asset servicing times

# Regulatory Handbook 2019


**Editor: Becky Butcher**
beckybutcher@blackknightmedialtd.com
+44 (0)203 750 6019

**Reporter: Jenna Lomax**
jennalomax@blackknightmedialtd.com
+44 (0)203 750 6018

**Reporter: Maddie Saghir**
maddiesaghir@blackknightmedialtd.com
+44 (0)203 750 6019

**Contributors: Barney Dixon and Ben Wodecki**

**Designer: James Hickman**
jameshickman@blackknightmedialtd.com
+44 (0)203 750 6021

**Publisher: Justin Lawson**
justinlawson@blackknightmedialtd.com
+44 (0)203 750 6028

**Associate Publisher: Joe Farrell**
joefarrell@assetservicingtimes.com
+44 (0)203 750 6024

**Office Manager: Chelsea Bowles**
accounts@blackknightmedialtd.com

**www.assetservicingtimes.com**
**@ASTimes_**

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# Locked in for the future

With various regulations hitting firms over the last 10 years, the asset servicing industry has been faced with many challenges and significant costs.

Most of those challenges come from executing projects to update systems and processes to ensure compliance. However, certain now-implemented regulations have shown that the deadline is not where the work grinds to a halt, it can continue months, sometimes years, after an implementation date.

Challenges do not just sit with internal struggles, with the second Markets in Financial Instruments Directive (MiFID II), in particular, firms were hit with a late bump in the road when regulators made changes a month before the implementation date.

Throwing all that into the mix, you can see why some firms are struggling to keep up with the latest regulations.

In this year's Regulatory Handbook, we provide insight on a range of regulations including the Alternative Investment Fund Managers Directive, the second Markets in Financial Instruments Directive, the Central Securities Depositories Regulation and more.

We also consider how regulatory transformation is entering a consolidation phase of supervisory enforcement and new areas of legislative focus. While the industry is recovering from the likes of MiFID II and General Data Protection Regulation, new trends are emerging.

Looking ahead, industry participants suggest that regulators will keep their focus locked in on transparency with investors, cost disclosures particularly, reporting obligations and compliance, product governance, fund distributors more widely, and financial advisers in particular.

Although the industry is battling these regulatory challenges and deadlines, the new regulatory landscape does provide a big opportunity for firms to replace traditional processes and implement new technologies to optimise workflows.

**Becky Butcher**
**Editor**

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# A new settlement regime

**After CSDR entered legal force in 2014, Bob Santangelo of Broadridge explains that the regulation has and will continue to have a considerable impact on firms**

The Central Securities Depository Regulation (CSDR) is one part of a far wider EU regulatory reform created in the aftermath of the 2008 financial crisis. It was implemented by the European Commission in efforts to strengthen the EU financial system.

CSDR, alongside the second Markets in Financial Instruments Directive (MiFID II), ensures that systemically important securities infrastructures are subject to common EU rules. To that end, CSDR's aim is to improve the functioning and stability of financial markets in the EU by enhancing the legal and operational conditions for cross border settlement.

CSDR was published in the Official Journal of the EU in August 2014 and is gradually entering into force. It applies across all EU central securities depositories (CSDs)—including the international CSDs, Euroclear and Clearstream—as well as market operators, in the context of all their market settlement operations.

The principal way that compliance with CSDR will be enforced is through authorisation of CSDs (by the home member state Competent Authority), a process which began in the first half of last year.

The European Commission is overseeing CSDR with the technical standards being defined by the European Securities and Markets Authority (ESMA) in cooperation with the European System of Central Banks (ESCB).

### How responsibilities are mapped out

An overriding priority for CSDR is to harmonise the different rules applicable and establish a level playing field among European securities depositories. Another imperative is to increase the safety of assets and improve the operational efficiency of securities settlement, leveraging enhanced infrastructure and more robust, consistent discipline measures that will encourage timely settlement.

The principal way European regulators aim to achieve this is by insisting that CSDs and International Central Securities Depository (ISCDs) ascribe to a single set of rules that are consistent across the EU 27 markets.

With TARGET2-Securities (T2S) we have already seen the transition of settlement cycles to a T+2 settlement regime, and a move to dematerialisation, where an investor's physical share certificate is converted to an electronic format, that brings us to nearly 100 percent book entry form for securities.

Under CSDR, CSDs will additionally be bound by regulation to perform a daily reconciliation of securities balances, with support and data from market participants. They are also required to maintain the segregation of client assets throughout the settlement and safekeeping process. As such, CSDR aims to enforce a more rigorous process and calculation of cash penalties for any settlement fails. Reporting such fails will impact all participants in the transaction process and enforce buy-ins for participants' delivery fails. This is a significant change, as many markets have never applied such disciplines from a regulatory mandate.

### Implications for market participants

The new regulations imposed by CSDR carry clear implications for the wider securities industry in Europe and will mandate changes in a number of the steps in the process lifecycle. The goals of efficiency, consistency and risk reduction are all addressed by the CSDR requirement for T+2 settlement for all European CSDs.

Completing settlements for all on-exchange trades two days following their transaction date brings all CSDs on to a harmonised model for finalising the settlement cycle (this requirement was fulfilled when Spain migrated in September 2016). Some of the biggest changes under CSDR have primary impacts beyond the CSDs themselves, to institutional market players and custodians. These changes involve the settlement process.

Chief among these is a newly restyled settlement discipline regime, which targets timely and efficient settlement in two steps—through the introduction of cash penalties, and by implementing a mandatory buy-in procedure. Cash penalties and mandatory buy-ins are components of a settlement discipline regime to address and prevent settlement failures, with the aim of encouraging the timely settlement of transactions by all participants (including indirect participants) at a CSD, monitoring settlement fails and providing regular reporting to the respective regulators. This will apply as a single model across the EU. CSDs can also suspend customers that consistently fail to deliver securities or impose limitations on such customers.

Daily reconciliation is another area of focus. To ensure and validate the integrity of issues in the market, CSDs will be expected to take appropriate reconciliation measures, on a daily basis, that verify the number of securities making up an issue submitted to the CSD is equal to the sum of securities recorded on the securities accounts of the market participants.

This action will fall upon both the CSDs and market participants to complete, as participants will need to provide the CSD with all information required to ensure the integrity of an issue and work with the CSD to solve any reconciliation breaks.

CSDs will also be required to enable the full segregation of securities between participants, and between participants and their clients. They must offer both omnibus and individual client segregation. Requirements placed on CSDs are:

- Enable the segregation of securities for one participant from securities of another participant
- Enable a participant to segregate their securities from the securities of that participant's clients
- Enable a participant to hold in one securities account the securities of different clients of the participant (omnibus client segregation)
- Enable a participant to segregate the securities of any of the participant's clients (individual client segregation)

**For market participants, the segregation requirement is to offer clients the choice between omnibus and individual client segregation, as well as advise costs and risks associated with each option.**

## How can the market prepare?

While many key deadlines for CSDR have passed, starting with its publication in the European Journal in August 2014, this is a continual process with key milestones still to come.

The next deadline approaches on 12 July 2019 where the first internalised settlement report is due to national competent authorities, and then the settlement discipline comes into force in 2020.

Further down the line, the CSDR's requirement for new issues to be represented in book-entry form will apply from 1 January 2023, and this is followed by a 1 January 2025 deadline for all transferable securities to be in book-entry form. In order to prepare for these dates, steps need to be taken in order to meet requirements.

CSD/ICSDs, issuers, brokers, intermediaries and asset managers should set themselves clear self-assessment checklists. For example, market participants will need to consider improving settlement processes to avoid daily late settlement penalties and mandatory buy-ins and consider how they will approach the various options for client securities segregation.

Ultimately, whether you are a CSD, broker, issuer, intermediary or asset manager, CSDR has had and will continue to have a considerable impact. In order to mitigate risk and remain compliant, practices need to be reviewed.

**Bob Santangelo**
**President, international sales**
**Broadridge**

# Weighing up your options

## Derbhil O'Riordan of Dillon Eustace discusses marketing investment funds in the EU as a third country manager

The EU is a key target market for sales of investment funds.

For those seeking to sell investment funds in the EU, three different investment fund regimes exist:

- The UCITS regime: This regime relates to EU UCITS funds. UCITS are permitted to be sold on a cross-border basis in the EU. As the marketing passport for a UCITS attaches to the UCITS itself and not its manager, we have not considered further the marketing of UCITS in the EU by third country managers.
- The Alternative Investment Fund Managers Directive regime (AIFMD regime): This regime applies to the EU single market and relates to alternative investment fund managers (AIFMs) managing alternative investment funds (including private equity and hedge funds) (AIFs) within the EU.
- National private placement rules (NPPR): This regime imposes rules at EU level for selling non-EU funds in the EU but also allows individual member states to impose their own requirements on any sale within their own border.

