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 **NORTON ROSE FULBRIGHT**

Extended briefing: MiFID II – from implementation to daily routine

Norton Rose Fulbright LLP
6 September 2017



Content:

1. **Our thinking on the FCA's July Policy Statement**
2. **Session A: Sector focus – Buy-side topics**
3. **Session B: Sector focus – Sell-side topics**
4. **Practical MiFID II documentation and compliance**



Programme

Time	Topic	Room
8:30 – 8:40	Registration and breakfast	Terrace Suite
8:40 – 8:45	Introduction	Terrace Suite
8:45 – 9:30	Our thinking on the FCA's July Policy Statement: <ul style="list-style-type: none"> • Conduct of business • Perimeter guidance 	Terrace Suite
9:30 – 10:15	Session A – Buy-side topics: <ul style="list-style-type: none"> • Transaction reporting • Recording communications • Inducements and payment for research 	Terrace Suite
9:30 – 10:15	Session B – Sell-side topics: <ul style="list-style-type: none"> • Trading obligation • Best execution • Transparency • Other key obligations 	Rooms 1&2
10:15 – 10:30	Coffee and tea	Terrace Suite
10:30 – 11:15	Practical MiFID II documentation and compliance: <ul style="list-style-type: none"> • Compliance documentation challenges • Customer facing documentation • Securing consents from clients 	Terrace Suite

Should you hear the fire alarm

- Please listen to instructions and exit the building via the front entrance.



1. Our thinking on the FCA's July Policy Statement

**Jonathan Herbst and Imogen Garner
Partners, Norton Rose Fulbright LLP**



In this session we will cover:



Where have we got to in the mountain of MiFID II paperwork and how helpful have the ESMA Q&As been?



What are the headlines in the FCA's July Policy Statement and updated PERG? Do they answer all the questions?



What are the practical MiFID II issues that we are seeing when working with clients?



The territoriality debate and impact on group structures

The countdown to MiFID II / MiFIR implementation as of 8:45am this morning...

118

DAYS

15

Hours

15

Minutes



But if you take away weekends and public holidays it is really 81 working days!

Are you ready for MiFID II?

“We have various powers that we can use to safeguard the orderly operation of markets and to ensure that firms carry on activities in accordance with regulatory requirements.” (FCA 25 July 2017)

**How ready are you for
MiFID II implementation
on 3 January 2018 ?**

(A) Very ready

(B) Somewhat ready

(C) Not ready

Update on EU implementation

How do the key MiFID II pieces fit together?

MiFID II / MiFIR Level 1:

- Framework legislation
- MiFID II requires transposition
MiFIR directly applicable
- Dictates who needs to be authorised
- Organisational and conduct of business requirements
- Transparency requirements
- Third country provisions

MiFID II / MiFIR Level 2:

- The depth of the Level 2 measures is a key difference compared to MiFID I
- Delegated Acts, Regulatory Technical Standards, Implementing Technical Standards and Implementing Acts
- Supplements the Level 1 text with greater detail
- Almost all have been finalised but keeping tabs on them has been difficult due to their number

Level 3 materials:

- Practical guidance designed to enhance supervisory convergence on key topics
- Guidelines developed by ESMA and addressed to national competent authorities: non-binding, must “comply or explain”
- Example: Guidelines on transaction reporting, order record keeping and clock synchronisation
- Q&As – ongoing process, questions submitted directly to ESMA or via competent authorities

FCA materials:

- Key policy statements: PS17/5 and PS17/14
- Key consultation papers: CP15/43, CP16/19, CP16/29, CP16/43, CP17/8, CP17/19
- PERG updates
- FCA MiFID guide
- FCA navigation guide for SYSC
- FCA applications and notifications user guide
- Expecting soft guidance in the form of FCA speeches

PRA materials:

- PS29/16: systems and controls for firms who undertake algorithmic trading and DEA; extension of scope and harmonisation of MiFID II passporting regime
- PS9/17: granting authorisation in respect of new MiFID II activity, operating an OTF, new MiFID II financial instrument, emission allowances and regulated activities of dealing, advising, managing and arranging structured deposits; certain notification requirements

HM Treasury and UK statutory instruments:

- HM Treasury Policy Statement confirms the position as regards the Article 39 MiFID II branch regime
- The Financial Services and Markets Act 2000 (Markets in Financial Instruments) Regulations 2017
- The Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2017
- The Data Reporting Services Regulations 2017

Finding all the MiFID II materials: Pegasus

This web page contains the latest MiFID II – related papers issued by the European Commission, ESMA and ESRB

This web page contains the latest MiFID II - related papers issued by the HM Treasury, FCA and the PRA

This web page contains slides on our previous briefings, webinars and videos on MiFID II updates

Each topic contains briefings, slides, webinars and a getting started with the legislation document that provides high level information on Level 1, 2 and 3 legislation

The sector analysis web page has four icons: sell-side, buy-side, retail and institutional

Pegasus - Preparing for MiFID II

- Our products and experience
- Legislation tracker
- Legislation and relevant papers - EU
- Legislation and relevant papers - UK
- MiFID II Academy
- Investor protection
- Transparency, transaction reporting and wholesale conduct
- Trading venues and market infrastructure
- High frequency and algorithmic trading obligations
- Impact on commodities and commodity derivatives trading
- Corporate Governance
- Third country issues
- Sector analysis


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We are committed to helping firms keep on top of MiFID II


Pegasus is our dedicated online resource housing all our MiFID II know-how and links to other resources clients will need for any MiFID II project.

Our materials are strategically grouped under the core topic headings below so that information is readily accessible.


Our products and experience >




Legislation tracker >




Legislation / Relevant papers EU >




Legislation / Relevant papers UK >




MiFID II Academy >




Investor protection >



Transparency, transaction reporting and wholesale conduct >



Trading venues and market infrastructure >



ESMA Level 3 work



Questions and Answers

On MiFID II and MiFIR market structures topics

Questions and Answers

On MiFID II and MiFIR commodity derivatives topics

Questions and Answers

On MiFID II and MiFIR investor protection topics

Keep an eye out for when ESMA updates these

Questions and Answers

On MiFID II and MiFIR transparency topics

Questions and Answers

On MiFIR data reporting

ESMA's Level 3 work is now key to promote common supervisory approaches: But do the Q&As, guidelines and opinions provide all the answers?

