Who is Ready for MiFID II?

Gearing-up RegTech in 2018

17 July 2017

Contents

I. Introduction

MiFID II will be one of the biggest regulatory changes since the 2008 financial crisis. It is a complex and interconnected beast that will affect business and operating models in ways that are not always obvious – even to the experts – and it will cost the financial industry billions to implement.

Getting MiFID II right is going to be crucial to operating models, technology stacks and, ultimately, bottom lines. JWG have been working with MiFID experts since 2005, conducting our first MiFID survey back in 2006.

This time around, we have been helping to crowdsource implementation intelligence during the last 2 years with 200+ individuals from dozens of leading firms and vendors through our MiFID Implementation Group (MIG). The MIG is a JWG-facilitated working group of industry experts who have had nearly 100 meetings to agree a common view of how to approach MiFID's many implementation challenges which are now documented on over 1,000 pages of guidance.

II. Executive summary

Firms are generally taking an analog approach to disruptive, digital regulation:

- Although the results show an uptake in smart technological methods of managing requirements, they also show that a majority continue to rely on manual, resource intensive and less effective routes to compliance
- Transaction reporting, best execution, record keeping, trade reporting and costs and charges are recognised as the biggest data management challenges respectively
- Nearly half of firms are attempting to implement MiFID II with a head count of less than 5. This demonstrates that the importance of crowdsourced interpretation of the requirements has never been higher, since trying to get small teams to cover huge, complex, and overlapping regulation is not possible with this approach.

The road ahead will be bumpy for those that do not continue to fund change programmes in 2018:

- Two thirds of buy-side firms are still in the relatively early stages of their MiFID II programmes with time quickly running out
- 90% of firms believe they are at either high or medium risk of not being fully compliant by 2018. Given that the deadline has already been delayed by a year, they now face a significant risk of penalties in the next 18 months
- With just under a third of firms saying that they are actively seeking benefit from MiFID II, those who are trailing behind risk missing significant competitive advantage if they do not smarten up their MiFID programmes.

This legislation will be a catalyst for new RegTech solutions that will fill the large capability gaps which currently exist:

- There are many areas (research, inducements, best execution) in which a large number of firms have not finished analysing the requirements, underlining a lack of preparedness
- Information to clients and transaction reporting appear to be the areas in which firms are most prepared, with a majority having decided how to meet the requirements
- Reporting is by far the most outsourced of all the MiFID II requirements. However, there is also a substantial amount of demand for record keeping and data management solutions. A small number of firms have outsourced their regulatory change management as a whole, and most appear to be keeping issues such as research, trading and client management in house.

In conclusion: It is now time to prioritise and focus on gearing up regulatory change programmes with RegTech to achieve compliance in 2018. Based on the results and our experience in the world of MiFID II implementation, we have developed a 10-point plan, detailing the next steps for firms grappling with implementation programmes; these steps are focussed around collaboration and taking a strategic view of the RegTech capabilities required.

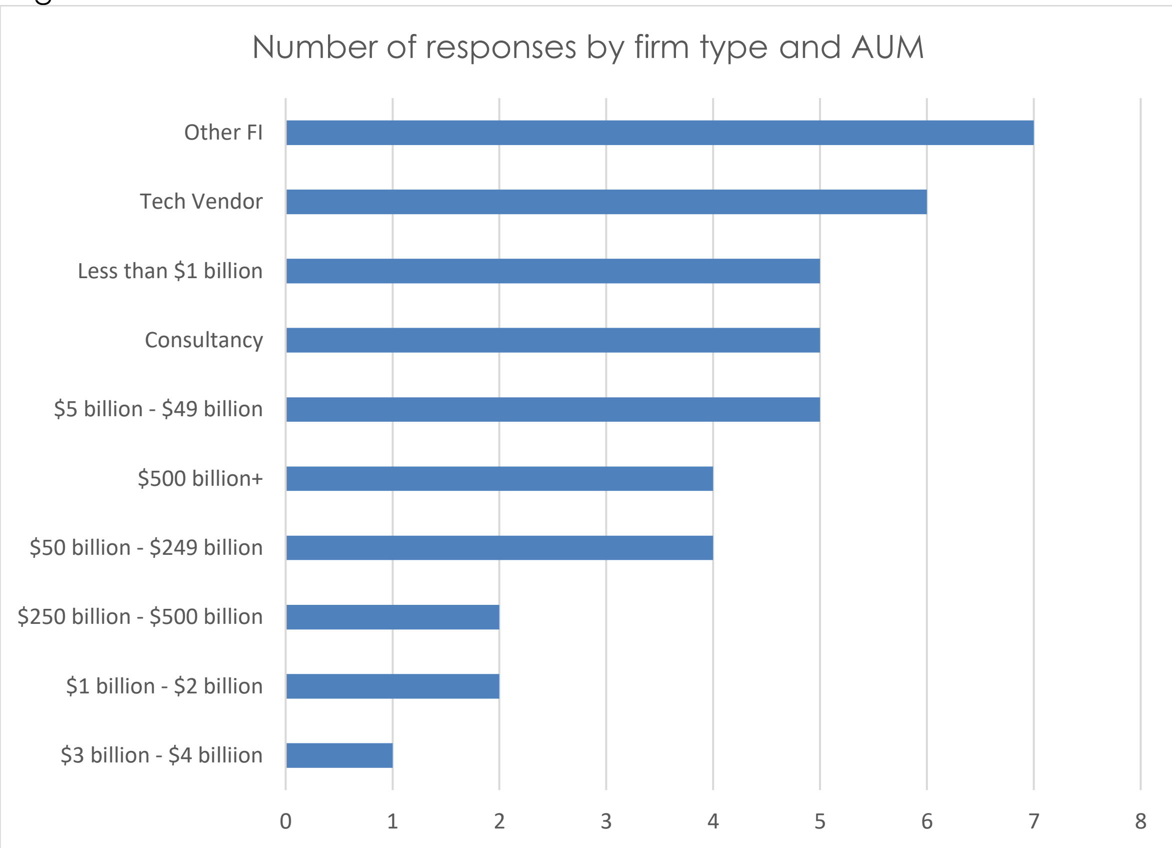
III. About the survey

The survey opened on 03 May and ran for 6 weeks to 09 June. Our thanks go out to our partners who helped us distribute the survey to individuals in senior legal, ops and compliance functions at over 200 buy-side firms.

In total, we received 42 responses from individuals at different firms – a relatively low response level which is further evidence of the late take-up of MiFID II implementation programmes on the buy-side.

All the respondents answered a majority of the questions, however, not all respondents answered all the questions, for this reason not all questions that are analysed in this paper have 42 responses. There are some respondents who do not directly work for an asset manager (i.e. vendors, consultants and other financial institutions). We considered approaching our analysis by removing these responses, however, we found that the trends correlated with responses from asset managers, therefore the data which you see in this paper includes these respondents.

Figure 1

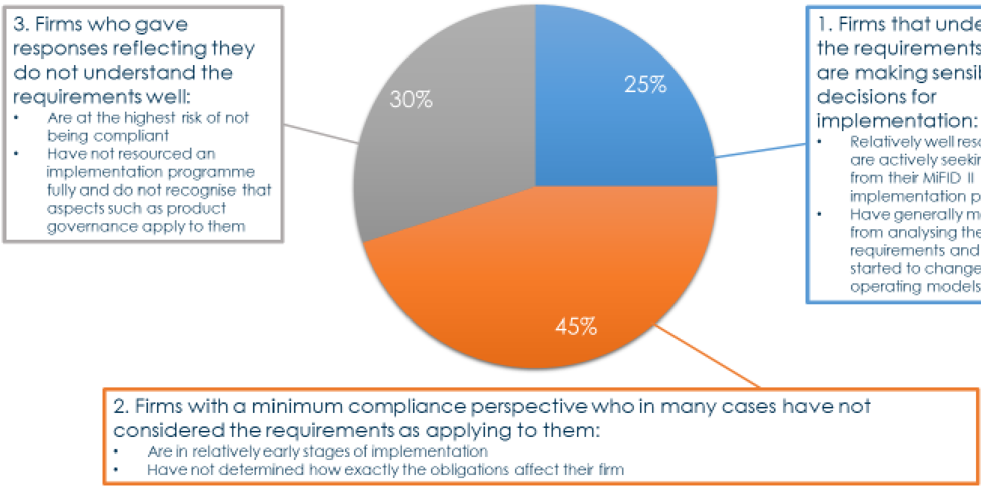


Source: 42 responses to MiFID II buy-side implementation benchmark survey 03/05/17 - 09/06/17

IV. Key trends and expectations

In analysing the results, we classified respondents into three key MiFID II profiles:

Figure 2



Source: JWG analysis of 29 responses to MiFID II buy-side implementation benchmark survey Q2 2017

Based upon the nature of the responses to our survey, we draw a number of conclusions about who will be the post MiFID II implementation winners and losers.

Winners:

- **Firms getting it right**: Those in our 1st profile (see above) will develop an advantage in terms of how they come across to their clients and in savings on remediation programmes
- **Consultants**: In 2018, we expect large invoices will be fueling consulting remediation practices to overcome the implementation deficit we are seeing this year
- **Data scientists**: Will be in high demand, as without good data, good work in other areas will not be possible
- **Early adopters of RegTech**: Firms that have developed traceability and auditability of requirements through good RegTech will reap rewards when it comes to evidencing how their obligations have been met.