In this article, we will briefly look at the AIFMD and NPPR regimes as they currently co-exist, and how they are accessed by non-EU managers.

### AIFMD regime

AIFMD creates a single marketplace within the EU for the marketing of AIFs, known as a marketing passport. Under the AIFMD, the activity of marketing includes "any direct or indirect offering or placement at the initiative of the AIFM or on behalf of the AIFM, of units or shares in a fund it manages to or with investors domiciled in the EU".

This definition does not include reverse solicitation, which should be considered to be outside the scope of the AIFMD and is not considered in this article. In addition to managers based in the EU, the AIFMD applies to any non-EU based fund manager (including, for example, fund managers based in the UK (post-Brexit), US or Asia) that:

- Manages one or more AIFs domiciled in the EU; and/or
- Markets AIFs to investors in the EU (irrespective of the AIF's domicile)

For example, a US-based fund manager managing Cayman-based offshore funds that are marketed to EU investors in a master-feeder structure would typically fall within the scope of the AIFMD.

At the time of writing, only entities established in the EU can be authorised as AIFMs to obtain the marketing passport for their EU domiciled AIFs.

However, European Securities and Markets Authority (ESMA) and the European Commission are currently analysing the suitability of a number of non-EU jurisdictions (separately, on a case-by-case basis) with a view to deciding whether they will decide to "switch on" certain provisions of the AIFMD for those jurisdictions.

Where the relevant provisions of AIFMD are "switched on" in respect of a given jurisdiction, non-EU based managers based in the relevant jurisdiction will be permitted to apply to become authorised as an AIFM under the AIFM Directive and market its funds in the EU under the marketing passport. However, for the time being, managers based outside the EU (being "third country" managers) can continue to market in an EU member state without the marketing passport, provided the marketing is subject to:

- The EU member state's own NPPRs
- Transparency rules imposed by the AIFMD

## EU-based AIFMs with AIFs inside the EU: notification procedure

Under AIFMD, subject to a straightforward notification process, EU-authorised AIFMs have a passport to freely market EU-domiciled AIFs to professional investors—that is, investors considered to be professional clients or treated as professional clients on request, within the second Markets in Financial Instruments Directive (MiFID II)—in both its own member state and other EU member states.

Once the AIFM is authorised in one EU member state, it does not require further authorisation in any other EU member state to market its EU AIFs to professional investors in other member states. Unlike UCITS, the passport does not attach to the AIF and is instead granted to the AIFM.

An AIFM established in an EU member state and authorised by the competent regulatory authority in that member state has the right under the AIFMD to both:

- Market shares of an EU AIF that it manages to professional investors in the AIFM's home member state (subject to providing a prescribed Notification File to its home EU member state regulator).
- Market shares of an EU AIF that it manages to professional investors in another EU member state—subject to providing a prescribed Notification File to its home EU member state regulator.

The home EU member state regulator can only prevent the marketing of shares in EU AIFs if the information in the notification shows that the AIF concerned will not be managed in accordance with the AIFMD.

## EU-based AIFMs with AIFs outside the EU: notification procedure

Under the AIFMD, each EU member state can allow an authorised EU AIFM to market a non-EU AIF to professional investors in that EU member state under that EU member state's own NPPRs, without a passport, provided:

- The AIFM complies with basic depositary and custody requirements under the AIFMD (such as the safekeeping of assets and the supervision of administrative functions).
- There is a co-operation arrangement for the purpose of systemic risk oversight between the regulator of the AIFM's home member state and the supervisory authority of the non-EU country where the AIF is established.
- The non-EU country where the AIF is established is not listed as a non-co-operative country and territory by the Financial Action Task Force on anti-money laundering and terrorist financing.

As mentioned above, it is envisaged that certain provisions of the AIFMD will be 'switched on' in order to allow for EU AIFMs to apply for a passport for their non-EU AIFs, depending on the jurisdiction in which they are established.

The AIFMD also envisages that three years after the European passport becomes available to EU AIFMs of non-EU AIFs, ESMA will issue a further opinion on the continuation of the NPPR regime in the EU.

Subject to the provisions of this advice, it is envisaged that:

- The EU will adopt rules to terminate the NPPRs as a means of access to the EU
- The European passport will become the sole and mandatory regime applicable in all member states

### AIFMs based outside the EU with AIFs based outside the EU: notification procedure

Under the AIFMD, each EU member state can allow non-EU AIFMs to market a non-EU AIF to professional investors in that member state under that member state's own NPPRs (that is, without a passport) provided:

- The AIFM complies with the transparency rules in respect of each AIF marketed by the AIFM and (where applicable) with certain additional rules relating to acquiring control of non-listed entities
- There is a co-operation arrangement for the purpose of systemic risk oversight between the regulator of the EU member state where the AIF is marketed, the supervisory authorities of the non-EU country where the non-EU AIFM is established and the supervisory authority of the third country where the AIF is established
- The non-EU country where the AIF is established is not listed as a non-co-operative country and territory by the Financial Action Task Force

The advice from ESMA being issued on a country-by-country basis in respect of the extension of the EU passport to EU AIFMs of non-EU AIFs are also envisaged to cover non-EU AIFMS and their non-EU AIFs. Subject to the provisions of this advice, it is envisaged that certain provisions of the AIFM Directive will then be "switched on" to allow for non-EU AIFMs to apply for authorisation under the Directive, enabling them access to a European passport.

### The transparency rules

The transparency rules impose specific obligations on AIFMs applicable to AIFs marketed in the EU, including annual report disclosure requirements, disclosure to investors, and periodic reporting to competent authorities.

### National private placement rules

Under the AIFMD, member states have discretion (to allow for the marketing of non-EU AIFs marketed by EU AIFMs and AIFs marketed by non-EU AIFMs on a private placement basis.

Countries that intend to allow private placement must apply the minimum AIFMD standards to AIFMs marketing under the regime. In addition to the standard AIFMD requirements, each EU member state can impose its own additional NPPRs in relation to the marketing of the product.

If an investment fund intends to access an EU market through private placement, the fund manager should be familiar and compliant with the relevant NPPRs of the member state. In addition, considering the broad level of discretion given to individual member states and the wide variety of applicable rules in each jurisdiction, the fund manager should consult legal counsel in the relevant member state before approaching investors.

An overview of the NPPRs for each EU member state is outside the scope of this article. Managers should note that it is necessary to obtain advice on a jurisdiction-by-jurisdiction basis before sell in the EU under the NPPRs.

### UK and Brexit

On the UK's exit from the EU, the UK will no longer (subject to the outcome of the negotiations with the EU) have the benefit of AIFMD.

Therefore, the UK can lose certain rights that EU managers and AIFMs currently have. For example, in terms of managing EU AIFs, a UK AIFM will most likely have the same rights as a US AIFM.

However, a UK AIFM could no longer market its EU-domiciled AIFs cross-border within the EU.

Although similar to a US AIFM, a UK AIFM could act as investment manager to Irish funds and so continue its management activities, the cross-border distribution will most certainly be affected. UK managers that see the EU (even if only a few EU countries) as their target distribution base will need to ensure that they keep a foothold in the EU before enjoying the benefits of EU-regulated entities in the financial services industry.

The available options for UK managers include:

- Setting up an AIFM or Super ManCo (that is, a regulated entity that can manage and market both UCITS and AIFs) in another EU member state (such as Ireland or Luxembourg)
- Using a third-party AIFM established in another EU member state
- Putting their fund on a third party platform that is already established in another EU member state

Although the second and third options certainly benefit from economies of scale (both in terms of start-up and ongoing maintenance costs), they should both be considered carefully in terms of practical distribution issues and future business growth.

### Conclusion

Before setting out to market an investment fund in the EU, managers of investment funds should consider the three regimes currently in force and weigh up the benefits and costs of each.

Given the strict rules around marketing in the EU, the choice of the regime should be made before approaching investors.

Both the UCITS and AIFM Directive regimes now offer an EU passport.

However, for funds (or AIFs) that cannot fit within those regimes, the EU will remain a patchwork of regulation which must be navigated carefully with the assistance of local counsel in each relevant jurisdiction.

As has always been the case, for those selling in the EU without the benefit of an EU passport, the legal requirements of certain jurisdictions will remain easier to navigate than others.

