should be done. In the end, this will result in higher quality products and solutions that help clients streamline their processes being delivered to the market, which is great for us and the industry as a whole.

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> **David Nowell**
> **Head of Industry Relations and Regulatory Compliance, UnaVista**

David Nowell: The service providers have time to rethink their cutting edge products; they benefit from an extended timeline with the aim at redesigning better tailored solutions for the market participants' needs.

ISS: How will the recast regulation impact on Systematic Internalisers (SIs) and Approved Publication Arrangements (APAs)?

Richard Frase (Dechert is not involved in APAs)**:** The old SI regime was seen as having been unsuccessful in that very few firms applied for authorisation as SIs and the SI concept itself failed to capture the OTC dealer markets business in the way the EU had envisaged.
This time round there is much more pressure on dealers who generate their own liquidity to accept categorisation as SIs and the tough requirements on disclosure and pricing that go with it.
Dechert' s own focus is on the buy-side, and the enhanced regime for SIs has some potential to improve market access, balanced however with the concern that this may reduce liquidity and that prices, by becoming more visible,may also become less competitive.

David Nowell: MiFID II extends the systematic internaliser regime from applying solely to shares to a much broader range of asset classes: equity-like instruments (depositary receipts, ETFs, certificates and other similar financial instruments), and non-equity instruments (derivatives, bonds, structured finance products and emission allowances). When MiFID II/MiFIR enters into effect on January 3, 2018 investment firms entering into OTC transactions must comply with new transparency requirements. Amongst these requirements, investment firms will have to make certain post trade information public through an APA. So, the recast regulation impact on SIs and APAs could be translated into a higher degree of transparency in the area of non-trading venues.

UnaVista

UnaVista is London Stock Exchange Group's global hosted platform for all matching, validation and reconciliation needs. It offers a range of business solutions through one interface designed to help firms become more efficient and reduce operational and regulatory risk across all asset classes. UnaVista provides a number of award winning regulatory solutions to help firms not only comply with regulations, but get better business insight and safeguard against future regulatory change.

ISS: How will technology firms cope with the surge in IT investment - do they have the capacity?

Richard Frase: Undoubtedly technology firms will benefit from

David Nowell
Head of Industry Relations and Regulatory Compliance, UnaVista at London Stock Exchange

David Nowell has over 20 years' financial services experience on both sides of the regulatory fence, having worked previously for the FSA, Reuters and Credit Suisse. At Credit Suisse, he was Transaction Reporting Manager, responsible for ensuring compliance across all aspects of the reporting process and advising on new regulatory requirements. Prior to this, Nowell was a Technical Specialist within the Transaction Monitoring Unit at the FSA, where he was responsible for shaping the transaction reporting rules and providing guidance to UK firms. As the FSA's representative on transaction reporting in Europe, he was intimately engaged in policy negotiations with other regulators, giving him a unique insight into the policy making process and the regulators' expectations of the industry.

the extra time to develop and test their offerings. This is an opportunity for them and we expect them to make the most of it. There is always the risk of a last minute rush but the delay can only be beneficial.

Adam De Rose: This is what we call a nice problem to have. Our company is in a mature growth phase. We've been steadily increasing our R&D (research and development) budget, spending more than US$65 million on R&D in 2015 alone. We've grown headcount to more than 1,000, with 40 percent each in R&D and client services. The ultimate goal of that investment is to deliver world-class industry and product expertise, a consistent experience with project management standards, increase the speed of resolution and finding new ways to engage our client base.

David Nowell: I think firms that have not planned strategically will inevitably struggle. At UnaVista, we constantly monitor the regulatory environment and we have already invested in infrastructure to ensure we have capacity for the ever-expanding regulatory requirements.

ISS: How will firms cope with integration, connectivity and reporting under the new regime?

Richard Frase: For small firms the process appears to be relatively straightforward, particularly given the extended timetable, which will assist in the production of off-the-shelf products. For larger more complicated business this is a more extensive exercise with much longer lead times and a need to gear processes up to the highest common denominator.

Adam De Rose: There's no doubt about it, this is going to be a huge challenge, but there are many avenues these solutions could take. Interfacing with third parties is a key part of our business. We have an entire layer of technology behind our core products that we call "Data Services" to facilitate these interfaces. This cloud-based tool allows us to build, deploy and update interfaces independent of our product release cycle.
We're also following closely the FIX Trading Community's development of the FIX Protocol for transaction reporting, and, of course, we have an eye on distributed ledger technology. In the short term, the interfacing will need to be done using current methods of flat file FTPs and APIs.

David Nowell: Implementation work and scheduling for firms' integration, connectivity and reporting under the MiFID II regime has already started for those market players that wish to be ahead of the game. The fundamental building block for compliant reporting is actually understanding the reporting requirements. Only then can an efficient gap analysis be conducted. Firms need to be able to source the new data and understand the data protection issues that are associated with some of the data elements. Choosing a service provider that has an excellent track record of current MiFID reporting and thoroughly understands the complexities of the new transaction reporting is absolutely essential.

ISS: Is postponement a good thing in your view? If so, why? If not, why not?

Richard Frase: It is a very good thing that the Commission has provided a practical response to a practical problem. However, achieving a one-year postponement has been a hugely cumbersome process.

David Nowell: I agree, implementation was postponed for good reasons – regulators and reporting firms alike faced

Richard Frase
Partner, Financial Services and Investment Management
Dechert LLP

Richard Frase advises on all aspects of financial services law. He has extensive experience of the legal and regulatory aspects of the UK financial services industry, gained in private practice, in-house and with the regulators, covering both wholesale and retail markets and including regulation and compliance, derivatives and trading documentations.

