

***Interview with a regulatory reporting expert***

- SPEAKER1 00:03 Uh. OK, so I think we are good, I think we're on. So first off, could you just describe sort of what your role has been, your experience in the investment industry, just to start off with?
- SPEAKER2 00:28 Yeah. So, in the investment industry, I've spent about 12 and a half years at [REDACTED] in the financial data area and eventually working as product manager there. And the activities team also went on to work at the FSA, as it used to be. So, they arose in that transaction monitoring units. So primarily focused with looking for market
- SPEAKER2 00:55 abuse,
- SPEAKER2 00:56 so intimately involved in the transaction reporting element, using those transaction reports to spot market abuse. Primarily at that time it was insider dealing, didn't do a huge amount on other elements of market abuse because quite frankly, we didn't have the systems at that time when I was at the FSA also went on to work in the policy area. So, working with CESR and ESMA to define transaction reporting
- SPEAKER2 01:31 policy works
- SPEAKER2 01:32 at [REDACTED]. I was head of that transaction reporting
- SPEAKER2 01:37 service and
- SPEAKER2 01:38 making sure that all their reports were submitted
- SPEAKER2 01:41 correctly on time to
- SPEAKER2 01:43 the
- SPEAKER2 01:43 regulator
- SPEAKER2 01:44 and then spent six years at the [REDACTED]. So, there I was, head of compliance for their approved reporting mechanism, the transaction reporting and also there and the trade repository. Then my final role spent a couple of years at [REDACTED] And so that was doing quality assurance testing or transaction reporting to the local regulators primarily that was to the UK FCA. But we also had quite a few clients who reported to EU competent authorities.
- SPEAKER1 02:25 And I mean, transaction reporting has changed massively in the last few years, especially with MiFID II and the expansion to other asset classes, in particular commodities and other sort of non-equity instruments. How would you rate the sort of quality and effectiveness of that transition to this new sort of expanded regime? And do you think that the regulators and the firms have sort of gotten to grips with it yet?
- SPEAKER2 03:05 Difficult to say. I mean, if we look at what billions of transaction reports from over 100 clients and none of those clients was getting the transaction reporting completely correct, that was at least one error normally. Sorry, Alex, can you just

bear with me? The door's gone. I'll be back in a minute. I. Hi, Alex, really sorry about that. It was. Right, we're very sorry.

- SPEAKER1 05:54 So, we're with sort of how you would I mean, that transition to the expanded regime.
- SPEAKER2 05:59 Yeah. So, from the firm's perspective, it wasn't perfect. So, with the firms that we look at, obviously we're doing that quite closely. Well, exceptionally closely. We looked at everything they reported. A lot of firms were making really basic errors. That doesn't mean to say that their reporting was useless to the regulator, that there's still a lot of good information in the report,
- SPEAKER2 06:26 even if there are
- SPEAKER2 06:27 errors in it. But some firms didn't
- SPEAKER2 06:31 handle that well.
- SPEAKER2 06:34 I would say probably on average, these are to be honest, even the bigger firms weren't making too good a job of it, and they should have done better. A lot of that was down to interpretation. So, a lot of firms simply didn't
- SPEAKER2 06:55 interpret the requirements
- SPEAKER2 06:57 correctly. And then secondly, if they did, they made errors in the coding
- SPEAKER2 07:02 some
- SPEAKER2 07:02 areas there. And the third of the big failures with the most data didn't have the supporting
- SPEAKER2 07:09 data to report correctly.
- SPEAKER2 07:12 If you look at it from the other way round, looking at the regulators, were they on the poor? None of them were. All firms experience problems with the regulators in their systems, couldn't always ingest the data. And databases weren't very good. So, their FIRDS database, which is essential for firms to know what instruments they needed to report on,
- SPEAKER2 07:45 that wasn't
- SPEAKER2 07:46 very good either, or it wasn't part of the job.
- SPEAKER2 07:50 So the
- SPEAKER2 07:50 regulators had
- SPEAKER2 07:51 issues themselves,
- SPEAKER2 07:53 as were.
- SPEAKER1 07:55 Do you think that those issues were foreseeable before the whole thing went live?

