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 **NORTON ROSE FULBRIGHT**

MiFID II / MiFIR – the road ahead

Financial Services 40 minute briefing

Financial Services Partners
Norton Rose Fulbright LLP

6 April 2016

Where are we up to with MiFID II?

The delay

Commission proposals:

- Commission has proposed a one year delay in the application date (i.e. 3 January 2018)
- European Parliament has agreed to the delay but added a legislative resolution that the date by which Member States must publish laws necessary to comply with MiFID II also be delayed by a year (i.e. 3 July 2017)
- Unclear exact timescale EU institutions are working to but agreement expected early summer

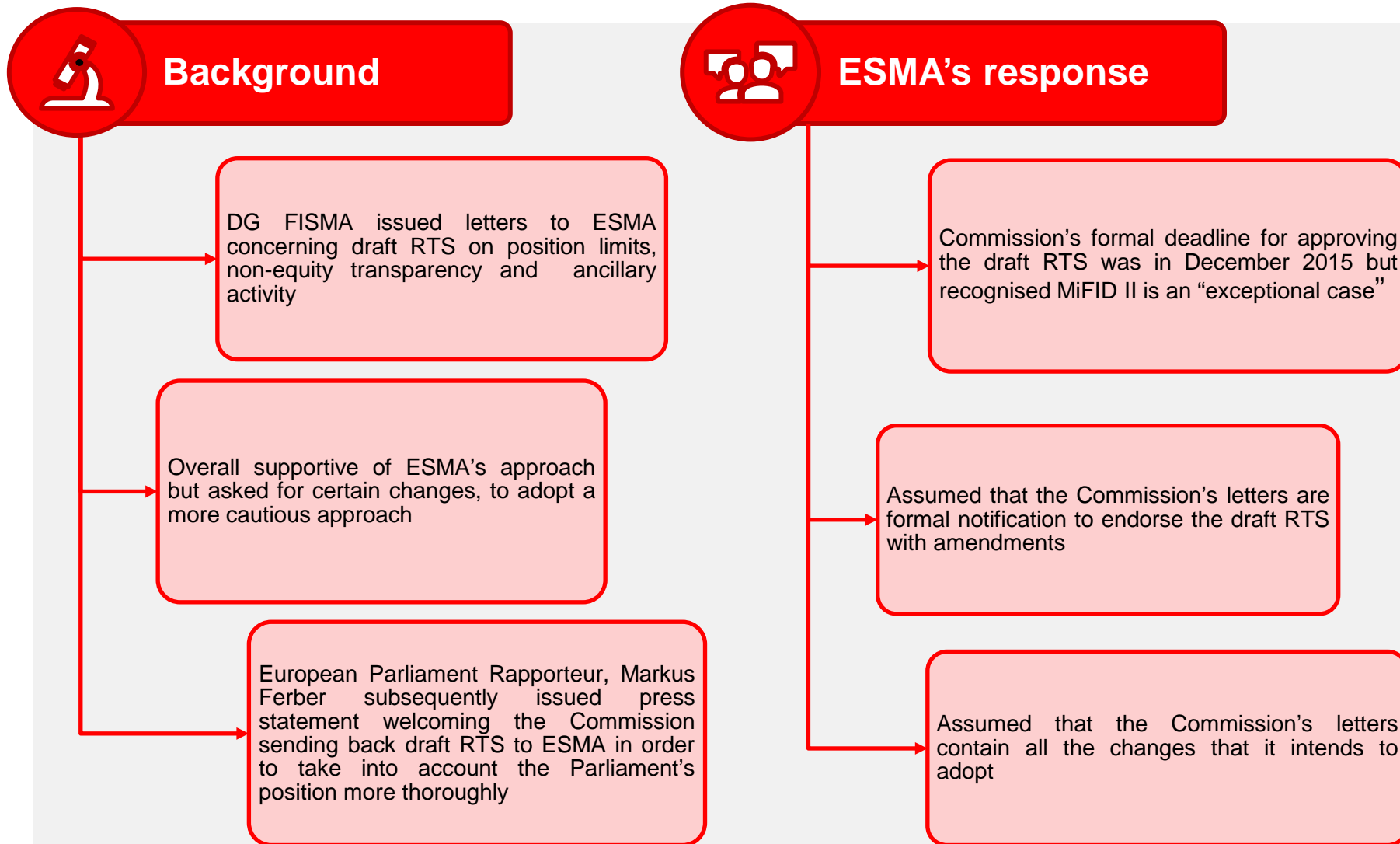
Impact on MAR:

- Still applies from 3 July 2016
- The concepts and rules as set out in MiFID I should be used until 3 January 2018
- MAR provisions referring to MiFID II concepts (OTFs, SME growth markets, emission allowances or auctioned products) will not apply until 3 January 2018

Impact on CSDR:

- Again, the concepts and rules as set out in MiFID I should be used until 3 January 2018

RTS and ITS: Commission and ESMA



Draft RTS on transparency requirements in respect to bonds, structured finance products and emission allowances

Issue

- Determining a bond (ISIN) as liquid on the basis of two trades per day might not reflect the existence of continuous buying and selling interest and might identify too many bonds as liquid instruments

Approach

- To better align with other non-equity instruments, DG FISMA recommends a phase-in of thresholds over four years as follows:
 - Year 1: 15 trades per day
 - Year 2: 10 trades per day
 - Year 3: 7 trades per day
 - Year 4: 2 trades per day

Testing

- ESMA would be obliged to assess liquidity in all classes of bond markets annually – this would include:
 - verification that the intended ISIN coverage ratio emerges once officially reported data under MiFID II becomes available
 - trading volumes and number of trades
- It would not be possible to move to the next threshold if trading volumes have declined

SSTI thresholds

- Commission is also concerned that the proposed SSTI thresholds might expose liquidity providers to undue risk and also suggests a more cautious, phased in approach for both bonds and other non-equity asset classes that currently use the 60th percentile:
 - Year 1: 30th percentile
 - Year 2: 40th percentile
 - Year 3: 50th percentile
 - Year 4: 60th percentile
- All current cash floors would stay in place during the phase-in period
- Again, ESMA would need to regularly assess the operation of liquidity providers to ensure the increases do not pose undue risks

Draft RTS on criteria for establishing when an activity is to be considered to be ancillary to the main business

The RTS lays down two tests:

- A market share test which compares the level of a person's trading against the overall trading activity in the Union on an asset class basis
- A main business test which determines the extent to which the activity of the persons within the group, who trade on own account or provide investment services in commodity derivatives constitute a minority of activities at group level

DG FISMA considers that the main business test ratio employed by ESMA:

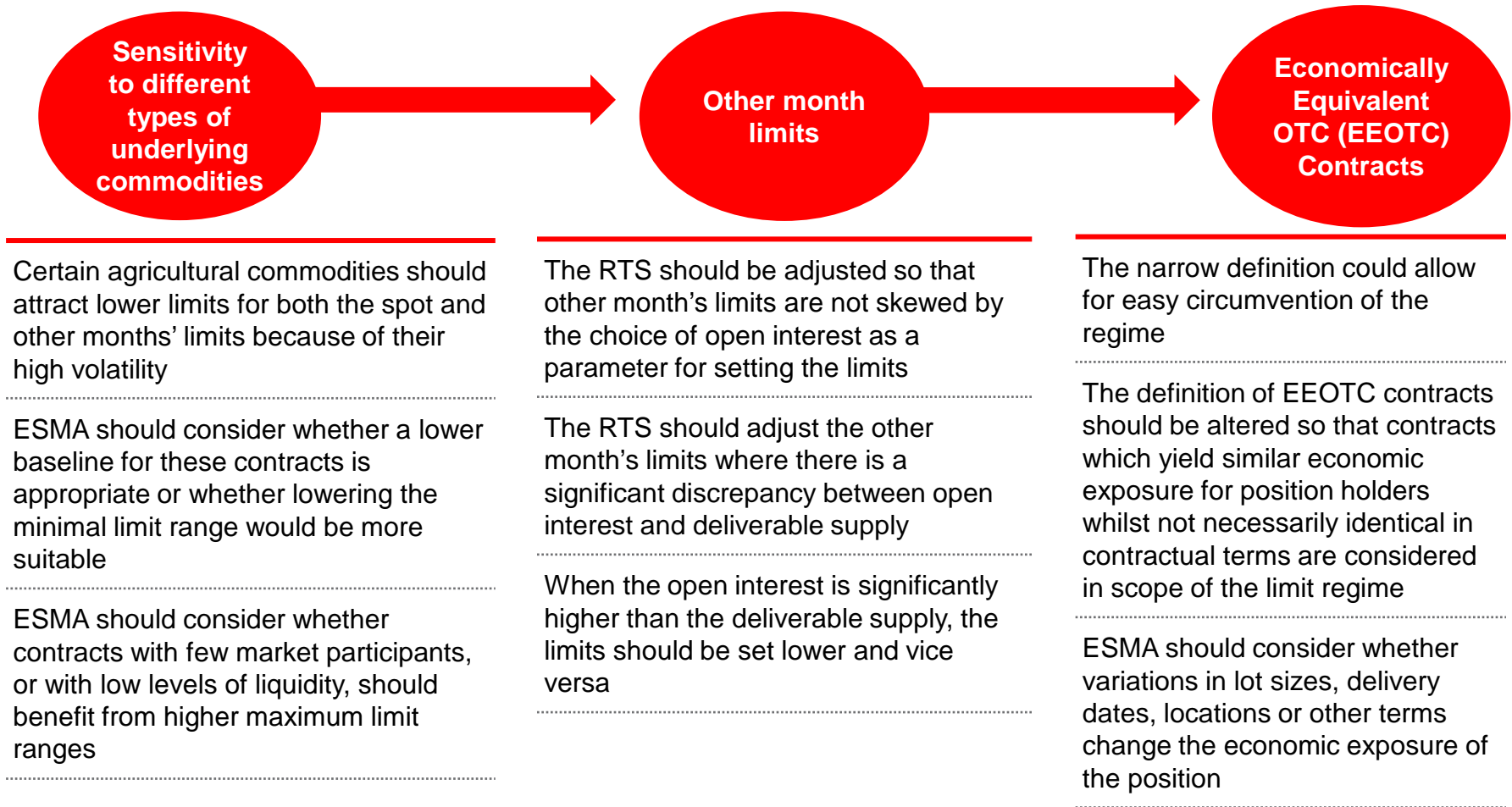
- Does not necessarily represent a group's commercial activity because commercial entities employ various means to hedge their business activity, including physical or financial means other than commodity derivatives
- Does not take into account commercial activities which do not require hedging or cannot be hedged
- Neglects considerable investments that are not reflected in corresponding hedging positions

DG FISMA suggests that:

- The main business test should consider a wider range of factors when determining the extent to which activities constitute a minority of activities at a group level
- Capital employed is an important parameter that should only be set aside if manifestly unsuitable to determine the "centre of gravity" of a group's business activities and ESMA has no evidence to suggest that it is manifestly unsuitable
- The capital test should be available for entities that have undertaken significant capital investments in the creation of infrastructure, transportation and production facilities

Draft RTS on the application of position limits to commodity derivatives

In order for the draft RTS submitted by ESMA to take full account of the objectives, the following amendments are required:



Regulatory update

- The FCA's second consultation paper on investor protection issues is expected to be published in the first half of 2016
- Commission informed Member States that it intends to submit both delegated acts and RTS to the Council and Parliament in July 2016
 - Draft copies were leaked in December 2015, indicating the Commission had eased restrictions around payments for certain types of research, and paved the way for the continued use of Commission sharing agreement
 - The delays in approving MiFID II's final delegated acts and technical standards will also have an impact on Europe's national regulatory bodies that are technically required to turn these standards into national law by June 2016
- Feedback to the HM Treasury's consultation on the Transposition of MiFID II:
 - **Third countries:** It might be prudent if HM Treasury considered reviewing its position 3 years from the implementation of MiFID II, to examine the actual use of the third country equivalence regime
 - **Data reporting services:** It does not seem appropriate to include DRSs in the scope of regulated activities since the regime applicable to them under MiFID II is distinct from that applicable to investment firms offering the investment services. This should be reflected in the UK implementation to keep the provision of DRSs as a separate regulatory concept from investment services
 - **Position limits and reporting:** It is important that the implementing legislation uses a more useful and correct definition to "commodity derivative" so that it, and the ESMA RTS 29, only apply a position limits and reporting regime to commodity derivatives
 - **Unauthorised persons:** It is unclear why Regulation 12 (DEA provision) has been included, as it appears to contradict MiFID II Article 48(7) which suggests that only authorised investment firms and credit institutions should be able to provide DEA to regulated markets
 - **Organised trading facility:** It would be consistent with the existing inclusion of operating an MTF under Section 25D of the RAO to include operating an OTF in a similar manner
 - **Power to remove board members:** Current FSMA powers would allow the FCA to direct a recognised body to remove a director. If HM Treasury considers that may not be sufficient, including whether such removal could be sufficiently 'immediate', extending the approved persons regime would not be ideal

FCA MiFID II consultation paper I: Overview

Issues related to the FCA's regulation of the secondary trading of financial instruments

- Some points may be impacted by as yet unpublished EU legislation and guidance

The FCA's approach is to not to copy Regulations into the handbook but rather to refer to them

- There may be exceptions where FCA needs to exercise a discretion – i.e. it proposes to apply waivers and deferrals from transparency obligations
- This means firms will need to look at levels 1 to 3 of the EU legislation and UK implementing legislation (for the Directive), as well as the FCA Handbook
- There are a few apparent additions – i.e. notifications to and cooperation with the FCA
- Note also new rule to apply MiFIR and level 2 regulations to third country investment firms when doing MiFID or equivalent business from a UK establishment

This consultation has closed. The FCA will publish its rules in a policy statement in the first half of 2016

- FCA will also consult on the conduct issues covered in DP15/3

FCA MiFID II consultation paper I: Some highlights

Trading venues and data reporting service providers

- Special MiFID Guide explaining how different pieces of legislation fit together
- New chapters in MAR for OTFs and DRSPs, and amendments to others and REC to implement provisions in Directive
- Restriction does not prevent an MTF operator from executing orders against proprietary capital or matched principal trading outside its MTF
- Existing ARMs and TDMs will need to apply to become DRSPs

Wider set of principles to apply to MiFID ECP business

- 6 on treating them fairly and 7 on communications
- 1 on integrity and 2 on skill, care and diligence
- 8 on managing conflicts

PERG

- FCA admits that extension of executing client orders to include issuing own securities raises difficult questions
- New guidance that a multilateral system exists if trading interests are able to interact, which could mean just the exchange of information about key terms
- Persons who satisfy the MiFID definition are market makers even if they are not under an obligation to quote
- FCA's view about how overlapping legislation on emission allowances works

FCA: latest FCA MiFID II implementation minutes



- The debate about using the delay, legislation to make substantive amendments seemed to be focussed on:
 - the application of pre-trade transparency to package transactions
 - the change in article 2(1)(d) to allow commercial firms to be members or participants in FX venues without being required to be authorised
 - whether the reference data requirements in MAR could also be delayed



- A question was raised about press reports that a leaked version of the delegated acts showed the Commission possibly narrowing the scope of instruments judged to be complex for the purposes of the appropriateness test
- The FCA said that it was necessary to wait for the official texts to see what the legislation states. As a general point, if the Commission had departed from ESMA's advice in the delegated acts, it would be necessary for it to explain the changes it had made



- Many Member States have expressed concern about the Commission's proposal to use only Regulations for the delegated acts. In particular, Member States have pushed for conduct and client asset matters to be included within a Directive
- In terms of level 3 work, although a preference for guidelines was expressed because they involve consultation, the FCA noted that they would take longer and firms are pressing for certainty ASAP. ESMA will approach this issue on a case by case basis
- FCA intends to provide clarity on transposition once it has certainty on level 2

PRA paper: Passporting

- CP9/16 Implementation of MiFID II: Part 1
 - Proposal 1: Extension of scope and harmonisation of the passporting regime
 - Proposal 2: Systems and controls for firms which undertake algorithmic trading and provide direct electronic access to trading venues
 - Consultation closes 27 May 2016
 - Further consultations expected

Passport notifications

MiFID II extends the passporting regime by extending the range of investment services and activities that can be passported: operating an OTF and emissions allowances

Dual regulated firms will need to notify the PRA if they wish to include these new activities and/or investment types – this will be treated as a change in particulars

Firms will need to use the appropriate notification form: the PRA proposes to delete its MiFID notification forms and insert a link in its Rulebook to the EU notification forms on the Commission's website

Interaction with CRD IV

PRA proposes to extend the current declaration form that is used for passport notifications under the CRD IV to MiFID II passport notifications but not to make any change to the process for firms passporting MiFID activities under CRD IV