*"Before setting out to market an investment fund in the EU, managers of investment funds should consider the three regimes currently in force and weigh up the benefits and costs of each"*

Derbhil O'Riordan
Partner
Dillon Eustace

# A long winding path of regulatory compliance

**With countless EU regulations having hit the industry over the last decade, Vivien Crayston of Eureka Financial explains that compliance with regulation is a long and winding path, and the industry is not near the end yet**

With countless EU regulations having come our way during the last 10 years or so, asset managers and administrators have incurred many process and system challenges, as well as significant costs. These will have come in the form of executing projects to re-align or change systems and processes, to ensure compliance with these regulations.

The reams of post-crisis regulation have simply overly encumbered this investment management industry, however, the reasons should be well understood based on the events like the Lehman's collapse in 2008 and the Madoff scandal that followed a few months later.

The challenges in some of these regulations, such as the second Markets in Financial Instruments Directive (MiFID II), have shown us that the deadline for implementation is not, in fact, the end of the work that needed doing, but in reality, it's just the beginning.

On the whole, there is a mixed bag of firms that were truly MiFID II ready, and those not quite arriving at the 'start line' as they thought they would, come 3 January 2018.

Now in 2019, a year down the line from the MiFID II regulatory implementation date; the challenges of getting this all right has become apparent with the multitude of teething problems experienced in the industry.

Some examples of these were in the form of data warehousing and data collation; unbundling of dealing commissions from research, research payment processes, regulatory technical standards (RTS) 28 top five venue reporting and increased challenges with best execution processes.

Best execution processes will now take a multitude of teams to deal with this function, to prove best execution requirements have been met. No longer will trade execution be under the sole purview of a trading desk.

The changes brought about, focused on better client outcomes and enhancing processes. The Financial Conduct Authority has, as we know, taken steps to let the industry know they are falling short of expectations. It is believed that in 2019 we will see more initiatives in this area.

Another fairly complicated piece of this regulation relates to the setting up of research payment accounts (RPA) or commission sharing agreements (CSA), the data feeds, profit and loss application and then reporting on rebalancing processes. This is usually quarterly as its labour intensive and adds an extra burden on teams managing this function.

From an investor's perspective, we would justifiably expect that they have the right to know how and where we are spending research commissions, as they are mostly being asked to fund it. It is worth noting, there are some asset managers who have decided to ease their administrative and reporting burdens, by rather taking the costs through to their own profit and loss; and not passing on costs to investors. This scenario enables them to utilise RPA/CSA arrangements for internal purposes alone, therefore not reporting into investors on those associated costs.

This direct cost to a firm's profit and loss will simply be attributed to a cost of doing business and asset management budgets will very likely have catered for this change in the 2018 budgeted year. Fund managers and their investment teams will have come to an agreement on how those costs are apportioned between them, if not passed onto investors.

The process changes, data supply and vendor engagement to manage all these were perhaps mostly underestimated. Now, firms through 2018/19, are still struggling to effectively and smoothly integrate into their business functions, working with the data vendor providers to streamline the processes.

It's also very likely regulators are receiving some challenges themselves as local European industry bodies will be lobbying and reporting into regulators, the difficulties the industry and their members are experiencing with the MiFID II challenges.

Plain and meaningful cost disclosures for funds remain firmly on the regulatory agenda and more and more of the EU regulators are also scrutinising the level of costs and charges in the industry.

We all know that the research market for investments/funds has had a tremendous shake-up due to this regulation, and although not entirely unexpected, reverberations are still being felt as complex processes are bedded down. Over time though, we can expect clearer transparency and more sustainable solutions as resources and systems are applied and deployed.

Another interesting and complicated piece of MiFID II is trading cost analysis (TCA) where implicit and explicit costs are to be assessed, collated and reported, for the purposes of producing the European MiFID II Template (EMT) or European PRIIPS Template (EPT) data sets.

Ensuring your vendor data provider produces this accurately can be a challenge; a few have been found to be lacking in data accuracy; but, is this due to firm's data feeds being questionable or with vendors reporting capabilities, or, perhaps even both?

Further than that, reporting such as RTS28 top five venue reporting with the first publications made on 30 April 2018, allowed for some leniency on data delivery. This year though, regulators expect full and complete data delivery.

# Regulatory Challenges

There are complexities in RTS that would have required added data capturing—potentially with system and database field change implications. This means that through the year as trades were executed, data points such as passive/aggressive orders—the definition of which was deemed somewhat ambiguous—will need to have been captured. Passive/aggressive is the term used to describe adding or removing liquidity from the market and this will be expected for the 2018 reporting due on 30 April 2019.

Similarly, for directed orders, again, there was some ambiguity as regards to definition. Firms should have already been well in process during 2018, with additional analysis sessions with their vendors who assist with this data collation, to start capturing, collecting and reporting this data in 2019.

While the RTS quantitative reporting was allowed to be performed on a “best endeavours” basis, in the first year of reporting it was made clear that regulators would expect a high level of qualitative reporting in year two and beyond. Firms should also expect qualitative reporting changes, as these will not remain static.

If we look at best execution, as a firm’s policies and business as usual processes in this area evolve, the regulators expect firms to update their disclosures.

Investment firms should also consider the language they use in qualitative reporting, depending on whether their client base is primarily institutional or retail.

This is the over-arching challenge asset managers have faced over the last three to four years since MiFID II work will have begun; assessing systems, selecting systems, selecting vendors, re-engineering processes, staffing the functions, capturing data, collating it, and reporting it.

Other regulations like the General Data Protection Regulation presented similar data storage and security measures to firms, in order to secure investors and clients personal information.

Rafts of communications were required to inform people of their rights, and the firm’s obligations to comply with these regulations. The system and process implications in this area again added a huge workload to compliance, HR and investor services teams with associated costs.

As can be seen on just a few of the topics covered here, there are many data providers, many issues and many complex regulations to consider when implementing solutions.

Regulator’s sights shall remain very firmly on transparency with investors, cost disclosures particularly, reporting obligations and compliance, product governance, fund distributors more widely, and financial advisers in particular.

Compliance with regulation is a long and winding path, and sadly we are nowhere near the end yet.

***“Compliance with regulation is a long and winding path, and sadly we are nowhere near the end yet”***

Vivien Crayston
Regulatory expert
Eureka Financial

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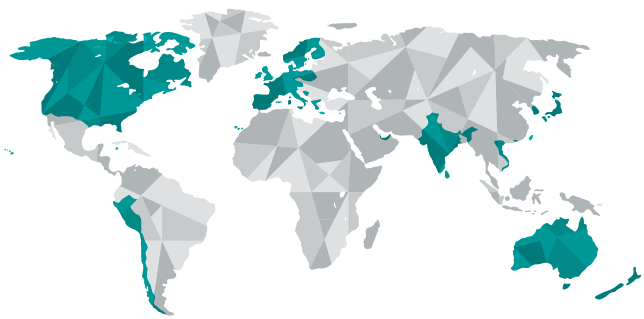

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# What lies ahead for asset managers and institutional investors?

## Charles de Cerjat and Celine Cottet of Pictet explain how regulatory transformation is entering a consolidation phase of supervisory enforcement

The regulatory transformation that followed the financial turmoil of 2007 and 2008 is not over. While asset managers and institutional investors are recovering from the implementation of large-scale regulation such as the second Markets in Financial Instruments Directive (MiFID II) or the General Data Protection Regulation (GDPR), new trends are emerging.

The regulatory transformation is entering a consolidation phase of supervisory enforcement and new areas of legislative focus.

### The regulatory transformation is not over

Asset managers and institutional investors across the EU and Switzerland are getting ready for a new set of regulations this year and beyond. Monitoring these regulatory developments with tracking dashboards to ensure a helicopter view has become essential to identify cross-sector regulatory trends. Below is a basic example of such a dashboard, displaying the preparation period before go-live and the impact level of upcoming regulations.

