MiFID II Transaction Reporting

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Quick Read

1. From January 3, 2018, the current MiFID I transaction reporting requirements will be replaced by the new MiFIR transaction reporting regime. The new rules are found in Article 26 of MiFIR and in RTS 22. ESMA Guidelines on transaction reporting, order record keeping and clock synchronisation under MiFID II providing significant additional clarity.

2. The core reporting obligation is that investment firms which execute transactions in financial instruments must report complete and accurate details of those transactions to their home competent authority as quickly as possible, and no later than the close of the following working day. The term "execute" has a wide meaning in the transaction reporting context.

   In addition, obligations are imposed on firms which "transmit" orders and the operator of a trading venue must report details of transactions in financial instruments traded on its platform which are executed through its systems by a firm which is not subject to MiFIR. In determining whether a transaction is reportable, where the instrument is traded is not relevant.

3. The reporting obligation applies to:

   (i) investment firms authorised under MiFID II;

   (ii) credit institutions authorised under CRD IV when they are providing investment services and/or performing investment activities; and

   (iii) market operators, including any trading venues they operate.

   UCITS ManCos and AIFMs are not subject to the reporting obligations, even where they have extended their authorisations to include individual portfolio management. (Note that in some jurisdictions, they have in fact been brought within the reporting obligation).

4. The new regime covers a wider range of instruments, requires a significant amount of additional information to be included within the transaction reports and imposes new reporting methods and formats over and above the current regime.

5. Transaction reporting is to be made to the firm's home competent authority and must be made by the firm or by its approved reporting mechanism or by the trading venue operator.

6. Significant control, security, technological obligations apply.

7. The new obligations apply from 3 January, 2018. The current MiFID rules apply up until that date.

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Introduction

The three main reasons for requiring that details of transactions in financial instruments be reported to competent authorities are that transaction reporting enables the competent authorities:

- to detect and investigate potential cases of market abuse
- to monitor the fair and orderly functioning of markets, and
- to monitor the activities of investment firms.

These may not give much comfort to those subject to the onerous reporting obligation, but they do give context to the regime described in this paper and to the requirement to not only identify the person responsible for execution of the transaction but also the person who made the investment decision.

What is the transaction reporting obligation?

The basic reporting obligation under Regulation (EU) No. 600 / 2014 of the European Parliament and of the Council of 15 May 2014 ("**MiFIR**") is that investment firms which execute transactions in financial instruments must report complete and accurate details of transactions to their home competent authority as quickly as possible, and no later than the close of the following working day.

In scope are transactions in financial instruments which are traded on a trading venue; and transactions in financial instruments where the underlying is a financial instrument traded on a trading venue or where the underlying is an index or basket composed of financial instruments traded on a trading venue.

Who do the rules apply to?

The transaction reporting obligation rules apply to:

(i) investment firms (as defined in Article 4(1)(1) of MiFID II); and

(ii) credit institutions when providing investment services and / or performing investment activities; and

(iii) market operators including any trading venues they operate;

(each a "**firm**")

Interestingly, they do not apply to UCITS ManCos or to AIFMs, even where they have extended their authorisations to include individual portfolio management. We understand that certain jurisdictions have, however, extended the transaction reporting obligation to those extended authorisation UCITS ManCos and AIFMs.

Where can I find the rules?

The transaction reporting rules are found in Article 26 of MiFIR and in Commission Delegated Regulation (EU) 2017/590 of 28 July 2016 supplementing MiFIR with regard to regulatory technical standards for the reporting of transactions to competent authorities ("**RTS 22**").

Article 26 of MiFIR imposes the reporting obligations, whereas the aim of RTS 22 is, amongst other things, to:

- explain what is meant by a "transaction";
- create consistency in the standards and formats used when reporting transactions;
- clarify which firms must report and in that context, in particular, what is meant by "executing" a transaction and what is "transmission";
- set down rules designed to avoid non-reporting or double reporting and rules relating to legal entity identifiers; and
- set down rules as to identification of persons or computer algorithms which make investment decisions (for market abuse purposes).

ESMA Guidelines

In addition to MiFIR and RTS 22, the European Securities and Markets Authority ("**ESMA**") has issued very detailed Guidelines on transaction reporting, order record keeping and clock synchronisation under MiFID II (the "**ESMA Guidelines**") which apply, with effect from 3 January, 2018, to investment firms, trading venues, approved reporting mechanisms ("**ARMs**") and competent authorities.

