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MIFID II: Transaction Reporting

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A transaction reporting regime has been in place at EU level for some time, albeit much was delegated to national implementation. Under MiFID II, the reporting regime will be overhauled and significantly extended in terms of scope and content. There are other reporting regimes, such as those under EMIR and REMIT, which create some overlapping requirements.

Introduction

This note discusses the transaction reporting requirements under the new Markets in Financial Instruments Directive (“MiFID II”)¹ and the Markets in Financial Instruments Regulation (“MiFIR”).² It is one in a series of client notes that will discuss the changes to the existing regime under the original MiFID I³ that will come into effect on 3 January 2017.

Obligation to Report Transactions in Financial Instruments

In 2007, MiFID I and the implementing Regulation⁴ introduced a harmonised regime of transaction reporting to ensure that regulators have enough trading information to be able to carry out day-to-day oversight of the markets. The general rule requires investment firms executing transactions in financial instruments to report details of their transactions to the national regulator as quickly as possible, and no later than the close of the following working day.

Which Financial Instruments?

The reporting regime of MiFID I only applies to financial instruments admitted to trading on a regulated market - that is, broadly, any security or derivative traded on EU exchanges. As of 3 January 2017, this will be broadened by MiFIR to certain additional categories of financial instruments:

¹ Directive 2014/65/EU.

² Regulation (EU) No 600/2014.

³ Directive 2004/39/EC.

⁴ Commission Regulation (EC) No 1287/2006 of 10 August 2006 implementing Directive 2004/39/EC.

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- those admitted to trading or traded on a trading venue⁵ (now including MTFs and OTFs) or for which a request for admission to trading has been made;
- when the underlying is a financial instrument traded on a trading venue; and
- when the underlying is an index or a basket composed of financial instruments traded on a trading venue.

Transactions should be reported even if they are not carried out on the trading venue. Generally, the investment firm executing the transaction is required to make the report. However, if the firm is not subject to MiFIR and executes a transaction on a trading venue, the reporting obligation is imposed on the operator of the trading venue.

Execution of a Transaction

In its Discussion Paper,⁶ ESMA proposes that, for the purposes of the reporting obligation:

- “transaction” includes actual trades, as well as any change (not related to corporate actions or valuations) in an investment firm’s and/or their client’s position in a reportable instrument; and
- “execution” means any action that results in a transaction and includes so-called “compressions” of derivatives where offsetting derivative transactions are wholly or partly terminated and replaced by fewer transactions with a reduced notional value.

The Discussion Paper sets out certain examples of actions which ESMA considers,⁷ or does not consider⁸ to be, an “execution of a transaction”.

Reporting Obligation Where Order Transmitted to Broker

Under MiFIR, the reporting regime will generally capture investment firms that pass on details of orders received from their clients to other investment firms. It will also cover investment firms acting on a discretionary basis that place orders with other investment firms.

An investment firm that transmits an order to another investment firm may choose either:

⁵ Under MiFIR, the term “trading venue” means a regulated market, a multilateral trading facility (“MTF”) or an organised trading facility (“OTF”).

⁶ Discussion Paper, MiFID II/MiFIR (22 May 2014, ESMA/2014/548).

⁷ E.g., purchases or sales of a reportable financial instrument; assignments, novations, terminations (totally or partially) of a reportable financial instrument, compressions or entering into a derivative contract in a reportable financial instrument; exercises of options, warrants or convertible bonds; when acting under a discretionary mandate on behalf of a portfolio or on behalf of a client, undertaking any of the aforementioned actions or instructing another party to do any of the aforementioned actions, pursuant to an investment decision by the investment firm.

⁸ E.g., issue of scrip dividends and the creation and redemption of exchange-traded funds; redemptions or expiration of securities; using financial instruments as collateral; give-ups for settlement/clearing; corporate events, including mergers, takeovers and stock splits; transactions within the same legal entity which are purely internal.

- to include in the transmission of that order all of the specified details; or
- if the transmitted order is executed, to report it itself.

Where the transmitting firm elects to report the transaction itself, it must include a flag in the report indicating that the transaction relates to a transmitted order. Either one or the other of the transmitting firm or receiving firm will have to report the transaction. ESMA proposes that the transmitting firm should be relieved from the reporting obligation only if certain conditions are met, which broadly are that the information must have been sent to the receiving firm by the transmitting firm, where the receiving firm agrees to make the report pursuant to written agreement with the transmitting firm, and the transmitting firm has the systems and controls to ensure accurate and complete reports.

