

NOTE on MIFID/MIFIR IMPLEMENTATION: DELAYS IN THE GO-LIVE DATE OF CERTAIN MIFID PROVISIONS

This note covers:

- 1. The identification of possible delays in the expected real applicability of certain MiFID provisions, especially those related to the development of IT systems (by both regulators and market participants) that need to interact.**
- 2. The reasons why those delays are hard to eliminate or manage.**
- 3. The possible alternatives on how to tackle them, in a coordinated EU manner.**

Introduction: new systems or system changes required by MiFID

4. MiFID II / MIFIR is a very complex legal instrument, with many practical implementation challenges. Many of the changes that it is going to induce in financial markets require the design, construction, testing and operation of IT systems, that will be based on the requirements contained in the Regulations.
5. In several cases, some MiFID-related systems are dependent on others, in the sense that they use the output of the latter to be able to work and operate normally.
6. Five sequential phases are typically observed when developing a system: business requirements, functional specifications, programming, testing and deployment. These phases are sequential and the first one (business requirements) cannot be completed before the final versions of the RTS are known and stable.
7. A few of the new systems or system changes required by MiFID II are complex, in the sense that 1) they interact with internal systems in the entities/organisations that run them and 2) they operate large volumes of data that require heavy automation.
8. Although this note concentrates on MiFID, there is also a very clear link between the MAR applicability date (envisaged for July 2016) and the tools for supervising it (contained in MiFID and the data systems linked to it).

The legal calendar

9. Most of these requirements depend on the Level 1 text as complemented and developed by the Level 2 text (RTS and ITS).
10. After the delay linked to the early legal review, Level 2 will be delivered by ESMA by late September 2015. The Commission has then, according to Regulation 1095/2010, three months to indicate if it will endorse the RTS/ITS (January 2016). Then the European Parliament and the Council will have between one and six months to exercise their right of objection.
11. Assuming the shortest delay (1 month) for the objection period, it is unlikely that the Regulations will be published in the Official Journal before March 2016.
12. Taking into account the date of application of MiFID/MiFIR (3 January 2017), the above calendar leaves less than 9 months to finalise Business Requirements, develop, program, test and deploy the systems needed for the MiFID implementation. Some could say that the specifications of those systems will be known well before that (in late September 2015, when ESMA published its draft RTS and ITS). However, it cannot be assumed that the EC will not introduce any relevant change on those drafts or that the Parliament and Council will not use their right of objection. Therefore, certain specifications will only become stable and final in the spring of 2016.
13. In some cases, the 9-month timeframe will still be sufficient but, in the case of the most complex systems, it will be way too short (even 15 months, from October 2015 to Dec 2016 would be extremely short).
14. In the course of the last couple of months, it has become evident for ESMA and NCAs that it will not be feasible to have those systems ready for 3 January 2017. Market participants, who will need to feed into those systems, are facing similar implementation challenges.
15. Some provisions could operate in the absence of all the market players and all authorities being ready. However, some others, because of their very nature, require a high degree of synchronicity as explained in the next section.

Main challenges

16. There are four areas where the complexity of the systems, their interaction and the need for a harmonised start date are especially acute. These four areas are the main concerns in terms of possible delays in the go-live dates and the ones that would require higher attention from the SCs, the BoS and the EC.
 - a. Reference data
 - b. Transaction reporting
 - c. Transparency parameters and publication
 - d. Position reporting

Reference data

17. The publication of reference data is one of the cornerstones of the MiFID data system. ESMA needs to collect and publish daily reference data from NCAs, which get them daily from Trading Venues. The reference data describes in a unified manner the characteristics of every financial instrument subject to the MiFID scope (and MAR through a twin provision). That description contains essential items to apply some of the other obligations under MiFID. It includes, for each instrument, a unique identifier (ISIN), the instrument classification (relevant for instance for the application of the transparency regime applicable to that instrument) or the competent authority for that instrument (the one of the most relevant market in terms of liquidity).
18. The reference data list is the “census” to which many other systems point or refer to. The absence of an instrument from the list, or the presence of wrong or incomplete information on it, will leave some other obligations inapplicable. For instance, APAs would not be able to determine the delays for post-trade information without a precise indication of the type of instrument. Similarly, NCAs or ESMA would not be able to route the files containing transaction reports to the relevant competent authority at the end of the day, for market surveillance purposes.
19. Reference data exists currently (and is kept by ESMA) for shares and bonds admitted to trading on regulated markets. However, the extension of the MiFID scope is creating, de facto, a brand new system, since in terms of number of venues and number of instruments, the enlargement is way bigger than the existing scope. Therefore, it calls for a new development of IT systems for venues, NCAs and ESMA.
20. Many NCAs and a high number of Trading Venues are expected to be late for the implementation of the collection, verification and publication of the new reference data systems. In those cases, availability of data will be incomplete in early 2017.
21. ESMA is running a project (FIRDS) to centralise the collection of reference data according to the Regulation and to collect it directly from venues by delegation of 21 NCAs. This requires direct connection to around 100 trading venues (and another 200 through NCAs) and the construction of a system to collect and process more than 15 million instruments (compared to only Regulated Markets and with just one tenth of the number of instruments in the current reference data system). The project will not add a significant delay to the situation in which an NCA collects those data directly, but is under the same time pressures and will not be operational before the third quarter of 2017.