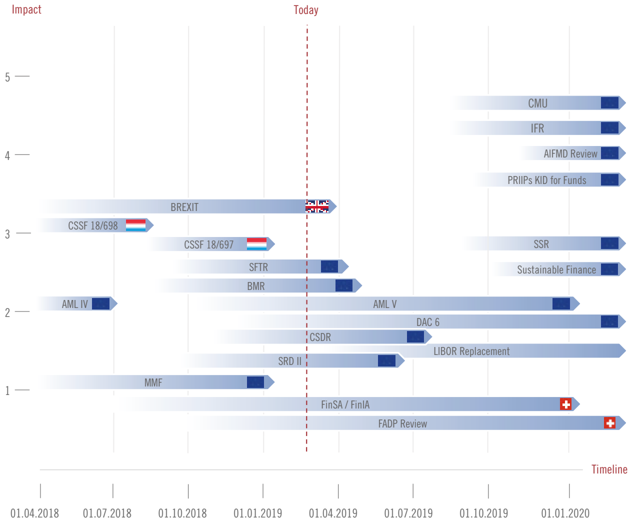
### Example of a high-level dashboard of an asset manager

For instance, the combined effects of the Capital Markets Union (CMU) proposals, the end of the Packaged Retail and Insurance-based Investment Products (PRIIPs) transition period for funds and the Alternative Investment Fund Managers Directive (AIFMD) review announce significant changes in cross-border product distribution. While the CMU legislative proposals tackle long-awaited simplifications, such as aligning national marketing requirements and regulatory fees or harmonising the conditions under which investment funds may exit a national market and allowing European asset managers to engage in pre-marketing activities, product manufacturers must constantly adapt their product strategy. This cross-sector regulatory approach allows to go beyond mere compliance and identify opportunities.

In addition to tracking upcoming pieces of legislation, asset managers and institutional investors must pay attention to the enforcement of the regulatory transformation by the supervisory authorities.

Market supervisors are giving signs of an increased survey regarding the implementation of recent regulation. Subsequent to the application date of MiFID II and MiFIR on 3 January 2018, the Financial Conduct Authority (FCA) in the UK announced six months later the launch of a probe on asset managers, focusing on research costs and corporate access. In October 2018, the Autorité des Marchés Financiers (AMF) in France published the summary of five inspections carried out relating to clients' investment knowledge and experience. This was part of the #Supervision2022 strategy: AMF is carrying out new types of inspection, known as Supervision des Pratiques Opérationnelle et Thématique (SPOT)—operational and thematic supervision of practices.

In other words, national supervisors are consolidating the new regulatory framework through enforcement. As relayed by market participants, enforcement ostensibly starts within a short period after the application date of new legislative instruments. Supervisors may occasionally grant official or unofficial grace periods, but asset managers and




**AIFMD Review:** Alternative Investment Fund Managers Directive review
**AML IV/V:** Fourth and Fifth Anti-Money Laundering Directives
**BMR:** Benchmarks Regulation
**Circular 18/697:** CSSF Circular on non-UCITS depositaries
**Circular 18/698:** CSSF Circular on investment fund managers
**CMU:** Two legislative proposals on cross-border distribution of funds
**CSDR:** Central Securities Depositories Regulation
**DAC 6:** Directive on Administrative Cooperation - cross border arrangements
**FADP Review:** Revision of Federal Act on Data Protection
**FinSA / FinIA:** Financial Services Act and Financial Institutions Act
**IFR:** Investment Firm Review
**LIBOR Replacement:** Worldwide phase-out of LIBOR
**MMF:** Money market funds Regulation
**SFTR:** Securities Financing Transaction Regulation
**SRD II:** Shareholder Rights Directive II
**SSR:** Short Selling Regulation
**Sustainable Finance:** Action plan on sustainable finance (pack of measures)

institutional investors in the EU and in Switzerland must prepare nevertheless to the new pace and intensity of monitoring.

This year, the top list of regulations monitored by institutional investors and asset managers is expected to include the new transparency standards around beneficial ownership, the phasing-out of London Inter-bank Offered Rate (LIBOR) and the sustainable finance framework.

## Shifting gear on beneficial owner transparency

The growing pressure on governments and companies to increase transparency has resulted in a global shift towards increased disclosure around beneficial ownership. The EU has recently revisited its legal framework on anti-money laundering and counter-terrorist financing with the Fourth and the Fifth Anti-Money Laundering Directives (AMLD). AMLD 4 entered into force in June 2017. While transposition of AMLD 4 was still ongoing, AMLD 5 was adopted in May 2018 and it must be transposed by the EU member states into national law by January 2020.

Among other headways, AMLD 4 requires the EU member states to establish a central register on the beneficial ownership of companies and other legal entities incorporated within their jurisdiction. Companies, including Luxembourg SICAVs, must provide the central register with certain personal data of their ultimate beneficial owners, including name, surnames, nationality, place of birth and country of residence. Individuals who share in capital or voting rights of a company exceed 25 percent or those who wield similar influential power must be reported to the register. AMLD 5 will push transparency one step further by making the registers accessible to the public.

Beyond Europe, other countries are also following suit in an attempt to increase transparency. A recent study shows that thirty-four jurisdictions around the world have beneficial owner registration laws, and eleven more by 2020. In most cases, beneficial owner registries of companies also have to be publicly available. The most recent advocacy for a beneficial owner register was in the Bahamas, where the government presented in December 2018 the freshly drafted Register of Beneficial Ownership Bill. While public access to the beneficial owner registers may be a source of socio-economic debates, investors must prepare for this new paradigm in a growing number of jurisdictions.

## Bracing for LIBOR replacement

Further to the manipulation scandal of 2012, the LIBOR, used as the basis for interest rates all over the world for more than thirty years, will be discontinued at the end of 2021. There is an estimated $260 trillion in outstanding contracts for loans and other financial instruments tied to LIBOR benchmark rates—for example, CHF LIBOR, EUR LIBOR, Euribor, GBP LIBOR and USD LIBOR. LIBOR is currently used by financial institutions in financial instruments, for risk measurement, as performance indicator for financial products and to calculate loan rates.

Financial institutions and regulators around the world are getting ready by developing alternate rates such as USD Secured Overnight Financing Rate (SOFR), GBP Sterling Overnight Index Average (SONIA), JPY Tokyo Overnight Average Rate (TONAR) and CHF Swiss Average Rate Overnight (SARON). Progress towards identifying alternative reference rates, determining conversion rates and spreads for each currency is at different stages of completion.

Industry players will need to apply the new reference rates to new contracts but also decide how to modify legacy contracts and financial instruments. In Switzerland, since January 2019, the Financial Market Supervisory Authority (FINMA) is contacting supervised institutions that are particularly affected. In particular, FINMA is reviewing the adequacy with which risks associated with a possible replacement of LIBOR are identified, limited and monitored.

## Seizing opportunities in the sustainable growth framework

Further to the Paris Agreement of 2015, the European Union aims to redirect capital flows towards sustainable investments, taking into account environmental, social and governance (ESG) considerations.

In May 2018, the European Commission adopted a package of measures including a proposal for a regulation on the establishment of a framework to facilitate sustainable investment and a proposal for a regulation on disclosures relating to sustainable investments and sustainability risks. Meanwhile, the directive on the encouragement of long-term shareholder engagement must be implemented by EU Member States by 10 June 2019.

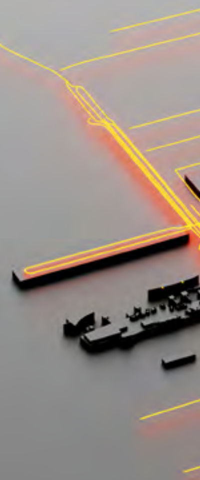
In Switzerland, the second round of climate compatibility tests is due to be initiated in 2020, for pension funds, insurance companies, asset managers and banks, under PACTA coordination (Paris Agreement Capital Transition Assessment). The results will support the current reflexions of the Swiss Federal Council for potential future regulation on sustainable finance.

The investors' demand for ESG solutions is on the rise. More than a quarter of the $88 trillion assets under management globally are now invested according to ESG principles, a McKinsey & Co study found. As the new regulatory framework will shed light on the commitment of financial institutions towards sustainable finance and corporate stewardship, major players are already deploying investment solutions that integrate ESG criteria.

**Celine Cottet**
Chief risk officer
Pictet Asset Services

**Charles de Cerjat**
Regulatory officer
Pictet Group

# Pivoting from optimisation to automation



## Gary Casagrande of Confluence explains why firms that move first to embrace and operationalise the digital transformation of their back-office operations will reap the biggest advantages

For asset management firms, back- and middle-office functions have typically not been hotbeds of innovation or the source of competitive advantages. But that is all changing as a confluence of factors is driving fundamental change and pushing these formerly low-profile areas to the forefront of firms' operations. To capitalise on opportunities that the emerging next-generation back office offers, firms will need to adopt a new mindset. Their teams need to focus less on back-office outcomes, such as new regulatory reporting requirements and tweaking their processes to accommodate them. Instead, they need to embrace a 'data first' and process automation orientation.

