

Preparing for MiFID II

A guide for investment managers

WHITEPAPER

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The updated Markets in Financial Instruments Directive (MiFID II) and accompanying regulation (MiFIR) create a huge and complex rulebook that will transform the way financial markets operate and how trading activity is conducted in the European Union. While designed more for the sell side than buy side, its scope means any investment manager that has dealings with European clients, funds or even assets will be impacted to some extent, and will need to adopt a MiFID II program.

The original MiFID, introduced in 2007, sought to promote competition between and access to trading venues, increase equity market transparency and enhance investor protection. While generally successful, evolutions in the trading environment have led to gaps or inconsistencies in parts of the regulatory framework, according to specialist investment management consulting firm Citisoft¹. MiFID II, when it takes effect on 3 January 2018, aims to further strengthen the single market and plug those gaps by widening the scope of investment services requiring authorization by member states and the range of investments covered.

It is also important to note that MiFID II sits alongside a multitude of other European and international regulatory initiatives that seek to create a more globally-aligned set of trading principles, and which are reshaping how markets operate. Market participants therefore need to assess how the various regulatory strands fit together, and what impact they will have on their businesses.

MiFID II objectives

Broadly, MiFID II focuses on the framework of trading venues where instruments are traded. MiFIR regulates the operation of those venues. Together, the emphasis is on:

- Effective, efficient and safe operation of financial markets.
- Enhancing conduct of business rules for intermediaries providing investment services.

To achieve these ends, the combined legislation has several core objectives:

- Greater investor protection to ensure clients are treated fairly and have access to transparent information that aids decision making (e.g. by strengthening the best execution framework, improving fee transparency and unbundling commissions).
- Aligning regulation across the EU in certain areas.
- Fostering competition in financial markets to provide a level playing field.
- Reinforcing supervisory powers to ensure regulators can police markets effectively and protect consumers.

Impact on the buy side

Much of the regulation is targeted at the sell-side (for instance, the rules on systematic internalizers). Nevertheless, many of the provisions in MiFID II will have a substantial impact on asset managers, wealth managers, fund managers and other varieties of buy-side firms.²

And its reach is extensive. While the initial rules focused on equities, MiFID II stretches across the OTC markets to include bonds and almost all derivatives that impact asset managers.

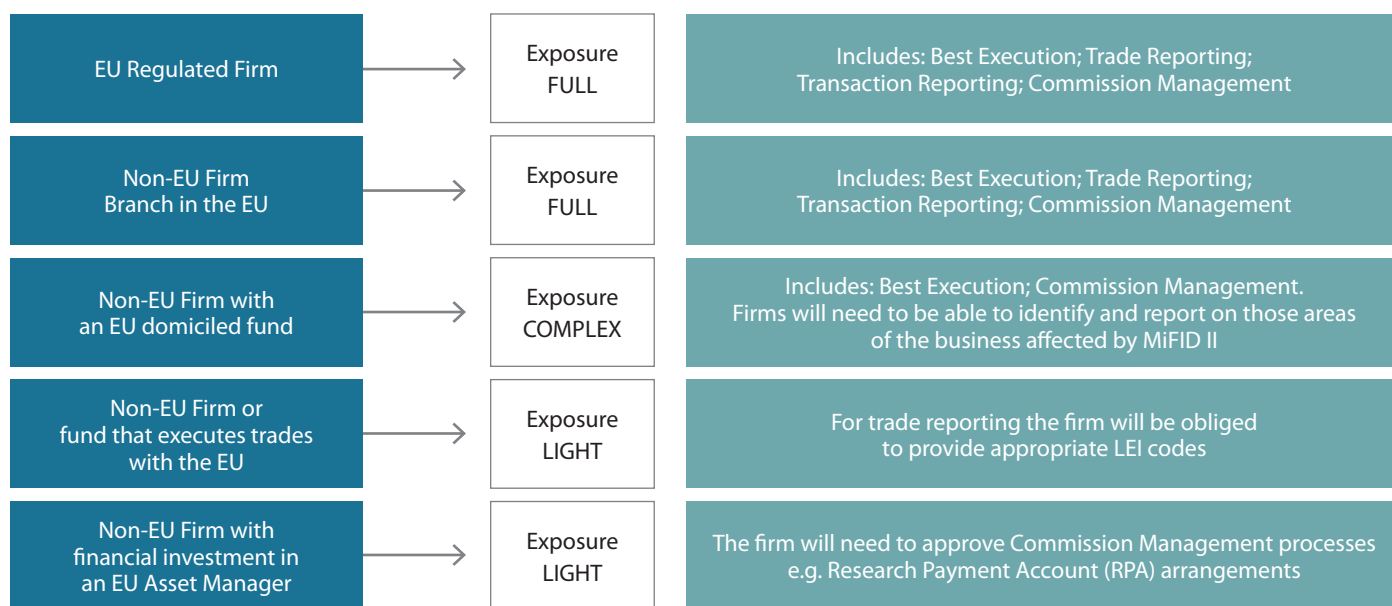
Any firm with a footprint in Europe, or that is involved in distributing and trading financial instruments in the EU will also be subject to aspects of the rules. As such, MiFID II extends as far as it can to non-EU organizations as part of its goal to level the playing field in Europe. For example, approximately two-thirds of US firms are expected to be impacted.