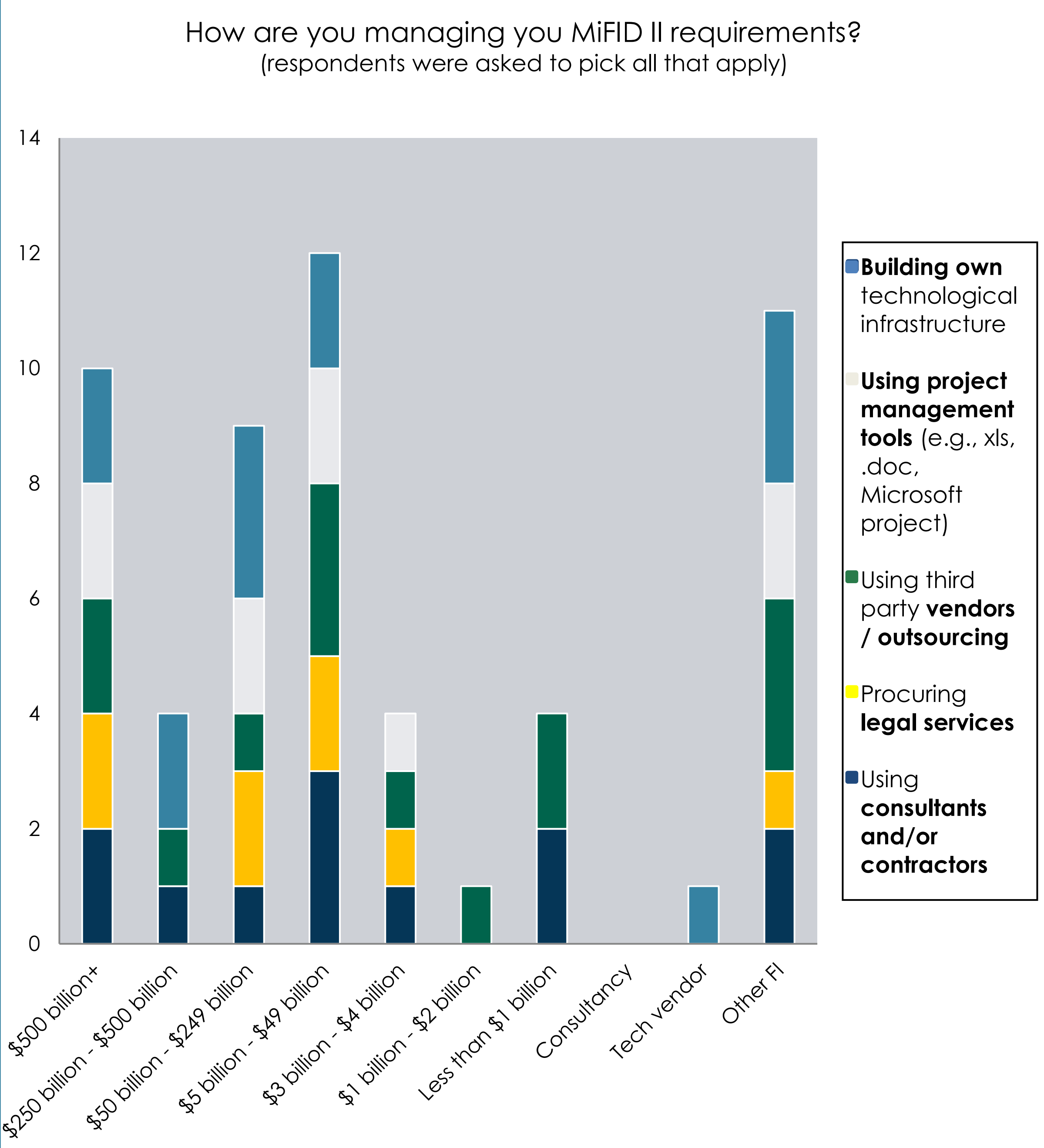
Losers:

- **Outlying firms**: Firms that are not with the herd could easily be caught out and made an example of
- **The politicians**: It looks as if politicians are unlikely to get the outcomes they desire and the industry will be plagued with remediation issues for an extended period
- **Firms behind the curve**: Those in profile 2 and 3 risk looking bad in front of clients and having to spend millions remediating bad work
- **Senior managers**: Under the FCA's Senior Managers Regime it will be key senior managers that are pinned for MiFID II failures and the penalties may be harsh.

V. Firms are taking an analog approach to digital regulation

Correlation between firm size and MiFID II approach

Figure 3

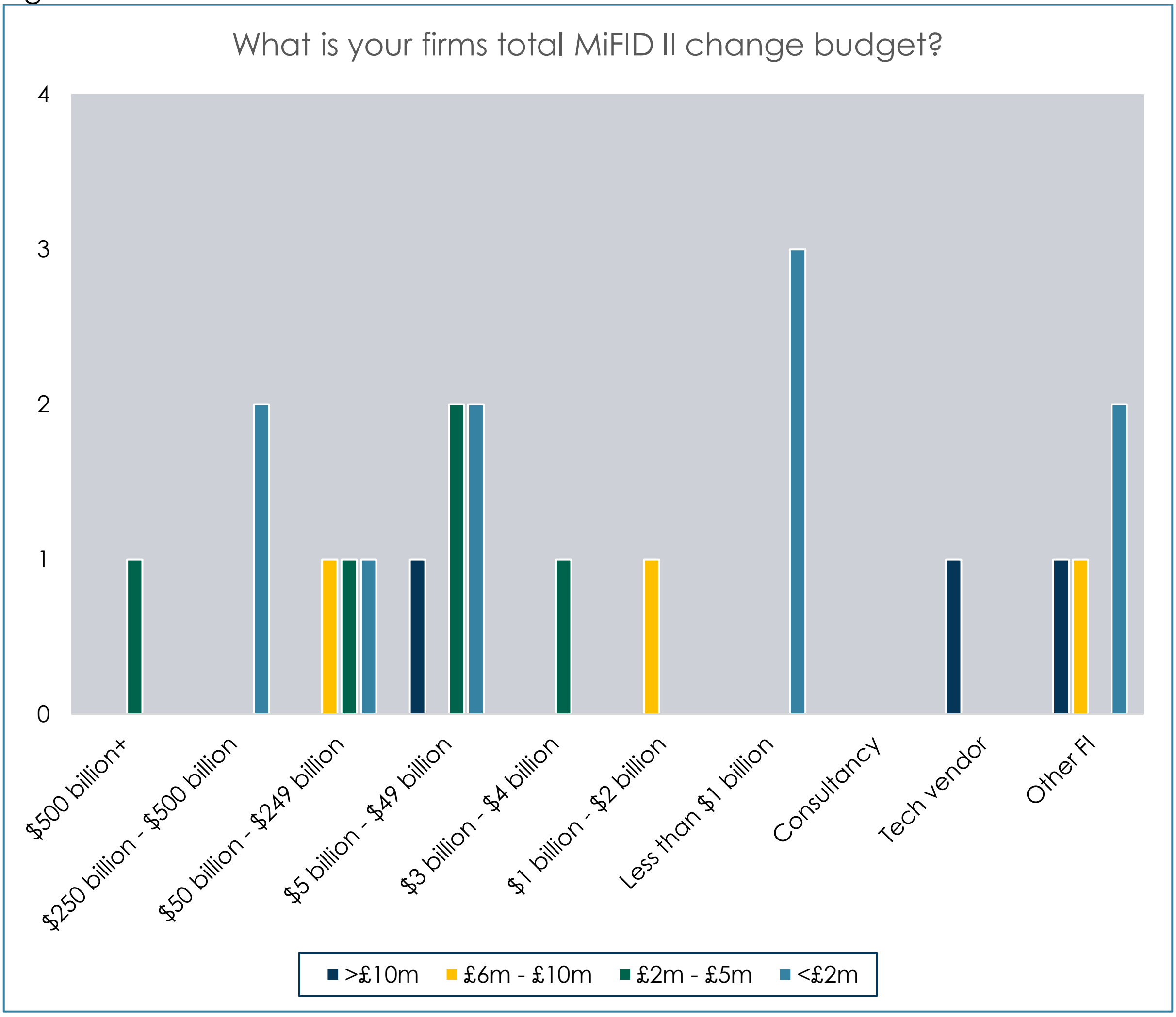


Source: JWG analysis of 21 responses to MiFID II buy-side implementation benchmark survey Q2 2017

Although the results show an uptake in smart technological methods of managing requirements, they also show that a majority continue to rely on manual, resource intensive which will be less effective.

Correlation between firm size and MiFID II budget

Figure 4



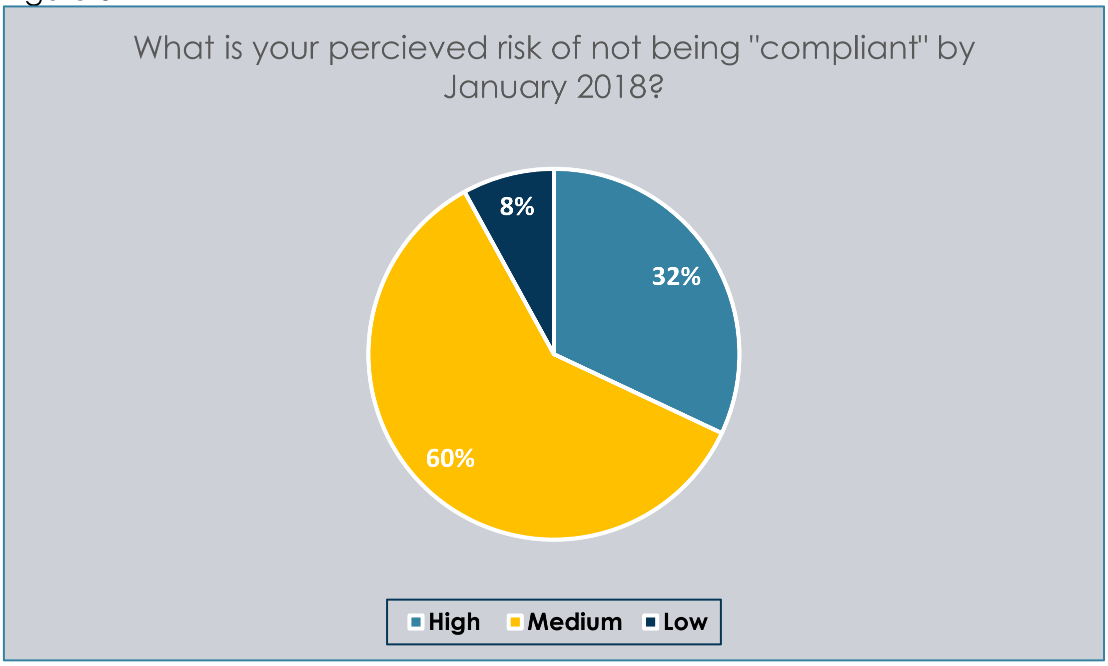
Source: JWG analysis of 21 responses to MiFID II buy-side implementation benchmark survey Q2 2017

A large amount of the industry appears to be arguably under-resourced for MiFID II. Half of firms are implementing on a budget of less than £2 million demonstrating a likely wide gap in capabilities come 2018. Size of budget and size of firm are not correlated.

