



FINANCIAL REGULATOR
Rialtóir Airgeadais

Compliance Ireland
MiFID Update – The Experience of 2009 and the Challenges for 2010
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Transaction Reporting

Good morning ladies and gentlemen. I would like to thank Compliance Ireland for inviting me here today to talk to you about transaction reporting which has been, and continues to be, a very ambitious EU level project. While it occupies only a few lines of the MIFID regulations, the idea behind it is striking - namely that regulators would be able to monitor all the many billions of transactions across the EU to spot inappropriate behaviour. One thing you can be assured of is that this vision for how regulators will monitor the market will not be fully implemented with ease. It will take years to get this right and it will be a constant process of development and refinement of the system. That will in turn mean that your firms will be called upon from time to time to develop and add to the reports you make to us.

The transaction reporting regime established pursuant to the provisions of the MiFID has been in place now for almost two and a half years and it is, therefore, an opportune time for us to have our discussion here today. I will firstly recap on the transaction reporting arrangements which are currently in place and then highlight some of the issues that have arisen with the transaction reporting data submitted to date. I will then outline our approach to non-compliance with transaction reporting requirements and also some future developments in the transaction reporting area.

Transaction Reporting Requirement

With regard to the transaction reporting arrangements currently in place, you will be aware that Regulation 112 of the MiFID Regulations 2007 imposes an obligation on investment firms to report certain transactions to the Financial Regulator as set out in this slide.

This obligation applies to transactions executed in financial instruments admitted to trading on any EEA Regulated Market or MTF operated by a market operator and it applies to transactions whether executed on or off the market.

Transaction reports must be submitted to the Financial Regulator as quickly as possible but no later than the close of business on the following working day. We have prescribed the manner in which transaction reports must be completed and submitted and details of our requirements, including copies of our Transaction Reporting User Guide and the current XML schemas to be used when uploading data to us via our Online Reporting system, are available on our website.

The onus of responsibility rests with investment firms to ensure their ongoing compliance with the transaction reporting requirements and firms must satisfy themselves that they have appropriate systems, procedures and controls in place to ensure they meet their transaction reporting obligations on a continuous basis. For us this legal responsibility on the investment firm, irrespective of whether the provision of the report is outsourced, is the fundamental pillar of the whole system. For us, making transaction reporting work always comes back in the end, to the investment firm living up to its responsibility to ensure that accurate, timely and complete information is provided to us and to check to make sure that their systems and their agents are doing the work properly.

So why are transaction reports important? The rationale for transaction reporting is to enable regulators to monitor the activities of investment firms so as to ensure that they act honestly, fairly and professionally and in a manner which promotes the integrity of the market, thereby maintaining public confidence in the market.

Transaction reports play an integral role in our detection and investigation of potential market abuse. However, if transaction reports are to contribute in a meaningful way to our market surveillance activities, it is essential that the transaction reporting data submitted to us is accurate and complete and is submitted to us on time and in accordance with our reporting requirements. So any firm that fails to properly report its transactions poses a very real threat to us meeting our statutory objectives, which exist for the benefit and protection of the market.

In 2009, we received 17.8 million transaction reports from Irish reporting firms. 14.7 million of these transaction reports were forwarded to other regulators as required under the MiFID. These regulators, in turn, forwarded 7.8 million transaction reports to us in relation to trading in financial instruments for which we are deemed to be the relevant competent authority under MiFID.

We never believed when setting up this system that everything would work perfectly from November 2007. We accepted that this was going to be a difficult challenge for firms. Consequently, we have spent a significant amount of time to date working with reporting firms to improve the quality of the transaction reporting data we receive. Work in this area remains ongoing and is proving extremely challenging given both the volume and complexity of transaction reporting data. This data quality work will continue to be a major focus of our work programme in 2010 and in the years ahead and we would hope that investment firms will continue to work with us in a collaborative manner as we seek to address the significant data quality issues arising.

Transaction Reporting Issues

I would like to take this opportunity to highlight some of the transaction reporting issues which have come to our attention. This is by no means a comprehensive list of all such issues which have arisen but it does indicate the kind of issues and deficiencies in reporting systems that can arise and of which reporting firms should be mindful.

Completeness of Transaction Reporting Data

The first issue I would draw your attention to is the need for investment firms to satisfy themselves that the transaction reporting systems and processes used to generate transaction reports capture all reportable transactions.