PRA paper: Algorithmic trading and DEA

General

- PRA proposes to create a new Algorithmic Trading Part of the PRA Rulebook: rules are related to but do not replace the existing rules on CRR firms' systems and controls
- PRA's proposals closely mirror those in the FCA consultation paper but there are subtle differences primarily based on the different statutory objectives of the regulators
- Notification requirement under Article 17(2) MiFID II is being consulted on by the FCA and the PRA proposes the FCA to be the appropriate authority

Algorithmic Trading

- Firms engaging in algorithmic trading should ensure that their trading systems:
 - are resilient and have sufficient capacity
 - are subject to appropriate trading thresholds and limits
 - prevent the sending of erroneous orders or contribute to a disorderly market
- Firms to have business continuity arrangements in place in the event of a failure: arrangements should be fully tested and monitored
- Record keeping requirements for firms engaging in high frequency trading

Direct Electronic Access

- Proposals require firms to put in place systems and controls; to review the suitability of clients using this service, prevent clients from exceeding appropriate pre-set trading and credit thresholds; and prevent trading by clients which may create risks to the firm
- Record keeping obligations that describe its systems and controls to comply with the PRA rules, evidence that the systems and controls have been applied and "on other relevant matters"

Third country firms – what should they be thinking about

Access to the EU by third country firms: the UK view

Retail & Opt Up Professional

Authorised branch

- Harmonises rules across the EU
- Inter-regulator MOU
- No passport

National regime

- Maintains current position
- Rules likely to differ across EU
- No passport

Member States can elect to use either MiFID authorised branch or a national regime

Professional & Eligible Counterparties

ESMA Register

- No branch
- Equivalence
- Reciprocity
- Submit to jurisdiction
- Passport

Authorised branch

- Harmonises rules across the EU
- Inter-regulator MOU
- Passport

National regime

- Maintains current position
- Rules likely to differ across EU
- No passport

Member States must permit use of the ESMA Register unless no positive equivalence decision is in effect

The basics of the third country regime

Article 39 MiFID II sets out certain conditions for a Member State's authorisation of a branch, which apply where a Member State chooses to require third country firms to establish a local branch in order to provide investment services or perform investment activities with or without any ancillary services to retail and/or elective professional clients in its territory

FCA consulting on not implementing Article 39 MiFID II

Article 46(1) MiFIR sets out a requirement for certain third country firms to register with ESMA. Subject to an equivalence assessment being undertaken by the Commission, Article 46(1) MiFIR provides that a third country firm may provide investment services or perform investment activities with or without any ancillary services to ECPs and per se professional clients established in the EU without the establishment of a branch where it is registered in the register of third country firms kept by ESMA

Buy-side space: Third country issues under MiFIR

- MiFIR makes it clear that Member States will not be able to impose any additional requirements on any third country firm
- A third country firm could face at least three issues:
 - MiFIR is silent as to whether a third country firm that is also an AIFM may be entered on the ESMA Register. Whereas the common lawyer's response is that this means that ESMA is free to register such a third country firm, there is the risk that ESMA would look for an express power before registering an AIFM
 - Articles 39 and 40 of AIFMD provide third country firms with passport rights with respect to any type of Recast MiFID Professional Client, the MiFIR passport will be restricted to services provided to ECPs and per se professional clients. In practice this means that a third country firm would be limited to offering investment services to professional investors properly-so-called, institutional investors and national and regional governments. It could not offer such services to, for example, high net worth individuals or local public authorities and municipalities
 - The MiFIR passport will only be available three years after the Commission has made any equivalence decision. Bearing in mind that MiFIR is only due to come into force in early 2018, and in light of the process set out in Article 5 of Regulation 182/201, to which the MiFIR equivalence decision provisions cross-refer, the process is unlikely to be swift

Unpacking the issues for firms

- A number of hot topics on the ESMA registration process:
 - Will ESMA adopt the literal equivalence approach or the EMIR style policy equivalence plus top up
 - The comparison of capital requirements is particularly sensitive as some non-EU countries have a different and lighter approach
- Pre-equivalence, will current domestic regimes continue to permit access? HM Treasury has indicated that the overseas persons exclusion will continue to apply
- Post equivalence, can a third country firm operate an MTF or OTF and what does this mean for the concept of trading venue and equivalent third country markets?
- There is a genuine debate about when a cross border service is being provided in the markets space but in reality any dealing with an EU counterparty will bite
- Note that the regime applies even to performing investment activities with EU professional clients and ECPs

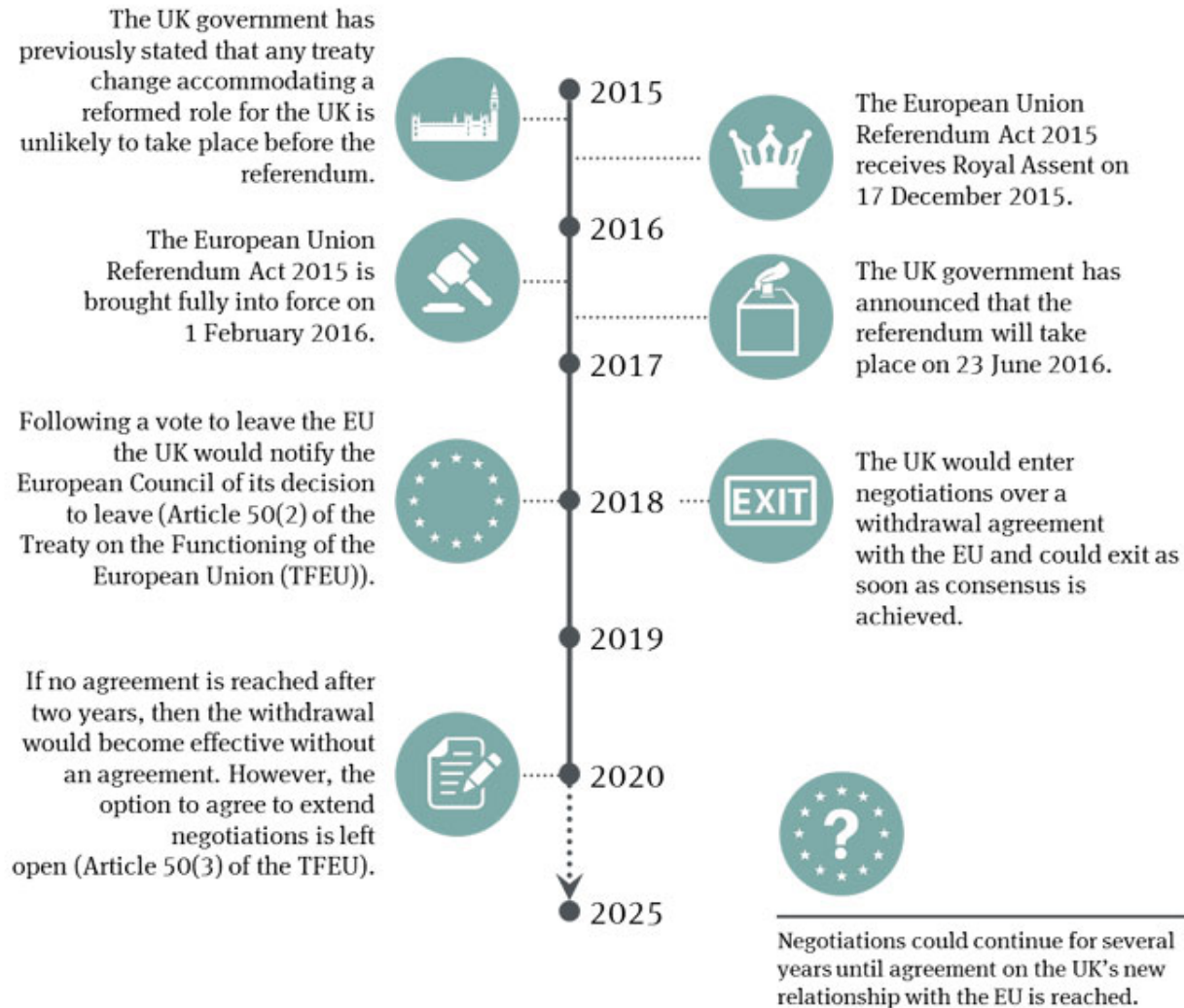
MiFID and the Brexit cross-roads: what are the potential implications?

What is the current state of play?