This starts with firms enhancing and unifying their existing data collection, normalisation, and processing functions. Once they have their upstream data assets unified and modernised, the next step is to weave more automation into their downstream back office processes. Doing so will enable firms to use their data more efficiently, flexible, and dynamically.

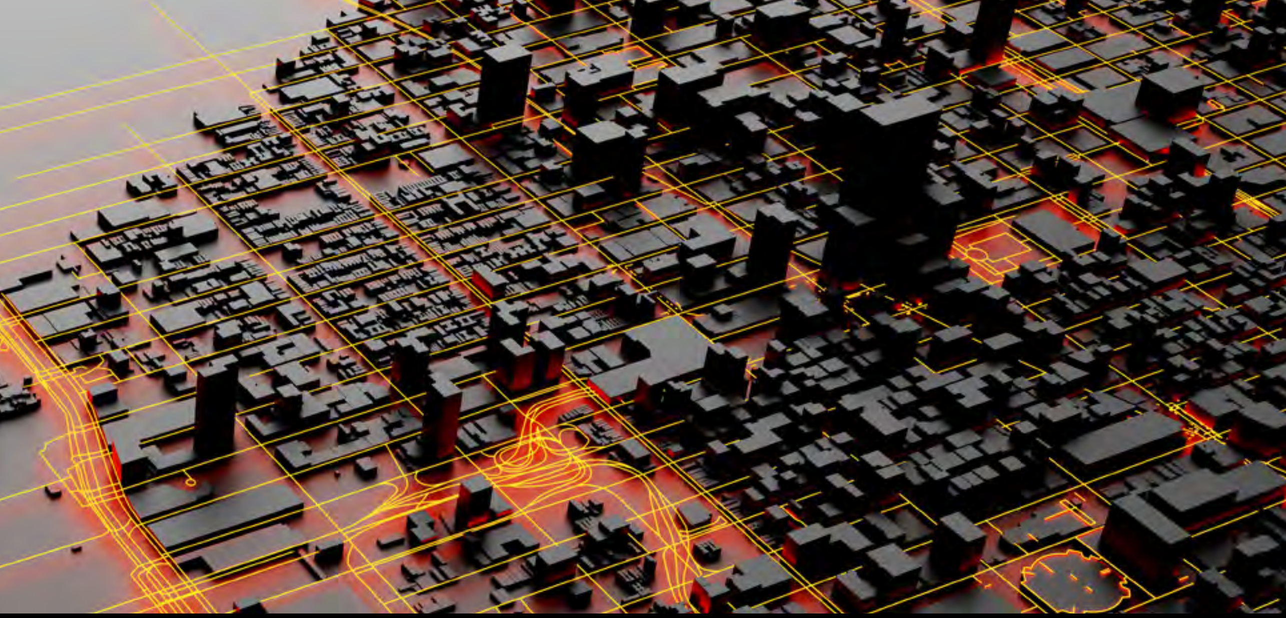
With modernised data structures feeding new, automated processes, it will be fast and easy for firms to make adjustments and meet any new business needs or regulatory requirements. For asset managers, this will unlock new ways to increase their operational efficiency. For service providers, this operational agility will create opportunities to differentiate their offerings and gain competitive advantages.

All of this requires the reinvention and retooling of old processes, replacing them with new, automated processes with next-gen digital technologies at their core. This fundamental change called 'digital transformation' is happening, and smart, forward-looking firms are already pursuing it in their back and middle offices.

### The old paradigm: perform needed functions and cut costs

Back office operations have always been an important part of the asset management industry, but perhaps not an exciting one. The standing orders were to strive for efficiencies while containing costs. It's entirely unlike the front office, where superstar portfolio managers and traders are always in the spotlight, and always have the latest and greatest technology at their disposal. Back- and middle-office professionals are rarely in the limelight, and their requests for new systems seem to be among the first to be turned down due to 'budget constraints' and those investments not producing significant enough return on investment.

Much of this cost-consciousness stems from the fact that back office work is all post-trade and, therefore, perceived as outside asset management firms' core competency and value-add for investors. That perception has affected back-office IT and staff budgets. That, plus long-standing processes and ingrained cultures, have contributed to technological advancements being very slow to work their way



into back-office operations. Thus, only incremental process optimisation occurred, most often at a glacial pace.

## Slow, incremental and siloed process advancements

Let's step back and look at the evolution of post-trade activities over the past few decades. This includes all of the communication between parties that is required from order execution, through clearing and settlement, custody and asset servicing, accounting and fund administration, transfer agency actions and other investor services.

Throughout the 1970s, most back office activities, such as matching the details of buy and sell orders, were handled over the phone with pen and paper. The process worked but it was slow and error-prone. The fax machine arrived in the mid-1980s, which sped up the process, but hand-written faxes became a new source of errors and problems.

Technological advances in the 1990s ushered in new systems that enabled more process optimisation. One example is trading allocation matching systems. These products gave all involved parties one place where they could set forth their understanding of forthcoming allocations. Early systems relied on unstructured data which limited their effectiveness. Subsequent generations of these products, which came out in the late-1990s, tapped the power of structured data to leverage automation in functions such as exception-based processing. The trend of back-office automation had begun.

## Regulatory burdens point toward automation

In more recent years, especially after the global financial crisis of 2008 to 2009, regulators have emerged as a major driver of back-office change. Managers of those operations have had to make many more of the incremental optimisations referenced above to accommodate an alphabet soup of new regulatory mandates. These include: Form N-MFP, Annex IV, Form PF, Form CPO-PQR and Solvency II, the second Markets in Financial Instruments Directive (MiFID II), Alternative Investment Fund Managers Directive (AIFMD), and the list goes on.

Like the earlier changes, these requirements were accommodated by incrementally optimising processes to produce new, human-readable outputs. Essentially, each of these changes was treated as one-offs and handled with small workarounds as opposed to making a wholesale change.

Collectively, however, the number of process changes started to pile up. So much so that back- and middle-office operations pros at top firms have started to think differently about post-trade data. They are trying to avoid starting downstream with the required outcome and bending their processes to produce it. Rather, they are looking upstream at ways to structure and manage the data so it can serve multiple operational purposes—in automated, machine-readable ways.

Getting there requires new roles, but not necessarily new hiring. For example, firms will need data stewards who understand data provenance and data governance frameworks—but they can be existing staff who receive some specialised training. Also needed are data architects and scientists who can design new workflows and processes. These people can often be found in-house and reassigned, even if temporarily. Firms also will need data platforms capable of supporting the automation that is the real payoff for all this process reinvention.

This will result in single, unified bodies of data, and easier ways to access and use that data to quickly meet evolving requirements. As mentioned earlier, this will provide asset managers with new ways to streamline their operations and give service providers new opportunities to gain competitive advantages through differentiating their offerings.

Take shareholder reporting functions as an example. Today, producing items such as annual reports, shareholder letters, and fund factsheets involve building processes around human-readable outputs, and a great deal of human intervention and interpretation is required. With a digitally transformed back office and a data-first (versus output-first) focus, a firm could automatically populate various investor communications with data and insights that the firm knows are reliably accurate. The result is a faster and more cost-effective production of high-quality investor communications—and that's in just one part of back-office operations. The data-first approach combined with automation can drive new operational efficiencies throughout the post-trade chain of activities and communications.

## On the cusp of digital transformation

The requisite pieces are well within reach for most firms. The ingredient that is most often missing is a vision. Leadership teams must see that major changes are already underway. They also must realise that given how fast change happens in the markets today, the old approach of focusing only on the next output with incremental process optimisation will no longer cut it. Leaders need to pivot to a data-first orientation powered by automation. Firms that move first to embrace and operationalise the digital transformation of their back-office operations will reap the biggest advantages.

The process of reinventing back-office operations requires vision and bold action. It's a path that is not without risks, but those risks are greatly outweighed by the major improvements in operational efficiency, flexibility and responsiveness this approach can deliver.

The only question is whether your firm and your team will make the change now or later. It's your call.

> *The process of reinventing back-office operations requires vision and bold action*

Gary Casagrande
Vice president of global market strategy
Confluence

# SFTR: the MiFID II for repo

## Tom Harry of MTS discusses SFTR, the challenges that come with it and what is required from firms involved

**How well prepared are institutions for the impending requirements of SFTR?**

Most repo market participants are aware of the new European Securities Financing Transactions Regulation (SFTR), but not everyone is clear on exactly what the second Markets in Financial Instruments Directive (MiFID II) for repo means for their business.