Firms need to ensure that appropriate and robust controls and oversight arrangements are in place to verify on an ongoing basis that their transaction reporting processes are operating effectively and that all required transaction reports are being submitted to us.

This work entails ensuring not only that the fundamental design of the relevant systems and processes is correct but also that due consideration is given to the impact that a change in the firm's business model or in its IT systems may have on these processes. Where system changes are made, there needs to be a formal impact assessment to ensure that there is no deterioration in the reports we are being sent. Even if a firm believes that it was sending in good quality and timely reports previously, it is possible that it is no longer doing so. If this happens, it isn't an unavoidable accident. It is a failure of diligence. The issue is not whether the firm allowed its reporting standards to deteriorate on purpose. Rather, the issue is that good I.T. development methodologies and business process design will mean such failing will not happen and when they do happen, whether within the reporting firm or within its agent, that is a reflection on the professionalism of the reporting firm.

Accuracy of the Transaction Reports

The second issue to note is the need for transaction reporting firms to ensure that the transaction reports submitted to us comply with our reporting requirements and that the data contained therein is both accurate and complete.

Our Transaction Reporting User Guide provides guidance on how to populate the various fields in a transaction report and I would ask you to review this guide carefully. Common reporting failings have included:

- completing the Buy/Sell Indicator incorrectly;

- incorrect reporting of the Trading Capacity – i.e., whether the firm executed the trade in a principal or agent capacity;
- failing to fill in all relevant fields for a particular transaction type. For example, failing to complete the underlying instrument identification field when reporting an OTC derivative trade; and
- inaccurate trade times, dates or unit prices.

Initially, we expected a lot of errors of these types. But we also expected that over time, the quality checks conducted by firms would pick these up, systems would be corrected and quality would slowly improve. But not all firms are doing the kind of sample checking and error reviews that we expect to see to push up data quality.

Amending Transaction Reports

I also think it is useful at this point if I remind you that if it is necessary to correct certain information included in a transaction report submitted to us, this should be done by amending the original transaction report rather than by cancelling the transaction report and resubmitting the transaction again under a separate transaction reference number.

Client Reference Data

As you are aware we require firms to include client identifiers on transaction reports and to submit corresponding client reference data to facilitate the identification of the client. This information is a key factor in enabling us to identify the initiator or ultimate beneficiary of a trade. In order to use this data effectively and to reduce the number of queries made to reporting firms, it is essential that:

- a unique code is allocated to each client and client codes are not reassigned;
- the client code provided in the Client Reference Data must match exactly the client code provided in a transaction report;
- the name and address of the ultimate beneficial owner of the client account should be included in the client reference data; and
- the client reference data must be updated regularly.

Not all EU regulators require this client data, but in my view CESR and its successor ESMA are likely to open discussions with the market in the near future on whether this kind of data should be required across Europe. If a common European standard emerges, we can expect some adjustments may be necessary to our domestic system.

XML Schemas

Investment firms using the file upload option on our Online Reporting System to submit their transaction reports should also ensure that they are using the current XML schemas. In October 2008 we advised that a new version of the Transaction Reporting Schema (Version 2.1) had been published and all firms were requested to switch over to this new schema by 31 March 2009. A number of firms, however, are still using the old schema. While we have continued to support this schema we will not continue to do so indefinitely. When that happens, firms who have failed to switch to the new schemas will be unable to submit their transaction reporting data to us and will then immediately be in breach of statutory obligations. We will set and publish a date for ceasing to support the old XML schema. When we do that, given how long we have run the two systems in parallel, we don't believe any further period of grace thereafter would be appropriate.

These are just a few examples of the types of transaction reporting issues which have emerged to date. The overall lesson is that investment firms should regularly review the integrity of their transaction reporting data, the adequacy of senior level involvement in such reviews and the adequacy of the control and oversight arrangements in place to ensure ongoing compliance with transaction reporting obligations.

Non-Compliance with Transaction Reporting Requirements

Where a firm identifies that it has not met its transaction reporting obligations, for example, it has failed to report or has incorrectly reported transactions, it must immediately notify us in writing, detailing the transaction reporting failure,

the reasons for the failure and the remedial action the firm intends to take to address the failure identified.

