

# MiFID II: WHAT ARE YOU MISSING?

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**After years of development, drafting, deliberation, debate, delay, denial and deferment, MiFID II is finally, for the most part, in effect.**

Buy-side firms now face new challenges. Firstly, implementing those residual requirements that were not enacted on January 3, 2018. And secondly, ensuring that what has already been implemented achieves full compliance.

The scope and complexity of the requirements have meant that industry consensus is still being formed in some areas. Many firms have implemented arrangements based on assumptions and understandings which will need to remain under review. Mistakes made during implementation could result in non-compliance and costly remediation if not identified promptly. MiFID II is a case in point of a large, time-constrained project with unclear and poorly defined requirements based on a shifting legislative base.

What could have gone wrong? And what should firms consider prioritising for their residual implementation activities and post-implementation assessment?

## TRANSACTION REPORTING

Transaction reporting is a new and complex headache for many buy-side firms following the loss of the [SUP 17.2](#) 'fund manager exemption'.

Those firms that have created their own reporting infrastructure will need to ensure that their reports are complete, accurate and timely. Non-compliance is immediately visible to the FCA and the number of enforcement actions taken under the less complex MiFID I regime demonstrates how easily firms can fall foul of the requirements. Identifying incorrect, under- and over-reporting early is critical as it will not only demonstrate to the FCA that the firm has effective systems and controls in place for identifying reporting failures, but will also reduce the size and scope of any re-reporting and remediation project.

Those firms which have successfully negotiated transmission agreements with the sell-side will still need to ensure that they are providing the requisite information to their counterparties when transmitting orders.

### CHECKPOINT

Have you:

- ⊙ Started monitoring the completeness, accuracy and timeliness of reporting?
- ⊙ Ensured that monitoring covers all transaction types and reportable scenarios?
- ⊙ Sense checked assumptions made in the implementation phase, in particular identifying reportable transactions and instruments?
- ⊙ Confirmed cancellation and amendment procedures are working correctly or have been fully tested?
- ⊙ Taken steps to obtain any missing LEIs?
- ⊙ Put remediation procedures in place to correct and prevent reoccurrence of reporting errors?

## POST-TRADE TRANSPARENCY REPORTING

Under the new post-trade transparency regime most reporting will continue to be fulfilled by trading venues and systematic internalisers (SI). But trades executed off-venue need to be reported by the seller if neither (or both) counterparty is an SI. Although many firms have taken steps to understand whether their counterparties will be acting as SIs prior to the related regime officially coming into effect on 1 September 2018, many counterparties have not 'opted in'. This increases the likelihood of buy-side firms finding themselves with the reporting obligation.

### CHECKPOINT

Have you:

- ⦿ Identified counterparties acting as SIs for the instruments the firm trades?
- ⦿ Identified scenarios where the firm will have a reporting obligation?
- ⦿ Put monitoring in place to identify any trades which required reporting but were not reported?
- ⦿ Identified potential solutions for a transparency reporting framework (where required)?

## BEST EXECUTION

Firms' immediate obligations under MiFID II are likely to already be in place in terms of updated best execution policies. The next challenge will be the [RTS 28 reporting requirements](#), with the first of these reports due by 30 April 2018.

Firms will therefore need to ensure that they have identified sources for the data to be included in their first RTS 28 report and are able to publish it in the required format. Firms will also need to ensure that their monitoring procedures have been suitably enhanced to incorporate the vast amount of execution quality data which venues and SIs will be required to publish on a quarterly basis from Q2 2018.

### CHECKPOINT

Have you:

- ⦿ Identified data sources for top five venue reports?
- ⦿ Put procedures in place for aggregating, calculating and publishing top five venue reports?
- ⦿ Defined an approach for creating the 'qualitative' reports on your firm's best execution arrangements?
- ⦿ Updated monitoring procedures to incorporate RTS 27 reporting disclosures?
- ⦿ Considered how new execution quality data could provide a competitive advantage?

## PAYMENT FOR RESEARCH

Firms face ongoing challenges identifying those materials and services which meet the definition of investment research that must be paid for. Firms which are funding their research consumption using their own resources will need to ensure that they are not underpaying (and so being induced). Firms operating Research Payment Accounts ('RPAs') will also need to ensure that their research budgeting, research evaluation and client disclosure procedures are all in place to auditable standards. Preventing the receipt of unsolicited research will remain a challenge.