Transaction Reports - Content

MiFIR sets out specific fields which must be populated in a transaction report and requires ESMA to specify the details to be included in each field. To provide investment firms with an indication of the type of fields which may be reportable under MiFIR, the Discussion Paper includes a sample table and offers some guidance as to the population of particular fields. The intent is to harmonise the content of transaction reports across the EU.

The number of fields in a transaction report will be greater than at present. For example, MiFIR requires the inclusion of new flags such as a waiver flag,⁹ a commodity derivatives flag¹⁰ and a short selling flag. Flagging of short sales will differ from the disclosure obligations under the Short Selling Regulation¹¹ as the latter relates only to disclosure of net short positions to the market or a national regulator. ESMA proposes that two fields should be included in a MiFIR transaction report: a short selling flag to indicate whether the transaction was a short sale within the meaning of the Short Selling Regulation and a separate flag to indicate whether the short sale was undertaken under an exemption from disclosure contained in the Short Selling Regulation.

Another significant change under MiFIR is that a transaction report must include 'details of the identity of the client' and 'a designation to identify the clients on whose behalf the investment firm has executed the transaction'. At present, the decision to collect client details is a matter for individual Member States, but MiFIR now makes client identification mandatory at the EU level. For short sales, there could be an element of duplicative reporting where a reportable net short position is created, which is in addition to disclosure of individual short sales falling under a reportable net short position threshold. Regulators will now be aware of short sales by underlying clients regardless of size or the overall net short position.

Transaction reports should identify the persons (Trader ID) and any computer algorithm (Algo ID) within the investment firm that is responsible for the investment decision and the execution of the transaction. National regulators will therefore have immediate visibility of any algorithms used without having to gather this information from investment firms on an *ad hoc* basis.

Reporting by Branches

Where a firm operates in another EEA member state through a branch, the branch will have to make transaction reports to the host state regulator. For services provided by branches outside the territory of the host Member State, reports will have to be made to the national regulator of the home Member State. All transaction reports received by a

⁹ According to the Discussion Paper, this field will identify the pre-trade transparency waiver used in accordance with Article 4 and 9 of MiFIR.

¹⁰ According to the Discussion Paper, where the relevant financial instrument is a commodity derivative, this field will contain an indication of whether the transaction reduces risk in an objectively measurable way in accordance with Article 57 of MiFID II.

¹¹ Regulation (EU) No 236/2012 of the European Parliament and of the Council of 14 March 2012 on short selling and certain aspects of credit default swaps.

host state regulator will be forwarded to the relevant home state regulator if the latter requests them. Thus, home state regulators should have access to all information about transactions carried out by branches of entities under their supervision.

Currently, this split of responsibilities between home and host state regulators leads to situations where branches report their transactions to two authorities. Helpfully, there is guidance¹² providing for the right of a branch to send all its transaction reports to the home state regulator only. In an attempt to simplify the requirements for firms operating through branches in other Member States, ESMA proposes that the head office of a branch reports the transactions to the home state regulator. Under this model of a “single connection point”, no transaction report is submitted by the branch to the host state regulator. Instead, the home state regulator is expected to share the information with other national regulators where it is most appropriate to do so bearing in mind the following factors:

- the most liquid market of the instrument;
- the host Member State of the branch that holds/maintains the client relationship;
- the host Member State of the branch of the executing trader; and
- the host Member State of the branch that holds the membership of the trading venue, where the transaction was conducted.

For third-country firms carrying out business in a particular Member State through a branch, MiFID II clarifies¹³ that the reporting obligation applies to the relevant branch and that reports should be made to the national regulator of the Member State.

Submission Process and Responsibility

Under MiFIR, the transaction reports can be made either by the investment firm itself or through an Approved Reporting Mechanism (“ARM”)¹⁴ reporting on the firm’s behalf or by the trading venue where the transaction was executed. As a general rule, investment firms are responsible for the completeness, accuracy and timely submission of the transaction reports. ARMs must have systems that can effectively check transaction reports for completeness, and identify omissions and obvious errors caused by the investment firm. Both ARMs and trading venues will be required to have systems in place that enable them to detect errors or omissions caused by the ARM or trading venue itself. An investment firm that has outsourced reporting to ARMs or trading venues must nevertheless take reasonable steps to check whether the transaction reports are correct.

