RTS 28: More to Compliance than Meets the Eye

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In April of 2018 European investment firms will be required to publish their first ever disclosures about quality of trade execution, under the guidance of MiFID II's RTS 28. At first glance, one might conclude that ESMA has attempted to make the task achievable by limiting the scope of the disclosure to documenting the top five trading venues used by an investment firm. Indeed, for small firms with uncomplicated trading, compliance with the rule will be relatively straightforward, but as a firm's activity increases in complexity, so does its reporting obligation.

There are several aspects of the rule that can potentially create a logistical headache for an investment firm, not the least of which is simply the broad scope of asset classes that are covered by RTS 28. ESMA has identified 22 asset classes that must be individually reported, spanning equities, debt instruments, OTC derivatives, structured products, emissions credits and even a category mysteriously called "other."

Creating reports for one or two asset classes might be straightforward, but pulling trade records from multiple order management systems, extracting the relevant data points, computing the statistics and then formatting them to a standard template becomes a very time consuming endeavor when extended to a greater breadth of trading activity.

The next complication arises from the multiple layers of trade classification required for compliant reporting. Beyond asset class, trades need to be classified by customer type – retail and professional customers must be reported on separate but otherwise identical tables. An investment firm must also classify orders based on attributes of the orders themselves and document when the investment firm acted as an executor of an order or as a receiver and transmitter of an order. A firm is deemed to have acted as an executor when it accessed liquidity on a venue directly and to have acted as a receiver and transmitter of an order when it sent a customer order to a third party for execution. Two different reports are required for documenting when a firm acts as a receiver/transmitter and when the firm acts as an executor, with additional data requirements depending on instructions placed on the orders themselves.

Under RTS 28, when firms access liquidity directly from a venue, or when they provide explicit instructions to a broker on how to execute an order, they must disclose passive and aggressive trading behavior. However, if a firm gives a broker discretion on how to access liquidity, then passive and aggressive information does not need to be disclosed. As a result, for a firm utilizing a mix of high touch and low touch trading across multiple brokers, analyzing broker instructions, order types and algorithms to determine reporting obligations will be a burdensome exercise.

An investment firm's job isn't over when it has finally captured data, classified activity, calculated statistics and formatted results. It still needs to provide a summary and conclusion of analysis including eight specific statements relating to the firm's "detailed monitoring of execution quality on the venues where it executed all client orders in the previous year." Furthermore, the rule explicitly states that the ongoing review of execution quality applies to all venues and is not limited to the top five required for public reporting.

Finally, RTS 28 requires the investment firm to publish all tables and summaries on a web page where anybody can view and download the reports in both human and machine readable formats. As a result, the task of compliance extends beyond the trading desk and compliance team to the web designers and administrators.

When assessed holistically, it is clear that complying with MiFID II's RTS 28, will require significant time commitment from employees in multiple areas of the firm. The risk is that instead of adding value to the enterprise by monitoring and analyzing execution quality, a compliance department will instead spend time and energy classifying trades, normalizing data, formatting reports, and dealing with web admins.

Overall, it's easy to underestimate the effort required to comply with RTS 28.

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