SPEAKER2 08:03 Good question. To me, it was no surprise if there was an element of surprise, it was probably that the firms got it so bad. I didn't see, let's

SPEAKER2 08:15 say, the buy side

SPEAKER2 08:16 in particular, putting enough effort into it. So, a lot of the buy side firms weren't used to transaction reporting. They enlisted one. They relied on their brokers to report on their behaves. And really, they couldn't do that going forward. Or it was so onerous to do that. They didn't take advantage of some of the exceptions there because they were giving away a lot of personal information. So, I wasn't too surprised about the buy side making more errors, quite surprised by some of the larger firms. I expect them to do better when it comes to the regulators,

SPEAKER2 09:05 quite

SPEAKER2 09:06 frankly, not surprised at all because it is a tough job. I mean, it's a huge change in the requirements and a lot of the smaller regulators in particular don't have the resources to do it. And again, not too surprised by even the larger regulators, the FCA, the AMF, the BAFIN

SPEAKER2 09:30 and having problems

SPEAKER2 09:31 as well, because the amount of data contributed was up by a factor of around about five.

SPEAKER1 09:41 And one of the more controversial elements

SPEAKER2 09:45 of

SPEAKER1 09:45 the regulatory reporting regime was this introduction of personal identification information. Yeah, and I mean, I remember myself working in the industry on the south side, how much sort of consternation that caused amongst sort of brokers and traders, dealers? You know, they were worried that maybe they had a target on their backs. Yeah. I mean, how valuable do you think that is to the regulators? I mean, having worked in the regulator yourself, how much difference do you think that's going to make versus what regime was there before where that wasn't in existence? Or do you think, or have you seen instances where that's not really been done properly as well and that's maybe undermining its usefulness?

SPEAKER2 10:36 Yeah, there's

SPEAKER2 10:38 two parts to that. Really, what is enormously

SPEAKER2 10:42 useful, I would say, is for the private clients finding out who they are. So previously it was just the firm specific code. So, if you had a doctor evil with 57 accounts, you couldn't link those up because each of those 57 firms at a different way of identifying. And so, you couldn't find out exactly what he was doing. So, I think that that was enormously useful. Getting one meaningful code and also the

SPEAKER2 11:12 name and date of birth

SPEAKER2 11:15 was very useful. So, firms' authority regulators now can get a list of insiders to any

SPEAKER2 11:22 deals, look at the

SPEAKER2 11:23 names and obviously see if there's any connection with those names from the transaction report rather than having to go to the firm directly. So, from that perspective, I think that's enormously useful when it comes to decision makers within firms are not sure if the regulators have found that information as useful. Firstly, because I don't know how well that's actually populated, it does tend to get hardcoded a single

SPEAKER2 11:58 name rather

SPEAKER2 11:59 than the firms looking every time to see who exactly the decision maker was, who exactly was the responsible for the execution. So, I don't know how useful that's been. So, I think that's probably only the regulators can really answer that question. But I suspect that it's not that useful to the regulators. The true value they found, I would

SPEAKER2 12:27 imagine, is with

SPEAKER2 12:28 the private clients dealers for insider dealing, perhaps purposes.

SPEAKER1 12:35 Another innovation. I mean, and this sort of came which may have been a push from the Germans because they had their own high frequency trading act. Yeah. About ten years ago when we had the whole flash crash scandal. And it seemed to me that that led to the introduction of the idea of actually identifying trading algorithms as investment decision makers as well. And possibly also execution makers of these sort of short code, in your view, based on what you've seen, I mean, how. How consistent do you think that's been applied across the market, and is it something which is producing useful results, do you think?