Level 3: ESMA Q&A highlights (1)

Q&A on MiFID II and MiFIR market structure topics (7 July 2017)

- Policy issues on the SI/platform divide and strong lobbying from the platforms
- Arguably more heat than light as a result and many debates in the market
- Basic position that SIs cannot do matched principal on a regular basis but can enter into hedging positions arising from the execution of client orders subject to constraints
- Investment firm would not be bringing together multiple third party buying and selling interests where entering into transactions executed on a trading venue

- Problems arise from the position that SI would not undertake matched principal trading on an occasional and non-regular basis if it meets any of the following criteria:
 - the investment firm operates one or more systems or arrangements, be they automated or not, intended to match opposite client orders
 - when executing client orders, non-risk facing activities account for a recurrent or significant source of revenue for the investment firm's trading activity
 - the investment firm markets, or otherwise promotes, its matched principal trading activities

European Commission publishes on 28 August 2017 a draft Delegated Regulation inserting a new Article 16a into Commission Delegated Regulation (EU) 2017/565:

“An investment firm shall not be considered to be dealing on own account for the purposes of Article 4(1)(20) of Directive 2014/65/EU where that investment firm participates in matching arrangements entered into with entities outside its own group with the objective or consequence of carrying out de facto riskless back-to-back transactions in a financial instrument outside a trading venue”



Level 3: ESMA Q&A highlights (2)

Q&A on MiFID II and MiFIR investor protection and intermediaries topics (10 July 2017)

Best execution:

- ESMA was asked whether the RTS 27 reporting requirements apply to Securities Financing Transactions
- It clarified that they do not, although the MiFID II best execution requirements do otherwise apply to investment firms when carrying out Securities Financing Transactions – and RTS 28 also remains relevant

Telephone recording:

- A number of important answers on telephone recording confirming broad scope of rules, e.g. covers all media, all communications relating to trades and is irrespective of the fact that the execution of orders is allowed in addition to reception and transmission of orders, through a given channel
- More flexibility on the degree and type of monitoring which is appropriate

The clarity on SFTs helpfully seems to recognise and reflect SFTs do not fit easily, if at all, into the RTS 27 reporting templates. A question mark remains, though, over the usefulness of RTS 28 reporting.

Significant focus on scope questions in relation to taping: but how is this really translating into reality for firms?

Update on UK implementation

Setting the scene: Where have we got to?

FCA:

- Two key policy statements published in March and July: PS17/5 and PS17/14
- One outstanding consultation - CP17/19
 - Proposal to bring recognised investment exchanges operating MTFs and OTFs into the scope of the FSCS
 - Proposal to make certain changes to DEPP and the Enforcement Guide as described in CP17/8
 - Technical changes to the Prospectus Rules and Glossary arising out of legislative changes which implement MiFID II
 - Deadline for comments is 7 September 2017; final rules expected by November 2017

FCA guides:

- MiFID Guide – Appendix 2 of Consultation Paper 15/43: MiFID II implementation
- MiFID Navigation Guide for SYSC – Appendix 2 of Consultation Paper 16/19: MiFID II implementation
- MiFID II Application and Notifications Guide (January 2017) - since publishing the guide, the FCA has provided updates on its website regarding notifications for general clearing members and on the ancillary activity exemption

PRA:

- Policy Statement 29/16: MiFID II: Response to CP9/16 (26 October 2017)
- Policy Statement 9/17: Implementation of MiFID II: Part 2 (28 April 2017)

HM Treasury:

- HM Treasury response to consultation on the transposition of MiFID II (9 February 2017)

Key UK statutory instruments

The Financial Services and Markets Act 2000 (Markets in Financial Instruments) Regulations 2017:

- Designate the FCA, PRA and the Bank of England as competent authorities to carry out duties set out in Titles I to IV, VI and VII of MiFID II and MiFIR
- Contain provisions concerning third country firms providing investment services in the EU
- Implement Article 57 of MiFID II, which requires Member States to both put in place limits on the size of positions that can be held in commodity derivatives and to enforce position limits put in place by other Member State
- Impose controls relating to algorithmic trading on certain firms and individuals that are otherwise exempt from MiFID II
- Give the FCA and PRA powers to remove a person from the management board of an investment firm, credit institution or recognised investment exchange for the purposes of MiFID II

The Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2017:

- Creates a new specified activity of operating an OTF
- Certain derivatives relating to currencies, binary contracts and emission allowances are added as specified investments
- The specific activities of dealing in investments as agent, arranging deals in investments, managing investments and advising on investments are applied in relation to structured deposits

The Data Reporting Services Regulations 2017:

- Implement the authorisation requirements and organisational requirements for DRSPs under Title V of MiFD II
- Provide the FCA with powers to supervise and enforce the regime as required by Title VI of MiFID II – which deals with enforcement and supervision of MiFID II and MiFIR

How helpful are the ESMA Q&As?

“The purpose of these Q&As is to promote common supervisory approaches and practices in the application of MiFID II. It provides responses to questions posed by the general public and market participants in relation to the practical application of MiFID II and MiFIR.” (ESMA website)

**How helpful do you find
the ESMA Q&As in
answering your MiFID II
questions?**

(A) Very helpful

**(B) Helpful but there
are some gaps**

(C) Not helpful

FCA notifications



**An important message
from the FCA!**

“Firms who need to change their regulatory permissions as a result of MiFID II should submit a complete application for authorisation or a variation of permission now, to ensure that we can determine it before MiFID II takes effect. We expect firms to be busy considering what impact MiFID II will have on their business and to act accordingly.

Just to be sure that we can determine an application in time for 3 January 2018, it needs to be complete by 3 July 2017. Most applications are not complete when they are submitted. Firms who have not already done so should therefore submit applications as a matter of urgency to help us identify as soon as possible what, if any, further information is needed to complete the application. We cannot guarantee that any application which is only complete after 3 July 2017 will be determined by 3 January 2018.”