Transaction reporting

22. The information on transaction reports submitted by investment firms to the competent authorities is the essential core data used for the market abuse surveillance purpose. The reports are submitted by market participants (including through ARMs and trading venues) on daily basis, input into national surveillance systems for analysis and exchanged between competent authorities based on the competence for the most relevant market in terms of liquidity. The accuracy and completeness of the data contained therein is automatically checked against reference data for financial instruments. Equally, determination of the relevant

competent authority and, therefore, of the destination where a given transaction report needs to be routed, is done on the basis of the reference data.

23. Importantly, submission of transaction reports is not a new requirement introduced under MiFIR, but a revision of current applicable rules. Amendments and changes introduced through MiFIR, pursue two important goals: 1) expanding the set of information available on a given transaction and 2) full harmonisation of the content and format of the reports collected across the EU. The magnitude of the change between MiFID I and MiFID II should not be underestimated: in most instances, a newly built system (not just an adaptation or a tweak of previous systems) will be required.
24. It is of utmost importance to ensure a smooth, well planned and coordinated transition process from the current reporting regime to the new one to assert that there is no loss of visibility of ongoing market activity by competent authorities at any point of time. As evident by the close interlink between the reference data and information on transaction reporting, the launch of the two regimes also needs to be fully aligned. If reference data would not be available by the time the new transaction reporting system starts, neither firms, nor competent authorities would be able to produce and process the reports. In turn, competent authorities would not be able to route those transactions to the relevant competent authority of the most liquid market. The consequences of that would be significant over the quality and therefore the usability of the information for market monitoring purposes.

Transparency parameters and publication

25. MiFID II also encompasses an exponential increase in the number of instruments under pre- and post-trade transparency obligations. This is due to the extension in scope to ETFs, bonds and derivatives among other instruments.
26. MiFID II also foresees the establishment of a substantial number of thresholds and other determinations like which is the most relevant market in terms of liquidity which are based on the collection, consolidation, calculation and publication of data. The new platforms (OTFs) that will appear in 2017 will also determine, in practice, the extent of the MiFID scope.
27. ESMA is planning to perform these functions centrally as part of the FIRDS project on behalf of 27 NCAs and currently the first calculations for individual instruments will be required starting January 2017 date and the first massive, complete calculations are foreseen for the first half of 2018 (a first calculation would have to be performed on an ad hoc basis in 2016 although there are still questionmarks over this timetable due to legal reasons). While therefore a bit of time appears to be left the FIRDS project not being operational until later in 2017 still remains an issue as the 2018 calculations would have to be performed in respect of the whole year 2017. FIRDS is supposed to work based on daily calculations so any delay past 3 January 2017 would require backloading of substantial data volumes which would have to be collected once FIRDS is in place carrying with it operational issues. APAs will also have severe difficulties operating without a complete and accurate reference data set.

28. A specific implementation problem in this context is imposed by the new rules for the double volume cap mechanism which apply from 3 January 2017 based on 2016 data as per the Level 1 text. Breaches of the double volume cap come with serious and almost immediate legal and economic consequences meaning that it is essential that ESMA and competent authorities get these calculations right from the start of 2017.
29. Also the double volume cap implementation relies on the reference data system being in place and it would need to be implemented in parallel to the collection mechanism for reference data so that any delay of FIRDS has an immediate impact requiring an alternative solution.

Position reporting

30. The position reporting system is another new, data-heavy obligation imposed by MiFID II requiring trading venues, members and participants of trading venues and investment firms trading OTC in commodity derivatives to provide a daily account of the positions held by them and their clients.
31. The position reporting system should enable trading venues to publish weekly commitment of trader reports and, more importantly, enable the competent authorities to supervise and enforce the position limits regime.
32. The regime as foreseen in the Level 1 raises a number of implementation issues such as the aggregation of positions on a group basis or the sensitivity of position information being passed up a chain of intermediaries which are yet to be solved.
33. In any case it will require at least each competent authority with a trading venue trading commodity derivatives in its jurisdiction to implement a new reporting system within a very demanding timeframe.

Origins of a possible delay and alternatives to handle a delay

34. The possibility of a delay is, in some cases, already a certainty. The current state of the final rules and the expected publication time prevent the different parties to start working with the necessary certainty and we are already past the point of no return after which the launch of the system into production in January 2017 becomes unfeasible.
35. The causes or origins are diverse: in some cases the investment firms and trading venues will not have the full specifications in due course to build the systems on time. There are also constraints in NCAs, which are (as opposed to private entities) faced with budget constraints and procurement rules that complicate the development of systems. Lastly, ESMA is also facing the same types of constraints and will not be able to deliver the centralised parts of all different systems in January 2017.
36. This note does not address to which extent the absence of the above mentioned systems in place before the application date would constitute, or not, an infringement of the Regulation or the Directive. It simply assumes that, even if a deadline is set in a legal text, when this requires the development of complex IT systems from scratch, reality and technical feasibility need to be assessed.

