

Innovation Plan consultation  
Banking and Credit team  
HM Treasury  
1 Horse Guards Road  
London SW1A 2HQ

Submitted via email to [innovationplanconsultation@hmtreasury.gsi.gov.uk](mailto:innovationplanconsultation@hmtreasury.gsi.gov.uk)

London, May 6<sup>th</sup> 2016

## HMT consultation on draft innovation for financial services

Dear Sirs,

Markit is pleased to submit the following comments to HM Treasury (“**HMT**”) in response to its Consultation Paper on *Draft innovation for financial services* (the “**Consultation Paper**” or the “**CP**”).

Markit<sup>1</sup> is a leading global diversified provider of financial information services.<sup>2</sup> Founded in 2003, we employ over 4,000 people in 11 countries and our shares are listed on Nasdaq (ticker: MRKT). Markit has been actively and constructively engaged in the debate about regulatory reform in financial markets, including topics such as the implementation of the G20 commitments for OTC derivatives and the design of a regulatory regime for benchmarks. Over the past years, we have submitted more than 150 comment letters to regulatory authorities around the world and have participated in numerous roundtables.

### Introduction

Markit provides innovative solutions with many of our services designed to support our customers’ compliance with regulatory requirements across asset classes, throughout the trade workflow and for a range of financial market participants and service providers on a global basis. We would see ourselves as synonymous with the Regtech agenda as Markit’s services, and those of its competitors, are designed to reduce the costs of complying with regulation for firms and the economy while strengthening regulatory standards, lowering barriers to entry and so fostering competition in the market place. This is often achieved by providing shared services which enable firms to contract high quality, flexible but standardised solutions that ensure they meet their regulatory requirements but without the need to build entire systems and solutions themselves. This also benefits the regulators as they would have confidence that standards and consistency of approach being maintained while not having to assess and monitor different approaches at every firm.

On the pre-trade side our solutions help firms, for example, to perform due-diligence on their counterparties,<sup>3</sup> trading algorithms<sup>4</sup> and vendors<sup>5</sup> and to manage their research payments in an effective and transparent

---

<sup>1</sup> See [www.markit.com](http://www.markit.com) for more details.

<sup>2</sup> We provide products and services that enhance transparency, reduce risk and improve operational efficiency of financial market activities. Our customers include banks, hedge funds, asset managers, central banks, regulators, auditors, fund administrators and insurance companies. By setting common standards and facilitating market participants’ compliance with various regulatory requirements, many of our services help level the playing field between small and large firms and foster a competitive marketplace.

<sup>3</sup> Provided by Markit’s KYC.com platform.

<sup>4</sup> The Markit Counterparty Manager platform (MCPM) helps firms perform due diligence on trading algorithms used by their executing brokers. This is a requirement, for example, in Hong Kong and under MiFID 2.

manner.<sup>6</sup> Post-trade firms use our services to comply with their best execution,<sup>7</sup> reporting and margin calculation requirements.<sup>8</sup> Other Markit services assist firms in complying with tax regulations<sup>9</sup> or valuation requirements.<sup>10</sup> We also support investment managers, wealth managers, and brokers in creating solutions to facilitate their clients' investment decisions (so called robo-advice).

Innovation has been a vital component of Markit's success and we are excited about the Regtech and Fintech agendas in the UK. We, therefore, welcome HM Treasury's consultation on innovation and would, based on our experience, make the following recommendations. To foster innovation in Regtech services HMT should:

- 1) Ensure that the FCA provides a channel for communication with (unregulated) firms (and their advisors) looking to discuss innovation or the use of Regtech;
- 2) Systematically consider the impact of regulation and its calibration and implementation so they encourage (or at least do not hinder) innovation;
- 3) Encourage the FCA and the PRA to take active steps to help innovative solutions develop by being clear on supervisory expectations – for example by endorsing the standards of some innovative solutions; and
- 4) Consider having the UK authorities conduct a thematic review on firms' use of Regtech solutions in the financial services industry.