The section of the ESMA Guidelines on transaction reporting is split into four parts:

Part I – General principles. This part describes the general principles to apply to transaction reporting. It covers how to construct a transaction report, and in what circumstances and where to send the report. It provides high level approaches to reporting and further guidance on certain exclusions from the meaning of transaction as specified in Article 2(5) of RTS 22.

Part II - Blocks. This part covers blocks (collection of fields), where each block addresses the relevant fields for a particular topic, with accompanying examples of how to populate these. The blocks are structured to be independent of each other.

Part III - Scenarios. This part provides examples based on different trading scenarios that a reporting party might experience. In particular, transactions resulting from transmissions of orders, grouped orders and the provision of Direct Electronic Access ("**DEA**") are presented.

Part IV - Instruments. This part focuses on reporting guidance for various financial instruments. Most examples are focused on derivatives given that these financial instruments have a more complex reporting pattern.

The ESMA Guidelines are extremely detailed, addressing in a very practical way most reporting scenarios that one can envisage.

Central Bank Publications

The Central Bank of Ireland ("**Central Bank**") has issued several transaction reporting documents including, but not limited to:

- Test Online Reporting System – MiFIR Transaction Reporting User Procedure Document (Draft) [27 September 2017]

- Transaction Reporting under Regulation 600/2014 ('MiFIR') – Operational and Technical Arrangements [26 September 2017]

- Letter to Industry re MiFIR Transaction Reporting – Testing Arrangements [23 June 2017]

The Central Bank has also issued several other communications on the MiFIR transaction reporting topic. It expects that firms will by now :

- have assessed, and understand, the impact that MiFIR has on their transaction reporting processes and procedures;

- be fully informed of their obligations; and

- have made key decisions with regards to meeting their obligations (e.g. using the services of an Approved Reporting Mechanism.

Timing

The new reporting obligations apply from 3 January, 2018 and are expected to involve significant costs (IT, process enhancement, training costs, legal costs) for firms. The current MiFID rules apply up until that date.

Trading Capacities

The ESMA Guidelines provide background information on the purpose of transaction reporting and very useful explanations as to how to report across the three different trading capacities. In this section of this paper we have simply replicated (or summarised) those parts of Part 1 – General Principles of the ESMA Guidelines that explain the reporting obligation in the context of the three different trading capacities.

Purpose

The purpose of transaction reporting is to provide competent authorities with information about transactions in a way that informs the competent authority about all relevant circumstances under which the transaction took place.

Market side AND Client Side

Depending on the trading capacity of the investment firm and whether or not it is dealing for a client, a transaction may have to be reported in more than one report and the individual reports for a transaction should be consistent with each other and accurately reflect the roles of the investment firm, its counterparties, the clients and the parties acting for the clients under a power of representation. An investment firm's transaction reports should include not only the information about the market side of the transaction but also information about any associated allocation to the client, where relevant.

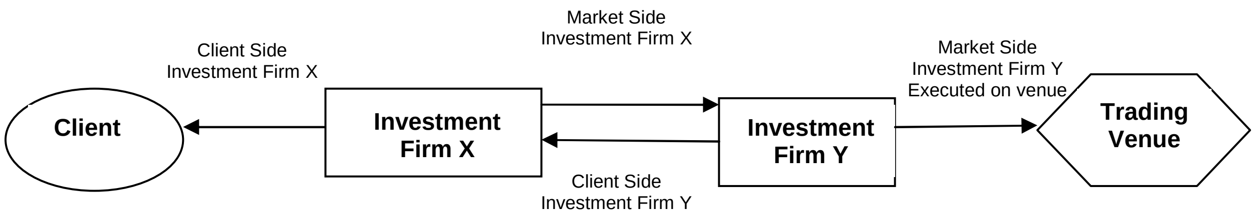
For example, where investment firm X, acting on behalf of a client, purchases financial instruments from investment firm Y, then X should report that it has traded with Y for X's client.

If investment firm X is buying the financial instruments from investment firm Y on an **own account** basis and sells those financial instruments to a client, then the purchase from investment firm Y and the sale to the client should be reported in two separate own account transaction reports.

Similarly, where an investment firm executes a transaction with another firm by aggregating several clients it should report the aggregate ("**block**") trade with the firm or investment firm ("**market side"**) as well as the individual allocations to its clients ("**client side**"). Where an investment firm is trading on a trading venue for a client on an own account basis it should submit two transactions reports: one for the transaction with the trading venue (market side) and the other for the transaction with the client (client side).

