Thistle Initiatives

Financial services compliance, without the complexity

MiFIR Transaction Reporting Six Years On

Whitepaper

In collaboration with

LSEG POST TRADE

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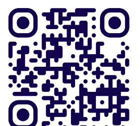

2018 – A seismic change in reporting requirements

An increase in transaction reporting requirements went live in January 2018 under the MiFID II package, increasing the scope and complexity of transaction reporting in the EU. These requirements were transposed into UK law post Brexit. Previously, MiFID only required up to 24 fields to be populated in a report[1], but MiFID II / MiFIR increased this number to 65 XML fields (and many of these XML fields comprise multiple data elements; for example, 'price' actually requires both a 'value' and a 'price type'). However, this change wasn't simply a case of additional fields; it also introduced the reporting of new asset classes (FX, commodity and interest rate derivatives), new reference data standards such as the use of Legal Entity Identifiers (LEIs), and the obligation to provide meaningful identifiers for individuals – whether they are clients, traders or decision makers within a firm. It also changed the scope of entities caught by the reporting requirements and this particularly impacted the buy side where many more firms had to start reporting as previous "exemptions" no longer applied.

Whilst the changes to MiFID reporting were substantial and created additional complexity, these were required by the regulators in order to ensure fair and efficient monitoring could be applied in an evolving market.

Data Quality – "Complete and Accurate" Reporting

The very first line of MiFIR Article 26 states:

> ***"Investment firms which execute transactions in financial instruments shall report complete and accurate details of such transactions to the competent authority..."***

This mantra of ***"complete and accurate"*** transaction reporting is emphasised throughout the Technical Standards and repeated throughout the numerous FCA communications with firms[2]. The FCA provides firms with a wealth of information on transaction reporting requirements and its expectations of firms via its web page **https://www.fca.org.uk/markets/transaction-reporting**

It is telling that the opening statement on this page is:

> ***"Complete and accurate data is critical to transaction reporting. In order to be able to monitor for market abuse effectively, we need to receive complete and accurate information regarding the types of instruments, when and how they are traded and by whom."***

The regulators are prescriptive on the systems and controls that firms need to have in place to help meet the over-arching ***"complete and accurate"*** obligation. These are detailed in Article 15 of RTS 22 and include:

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1 Although many National Competent Authorities 'gold plated' it by adding a limited number of additional fields.

2 FCA Market Watches 50, 59, 62, 70 and 74 all stress the need for "complete and accurate" transaction reporting

- systems to ensure the security and confidentiality of the data reported;
- mechanisms for authenticating the source of the transaction report;
- precautionary measures to enable the timely resumption of reporting in the case of a failure of the reporting system;
- mechanisms for identifying errors and omissions within transaction reports;
- mechanisms to avoid the reporting of duplicate transaction reports;
- mechanisms to avoid reporting of any transaction where there is no obligation to report; and
- mechanisms for identifying unreported transactions for which there is an obligation to report.

Even if a firm's reporting is complete and accurate, it will still be in breach of the regulations if it doesn't include these requirements in its systems and controls. Whilst all these obligations are important, two are of particular note:

1. Authenticating the source of the transaction report (reconciliation)

This requirement is to ensure that the data within a submitted report correctly aligns with the source data for the report. Article 15 of RTS22 provides greater detail on the reconciliation required and obliges firms to perform ***"a regular reconciliation of their front office trading records against data samples provided to them by their competent authorities"***. **Thistle Initiatives has found that many firms haven't fully appreciated this requirement,** which is not simply about ensuring that all the reportable transactions have been duly reported – it is also about ensuring that the data within all of the reported fields correctly reconciles against the data held within the firm's source systems. This can be an onerous task for two main reasons. Firstly, the data when returned from the regulator may be in XML format, which may not be the format sent by the firm to the ARM. Secondly, there may have been a degree of transformation from data held within firms' source systems to meet the transaction reporting requirements. It is clear from FCA Market Watch 74 that the FCA is monitoring data extracting from the MDP, highlighting where firms are not undertaking full reconciliations.

2. Mechanisms for identifying errors and omissions within transaction reports

Thistle has seen many firms fall into the trap of thinking that if their transaction report has been accepted by the regulators then it must be complete and accurate. This may not necessarily be the case. As the FCA states in Market Watch 59:

> ***"Firms should not assume that a report was accurate because it was accepted by the Market Data Processor, as business validation rules are not intended to identify all errors and omissions"***[3].