37. Faced with the very high probability of a delay in all of the above 4 systems (mentioned in the section on main challenges), the first question is what will be the feasible date for each of the systems. At this stage, determining that with a high degree of precision is not possible without having the full specifications (RTS/ITS) published first and subsequently analysed by IT experts and external stakeholders. Therefore, a first estimate will not be available probably until October/November at the earliest (before, in any case, the EC declares its intention to endorse the RTS/ITS) and a final estimate will not be available before March 2016, but very early estimates point out that it could easily amount to one year on average.
38. The second question is how to handle that delay, from the technical and legal point of view. We think that four principles should apply in that situation:
- I. Give legal certainty, as early as possible, to the entities subject to MiFID (avoid announcing a delay well into 2016, when most investments will be ongoing)
 - II. Minimise the delay as from the original start date
 - III. But, on the other hand, avoid re-adjustments to the date (move it only once)
 - IV. Define dates that maximise the possibility of simultaneous launch for all the markets/Member States
39. A number of options appear for the consideration of NCAs, ESMA, EC and the co-legislators:
- a. A Level 1 fix, of the type that was already used in MiFID I (by postponing for a few months the application date of some articles).
 - i. Pros: This is the best option in terms of legal certainty, and synchronicity. Very importantly, it also avoids in cases like transaction reporting the creation of a “legal vacuum”: a period in which, if no Level 1 fix was provided, the MiFID I would be legally repealed as from January 2017, as already envisaged but the new MiFID II regime, including the Technical Standards, would not yet be into force.
 - ii. Cons: 1) it is not a precise tool, since it affects all elements of a Level 1 provision, without the ability to fine tune and have some components (specified in the RTS/ITS) enter into force later than others. Therefore, it may also require some Level 2 adjustments. 2) It may be politically harder to accept.
 - b. A Level 2 fix, of the type that has been already used in many occasions by fixing the applicability date, due to duly justified technical reasons, at a later moment than the applicability date of Level 1 (the last one, the delay by 24 months of the buy-in regime in the CSDR RTS).
 - i. Pros: In terms of legal certainty and synchronicity, it achieves similar results of the Level 1 fix.

- ii. Cons: It is not a solution for Transaction Reporting and for the old scope of Reference Data (equities). In that respect, it does not solve the problem of the legal vacuum (see par 39.a.i), which puts at risk the enforceability of some key provisions.
- iii. This solution admits two variants:
 - 1. Establish a fixed date (i.e., 3 January 2018). This gives maximum certainty in legal terms and also in terms of the actual time that all stakeholders have for getting ready. However, to avoid moving the date several times, it requires either full certainty about the earliest date or a certain buffer to accommodate possible further delays.
 - 2. Establish a relative date with respect to another public and recognisable event (like it was already used in EMIR RTSs for the start of the reporting obligation, defined as 90 days after the authorisation of the first TR). In this case it could, e.g., work as X days after the publication of an ESMA Opinion/decision in all official languages in the Official Journal. It could work with a single date for all provisions or even two dates, depending on the obligations. This second variant has the benefit of minimising the delay to the minimum necessary (as opposed to a fixed date, which will need to build a buffer of time, to ensure the timeline does not slip, making the overall delay bigger than strictly required). However, it is more challenging legally and, more importantly, introduces an element of uncertainty that will complicate the planning of the different systems, since nobody will know, exactly, for when those systems should be ready since they depend on another one.
- c. A Level 3 fix, of the type that several authorities already applied in 2006 when MiFID I came into force but their systems were not ready to implement it. This would consist on agreeing between all NCAs, and publishing at ESMA level, on an implementation date that would be later than the one contained on the RTS/ITS.
 - i. Pros: It is the most flexible solution, since it does not require legal changes
 - ii. Cons: 1) Does not bring any legal certainty at all both for regulators and firms (therefore, increases the legal risks for all); 2) Has the same “legal vacuum” problems as some other options (especially since MiFID I is repealed in 2017) and 3) Being a non-binding instrument, there is a risk of uneven application of the agreement, with non-convergent implementation in different Member States.

40. In any case, the supervisors, ESMA and the EC will need to agree what transitory regime (in legal or practical terms) is applied:

- whether the old systems (when applicable) are continued with the old scope (for instance, the current transaction reporting and the current reference database of shares). This option would avoid having to implement a third transitory regime and a significant effort for the industry as well as competent authorities to take on-board new requirements under the transitory framework and then later implement the MiFIR requirements in full;
- what changes, if any, are required in the current systems;
- how and when this is communicated to the industry;
- whether there are any legal implications on the enforceability of the “old” MiFID in the period between 3 January 2017 and the date in which the new systems go live.

41. The relevant ESMA Committees and the ESMA Board have discussed this note and have a strong preference for a Level 1 solution, for the reasons explained above.

42. ESMA stands ready to advise the European Commission, as holder of the right of initiative, and expand any item of this note to come to a concrete solution as soon as possible.