Where an investment firm is acting on a **matched principal** or '**any other capacity'** basis for a single client then it should submit a single transaction report encompassing both the market side and the client side and should include all the fields applicable to the client.

ESMA gives the following diagram to illustrate these concepts:



Trading capacities

There are three different trading capacities that may be reported: *dealing on own account; matched principal* and '*any other capacity'*. The reported trading capacity should reflect the capacity in which the firm actually traded and should be consistent with the rest of the information in the firm's transaction report(s). ESMA has explained these below but note that what follows below is a highly truncated extract from the ESMA Guidelines on these capacities. Significant additional detail – and examples – is given in the Guidelines themselves.

(i) Dealing on own account ("DEAL")

Where an investment firm is **dealing on own account**, it should be reported as either the buyer or seller in the transaction report. The corresponding seller or buyer will be the counterparty or client or trading venue that the investment firm is dealing with.

The firm may be acting purely to action its own proprietary trades or may be acting on own account with a view to filling orders that it has received from a client. In the latter case, the trading time and date for the client side report may be the same as for the market side report or could be later and the price of the market side and client side report could be the same or could differ.

(ii) Trading in a matched principal trading capacity ("MTCH")

Article 4(1)(38) of MiFID II defines **matched principal** trading as a "*transaction where the facilitator interposes itself between the buyer and the seller to the transaction in such a way that it is never exposed to market risk throughout the execution of the transaction (…)*". Consequently, the transaction report should show that the executing investment firm does not have a change of position as a result of the transaction.

Where there is only one client a single transaction report should be submitted including both the market side and client side information. The client(s) should be populated in the buyer/seller field while the venue or counterparty should be populated in the seller/buyer field.

(iii) Trading in an 'any other capacity' ("AOTC")

All other activity that does not come under the definitions of own account trading or matched principal trading should be reported with a trading capacity of '**any other capacity**' which includes where the activity is taking place on an agency basis.

(iv) Restrictions on trading capacities

Investment firms dealing on own account or on a matched principal trading basis are acting directly themselves and cannot 'transmit orders' under Article 4 of RTS 22 as any orders they submit to another firm are their own orders rather than being transmission of an order received from a client or resulting from a decision to acquire or dispose of a financial instrument for a client under a discretionary mandate.

Therefore where investment firms transmit orders but do not comply with the conditions for transmission under Article 4 of RTS 22, ESMA only expects them to report in an 'any other capacity'.

A DEA provider should report as acting in AOTC or MTCH capacity.

The Transaction Reporting Obligation

Who has to report?

As noted earlier, the obligation to report is imposed on **investment firms which execute transactions** in financial instruments. However, it is not just firms which execute transactions which are subject to obligations.

Firms which transmit orders in financial instrument are required to include in the transmission of the order all the details specified below (see p.12) to the extent known / applicable. Instead of including those details when transmitting the order, the firm can choose to report the transmitted order, if it is executed, as a transaction in accordance with the requirements for firms which execute transactions. In such a case, the transaction report by the firm shall state that it relates to a transmitted order.

Where a firm which is not subject to MiFIR executes a transaction in financial instruments on a trading venue via that venue's systems, the operator of the trading venue must report details of the transaction.

Note that the terms "*execute*" and "*transmit*" have wider meanings in this context.

What is a transaction?

The obligation to report is in relation to "transactions" in financial instruments. So what is a transaction? The conclusion of an **acquisition** or **disposal** of a financial instrument constitutes a transaction.

An *acquisition* includes a purchase of a financial instrument; entering into a derivative contract; and an increase in the notional amount of a derivative contract.

A *disposal* includes the sale of a financial instrument, closing out of a derivative contract; and a decrease in the notional amount of a derivative contract.

A transaction also includes a simultaneous acquisition and disposal of a financial instrument where there is no change in the ownership of that financial instrument but post-trade publication is required under Articles 6, 10, 20 or 21 of MiFIR.

RTS 22 includes at Article 2(5) a long list of items which do <u>not</u> constitute a transaction for reporting purposes including:

- securities financial transactions (e.g. stock lending, repurchase agreements);
- post-trade assignments and novations in derivatives,
- portfolio compressions,
- the creation, expiration or redemption of instruments resulting from pre-determined contractual terms or mandatory events where no investment decision is occurring; and
- a change in the composition of an index after a transaction has taken place.