FCA webpage on MiFID II



MiFID II / MiFIR notifications (1)

Past key dates and deadlines

30 January 2017	<ul style="list-style-type: none">• Authorisation gateway open for draft applications for FCA solo regulated firms• New forms for all firms applying for a Part 4A permission or a VoP, that will amount to an authorisation under MiFID, and firms applying to be exempt under Article 3 of MiFID• New MiFID Form A available• DRSP Application for Authorisation forms available
1 February 2017	<ul style="list-style-type: none">• Deadline for equity and equity-like instruments waiver applications
1 June 2017	<ul style="list-style-type: none">• Deadline for bonds and derivatives waiver applications
3 July 2017	<ul style="list-style-type: none">• Deadline for submission of complete applications for authorisation of investment firms and DRSPs or VoP applications to guarantee FCA will determine them by 3 January 2018
31 July 2017	<ul style="list-style-type: none">• Passporting notification gateway opens
Early as possible after 31 July 2017	<ul style="list-style-type: none">• Notifications of establishment passports for branches to be sent to FCA: changes to scope such as own account dealing/matched principal dealing

MiFID II / MiFIR notifications (2)

Upcoming key dates and deadlines

31 October 2017	<ul style="list-style-type: none">• Deadline for existing operators of MTFs, including RIEs, to provide FCA with the information on their MTF under ITS 19, and any application to register an MTF as an SME growth market
2 December 2017	<ul style="list-style-type: none">• Deadline for notifications of cross-border passports
2 January 2018	<ul style="list-style-type: none">• Transitional arrangements finish for structured deposits: notification prior to this• Deadline for applications to amend existing MiFID passports or applications for MiFID II passports
3 January 2018	<ul style="list-style-type: none">• New notification requirements for investment firms• New requirements to use the form in Annex III to the authorisation ITS for changes to members of the management body• New fees to come into force• Deadline for first annual notification of the use of the exemption from the requirement for authorisation in Article 2(1)(j) for commercial firms trading commodity derivatives or emission allowances

Update: In paragraph 3.42 and Table 1 in the MiFID II Application and Notifications Guide, it states that firms are required to notify if they want to act as a general clearing member. MiFID II does not explicitly require this and so, after further consideration, FCA has said on its webpage that it will not require firms to inform it if they act as a general clearing member.

Spotlight on PS17/14

Chapter 3 of PS17/14: PERG

The meaning of 'multilateral system'

- FCA has referred to ESMA's Q&As on market structure topics: As noted above, ESMA Q&A leaves a number of questions
- FCA has instead focused on the scope of operating an OTF or an MTF, with a view to enabling firms to consider whether and what authorisation they require
- Guidance in MAR has been updated to reflect the FCA view that any system that merely receives, pools, aggregates and broadcasts indications of interest, bids and offers or prices should not be considered a multilateral system - although this may amount to an activity under Article 25(2) of the RAO

Flexible forward contracts and binary bets

- FCA revisited its guidance on flexible forward contracts: Length of the delivery period not relevant to whether or not an instrument is an option, although it is a relevant factor when considering whether the contract is likely to be a means of payment
- In relation to binary bets with multiple outcomes, the FCA expects these types of contracts to fall within the definition of contracts for differences

Executing client orders

- FCA confirms its view that the issue of its own securities by an ordinary commercial company should not generally be within the MiFID II perimeter and that no further clarification is needed

Extract from PERG guidance (1)

Foreign exchange contracts - PERG 13, Q31B

- Main point to note is how complex the exemption is and the fundamental question is how much due diligence a firm would need to do to be comfortable in relying on this
- A significant change to the market that has been largely overlooked
- Only applies if one party is not a financial counterparty
- Confirms that not every FX contract is caught by MiFID II with two key exclusions: (i) spot contracts (PERG 13, Q31C); and (ii) foreign exchange transactions connected to a payment transaction (PERG 13, Q31G)
- Exclusions do not apply to an option or a swap on currency, regardless of the duration of the swap or option and regardless of whether it is traded on a trading venue or not

Impact of netting on exclusions for foreign exchange - PERG 13, Q31R

- A foreign exchange contract may involve a valuation of the currencies being brought and sold for the purposes of settlement and a single payment being made
- Spot contract exclusion in PERG 13, Q31C requires there to be exchange and delivery. Broadly, netting is not permissible
- The fact that a foreign exchange contract provides for early termination and netting on default does not mean that the exclusions cannot apply. Similarly, the existence of force majeure provisions dealing with bona fide inability to settle physically does not prevent a contract from benefitting from the exclusions

Extract from PERG guidance (2)

Guidance on money market instruments (C2) - PERG 13 Q28A

- Classes of instruments which are normally dealt with on the money market
- Examples include treasury bills, certificates of deposit and commercial paper
- Money market instrument does not include an instrument of payment
- Money market instrument must meet the following three conditions: (i) has a value that can be determined at any time; (ii) does not fall into sections C4 to C10 of Annex 1 to MiFID II; (iii) has a maturity at issuance of 397 days or less

Guidance on operating an OTF - PERG 13 Q24A

- Only bonds, structured finance products, emission allowances and derivatives may be traded. Equity instruments may not be traded on an OTF
- More information on multilateral systems covered in PERG 13 Q24B
- See also ESMA Q&As on market structure topics

Limited licence firm – PERG 13, Q64

- Important distinction between own account dealing definitions in MiFID 2 and CRD
- For the purpose of the definition of a limited licence firm, a firm does not deal on own account when executing client orders by matching them on a matched principal basis (back-to-back trading) if its activities are consistent with the conditions of Article 29(2) of the CRD or Article 5.2 of the recast CAD

How are you treating FX instruments?

“Is every foreign exchange contract caught by MiFID II?” (FCA PERG at Q31B)

Are you drawing a distinction between regulated and unregulated FX instruments or are you treating them the same?

(A) Drawing a distinction

(B) Treating them the same



Chapter 4 of PS17/14: CASS

Client Assets Sourcebook:

- TTCA with retail clients will be prohibited, as retaining them is contrary to MiFID II, and for non-retail clients firms must carefully consider the TTCA's appropriateness
- On custody and client money liens, final rules implement the prohibitions set out in MiFID II with only the permitted exceptions stated in MiFID II – liens to be recorded in client contracts and in books and records
- When placing a client's money in a qualifying money market fund, firms will be required to make internal assessments and obtain express client consent
- Firms will be provided with an exemption from the prohibition on depositing over 20% of client money in a group bank if they meet certain requirements
- Firms to have measures in place to prevent unauthorised use of client assets
- Firms to ensure appropriate collateral provided and monitor its suitability regarding securities lending

Practical points:

- Existing TTCAs with retail clients to be terminated, and others will need to be reviewed
- Updates may be required to client agreements for custody liens, to repaper clients for consent to place assets in a QMMF and to agree procedures for where there are insufficient assets
- Updates to books and records for custody liens – and will firms need to seek legal advice in jurisdictions where they currently have liens?
- Diversification assessments to be conducted alongside firms' annual CASS classification exercise?