Overlaps with EMIR and REMIT Reporting

Due to the broadened scope of the reporting regime under MiFIR, there is a risk of conflict and duplication with other reporting regimes,¹⁵ in particular the requirements for reporting under the European Market Infrastructure Regulation (“EMIR”) and the Regulation on Wholesale Energy Market Integrity and Transparency (“REMIT”).¹⁶

The reporting obligation under EMIR came into effect on 12 February 2014 and requires counterparties to report derivative transactions of all types, whether over-the-counter or exchange-traded, to an ESMA-registered trade repository (“TR”). To avoid double reporting of the same information, investment firms will be deemed to be in

¹² CESR Level 3 Guidelines on MiFID Transaction Reporting (Ref: CESR/07-301).

¹³ Article 41(2), MiFID II.

¹⁴ Under MiFID II, a person wishing to provide the service of reporting details of transactions to competent authorities or to ESMA on behalf of investment firms must seek prior authorisation as an ARM.

¹⁵ As to any duplicative reporting under the Short Selling Regulation please see above “Transaction Reports – Content”.

¹⁶ Regulation (EU) No 1227/2011 of the European Parliament and of the Council of 25 October 2011 on wholesale energy market integrity and transparency.

compliance with the MiFIR reporting obligation where transactions are reported to a TR in accordance with EMIR and the TR transmits to the national regulator all the information required under MiFIR on time. MiFIR also provides that a TR registered or recognised under EMIR may seek authorisation as an ARM under MiFID II. ESMA has reaffirmed¹⁷ its commitment to work towards a consistent reporting mechanism and, consequently, TRs expect to be able to offer a single reporting service for both EMIR and MiFIR purposes, with the data sets required under EMIR and MiFIR ideally aligned.

There is also a risk that the reporting regime under MiFIR will create an overlap with REMIT. Under REMIT, market participants will be required to provide the Agency for the Cooperation of Energy Regulators (“ACER”) with a record of wholesale energy market transactions, including orders to trade. On 8 July 2014, the European Commission’s DG Energy published an updated draft of the implementing act on data reporting under REMIT.¹⁸ The reporting obligation under REMIT will apply with effect from 6 months¹⁹ after the date on which the implementing act has been adopted. To avoid double reporting relating to transactions covered by REMIT as well as MiFIR or EMIR, the draft implementing act provides that information in relation to wholesale energy products which has been reported in accordance with MiFIR or EMIR shall be provided to ACER by:

- the relevant TRs under EMIR;
- the relevant ARMs under MiFIR;
- the competent authorities under MiFIR; or
- ESMA.

The draft implementing act also clarifies that, where persons have reported details of transactions in accordance with MiFIR or EMIR, their obligation to report those details under REMIT will be considered as fulfilled.

Despite these efforts to coordinate the flows of data required under MiFIR, EMIR and REMIT, it remains to be seen how the alignment of the reporting regimes will work out in practice.

Obligation to Supply Financial Instrument Reference Data

For the purpose of monitoring the activities of investment firms, MiFIR requires trading venues and systematic internalisers to provide national regulators with relevant instrument reference data. As the data required under MiFIR is similar to the details to be notified under the Market Abuse Regulation²⁰ and both regulations provide that the relevant data are published by ESMA on its website, ESMA considers it appropriate to maintain a single list of financial instruments for the purposes of both regulations. The fields to be reported as instrument reference data may vary with the categories of financial instruments. ESMA is considering suitable classification standards together with some guidance on how to populate the proposed fields for each category.

¹⁷ See also Consultation Paper, Draft Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories (25 June 2012, ESMA/2012/379).

¹⁸ Draft Implementing Regulation: COMMISSION IMPLEMENTING REGULATION (EU) No .../.. of XXX on data reporting implementing Article 8(2) and Article 8(6) of Regulation (EU) No 1227/2011 of the European Parliament and of the Council on wholesale energy market integrity and transparency.

¹⁹ Some market participants anticipate an extension of this deadline.

²⁰ Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC.

Obligation to Maintain Records

MiFIR imposes record-keeping obligations on both investment firms and operators of trading venues. There is an extensive and non-exhaustive list of information that trading venues will have to maintain. The relevant data must be transmitted to the national regulator upon request. Such data is meant to supplement the data available under the reporting obligation and should enhance market monitoring during any given period of time.

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