The full list is reproduced in Appendix 1 to this paper

Which financial instruments?

The term "financial instrument" refers to a financial instrument specified in Section C of Annex I to the MiFID II Directive.

What is "execution" of a transaction?

A firm will be deemed to have executed a transaction where it provides any of the following services or performs any of the following activities that result in a transaction:

(i) reception and transmission of orders in relation to one or more financial instruments;

(ii) execution of orders on behalf of clients;

(iii) dealing on own account;

(iv) making an investment decision in accordance with a discretionary mandate given by a client;

(v) transfer of financial instruments to or from accounts.

A firm will not be deemed to have executed a transaction where it has transmitted an order.

What is "transmission" of an order?

A firm transmitting an order will be deemed to have transmitted that order only if the following conditions are met:

(i) the order was received from its client or results from its decision to acquire or dispose of a specific financial instrument in accordance with a discretionary mandate provided to it by one or more clients;

(ii) the transmitting firm has transmitted the order details referred to below (*Which order details to transmit*) to another investment firm (receiving firm);

(iii) the receiving firm is subject to Article 26(1) of MiFIR and agrees either to report the transaction resulting from the order concerned or to transmit the order details in accordance with these same requirements to another investment firm.

The agreement referred to in (iii) must specify the time limit for the provision of the order details by the transmitting firm to the receiving firm and must provide that the receiving firm will verify whether the order details received contain obvious errors or omissions before submitting a transaction report or transmitting the order.

When transmitting an order, which details to transmit?

The following order details must be transmitted, insofar as pertinent to a given order:

(a) the identification code of the financial instrument;

(b) whether the order is for the acquisition or disposal of the financial instrument;

(c) the price and quantity indicated in the order;

(d) the designation and details of the client of the transmitting firm for the purposes of the order;

(e) the designation and details of the decision maker for the client where the investment decision is made under a power of representation;

(f) a designation to identify a short sale;

(g) a designation to identify a person or algorithm responsible for the investment decision within the transmitting firm;

(h) country of the branch of the investment firm supervising the person responsible for the investment decision and country of the investment firm's branch that received the order from the client or made an investment decision for a client in accordance with a discretionary mandate given to it by the client;

(i) for an order in commodity derivatives, an indication whether the transaction is to reduce risk in an objectively measurable way in accordance with Article 57 of MiFID II Directive;

(j) the code identifying the transmitting firm.

Avoiding Non-Reporting or Duplication

In order to avoid non-reporting or double reporting by firms which transmit orders to each other, the firm that intends to transmit the order should agree with the firm receiving the order whether the receiving firm will report all the details of the resulting transaction or transmit the order onwards to another investment firm.

In the absence of an agreement, the order should be deemed not transmitted and each firm should submit its own transaction report containing all the details that pertain to the transaction that each firm is reporting.

The reason for setting out which details relating to the order to be transmitted between firms should be specified is to ensure that the competent authorities receive information that is relevant, accurate and complete.

What has to be reported and how?

Article 1 and Annex I of RTS 22 set out the required transaction report details as well as the submission standards and formats.

All details to be included in transaction reports must be submitted in accordance with those standards and formats, in an electronic and machine-readable form and in a common XML template in accordance with the ISO 20022 methodology.

What information must be included in the transaction report?

Transaction reports must, in particular, include:

(i) details of the names and numbers of the financial instruments bought or sold;

(ii) the quantity;

(iii) the dates and times of execution;

(iv) the transaction prices;

(v) a designation to identify the clients on whose behalf the investment firm has executed that transaction [using a legal entity identifier or "**LEI**" established to identify clients that are legal persons];

(vi) a designation to identify the persons and the computer algorithms within the investment firm responsible for the investment decision and the execution of the transaction;

(vii) a designation to identify the applicable waiver under which the trade has taken place;

(viii) means of identifying the investment firms concerned; and

(ix) a designation to identify a short sale [as defined in Article 2(1)(b) of Regulation (EU) No. 236 / 2012] in respect of any shares and sovereign debt within the scope of Articles 12, 13 and 17 of that Regulation.

The format and fields are set out in the Annex to RTS 22.

Identification Obligations?

In the report you need to identify:

(i) the investment firm executing a transaction (by LEI);

(ii) natural persons (specific code requirements);

(iii) client (full name and DOB). Where client is not the decision taker, identify the decision maker;

(iv) person or computer algorithm responsible for the investment decision: Where more than one, you must identify the person taking primary responsibility for the decision;

(v) the person or computer algorithm responsible for execution of a transaction;

(vi) any applicable waiver;

(vii) a short sale;

(viii) execution for a combination of financial instruments.