SFTR came into force in January 2016 as an EU Regulation with the aim of increasing the transparency of securities financing transactions, such as classic repo, triparty and securities lending. The scope of SFTR is wide. It encompasses, with limited exceptions, European Economic Area (EEA) firms, their branches and even EEA branches of non-EEA firms that engage in repo trading.

The European Commission has recently endorsed the technical standards drafted by ESMA and therefore the countdown to SFTR reporting has begun, with the first wave of reporting expected for banks and investment firms in 2020, followed by central counterparties (CCPs), asset managers, insurers, pensions funds and eventually non-financial companies. UK-based firms will also have to consider potential Brexit impacts.

This means the time has come for both the buy-side and the sell-side to take a close look at their repo businesses and to sketch out their roadmap to meeting these new reporting requirements.

**What challenges do you anticipate for market participants given the way the repo market currently operates?**

SFTR will require firms to report repo trades, lifecycle events and collateral reuse to a trade repository, such as UnaVista, by T+1. Both sides to a trade will face about 110 reportable fields for repo.

The European Securities and Markets Authority (ESMA) has also stipulated that many of these fields will have to match. This presents a huge challenge to repo market participants whose trading activity is currently fragmented across phone, email, chat systems and electronic platforms, particularly in the dealer-to-client space.

The reportable fields extend well beyond trade economics. Significant effort will be required to create and to maintain extensive counterparty, collateral and even stakeholder reference data. Attempting to capture the data required for this many fields and to submit accurate and complete reports by close of business the following day will present a real challenge for firms, across multiple workflows with little or no standardisation.

As with European Market Infrastructure Regulation (EMIR) for over the counter derivatives, reporting firms will have to invest time and resources to address "reporting breaks" should the two sets of data sent to the trade repositories not match. This can be a hugely time-consuming task that distracts individuals away from trading, ultimately impacting their performance and profitability.

Beyond the content of the reports, firms will have to consider who will do the reporting. SFTR is a double-sided reporting regime where delegated reporting is allowed, and in some cases mandated. From a buy-side perspective, the question is whether you are prepared to report yourself or if you would prefer to delegate the reporting to your dealers—with the risk that they may not be prepared to report for you. From a sell-side perspective, meanwhile, the issue is the potential cost of building the ability to report on behalf of clients and hiring the teams to support this activity when their trading is fragmented across so many different communication channels.

One additional challenge for the sell-side is that their reporting obligation will start before many of their clients need to report. This means that their clients may not be prepared to provide the sell-side with the necessary data points to submit complete reports, which increases the risk of late reporting by the sell-side.

### How can these challenges be tackled?

The first step is for firms to assess when they need to report and to identify for their different workflows what data points they have and in which systems they have them. This is a challenge in itself given the number of workflows they follow and limited standardisation between them.

In this sense, SFTR presents an opportunity to the repo market to improve the efficiency of trading workflows. The use of electronic trading platforms for both 'dealer to dealer' and 'dealer to client' workflows could eliminate the need to book trades manually, freeing up the time of traders and sales people to focus on trading, as well as reducing the uplift to meet reporting requirements.

Shifting flow away from fragmented manual channels such as phone, chat and email and onto an electronic platform not only delivers the benefit of full straight-through processing connectivity to trade repositories and third parties, but also ensures trade data is fully standardised and consistent across both counterparties.

> ***SFTR presents an opportunity to the repo market to improve the efficiency of trading workflows***

**Tom Harry**
Product manager at MTS
Fixed income and regulatory specialist at LSEG

# The time is now

## With the final phases of initial margin approaching, David White of TriOptima explains how his firm enables you to meet your IM obligations with ease

### Step one: the ground work

**Is my firm in-scope for initial margin, and if so, when?**

The first task is to determine if your firm is in-scope for initial margin (IM). If in-scope, you must understand when you need to start exchanging IM. This depends on the structure of your group and the overall size of your derivatives portfolio.

To determine when you are subject to IM you must calculate your aggregate average notional amount (AANA) outstanding for all non-centrally cleared derivatives during the months of March, April and May each year.

The frequency of your AANA calculation will vary depending on your location; in the US the calculation is done on a daily basis during the specified time period, whereas in the EU it is calculated monthly.

Regardless of where you are located, all non-cleared bilateral derivatives including physically settled foreign exchange (FX) forwards and swaps, as well as non-cleared intra-group transactions, should be included in the AANA.

For corporate groups, the above calculation must be performed and aggregated across all members of the group. It's important to note that investment funds are generally considered distinct legal entities, as long as they are not collateralised by or otherwise guaranteed by other entities, funds or advisors for insolvency purposes.

Once you have done this calculation, refer to the chart to determine whether you exceed the threshold for any given year. If so, you will be subject to regulatory IM as of 1 September for the year in which the threshold is exceeded.

| Threshold Amount (USD, EUR or CHF) | Threshold Amount (JPY) | Threshold Amount (CAD) | Threshold Amount (SGD) | IM Phase in Date |
|---|---|---|---|---|
| 3 trillion | 420 trillion | 5 trillion | 4.8 trillion | Sep 1, 2016 |
| 2.25 trillion | 315 trillion | 3.75 trillion | 3.6 trillion | Sep 1, 2017 |
| 1.5 trillion | 210 trillion | 2.5 trillion | 2.4 trillion | Sep 1, 2018 |
| 750 billion | 105 trillion | 1.25 trillion | 1.2 trillion | Sep 1, 2019 |
| 8 billion | 1.1 trillion | 12 billion | 13 billion | Sep 1, 2020 |

### Step two: the practicalities

**Which counterparties do I need to contact?**

Once you have determined your firm's compliance date it's now time to confirm which counterparties you need to interact with.

You will have to be set up to exchange regulatory initial margin with all your counterparties who fall into any phase-in date up to and including your own.

All counterparties need to be contacted and you should work together to confirm the mutually effective dates, and also to determine which tri-party agent(s) you will each use to manage the IM segregation.

Ensure you begin this discussion well in advance, as the custodial account control agreements and the credit support annex (CSAs) covering IM exchange take time to negotiate.

You must also consider that custodians often set deadlines well in advance of the annual 1 September date, by which time the account control agreements must be in place to ensure the custodian can operationally on-board them in advance of the IM exchange effective date. This insight is often mentioned by existing in-scope firms, so is an important “lesson learned”.

## Step three: the number crunching

**How do I calculate initial margin?**

The regulation stipulates that you can calculate margin in two different ways: scheduled-based calculation and regulatory approved model-based calculation.

So far, the industry is united on using the International Swaps and Derivatives Association’s (ISDA) Standard Initial Margin Model (SIMM) to calculate IM. ISDA members worked together to develop this sensitivity-based approach to provide ease of calculation, transparency and effective dispute resolution. Risk factors and sensitivities form the inputs, while risk weights, correlations and aggregation formulae produce initial margin amounts.

As a starting point for the initial margin calculation, the model requires firms to calculate sensitivities in accordance with ISDA SIMM for all in-scope trades. This can be a significant data exercise in itself. Trades need to be identified as being in-scope, labelled correctly and appropriate sensitivities must be calculated for each trade. With an average of 20 sensitivities applicable to each trade and 150 or more sensitivities applicable for more exotic trades—the effort required for this step should not be underestimated and preparation is essential (see step four).

Firms must consider whether they will build internal processes to calculate the SIMM sensitivities themselves or whether they wish to have a vendor provide this service. Since the SIMM model will evolve, consideration should also be given to the ongoing internal development and testing required for model changes over time.

TriOptima's centralised web-based service, triCalculate, can calculate trade sensitivities for you. Easy to integrate to and requiring limited data, SIMM inputs can be produced in-line with the latest SIMM model. Once you are able to calculate sensitivities the SIMM model can be applied to calculate the daily initial margin pledgor and secured amounts.

Once the task of calculating sensitivities has been completed, you then need to calculate your IM amount. To date, the majority of phase one, two and three firms have leveraged AcadiaSoft's IM Exposure Manager to generate IM numbers. The AcadiaSoft service, which is powered by TriOptima, calculates and returns IM exposure from both the perspective of secured party (where you must collect IM) and pledgor party (where you must pay IM). The service also solves the significant challenge of reconciling each parties IM inputs, trades and sensitivities; allowing firms to investigate and resolve any differences in their respective IM calculations.

## Step four: the analytics

**What can I do in advance to ensure a smooth go-live?**

Now you're familiar with the post-go-live number crunching, it's important to consider what should be done now to ensure a smooth go-live.