### CHECKPOINT

Have you:

- ⊙ Begun monitoring materials and services received to ensure that:
  - a) Those requiring payment are being paid for in a way that reflects their value?
  - b) Those which are not required are being stopped?
  - c) Research trials are either stopped after 3 months or converted into a paid service.
- ⊙ If using RPAs:
  - a) Set budgets based on actual need and agreed with clients?
  - b) Begun evaluating research received, and reflecting the results in payments?
  - c) Begun monitoring payments vs budgets to a standard that can be audited independently?

## RECORD KEEPING (INCLUDING COMMUNICATIONS RECORDING)

The prospect of trade reconstruction requests by the FCA will mean that firms need processes that can be promptly executed and completed when required. If automated systems have not been implemented for this purpose then a 'dry run' to extract all relevant information and conversations relating to a transaction could identify the resources required in advance of a regulatory request.

### CHECKPOINT

Have you:

- ⊙ Ensured all data points for client orders, decisions to deal and transactions are captured and retained?
- ⊙ Captured all communication records for all relevant conversations?
- ⊙ Begun monitoring to confirm completeness and accuracy of communications records and potential market abuse?
- ⊙ Tested trade reconstruction procedures (either via automated solutions or manually)?
- ⊙ Documented a system of traceability to UTC for all venue trading?

## MANAGEMENT BODY RESPONSIBILITIES

MiFID II obligations relating to the Management Body are broad, touching on ownership and oversight of policies, management body composition and competence, outside business interests and the ability to effectively oversee the firm.

## CHECKPOINT

Have you:

- ⦿ Updated Management Body terms of reference to reflect ownership and oversight of all relevant activities?
- ⦿ Enhanced Management Body reporting to include information relating to complaints, product governance and communications recording?
- ⦿ Implemented a Management Body induction training programme?
- ⦿ Commenced ongoing assessments of management body members' outside business interests?
- ⦿ Aligned Management Body arrangements with forthcoming Senior Managers & Certification Regime requirements?

### And there's more!

- ⦿ Gifts & entertainment – are you monitoring non-monetary benefits given and received, incorporating an assessment of the criteria for acceptable minor non-monetary benefits?
- ⦿ 10% portfolio depreciation – is a methodology in place for calculating 10% falls and notifying clients?
- ⦿ Product manufacturing – are design and approval procedures in place incorporating target market assessments, and are arrangements in place for providing information to distributors?
- ⦿ Distribution – have you implemented arrangements with manufacturers for obtaining product information and providing sales information?
- ⦿ Costs & charges – have you rolled out a calculation methodology that takes into account all required sources of costs and charges and are information exchange procedures in place with all third parties?

When the FCA set out its approach to enforcement of MiFID II in September 2017 it stated that “we have no intention of taking enforcement action against firms for not meeting all requirements straight away where there is evidence they have taken sufficient steps to meet the new obligations.”

Given the breadth and complexity of regulatory reform brought about by MiFID II it would be naïve to presume that implementation efforts are complete. There are many questions that investment management firms should be asking themselves, along with residual implementation efforts that have yet to take effect.

Having something in place for 3 January 2018 was the first hurdle, the next one is ensuring that the arrangements are effective.

With that in mind, firms would be well advised to carry out a full assessment to gauge the success of their initial implementation, particularly as market consensus builds and further guidance clears up any nuances that may have been ambiguous on day one.

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Jon leads our project assignments covering independent compliance conduct and prudential assurance, CASS client money and assets, UCITS, ICAAP and operational risk and compliance infrastructure reviews. He led Cordium's service development for MiFID II and AIFMD and regularly leads Cordium regulatory seminars and our annual regulatory forum.

Jon has over 20 years' financial services experience, having qualified with Coopers and Lybrand, then moving on to positions with UK regulator, UBS, Deutsche and Merrill Lynch Investment Managers. He is a Chartered Accountant with a politics degree from Warwick University.

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Matt is a senior consultant in Cordium's Regulatory Compliance team specialising in regulatory implementation projects. He also advises asset management and private equity clients on broader compliance matters and has extensive experience in the design and delivery of compliance monitoring programmes and regulatory risk assessments.

Previous to Cordium Matt began his career as an internal auditor before spending three years in sell side Compliance and five years in buy side Compliance, most recently with Capital Group. He has a BA Hons in Modern Languages from Oxford University and is a Certified Information Systems Auditor.