The Dillon Eustace Listing Team can assist you in obtaining LEI codes in advance of MiFID II reporting but warn that given the significant increase in the volume of code requests, requests for LEI codes are taking a number of 3 weeks to process. It would be advisable to start the process soon, rather than wait until closer to January 2018. .

See recent Dillon Eustace briefing on **LEI Codes – MiFID II Requirements and Regulatory update** [June 2017].

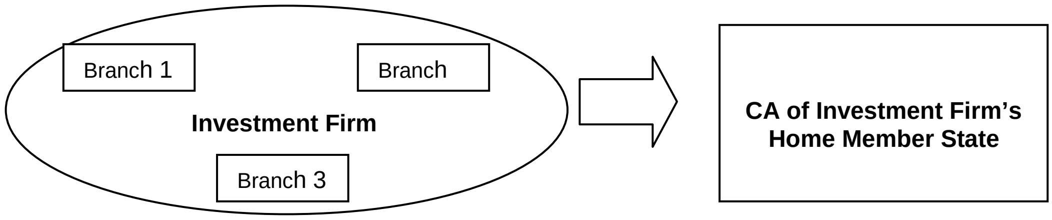
Which competent authority do you report to?

The reports should be made to the investment firm's home competent authority.

Reporting transactions executed by branches

Transactions executed wholly or partly through a branch of an investment firm should be reported by the firm to the competent authority of the firm's home Member State, unless otherwise agreed by the competent authorities of the home and host Member States.

Where a firm executes a transaction wholly or partly through its branch, it should report the transaction only once.



In the case of EU branches of third country firms, if the third country firm has only one EU branch, the transaction report should be submitted to the competent authority which authorised the branch.

If it has more than one branch in more than one EU member state, then one of the competent authorities in those member states must be chosen by the branches and it then is the competent authority to submit the reports to.

Short Sales?

Short sale transactions should be specifically flagged as such regardless of whether they constitute a full or partial short sale transaction.

Transactions in a combination of financial instruments

Investment firms which execute transactions in a combination of financial instruments should report the transaction for each financial instrument separately and link those separate reports by an identifier that is unique at the level of the firm to the group of transaction reports related to that execution.

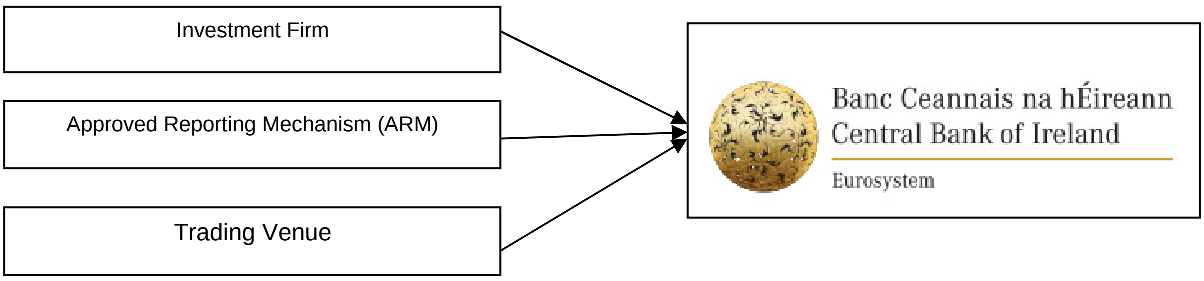
How to report?

The reports are to be made by either:

(i) the investment firm itself;

(ii) by ARM acting on behalf of the investment firm; or

(iii) by the trading venue through whose system the transaction was completed.



Responsibility, Security and Ancillary Matters

Who is responsible?

As noted above, transaction reports must be made to the competent authority either by the firm itself, an ARM acting on its behalf or by the trading venue through whose system the transaction was completed.

The investment firm has the responsibility for the completeness, accuracy and timely submission of the reports which are submitted to the competent authority. However, where a firm reports details of those transactions through an ARM which is acting on its behalf or a trading venue, the firm will not be responsible for failures in the completeness, accuracy or timely submission of the reports which are attributable to the ARM or trading venue. In those cases (and subject to Article 66(4) of MIFID II Directive), the ARM or trading venue should be responsible.