3 https://www.fca.org.uk/publication/newsletters/market-watch-59.pdf

This clearly indicates passing validation is not enough – firms must additionally have mechanisms for identifying errors in reports that have successfully passed the basic validation. Many firms meet this obligation through sample checking of reports – i.e., requesting submitted reports back from their regulator and performing rules-based tests on the accuracy of the data. Unfortunately, there are two problems with this approach.

Firstly, sample checking can never give 100% confidence that all submitted reports are correct. Secondly, when firms use sample checking, the appetite for discovering issues may not be as great as it should be. Thistle notes that many of the firms sanctioned by the FCA for transaction reporting failures were doing some form of in-house sample-based checking, but this didn't result in all the errors being discovered.

Data Quality – how good, or bad, is transaction reporting?

Before answering this question, let's travel back in time to the previous reporting regime, MiFID. MiFID was a simpler regime as the reporting only covered equity and debt instruments and a report only contained up to 24 fields. However, some firms struggled with this reporting regime and many firms were fined for poor quality reporting (see https://www.fca.org.uk/markets/transaction-reporting/transaction-reporting-fines for details of the fines).

As some firms struggled with MiFID reporting obligations, it is natural that the far more complex obligations in MiFID II would present a considerable challenge. This was recognised by the FCA, who promised that it had "no intention of taking enforcement action against firms for not meeting all requirements straight away where there was evidence they had taken sufficient steps to meet the new obligations by the start-date"[4]. However, this flexible approach could only be expected to last for the initial period after go-live. Since then, the FCA has continued to issue warnings about the quality of transaction reporting data through its Market Watch publications. In the recent Market Watch 74, the FCA made it clear that some firms were not heeding these warnings when it stated[5]:

> ***"Transaction reports continue to play a key role in our ability to conduct effective market oversight. There has been a trend of improved data quality since 2018. But issues persist, and some firms are not paying sufficient attention to our warnings on the importance of reporting transactions to us in a complete, accurate and timely manner."***

Market Watch 74 also provides a host of interesting data, not least in the number of error and omissions forms submitted by firms for transaction reporting breaches:

4 Speech by Mark Stewart, FCA Director of Enforcement and Market Oversight, 20 September 2017
https://www.fca.org.uk/news/speeches/better-view

5 https://www.fca.org.uk/publications/newsletters/market-watch-74 July 2023

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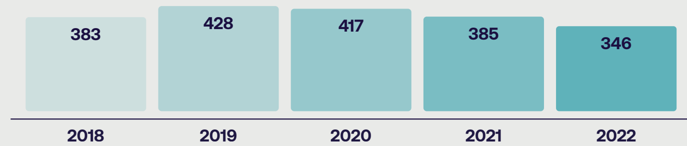
Fig.01
Number of error and omissions forms submitted by firms for transaction reporting breaches



One would assume this data would indicate that reporting is getting materially better over time. However, if, as the FCA states, complete and accurate data is critical to the FCA's ability to monitor for market abuse effectively, it is concerning that well over 300 reports of transaction reporting breaches were submitted to the FCA when the regime is so mature.

Why do firms struggle with reporting?

There are many different views on the root cause of the issues. **Thistle has heard from many firms that believe the reporting requirements are too complex whilst the FCA has stated that some firms are not heeding their warnings on providing complete and accurate reports.** On a practical basis, we believe many of the problems can be grouped into two major categories: firstly, firms didn't, and perhaps still don't, fully appreciate the extent of the reporting requirements and, secondly, they may not have implemented sufficiently robust systems and controls around transaction reporting.

It is difficult to fully understand the reporting requirements as they are detailed in many publications. Firstly, there is the MiFIR regulation, although only a few articles directly relate to reporting, and the MiFID directive provides details on which entities are within scope. However, it's at Level 2 where the real detail of the transaction reporting legislation lies, and this is detailed in RTS22 and its annexes. That's not where it ends – we still have nearly 300 pages worth of Reporting Guidelines[6] and whilst this is at Level 3 and is not technically legislation, the regulators expect firms to adhere to these guidelines. Although all this documentation was published well in advance of go live, it is a huge amount of information to digest and understand completely. Industry working groups spent a significant amount of time trying to decipher the reporting requirements, so it was almost inevitable that mistakes were made.