- 23 June 2016, Referendum: 'Should the United Kingdom remain a member of the European Union or leave the European Union?'
- The official referendum period commences on 15 April, but there has already been significant debate and press coverage
- Current opinion polls suggest the vote may be tight



What happens next if there is a vote to leave?



What are the options for the UK after the vote?

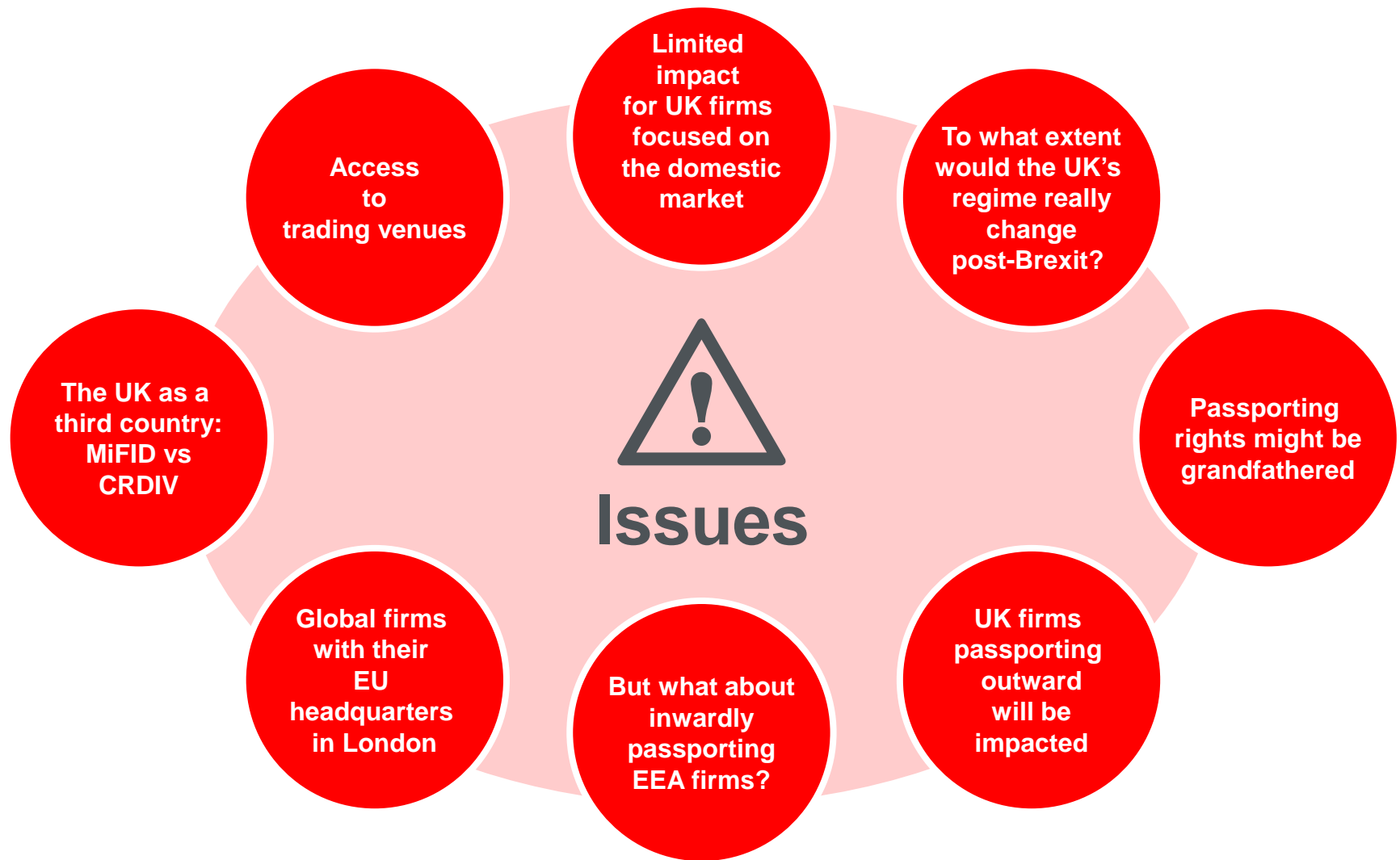
“In” scenario

- **Reformed EU:** the UK votes to stay in the EU after extensive reforms and/or opt-outs are negotiated
- **Potential implications:** multi-speed Europe (other EU countries integrating at a different level and pace to the UK), with the UK gradually diverging from the ‘core’ EU

“Out” scenarios

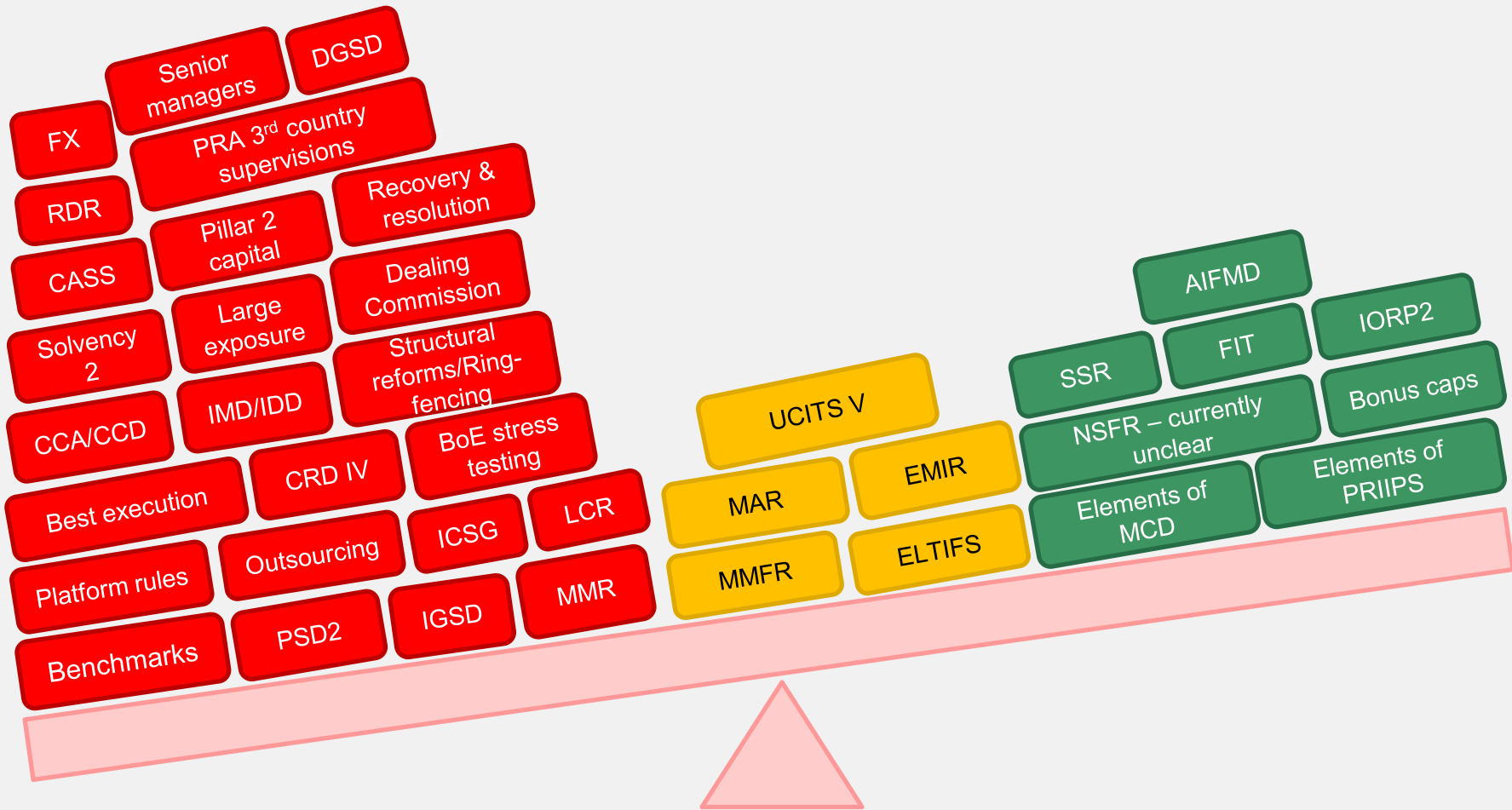
- **The Norwegian model:** the UK is part of the EEA and EFTA. It continues to have full access to the Single Market, but must adopt EU rules.
- **Potential implications:** UK will need to make a substantial contribution to the EU budget; no formal seat at the EU table; and issues concerning compliance with measures produced by ESAs need to be dealt with
- **The Swiss model:** the UK is part of EFTA and negotiates a series of bilateral agreements with the EU (or a new comprehensive agreement)
- **Potential implications:** the UK could have some access to the Single Market, at the cost of adopting the relevant EU regulations; note Switzerland does not have a bilateral agreement on financial services
- **No access agreement:** the UK does not establish any new trade agreements with the EU
- **Potential implications:** only WTO terms are still applied – UK goods and services would be treated in the same way as, e.g., those from the US are. However, new agreements possible with third countries as UK may negotiate these bilaterally

The MiFID angle: What are the potential implications?



