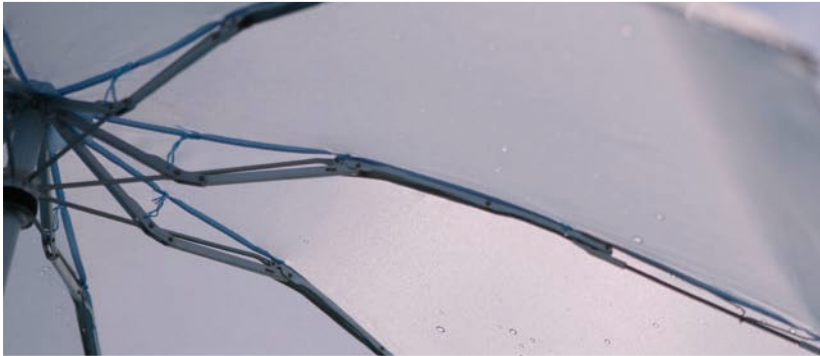


Transaction reporting for Investment Managers: A regulatory update



“When dealing with non-EEA brokers, Investment Managers (“IM”) need to be aware that dual listed securities should be reported.”

The FSA has always regarded transaction reporting as an important part of its regulatory toolkit. The recent imposition of a £2.45m fine against Barclays Capital Securities Ltd and Barclays Bank PLC for failing to provide accurate transaction reports and for serious weaknesses in systems and controls in relation to transaction reporting is testimony to that. It provides a timely reminder for all firms to ensure that the processes they have in place are suitably robust.

Indeed, given the ongoing work on the Alternative Instrument Identifier (“AII”) project and the recently published updated Transaction Reporting User Pack (“TRUP”), it is an opportune time to remind ourselves of the essential issues some of which, as you may recall, remained outstanding at the advent of MiFID.

→ The requirement

Whilst many firms continue to rely on their brokers to report transactions undertaken on their behalf, it is important that firms are keenly aware of the requirements overall in order to ensure that they understand the limitations on responsibility carved out of broker terms of business. Certainly, and perhaps obviously, this is an important element of demonstrating in a meaningful way that systems and controls are in place.

SUP 17.2.2 G exemption

For a firm providing a “service of portfolio management”, and entering into a reportable transaction with a broker, this should result in the submission of a transaction report to a competent authority. However, if the firm providing such a service can rely on the SUP 17.2.2 G exemption (reliance upon an executing broker to transaction report), it would not be obliged to make said report. This is because the FSA, or another competent authority, would have already received the required information as a result of the transaction report made by the broker.

Ongoing obligation

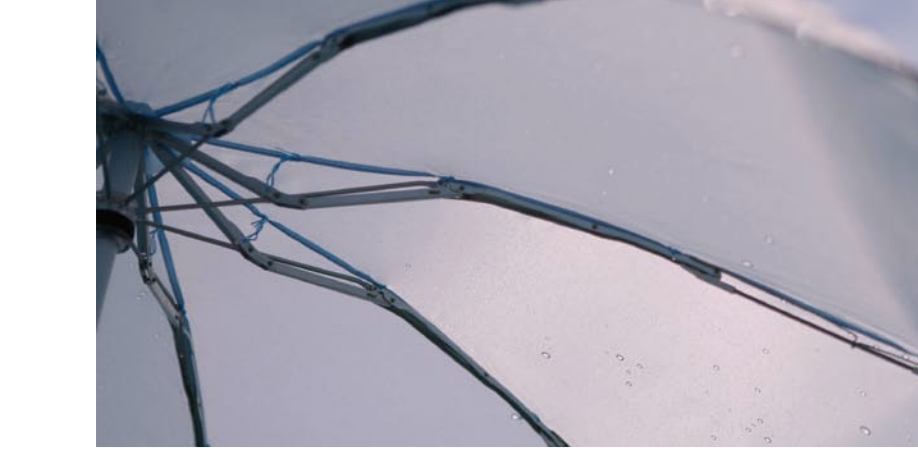
Firms utilising the exemption in SUP 17.2.2 G should ensure on an annual basis (as suggested in section 4.1 of the TRUP) that executing brokers are indeed transaction reporting on their behalf. This demonstrable act is an important step in establishing the processes, and the good faith that the FSA has requested in this regard. Such steps demonstrate your adherence to Principle 3 and your participation in the very topical fight against market abuse.

Dual listed instruments and other scenarios; reporting obligations for Investment Managers

When dealing with non-EEA brokers, Investment Managers (“IM”) need to be aware that dual listed securities should be reported. As the non-EEA broker is not in a position to report to a competent authority, the obligation therefore falls upon the IM. Other examples of where an IM maybe required to report are highlighted in the TRUP and include:

- > Where the broker is not a MiFID investment firm (and so will not be required to transaction report to a competent authority) and the financial instrument is admitted to trading on a regulated or prescribed market.
- > When the firm providing a service of portfolio management undertakes an inter fund transaction without using a broker who is a MiFID investment firm.
- > Where the transaction is reportable under SUP 17 but is not a transaction in a financial instrument admitted to trading on a regulated market and the broker is a non-UK MiFID investment firm. This covers areas where the UK is super-equivalent to the MiFID requirements. It includes transactions in OTC derivatives where the underlying instrument is traded on a regulated market or prescribed market and transactions in financial instruments admitted to trading on prescribed markets.
- > Where the counterparty is another firm providing a service of portfolio management.