Chapter 7 of PS17/14: Inducements - research

Key themes:

- Extension of MiFID II requirements on inducements and research to most forms of CPM, including UCITS management companies, AIFMs and most small authorised UK AIFMs and residual CIS operators
- Research charges should be swept to an RPA either immediately or within the settlement period of the transaction “without undue delay”
- The client money trap avoided - FCA clarified that RPA monies belong to the investment firm
- Firms must have in place clear frameworks to evaluate the type, level and the quality of research services before reception and consumption
- The investment firm must retain the full discretion and control over the use of the RPA even when the administration of the RPA is outsourced to third parties: Complex issue where brokers/others used to administer
- The FCA has amended COBS 2.3A.19R to include a limited trial period for a research service subject to other strict conditions constitutes an acceptable non-monetary benefit

Observations:

- Likely to be an area of regulatory focus early on in the post-MiFID II world
- Direction of the industry in the near-term and also the longer term
- Commercial pressures are also a key factor



Chapter 8 of PS17/14: Client categorisation

The FCA:

- Introduced a fourth quantitative categorisation criterion to COBS 3.5.3BR(2), namely that the local authority uses investment services as part of the administration of a pension fund with the local government pension scheme
- Reduced the portfolio threshold size for the quantitative test to £10 million
- Confirmed that the opt-up test must be run separately on a local authority's treasury management function and its pension fund administration
- Re-iterated that, where a UK firm has a client which is a non-UK local authority, it should defer to the local criteria deemed appropriate for local government in the territory in which the authority is located
- Permitted firms flexibility to opt-up clients before 3 January 2018 rather than wait until that date before commencing the process – however, firms will not be expected to re-consider categorisation of existing clients other than local authorities, where MiFID II rules are the same as existing MiFID rules transposed in COBS 3

Practical points:

- Tight timescales, and other challenges, for firms reviewing an opting up existing local authority clients where possible pre-3 January 2018
- Complexities for firms with non-UK local authority clients



Chapter 9 of PS17/14: Disclosure requirements

The FCA:

- Clarified that for non-MiFID firms, unless the firm is an Article 3 firm, the rules that apply in relation to costs and charges are unchanged
- Published new disclosure provisions relating to firms doing MiFID business that apply in relation to:
 - Cross-selling/bundled products or services
 - Some more detailed post-sale reporting requirements
 - A revised requirement to retain records for at least five years
- Is not considering, for now, a standardised format setting out how firms should calculate and disclose point-of-sale or post-sale information, including information on costs and charges. Firms will need to develop their own approach to disclosure that will meet the needs of their clients and reflect their business propositions
- Unless the firm is an Article 3 firm carrying out MiFID-scope business, its existing disclosure rules will continue to apply to firms doing non-MiFID business in the same way they currently do

Practical points:

- Format of, content and extent of detail in, timeliness in relation to, personalisation of ex ante and ex post costs and charges disclosure
- Differing viewpoints of trade associations



Chapter 19 of PS17/14: Taping

The FCA confirmed that:

- New requirements should not prove significantly more prescriptive or costly than its existing regime for those already in scope
- Its rules on taping will apply in relation investment activities specified under SYSC 10A, not only to MiFID firms but also to collective portfolio managers, including AIFMs, UCITS as well as Article 3 firms, UK branches of third country firms and energy and oil market participants.
- It will remove the current partial exemption from the taping rules for firms providing discretionary investment management services
- It will not apply a requirement for recording phone conversations and taping to all investment services and activities carried out in relation to corporate finance business. Certain corporate business communications will be in scope, if communications occur in the process of providing relevant client order services and own account dealing
- For non-MiFID firms which are currently subject to the taping rules, the scope of relevant instruments is to be reduced to exclude financial instruments not linked to trading on a trading venue
- Article 3 firms don't need to tape but must take a note of the telephone conversation. The FCA expects the note to include key details of any orders taken and the key substance of the main points of the conversation. Minimum key information includes: (i) the date and time of the meeting; (ii) the location of the meeting; (iii) the identity of the attendees; (iv) the initiator of the meetings; and (v) relevant information about the client order including the price, volume, type of order and when it will be transmitted or executed

Practical points:

- Considerable focus on scope: but is it easier to take a more blanket approach, from a practical perspective?
- A key area where technical, HR and business engagement are all key – as well as, of course, compliance and legal
- Some misunderstanding of the FCA's feedback on scope for, e.g. corporate finance firms



Other practical issues we're seeing (1)

Suitability:

- Note implications of new client categorisation rules for suitability assessments for opted up local authority clients
- Dealing with 'insistent' clients

Appropriateness:

- Remains a retail client issue
- Note FCA's final stance on investment trusts and NURS

Product governance:

- Making sense of the requirements in relation to professional business, and in relation to services
- Impact on relationships between manufacturers and distributors, and co-manufacturers

Complaints handling:

- Incorporating the new requirements in a non-retail context
- Requirement to 'publish' complaints handling procedure

Other practical issues we're seeing (2)

Client agreements:

- What does the new requirement for client agreements with professional clients mean in practice for documentation and client engagement?

Best execution:

- What does the new due diligence look like?
- What does the new reporting look like?

Reporting to clients:

- What does it mean in the execution-only world?
- What does “limited application” really mean in the professional and eligible counterparty world?

Territorial issues

Recap on access to the EU (1)

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 all client types (including retail and elective professional clients)

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

Recap on access to the EU (2)

Professionals and ECPs

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

Retail and opted up professionals

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

Challenges for global models



- Issues for TCFs providing services to EU firms, as delegates or otherwise
- Is the recipient of services subject to MiFID requirements, directly or as a result of gold-plating?
- Potential impact on non-EU service providers, e.g. contractual requirements, adoption of policies – debates around best execution and research in a global context
- Issues arising in the product governance context, e.g. ‘out of scope’ non-EU manufacturers
- Issues for TCFs receiving services from EU firms, such as brokers
- Implications for trading on EU markets or with EU counterparties
- Application to non-EEA branches

Opening comments on documentation

Macro themes on documentation

Terms of business and professional clients:
A written agreement setting out the essential rights and obligations of the firm and the client must be entered into when the firm provides investment services or ancillary services and safekeeping and administration to a professional client after 3 January 2018

The consent issue: The problem of determining when you can rely on contractual powers to amend your existing agreements and what the difference is between MiFID II provisions that refer to “prior express consent”, “prior consent” and “explicit consent” – Previous CESR papers provide limited help

The common interpretation problem:
Divergences exist in general contract law across the EU which leaves room for different national approaches to interpreting and enforcing consent and notification requirements – does this mean that your documentation has to be subtly amended Member State to Member State?