VI. 2018 Investment Priorities

Risk of not being fully compliant by 2018 deadline

Figure 5

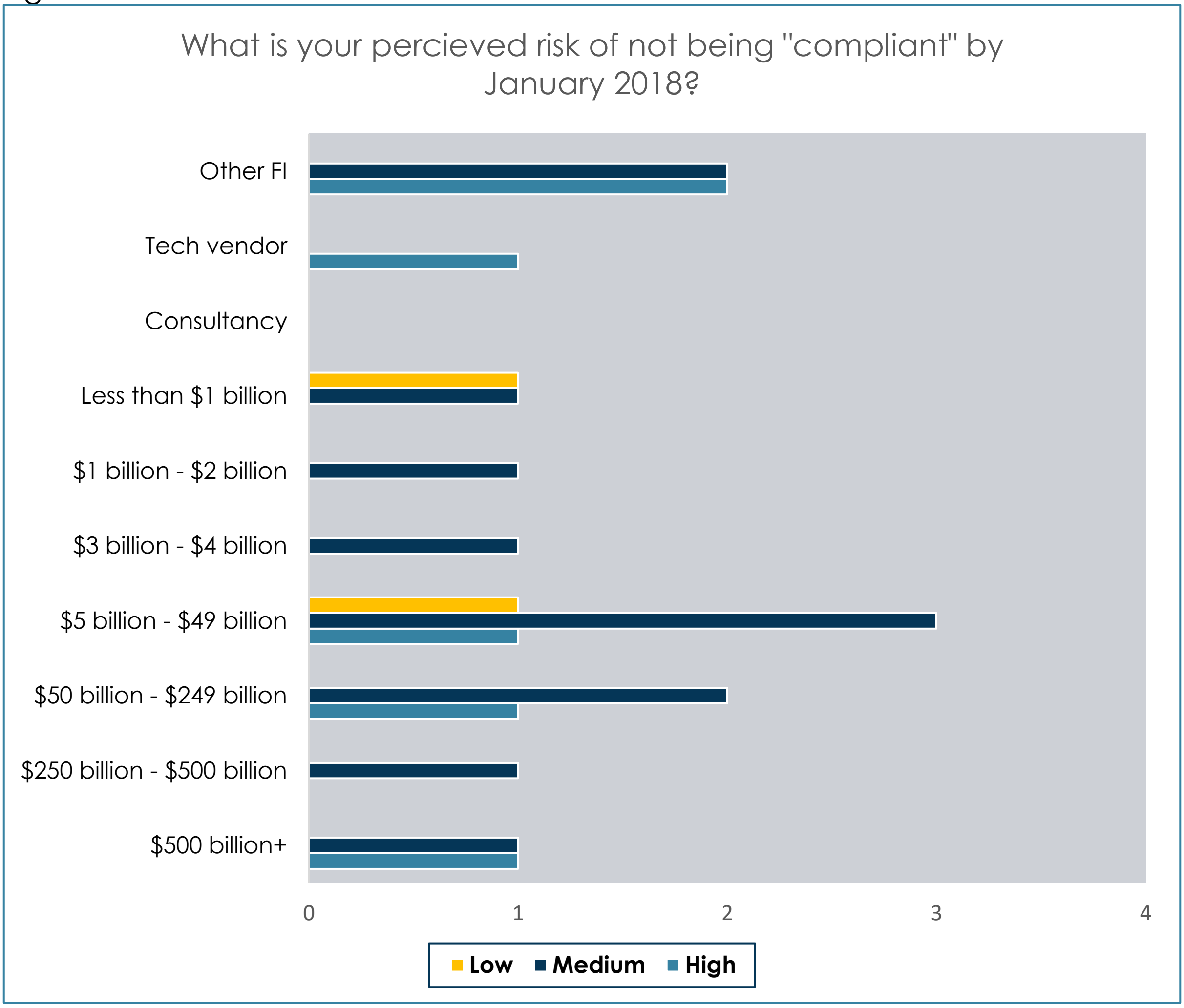


Source: JWG analysis of 25 responses to MiFID II buy-side implementation benchmark survey Q2 2017

Over 90% of firms believe they are at either high or medium risk of not being compliant by 2018. Given that the deadline has already been delayed by a year and the impact that is likely to have on the leniency of regulators, it is clear that firms need to get serious about their MiFID II compliance now or face significant risk of penalties in 2018.

Correlation between firm size and risk of not being compliant

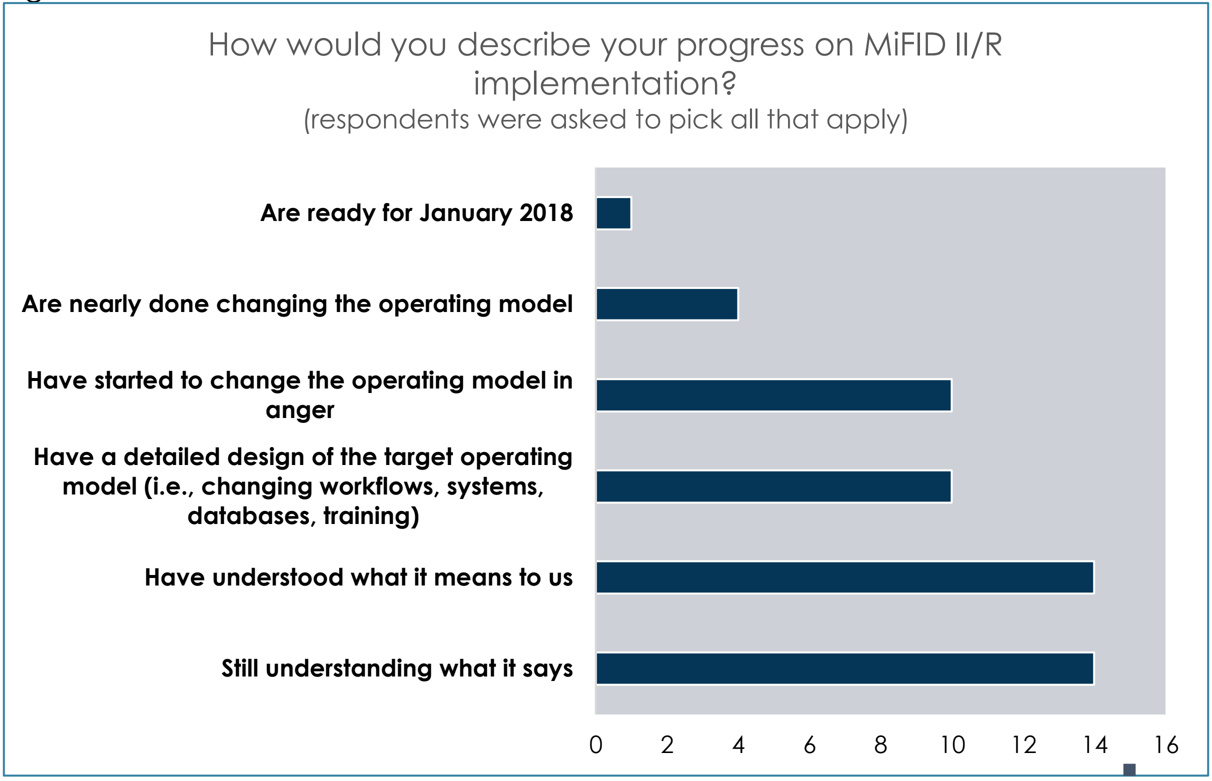
Figure 6



Source: JWG analysis of 20 responses to MiFID II buy-side implementation benchmark survey Q2 2017