SPEAKER2 13:25 I don't know. Again, I think it's only the regulators that can answer that one. We see in the field populated, but I can't say how accurately it's been populated. It's very difficult to get a list of algorithms of firms. So that's the basic check that we could have to make sure that where it is populated with an algo identifier, it is a proper code. So, firms aren't particularly good at giving us that information, which makes me suspect. But they can't prove that. Actually, it's not. Perfect. They haven't put too much effort into that, but that that's a little bit of conjecture, I don't really know. But the difficulty in getting hold of that information of firms certainly suggests to me that perhaps it's not

SPEAKER2 14:25 as robust

SPEAKER2 14:26 a mechanism as

SPEAKER1 14:28 I think one of the challenges that firms have found with the algorithm code in particular is I think we've got the MIFID II effort to sort of broadly outlined three

types of algorithms. They had order router, which was the sort of more basic. You know, you've got five venues that maybe or less the same security, and it sends the order to one of those venues. You've got the execution enhancements also be set on a platform, sort of like a huge one of those types of platforms, typically, and maybe that helps you with, say, spreading a client or it gives you iceberg or the functionality. Quite simple. The human being still has a large degree of control over the parameters of the order. But once you put the parameters in, it's the algorithm that takes over and then you've got the further end of the scale where you've got somebody, you know, designing a black box, which actually comes up with its own investment decisions. It seemed to me that in the middle of those they executed, an enhancement was that you might find on the trading platform, they seemed to be a lot of confusion around, you know. Who is actually responsible for the order, is that the algorithm or is it the broker?

SPEAKER1 15:51 Was that something

SPEAKER1 15:52 which you come across as well?

SPEAKER2 15:56 A little bit, yes, I say a little bit because we did get us one or two questions about that, and in that situation, we as a commercial enterprise, we can't answer that and we can look at the Q&A,

SPEAKER2 16:10 but

SPEAKER2 16:11 there's nothing in there. There's nothing really in the Q&A, not really enough in the guidelines documents to answer that kind of question. So, when clients came to us with that type of question, all we could say was approach the regulator and see if you can get an answer. So certainly, we certainly picked up that there was an element of great inside.

SPEAKER1 16:41 So that's maybe a gap that policymakers could work on to try and

SPEAKER2 16:45 yeah, and it is a little bit of a surprise because the regulators must have been asked that question a lot

SPEAKER2 16:53 of times

SPEAKER2 16:54 and nothing definitive appeared in the Q&A. So, you would have thought since that is a common question, they could have answered it quite easily. When I say easily, course it never is, because in a Q&A, you've got to have all the regulators thinking about it and coming up with an answer.

SPEAKER1 17:18 One of the other things which was I've been going through this process and interviewing other people is what's come up is direct electronic access, particularly with brokers offering sort of API connectivity or something, and they might face another broker somewhere else, maybe in the Far East, and then they have their own clients. And one of the challenges that they've got is that often these clients, you know, that their own clients' activities can sometimes cause problems, maybe because they're not really familiar with the market. Maybe they're developing, you

know, some of them developing their own algo functionality on the API connection. And it hasn't been conformance tested or something. You know, there's a number of these types of issues that come up and in that scenario. It's my understanding that the PII information stops at your direct client.

SPEAKER2 18:19 Yes. Yeah.

SPEAKER2 18:22 You don't have to look further back than your own direct client.

SPEAKER1 18:27 How much of a weakness do you think that is in the transaction reporting regime at all?

SPEAKER2 18:35 I don't think it's a weakness. I mean, there are going to be limits to what you can do as a regulator, what

SPEAKER2 18:42 you can find.

SPEAKER2 18:43 And to try and ask firms to go with stage back, I think would be too onerous. And I don't think it would be proportional of the regulators to do that. So, with your firm, I think it's only fair that the regulators can ask you to go back as far as the client. And if that client

SPEAKER2 19:05 is new

SPEAKER2 19:06 client, then they will not be identified in the next stage if it's not in the new clients. Well, tough luck, really. There's only a certain amount that the regulators can take.

SPEAKER1 19:21 just in terms of I mean, that difference between you and rest of the world, to my knowledge, and correct me if I'm wrong here. It seems to me that the UK and the European Economic Area, I say, are the only regions in the world which have something like this. I mean, there's this other I mean, there's post trade reporting, I think sort of Dodd-Frank / EMIR style stuff. And I've seen initiatives to introduce similar things, obviously, from G20 and Southeast Asia and things.