Collecting information from the client: For example in relation to suitability, transaction reporting, direct electronic access, position limits and portfolio compression

Documentation issues in practice

Client categorisation and local authorities

Local authorities categorised as retail clients by default but can request to be treated as elective professional clients

Firms need to assess any local authority requests for upgrading client status as having the requisite knowledge and experience to meet the opt up criteria

Client data look-back process to identify all local authority clients that may need to be remediated and reclassified

Outreach programme to each local authority client to inform them of their reclassification and solicit consent if they elect to change their client status

Process needs to be put in place whereby all consent documents can be signed, returned and processed

The documentation challenge

“MiFID II is presenting unique and onerous documentation challenges that some buy-side firms may not be prepared for.” (AIMA)

Which of the following areas is your firm most focused on at the moment ?

(A) Client reporting

(B) Updating internal policies and processes

(C) Systems build

(D) Third party issues (e.g. research pricing etc)

Sector concerns

Final word on sector concerns

Investment banks

Investment banks across Europe appear to be focussing on four areas in their MiFID II implementation efforts:

- Market structure and the revised systematic internaliser regime
- Product governance, particularly rules for product manufacturers
- Costs and charges disclosures, especially the impact on their business
- Transaction reporting
- Conflicts and inducements

Retail banks

Retail banks appear to have four particular areas of interest:

- Product governance – target market and interaction with distributors
- Inducements, mainly the impact on existing fee models
- Conflicts of interest, especially around captive products
- Independent vs non-independent advice – the scale of identification and separation

Wealth managers

Wealth managers appear to be particularly concerned about:

- The ability of staff to deal with MiFID II reporting requirements (in terms of reporting to their own clients, reporting to product manufacturers and transaction reporting)
- The ability of staff to implement successful MiFID II change programmes

Asset managers

Asset managers appear to be particularly concerned about:

- Inducements and research
- Costs disclosure
- Transaction reporting
- Market structure
- How distributors will share product sales data with manufacturers
- Implications for delegation models

Breakout sessions

Room details for the breakout sessions

Time	Topic	Room
9:30 – 10:15	Session A – Buy-side topics: <ul style="list-style-type: none">• Transaction reporting• Recording communications• Inducements and payment for research	Terrace Suite
9:30 – 10:15	Session B – Sell-side topics: <ul style="list-style-type: none">• Trading obligation• Best execution• Transparency• Other key obligations	Rooms 1&2

2. Session A: Sector focus – Buy-side topics

**Imogen Garner and Charlotte Henry
Partners, Norton Rose Fulbright LLP**



In this session we will cover:



Research



Product governance



Costs and charges

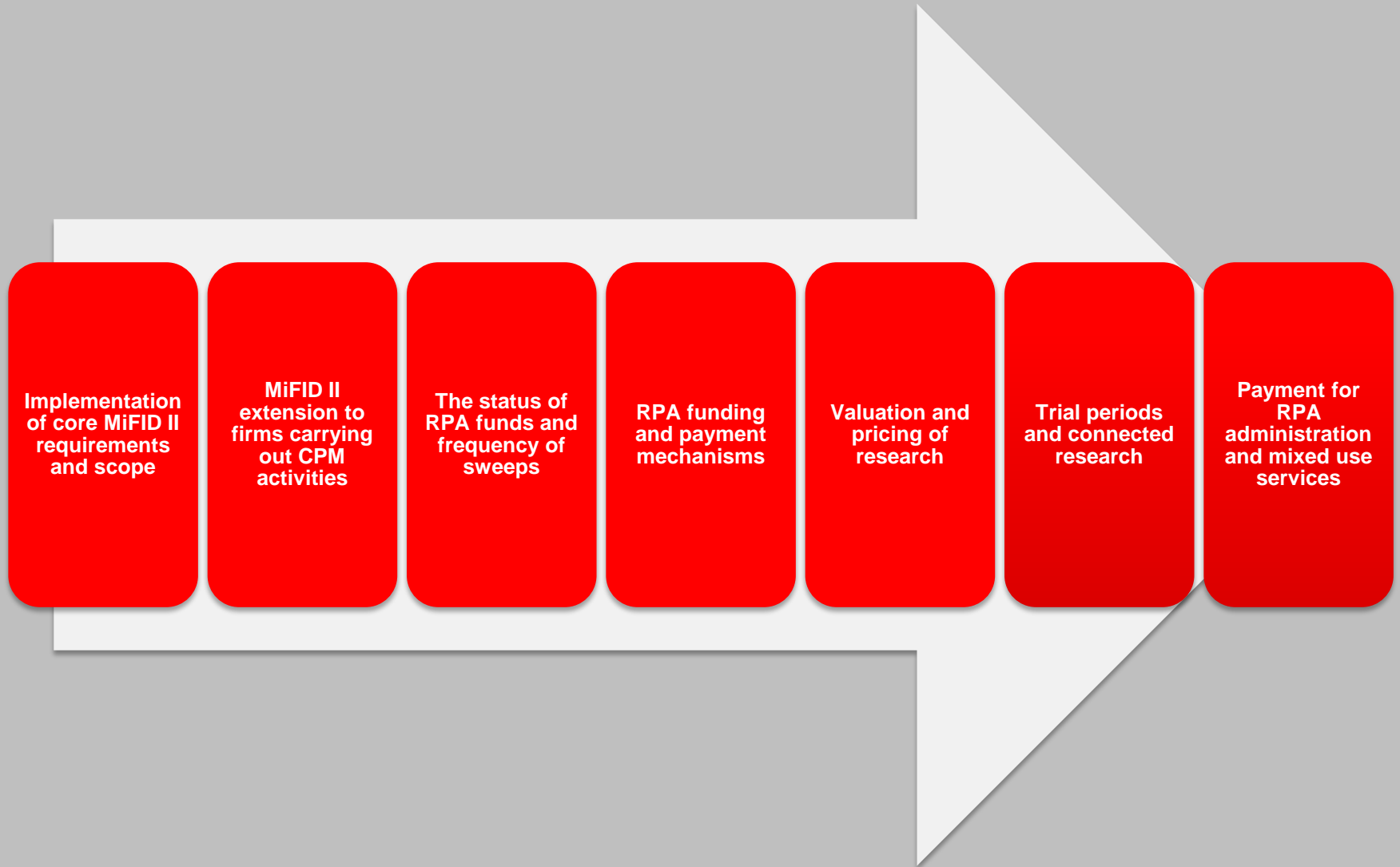


Recording communications



Transaction reporting

Research



Research



- **Which route are firms intending to take?**
 - A. P&L
 - B. RPA
 - C. Undecided

Implementation of core MiFID II requirements

Proposed new COBS sections:

- COBS 2.3B sets out requirements that, if met, allow a firm to receive third party research without it constituting an inducement
- COBS 2.3C sets out requirements on firms that supply both execution and research to provide discrete pricing for each of those services to ensure greater transparency to recipient firms, particularly those that may wish to avail themselves of the option of paying for research from their own resources or through an RPA
- Investment firms do not have to price separately to third country firms based outside the EEA, although they may choose to do so voluntarily
- Pricing should be provided to all MiFID investment firms regardless of the activities carried out
- **Policy intention:** to reduce inducements risks and improve transparency and accountability over costs passed to investors and ensure a priced research market that enhances competition

Execution-related services:

- Some activities can be considered inherent to the provision of execution services: working large orders, taking trades on risk or structuring a series of derivatives transactions
- An investment firm could also accept transaction reporting offered by a broker as part of the execution services, provided it does not influence best execution and is offered as a standard term of business



MiFID II extension to firms carrying out CPM activities



- Extension of MiFID II requirements on inducements and research to most forms of CPM, including UCITS management companies, AIFMs and most small authorised UK AIFMs and residual CIS operators
- Exemption for certain CPM activities, such as AIFs and CISs that do not involve investing in MiFID-scope financial instruments (e.g. commercial real estate and PE/VC funds)
- Target: UK asset managers to be more efficient and effective in their procurement of research and allow better scrutiny and control over execution services → lower cost funds and better net performance
- Any impact on competitiveness of UK firms?

The status of RPA funds and frequency of sweeps



- Research charges should be swept to an RPA either immediately or within the settlement period of the transaction “*without undue delay*”
- The FCA clarified that RPA monies belonging to the investment firm
- The investment firm must retain the full discretion and control over the use of the RPA even when the administration of the RPA is outsourced to third parties
- The investment firm should ensure transfer of research charges into an RPA within 30 days (FCA’s minimum expectation) from a transaction taking place
- Single RPA vs multiple RPAs – the FCA does not intend to prevent a virtual RPA with multiple underlying RPAs provided that each individual RPA is protected in line with COBS 2.3B19G and ESMA’s Q&A

RPA funding and payment mechanism



Freedom of choice

Firms should have the ability to implement a combination of RPA-based methods and usage of their own resources to pay for external research



Pros & cons

Pros: gives firms the option to choose the best model to fit the types of assets being managed

Cons: firms might implement complex arrangements, plus FCA concerns that a mixed funding approach might give rise to potential conflicts of interest between firm and client



FCA view on netting

Payment netting could have the potential to reduce the transparency and oversight applied by the investment firms and the FCA's ability to supervise such arrangements

Payment netting may reduce the incentive on the investment firms to scrutinise research payments and controls over budget allocations

Valuation and pricing of research



ESMA Q&A

A firm must have “a clear methodology to establish what they expect to pay providers for research before they receive and consume services”

“Any ex post variation in payments made to the research firm based on actual services received should be made in a proportionate and predictable manner based on those [ex ante] criteria”



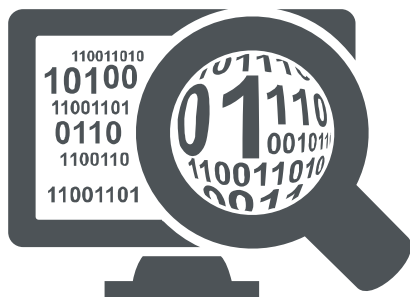
FCA view

Firms must have in place clear frameworks to evaluate the type, level and the quality of research services before reception and consumption

Payments to third party research providers from a set budget must also be subject to management control and oversight

The service and levels of payment to be reviewed on a regular basis (e.g. in-year)

Trial periods and connected research



Trial periods:

- The FCA has amended COBS 2.3A.19R to include that a limited trial period for a research service subject to other strict conditions constitutes an acceptable non-monetary benefit
- Conditions for an investment firm:
 - Can only receive a free trial for up to three months
 - Should not be required to provide any monetary or non-monetary consideration to the research provider for research received during trial
 - Should not accept a new trial with the same provider within a 12 month period from the date on which a previous trial, or existing research agreement, ceased
- Research for a trial period should be consistent with the other conditions for acceptable minor non-monetary benefits

Connected research:

- The FCA amended COBS 2.3A.19R indicating that connected research can be provided and accepted without being considered as material research that would not be receivable by firms subject to the inducements regime
- This is a limited exemption and does not extend to provision of research outside a capital raising context

Payment for RPA administration and mixed use services



- **Market data services and RPA administration do not fall under the description of research under the new rules, and therefore, such services cannot be paid for from an RPA**
- **The FCA is of the view that an investment firm should pay a discrete charge to an RPA administrator from the firm's own resources**
- **Charges are decided on a mutual agreement between the investment firm and the RPA administrator**

Further issues



**Blocking of
unwanted research**

**Fixed income
research**

**MiFID requirements
vs US brokers
receiving payments
for research**

Product governance

Scope



EU investment manager

EU subsidiaries of non-EU firms/global groups



EU and non-EU UCITS managers (for activities outside any 'top up' permissions) *

EU and non-EU AIFMs (as above) *

Non-EU investment managers *

For UCITS, the manufacturer is generally considered to be the ACD but can also include the sponsor(s)
For self-managed UCITS/AIFMs, manufacturer is the UCITS/AIFM itself plus any additional sponsor.

* While these entities may be out-of-scope as a regulatory matter, they may come into scope as a contractual matter

Liability between co-manufacturers

In-scope co-manufacturers

- In-scope for all regulatory requirements regardless of contractual split
- Have own regulatory obligations as regulated entity which cannot shift
- Contract operates like an outsourcing (so regulatory responsibility remains) and like an SLA

Out-of-scope co-manufacturers

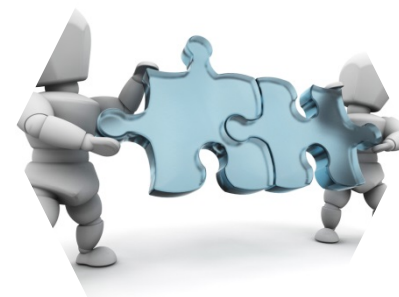
- Out-of-scope for regulatory requirements
- Watch increased regulatory risk if assume regulatory requirements through a contract with an in-scope distributor

In-scope / Out-of-scope co-manufacturers

- In-scope co-manufacturer likely to be in-scope for all regulatory requirements regardless of any contractual shifting of a regulatory requirement to the out-of-scope co-manufacturer
- Contractual indemnity cannot compensate for reputational damage