State of readiness

Figure 7

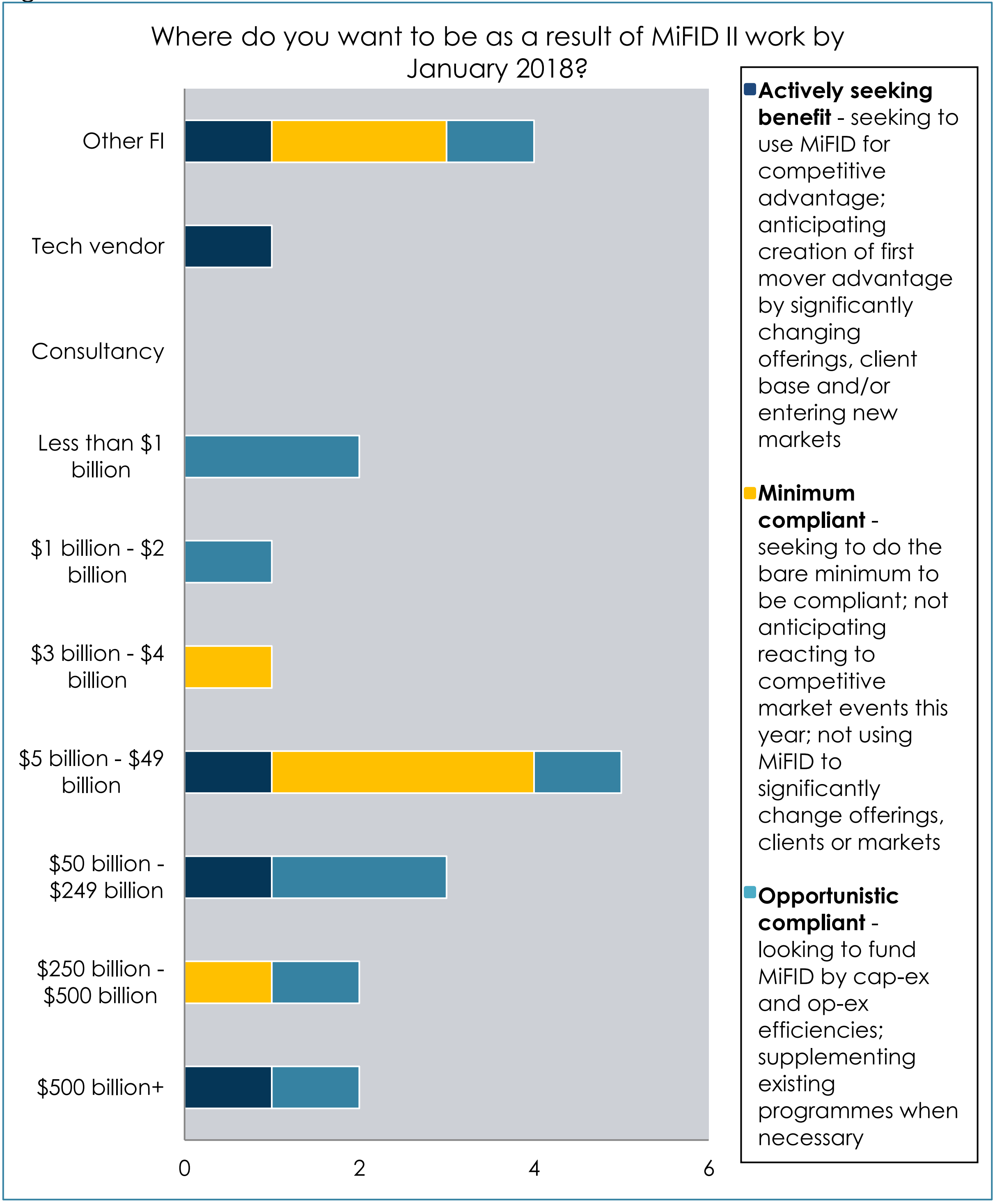


Source: JWG analysis of 28 responses to MiFID II buy-side implementation benchmark survey Q2 2017

A large majority of firms are still in the relatively early stages of their MiFID II programmes with time running out fast. Only around a third of the firms have started implementing the necessary changes and nearly as many are still understanding what it means. This demonstrates the risk that a large portion of the buy-side may not be ready come 2018. This should be a cause for concern across the industry as it will not just be firms who are unprepared who are affected, but also their clients, their suppliers and their counterparties.

Implementation strategy by firm size

Figure 8



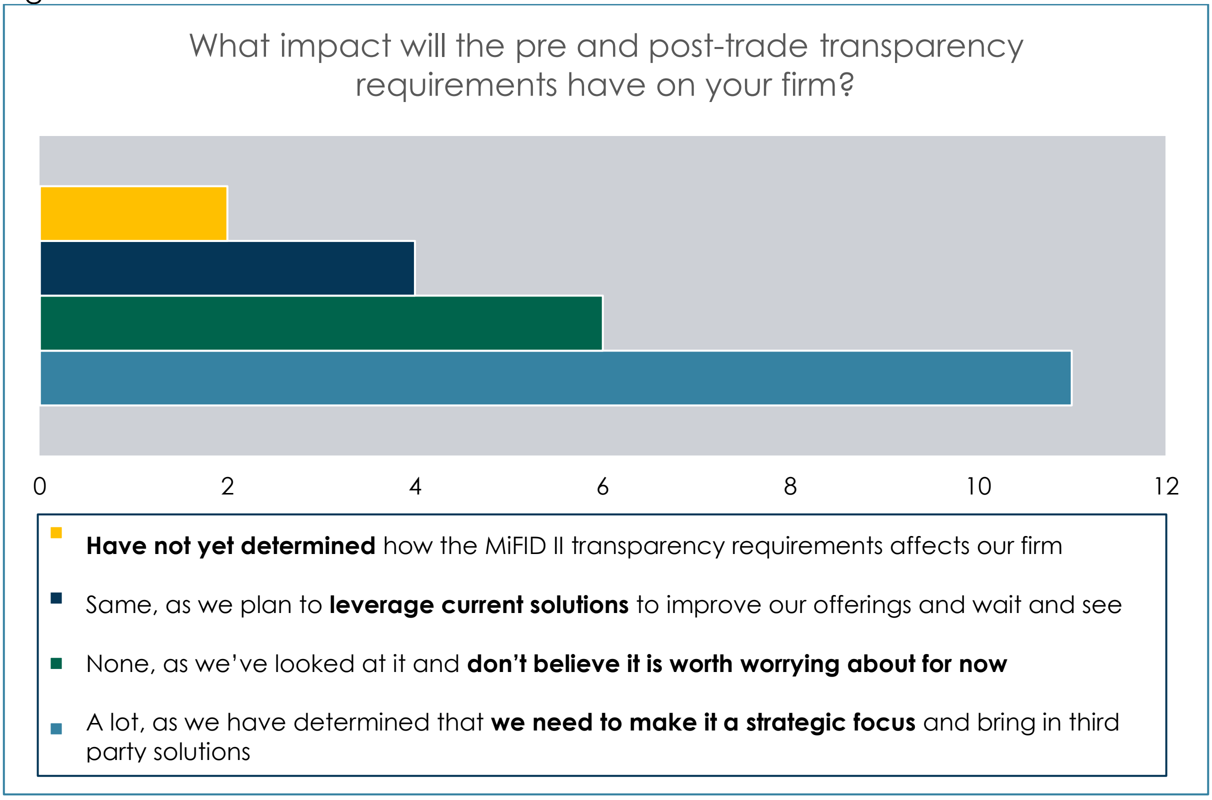
Source: JWG analysis of 21 responses to MiFID II buy-side implementation benchmark survey Q2 2017

Largely, the industry has modest aims as far as MiFID II goes, however, there are a smattering of firms aiming to actively seek benefit. The fact that there is no real correlation here in terms of the size of firms suggests that the size of firm does not infer MiFID II success.

VII. Current capability gaps

Perceived impact of transparency requirements

Figure 9

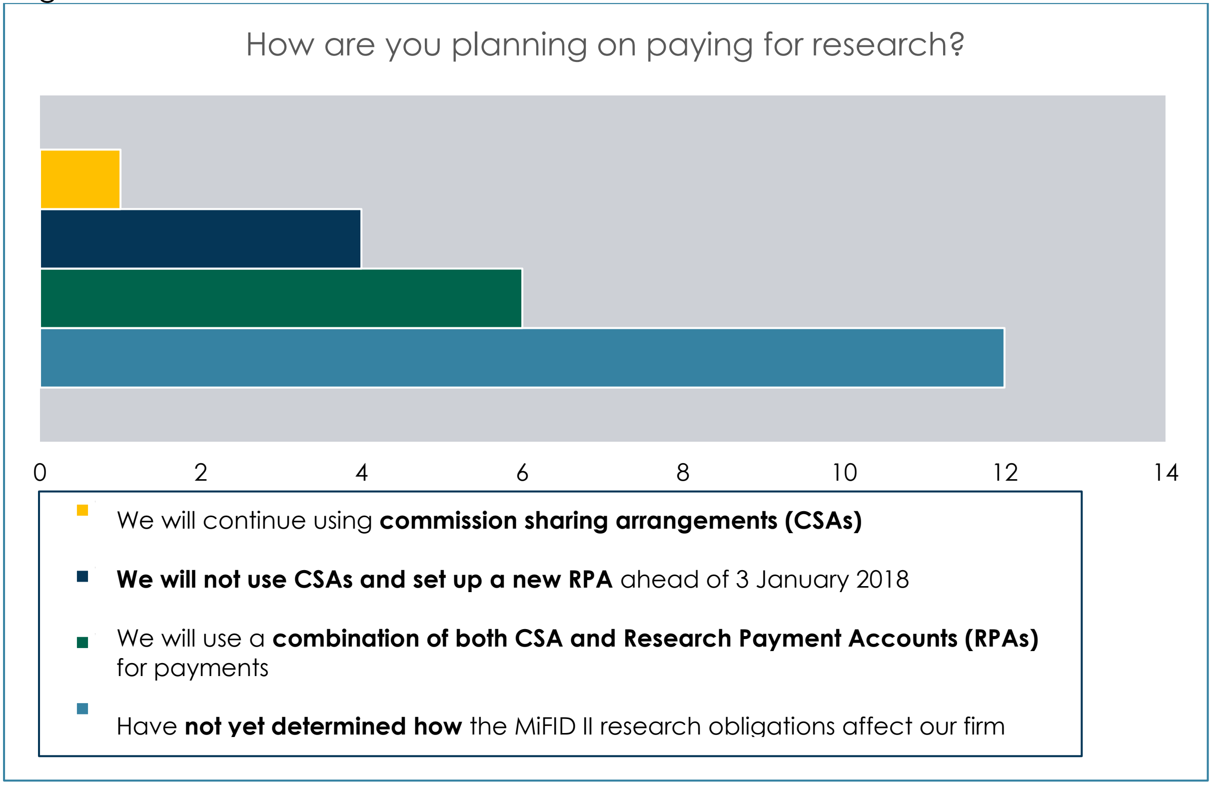


Source: JWG analysis of 23 responses to MiFID II buy-side implementation benchmark survey Q2 2017

Most respondents clearly see transparency as a key issue under MiFID II as they are making it a strategic focus. However, there is certainly more misalignment here as a decent number of firms see little to no impact.

