Capital Markets | Rethinking Investment Banking

MiFIR Transaction Reporting: Preparing for the Challenges Ahead

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Implementing transaction reporting under MiFIR will be a significant challenge. By acting swiftly now, building on experience gained from MiFID I, and developing a reporting model to suit their business, market participants could get ahead of the curve.

When the Markets in Financial Instruments Regulation (MiFIR) enters into force on 3 January 2017 as planned, it will significantly raise the bar for transaction reporting across all EEA1 member states. As firms digest MiFIR’s Technical Standards, published late September 2015, one thing is certain: the tight deadline for implementation means market participants, from buy and sell side firms to Approved Reporting Mechanisms (ARMs) and exchanges, will have a lot of work to do in the coming months.

MiFIR, the regulation accompanying MiFID II, is being introduced to strengthen investor protection, mitigate market abuse and bring greater transparency to the financial markets. In an increasingly complex trading environment, MiFIR significantly extends the scope of the existing reporting regime to all financial instruments which are traded on Multilateral Trading Facilities (MTF) or Organised Trading Facilities (OTF). In addition, this regulation will include financial instruments for which the underlying is directly, or indirectly (through an index), traded on a trading venue. This will encompass a broader range of asset classes, from commodities and foreign exchange to interest rate products. It also triples the number of reportable data fields – from 26 under the current MiFID regulation to 65 at the start of 20172.

The clock is ticking: factoring in the time needed to test their MiFIR reporting capabilities ahead of go-live, firms have little more than one year for implementation.

Transaction Reporting under MiFID and MiFIR

<table>
<thead>
<tr>
<th>MiFID</th>
<th>MiFIR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fields</td>
<td>Reporting of 26 fields</td>
</tr>
<tr>
<td>Product Scope</td>
<td>Cash Equities, Bonds, Indexes, Equity Derivatives (OTC &amp; ETD)</td>
</tr>
<tr>
<td>Counterparty Data</td>
<td>Counterparty ID (BIC or internal code), No identification of underlying client required</td>
</tr>
<tr>
<td>Instrument Data</td>
<td>Basic instrument data (Aii - Alternate Investment Identifier / ISIN codes) with identification of underlying instrument</td>
</tr>
<tr>
<td>Execution Transparency</td>
<td>None in addition to basic trade economics</td>
</tr>
</tbody>
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1 European Economic Area

2 Source: Accenture Research based on ESMA information from its website: http://www.esma.europa.eu
As market participants plan their responses to MiFIR, they should consider lessons learned from experience with MiFID I. When that directive was introduced in 2007, numerous firms failed to respond appropriately. This resulted in costly late remediation efforts and a series of hefty fines (totalling over £33 million to date) along with the corresponding reputational damage.

We believe that six key lessons stand out from MiFID I implementation projects:

1. **Governance and ownership**
   With such complex development required, any shortfall in governance or ill-defined accountabilities can severely undermine progress. Focus on developing a target operating model for MiFIR to cover management of transaction reporting post-go live. Define an ownership model, including roles and responsibilities, ensuring front-to-back and inter-entity sponsorship. Crucially, obtain senior stakeholder buy-in as soon as possible.

2. **Legacy architecture & scalability**
   As some firms found with MiFID I, legacy architectures used for transaction reporting may not be fit for purpose. Ensure that legacy architectures can scale to support the significant increase in reportable transactions mandated by MiFIR. Consider tactical versus strategic and internal versus external solutions to address any shortfall in capacity.

3. **People and skills**
   Some firms underestimated the change experience and regulatory skills required for MiFID I. To ensure a fast, efficient and effective MiFIR implementation, ensure the team has the right mix of transaction reporting knowledge, IT versus non-IT capabilities and change management skills. A suboptimal team structure will be detrimental to MiFIR’s implementation.

4. **Programme mobilisation**
   At a time when market participants are starting the next fiscal year’s planning season, underestimating the time and budget needed for implementation will have serious consequences. With less than 18 months to go-live, firms need to be realistic about the cost. We estimate that a typical tier 1 investment bank will need to spend around US$15 million on MiFIR, factoring in both ‘run-the-bank’ and ‘change-the-bank’ costs.

5. **Front-to-back impact**
   Like MiFID I, MiFIR will create challenges across front, middle and back office systems and databases. Assess these impacts as early as possible. Expect a significant increase in data requirements for the front office (such as Algorithm Identification Code and Natural Person Identifier), as well as complex reference data. Carry out detailed field-by-field analysis to determine appropriate data sources and document specific rules and business logic to define reportable transactions.