Firstly, you need to decide if your firm will use the schedule or SIMM calculation methodology pre-go-live as it needs to be agreed and communicated with your counterparties. triCalculate supports both methodologies and can help in the SIMM vs. schedule decision-making process with analytics on the effects of each methodology on your IM costs.

Secondly, you should understand what your initial margin cost will be before going live so you can manage expectations. It is difficult to predict your exact trading behaviour for trades eligible for initial margin, however, you can make an educated guess.

By working with triCalculate, you can identify a suitable portfolio for your first weeks, months, and years worth of trading and simulate your SIMM initial margin cost across all eligible relationships, allowing a more accurate depiction of what you can expect post-go-live.

Finally, it's important to recognise where you stand with the thresholds for exchanging initial margin. You will have to actively exchange initial margin with all in-scope counterparties that exceed the threshold, however, you do not need to physically post initial margin until your IM amount breaches this threshold. Therefore, after go-live, you may have many in-scope counterparties that will not require the immediate posting of IM.

triCalculate helps many firms to generate analytics on their previous trading behaviour, allowing them to prioritise setting up IM agreements with counterparties that are likely to imminently breach the threshold.

## Step five: the streamlining of the collateral process

**How can I make the collateral management process more efficient?**

Integrating the initial margin calculations with your collateral process, exchanging and agreeing on the collateral amounts with your counterparty and establishing a dispute resolution workflow are the next steps you need to consider.

With margin notification times moving earlier in the business day, and a need to agree on margin calls ahead of custodian cut-off times, it is crucial to establish an efficient workflow process for exchanging and agreeing on margin calls with your counterparty. triResolve Margin, TriOptima's collateral management solution, automatically captures IM amounts from the AcadiaSoft IM Exposure Manager—or allows upload from other sources—where they can be processed alongside those for variation margin on a single platform. All calls can be exchanged in real-time using MarginSphere—AcadiaSoft's Hub electronic messaging service.

Perhaps the biggest challenge for the industry is having a dispute resolution method in place with counterparts for initial margin amounts. Due to the way that SIMM is structured, disagreements will arise when you provide different inputs. The sheer volume of sensitive data will likely mean you have a large number of small differences. AcadiaSoft's IM Exposure Manager allows you to pinpoint meaningful differences, enabling you and your counterparty to work together to resolve them and minimise your disputes. This is increasingly important as this is now a regulated part of the market.

To achieve full compliance with ease, leveraging existing out-of-the-box industry tools to reconcile your inputs and automate the process is highly recommended.

### Step six: the governance

**How can I keep pace with the evolving SIMM model and demonstrate my compliance?**

Once you are set-up with your SIMM initial margin daily workflow, you then need to consider your ongoing commitment to your SIMM governance.

ISDA carry out revisions to the SIMM model at least once a year. As a SIMM user, you will be obligated to keep up-to-date with an implementation of the latest SIMM model. If you are using TriOptima's solution, this obligation is taken care of for you.

Further, as a SIMM user, it's likely you'll be required by ISDA or your regulator to demonstrate the suitability of the SIMM model for your trading portfolio. This can be achieved through backtesting and benchmarking.

triCalculate supports two methods of backtesting. With a simple trade file submission triCalculate can run backtesting for you and generate the respective reports in the format required by ISDA.

triCalculate's backtesting approaches:

i Comparison of actual portfolio level PnL moves with IM generated from SIMM either a 10-day SIMM to 10-day actual PnL moves, or one-day SIMM to one-day actual PnL moves.

ii 1+3 Standard: To assess whether a spike in risk factor volatility causes a SIMM margin coverage shortfall under the "1+3 Standard," backtesting is needed that reflects one year of stress and three years of most recent continuous portfolio market conditions.

### Step seven: bringing it all together

**How can I calculate my inputs, manage my margin calls and resolve my disputes?**

TriOptima has helped many phase one, two and three firms meet their IM requirements. We understand the complexities and are best placed to help you overcome them with our seamless solution that requires only one simple trade file.

*"Perhaps the biggest challenge for the industry is having a dispute resolution method in place with counterparts for initial margin amounts"*

**David White**
Global head of sales
triResolve

# MiFID II: a year on

## As MiFID II celebrates its first birthday, how has the industry adapted to the changes, and what challenges is it still facing?

*Jenna Lomax reports*

Just before its 3 January 2018 implementation date, less than half of attendees of the Global Custody Forum felt they would be compliant with the second Markets in Financial Instruments Directive (MiFID II) in time for the deadline.

MiFID II regulates firms that provide any services to clients linked to financial instruments and venues where these instruments are traded.

Firms prepared for the implementation of the initiative throughout 2017 and adapted their business models throughout 2018—this will no doubt continue as we move into 2019.

Peter Moss, CEO of SmartStream Reference Data Utility, says: “Last year, was a year of settling down the regulations, the processes and the data quality for the market as a whole. The European Securities and Markets Authority (ESMA) is continuing to look at the quality of the data being published and where necessary they will make changes or push participants to align to ensure the regulator’s goals of market transparency are achieved.”

Back in 2017 and throughout 2018, many industry participants raised concerns about the scope of the changes and the uncertainty surrounding the directive, with many suggesting it had been the biggest challenge of the year.

As Chris Turnbull, co-founder of Electronic Research Interchange, surmises: “With the MiFID II regulation now reaching its first birthday, it is interesting to look back at a year that many thought would bring substantial change for the asset management industry.”

He adds: “In hindsight, it may have been naïve to expect quick-fire change from an industry that has operated in a certain way for decades. The overwhelming majority of firms were unprepared for

the changes last January, and the state of confusion continued throughout the year."

As Volker Lainer, vice president of product management at GoldenSource, mirrors: "The regulatory technical standards were continually changing as late as Q3 last year. As such, banks, brokers and fund managers alike were backed into a corner and had no choice but to adopt sticking plaster solutions."

This was felt just a month before the implementation date when ESMA delayed the enforcement of the legal entity identifier (LEI) requirements by six months to July 2018. MiFID II requires all legal entities involved in a trade to include their LEIs in European trade reporting. The six months adjustment period was introduced since not all firms succeeded in obtaining LEIs in time for the January deadline.

Similar to the LEI delay, firms had to make other amends to their existing systems and processes based on the varying feedback they received from local regulators. In addition, banks and asset managers had to centralise and check their data thoroughly—many are still in the process of achieving this.

As Moss indicates: "The biggest challenges were the inconsistencies between how standards were applied by various participants. ESMA definitions differed from Association of National Numbering Agencies (ANNA) definitions and market participants contributing data all had mixed interpretations."

Brian Charlick, risk and regulation, financial services at CGI affirms that another challenge was remaining compliant with the General Data Protection Regulation.

Charlick highlights: "Trader details are required and only the reported fields were to be consumed and stored as an audit trail is essential. To get around this, the client had to ensure each of the traders and clients provided authorisation for the client to use and maintain the relevant data for regulatory and auditory purposes."

Other members of the industry were concerned about reference data. David Farmery, vice president of message automation at Broadridge, suggests: "The biggest challenge was around reference data needed to determine whether instruments were reportable or not."

He adds: "There was significant uncertainty very close to go live date around how the regulations and the market infrastructure would work, particularly around trading on a trading venue (ToTV)."

"This resulted in market infrastructure providers such as approved publication arrangement withdrawing eligibility services very late in the day."

And as Ben Duckworth, head of business development at Simplitium, mirrors: "Reference data has been the biggest challenge for us and our clients. The ToTV instrument universe was a problem in Q1 and Q2 but has significantly improved. However, a gap that remained was the system identifier (SI) status of market participants. Understanding the SI status of your counterparty for each instrument traded is a critical requirement for accurate reporting, however, no mechanism is defined in the MiFID II framework to make this data available."

## Are we still not ready?

Although the implementation date was on 3 January last year, the industry has still been working on the regulation with post-implementation work.

As Farmery explains: "Ahead of the MiFID go live, regulators were strongly suggesting banks should keep their project teams intact for a good six months post go live. This has proven to be wise advice."

A recent survey, released in December last year and conducted by Cappitech, found almost 30 percent of those asked said they are only "fairly confident or not confident at all" in keeping up with MiFID II changes.

More than half said they were not ready, or not reporting correctly when MiFID II first went live in January.

The survey, entitled 'MiFID II and best execution: headache or opportunity', asked approximately 100 capital markets firms to assess the extent to which they had been affected by the new directive.

To help solve this, 50 percent of respondents said they plan to employ a dedicated member of staff to manage their regulatory reporting.