Current state on how to pay for research

Figure 10

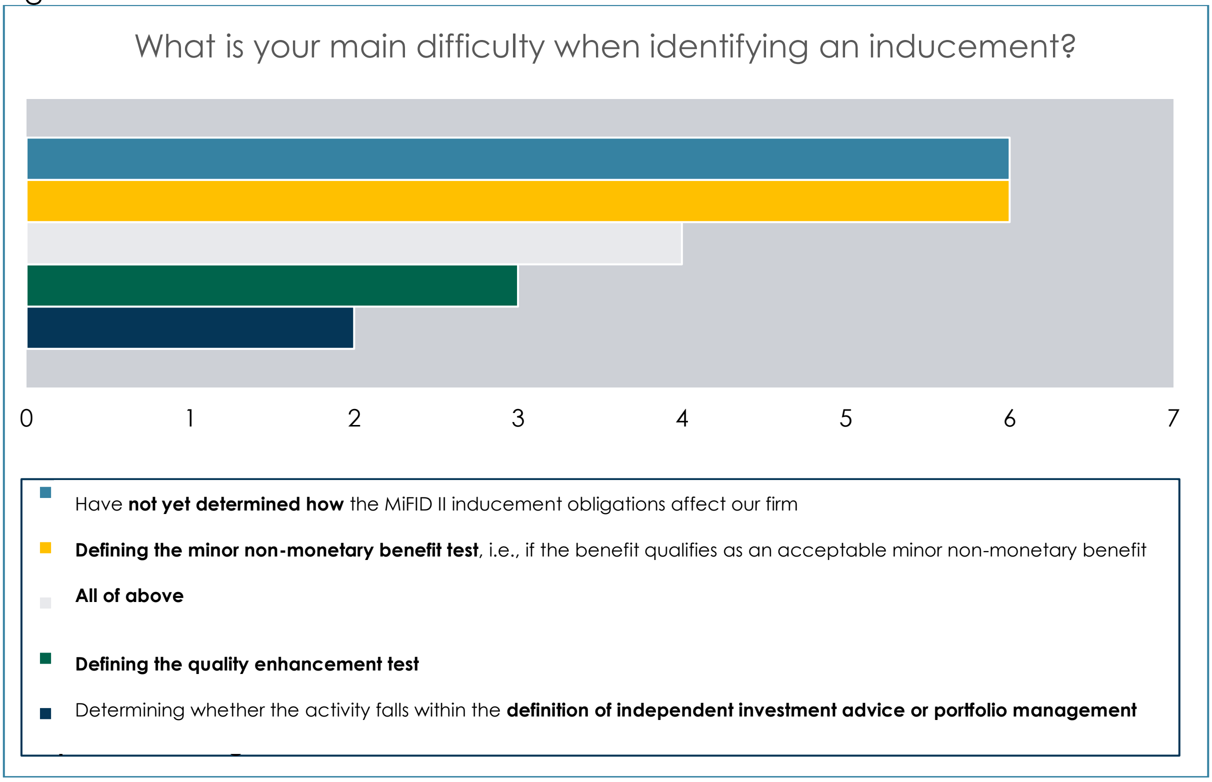


Source: JWG analysis of 23 responses to MiFID II buy-side implementation benchmark survey Q2 2017

A majority of respondents still do not know how they will be paying for research under MiFID II. In one of the most substantial areas of change for the buy-side under MiFID II, it is concerning that so many firms are yet to tackle this issue. This is made more concerning by the fact that the sell-side have largely been waiting for the buy-side to move first on this issue, making it something that requires a lot more cross industry focus throughout the rest of the year.

Current state on how to determine an inducement

Figure 11

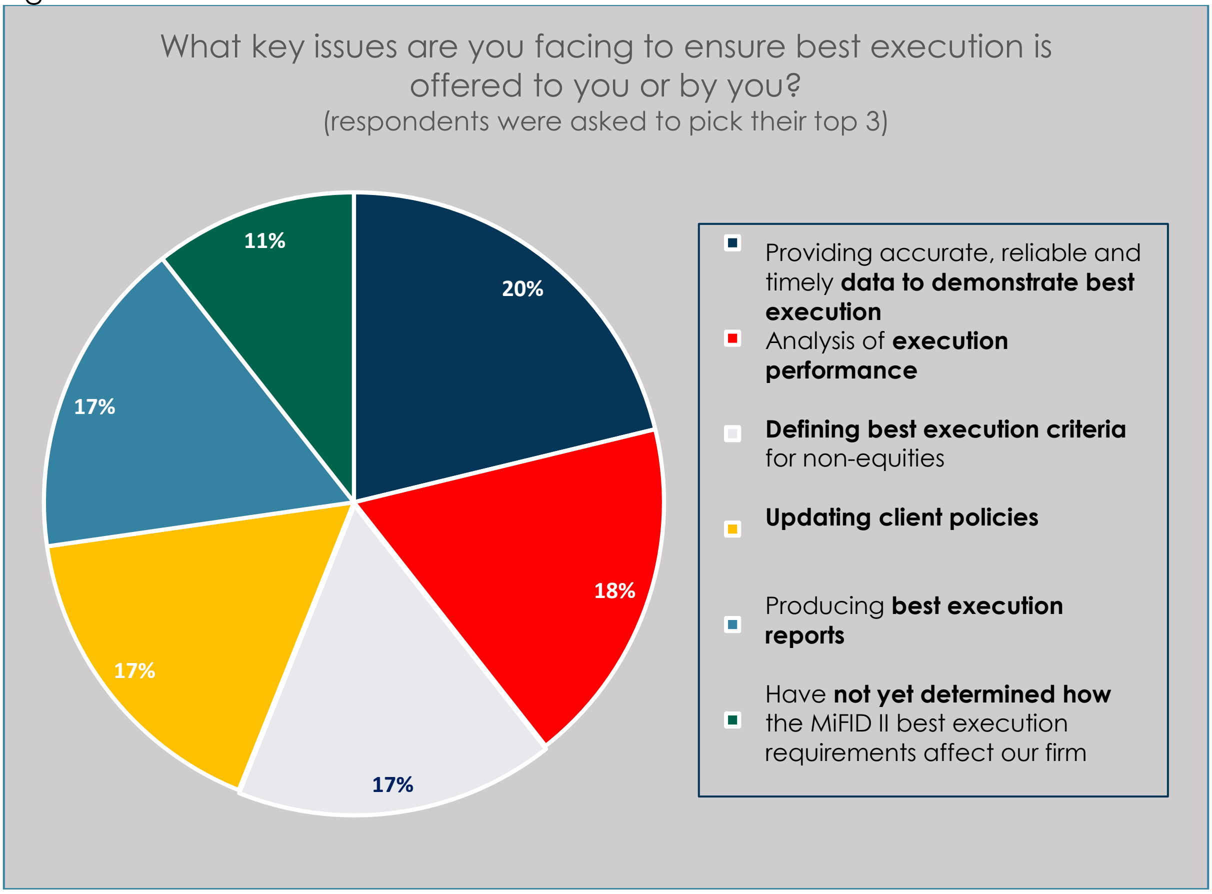


Source: JWG analysis of 21 responses to MiFID II buy-side implementation benchmark survey Q2 2017

This is another question in which most firms have not determined the impact. For those who have analysed the requirements, defining the minor non-monetary benefit test appears to be the biggest challenge. But with all of the above also scoring highly, this is clearly a challenging area for the buy-side.