Moreover, with its emphasis on increased investor protection and confidence, enhanced transparency, fairness, disclosure and reporting, MiFID II may come to represent a best practice standard for asset owners around the world. Non-EU firms could thereby find there are competitive advantages in adhering to the rules when pitching for mandates.

¹ SS&C Advent recently commissioned Citisoft to conduct an in-depth study on the impact of MiFID II. Its findings have been used to inform this report.

² The regulation remains somewhat of a moving target at the time of writing (March 2017). Therefore, the requirements outlined may evolve in the weeks and months to come.

Figure 1: **Competitive advantages for non-EU firms**



Implementing principles

A host of complex provisions are set to be introduced to put the regulation's overarching objectives into practice. The clear intent though is to ensure affected institutions comply not just with the letter of the stated rules, but as far as possible with the spirit of the regulations.

This creates a significant challenge, since MiFID II is not as prescriptive as previous directives. Instead, it focuses more on principles concerning how organizations deal with clients. It is then up to investment firms to interpret those principles and change their operations in response.

Citisoft has identified the following central principles that buy-side firms need to adopt, and which should serve as a guide when determining your decisions about client actions and system functionality.

Market fairness and transparency

MiFID II extends the concept of a level playing field for all participants, and the need to ensure the fairness and transparency of all charges, fees and other practice elements that might affect market competition.

For example, all costs—including product charges and transaction costs, which distributors will need to obtain from manufacturers—will have to be aggregated in client disclosures on both an ex-ante and ex-post basis. Meanwhile, professional advisors and discretionary fund managers will be prohibited from accepting any monetary inducements.

Best execution and investor protection

There is heavy emphasis on improving investor protection, and providing controlled, monitored and auditable execution to ensure fairness for all end-clients. This includes introducing robust controls to avoid conflicts of interest, banning hidden commissions for investment advice and portfolio management, and providing greater pre- and post-execution transparency.

Demonstrating best execution will be a major challenge. Investment firms will need to gather, analyze and publish extensive information on where they execute trades and the details of those transactions, with the demands extended to non-equity instruments.

Commission unbundling is another new requirement. Research will become a distinct service that must be assessed and paid for either out of firms' own resources or from a defined research payment account (RPA). Buy-side firms will need systems and controls to determine the research they need, assess the quality of the research received and show it provides value.

Disclosure and reporting

Industry participants face stringent demands around communication, disclosure and specific reporting to investors. Vast quantities of data (provided either directly or via sell-side relationships) will be needed to meet the increased disclosure and reporting obligations, with asset managers facing a much greater reporting responsibility than under the original regulations.