Investment firms must, nevertheless, take reasonable steps to verify the completeness, accuracy and timeliness of the transaction reports which were submitted on their behalf.

Errors and Corrections

Where there are errors or omissions in the transaction reports, the ARM, investment firm or trading venue reporting the transaction must correct the information and submit a corrected report to the competent authority.

Methods and arrangements for reporting financial transactions

The methods and arrangements by which transaction reports are generated and submitted by trading venues and investment firms must include:

(a) systems to ensure the security and confidentiality of the data reported;

(b) mechanisms for authenticating the source of the transaction report;

(c) precautionary measures to enable the timely resumption of reporting in the case of a failure of the reporting system;

(d) mechanisms for identifying errors and omissions within transaction reports;

(e) mechanisms to avoid the reporting of duplicate transaction reports, including where an investment firm relies on a trading venue to report the details of transactions executed by the investment firm through the systems of the trading venue in accordance with Article 26(7) of Regulation (EU) No 600/2014;

(f) mechanisms to ensure that the trading venue only submits reports on behalf of those investment firms that have chosen to rely on the trading venue to send reports on their behalf for transactions completed through systems of the trading venue;

(g) mechanisms to avoid reporting of any transaction where there is no obligation to report under Article 26(1) of Regulation (EU) No 600/2014 either because there is no transaction within the meaning of Article 2 of this Regulation or because the instrument which is the subject of the transaction concerned does not fall within the scope of Article 26(2) of Regulation (EU) No 600/2014;

Appendix 1

Items which are NOT transactions for reporting purposes

A transaction for the purposes of Article 26 of Regulation (EU) No 600/2014 shall not include the following:

(a) securities financing transactions as defined in Article 3(11) of Regulation (EU) 2015/2365 of the European Parliament and of the Council ;

(b) a contract arising exclusively for clearing or settlement purposes;

(c) a settlement of mutual obligations between parties where the net obligation is carried forward;

(d) an acquisition or disposal that is solely a result of custodial activity;

(e) a post-trade assignment or novation of a derivative contract where one of the parties to the derivative contract is replaced by a third party;

(f) a portfolio compression;

(g) the creation or redemption of units of a collective investment undertaking by the administrator of the collective investment undertaking;

(h) the exercise of a right embedded in a financial instrument, or the conversion of a convertible bond and the resultant transaction in the underlying financial instrument;

(i) the creation, expiration or redemption of a financial instrument as a result of pre-determined contractual terms, or as a result of mandatory events which are beyond the control of the investor where no investment decision by the investor takes place at the point in time of the creation, expiration or redemption of the financial instrument;

(j) a decrease or increase in the notional amount of a derivative contract as a result of pre-determined contractual terms or mandatory events where no investment decision by the investor takes place at the point in time of the change in the notional amount;

(k) a change in the composition of an index or a basket that occurs after the execution of a transaction;

(l) an acquisition under a dividend re-investment plan;

(m) an acquisition or disposal under an employee share incentive plan, or arising from the administration of an unclaimed asset trust, or of residual fractional share entitlements following corporate events or as part of shareholder reduction programmes where all the following criteria are met:

(i) the dates of acquisition or disposal are pre-determined and published in advance;

(ii) the investment decision concerning the acquisition or disposal that is taken by the investor amounts to a choice by the investor to enter into the transaction with no ability to unilaterally vary the terms of the transaction;

(iii) there is a delay of at least ten business days between the investment decision and the moment of execution;

(iv) the value of the transaction is capped at the equivalent of EUR 1 000 for a one-off transaction for the particular investor in the particular instrument or, where the arrangement results in transactions, the cumulative value of the transaction shall be capped at the equivalent of EUR 500 for the particular investor in the particular instrument per calendar month;

(n) an exchange and tender offer on a bond or other form of securitised debt where the terms and conditions of the offer are pre-determined and published in advance and the investment decision amounts to a choice by the investor to enter into the transaction with no ability to unilaterally vary its terms;

(o) an acquisition or disposal that is solely a result of a transfer of collateral.

The exclusion provided for in point (a) of the first subparagraph shall not apply to the securities financing transactions to which a member of the European System of Central Banks is a counterparty.

The exclusion provided for in point (i) of the first subparagraph shall not apply to initial public offerings or secondary public offerings or placings, or debt issuance.

Article 2(5) lists off a long list of items which do <u>not</u> constitute a transaction for reporting purposes.

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