

WHITEPAPER

# MIFID II

» Turning MiFID II into an opportunity

**"COMPLIANCE IS MORE THAN  
REGULATORY REPORTING."**

WOLFGANG FABISCH, CO-FOUNDER & CHIEF EXECUTIVE OFFICER // B-NEXT

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As market participants prepare to comply with MiFID II, this paper explores how the latest automated technologies can help market participants to fast track their compliance programmes, while seizing an opportunity to strengthen their business. The mandate requires compliance in the areas that include best execution and also recording and retrieval of voice and other digital communications.

While these are complex and burdensome tasks involving vast amounts of data, they represent a huge opportunity for investment firms to increase transparency, improve execution, reduce risk and costs.

# EXECUTIVE SUMMARY

MiFID II builds on the requirements of MiFID I to “minimise the risk of the loss or diminution of client assets, or of rights in connection with those assets, as a result of misuse of the assets, fraud, poor administration, inadequate record-keeping or negligence.”<sup>1</sup> As a result, MiFID II introduces further requirements extending the measures that must be taken to ensure best execution and also detailed record keeping.

As market participants prepare to comply with this new regulatory mandate, this paper explores how the latest automated technologies can help market participants seize the opportunity to strengthen their business and fast track their compliance programmes. MiFID II requires compliance in the areas of best execution and also recording and retrieval of voice and other digital communications. While this is a complex and potentially time-consuming task, it is also a huge opportunity for firms to reduce risk and costs, as well as meeting their regulatory obligations. Technology will be pivotal in helping firms to do the right thing in terms of compliance, while also driving efficiencies that will help to reduce long-term costs, improve execution standards and increase transparency.

A recent survey found that 90% of buy-side firms across Europe believe they are at high or medium risk of not being fully compliant by 2018<sup>2</sup>. The same research found two thirds of buy-side firms are still in the relatively early stages of their MiFID II programmes. Recent media reports also suggest that around 25% of smaller funds are struggling to get ready for the deadline<sup>3</sup>.

Automated systems can help participants struggling to cope with the magnitude and dynamic nature of trade surveillance. Such automation can help to reduce the administrative overhead and cost associated with MiFID II compliance.

## Benefits include:

- » Rapid response to regulatory change
- » A reduction in workload and costs
- » Increased competitive advantage and optimal returns
- » Improved risk management and compliance oversight

Such is the evolving nature of market abuse, the threat of reputational damage remains ever-present. Regulators and market participants cannot risk standing still.

MiFID II will likely be followed by further regulation in years to come, perhaps in the shape of MiFID III. Technology will help market participants to keep in step with regulatory change and one step ahead of those intent on market abuse. By embracing solutions designed to scale and adapt to such change, market participants will benefit from timely and cost effective responses to new regulations and evolving forms of market abuse.

<sup>1</sup> Directive (EU) 2016/1034 of the European Parliament and of the Council ([http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:0J.L\\_2016.175.01.0008.01.ENG](http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:0J.L_2016.175.01.0008.01.ENG))

<sup>2</sup> Who is ready for MiFID II? JWG July 2017 ([https://jwg-it.eu/?wpfb\\_dl=680](https://jwg-it.eu/?wpfb_dl=680))

<sup>3</sup> Financial Times 27 January 2017 ([www.ft.com/content/ba243304-e224-11e6-9645-c9357a75844a](http://www.ft.com/content/ba243304-e224-11e6-9645-c9357a75844a))

## 02

# MIFID II OVERVIEW

## Countdown to MiFID II

Market abuse has fractured the reputation of the financial markets and dented investor confidence. Global regulators have responded with billion dollar fines and regulations such as MiFID I, MAR and Dodd-Frank. The next major regulatory mandate will be MiFID II in January 2018.

"MiFID II and MiFIR can be summarised as enabling financial markets to work for the benefit of the economy, supporting jobs and growth through making them safer and more transparent and enhancing investor confidence."<sup>4</sup>

MiFID II strengthens MiFID I requirements relating to best execution. It is more forceful than its predecessor, requiring firms to take "all sufficient steps" vs. MiFID I's "all reasonable steps" to provide best execution for their customers. Investment firms must also publish reports offering information on orders connected with their top 5 execution venues by trading volume.