Brexit: Creating blocks of regulation

- UK “gold-plates” EU/has stated intention to do so/is constrained
- UK/EU broadly equivalent stances
- UK desires different or lighter regulatory regime than EU



The future of passporting for a post-Brexit UK

In the event of Brexit, the key question is whether passporting rights would continue to exist, such that UK firms would still be able to passport into other EEA countries and vice versa

There might also be grandfathering and transitional provisions

The answer to this question is potentially yes, under the Norwegian model in particular

If the passport were to lapse, affected firms would need to consider how their business models and group structures may need to change

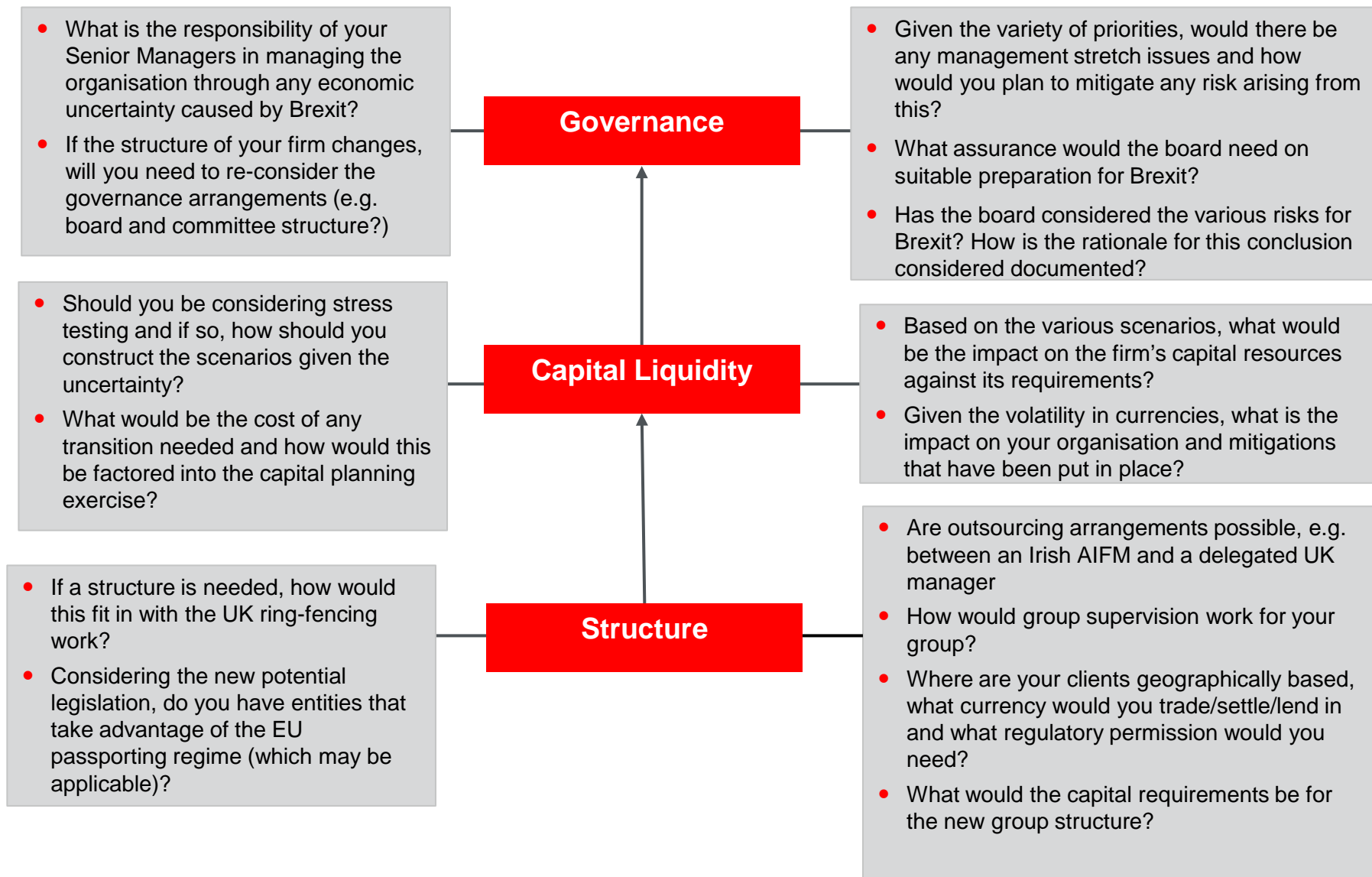
For those passporting into the UK on a cross-border basis, the operation of the overseas persons exclusion will be key

Firms passporting into the UK via a branch may need to obtain a separate UK authorisation. Would the UK consider providing for a streamlined authorisation process?

Outwardly passporting UK firms would need to consider similar issues – the UK would be a third country for purposes of MiFID II (though note that there is no similar third country access regime for banking services under CRDIV)

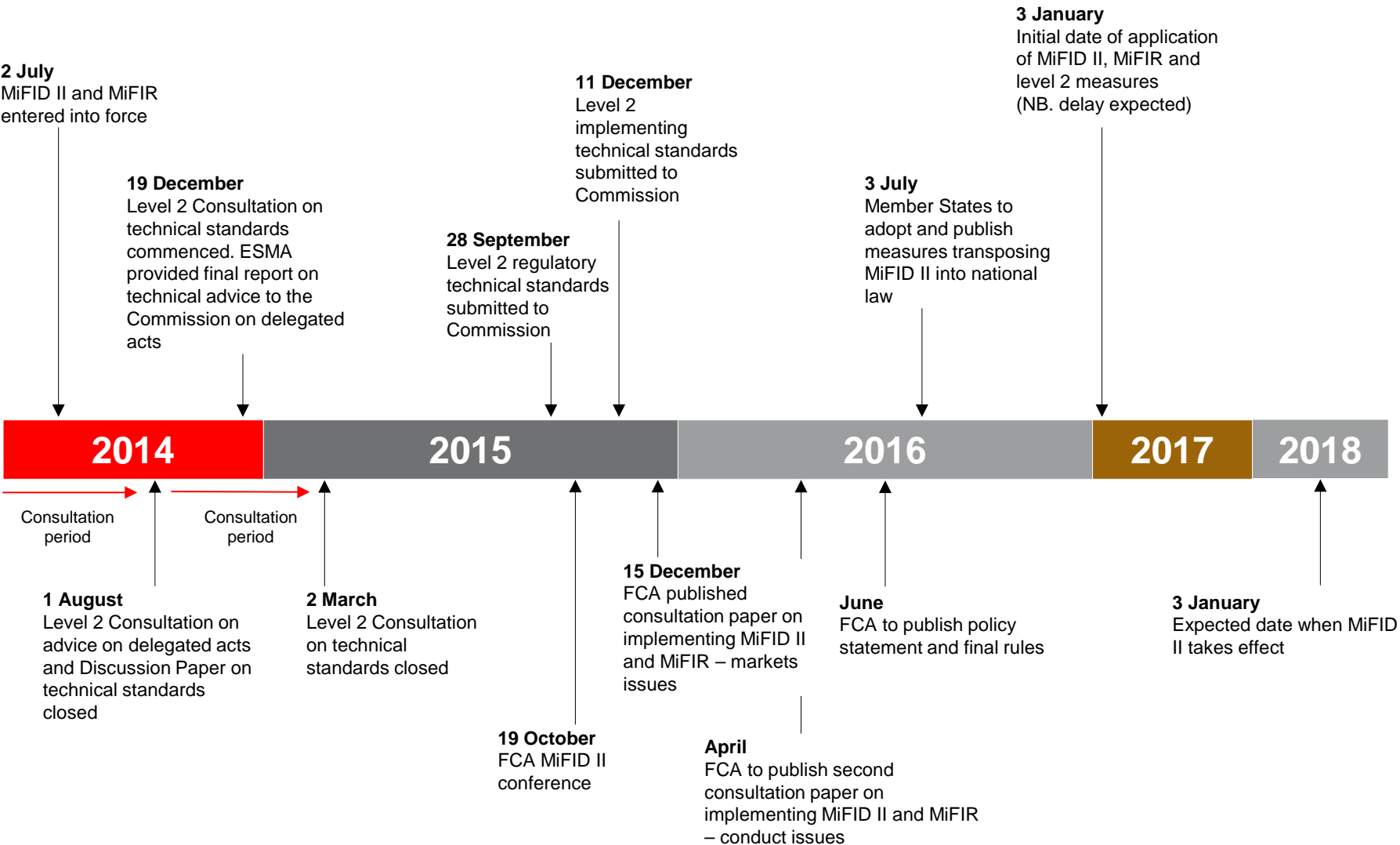
There are those who argue that loss of the passport system for UK financial institutions would be likely to trigger some migration of global firms' EU headquarters away from the UK. However, all may depend on what replaces this and whether there is a new bilaterally negotiated passport