Likely legal position

- **Starting Position:** Both firms jointly and severally liable
- **Factual Overlay:** Actual role played by the co-manufacturer to limit the extent of a firm's liability for the regulatory responsibility
- **Contractual Overlay:** Non-binding consideration that regulators will take into account provided:
 - delegation is of a responsibility that can genuinely be delegated
 - delegation is reasonable
 - co-manufacturer retains sensible oversight



Out-of-scope Co-Manufacturers



- **Are out of scope manufacturers choosing to comply by providing data / information through the EMT?**
 - A. Yes
 - B. No
 - C. Not sure

Proportionality

Infrastructure	<ul style="list-style-type: none">• Complete new infrastructure or separate infrastructure not needed• Can be implemented in such a way that builds on existing structures• Need to sign-post requirements into existing structures for audit trail
Assessment	<ul style="list-style-type: none">• How assessing that proposed proportionate implementation is appropriate?• Assessment of all options in order to have made informed decision?• Level of assessment needed
Governance	<ul style="list-style-type: none">• Senior management sign-off on proportionality needed
Regulatory expectations	<ul style="list-style-type: none">• Lack of market practice• Expect FCA 'good' and 'poor' practice in due course

Proportionality



- **How are firms benchmarking proportionality?**
 - A. Internal assessment only
 - B. Checking what firms are doing through trade associations
 - C. Checking with other firms
 - D. No benchmarking

Target Market



-
- What to do with ‘deviations’ from a Target Market and how to assess / approve as being ‘reasonable’?
-
- What is ‘reasonable’ in assessing/overseeing that products are actually sold to the target market?
-
- For out-of-scope manufacturers who are unwilling to provide EMT information, level of reliance on Prospectus / KID / KIIDs for target market information
-
- Level of detail in disclosing target market (and negative target market)
-
- Level of detail needed in defining target market
-
- Different Member State requirements
-
- Distributing non-EU products – level of detail of target market and disclosure
-

Target Market



- **How are firms assessing that products are sold to the target market?**
 - A. Proprietary surveys of third-party distributors and/or input from sales and distribution teams
 - B. Transaction data from third parties (e.g. order-routing providers, settlement services)
 - C. Bilateral arrangements with distributors (e.g. platforms) for data exchange
 - D. Benchmarking data of sales, fund flows, and market trends from analytics providers

Distributor requests

- Completing the EMT template and EPT template:
 - liability for information provided
 - frequency of updating information
- Target market information requests
- Inputting data into distributor software/system
- Bespoke arrangements
- Watch rebate requests
- Member State differences in application of requirements

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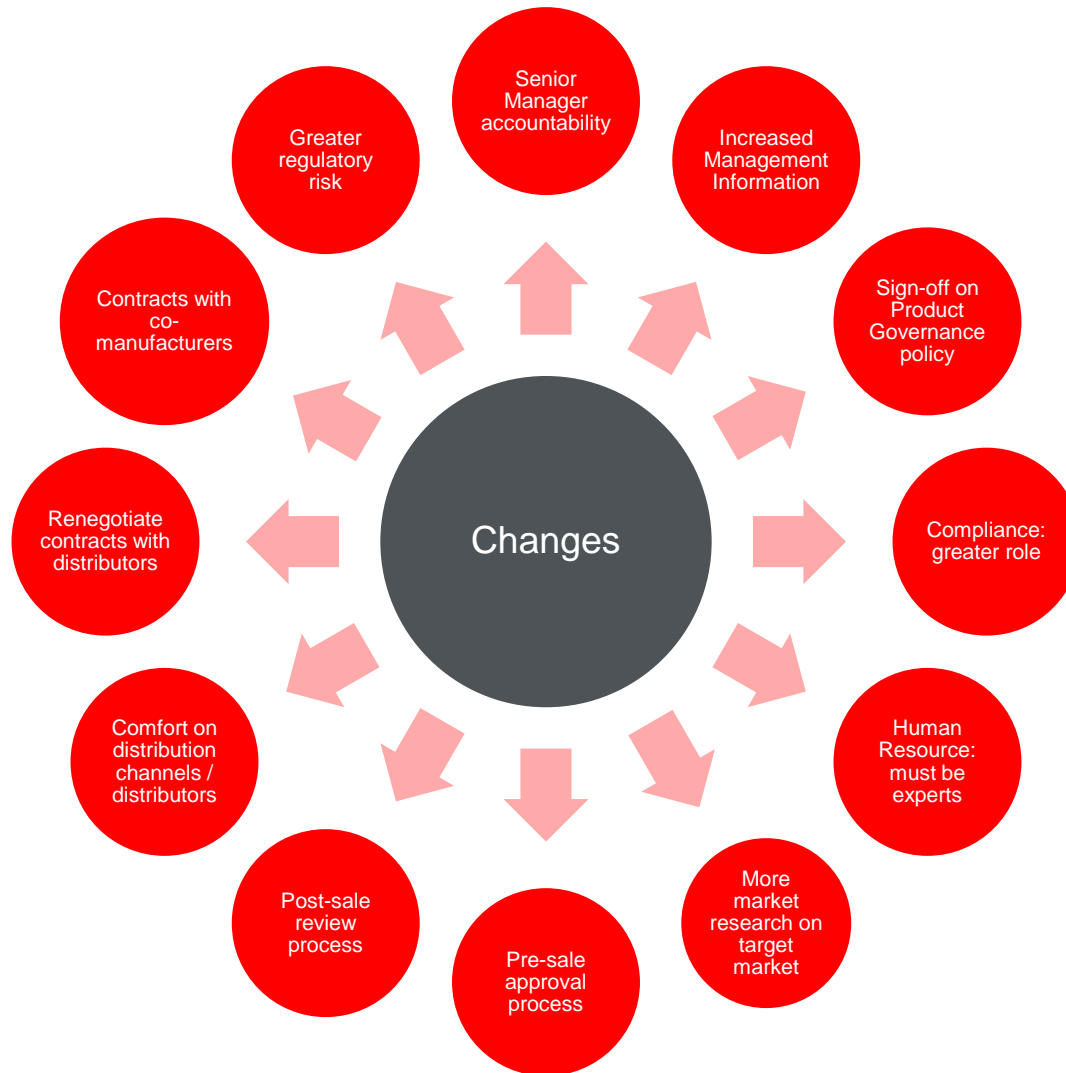
We support the product-governance provisions in MiFID II and expect them to lead to improved customer outcomes

FCA Consultation Paper III CP16/29

”



Implementation projects



Existing products

Back book of products

- ESMA Final Guidelines: products manufactured or distributed before 3 January 2018 are out of scope for product approval requirements
- If they are relaunched / reissued, they are back in scope
- Products manufactured before 3 January 2018, but distributed after, are in scope (products treated as if manufactured by an out-of-scope entity)
- All subject to annual review process