In the Commission delegated regulation of 25.4.2016, Article 76 also addresses the requirement for Recording of telephone conversations or electronic communications, stating, "Investment firms shall establish, implement and maintain an effective recording of telephone conversations and electronic communications policy, set out in writing." And in Article 76 clause 10 it states, "Records shall be stored in a medium so that they are readily accessible and available to clients on request."<sup>5</sup>

As we approach the MiFID II deadline, market participants face the twin challenges of preparing their business to meet this regulatory mandate, while responding to increased external pressure to deliver the best returns. Automation can help them to meet these challenges on time and in a cost effective manner.

<sup>4</sup> <https://ec.europa.eu/transparency/regdoc/rep/3/2016/EN/3-2016-2031-EN-F1-1.PDF>

<sup>5</sup> Commission Delegated Regulation (EU) Article 76 (<http://ec.europa.eu/transparency/regdoc/rep/3/2016/EN/3-2016-2398-EN-F1-1.PDF>)

# AUTOMATED SURVEILLANCE SYSTEMS

According to Article 2 1(f) of MiFID II/MiFIR “Firms must introduce adequate organisational arrangements to minimise the risk of the loss or diminution of client assets, or of rights in connection with those assets, as a result of misuse of the assets, fraud, poor administration, inadequate record-keeping or negligence.”<sup>6</sup>

The potential complexity, magnitude and dynamic nature of the surveillance and reporting task required by MiFID II cannot be underestimated. Imagine sifting through and analysing petabytes of data every hour; day; week; month and year. It's a task unsuited to manual processes but ideally suited to automated data processing and analytical technologies.

The ability to process and analyse vast quantities of data incredibly quickly can give you a competitive advantage in terms of response and access times. It can also help you strengthen your market position and avoid unwanted risks.

Automated surveillance systems can alert compliance officers to market abuse attempts early on. By identifying suspicious situations based on a number of pre-defined scenarios, the system can help prevent market abuse from escalating.

## The benefits of automation

The benefits of implementing automated solutions are wide reaching and include:

- » The ability to respond quickly to regulatory changes
- » A reduction in workload and associated costs
- » Proactive management of suspicious trends
- » Improvements to the quality of market abuse monitoring
- » Improvements to risk management and compliance oversight
- » Increased competitive advantage
- » Reduced exposure to risk



## Cost and risk reduction

Market participants can seize these opportunities while improving their management of risk and reducing costs. This can be achieved by driving trading efficiencies through cost effective hosted technology solutions that offer advanced multi-venue, multi-asset class surveillance and compliance with MiFID II and other regulatory mandates.

<sup>6</sup> Commission Delegated Regulation (EU) Article 76 (<http://ec.europa.eu/transparency/regdoc/rep/3/2016/EN/3-2016-2398-EN-F1-1.PDF>)

## How b-next can help

At b-next we understand the importance of complying with regulatory mandates such as MiFID II, and the pressure to optimise returns in highly competitive markets. We also acknowledge the need for an independent perspective when identifying instances of market abuse.

At the vanguard of automated trade surveillance solutions, **b-next's CMC:Suite** is a proven, advanced integrated trade surveillance platform. It helps you to comply with MiFID II by detecting market abuse, insider trading, and conflict of interest, as well as monitoring derivatives/OTC, best execution, reporting and monitoring of trading activity.

The platform identifies market abuse predictively through a system of alerts. Intuitive analytics, price comparison, data gathering and market replay tools also make it easy to conduct post-trade and best execution analysis.

This solution simplifies processes for trade exception monitoring and compliance reporting. In this way, market participants can seize an important opportunity to meet regulatory obligations and manage trading risk optimally.

Market abuse is a moving target, so while there are software solutions that can help institutions to protect themselves, the need for flexibility and innovation remains constant. It is with this in mind that we shall next examine best execution automation and its role in helping participants to adhere to MiFID II.