For instance, firms must report complete and accurate details of any financial instrument transactions to the relevant National Competent Authority (NCA) no later than the end of day on T+1. All legal entities will also need to obtain a Legal Entity Identifier (LEI), as these have to be included in transaction reports.

Where SS&C Advent can help is with the sophisticated product and service functionality that we have developed, and continue to develop, to support investment institutions' operations.

Onus on governance

MiFID II emphasizes the importance of compliance, audit and risk management functions, especially in relation to the production and marketing of new financial instruments, reporting and conflicts of interest.

To this end, robust governance arrangements must be put in place to ensure firms' products and services are compatible with the needs, aims and characteristics of their target market. Product distributors will need to determine each client's risk tolerance and capacity for loss, and provide manufacturers with feedback on their suitability. Manufacturers must ensure products designed for a specific target market are sold to the appropriate client base.

Conduct of business

Business conduct is under the spotlight. To ensure appropriate standards are maintained, supervisors' powers are being extended and reinforced to allow interventions on both a pre-execution (in relation to product development) and post-execution (regarding sales) basis.

Partnering with a trusted technology provider

MiFID II poses wide and complex challenges. To meet these, it is vital asset management organizations determine internally the full scope of the impacts and changes they must make across their operating model. The main areas of emphasis for many buy-side firms though will likely be around commission management, best execution support and transaction reporting.

It is important to stress that no technology provider, including SS&C Advent, can solve your MiFID II challenge for you. Moreover, there is no one-size-fits-all approach to achieving compliance. Different investment firms may opt to implement differing solutions as their size, complexity, client base and operating models dictate.

Where SS&C Advent can help is with the sophisticated product and service functionality that we have developed, and continue to develop, to support investment institutions' operations. This includes:

Suitability and appropriateness

Our systems enable users to efficiently categorize clients, handle investment mandates and ensure they invest in appropriate asset classes.

Investor protection

We have long supported investor protection with solutions that deliver transparency and promote fairness.

Commission unbundling

We are updating our Moxy® order management system to separate and store distinct research and commission values to support transaction unbundling.

Transaction reporting

SS&C GlobeOp is partnering with leading Approved Reporting Mechanisms (ARMs) with links to all the major European NCAs. This will provide clients with a highly efficient way to submit reports to their relevant NCA to satisfy their trade reporting obligations.

Best execution

SS&C Advent has a long-standing partnership with ITG to meet the equity-related best execution and transaction cost analysis requirements. We are now collaborating with ITG as it builds out its fixed income solution to support the best execution extension to non-equity instrument types.

We will also continue to enrich our platforms as the rules evolve and users' obligations demand.

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Conclusion

MiFID II will have an enormous impact on Europe's financial markets. With its emphasis on enhancing investor protection, improving transparency, reducing systemic risk and creating a level playing field across the region, its reach will be both broad and deep.

Investment managers may not be the primary target for many of the updated rules and requirements. Nevertheless, they will face rigorous new demands and obligations. SS&C Advent, together with our third-party partners, is well-positioned to provide state-of-the-art technology solutions and services to help you meet many of these challenges and flourish in the changing environment.

About SS&C Advent

SS&C Advent, a division of SS&C Technologies, develops and delivers industry-leading technology solutions and services to the buy side. As a trusted partner to more than 4,300 clients of all sizes located in every region around the world, we have extensive experience and expertise in helping clients adapt to the ever-changing global regulatory landscape.

By continuously investing in maintaining and improving our technology, we have created truly scalable solutions able to deliver the efficiency, transparency, controls and regulatory robustness asset managers need today. Our solutions support firms' compliance activities by keeping information secure, organized and easily retrievable for regulatory reporting. We provide tools that enable firms to monitor portfolios and check trades for adherence to client restrictions. And our highly-automated platforms significantly reduce users' operational risks.

For more information on how SS&C Advent can help you prepare for MiFID II, contact advent@sscinc.com.