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Sungard Kiodex Preps for MiFID Impact on Commodity Derivatives

As the April 30 deadline for the call for evidence on a review of the regulatory framework for Europe's commodity and exotic derivatives business approaches, Sungard's Kiodex division has been working with its European customers to ready its commodity derivatives solution for the impact of MiFID on this business.

Kiodex provides a web-based commodities risk management solution that integrates deal pricing and capture, valuation models, risk measurement and financial reporting. It also carries market data, including representative prices, volatilities and volatility skews across European and global commodities markets. Users of Kiodex Risk Workbench include banks, hedge funds, FCMs and participants in the energy, transportation, chemical, mining and metals, manufacturing and construction industries. It counts as clients Deutsche Bank, Man Financial, HVB Group, Merrill Lynch, NordBank and Prudential, among others.

The European Commission's call for evidence comes in light of the fact that MiFID – and the recast Capital Adequacy Directive – require a review of the regulation of the commodity derivatives business. A number of issues are up for review regarding the provision of investment services in relation to commodity and exotic derivatives. They include: whether the current exemption of some parties active in the commodity and exotic derivatives markets from the scope of

MiFID remains valid, and whether further changes to the MiFID framework are necessary; a re-examination of the provisions relating to criteria for determining which OTC derivatives contracts relating to commodities and exotic derivatives are to be treated as financial instruments for the purposes of MiFID; and whether it is desirable to amend MiFID to create a further category of investment firm whose main business consists exclusively of the provision of investment services in relation to derivatives relating to energy supplies.

The Commission has requested the assistance of CESR in fact-finding as it continues its preparation to report next year to the European Parliament and Council of Ministers on the scope of regulation for the commodity derivatives business in terms of instruments and persons.

As part of its MiFID-related efforts, Sungard Kiodex recently hosted a webinar exploring how commodity trading activities, instruments and firms could be affected by the directive. Though they are excluded from the November 2007 enforcement, as a result of the review under way firms trading commodities in the EU may need to change their business processes in 2008. In preparation for this Sungard Kiodex has already commenced work in a number of areas, including pre- and post-trade pricing, electronic reporting and retention of transaction data.

Leslie Barbagallo, senior vice president at Sungard Kiodex, says that while MiFID is not an issue for its corporate and hedge fund clients, its bank and investment management clients do fall in scope of the directive. "There are two categories – the banks that are already covered by MiFID, and the commodity dealer specialists that for the moment have been exempted. This is under review, however."

One area Kiodex has addressed to date is transaction reporting, she says. "Kiodex already supported electronic reporting. What we are trying to do is keep ahead of the requirement for new fields. Not all transactions need to be reported – it depends on who the counterparty is – so we are adding fields to enable users to split out transactions accordingly."

Adding fields is not the major challenge, Barbagallo says. "The harder thing is the audit trails and the ability to track the trade throughout its lifecycle. We will release new functionality to add to the existing audit trails with a price tracking trail."

Another focus for Kiodex is to expand its market coverage both on the exchange-listed and OTC sides. "We do want to be a one-stop shop for European commodity derivatives," she says. "We have added literally hundreds of commodities in the past 12 months."

Kiodex has also put effort into improving the performance of its

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system, which will place it in a strong position if MiFID has the expected impact of reducing transaction sizes and increasing volumes, and will also support real-time reporting if required. Further work will centre on recordkeeping, Barbagallo says, adding that a significant challenge to be faced if MiFID does begin to bite in the commodity derivatives business is the lack of a standard instrument identifier.

“For the equity market there are ISINs, but for commodity derivatives no such identifier exists,” she says.

“We are hopeful that there will be some clarity on that, and that there will be a pan-European solution as opposed to national codes.” The other challenge Barbagallo identifies is reliance on the timely publication by regulators of their exact requirements. “It is easy to add fields,” she says, “but we do need the time to add them and then test them.”