SPEAKER1 19:57 Are you aware of

SPEAKER1 19:58 any equivalent moves to brings something in like MIFID in any of these other jurisdictions and

SPEAKER2 20:05 then I think the CME

SPEAKER3 20:09 or trying

SPEAKER2 20:10 to do so, I think they may have already done it. I'm not sure what stage they're at. The thing we're certainly looking at, it's. Apart from that, I'm not aware of anybody

SPEAKER1 20:26 is that is that sort of , again , looking at trying to tackle global abuse and the way that markets are linked now to transnationally, is that is that something which, you know , if you're trying to improve conduct on a on a market and in the U.K., is that something which you think more may need to be done on ? Let's try and get consistently. Do you think there's much of a possibility of those other jurisdictions

Introducing something similar was that not really, there's not really much of a motivation for that?

- SPEAKER2 21:05 I don't know, and it's only fair, of course, it's mainly about market abuse. So, all jurisdictions should be very concerned about market abuse. And to be honest, I don't see how we can monitor for market abuse without
- SPEAKER2 21:22 having that personal
- SPEAKER2 21:24 information.
- SPEAKER2 21:27 It's pretty difficult to do.
- SPEAKER2 21:32 So, I would
- SPEAKER2 21:33 hope that all
- SPEAKER2 21:35 jurisdictions would do that. Of course, many jurisdictions have different. Private data legislation, so maybe in places like
- SPEAKER2 21:47 Korea, Russia, potentially,
- SPEAKER2 21:49 that's impossible to do.
- SPEAKER1 21:54 In terms of another thing that sort of strikes me is that there's all this information there about trading activities and maybe in some cases there's actually some duplication. Sometimes there's more information being collected with the Mafia reporting that may be what is coming out of some firm systems for that
- SPEAKER2 22:17 on market
- SPEAKER1 22:17 abuse monitoring. Yeah. FCA has been huge on conduct since the financial crisis and trying to identify market abuse is obviously a big part of that. But there are other types of issues as well. Is your sense? Do you think your sense is that firms are using this massive amount of information that they have to send to the FCA? Are they using that at all internally? Have you seen any,....to sort of monitor their own conduct, their own behaviour? Or is it very many Jobcentres, the FCA and they can look at information and we're not really going to use it internally?
- SPEAKER2 22:58 To be honest, I don't
- SPEAKER3 22:59 know that
- SPEAKER2 23:01 question to me, it would seem obvious that if you got that information, then you're sending it to the FCA, then you should be using it yourself. And all firms have an obligation under themselves to monitor the reviews. So, it would seem obvious to use the same data that you're sending to the FCA.
- SPEAKER1 23:24 OK. Uh, I think I'm just finally on the surveillance capabilities of the FCA. How has that team evolved the team, which looks at things like the transaction monitoring unit?

SPEAKER2 23:45 It is now. I got pushed more towards just monitoring the quality of the data submitted at sites, the markets reporting team. I see. And you had a bit of a change of name. So, it's the market combat team, but actually looked for the market abuse.

SPEAKER1 24:05 How sizable is that now, how big is that?

SPEAKER2 24:08 To be honest, I don't know. I have no idea how big it is now. So, with the massive increase, the data that they're

SPEAKER2 24:18 receiving, you would

SPEAKER2 24:19 have thought that that team would have grown accordingly? I'm not sure if it has.

SPEAKER1 24:28 Do you think there's much connectivity between the different departments because you've got your sort of supervisors of firms, although they may be in a port supervision and the markets reporting team, do you think there's much crossover there? Or is it being your sense that it's quite siloed?

SPEAKER2 24:42 I think it's quite siloed, which is a bit of a shame

SPEAKER2 24:45 because it

SPEAKER2 24:47 takes a lot to actually understand the data. So, when I was there, that's going back quite a long time. We did get a lot of questions from supervisors about

SPEAKER2 25:01 the data are

SPEAKER2 25:02 probably not enough questions. So even back in the day, I was quite surprised that supervisors weren't using the data. And of course, that idea of having a supervisor now that's getting more and more watered down. So, a lot of firms don't have a name supervisor. It's just a general contact centre.