If the largest firms have had difficulty understanding the reporting requirements, it is inevitable that smaller firms, who don't have similar resources to devote to transaction reporting, may have even more issues. Also, it should not be forgotten that many buy-side firms were no longer able to rely on previous "exemptions" on reporting and were faced with an incredibly steep learning and implementation curve.

This problem is exacerbated when firms may need to transform data to meet the reporting standards. Whilst many firms can perform the

6 https://www.esma.europa.eu/sites/default/files/library/2016-1452_guidelines_mifid_ii_transaction_reporting.pdf

whole extraction and transformation process themselves, many use third parties. This brings us nicely to the second major category of systems and controls because, whilst it is acceptable to use third parties in the reporting process, it is essential that firms have robust controls in place to ensure these third parties are effective. We have seen some firms having no advance sight of the reports that have been submitted to the regulator in their name and no effective monitoring of the accuracy of these reports. In such scenarios, firms, or third parties, may have originally misunderstood the requirements, have no controls in place and have been misreporting since go-live. This makes remediation far more challenging when errors are eventually discovered.

As detailed earlier, RTS22 is prescriptive in the systems and controls a firm needs to have over transaction reporting. Without these controls, firms won't know if they have an issue and won't be able to help prevent further issues arising. Two of the most important controls are quality assurance monitoring and the reconciliation of submitted reports to source systems. Market Watch 74 suggests that there has been a real improvement in this area: it notes that only 451 firms requested data from the FCA to perform these tasks in 2018, but this number grew significantly to 745 firms in 2022. Whilst encouraging, this can only be considered as an improvement if the firms use this data from the FCA to effectively meet their quality assurance and reconciliation obligations, and it should be noted that this figure only represents approximately 50% of executing entities. The fact that the FCA is still finding errors and independent QA firms are discovering incorrect reports suggests that data quality issues still persist.

FCA Data Quality perspective

It's not just fines that firms need to worry about - the FCA has a policy of making firms back report up to 5 years of reports that contain an error or that they have failed to report (it is actually an obligation under Article 26(7) of UK MiFIR) and the cost of this remediation should not be underestimated. The initial task of discovering which reports contain errors can be onerous, but then finding the required data and implementing the required changes can prove extremely costly. Many firms have found out to their cost that investing resources in systems and controls is a far cheaper alternative to remediation exercises. Clearly, the sooner an issue is discovered the easier it is to remediate.

What should you be doing to meet the transaction reporting requirements?

It is important for firms to understand their data and data flows from source systems through any transformation points to the regulator. Understanding where errors may be introduced and creating control processes to capture and remediate any errors is necessary. Reconciliation is an important part of the process comparing order management

systems to the ARM and authority (where the data is available). These checks can capture a number of errors and omissions, assisting firms with data quality controls.

There are a variety of tools that firms can utilise to test and evaluate control processes. As the Regulatory Reporting service, at LSEG Post Trade we have seen a large percentage of regulator CON errors can be traced back to a small number of fields such as Instrument Identification code and report status. Through our enhanced analytics package we have performed peer to peer comparisons to help firms understand the specific issue areas to focus remedial efforts on; combined with additional validations, this validates the logical population of reports beyond the level of validations applied by the authorities.

Recently, we have launched our MiFIR pairing and matching solution for on-venue trades. This has highlighted some root cause issues with several firms identifying where two parties to the trade have a different interpretation or a trend of errors (such as prices that are different beyond tolerance). This level of analysis has highlighted that there are still differences in both interpretation and data quality within firms.

As a result of the increased scrutiny in data quality and governance, LSEG Post Trade has developed a suite of services to assist firms – these can be broadly categorised as pre-reporting, analytics and additional services (such as reconciliation, reference data reporting and commodity position reporting.

Thistle Initiatives provides compliance support to investment firms in a wide variety of areas, including transaction reporting. Further details of these services can be found at:

https://www.thistleinitiatives.co.uk/sectors/investments/

LSEG Post Trade provides a variety of service to assist firms with transaction reporting. Further details of these services can be found at:

https://www.lseg.com/en/post-trade/regulatory-reporting

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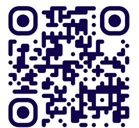

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