Mr. Frase was head of litigation at the Personal Investment Authority (later the Financial Services Authority and now the Financial Conduct Authority) from 1995-1998, where he dealt with a range of compliance and enforcement matters involving life companies and financial advisers. He was seconded to the Securities and Futures Authority during 1989-1991, where he advised on policy and legal matters, and carried out extensive work on the conduct of business rules. He was a member of the London Metal Exchange and SFA arbitration panels for 10 years, sitting as an arbitrator in more than 30 arbitrations.

Mr. Frase is recommended in the 2016, 2015 and 2014 editions of Chambers UK. The 2016 guide notes that Mr. Frase has a great deal of experience in financial services, having served previously both in-house and at the regulator. He garners respect from peers who comment on his “credibility in the sector and huge amount of knowledge.”

Mr. Frase is Chair of the Alternative Investment Fund Management Association (AIMA) MiFID II Working Group covering Product Governance. As Chair he leads a working group composed of AIMA members preparing guidance materials addressing the product governance elements of MiFID II. In addition to the MiFID II product governance working group, Mr. Frase also sits on the MiFID II Best Execution working group.

insurmountable challenges, so it has to be regarded as a good thing. What is paramount now is to take full advantage of the delay and ensure you are fully prepared for January 2018. Many firms are already testing their readiness and UnaVista has already gone out to the market with a well-prepared cutting edge product, the MiFIR Accelerator, to help firms check their readiness.

ISS: Are the protests that we are beginning to hear about over-regulation starting to build momentum?

Richard Frase: Earlier this year there were signs that the regulatory pendulum might finally be swinging back in the direction of reduced regulation.
The stated aims of Jonathan Hill’s Capital Markets Union Action Plan included encouraging long term investment and private equity financing, relaunching securitisation markets and achieving better regulation through a review of the EU regulatory framework for financial services.
One area for better regulation that had already been identified was a more proportionate regime for reporting and disclosure requirements. There is a plethora of over-detailed reporting requirements, with separate but overlapping regimes for derivatives, alternative investment fund managers, transaction execution, transaction reporting, energy trading and

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Dechert has a long track record of helping global asset managers deal with European regulatory change. We are the firm of choice for many of the world’s largest investment managers seeking a comprehensive, joined-up cross-border service.

Adam De Rose, Associate Director, Product Management, Eze Software Group

Adam De Rose joined Eze Software Group in January 2014 and is now a Product Manager focusing on MiFID II and Best Execution. Previously, he was responsible for selling Eze EMS to hedge funds and asset managers in Europe, and prior to that was a Sales Engineer across the wider Eze Software Investment Suite. Prior to Eze Software, Adam worked at TradingScreen on U.K. Hedge Fund EMS sales from 2012 to 2014. In 2009, Adam was part of a team that launched Javelin Capital, a long-short equity hedge fund, where he was responsible for technology platform selection during launch and subsequently became head of trading. The launch team came from Goldman Sachs Asset Management, where Adam spent two years on the portfolio construction team attached to $8bn of AUM in Emerging Markets and BRICs funds. Adam graduated in 2001 from the University of Birmingham and has a BSc in Money, Banking and Finance.

transaction financing. It is an obvious area for regulatory rationalisation.

However, since Hill's resignation from the EU Commission, it is unclear whether this will continue. New initiatives by unelected supra-national bodies such as the European Systemic Risk Board and the Financial Stability Forum appear to revert to the idea that economic growth should be seen primarily in risk terms to which ever more prescriptive regulation is the only answer.

Adam De Rose: People have certainly voiced concerns that regulators have perhaps lost sight of the perfectly valid and honourable goals they originally had in mind. We know that the European Commission is reviewing the unintended consequences of MiFID I and other recent reforms. The obvious question is whether we should wait until those consequences are well understood and, if so, address them in MiFID II.

David Nowell: Financial markets infrastructure regulation has changed dramatically in the past six years. In response to some of the practices seen in the run-up to the 2007 financial crisis, EU rules have necessarily become more prescriptive. Legal and regulatory certainty is one of the prerequisite for the well-functioning markets. The European Commission launched a consultation in July - "Call for Evidence" - on the impact of financial regulations on bank financing of the economy with the view to take the market pulse and better understand its perceptions on the current regulatory framework. The EU has put in place a range of rules designed to increase transparency and provide more information to the regulators, investors and the public in general. The information contained in these requirements is necessary to improve oversight and confidence and will ultimately improve the functioning of markets. In some areas, however, the same or similar information may be required to be reported more than once, or requirements may appear to overlap. However, I believe supervisory authorities in the EU are listening to market's concerns. I also believe there is scope for the industry to take advantage of some of the synergies between the reporting regimes.

ISS: Could we see further postponements? Or even the scrapping of some regulation? If so, which part would participants most like to put into Room 101, as it were?

Richard Frase: This is just possible if, in 2017, it emerged that there was still a major problem with developing and implementing the necessary systems. However it seems very unlikely. The EU lacks the ability to provide a flexible response to new developments. Its legislative process is slow, and there is no equivalent of the SEC no action letter process under which it is relatively easy for SEC staff to give a semi-formal commitment to enforce (or not to enforce) a law in a particular way.
And if EMIR is taken as a precedent, the EU was prepared to press ahead with the introduction of new reporting rules which it knew firms could not reasonably be expected to be meet.

David Nowell: This is notoriously difficult to predict. However, an agile reporting solution is essential for firms to be able to respond to any unexpected regulatory developments.