



# **MiFID II: UNDERSTANDING THE REGULATIONS AND EMBRACING REGTECH SOLUTIONS FOR COMPLIANCE**



## **Electronic Assignment Cover sheet**

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**Assignment Title:** MiFID II: Understanding the Regulations and Embracing RegTech Solutions for Compliance.

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## ABSTRACT

MiFID II, the Markets in Financial Instruments Directive II, is a regulatory framework devised to regulate the European financial markets. The MiFID II aims to improve market transparency and investor protection through the compliance requirements imposed on financial institutions. This report explores the evolution of MiFID into MiFID II and the following changes along with its impacts on financial institutions. It includes detailed information on changes introduced by MiFID II in areas like investor protection, governance, transparency, and product governance. Later, we discuss the obligations our financial institution has towards MiFID II, mostly focusing on the market infrastructure, product governance and transaction reporting. We emphasize the need for accurate, detailed and timely reporting of transactions. Additionally, we highlight two RegTech compliance companies, SteelEye and Cleversoft, that offer compliance solutions for MiFID II. We discuss their technical approaches and benefits in detail to ensure regulatory compliance.

## INTRODUCTION

The Markets in Financial Instruments Directive II (MiFID II) is a European Union regulation which was devised to improve investor protection and enhance market transparency in European markets. This report provides an overview of MiFID, how it was created and constantly keeps changing with the changing market. Also, we discuss a few RegTech companies that can help us comply with MiFID II requirements.

A few key objectives of MiFID II/MiFIR are:

- Improving investor protection by making financial institutes provide clearer and more accurate information to their clients.
- Enhancing market transparency by making real-time reporting mandatory and making the financial institutions report more data and information about their trade.
- Also, MiFID helps the markets in the EU have healthy competition by making sure they are all governed by the same rules and laws.

Following are the few obligations of financial institutions under MiFID II/MiFIR:

- Increased regulatory burden – The cost of compliance has increased due to several new requirements set by the MiFID/MiFIR for financial institutions.
- Increased Complexity – The additional reporting requirements have made it challenging for financial institutions to stay compliant with MiFID II/MiFIR.
- Increase in usage of RegTech services – The automation offered by the RegTech companies helps reduce the risk of non-compliance for the financial institutions and hence it becomes alluring for financial institutions to buy these services.

## MIFID II – WHY AND HOW WAS IT CREATED?

The formation of the MiFID II/MiFIR was a result of constantly updating and improving the regulations around the financial instruments. It was updated multiple times to make the directive robust against the latest market scams and frauds. We will now see how the MiFID evolved and reached the latest version of MiFID II/MiFIR.

### ORIGINAL MiFID – Phase one

The original MiFID, the Market in Financial Instruments Directive, focused on making trading fair, smooth and connected across markets like exchanges, bonds, and currencies (*What is MiFID and MiFID II?*, no date). MiFID was introduced in November 2007 to regulate the securities and financial markets in the European Union (EU) (*MIFID Firms / Central Bank of Ireland*, no date).

MiFID covered policies related to the conduct of business and requirements for investment organisations, authorisation for existing regulated markets, continuous reporting to keep market abuse in check, maintaining transparent policies while trading shares and rules for adding new financial instruments for trading platforms. (*Deutsche Börse Group - MiFID I to MiFID II*, no date)

### MiFID II/MiFIR – Phase two

However, the financial crisis in the following year of the adoption of MiFID highlighted the flaws in the directive and the EU rushed to amend the rules in the directive to protect the banks and other financial institutions from collapse (*What is MiFID and MiFID II?*, no date). Later, in January 2018, MiFID was revised and new changes were brought in to ensure further investor protection in the European Economic Area (EEA). The newly revised directive was MiFID II (*MIFID Firms / Central Bank of Ireland*, no date).

The changes in the key areas covered by MiFID II/MIFIR are:

- **Conduct of Business & Investor Protection** – The role of compliance officer has now become more important and they also need to ensure that they educate the people who are selling or advising consumers on the MiFID financial instruments. Also, more information needs to be disclosed to clients regarding the policies as well as remuneration generated by the agents advising.
- **Supervision powers** – The authorities like the European Securities and Markets Authority (ESMA), European Banking Authority (EBA) and the state's own central banking authority has rights to control the marketing of financial instruments when the situation demands.
- **Governance** – The senior management must implement stricter requirements on the investment firms to ensure that they are being compliant with the MiFID II.
- **Broadened Scope** – The MiFID II has widened the list of financial instruments within its scope such as commodities derivatives, interest rate derivatives and FX derivatives.
- **Firm Authorizations** – The firms that provide the financial instruments must get the EU standardized authorization from central authority in the state.
- **Organised Trading Facility (OTF)** are being launched to regulate the non-equity financial instruments like bonds and derivatives.
- **Transaction Reporting** – More information must be included in the report such as identification of the individuals and the OTFs must include the underlying technical details of the instruments responsible for the investment.
- **Transparency** – The overall transparency in the trading venues as well as non-equity instruments has been increased by implements more rules as well as increasing the scope of reporting.