SPEAKER1 25:31 Yeah, no, I've seen that myself. I mean, very few I think certain firms, they tend to be I think they call it fixed and flexible or something.

SPEAKER3 25:38 Yeah, yeah.

SPEAKER1 25:40 And if you're a big player in a pool of firms, you'll get a lot more attention. But the same supervisor will look after a group of supervisors, look after the smaller firms as well, maybe have less conversations with that, fewer conversations with them.

SPEAKER2 25:55 Yeah, and I don't know about the systems. Of course you can't.

SPEAKER2 26:01 People submit 50 million

SPEAKER2 26:04 transaction reports every day. So, the systems are all important.

SPEAKER2 26:08 And again, it's going back

SPEAKER2 26:10 quite a long time

SPEAKER2 26:11 now, but our systems

SPEAKER2 26:13 at the time

SPEAKER2 26:14 were more they being

SPEAKER2 26:16 attuned to market abuse rather than market manipulation rather than conduct risk. And even then, I mean, thinking about if you think well of the FCA announcements. What market

SPEAKER2 26:35 abuse successes

SPEAKER2 26:37 that they had since MIFIR and it's less than they had with MiFID, I'm sure of it, so we're not seeing the results.

SPEAKER1 26:52 That's what I find quite intriguing, because, you know, this is something which has come up in other interviews actually is how horrific the US authorities are in identifying, finding, banning. I mean, they tend to do it more exchange level. But you'll see quite often there'll be somebody getting skewered for Larry and spoofing as an example on this on CME and they will get a 90-day ban and a fine or something.

SPEAKER2 27:21 I can't remember seeing a manipulation case since MiFIR or I could be wrong, but I can't remember one and. When it's markets sorry, when it's insider dealing, I think there's only been a couple and there is a long lead time to some of these cases, but it's pretty disastrous, really. If you look at what is the outcome of all the states, or I just can't see.

SPEAKER1 27:56 Yeah, it's interesting as well, because, you know, we've got a civil enforcement regime. One of the regimes that we've obviously we've got the criminal regime for insider dealing as well, but we've got civil enforcement regime for things like market manipulation. And in theory, it should be easier to bring a case because you have a low evidential standard.

SPEAKER2 28:19 That's when I was there. That was our great

SPEAKER2 28:22 hope that

SPEAKER2 28:23 the threshold for the civil cases was exactly the same as it was for the criminal cases. It was never a balance of probability.

SPEAKER1 28:35 So, in practice,

SPEAKER2 28:37 it was

SPEAKER2 28:39 the thresholds were the same. That's one of the big disappointments that we found.

SPEAKER1 28:45 And that I would presume that's because of the human rights legislation, I would presume.

SPEAKER2 28:50 I don't know. I'm afraid I wouldn't be surprised. But yeah, I think I know the FCA was disappointed.

SPEAKER1 28:59 Do you think the FCA might? Do you think there's any way because of Brexit that the FCA may reconsider its reporting?

SPEAKER2 29:09 Yes, I think that the FCA

SPEAKER2 29:13 did

SPEAKER2 29:13 have a major hand in the legislation, but there were some elements that it wasn't keen on. And one of the ones that it was quite vocal on was the short selling indicator. As good luck would have it, the short

SPEAKER2 29:28 selling

SPEAKER2 29:30 indicator is going to go and the next version of the regulation. But the FCA has a tough job. It wants to be proportional, but it also wants to be equivalent to the EU regulation. And that equivalence may not

SPEAKER2 29:49 imply complete alignment, but I

SPEAKER2 29:53 wouldn't be surprised if the

SPEAKER2 29:55 FCA does

SPEAKER2 29:57 diverge from the EU. I think it's far more likely with any trade reporting, but I think there is scope there and also with MIFID transaction reporting data to not go its own way but diverge from the excellent.

SPEAKER1 30:21 Okay. That they that concludes my questions and I just I'm just going to stop the recording. Thank you very much for that. And I stop the recording now. I'll switch off.