



MiFID II's Buy-Side/Sell-Side Standoff: The Good, the Bad and the Ugly

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Under MiFID II, dealers' terms of business are changing, and buy-side firms have to review these terms for each sell-side relationship. The scale of the repapering challenge that asset managers have to manage is immense, and there may be delays caused by disagreements. But investment managers and brokers both lose unless they resolve differences by the MiFID II deadline.

Repapering of terms under MiFID II is potentially a massive problem for the buy side. This issue is often overlooked, as asset managers typically rely on their sell-side partners for support. Broker-dealers and banks provide trading strategies, liquidity and even reporting.

Now, under MiFID II, dealers' terms of business are changing. Buy-side firms have to review these terms for each sell-side relationship at speed to meet the 3 January 2018 deadline. The repapering of derivative trading terms with sell-side partners at the start of 2017 was an arduous task; that experience was very focused compared with the more complex and extensive challenges presented by MiFID II.

While the new terms of business put in place by MiFID II are for investor protection purposes, they can sometimes vary by client categorization and require additional attention. For example, when a client expresses consent to trade off venue, consent is required to protect both the dealer and the client. Another example of this enhanced protection is the MiFID II requirement that prevents a dealer or any investment firm

from using a client's financial instruments for the dealer's own account except under the client's consent.

Making better partners

Buy-side firms will therefore need to find a way that they can track their counterparties' statuses. By investing in an automated solution, firms can turn obstacles into opportunities through managing and sharing of documentation and addressing regulatory outreach and repapering between counterparties. There is an emergence of new platforms designed to automate client contact, some to centralize communications and others offering a full utility to address the entire outreach process. Since it is valuable to invest in a solution dynamic enough to fulfil requirements beyond MiFID II, it is important for firms to find a 360-degree view of continuous multi-lateral communications when conducting regulatory, tax, KYC and general client outreach. Digitizing manual processes builds a full audit history of information exchanged and can also feed valuable data to downstream systems, for trading, risk and reporting requirements.

Reusing data affords the opportunity to increase efficiency. Any problems in accepting those terms could make things even more complicated for asset managers. Although these are non-negotiable documents, some buy-side businesses may be tempted to avoid responding to them, or fail to acknowledge receipt. If the buy-side does not engage, or worse, actively delays the process of settling the agreement, both could end up in a standoff that pushes parties beyond the deadline and into non-compliance.

Instead of holding one another hostage and the resulting delays, the two sides need to cooperate. Asset managers must get involved in the repapering process. While there may be delays caused by disagreements, time can be found by making the process more efficient. The scale of repapering challenge that asset managers have to manage is immense. A buy-side firm could easily become swamped in administration if efficiency is not improved.

High noon for decision makers

Consider the scale of the change; MiFID II is reinventing the investment and trading process for non-equity instruments. Much of the focus has been around massive changes to the model for payment of research and execution. While these rules are enhancing transparency between clients, dealers and end investors, any firm managing money has to ensure it is conducting due diligence on the brokers that are handling its orders. From the employment of algorithmic trading strategies to order routing and crossing, investment firms must be fully aware of the activity being conducted on their behalf.

This slows down the repapering process. It also adds complexity because the classification of counterparties under the rules can change over time. For example, the dealer community has become highly specialized when viewed on a cross-asset basis. The ability to share regulatory status between dealers and clients will be necessary for asset managers as they assess their own responsibilities and disclosures. Instead of arm-wrestling one another over agreements, the buy and sell-side need to figure out a way to shake hands on the right deal in a timely manner.

Given the breadth and complexity of new MiFID rules and the effect they will have upon service agreements, buy-side firms will need to automate and consolidate their administrative management as much as possible in order to accelerate implementation, or risk running out of time.

Originally appeared in Tabb Forum | LinkedIn | October 2017