MiFID II and its relevance for Asia

Simon Abbott, Senior Regulatory Manager Equity Markets and Commodities at Commerzbank conducted a workshop to explain to Asia-based independent wealth managers the challenges and opportunities arising from MIFIR and MiFID II. He provided a detailed, but concise and thought-provoking introduction.

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ABBOTT WORKS AT COMMERZBANK based in London and is responsible for all regulatory topics within the Equity Markets and Commodities trading business. "I have 40 minutes today, but I could take six months to cover this," he explained. "So, I am going to focus in on three core topics." These, he said, are the MiFIR transparency regime, T+1 reporting and the Asia scope, and the costs, target market and KIDs.

Abbott noted that MiFID II is two regulations comprising MiFIR and MiFID, which together are known as MiFID II, and that came to force on January 3rd 2018.

"The key difference to this regulation is transparency," he explained. "Previous regulations, EMIR in the EU and Dodd-Frank in the US, have all been focussed on risk, as is normal following the global financial crisis. The previous MiFID regulation, MiFID I, went live in 2007, and at that time a mere 4% of people had broadband internet. So, MiFID II is for a very different world today."

Abbott reported that there are three main parts to the MiFIR transparency regime. The first is what is known as a systematic internaliser. "That is a firm that executes client trades on a frequent, systematic and organised basis without operating a trading venue. So, this is a bank or an investment firm that trades extensively Over-The-Counter (OTC) with clients on its own book. For example, at Commerzbank our Exchange Traded Fund (ETF) market making business falls exactly into that systematic internaliser definition. Firms are either included in this definition, or can opt in."

Lifting the veils

What does the transparency regime mean for Asia? "It only affects European investment firms and potentially their branches," Abbott noted, "but European systematic internalisers now have to provide transparency both pre- and post-trade. That will have an impact on Asia. For example, if our Asia branch trades a product that is traded in Europe we will potentially have to show post trade transparency on that, this has not been available before. When combined with the quoting requirements of pre-trade transparency you will never have seen the OTC market in such detail."

Abbott also explained that the post trade reporting times are 1 minute for equity products and 15 minutes for non-equity products including derivatives. "This is immensely challenging," he said. "A consequence of the transparency regime is the huge amount of data. For Commerzbank, for example, on any given day just for the equities and commodities business that I look at, we stream millions of quotes on products. And then there are tens of thousands trade executions. And we are just one of maybe 100 firms."

Data collection and refining

Abbott explained that the massive amount of publically available data from market data vendors could be very valuable. "It will show all the quotes that happened, all the executions that happen, the most popular products, also where they are being traded. For now, the data coming through is not in a perfect form but it will improve markedly and will allow investment firms to realistically start mining it, start producing reports and analysis."

Abbott moved on to T+1 reporting and the Legal Entity Identifier. "For the MiFIR regulation, you have three scenarios where a trade should be reported, all linked back to the EU. Every single trade in Europe now must have a trader and a salesperson, so every single trade is now linked to two people, the execution decision maker and the investment decision maker. For European investment banks with Asia branches, the Asia branch trades must be reported."

Counterparty identification

He further explained that if a firm is solely based in Asia with no European operations, there is no reporting obligation. But the Legal Entity Identifier must be put on every single trade. "This, in turn, should now mean that no European bank or investment firms could trade with a counterparty who does not have an LEI. It has been delayed a further six months because not everybody had the LEI, but from the July 1 if you do not have an LEI you will not be permitted to trade with the universal firms. They will be unable to trade with you."

Abbott moved then to explain the cost and the Key Information Documents (KIDs). He first clarified that the KIDs for PRIIPs regulation (packaged retail investment and insurance-based investment products) are not part of MiFID II and are a separate regulation where the go-live was aligned with MiFID II.

"However, from now financial institutions have to provide clients with cost information for all transactions. Asian firms distributing and selling to European investors will be required to provide a breakdown of those products and those costs. You will have to provide the reports to clients, providing full transparency on what the costs were with quarterly reports, yearly reports and also disclose any inducements they receive. However, it can be very difficult for clients to understand, especially retail clients."

Abbott also explained briefly the MiFID II target market. "Each product manufacturer needs to have a target market for their products, meaning every time they create a product they will state what the target market is. Asian firms that are manufacturing products for European distributors will need a target market created and sent to the European distributor who will define his own target market within the parameters of the manufacturer target market."

He then added further clarity on the subject of KIDs. "This is something that our clients in Asia been asking us about," he reported. "The key information documents are designed to provide information about the product to prospective clients in a very prescribed format. They can only be three pages long and they must be easily understandable by retail investors. A KID should be provided where the product could end up with retail clients. So, in those three pages, you have a huge amount of information and it should be relatively easy to understand."

Abbott conceded that his whistle-stop tour of these key three issues could do little more than scratch the surface in the 40 minutes available. "But," he said, "I hope this has helped bring these key issues to your greater attention and that you will each then further investigate the implications for your firms and clients." ■