THOMSON REUTERS

MiFID II: The Unintended Accelerator in the Next Industry Standards Evolution

Market participants will have to become far more adaptable under the MiFID II regime—not a bad thing in a Darwinian struggle for success or extinction, writes Tim Lind, global head of financial regulatory solutions at Thomson Reuters

Much has been made of the expected impact of the European Union's (EU) pending Markets in Financial Instruments Directive II (MiFID II) on trading firms and their clients, particularly around conduct of business and organizational and infrastructural issues. However, the most sweeping changes apply to the pre- and post-trade transparency regime of EU financial markets. MiFID II extends the current transparency requirements to derivatives and other non-equity instruments traded on any trading venue, including multilateral trading facilities and organized trading facilities.

Systematic internalisers (SIs) and other investment firms that trade over the counter (OTC) in financial instruments will also be subject to expanded pre- and post-trade transparency obligations. Determining whether a dealer is an SI for a given instrument requires the aggregation of total market volume across venues and represents one of the key data challenges imposed under the new rules. The European Securities and Markets Authority (ESMA) will publish volume data on a quarterly basis, but many dealers believe this will not be sufficient. And it does not stop there.

New Data Standards

Reporting in non-equity markets will require transaction-based post-trade transparency, with the provision of price, volume, time of trade and reference characteristics of data remaining the primary reference data considerations, along with codes being created for non-equity-based instruments. To its credit, ESMA is embracing International Standards Organization-based classifications and identification codes in its regulatory technical specifications to further promote the adoption of data standards. However, this creates new challenges.

Tim Lind, Thomson Reuters

Using International Securities Identification Numbers (ISINs) as the protocol for trade reporting will require the assignment of codes to millions of securities that had not previously been identified by an ISIN, most notably derivatives contracts. Accelerating the development of derivative taxonomies capable of describing the economic terms of a contract is also a massive effort requiring collaboration among standards bodies, vendors and practitioners. The system to allocate ISINs will become a critical piece of market infrastructure, which all pre- and post-trade reporting processes will become dependent on.

The speed with which new ISINs need to be created calls for a near real-time process that will require the development of a market infrastructure vastly more sophisticated than exists today. Development of the central engine is one hurdle, but building interfaces with hundreds of trading venues needing ISINs for products they trade is perhaps the biggest challenge. Development, integration and testing of the end-to-end ISIN process must be completed in just over a year, which is extraordinarily ambitious and represents one of the largest risks to MiFID II going live in January 2018.

MiFID II will also require the adoption of other data standards that are still not fully mature, namely market identifier codes (MICs) and legal entity identifiers (LEIs). The assignment of LEI codes has been driven by OTC derivatives reporting, but thousands of additional LEIs will now need to be assigned to market participants across all asset classes. The edict of "no LEI, no trade" will force the registration of thousands of LEIs and challenge market participants to onboard all of these new identifiers into their core databases.

MICs identify the trading venue and must be combined with the ISIN to determine if a security carries a MiFID II reporting obligation. The MIC has existed for decades but has flaws in how codes are assigned and does not always identify venues at the appropriate level of granularity. As a result, combining MICs and ISINs will not only require additional logic but may also result in potential reporting errors.

MiFID II, like many regulations, is well intentioned and will be an effective catalyst to drive adoption of industry standards and the promise of better market transparency. Political considerations will make it very difficult to postpone implementation further, so we expect frenetic activity over the next 12 months. However, the overall time frames for adoption and requisite systems changes will put immense pressure on institutions and service providers to onboard a large amount of new data in a relatively short amount of time. Inevitable shortcuts and unsustainable processes will emerge from the need to hit the January 2018 implementation target date.

With the backdrop of unprecedented re-regulation of financial services, MiFID compliance arrives at one of the more challenging times in the modern history of this industry. As Charles Darwin suggested, it is not the strongest species that survives nor the most intelligent, but the one most adaptable to change. MiFID will enforce this and accelerate the evolution of participants within our industry towards either strength or extinction.

For more information, please visit
mifidii.thomsonreuters.com