Biggest challenges in ensuring best execution

Figure 12

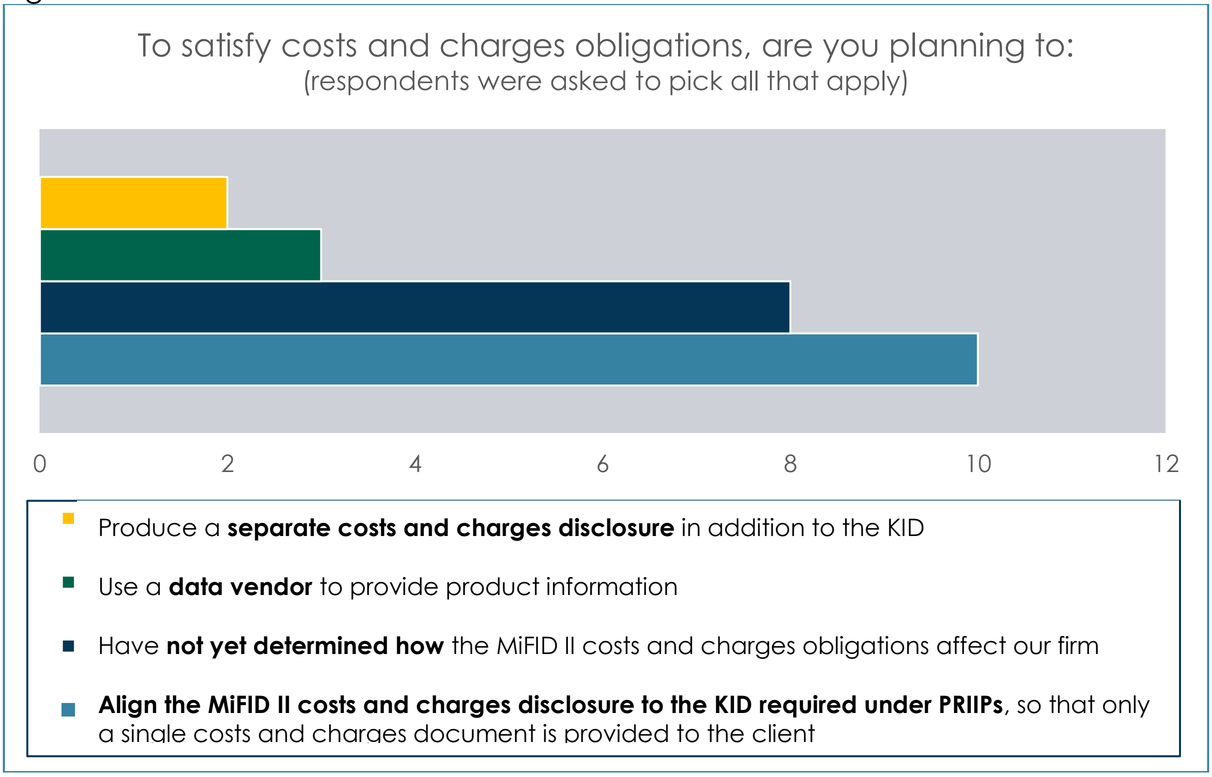


Source: JWG analysis of 22 responses to MiFID II buy-side implementation benchmark survey Q2 2017

The balanced spread of responses here demonstrate that all aspects of best execution appear challenging on the buy-side.

Current state of plans to satisfy costs and charges obligations

Figure 13

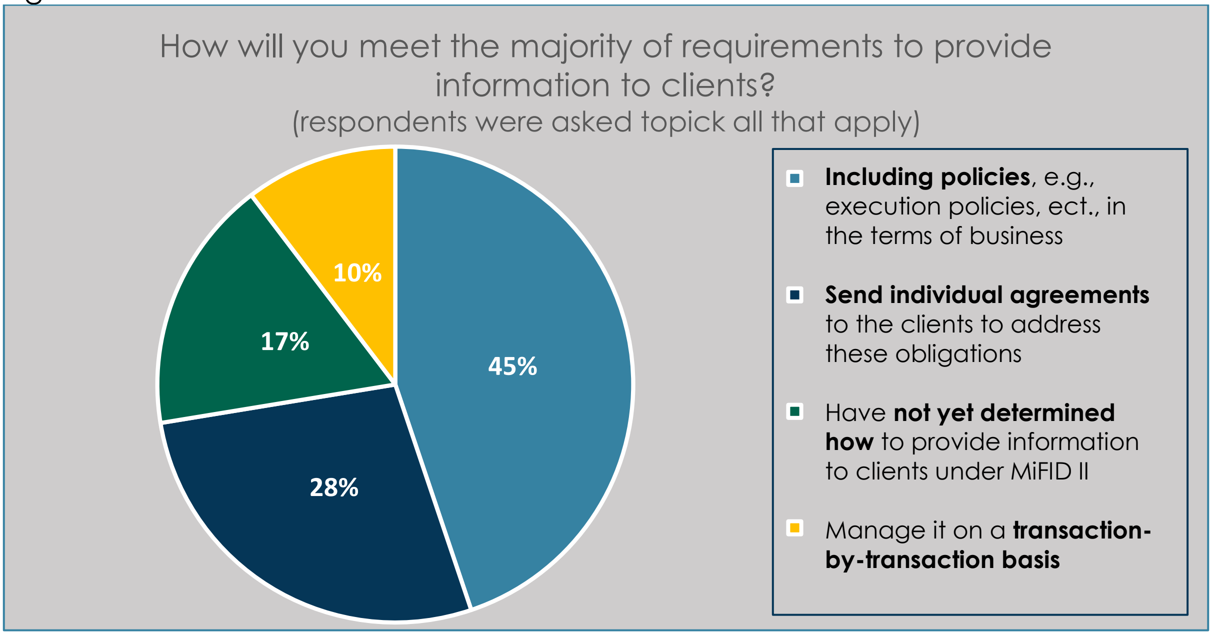


Source: JWG analysis of 23 responses to MiFID II buy-side implementation benchmark survey Q2 2017

The focus on the cross-over with PRIIPs is the clear focus here for firms. It is clear that the fact that there are a large number of requirements which are similar but are described differently under PRIIPs, is causing problems as the industry grapple with consolidating the two regimes.

Current state of plans to meet information to clients' requirements

Figure 14

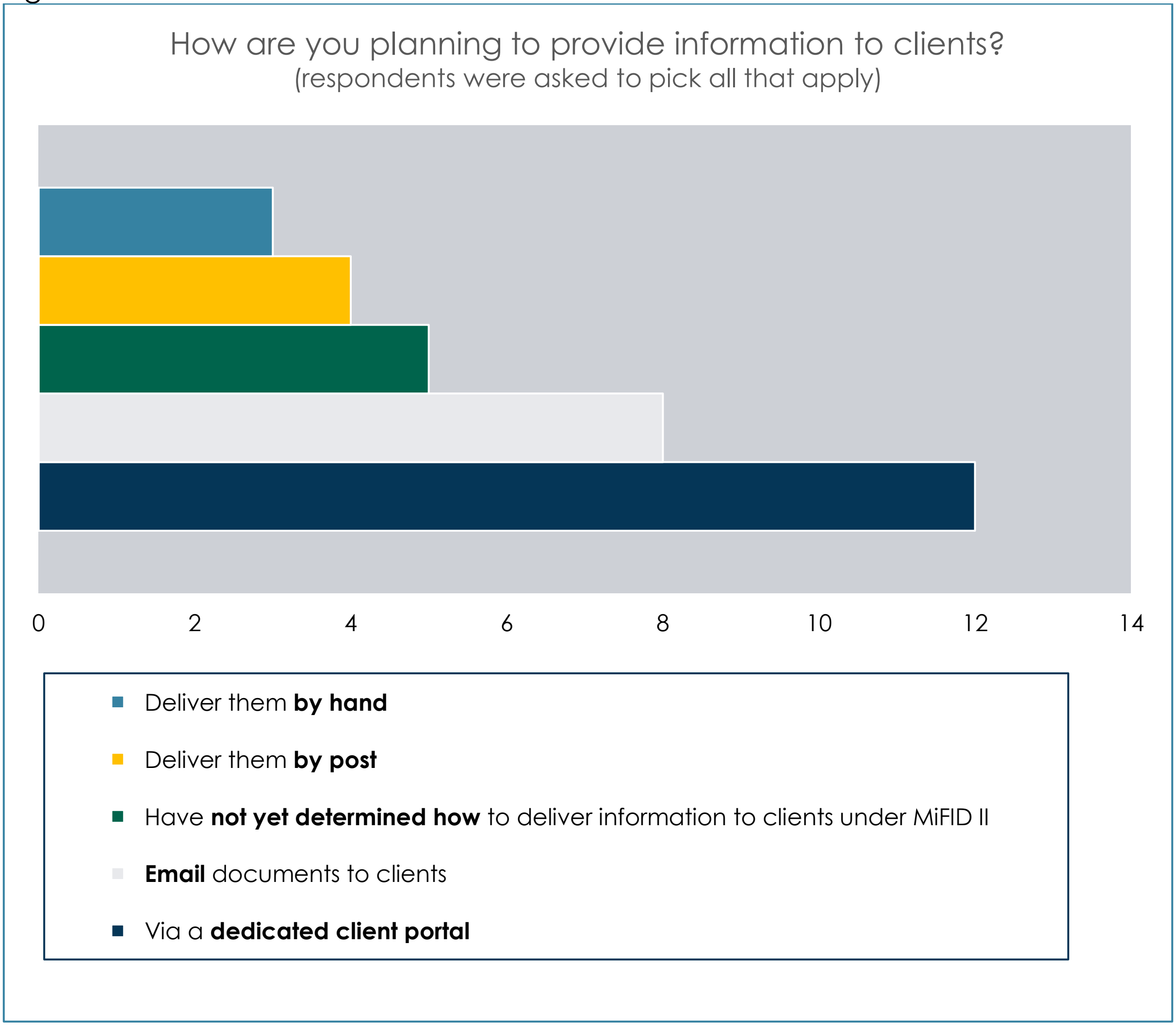


Source: JWG analysis of 22 responses to MiFID II buy-side implementation benchmark survey Q2 2017

A majority of firms have determined how to meet these requirements, putting information to clients as a topic ahead of the general implementation curve. Most have settled for including updates to existing policies or new polices in the terms of business, with some opting to send individual agreements to clients and relatively few determining that managing this on a transaction by transaction basis is the best course of action.

