Streamlining MiFID II

MiFID II means new complexities, and fund businesses are looking for ways to de-tangle their data streams, says Fundsquare's Paolo Brignardello

The fund industry's inefficient data transaction practices are being exposed to a greater extent by the Markets in Financial Instruments Directive (MiFID) II. This new EU regulation requires players to collect and share substantially more data than under current MiFID I rules. Communication and collection systems based on point-to-point connections, using non-standardised data, risk being more difficult to manage and prone to error.

MiFID II is substantially more comprehensive than its predecessor. MiFID I sought to nudge the financial sector towards greater competition, higher investor protection standards, and a more open EU single market. MiFID II, on the other hand, is conceived as a major response to the consequences of the financial crisis, and has ambitious aims to increase resilience and investor protection.

Fund sector impact

The whole financial sector is affected, with the fund businesses impacted heavily. Changes are needed in transaction reporting, investor protection, governance, and pre- and post-trade transparency. The bottom line is that more data has to be collected, exchanged more frequently, refreshed regularly, and communicated efficiently to clients and counterparties. This will put more strain on IT systems, adding further to complexity. New requirements will include:

- **Investment strategy disclosure:** clients will receive more information on financial instruments, such as functioning and likely performance in different market conditions, investment strategies used in each fund, and appropriate risk warnings. Part of this will be reporting on all instruments traded on organised trading facilities, regulated markets and multilateral trading facilities. The number of reporting fields will be increased from 23 to 81.
- **Investment advice:** products deemed to be complex must be sold with professional financial advice, including non-UCITS funds and certain structured UCITS. MiFID firms that provide investment advice will be obliged to make suitability checks on the investor's risk profile and experience in the relevant investment field.
- **Organisational matters:** the MiFID I rules on outsourcing of certain functions will be tighter and reporting requirements increased.
- **Cost disclosure:** information on explicit and embedded costs and fees must be communicated to both professional and retail clients. This disclosure includes several facets, such as: investment and other services, including the cost of advice; the way costs will be charged; and third-party payments and rebates. Also, when the cumulative effect of costs on return is described, it must be aggregated to show the overall cost to the client.
- **Client statements:** the detail and frequency of communication by asset managers to clients will increase. Statements will be at least quarterly, rather than every six months as at present. They will include data on valuations, a review of activities, performance, any depreciation in the portfolio in excess of 10 percent, and changes on the ownership of assets.
- **Complaints procedures:** rules about complaints will be extended, with the need to publish details of policy and reports.
- **Remuneration:** portfolio managers will be forbidden from accepting fees from many third parties relating to services provided to clients.
- **Competence:** the necessary knowledge and competence of portfolio managers must be ensured and demonstrated to the authorities.

It is clear from this non-exhaustive list that a lot of new data needs sharing within fund companies, and with partners. Luxembourg's cross-border fund industry has grown from nothing to being the world leader in a little over three decades, and information-sharing links have evolved rapidly under the pressure of tight deadlines. The result is that a visual representation of fund firms' information flow relationships would resemble a plate of spaghetti. Non-standardised data and communication systems are widespread. This complication almost invites human error.

Having digested the implications of MiFID II, fund businesses are now seeking efficient ways to cut through the complexity, control costs and limit errors. The confused picture of point-to-point, bilateral communication systems could be replaced by more efficient 'hub and spoke' models.

When possible, it makes more sense to list and share data via a central portal managed for mutual benefit. Much of the infrastructure for achieving this exists already and is reliable, it is just in need of new procedures. Several players are already working on this challenge, but more needs to be done to grow a comprehensive solution. A consortium of industry players could drive this forward to win efficiency and build standardised approaches.

The delay to implementation of MiFID II, confirmed by the European Commission on 10 February, creates an opportunity. A later start date of 3 January 2018 gives financial sector players more time to update IT and train staff. It also allows space to create strategic, simplified, standardised approaches featuring data hubs.

Work is ongoing, with the pioneers starting to set standards as they collaborate to build systems. **AST**