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“A further important confirmation in the latest TRUP is that firms can be relieved of their obligation to make a report if the transaction is instead reported directly to the FSA ”

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- > When a firm providing a service of portfolio management undertakes a transaction in an agency or principal capacity on behalf of a client on an execution-only basis.
- > In the event that a firm providing a service of portfolio management contacts an EEA broker to conduct a transaction in a reportable instrument on a non-EEA exchange, that broker may pass the order to a non-EEA broker to execute the trade. If the EEA broker is not itself entering into the transaction in an agency or principal capacity because the relationship with the firm providing the service of portfolio management has been given up to the non-EEA broker, then the firm providing a service of portfolio management, rather than the EEA broker, would have an obligation to transaction report. Some broker terms will exclude this type of trade.

→ Reportable transaction exemptions

Non-securities derivatives

It has been agreed by CESR and the European Commission that competent authorities need not require firms to report transactions in non-securities derivatives (i.e. commodity, interest rate and FX derivatives) admitted to trading on regulated markets.

This fact is now codified in the updated TRUP that states that FSA does not require firms to report transactions in these derivatives, and work continues with LIFFE, the London Metal Exchange (LME) and Intercontinental Exchange (ICE) to ensure that all competent authorities have access to information on transactions in these derivatives.

Reporting via an ARM or MTF

A further important confirmation in the latest TRUP is that firms can be relieved of their obligation to make a report if the transaction is instead reported directly to the FSA by an Approved Reporting Mechanism (“ARM”) or by a regulated market or multi-lateral trading facility (“MTF”) through whose systems the transaction was completed.

A list of ARMs is available at: <http://www.fsa.gov.uk/Pages/Doing/Regulated>Returns/mtr/arms/index.shtml>

Non-EEA derivative markets

In order to avoid any possible loopholes in the coverage of the rules, the FSA decided to retain the handbook rule SUP 17.1.4 that compels the report of transactions in non-EEA markets in instruments whose value is dependent upon an equity or debt

related instrument admitted to trading on UK regulated or prescribed market.

However, the FSA was asked to consider restricting this proposal to where the underlying instrument is a single equity or single debt instrument and this exemption duly came into force on 21st September 2009.

→ Alternative Instrument Identifier - background

For the reporting of debt and equity instruments, CESR originally recommended the use of the International Securities Identification Number (“ISIN”) as the only means with which instruments should be identified. However, the costs and practicalities involved for introducing ISINs where they were not already in use prompted a u-turn.

Where regulated markets did not use ISIN’s (e.g. LIFFE) firms would have to use a standard Alternative Instrument Identifier (“All”) to specify the instrument. Reports for products traded on these markets would be required to use the All.

Implementation of the All

From 21st September 2009, the FSA was set implement the use of All codes for all on-exchange derivatives. The aim of the project was to “receive and process all on-exchange derivative transaction reports in an efficient and secure manner...” thereby meeting its MiFID obligation.

However, due to systems issues, the FSA has postponed the implementation date to ‘early February 2010.’ Until such time, firms are not required to report equity/debt derivatives undertaken on regulated markets which do not use the ISIN. The FSA continues to receive a feed from LIFFE’s transaction reporting system thus allowing firms to place reliance on that reporting to satisfy the obligation to report the ‘market-side’ of transactions.

The introduction of the three new derivative type classifications;

- > spread bet on an option on an equity,
- > contract for difference on an option on an equity; and
- > complex derivatives,

will still be effective from 21st September 2009 but the FSA state that no action will be taken against firms that wish to implement this change at the same time as implementation of the All.

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→ Firms' high level obligations

As noted already, the new TRUP codifies a number of outstanding issues and contains important clarification and technical detail with regards to the reporting of OTC and on exchange derivatives that were previously scattered amongst several of the FSA's Market Watch Newsletters.

Whilst not all of the aforementioned is strictly applicable to IMs, it is nevertheless important that all firms are cognisant of the obligations and the processes they may rely upon to meet them.

The FSA would certainly expect all firms to consider the overall systems and controls as required by SYSC and Principle 3. This may, among other things, require:

- > A clear allocation of responsibility for transaction reporting within an organisation.
- > Appropriate training for staff in respect of transaction reporting.
- > Appropriate information produced on a regular basis to enable proper oversight of the transaction reporting process.

- > Processes for ensuring continued transaction reporting accuracy and completeness post any system or process changes.
- > Appropriate oversight of transaction reporting by compliance including reviews as part of the compliance monitoring programme.
- > Where reliance is placed on reporting by an ARM or another third party, that periodic checks are carried out to ensure that the transactions are being reported. This may include seeking confirmation from the third party that a sample of trades has been duly received. The FSA's Transaction Monitoring Unit can provide such confirmation to the reporting party.

Certainly, the ire raised by the continuing and sheer quantity of inaccurate reporting in the Barclays case, as detailed in the final notice issued by the FSA, should suggest that a periodic review of the controls in place is a sensible course of action.

→ Next steps

MMS Regulatory Solutions can help you address these important regulatory issues and ensure you remain abreast of the developments as they occur. Please contact your consultant for further details.

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