(*MIFID Firms* / Central Bank of Ireland, no date; 'Moodle Week 7 - MIFID continued .pptx', no date)

## QUICK FIX DIRECTIVE – Relaxing MiFID for quick recovery

In February 2022, the Quick Fix Directive was introduced by European Commission as a part of the Capital Markets Recovery package to help the market recover from the COVID-19 pandemic. This directive focused on few essential changes that would ensure the investor protection and help smoothen the decision-making process for investments (*MiFID II: Quick Fix Directive transposed into Irish law, no date*).

The Quick Fix Directive included following changes:

- **Communication media** – Information had to be provided to the customers in electronic form through email or any other such medium instead of paper forms.
- **Product Governance** – Corporate bonds that allowed early retirement of bonds were exempted from product monitoring.
- **Information for investors** – The information such as costs incurred need not be provided before the contracts had finalised and could be provided on demand by customer, the service costs need not be provided in detail, and the investment firms do not have to ensure that the orders were carried out under most suitable conditions anymore.

(‘Factsheet-MiFID-Quickfix-EN.pdf’, no date)

Hence, the MiFID has been constantly amended and enhanced to improve investor protection, enhance market transparency, and foster competition in the European financial markets.

## HOW DOES MIFID II AFFECT OUR INSTITUTION?

MiFID II imposes a wide range of obligations on our financial institution including the authorization, conduct of business and market transparency practices. These obligations must be fulfilled by our financial institutions to make sure we are always compliant with the MiFID II/MiFIR clauses.

Below mentioned are few obligations we must fulfil to comply with the MiFID II policies.



## MARKET INFRASTRUCTURE AND TRANSPARENCY

The market infrastructure includes all the trading venues such as regulated markets, Organised trading facilities (OTFs) and Multilateral trading facilities (MTFs).

- We need to make sure to timely enhance the robustness and capacity of the regulated markets and the MTFs by improving risk management, data reporting and ensuring the stability of the trading venues.
- We also need to make sure to promote organised trading venues to implement wider range of financial instruments by extending our transparency to include non-equity instruments like bonds and derivatives.
- MiFID II also stresses the importance of transparency to make sure the participants in trading have timely and accurate information about the market.
- To comply with pre-trade transparency, we need to make sure to disclose the quotes to trade before executing transactions as this helps our participants get better understanding of market.
- We also need to report the executed trades and make the data available for public for the same reason to make sure the participants can take better trading decisions.

(‘pimco-mifid-ii-transparency-rules.pdf’, no date)

## PRODUCT GOVERNANCE

The product governance makes sure that the financial instruments being produced in market are always compliant and updated according to the current market trends. Also, it helps make sure the participants are aware of the technical details underlying the financial instrument.

- We need to make sure while making new financial instruments that we maintain, operate, and review the process for approval of each instrument before it is released in the market.
- We also need to make sure to constantly monitor if the instrument is relevant to the ever-evolving target market as well as the participants in the market.

- As the financial instrument manufacturer, we need to make sure all correct and precise information is provided to the distributors, and the information is clear and not misleading in any sense.

(‘grant-thornton-mifid-ii-product-governance-2017.pdf’, no date)

## TRANSACTION REPORTING

The transaction reporting under MiFID II helps the National Competent Authorities (NCAs) to recognise abuses in market under Market Abuse Regulation (MAR). Also, this data is useful to monitor market activities, the activities of data reporting service providers and helps analyse the market trends.

- We need to make sure to comply with the following reporting obligations
  - Transaction reporting
  - OTC trade
  - Systematic Internaliser Services
  - Best Execution
- We as an investment firm must report complete accurate detailed information of transactions in financial instruments to the competent authority as quickly as possible.

### Transaction reporting

- Transaction reports must include details of name and number of financial instruments bought or sold, the quantity of instruments along with date, time, and price of the transaction.
- Other important details like Transaction reference number, trading venue transaction identification code, Buyer/Seller identification code, Instrument identification code should be included in the transaction reports.
- The people or algorithms responsible for the investment decision and execution of transaction must also be reported. (‘160728-rts-22-annex\_en.pdf’, no date; ‘Moodle Week 7 - MIFID continued .pptx’, no date)

### Over the Counter (OTC) trade reporting

- OTC trade report aims to enhance transparency if trade between the two parties involved outside of the trading venue.
- For each OTC executed we must report the details such as price, quantity, and time of trade along with other details mentioned in the transaction reporting.
- These reports should be published in real-time and can be done with help of Approved Publication Arrangement (APA).

### Systematic Internaliser reporting

- A Systematic Internaliser is a financial institution that on a frequent and systematic basis deals on own account when dealing with customers which are outside the regulated market, an MTF or an OTF.
- Each Investment Firm (IF) is required to make a quarterly assessment on its previous 6 months' data to determine if it qualifies as a Systematic Internaliser (SI).
- We need to make sure to notify the Central Bank when we became a Systematic internaliser since we are going to opt-in to become a Systematic internaliser.
- We must make pre-trade quotes public through trading venues and also need to make sure to provide the quotes on demand to any participant.
- We must perform post-trade transaction reporting in which all information related to the trades undertaken needs to be reported to Approved Reporting Mechanisms (ARMs).
- As a Systematic Internaliser we need to make sure to provide quotes for liquid financial instruments such as shares, bonds, and make them available to public on request.
- We must report details of the transactions in these financial instruments to the relevant regulatory authority which must include price, quantity, date, time, and venue of transaction.