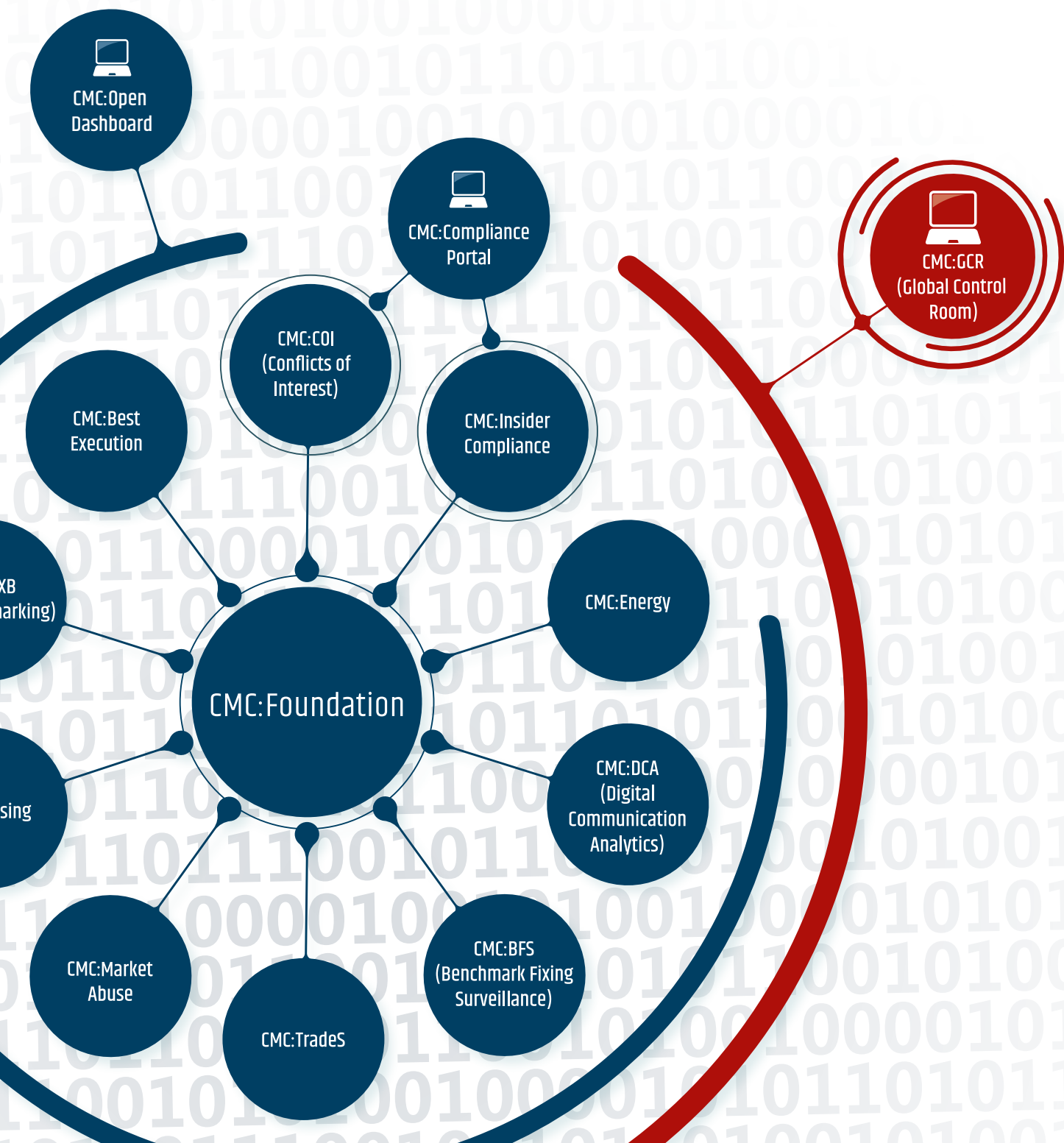
CMC:FX  
(FX Benchmark)

CMC:Cross



## CMC:SUITE OVERVIEW

- » Integrated and highly flexible platform
- » Comprehensive solution spans all asset classes and trading venues
- » Multi-client for even the largest global financial groups
- » Reduces and automates compliance workloads, thus improving decision-making and allowing attention to be focused on risks and process deficiencies



# 04

## BEST EXECUTION

Article 27 of MiFID II mandates an “Obligation to execute orders on terms most favourable to the client”. Article 27 (clause one) also requires that “Investment firms take all sufficient steps to obtain, when executing orders, the best possible result for their clients taking into account price, costs, speed, likelihood of execution and settlement, size, nature or any other consideration relevant to the execution of the order.” Additionally, clause four requires “Investment firms to establish and implement an order execution policy to allow them to obtain, for their client orders, the best possible result.” Furthermore, clause 6 states “Member States shall require investment firms who execute client orders to summarise and make public on an annual basis, for each class of financial instruments, the top five execution venues in terms of trading volumes where they executed client orders in the preceding year and information on the quality of execution obtained. The ethical elements of Article 27 also apply.