A further 45 percent of respondents said transaction reporting was the most challenging element of the MiFID II ruling, while 29 percent said they found best execution reporting and monitoring accounts a challenge.

Another report from the International Capital Market Association (ICMA), said European bond markets are still waiting to experience the benefits of MiFID II and Markets in Financial Instruments Regulation (MiFIR).

The report highlighted that while the European bond markets continue to function, MiFID II/MiFIR is yet to deliver on its objectives of improved investor protection, greater transparency, and a more competitive landscape.

One of the main objectives of MiFID II/MiFIR was to encourage more trading on regulated venues rather than in the over-the-counter (OTC) market, and there is evidence that this has been the case, ICMA noted.

However, ICMA suggested that the liquidity and market functioning appear to have been maintained in the wake of regulation despite ongoing issues. These issues are particularly related to the transparency regime and the accessibility and quality of pre- and post-trade data.

While it is accepted that this will improve over time, the implementation of MiFID II/MiFIR seems to have missed an opportunity to provide a utility based consolidated tape for fixed income, ICMA revealed.

## Unbundling

A new study conducted by Plato Partnership in December last year found research unbundling is already going global—53 percent of buy-side respondents have already implemented a global policy and a further 20 percent will do so within the next five years.

"In Europe, the change may be regulatory driven, but across the rest of the world it is being led by end investor demand", Plato Partnership said.

Rebecca Healey, head of Europe, the Middle East and Africa market structure and strategy at Liquidnet, says: "It isn't surprising that unbundling is a global phenomenon just one year after the implementation of MiFID II."

She further indicates: "Across the world, there has been a growing demand from end-investors to be assured that they are getting value for money, and a need for greater transparency is a direct consequence of this. Ability to track research providers, the type of research they provide and at what cost unlock possibilities that weren't previously available, all leads to increased value for end-investors."

However, Turnbull says a year on from MiFID II unbundling, there's still slow progress and a long way to go.

He says: "[After the MiFID II implementation], asset managers were expected to become more transparent and reveal both their research costs and how they are paying for them. But many pre-MiFID II behaviours, such as deciding on the value of research after consuming it, have not changed."

"It is easy to see this as a disappointment and ultimately a signal of MiFID II's struggles, but things are starting to move in the right direction."

## Looking to the future

Commenting on the industry's seeming lack of confidence in some areas, Cappitech concluded: "Keeping abreast of changes in regulation takes skill, time and resources. Not everyone feels confident to take on this task."

As Moss affirms: "Complying with regulations is an ongoing process. Since the 3 January, ESMA has implemented a range of additional MiFID requirements on a regular basis, this included the double volume cap, the no LEI, no trade rule, the SI mandatory regime for equities and fixed income. In March 2019, this will be extended to incorporate OTC derivatives. At SmartStream we have continued servicing our clients with the ongoing implementations with each of these ESMA deadlines. MiFID II was ambitious in the scope and detail of the definitions that it imposed on the market; other regulators have learned from this approach and are revisiting some of the regulations, for example, such as Dodd-Frank in the US."

As Matt Smith, CEO of SteelEye, affirms: "If the Financial Conduct Authority delivers on what it promised, to begin crackdown on non-compliance in 2019, then we will likely see a domino effect of firms taking action to comply—and as a result, a more transparent, competitive and efficient industry should emerge."

"Hopefully, once clarification is provided and regulation requirements are gradually met, the entire market infrastructure and those who participate in it will be more in control and stronger than ever before."

To improve meeting deadline targets for implementation dates, Christian Voigt at Fidessa, says: "If MiFID II teaches us anything it is that we shouldn't have such large regulations in the first place."

"Instead of consulting and negotiating for ten years on texts exceeding 1.7 million paragraphs, how about lawmakers work on a steady stream of smaller changes."

"Faster time to market, better impact assessment, lower implementation costs, reduced risks, the benefits for everyone could be tremendous." AST

# Facing the future

## Industry participants share their outlook on what regulations will be the most challenging in the coming months

The beginning of last year saw the introduction of the second Markets in Financial Instruments Directive (MiFID II), shortly followed by the General Data Protection Regulation (GDPR) in May.

While the industry is not being kept awake at night with MiFID II nightmares, there are still many challenges. One of the biggest challenges financial services firms will face this year is the UK's departure from the EU—the industry's biggest challenge is undoubtedly the uncertainty around Brexit.

As firms continue to adapt to the new regulatory landscape, there is a big opportunity to replace traditional processes and implement new technologies to optimise workflows.

**What regulations will be the biggest challenge for the industry?**

**Brian Collings:** More than specific regulations, the breakup of consensus on rules between the US and Europe and between the UK and Europe poses the greatest potential challenge for compliance teams.

Fragmentation of rules is hard to manage from an operational point of view. Even the threat of fragmentation will require firms to think about how their current operational and technology architectures are put together. We're seeing authorities question the rollout of some rules, such as the Fundamental Review of the Trading Book and the Volcker Rule, which could lead to existing projects being changed significantly.

Furthermore, the European Parliament's elections in May might create a very different atmosphere for financial regulators.

**David White:** This year and 2020 are set to bring potentially thousands of firms in scope for the mandatory exchange of initial margin (IM). Meeting the requirements for IM have proved to be time-consuming and laborious to implement so firms need to begin their preparations now.

Through working with phase one, two and three firms, we've found the main pain points are calculating the inputs for International Swaps and Derivatives Association's (ISDAs) Standard Initial Margin Model (SIMM), finding an efficient way to agree and exchange margin calls with counterparties, and pinpointing dispute driving differences as they arise.

**Tony Freeman:** This year will definitely be the year during which firms across the buy-side and sell-side begin to prepare for the regulatory avalanche that will take place in 2020.

This includes the Securities Financing Transactions Regulation (SFTR), the Settlement Discipline Regime component of the Central Securities Depositories Regulation (CSDR) and phase five of the mandated implementation of initial margin rules for over-the-counter derivatives.

Furthermore, a new European Parliament and Commission will start work in September and set the regulatory agenda for the next few years.

**Demi Derem:** The updated Shareholder Rights Directive (SRD II) in Europe and the publication of its Implementing Regulation means that intermediaries now have enough clarity to start evaluating their product offerings.

New requirements, including significantly more stringent processing deadlines and new processes such as shareholder identification, must be factored into their asset servicing capabilities and product development plans.

**Brian Collings**
CEO
Torstone Technology

**David White**
Global head of sales
triResolve

**Tony Freeman**
Executive director, industry relations
DTCC

SRD II also leaves a lot of room for member states to choose different directions or standards. This year, custodian banks will either need to collaborate and lobby strongly for consistency or deal with divergent standards and challenging technical requirements for compliance. CSDR will also be a high and growing priority. Some of the biggest changes under CSDR have primary impacts beyond the CSDs themselves, to institutional market players and custodians.

Chief among these is a newly restyled settlement discipline regime, which targets timely and efficient settlement in two steps—through the introduction of cash penalties, and by implementing a mandatory buy-in procedure.

**Kevin O'Neill:** The reporting pillar of the SFTR requiring financial counterparties and non-financial counterparties to report their securities financing transactions is expected to come into effect as early as Q1 2020 (on a phased approach).

Asset management firms must start to prepare now by allocating resources or risk being left behind. The planned European Market Infrastructure Regulation (EMIR) regulatory fitness and performance proposals are also going to be of importance.

A draft regulation is currently undergoing negotiation, however, the first amendments could come into force this year.

Elsewhere, GDPR has led to a worldwide scramble to update national data protection policies as the free flow of data becomes increasingly regulated, impeding trade and commerce in a progressively more digitalised world.

Jurisdictions are generally seeking an adequacy decision or just wish to be considered as having the required safeguards in place. This uptake in data privacy laws can be seen clearly in the Asia Pacific as India, Thailand, Indonesia and Vietnam have all published draft bills in recent months. These are expected to continue through the legislative stages this year.

In March, Brexit will see GDPR continue to be applicable in the UK but will also start a race to obtain an adequacy decision from the European Commission.

The European Data Protection Board is expected to release new guidance this year on particularly sticky points from GDPR, for example, extraterritoriality.

Regulators globally will be focusing on the regulation of crypto-assets and within Europe, providers engaged in exchange services between virtual currencies and fiat currencies will be brought into the scope of the Fifth EU Money Laundering Directive, as they will be classed as obliged entities. AST

**Demi Derem**
General manager, investor communication solutions international
Broadridge

**Kevin O'Neill**
Global head of buy-side division
Fenergo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