6. **Regulator engagement**
   Both during and post MiFID I, communication between market participants and regulators was inadequate. Fines may have been lower or avoided through proper engagement. Ensure transparency with the corresponding National Competent Authority over risks and issues faced throughout implementation. Collaborate with industry peers to discuss challenges to reduce individual operational and reputational risk.

Many firms have spent the past seven years trying to fix the problems they accumulated from MiFID I. The importance of learning from that experience, and applying these six lessons, is key in the implementation of MiFIR.
Preparing for the challenges ahead

As market participants embark on this implementation, we believe that they will have to confront a number of challenges. The first will be to ensure the right foundations are in place. MiFIR builds on the requirements of MiFID I, so it’s critically important that the existing transaction reporting capability is fit for purpose so it can cope with the impending upsurge in volume. The Portfolio Exemption Rule introduced by MiFID I in SUP 17.2.2—in which portfolio management firms enjoy a provision for relying on the broker’s reporting of a transaction—will no longer apply in its current form. Because of this, buy-side firms may be unable to rely on brokers to report on their behalf. For most buy-side firms, this assumption of reporting responsibility represents a significant leap into the unknown.

Whether they’re buy-side or sell-side, firms need to build some flexibility into their solution.

Firms must, include realistic assessments of the data challenges created by MiFIR’s broad scope. Mandatory data fields will include natural person identifier, trader and algorithm identification code. Reference data required to comply with MiFIR will be technically and legally difficult to source. Sourcing, storing and maintaining it will require significant effort. Data privacy issues will inevitably arise, including the threat of legal action from countries which have laws against disclosing investor identity. These data challenges must be understood and overcome by all market participants.

Market participants should consider alignment with existing reporting regulations, such as EMIR, REMIT, SFTR, DFA and others. To make maximum use of already overstretched reporting resources and to simplify reporting architecture, it may be possible to find synergies across reporting regimes.

What should firms be doing now?

Think differently, broaden horizons and move fast. Given the short time until MiFIR takes effect, market participants should move quickly to identify and implement a transaction reporting model that is best suited to their business. Shown in the graphic below, choices range from in-house solutions to vendor managed approaches (leveraging market utilities or business process outsourcing).

Decide on the transaction reporting model that suits your firm.

### Option A – Siloed Solution

Tactically add new trade flows and connections to existing transaction reporting architecture.

- **Pros**
  - Short term cost benefits
  - Quick to market
  - Ownership and control

- **Cons**
  - Technology driven
  - Builds on legacy architecture
  - Scalability issues

### Option B – Single Reporting Hub

Create an in-house platform (hub) that meets multiple regulatory requirements of transactional and trade reporting.

- **Pros**
  - Ownership and control
  - Internal efficiencies
  - Extensible solution

- **Cons**
  - Slower to market
  - Requires internal SMEs
  - Cost of delivery

### Option C – Vendor Managed

Transaction reporting through business process outsourcing or utilisation of market utilities.

- **Pros**
  - Potential lower costs
  - Externally managed rules
  - Shared risk

- **Cons**
  - Vendor quality risk
  - Reliance on external vendors
  - Client data risks

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EQT: Equities | IR: Interest Rates | CTY: Commodities | FX: Foreign Exchange | CRD: Credit Derivatives

Source: Accenture Research based on ESMA information from its website: http://www.esma.europa.eu
Some firms may favour a Siloed Solution, bolting new trade flows and connections onto existing transaction reporting architectures. However, ongoing control of reporting, short-term cost benefits and speed-to-market advantages will need to be balanced against the technology challenges that may arise from doing so. Making changes related to scalability and functionality to a siloed solution can be costly and difficult.

Other firms might respond more strategically. This will mean replacing siloed reporting functions with a unified Single Reporting Hub to address multiple regulatory requirements. The benefits of this approach include centralisation of, and greater control over, reporting capabilities. Other benefits in having a repository of transaction data include enhanced management information and completeness and accuracy validation. However, with less than 18 months before MiFIR takes effect, the risk is that it might take too long to implement and represents an expensive one-off cost.

The world has changed enormously since 2007 when firms were reluctant to release ownership of their back-office systems. Today they are under far greater pressure to realise efficiencies and Vendor Managed solutions could offer an alternative to an in-house transaction reporting model. Vendors are developing one stop reporting solutions which integrate business/filter logic, life-cycle events and exceptions management with ARM functionality. However, some firms might yet be unwilling to cede control of their data to third-party providers. At this point, cautious assessments of these capabilities are required. After all, the maturity of market utilities varies considerably and choice of provider remains limited, although this may change in the coming months as utility solutions develop.

In order to be successful, market participants should not only learn from the experience of MiFID I, but be proactive in both identifying and implementing a transaction reporting approach that complements their business model.

Selecting the right response to MiFIR is an urgent priority. Time is short.
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