Current state of mechanism to deliver information to clients

Figure 15

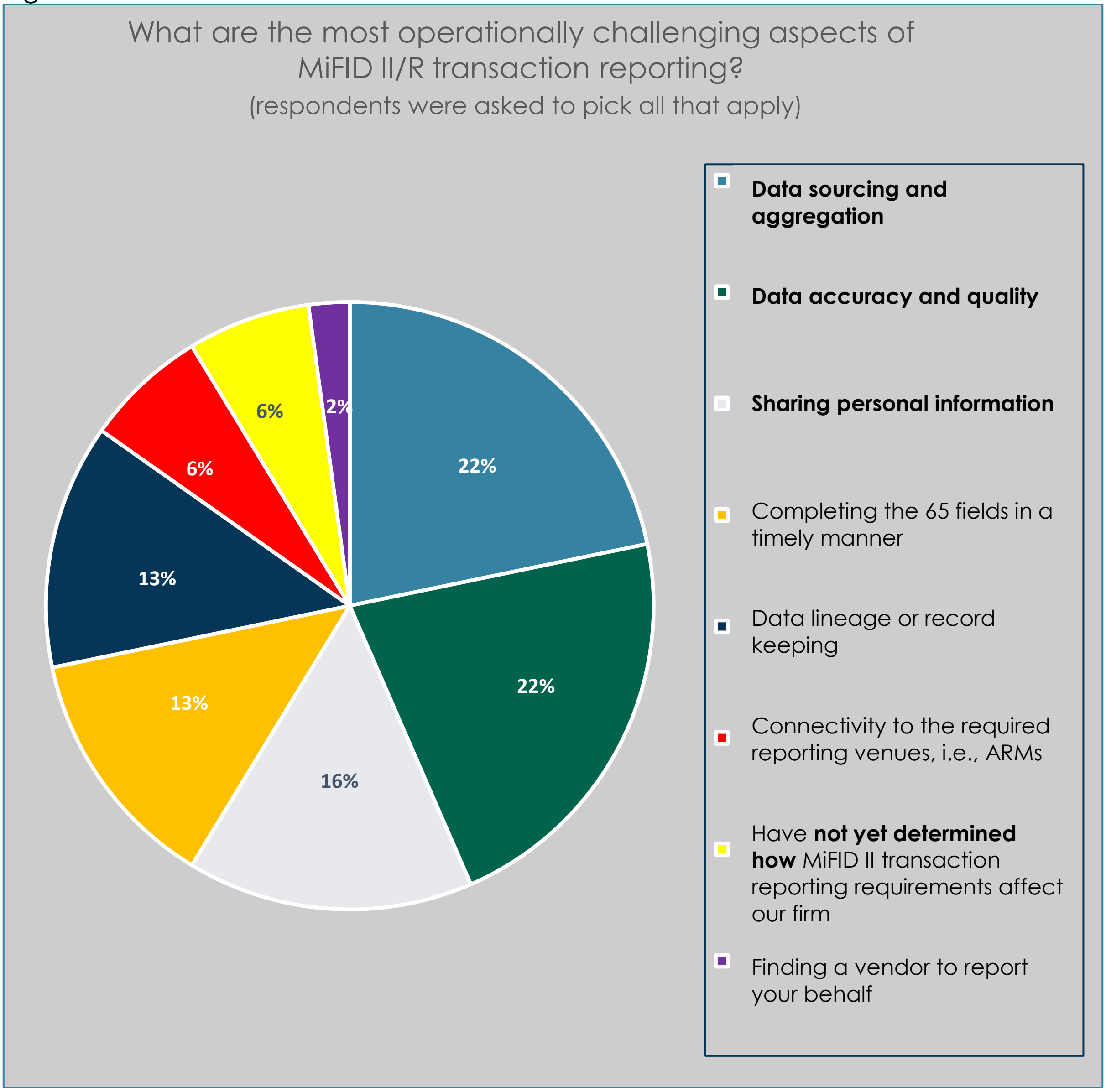


Source: JWG analysis of 23 responses to MiFID II buy-side implementation benchmark survey Q2 2017

Most respondents are planning to provide information to clients through a dedicated client portal, although a significant number are planning to use an e-mail based solution. Delivering either by hand or by post is being opted for by relatively few. This is again in area in which a smaller number are yet to analyse the requirements by comparison with other areas of requirements.

Perceived most operationally challenging aspects of transaction reporting

Figure 16

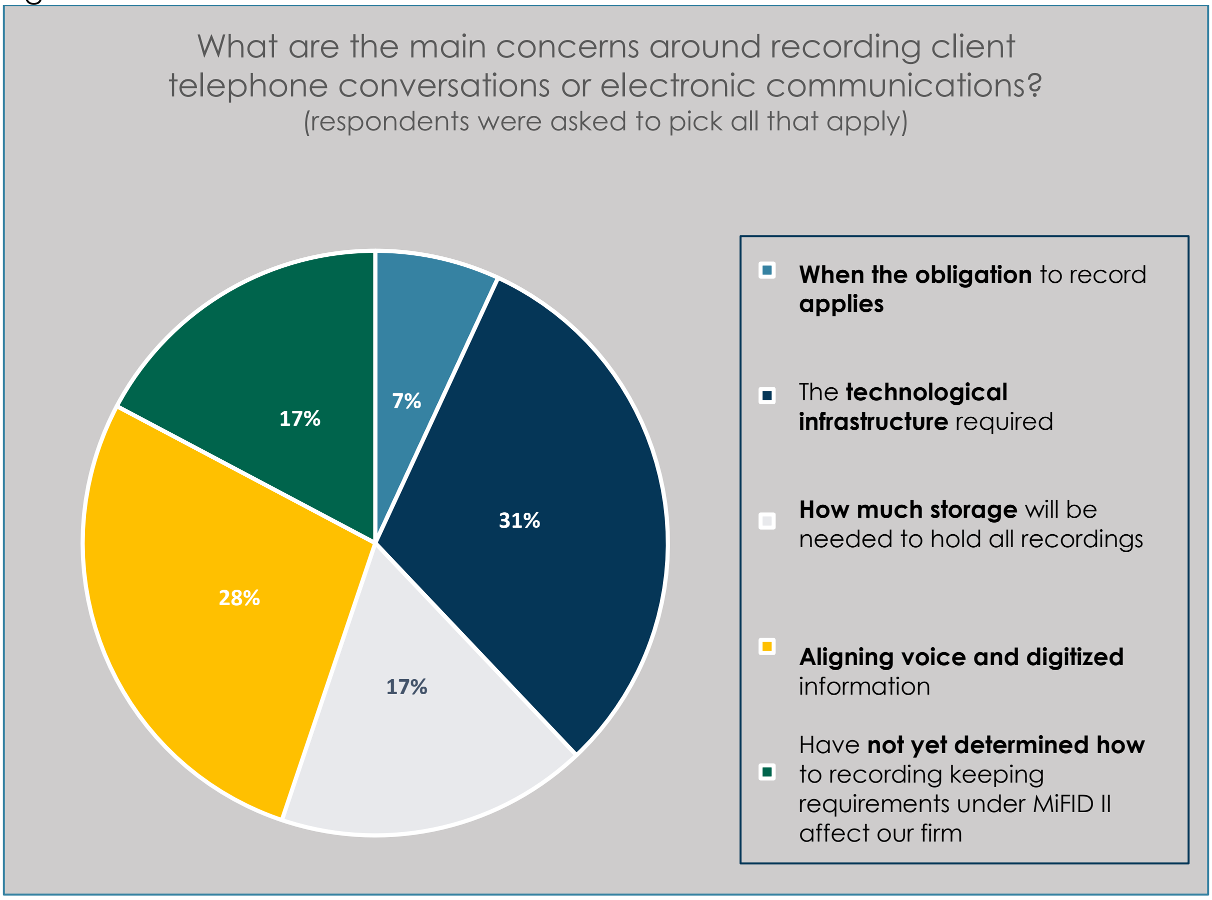


Source: JWG analysis of 22 responses to MiFID II buy-side implementation benchmark survey Q2 2017

The most challenging aspect of transaction reporting is clearly the data. When combined, the issues of data sourcing and data accuracy account for nearly 50% of the responses in respect of operational challenges of transaction reporting. Issues of data privacy and concerns about sharing data privacy as well as completing the process in the given T+1 deadline are also key concerns. Firms appear to be relatively relaxed about vendor issues in terms of finding vendors and connecting to external platforms.