## Questions

### **Q1: Does the UK's regulatory environment for financial services effectively support innovation?**

We welcome the UK's recent focus on innovation in the financial services sector generally and the regulatory framework more specifically. The Regtech agenda is particularly welcome and offers firms very useful opportunities to engage with the FCA on innovative solutions to the increasing burdens of regulation. We were also pleased to see the Financial Advice Market Review and its aim of ensuring robo-advice can develop in the UK while maintaining appropriate levels of investor protection.

However we believe communication with regulators remains a problem for firms outside the regulated sector who are developing innovative solutions. It would help if they could discuss with regulators how their solutions can more effectively work for regulated firms. We believe that the FCA could most effectively foster innovation in the UK by establishing an official channel for communication between the FCA and Regtech/innovative providers (and, where applicable, their advisors).

The success of Project Innovate demonstrates the value of creating a single point of contact for firms who are not currently regulated to engage with the FCA. We recommend use of a similar approach also for providers of relevant RegTech and other innovative services.

---

<sup>5</sup> Firms perform due diligence on their third party vendors as part of their business continuity and disaster planning programs. See <http://www.markit.com/product/ky3p> for more details.

<sup>6</sup> Markit's Commission Manager platform helps firms manage commission sharing agreements in an efficient manner. See <https://www.markit.com/Product/Commission-Manager>

<sup>7</sup> As required, for example, under MiFID 2. See <https://www.markit.com/Product/Transaction-Cost-Analysis>

<sup>8</sup> This is required, for example, under the EMIR and Dodd-Frank risk mitigation techniques for uncleared derivatives. See <https://www.markit.com/product/analytics>

<sup>9</sup> Our platforms help firms comply with "Common Reporting Standards" (see <http://www.markit.com/Product/File?CMSID=675f66d146e94986ad043d78f47e3558>) as well as with the Foreign Account Tax Compliance Act (FATCA) requirements. See <https://www.markit.com/Product/Fatca-Service-Bureau>

<sup>10</sup> The Investment Company Act in the US requires firms to determine the "fair value" of their assets in situations where market quotations are not available. See <https://www.markit.com/Product/Pricing-Data-Fair-Value>

**Q2: Do financial services regulators understand innovation in financial services and potential areas where new technologies and disruptive business models might emerge in the sector?**

We believe that the UK authorities demonstrate a good understanding of how regulatory action might impact innovation in the financial services industry and we would encourage them to continue to take an active interest in technological development. However, it is important that regulators do not try to engage in ‘picking winners’ and choose which specific technological developments they will support (for example focussing too much on payment service providers) rather than taking a holistic view of creating an environment that promotes innovation, regardless of sector or type of firm. We are therefore encouraged by the apparent ‘do no harm’ approach emerging in the UK.

We encourage regulators to also develop more awareness of the unintended consequences of some regulations and to systemically consider how regulation could impact innovation. All too often well intended provisions can act as a brake on innovation if they are implemented in such a way that means innovation is not practical or possible. This usually happens when requirements are particularly demanding or disproportionate. Such requirements can create concern about the ability to comply when using third parties which stops firms exploring innovative approaches (and could be exploited by incumbents seeking to protect existing business practices).

To provide a practical example, MIFIR Article 29 states that CCPs, trading venues and clearing members should ensure transactions are submitted and accepted for clearing as quickly as technologically possible. This article empowered ESMA to specify the requirements and timeframes, taking into account the need for proper management of risks. ESMA proposed<sup>11</sup> that all ‘electronically traded’ cleared derivatives should be cleared within 10 seconds in a process known as straight through processing (STP). In principle, trades should be moved into clearing as soon as reasonably practicable. However, such overly demanding requirements will provide little marginal benefit and are likely to push market participants into having to use trading and clearing services from the same provider as they could be presented as being the only way that onerous STP requirements can be met. This effectively stops market entrants with innovative services from being able to provide alternative or more efficient, innovative services that produce the same or better outcomes.

Similarly ill-calibrated requirements can be manipulated to lock out innovative providers. An example appears in the Access provisions in MIFIR Articles 35 and 26. These make it clear that, inter alia, a trading venue must consider a request for a CCP to connect to another provider’s trading venue. Firms like Markit have experience in building and providing efficient and technically innovative connectivity services in line with the policy intent of these regulatory provisions. However as the requirement is only for a firm to allow – in the case of this example – another CCP to connect to its trading venue, it could potentially refuse a request for access by a Fintech or Regtech specialist provider simply because they were not a CCP. In this way the incumbent firm would significantly raise the costs of the CCP connecting to the trading venue as it would need to design and build the connections itself, reducing the scope for innovative providers leading to less likelihood of competition. Markit would be happy to discuss the specifics of this kind of practice but such problems could be avoided by making allowance for the specific firms and their agents.