### Best Execution reporting

- Best Execution reporting requirements are designed to promote transparency and accountability in the investment industry.

- This obligation requires us to take all sufficient steps to reach best possible result considering the execution factors, when undertaking client orders.
- The financial instruments that come under this reporting are Equities, bonds, derivatives, structured financial products, and so on.
- We have to provide periodic reports to show the quality of our best execution practices and includes details about the type, venue, price, and time of execution of the order.
- The reports must include the category of financial instrument used, the venue where the client order was executed and the factors affecting the choice of execution venue.
- Also the reports must contain information on how orders will be executed by the financial institution explained clearly, in details and in a way that can be easily understood by participants.

('Moodle Week 7 - MIFID continued .pptx', no date)

## INDUCEMENT AND UNBUNDLING OF RESEARCH

- The inducements received by the firms cannot be retained if they are not being used to enhance the quality of service to the client and do not affect the financial institution's drive to act honestly and fairly with best interest of participant in mind.
- We can retain the non-monetary benefits which are clearly disclosed to the clients.
- Under this clause the cost of research now must be "unbundled" from the cost of other services provided and the participants must be informed on the fee structure.
- We need to make sure the client is well informed on mechanisms for transferring the fee, commission, monetary or non-monetary benefits received by firm when the trade is being made.
- Under MiFID II we are obliged to execute on basis of most favourable terms to our clients and hence the research cost included while researching these best

terms has to be displayed separately and clearly from the cost of the order execution services.

('trv\_2020\_2-mifid-ii-research-unbundling-first-evidence.pdf', no date)

## REGTECH SOLUTIONS FOR COMPLIANCE ASSISTANCE

There are several good RegTech companies that offer solutions for MiFID II compliance for financial institutions. The services offered by these RegTech companies help automate the reporting and other regulatory tasks and hence make the compliance process easier and more efficient for the financial institutions. Below are two of the best RegTech companies with details on how they help with our reporting needs and benefits of using their services.

### SteelEye

SteelEye is a RegTech company that specializes in regulatory compliance solutions for financial institutions. They provide a platform which helps with MiFID II compliance including **transaction reporting, best execution, and record-keeping services**. It helps the financial institutions to comply with transaction reporting obligations.

Technology used – SteelEye uses technologies like AI, machine learning and integrated cloud-based platforms. This helps in integrating data across platforms, filtering the data, and maintaining uniform formats to ensure compliance with reporting requirements.

We should choose the services offered by SteelEye, for MiFID II compliance, as it provides comprehensive platform that addresses transaction reporting and additional services like infrastructure reconstruction and best execution monitoring. Also, it uses the latest technologies that helps us comply easily and more efficiently with the MiFID compliance requirements. (SteelEye, no date)

## Cleversoft

Cleversoft is a RegTech company that specializes in providing compliance solutions for financial institutions in regulatory compliance including MiFID II/MiFIR regulations. Cleversoft can assist our financial institution in regulatory reporting, compliance management and data management solutions. They provide tools that help **automate transaction reporting, increase accuracy of the reports, and send timely reports to the concerned authorities.**

Technology used – Cleversoft uses technology like data analytics, automation, and robust data management to make sure we can experience seamless reporting compliance.

We should choose Cleversoft as a tool for MiFID II compliance as the services offered by them are in-line with our requirements. They aid with regulations on complex reporting and compliance imposed on us by MiFID II/MiFIR. Their automated solutions help reduce manual errors and inefficiencies. Also, their ever-evolving solutions will help us keep in pace with the changing regulatory requirements. We can rely on Cleversoft's expertise and technology to reduce risk of non-compliance (*MiFID II Product Governance*, no date).

## CONCLUSION

In Conclusion, the MiFID II/MiFIR stands as a strong regulatory framework which affects the operations and compliance obligations of financial institutions. Throughout this report we have seen the complications of the directive and the main objectives as well as best practices from a compliance point of view. We can see that the strict reporting requirements and compliance standards make the financial institutions very active and alert. Also, the financial institutions have to efficiently manage large amounts of data and accurately report all trade details using this data.

The financial institutions thus, must embrace the technology driven solutions to handle the complex requirements of MiFID II/MiFIR. RegTech companies play an important role in offering custom solutions to automate these complicated processes and enhance compliance monitoring. These solutions enable financial institutions to not only meet regulatory requirements but also reach operational efficiency and risk management. Moreover, using these services offered by the RegTech companies the financial institutions can redirect their resources towards other important sectors.

Hence, it is important for financial institutions to adopt and evolve on faster pace and make sure to constantly be alert and keep improving compliance strategies. Getting involved early with RegTech tools, along with always striving to do things better and having strong commitment to following the law, will help financial institutions handle MiFID II/MiFIR rules in better way. This is not just about obeying the rules, it is also about doing things really well, building trust with everyone involved, and making the company strong in a constantly changing financial world.

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