MiFID II

Transaction reporting

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MiFID II planning and implementation is a top priority for asset managers affected by European regulations and brings with it both challenges and opportunities.

The transaction reporting obligation

Under Article 26(1) of the MiFID II implementing regulation (MiFIR), "investment firms" (EU incorporated entities regulated to provide investment service and activities subject to MIFID II) executing transactions in financial instruments must report complete and accurate details of such transactions to their regulators as quickly as possible, and no later than the close of the following working day.

Financial instruments and activities within scope

Under MiFID I, transaction reporting applies only to financial instruments admitted to trading on a regulated market, plus any OTC contract which derives its value from any such instrument. MiFID II broadens the scope of transaction reporting to capture:

– Financial instruments admitted to trading or traded on an EU trading venue or for which a request for admission has been made. "Trading venues" now include Multilateral Trading Facilities (MTF), and the new category of Organised Trading Facilities (OTF), as well as regulated markets.

– Financial instruments where the underlying instrument is traded on a trading venue.

– Financial instruments where the underlying is an index or a basket composed of instruments traded on a trading venue.

The definition under the Regulatory Technical Standards implementing MiFID II of "transaction" covers the "acquisition, disposal or modification" of a reportable financial instrument, including but not limited to:

– A purchase or sale (this is the current MiFID I definition).

– A simultaneous acquisition and disposal where there is an obligation to publish post-trade, even if there is no change of ownership (e.g., when exercising options).

– The entering into or closing out of derivatives.

Exclusions from the definition of "transaction" include:

– Securities financial transactions (e.g., stock lending, repurchase agreements).

– Post-trade assignments and novations in derivatives.

– Portfolio compressions.

– The creation or redemption of units of a collective investment undertaking by the administrator of the collective investment undertaking.

– The creation, expiration or redemption of instruments resulting from pre-determined contractual terms or mandatory events where no investment decision is occurring.

– A change in the composition of an index after the execution of a transaction.

2007	2011	2014-2015	2016	3 July 2017	3 January 2018
MiFID in force	Proposal for MiFID II	ESMA consults on implementation	MiFID II application delay confirmed	Deadline for incorporation of MiFID II into EU Member State national law	**MiFID II and MiFIR apply**

"Execution" is now defined, in contrast to MiFID 1, as:

– Reception and transmission of orders in relation to one or more financial instruments.

– Execution of orders on behalf of clients.

– Dealing on own account.

– Making an investment decision in accordance with a discretionary mandate given by a client.

– Transfer of financial instruments to or from accounts.

Therefore, where an investment manager makes a decision to deal and passes this order to an executing broker, both parties "execute" here.

Exemptions

"Transmitting firms" may rely on the "receiving firm" to make a transaction report on their behalf if the following conditions are met:

– The order was received from its client or results from its decision to acquire or dispose of a specific financial instrument in accordance with a discretionary mandate provided to it by one or more clients.

– The transmitting firm has transmitted certain information ("order details") to another investment firm (a "receiving firm").

– The receiving firm is subject to Article 26(1) of MiFIR and agrees either to report the transaction resulting from the order concerned or to transmit the order details to another investment firm.

– A transmission agreement must be in place, which must specify the timing for the provision of the order details by the transmitting firm to the receiving firm and provide confirmation that the receiving firm shall validate the order details received for obvious errors and omissions before submitting a transaction report.

Failure by the transmitting firm to provide information to the receiving firm results in an obligation on the transmitting firm to submit this information itself.

The transmission exemption thus provides a mechanism for investment managers to continue to rely on their brokers to report on their behalf, though given the scope of information needed to fall into the "transmitting firm" exemption, a number of UK investment managers intend to report directly to the regulator.

Further, the fact that a "receiving firm" must be an investment firm that itself is subject to the transaction reporting obligation cuts across any ability of an investment manager to rely on a non-EU firm to transaction report on its behalf.

Data required to be submitted

The number of data fields required in the reports will rise significantly: from 23 fields under MiFID I, to 65 under MiFID II. Only 13 of the 23 existing fields remain unchanged.

One particular area of concern is the more exacting details required for identifying the client. Within the UK, under MiFID I it is sufficient to name the investment management firm responsible for initiating the transaction in the "client" field.

Under MiFID II, each and every client (fund, account or natural person) will have to be identified in a standardised format. For funds and managed accounts this must be a valid Legal Entity Identifier (LEI) code.

In addition, there are new requirements to identify both the originator of the decision to trade and those executing it. These include:

– A natural person making the decision to acquire or dispose of a reportable financial instrument or modify an existing contract (e.g., the portfolio manager).

– A committee making such a decision, using a unique identifying code with the prefix "COM". Where this applies, firms must keep adequate records of the composition of the committee, and provide those to the FCA on request.

– An algorithm making a decision to trade (this must be unique and exclusive to each and every trading strategy constituting an algorithm).

– An algorithm actually executing a transaction.

Application to alterative investment fund managers (AIFMs)

Whilst the transaction reporting obligation does not apply to AIFMs who only carry out portfolio management (and so "execute") on behalf of the alternative investment funds (AIFs) they manage, an AIFM that also carries out portfolio management of managed accounts in addition to AIFs (so for UK purposes, a "collective portfolio management investment firm") also "executes" for MIFID II purposes.

However, to the benefit of UK AIFMs, the FCA has confirmed that collective portfolio management investment firms are excluded from the transaction reporting obligation.

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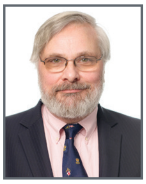

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