Where compliance issues have been identified to date by investment firms, we have worked with the relevant firms to resolve the issues arising and have required that all outstanding or incorrect transaction reports are reported retrospectively or amended, as appropriate.

While this has been our approach to date we are mindful that the transaction reporting regime has been in place for some time now and firms should have had sufficient time to identify and correct any deficiencies in their transaction reporting systems and processes.

Accordingly, in dealing with transaction reporting breaches in the future we will have to consider all regulatory options available to us, including pursuing administrative sanctions cases against non-compliant investment firms. It would not be correct to assume that the approach we have taken in the initial period after the system was established will continue. It seems likely now that we will have to ratchet up our approach to create an environment where not only the best firms but all firms have a clear focus on the need to work proactively on the quality and timeliness of their data. My core purpose here today is to deliver that message, while also reassuring any firm that resolves to take action that we continue to be there to support and assist you in any way we can to get the reports right. We will now take an additional step of posting a dedicated helpline number on our website to assist firms. For your part, I would ask you to reflect on the fact that sample quality checks, impact assessments of I.T. projects and close monitoring of the work of agents are all important features of the management of transaction reporting. Where there are separate internal audit functions, we would also expect internal audit to consider these matters as part of their work programme. If we continue to find significant quality problems and we do not see evidence of consistent effort along those lines, then it seems to me the case for moving to the use of administrative sanctions will become very much stronger.

Future Developments

Looking now to the future, as I have already indicated our focus in 2010 will be on improving the quality of the transaction reporting data submitted to us. As our own transaction reporting and monitoring systems develop, our ability to interrogate and analyse transaction data will also improve and this will lead to more queries being raised with reporting firms regarding the transaction data submitted to us.

At an EU level work is also being undertaken by CESR which will impact on the transaction reporting regime. In particular, I would like to mention two projects.

In 2007 CESR issued Level 3 Guidelines on MiFID Transaction Reporting which dealt with, amongst other issues, the question of what constitutes execution of a transaction. Due to differences in market practice, it was not possible at that time to achieve a fully harmonised definition of what constitutes execution of a transaction. As an interim solution CESR members agreed to collect certain information in relation to transactions and committed, after one full years operation of the transaction reporting regime, to review the scope of the transaction reporting obligation with a view to producing definitive guidance in this area with the aim of converging practices between CESR members. This review commenced in November 2008 when CESR published a Call for Evidence on the "Review of the Scope of the Transaction Reporting Regime". Work on this complex issue is ongoing and it is expected that a consultation paper outlining CESR's proposal on this and other related matters will be published in the near future. I would encourage you to review and respond to this consultation paper in due course

I would also like to mention the work of CESR's OTC Derivatives Taskforce. The MiFID imposes a requirement on investment firms to submit to their competent authority transaction reports in respect of trades executed in financial instruments admitted to trading on regulated markets. However, in order to enhance their ability to monitor market activity some Members States, including Ireland, extended the scope of their reporting requirements to include certain

OTC derivatives. Currently these transaction reports are not exchanged by competent authorities. CESR, however, has decided to allow members to utilise its Transaction Reporting Exchange Mechanism (TREM) to exchange transaction reports in OTC derivatives and it is hoped to commence the exchange of these reports in Q4 2010.

Work on this project is well advanced. A decision on the technical standards for the classification and identification of OTC derivative instruments has already been agreed. On 29 January 2010 CESR published a consultation paper on "Guidance to Report Transactions on OTC Derivative Instruments". This paper aims to define common standards for the consistent collection of data from investment firms and it defines and explains for each derivative type how the fields in the transaction reports should be populated. The closing date for this consultation is 1 April 2010.

While the current proposals are very similar to those already in operation in Ireland, it is likely that some adjustment to our reporting requirements and schemas will be required. We will, of course, be contacting reporting firms in this regard when all the arrangements for the exchange of OTC derivatives have been finalised.

Conclusion

In conclusion, the transaction reporting project continues to be extremely complex and challenging both for regulators and investment firms. We do understand that systems like this impose costs and operational constraints on firms. But there is a clear and common EU consensus that these systems are needed and the momentum towards their further development and refinement and their increasing importance seems to me to be obvious. We hope that a collaborative approach in our dialogue and interaction with investment firms will serve to effectively meet such challenges.

Thank you for your attention.