Biggest concerns regarding communications recording

Figure 17

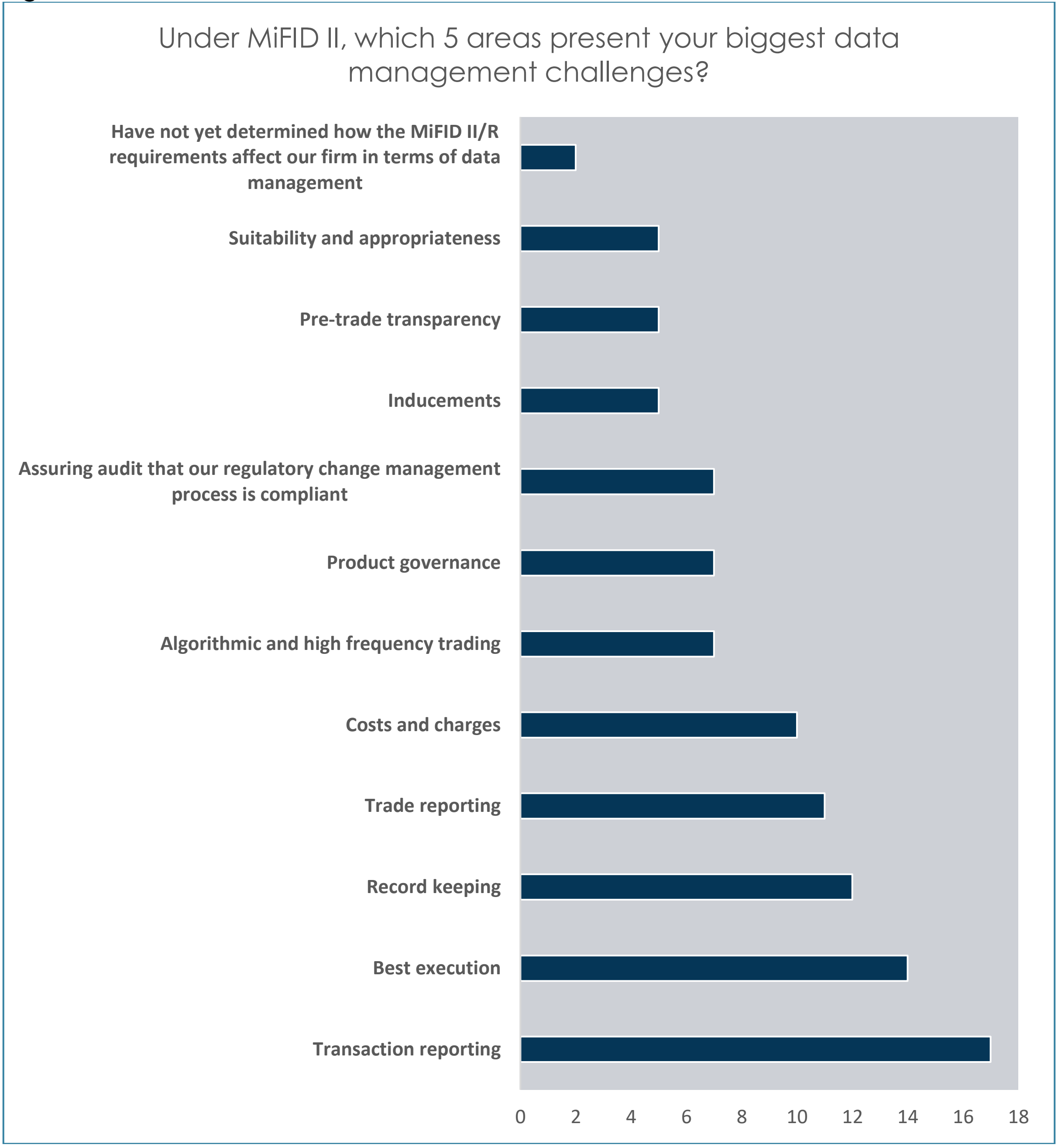


Source: JWG analysis of 21 responses to MiFID II buy-side implementation benchmark survey Q2 2017

There are clear concerns around the technology infrastructure required around recording communications, with the alignment of voice and digitised information being a main concern. Issues of storage and when the obligations apply appear to be better understood.

Perceived top 5 biggest data management challenges

Figure 18

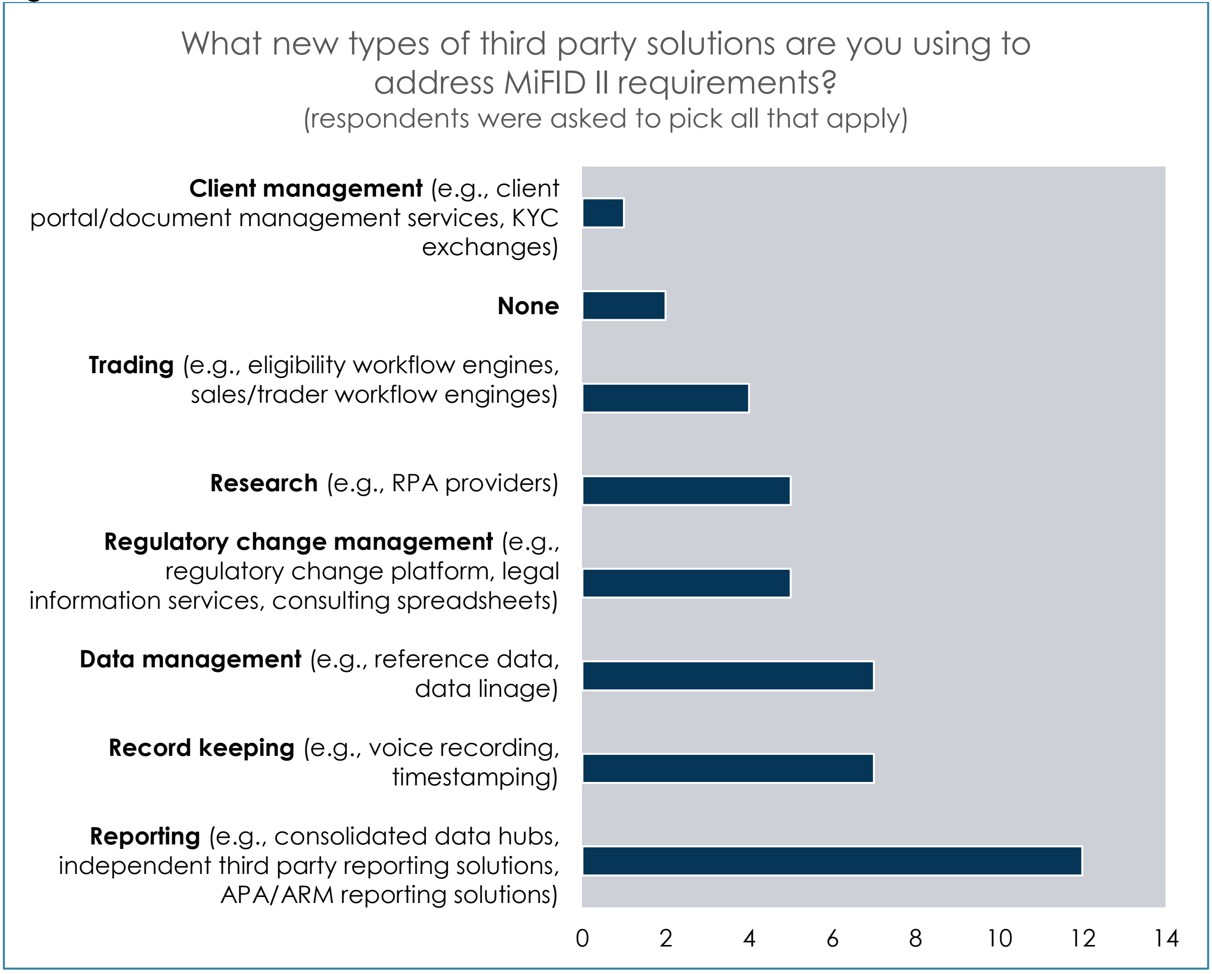


Source: JWG analysis of 23 responses to MiFID II buy-side implementation benchmark survey Q2 2017

Transaction reporting, best execution, record keeping, trade reporting and costs and charges are considered to be the biggest data management challenges respectively.

Current state use of new types of third party solutions

Figure 19



Source: JWG analysis of 23 responses to MiFID II buy-side implementation benchmark survey Q2 2017

Reporting is by far the most outsourced of all the MiFID II requirements, however, there is also a substantial amount of demand for record keeping and data management solutions. A small number of firms have outsourced their regulatory change management, and most appear to be keeping issues such as research, trading and client management in house.

VIII. Conclusion

This survey appears to suggest that there will be far more losers from MiFID II implementation than there will be winners. The stakes for getting this cornerstone of EU regulatory reform right are large, and these survey results should make senior managers sit up and take notice given that when looking at the fundamental level of change being proposed and the substantial lack of certainty that still exists, the impact on the market is likely to be highly significant.

The key question is what now? There are less than 120 working days left to fill as many voids and bridge as many gaps as possible. There is still time and we hope that these survey results highlight the largest gaps and get firms to think about how they can be bridged. Based on the results and our experience in the world of MiFID II implementation, we have developed a 10-point plan detailing the next steps for firms grappling with implementation programmes:

Collaborating in the right areas has been and will continue to be crucial to success:

1. Collaborate with your peers on non-competitive issues to come to a common view, pool implementation resource and reduce the risk of misalignment
2. Leverage work that has already been done in industry working groups and trade associations to catch up with the herd
3. Work with the sell-side in order to understand the connections and hand-offs to reduce the risk of misalignment across sectors
4. Ensure that clients facing requirements (e.g. costs and charges disclosures and best execution) are delivered effectively and efficiently, so you look good to your clients.

Leverage the right technology in the right way in order to implement in a better, cheaper and safer manner should be a priority:

5. Utilise smart RegTech to manage the requirements contained within the 1.4 million paragraphs of MiFID II to house a single version of your business' MiFID truth
6. Know when to outsource and when to keep solutions in house, leverage the right options in the right way.

Taking a strategic view of the RegTech capabilities required will enable a shift from reactive last-minute solutions to more strategic value add solutions:

7. Focus on the interdependencies with other regimes such as PRIIPs, MAR and SFTR in order to reduce the chances of redoing work
8. Ensure the final push towards implementation is resourced properly to cut down on further spend down the line on remediation and fines
9. Get the data right: bad data will impact good work elsewhere
10. Expect to continue your programme through 2018 as further guidance is published and industry standards and practices develop.

IX. About JWG

We are operations and technology professionals, trusted by the global financial services industry as experts in regulatory change management. We pride ourselves on capturing every financial services regulation published the world over and are the only organisation to set ourselves this global challenge.

For the past decade, our team of independent analysts has helped the industry interpret large quantities of regulatory reform and action it in a smart and intelligent way. JWG work with trade bodies and regulators to facilitate the understanding of regulatory change and its impacts on financial institutions, both sell and buy-side, market infrastructure and the vendors that serve them all. Facing the ever-pressing challenge of understanding, enacting, complying with and facilitating regulation, respectively, JWG play a crucial role, bringing together a wide variety of stakeholders and pooling their knowledge and understanding to provide invaluable insight, context and feedback.

We do this in three ways. Firstly, we track the totality of the FS reform across the globe in order to educate the market via our publications, events and training programmes. In parallel, we run collaborative special interest groups to crowdsource the impact from legal, compliance and operational perspectives. Finally, we offer the world's first regulatory change management platform, RegDelta.

Join nearly 3,000 industry professionals and follow the MiFID II journey as part of MiFID II: The working group from JWG: https://www.linkedin.com/groups/8129648