Advanced automated tools can help participants to manage the best execution requirements of MiFID II cost effectively. Once managed in this way investment firms will also benefit from improved processes that will enable them to deliver optimized returns to investors.

### Functionality

The functionality required to address the MiFID II best execution mandate should include the following:

- » Identification of the best venues for executing client orders
- » Revelation of opportunities for improving trading systems/desks
- » Profitability and competitive analysis functions
- » Proactive management of customer requests, e.g. daily, monthly, and quarterly reports
- » Version management of policies
- » Ability to create a best execution policy for specific customers/customer groups/asset classes/venues

### How b-next can help

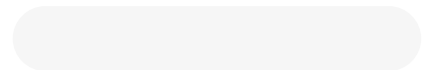
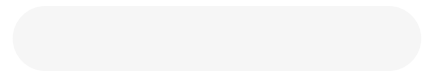
Tools such as b-next’s CMC:Best Execution module have been designed to incorporate the above functionality. For example, the module provides automated checking of transactions against price, VWAP (volume-weighted average price), liquidity, speed, multiple venues, profitability, customer internal trading benchmarks, and more. This capability enables market participants to measure the efficiency of their order execution processing and ensure that stated best execution policies are always met, across asset classes and trading venues.

### The benefits include:

- » Out of the box solution offers full, easy and cost effective integration with CMC:Suite
- » Compliance with the latest Dodd-Frank Act and MiFID II Directive 2014/65/EU
- » Meets MiFID II and other regulatory requirements for more in-depth analysis of where best execution was not met
- » Helps to optimize returns



Another area required by MiFID II relates to voice recording and retrieval. As with best execution, innovative solutions are available and we look at this topic next.



## 05

# VOICE AND DIGITAL MESSAGING ANALYTICS

Voice analytics has become increasingly important as a means of recording and analysing verbal submission patterns. Innovative trading and surveillance technologies are now available, combining and integrating advanced speech and digital text analytics. Such solutions can help participants to search and analyse voice call recordings and digital text communication including email, SMS, chat, social channels, by time frame, trader, counterparty and trader desk. This capability addresses requirements in increased regulatory demand for trading and communications surveillance, especially as regulators across the globe align capital markets mandates and rules, and increase financial and criminal penalties for fraud and market abuse.

## Reputation

Regulation is not the sole driver however. Loss of confidence in investor relations, as well as challenges to hard won reputations, have prompted a call for improved risk management and surveillance capabilities. Innovative surveillance technology offers protection against damages to reputation from market abuse and fraud, while also ensuring compliance requirements are met and associated processes are followed.

## Detection

The most advanced and effective market surveillance solutions will have the capability to detect and report suspicious trading activity involving collusion. A lot of daily benchmark rates are calculated based on trading activity so it is important that compliance monitoring is implemented. However, some benchmarks are still calculated based on a bank making a submission. Such submissions are often verbal. It is here where there's a clear need for participants to implement voice-monitoring solutions for this type of activity, especially in the light of the Market Abuse Directive (MAD I & II) and Market Abuse Regulation (MAR) directives and other regulatory requirements for searchable voice recordings. Digital Communications Analytics (DCA) can prove particularly relevant and valuable as a tool to address this need.

## How b-next can help

Solutions such as **b-next's CMC:DCA** (Digital Communications Analytics), include a high degree of surveillance automation while also demonstrating the following important capabilities:



### ADVANCED DATABASE TECHNOLOGY

Advanced database technology is pivotal in the surveillance and analysis of digital communication. In-memory techniques enable ultra-fast data processing, while intelligent, highly flexible rules with intuitive parameter controls can be used those with little knowledge of technology.