We therefore recommend the UK authorities carefully review existing and upcoming regulation to consider the potential implications for innovative providers.

**Q3: Are there any gaps in approach or areas where financial services regulators should be doing more to support innovative technology and disruptive business models in financial services?**

---

<sup>11</sup> 4 MIFIR RTS 26 - [www.esma.europa.eu/sites/default/files/library/2015/11/2015-esma-1464\\_annex\\_i\\_-\\_draft\\_rts\\_and\\_its\\_on\\_mifid\\_ii\\_and\\_mifir.pdf](http://www.esma.europa.eu/sites/default/files/library/2015/11/2015-esma-1464_annex_i_-_draft_rts_and_its_on_mifid_ii_and_mifir.pdf)

We believe that a lack of supervisory clarity can hold back the adoption of innovative solutions in financial services. It would be helpful for the FCA or PRA to be clear that they will look favourably on regulated firms that are trying new systems that meet the regulatory requirement in a more efficient and innovative way.

For example, in the adoption of KYC utilities, there is some confusion and inconsistent messages from supervisors about using such shared solutions. KYC utilities are platforms that facilitate market participants' compliance with KYC/AML requirements by creating a common system and avoiding duplication of processes. These services, including Markit's kyc.com platform, provide a standardised end-to-end managed service that centralises KYC data and process management and enable firms to address regulatory and counterparty requirements to a high, consistent standard. Ten of the largest global banks have signed up to our service or are in contractual negotiations and over 1,400 buy-side and corporate clients are registered. Without such a service, each firm would have to individually collect and manage all of their KYC information and each of their clients would need to provide the relevant information for every firm. This would clearly be extremely onerous and resource wasteful with potentially thousands of different systems for counterparties and authorities to deal with (in our example, the 14,000 clients are likely to reduce their compliance burden by 90 percent).

Despite the potential benefits of KYC utilities, we believe their development – and that of similar shared services in financial services – is being held back by inconsistent messaging from regulators. Of course, it is a firm's responsibility to ensure that it is compliant with regulation – but it would be helpful if regulators communicated more with such service providers and made clear to the firms they supervise they would take an open and facilitative approach to such innovation, for example by endorsing standards that such providers have established in dialogue with the industry, if it is clear the objectives of the regulation are met.

More generally, we believe that the UK authorities should, building on the recent Regtech call for input, conduct a thematic review on firms' use of Regtech solutions in the financial services industry to identify best practices and specific barriers to the development of such innovation.

**Q4: Is there more that financial services regulators could do to better utilise new technologies to deliver their own work more effectively?**

We believe that the use of innovative shared solutions can greatly help regulators in their work of monitoring compliance. For examples, use of specialist providers in reporting can lead to significant improvement in the quality of data produced from reporting. Other shared services like KYC utilities lead to consistent implementation and standards across the industry as they will often involve the agreement of a standardised approach between significant firms. As well as the reduced burden on firms (and by extension the economy), this means that the regulator is faced with assessing and monitoring far fewer approaches to compliance than it would if every firm built and adopted its own system. It also means there is less risk of a race to the bottom competition between firms as they would agree on standards among themselves that satisfy the compliance expectations of all of them which would then be operated by a third party. Clients of firms will then have no incentive to transact only with firms with lower compliance standards. As stated above, the regulator can help such a process by publically endorsing those standards that it believes satisfy its regulatory expectations.

\*\*\*\*\*

We hope that our above comments are helpful to HM Treasury. We would be more than happy to elaborate or further discuss any of the points addressed above in more detail. If you have any questions, please do not hesitate to contact David Cook ([david.cook@markit.com](mailto:david.cook@markit.com)) or the undersigned.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Schüler'.

Marcus Schüler  
Head of Regulatory Affairs  
Markit  
[marcus.schueler@markit.com](mailto:marcus.schueler@markit.com)