Brexit: Your ability to do business



MiFID II / MiFIR implementation projects

Timing: MiFID II / MiFIR





MiFID II: What is the purpose of the delay?

FACTS

- The reason for the extension lies in the complex technical infrastructure that needs to be set up for the MiFID II package to work effectively
- ESMA has to collect data from about 300 trading venues on about 15 million financial instruments. To achieve this result, ESMA must work closely with national competent authorities and the trading venues themselves
- However, the Commission was informed by ESMA that neither competent authorities, nor market participants, would have the necessary systems ready by 3 January 2017, the date by which the MiFID II package was initially scheduled to become operational



IMPACT

- This extension will not have an impact on the timeline for adoption of the 'level 2' implementing measures under MiFID II/MiFIR. The Commission will proceed with their adoption irrespective of the new date of entry into application of MiFID II. This will provide legal certainty for the new provisions



RESULT

- The extension of the deadline is strictly limited to what is necessary to allow the technical implementation work to be finalised



KEY MESSAGES

- Although there has been a breathing space provided, firms subject to MiFID II / MiFIR still have a lot of work that they can be getting on with to ensure that they are ready for the delayed implementation date
- Don't expect much sympathy from the regulators if you are not ready by the new implementation date

What we are seeing and the challenges

Scope management

- Needs to be managed robustly
- Acknowledge uncertainty and allow flexibility

Key questions

- What is your business?
- Who are your clients?
- Who else do you rely on?

Resourcing

- Need sufficient, deep organisation experience – use third parties to backfill BAU roles and second staff onto project
- Think ahead to what additional resources you may need
- Beware of split ops/ project roles – conflicts

Prioritisation:

- Where do we need to make decisions?
- What issues affect everything else?
- What dependencies do you have on others?
- Do you need to make any applications to regulators?
- Parallel options

**What are we seeing?
What are the challenges?**

Different ways of dividing the work

- Markets v investor protection
- Different instruments / desks
- Organisation v transaction level
- Discrete projects – e.g. MTF / SI, terms of business

Complexity

- Leads to uncertainty in itself
- Cannot solve all problems upfront – look for iterative approaches
- Learn from mistakes – acknowledge and understand what doesn't work

Angles to consider

- Your own perspective
- What your clients need
- How your service providers may change – what do you need to know about their plans?

Beware of silos

- Existing organisational silos will impact MiFID II projects
- Avoid creating a further silo MiFID II project team or silos within the team
- Avoid silos of project v post-project operations

MiFID Manager

Hard copy booklet

MiFID I covered

High level impact statement

Last Updated 1 January 2015

MiFID Manager – Investor Protection

Will include RTS text once issued

MiFID I	MiFID II	FCA
Conflicts of Interest		
<p>Levels 1 and 2 (Art 13(3) and 18 MiFID and Arts 21 - 28 MiFID Imp Dir)</p> <p>Level 1 (summary):</p> <ul style="list-style-type: none"> maintain and operate effective organisational and administrative arrangements with a view to taking all reasonable steps designed to prevent conflicts of interest from adversely affecting interests of its clients identify conflicts of interest that arise from the business conflicts of interest defined in Art 18 as including conflicts (i) between themselves (their managers, employees and tied agents, or any persons linked to them by control) and their clients; or (ii) between one client and another where arrangements are not sufficient to ensure with reasonable confidence that the risk of damage to clients will be prevented, disclose the general nature and/or sources of conflicts before undertaking business <p>Level 2 (summary):</p> <ul style="list-style-type: none"> detail on how to identify a conflict of interest (ones that are potentially detrimental to clients) establish, implement and maintain a written conflicts of interest policy (proportionate) and detail on what it must address and 	<p>Level 3 and Local Implementation</p> <p>Level 3</p> <p>Various CESR (now ESMA) recommendations on conflicts of interest</p> <p>Local Implementation Summary</p> <ul style="list-style-type: none"> reflects MiFID almost verbatim extended to also apply to UCITS management companies and AIFMs all other firms to take various parts of it into account as 'guidance' over-reliance on disclosure, without adequate consideration of managing/preventing conflicts, is not permitted <p>Rules/Guidance</p> <p>SYSC 10</p> <p>COBS 6 and 12</p> <p>Principle 8</p> <p>Finalised Guidance (FG14/1)</p> <p>Finalised Guidance (FG 13/1)</p> <p>Finalised Guidance (FG 12/13)</p> <p>Policy Statement (PS 14/7)</p> <p>Finalised Guidance (FG 12/16)</p>	<p>Level 1 (Final)</p> <p>No changes from MiFID 1</p> <p>Text not replicated as no changes but location is:</p> <p>Article 16(3) - organisational and administrative arrangements.</p> <p>Article 23(1) - identify and prevent / manage conflicts. A conflict includes those caused by the receipt of inducements from third parties or by the firm's own remuneration and other incentive structures.</p> <p>Article 23(2) – disclosure (in a durable medium).</p> <p>Express statement that one type of conflict is the receipt of inducements from third parties or by the firm's own remuneration and other incentive structures.</p> <p>With MiFID II now applying to investment firms and credit institutions selling their own securities, enhanced conflicts.</p>
	<p>Level 2 (ESMA's Final Advice)</p> <p>Significant changes to Level 1</p> <ol style="list-style-type: none"> ESMA considers that Article 22 of the MiFID Implementing Directive on conflicts of interest policies should be amended by inserting new provisions in relation to the disclosure of conflicts of interest. The following proposals are not intended to replace the existing provisions on conflicts of interest, but rather to clarify or supplement the existing regime. Investment firms should ensure that disclosure to clients, pursuant to Article 23(2) of MiFID II, is a measure of last resort that can be used only where the effective organisational and administrative arrangements established by the investment firm to prevent or manage its conflicts of interest in accordance with Article 23 of MiFID II are not sufficient to ensure, with reasonable confidence, that the risks of damage to the interests of the client will be prevented. When disclosure of specific conflicts of interest is required, the disclosure shall clearly state that the organisational and administrative arrangements established by the investment firm to prevent or manage that conflict are not sufficient to ensure, with reasonable confidence, that the risks of damage to the interests of the client will be prevented. The disclosure to clients 	<p>Will include RTS text once issued</p> <p>Includes change between initial and final advice as blackline</p> <p>Will include summarised FCA CP commentary once issued</p> <p>Will include Level 3</p>

Divided into topics

Local Implementation included

Either full text included or signpost included where no change from MiFID 1

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Heat Map

	Level 1 (final)	Level 2 (final TA)	Impact in UK
Client categorisation	Yellow	Yellow	Yellow
Client order handling	Green	Green	Green
Conflicts of interest	Green	Red	Red
Client assets	Green	Red	Yellow
Inducements (generally)	Green	Red	Red
Third Party Payments ban	Red	Red	Red
Record-keeping	Green	Yellow	Green
Suitability	Yellow	Yellow	Green
Complaints handling	Green	Red	Yellow
Clear, fair and not misleading communications	Green	Yellow	Yellow
Reporting to clients	Yellow	Yellow	Yellow
Appropriateness / execution-only	Yellow	Red	Red
Best execution	Red	Red	Red
Product governance and distribution	Red	Red	Yellow
Investment advice	Red	Red	Yellow
Product intervention	Red	Red	Green
Recording communications	Red	Red	Red
Remuneration	Red	Red	Yellow
Information to clients	Red	Red	Red
Dealings with eligible counterparties	Yellow	Yellow	Yellow