**Fig. 1:**  
CMC:DCA Dashboard



## **INTUITIVE STATE OF THE ART USER INTERFACES**

Ease of use not only minimizes training requirements, but also allows skilled domain experts to use systems without in-depth IT knowledge. Intuitive interfaces will play an important role in simplifying, search, navigation and workflows, while accelerating insights.



## **DATA ANALYSIS**

DCA solutions should have the capability to analyse data to reveal statistics relating to digital communication. This would include trends and frequency of communication, or the identification of participants in digital conversations and a ranking of key words used.



## **SEARCH AND FIND**

The ability to search and find digital communications data is stressed by MiFID II. DCA solutions must therefore offer fast, accurate and intelligent interrogation of voice and data activity. Ideally this will be achieved via keyword searches to find recorded voice and data communications, allowing users to listen to historical voice recordings or view digital text based communication on demand.



## **MULTI-LANGUAGE SUPPORT AND REPORTING**

As trading takes place across borders and trading venues, multi-lingual and reporting capabilities are crucial features. DCA solutions should be capable of lossless transcription of calls in multiple languages. Reporting functionality should include a tamper-proof audit trail, history of alerts and calls.



## **ALERTS**

The ability to alert users to potentially fraudulent activity is central to a DCA system. Important features will include the tagging of communications data for comment, as required, so that unusual communications data is linked and attached to alerts and highlighted for future reference.



## **VOICE ANALYTICS AND MIFID II**

As the above demonstrates, automated voice analytics can play a valuable role in helping market participants to comply with regulatory mandates such as MiFID II and the Dodd-Frank Act.

# 06

## TOWARDS MIFID III?

Compliance with MiFID II principles will play a vital role in the campaign to end market abuse and manipulation in the financial markets. And, as MiFID II comes into force in 2018, the case for adopting appropriate technologies will become increasingly compelling.

Without doubt, MiFID II sets a laudable compliance standard for all market participants – helping to ensure that they adhere to best practice for the good of the markets and their business. The right tools will be needed to help them to comply. Sophisticated, automated surveillance tools, offer market participants a practical and robust solution to meeting voice recording and best execution requirements of MiFID II. Such automation can help to reduce the administrative overhead and cost associated with MiFID II compliance. In this way, market participants can focus on maximising the opportunities for increased transparency and improved execution standards.

As for the future, market abuse is a moving target and no doubt we will see further regulation, perhaps in the form of MiFID III. As time moves on, there will be a renewed onus on participants to improve processes relating to surveillance, best execution and other areas. As with MiFID II, such regulation, whatever form it takes, will present new opportunities to improve and strengthen internal processes. Those that embrace it will benefit from improved trading efficiencies and strengthened reputations. And those who use automated technology to support their compliance and surveillance efforts, will be well prepared for regulatory change and evolving forms of market abuse in the future.



# GLOBAL GROWTH

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**100+**  
SCENARIOS

b-next's **CMC:Suite** solution offers a single integrated compliance platform with over **100 DIFFERENT SCENARIOS** for the detection of Market Abuse, Insider Trading, Conflicts of Interest, FX Benchmarking, Derivatives/OTC Monitoring, Best Execution Monitoring and Reporting of Trading Activity. It supports a diverse range of global clients including banks, brokers, asset managers, exchanges, regulators, funds and energy utilities.

**25+**  
YEARS

A highly focused provider of capital markets solutions for more than 25 years, b-next has a growing international client base, supported by offices in Europe and the US. Our proprietary development team and strong client centric approach ensure that our solution set remains at the leading edge of regulatory change and market best practice.







Germany  
Bielefelder Strasse 12 – 14  
D-32051 Herford  
+49 5221 99 280 0

UK  
80 Coleman Street  
London, EC2R 5BJ  
+44 20 7489 6430

USA  
80 Pine Street, Floor 24  
New York, NY 10005  
+1 646 437 1026

Ukraine  
77/38 Heroiv UPA #401  
Lviv 79015  
+49 5221 99 280 0

Singapore  
2 Marina Boulevard #17-01  
Marina Bay Financial Centre Tower 3  
Singapore 018982  
+65 6809 5217

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[www.b-next.com](http://www.b-next.com)