BEYOND MIFID II COSTS AND CHARGES

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Since January 1st, 2018, banks have been obliged to report costs and charges to their clients. These have in some cases been on demand or at negotiated event level. This new measure is part of the MIFID II regulation, which aims to reinforce investor protection. By increasing execution transparency, the ECB has fundamentally changed customer relationship management with subsequent impacts on clients bargaining power. Any professional client could now request from their banks, costs and charges on all of their banking activity and at negotiated event level.

With MIFID II Costs and Charges, banks are facing challenges already encountered with PRIIPs but on a wider scope.

METHODOLOGY

Computing costs and charges as the difference between the ClientPrice and the FairValue, as suggested by the PRIIPs methodology is, most of the time, impossible and leads to irrelevant results. It implies a perfect repricing of the product following the same pricing process as the one used for execution (with the same pricing model and market data). The challenges of this approach can be seen when facing a delay between execution and booking. For example, with dealing with an exotic product that may impact several trading desks or perhaps with dealing with non-liquid currencies. In these instances, this approach becomes impossible. It therefore seems more feasible to rethink the methodology and look for an alternative approach. In addition, the new approach adopted must also consider event management to ensure a perfect granular disclosure level and appropriate computation (costs and charges cannot be computed the same way on a creating event or a termination / restructuring event).

IMPLEMENTATION

Approximating costs and charges implies that you must understand the execution and booking process for all asset class under MIFID II regulation. Due to the potential high volume of trade event to process, any updates or changes in regulation, implementation must remain easily modified to match the regulatory expectations. Implementation streams should be partially focused on identifying data already computed and stored into different DPA and could be used to approximate costs and charges. The FairValue re-pricing process may be limited to bad data quality situations with low sensitivities and market volatility. Costs and charges repricing strategies have to be considered and implemented carefully to avoid any slow-down or overload of pricing and booking applications. The implementation phase might cover all the costs and charges eco-system and not only the pricing automatization stream.

AUTOMATIZATION

Automating costs and charges computation is the main challenge of Banks' implementation projects. The existing regulatory requirements for the execution and booking process are already time consuming, meaning the manual inputting of this data may be challenging. Furthermore, even if ex-post reports final disclose could be limited, all professional clients may potentially request it. With this in mind, banks might consider automatizing its production and think about all the eco system around costs and charges. Automating the process should not be limited to pricing solutions but must also cover controls, reporting, audit, etc.

NORMALIZATION

Trades are often not booked into the same Data Processing Application. To make the computation process easier to implement and automatize, banks might consider developing their own "costs and charges pricer" as an independent application. Additionally, it might be linked to all others DPA. Ex-post reports are required to communicate and aggregated information, which means that the data is needed to be harmonized and normalized in order for it to be easily manipulated. A 'normalization plan' could be part of a larger project covering other regulations or global reporting needs. Building a global normalized chain, which gathers all trades data could be a more compatible and efficient solution.

REPORTING

Designing a new reporting tool to monitor, update and control production process seems necessary in light of costs and charges. For example, Sales (or any other person in charge of communicating ex-ante costs and charges) will have particular reporting needs to monitor and control their costs and charges process. Having an ex-ante disclosure obligation, they will need to be alerted to any maximum costs and charges margins. Furthermore, part of the reports implemented should be linked to an existing global internal control process.

CONTROLLING

The costs and charges production must be controlled on a regular basis to ensure there is a perfect execution and that the process meets regulatory obligation. Controls should be defined at different level (running, end of day, end of months, etc.) with a different person in charge (Sales, Engineering, IT, Internal Control, etc.). It might cover different topics: methodology, computation process, disclosure obligation, etc. and might raise automatic alerts if needed.

TO CONCLUDE

By tackling these challenges, banks are not only answering MIFID II costs and charges regulatory obligations but are, moreover, building a whole eco-system that would give them the capacity to better monitor, control and understand their margin capacities. This new approach cannot work without clear governance and definition of roles and duties of all stakeholders involved.

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