Key:  Significant change  Moderate change  Minor / no change

Level 1 (Final)

Client categorisation

- No change to client categories (retail / professional / eligible counterparty) or opting up procedures
- Discreet change to treat municipalities and local public authorities as retail clients by default, with ability to become elective professional clients
- National/regional governments and public bodies that manage public debt are not local authorities
- Member States have discretion to design the opt up procedure

Client order handling

- Requirement to disclose unexecuted client limit orders to the public extended to capture additional trading venues created by MiFID II
- ESMA was not asked to provide technical advice

Clear, fair and not misleading communications

- No direct change to current regime
- Extension of fair, clear and not misleading regime to eligible counterparties

Inducements (generally)

- Existing test for receiving third party payments remains – (i) enhance quality of service, (ii) be in clients' best interest; (iii) be disclosed
- **Minor** non-monetary **benefits** excluded from ban for independent advisers and portfolio managers
- Confirmation of disclosure requirements to clients – must be

Suitability

- Requirement to assess suitability of product when advising retail/professional clients remains
- If advising on bundled/package product, overall product needs to be suitable
- New requirement for a suitability report for retail clients

Conflicts of interest

- No change to existing regime
- Amalgamation of Levels 1 and 2 of MiFID I
- Express statement that conflicts arise from inducements and remuneration structures

Complaints handling

- No significant change to MiFID I
- Member States to notify ESMA of their out-of-court complaints and redress procedures - ESMA intends to keep a list on its website

Client assets

- No significant change to MiFID I

Third party payments ban

- New EU wide ban on payments being received and kept (or offset against fees owed to firms)
- Applies to retail and professional clients
- 'Minor non-monetary benefits' excluded from ban
- Member States can gold-plate

Appropriateness/execution-only

- Appropriateness test remains the same
- List of '**non-complex**' financial instruments on which appropriateness can be undertaken is narrowed
- Explicit statement of what is a '**complex**' product (including structured UCITS)
- Appropriateness test always required where 'credit' provided

Level 1 (Final)

Best execution

- Firms must publish top 5 execution venues actually used each year, and to notify execution venue used for each trade
- Must take “all sufficient” steps for best execution
- Firms that RTO/place to have execution policies
- Policies to be tailored and detailed and material changes notified
- Demonstrate best execution to regulators on request



Record-keeping

- No significant change to MiFID I
- Clarification that records are also required to allow regulators to fulfil their supervisory duties under other EU regulations and to demonstrate firms' compliance with rules related to 'market integrity'



Information to clients

- Existing requirements remain and enhanced for :
 - investment advice (with new '**independent**' advice)
 - financial instruments (to implement product governance requirements)
- costs and charges (aggregated and individual costs, provided 'in good time' and annually updated)



Recording communications

- Was optional, but now mandatory for certain firms to record calls and electronic communications that (could) result in a transaction
- Records to be kept for 5 / 7 years
- File note of face-to-face meetings with clients to be kept



Product intervention

- Completely new regime for national regulators to ban products and services
- Complete new regime for ESMA / EBA under MiFIR and EIOPA under PRIIPs to temporarily ban products and services on an EU wide basis or in specific Member States



Investment advice

- No change to definition of investment advice
- New concept of 'independent' and 'non-independent' advice
- Parameters set that need to meet to give 'independent' advice



Reporting to clients

- Existing reporting requirements remain
- Extended to require 'periodic' reporting
- Extends reporting requirement to also apply to eligible counterparties



Remuneration

- New requirements for investment firms
- Restrictions on incentive schemes, internal rewards and sales targets for staff
- New remuneration policy and procedure approved and overseen by senior management
- Focus on responsible business conduct, fair treatment of clients, avoiding conflicts of interest, clients' best interests



Dealings with eligible counterparties

- Exclusion from MiFID requirements for “eligible counterparty business” remains
- Recitals extend some investor protection requirements to ECPs as they are 'clients'
- Obligation to act honestly, fairly and professionally
- Obligation to communicate in a manner which is fair, clear and not misleading



Product governance and distribution

- New EU wide product governance and distribution regime
- Detailed obligations apply to product manufacturers and, separately, distributors



Level 2 (Final Technical Advice)

Client categorisation

- ESMA was not asked to comment on treatment of municipalities and local public authorities or their opting up procedure
- Firms which are eligible to become elective ECPs narrowed (elective professionals excluded)
- New procedure for opting up to ECP status – warnings need to be given, specific procedure adopted, written confirmation required

Client order handling

- ESMA was not asked to provide technical advice

Clear, fair and not misleading communications

- Targeted improvements to communications with retail clients (i.e. consistent language, indication of risks, kept up-to-date, performance scenarios)
- To improve treatment of non-retail clients, extending some 'retail-like' obligations to professional clients
- Confirmed technical advice does not apply to communications to eligible counterparties

Inducements (generally)

- Non-exhaustive list of when 'quality enhancement' test not met - firms must prove quality enhanced
- Exhaustive list of 'minor non-monetary benefit' - narrowly interpreted and strictly applied
- Inducements to be disclosed, individually priced
- Dealing commission paying for research banned
- Level 3 guidelines expected to supplement what does not enhance the quality of a

Suitability

- Prescribed content of suitability reports and periodic reports
- Clients to be alerted where suitability may need to be reviewed periodically – no need to revisit the entire assessment, just what has changed
- Suitability assessment required for simplified advice (e.g. advice given through automated processes)

Conflicts of interest

- Disclosure can only be used as a 'last resort'
- Over-reliance on disclosure implies a firm's conflict of interest policy is deficient
- Disclosures must be tailored, and contain a warning
- Conflicts policies must be reviewed at least annually
- Operational separation of staff producing 'recommendations'
- Physical separation of staff preparing investment research (unless this is

Complaints handling

- Written complaints handling policy / procedures required and new complaints oversight function (can be provided by compliance)
- Applies to retail / professional / potential clients
- Complaints to be brought free of charge
- No clarity on what amounts to a 'complaint' in the context of professional clients
- Complaints data to be reported to regulators

Client assets

- New officer responsible for client assets
- Further restrictions on title transfer collateral arrangements and must demonstrate 'appropriateness' and disclose the risks of TTCAs
- New requirements for securities financing transactions; diversify where client funds held; limits on intra-group deposits; ban on custody liens / not segregating if not prescribed by applicable law
- Commission services non-paper (04/02/2015)

Third party payments ban

- Any third party payments received must be paid over 'as soon as reasonably practicable'
- Can pay over by paying into client money account
- Must have policy for ensuring amounts paid over
- Can inform clients of amounts paid over in regular statements

Appropriateness/execution-only

- Products expressly excluded from the 'non-complex' product definition are automatically complex and cannot then go through the separate test to see if they fall within being a non-complex product
- For the separate 'non-complex' test, a further two criteria have been added
- New recordkeeping requirements
- ESMA guidelines expected on the warning for clients where there is a "not appropriate" assessment

Level 2 (Final Technical Advice)

Best execution

- Tailored best execution policies
- Separate policy summaries for retail clients
- No clarity on how to satisfy 'all sufficient steps'
- Execution venues/entities to be notified (but not necessarily need to be listed in policies)
- Additional disclosure requirements
- Clarity on what constitutes a 'material change' to trigger a review of the policy
- Separately, draft RTS under discussion by ESMA

Record-keeping

- ESMA codifying Level 3 guidance from 2007
- Non-exhaustive list of type of records to be kept in writing (regardless of technology used)
- Extended to apply to a wider range of firms and situations
- Content of records prescribed
- Does not apply retrospectively
- RTS being developed and Level 3 guidelines expected

Information to clients

Increased information requirements for:

- Investment advice: applies to professional clients
- Costs and charges: significant level of detail
- Client agreements expanded
- ECPs can opt out from receiving information (but not where they on-sell to retail clients)
- Professionals can also opt-out in certain circumstances

Recording communications

- New policy required with senior management oversight and (proportionate) ongoing monitoring
- Record-keeping obligations
- Content of face-to-face file note prescribed
- To be stored in durable medium
- Must inform clients that calls being recorded and kept for a minimum of 5 years

Product intervention

- EBA has separately consulted on its product intervention powers for structured deposits; EIOPA is consulting on the same for PRIIPs
- Criteria for national regulators tweaked
- Criteria is non-exhaustive for national regulators but ESMA advises Commission to consider if it should be exhaustive for EBA/ESMA (and presumably EIOPA)

Investment advice

- Change to definition of investment advice - exclusion for where advice given through 'distribution channels' deleted
- Additional requirements in order to meet threshold for giving 'independent' advice
- Level 3 guidelines anticipated on what amounts to investment advice and to clarify how to meet 'independent' standards

Reporting to clients

- Confirms reporting requirements for all clients (but ECPs can agree different standards for content and timing)
- Professional clients to receive same reports as retail clients
- Depreciation thresholds which trigger reporting requirements (multiples of 10%)
- Some reports disapplied if information is available on a website which is a 'durable medium'

Remuneration

- ESMA is codifying its previous Level 3 guidance
- Includes in-kind benefits and career progression
- Compliance function and senior management to set remuneration policy
- Balance between fixed and variable remuneration
- Requirements extended to relevant people who affect a firm's services and its 'corporate behaviour'
- Also, ESMA consultation on Guidelines on sound remuneration policies under CRD IV (4 March 2015)
- Also EBA consultation on guidelines for sound remuneration policies

Dealings with eligible counterparties

- ECPs can opt out from receiving some reports/information but not where they are on-selling products to their own clients or where the product embeds a derivative
- Firms can also agree with ECPs different standards for the content and timing of reports

Product governance and distribution

- Applies to '**services**' as well as 'products', for all client types and to all distributors in the sales chain
- Also consider '**market threat**' in developing products
- Only one target market assessment required, for pure manufacturers this is on a 'theoretical basis'
- Non-MiFID entities not exempt from regime
- ESMA proposes to eventually harmonise product governance regimes across MiFID / UCITS / AIFMD

Impact in the UK

Client categorisation

- Impact for firms dealing with elective ECPs who are elective professionals, and local public authorities and municipalities (may need to recategorise these clients)
- Implement new elective ECP opting-up pack which complies with requirements
- DP: FCA considering (1) different opt-up approaches for local authorities (3 options proposed) and (2) extending retail classification



Client order handling

- Impact in relation to handling client orders on new trading venues



Clear, fair and not misleading communications

- UK regime already super equivalent
- Extension of some obligations to professional clients may mean the financial promotion approval process needs to be updated
- Dealing with ECPs in fair, clear and not misleading manner is unlikely to be much of a change



Inducements (generally)

- End to commission sharing arrangements and 'free' research (consistent with FCA's views on use of dealing commission – most recently in FS15/1)
- DP: FCA accepts that the existing 'permitted benefits' table in COBS 2.3 will likely need to be amended to mirror EU's stricter minor non-monetary benefits table
- Firms will need to prove that an inducement enhances quality of service and fits in the narrowed 'permitted benefits' table
- DP: FCA expects to apply stricter regime to all advisers (including restricted advisers)



Suitability

- UK regime already super equivalent but updating exercise needed
- Suitability assessments already applied to simplified advice models (FCA Finalised Guidance FG15/1)
- FCA DP: FCA considering applying MiFID II suitability standards to insurance-based investment products and pensions if IDD does not mirror MiFID II suitability requirements.
- Will apply to 'structured deposits'



Conflicts of interest

- Reassess the firm's conflicts, update policies and procedures, and implement periodic (at least annual) review
- Create suite of disclosure documents, tailored for different client types/services/strategies, with the new warning
- Consider how to demonstrate that disclosure is being used only as a last resort
- Physical separation of analysts, and additional operational separation required?



Complaints handling

- Extend existing retail complaints-handling regime to professional clients
- Change operational procedures
- May need to increase staff to deal with more complaints and to deal with FOS
- Regulatory fees likely to increase



Client assets

- UK regime already super equivalent (note PS14/9)
- Firms will need to reassess TTCA arrangements with professional clients; negotiate new threshold limits for portfolio management clients; renegotiate sub-custody arrangements so that third parties cannot disapply segregation requirements/require liens where they are not required by applicable law



Third party payments ban




- UK regime super equivalent for advisory firms as commission ban under Retail Distribution Review goes further than EU ban but only applies to retail
- Payments excluded from RDR ban may not match the 'minor non-monetary benefits' proposed to be excluded from the EU ban
- Extension to professional clients significant impact
- Huge impact for portfolio managers with new ban
- DP: FCA considering applying stricter RDR ban to portfolio managers (so may gold-plate MiFID II) or introducing a similar ban as that on UK platforms



Appropriateness/execution-only

- Firms' 'non-complex' product suite to be reassessed
- Reassessed 'complex' products cannot be sold execution-only
- Operational change for recordkeeping requirements
- Uncertainty on 'complex' / 'non-complex' distinction – FCA: *"the types of products that are considered 'non-complex' will be significantly limited"*.
- FCA DP: extending MiFID II appropriateness test to non-MiFID products
- Will impact D2C market significantly
- ESMA Consultation Paper (2015/610) on complex debt instruments and structured deposits



Key:  Significant change compared to MiFID I  Moderate change compared to MiFID I  Minor / no change compared to MiFID I

"IDD" means the revised Insurance Mediation Directive, proposed to be called the "Insurance Distribution Directive"

Impact in the UK

Best execution

- Reconsider entire best execution process
- Redraft policies / create retail summaries
- Evidence best execution, "all sufficient steps"
- Publish top 5 venues
- Publish required information in standardised form but with sufficient granularity
- Alignment with FCA paper on best execution

Information to clients

- Firms will need to negotiate the information ECPs / professional clients do not wish to receive
- Significant amount of new information to clients
- New KID for PRIIPs will represent significant operational projects for firms creating packaged products and firms distributing them.
- DP: FCA seeks views on technical challenges with aggregating costs and costs/charges disclosures and on the extent of standardisation

Remuneration

- UK already super-equivalent to MiFID requirements for many firms with SYSC 19
- May need to revisit who is caught by the new rules after there is clarity on who affects a firm's 'corporate behaviour' – delegates? contractors?
- Increased focus for FCA - clients' best interest rule and link between conflicts and financial incentives (FG13/1) and recent FCA/PRA consultation on changing SYSC 19 (CP14/14)
- FCA DP: Considering extending MiFID II requirements to non-MiFID firms

Dealings with eligible counterparties

- UK regime already super equivalent in some respects
- Firms subject to Principles for Businesses, which require them to communicate with ECPs in a way that is not misleading
- Information and reporting to ECPs is a more significant change

Investment advice

- definition of investment advice – no impact. UK regime has both advice and personal recommendations and substantial PERG guidance
- 'independent' advice – UK proposing to gold-plate test for being 'independent' to mirror the wider test introduced by the UK RDR (which also considers non-MiFID products and to bring structured deposits within the UK RDR net) but to have separate MiFID II independence tests for (1) shares and bonds and (2) derivatives)
- DP: FCA proposing two 'independence' regimes - one for retail clients (mirroring the RDR test) and one for professional clients (mirroring the MiFID II test)
- DP: FCA considering changing 'restricted advice' label – further DP coming

Record-keeping

- UK regime super equivalent in some scenarios but not in others
- Additional records may need to be kept
- Member States can gold-plate

Reporting to clients

- UK regime super equivalent but updating exercise needed
- Professional clients to receive what retail clients receive
- Negotiate with ECPs what reports they receive and record what is agreed
- May need to update terms of business
- If reporting online, need to ensure website is a 'durable medium'

Recording communications

- UK implemented optional regime from MiFID I
- Policies and procedures will need to be updated
- FCA proposing to remove current UK duplication exemption for discretionary managers and to subject those firms exempt under Article 3 of MiFID II to the regime.
- Extent of recording internal communications?
- Storage requirements to be updated so records can be kept for 7 years (not 6 months)
- Firms to determine if records kept in 'durable medium' that allows for immediate reproduction

Product intervention

- Nothing for firms to do in practice
- UK already super equivalent although there are differences between the UK and EU regimes
- Ensure compliance monitoring programme monitors for FCA bans

Product governance and distribution

- UK regime super equivalent
- Current UK guidance (in the RPPD and Product Governance Guidance) to be elevated to rules
- Differences between UK and EU regimes to be aligned – EU regime more detailed on: (i) target market specification; (ii) management oversight; (iii) distributor obligations
- This will impact on firm's product governance policies and procedures and committees
- Note: FCA thematic review of Product Development Guidance – Structured Products (March 2015)
- FCA DP: potentially extend MiFID II requirements to a wide range of non-

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