Exceptions

- Reviewing existing distribution arrangements
- Existing products that are not closed off for investment are treated as in scope products
- Existing products that have new tranches / share classes / issues / series, etc

“

MiFID II product governance obligations are to be observed from the date of application of MiFID II

ESMA Level 3

”



Existing products



- **When are firms with a back book of products proposing to conduct their first annual review?**
 - A. Before Q3 2018
 - B. Q3 2018
 - C. Q4 2018
 - D. Q1 2019 or later

Costs and charges

Legal Requirements

EU Developments



Level 1

- Provide appropriate information **in good time** to clients / potential clients
- Information means:
 - ✓ **all costs and associated charges**
 - ✓ relating to **investment** and **ancillary services**
 - ✓ including cost of **advice, financial instrument** recommended or marketed
 - ✗ those related to the occurrence of underlying **market risk**
 - ✓ **how** the client pays
 - ✓ **third-party payments**
 - ✓ **aggregated** and, when requested, an itemised breakdown
- Provide in a **comprehensible** form
- Provide on regular basis – at least **annually** during the life of the investment
- Member States may mandate **standardised** disclosure

Level 2

- **Total aggregation** plus **separate aggregation** for initial costs, ongoing costs and exit costs
- **£ and %**
- Includes costs charged by other firms **“where the client has been directed to such other parties”**
- Includes product **manufacturing costs** and cost of **managing** products
- Third party payments itemised separately
- **Annex II** to the Delegated Regulation contains the list of costs
- **Limited application** with professional clients and ECPs in particular circumstances
- If using UCITS KIID / PRIIPs KID for product costs, check for any **gaps**
- Use **actually incurred costs** (or reasonable estimation) as proxy for expected costs
- Provide **illustration** of cumulative effect
- Post-sale disclosure where there is an **ongoing relationship**: based on actual costs incurred and **personalised**

Level 3

- **Various additional information provided**
- Confirmation that **PRIIPs KID is complete** for covering all product costs, but UCITS KIID is not (does not disclose transaction costs)
- **No prescribed format** for the illustration
- Theme of **greater liaising** between MiFID firms and manufacturers to obtain necessary information. **Note**: Development of **European MiFID Template (EMT)**
- Use PRIIPs methodology for packaged products that are otherwise a PRIIP but not sold to retail but not for instruments that are not PRIIPs
- **Transaction costs** for UCITS and non-UCITS (i.e. funds not using a PRIIPs KID) should be assessed using the PRIIPs methodology
- Implicit and explicit transaction costs assessed on same basis as in PRIIPs (Note: This includes **slippage methodology**)
- Limited **transitional provisions** for first year post MiFID implementation

Directly applicable into the UK

Legal Requirements

UK Implementation



FCA PS 17/14:

- Delegated Regulation is directly applicable in the UK. Notwithstanding this, the FCA is copying it verbatim into COBS
- FCA is approaching implementing the MiFID II Level 1 requirements by lifting and dropping into COBS
- No gold-plating save in respect of RDR
- Rules apply to Article 3 exempt firms doing MiFID business
- New MiFID II requirements not being extended to non-MiFID business of firms (this includes the changes in relation to dealings with professional clients / ECPs)
- UK not proposing to prescribe a standardised format for disclosure but is open to the industry working on such an initiative

Legal Requirements

UK Implementation: Scope and Territoriality

- Applied as **rules** for:
 - UK firms undertaking **MiFID business** (including appointed representatives)
 - Subject to Brexit, **EEA firms** undertaking MiFID business from an establishment in the UK (but not where the EEA firm is undertaking business on a cross-border basis into the UK)
 - Subject to Brexit, **UK firms** undertaking MiFID business into other EEA states (whether on a cross-border basis or from an establishment in that member state) but not where the business is provided from an establishment in that member state to clients in that member state (as then the rules of the host member state apply)
 - **Third country firms** under MiFID business in the UK (UK is making the regime equivalent for third country firms)
 - **Article 3 MiFID exempt firms** doing MiFID business
- **Optional:** Firms can elect to apply MiFID II requirements to non-MiFID business but this is not a requirement. If this election is not made, existing cost disclosure rules / guidance apply

“

There are significant differences between the current and new MiFID approaches to disclosing costs and charges

”

FCA: CP16/29



Legal Requirements

UK Implementation: Transitional Arrangements



Back book of products / investments

- If product closed and no ongoing relationship, requirements **do not apply** but triggered again with certain events, e.g. investment maturing
- If product closed but ongoing relationship, **post-sale reporting applies** from 3 January 2018 but potential difficulties with availability of data
- If relaunch / reissue product back **in scope** for ex-ante and ex-post disclosures
- FCA appears to have accepted that post-sale reporting can start from **Q1 2019** to allow firms a full year to obtain data

Exceptions

- **Newly authorised MiFID firms** that have no historical data (in which case assess using 'reasonable estimations')
- **New clients** (again, make 'reasonable estimations')
- ESMA prescribes what amounts to a **reasonable estimate**: see ESMA Q&A on investor protection, 6 June 2017, Section 9, Question 14

Legal Uncertainties

UK Position



- **Transaction Costs / Implicit costs**
- **Illustration** of cumulative effect on return: possible performance scenarios (neutral, positive, negative)?
- **'Slippage methodology'**: used in PRIIPs but MiFID disclosures are not required to account for those related to the occurrence of underlying market risk. What is the interpretation of 'occurrence of underlying market risk'?
- Meaning of **"to which the client has been directed"**?
- **Regulatory liability** of distributor for disclosing manufacturers' costs/KID if they are incorrect. New COBS 2.4.6R(2): Firms can rely on information provided in writing by another person to the extent it is reasonable to do so. Scope of liability for data providers in EPT/EMT?
- Disclosure of costs and charges needs to address **other regulatory requirements**: Inducements; Conflicts (although disclosure should be a means of last resort); Best execution; Trade confirmations; Use of dealing commission
- **Unpacking the assumptions**: Personalised disclosures required but based on assumptions including assumed investment amount, yet are prescribed assumptions in the KID/KIIDs
- How to deal with disclosing permitted **trail commission**
- Disclosure on **'services'** versus **'instrument'** basis
- Meaning of **'in good time'**
- Assume **no growth**?
- What if no recommended **holding period**?
- How does **limited application** work?

Legal Uncertainty

Meaning of “in good time”



- This may vary and firms should take into account the **needs, experience** and **knowledge** of the investor (**Recital 83, MiFID II**).
- **Recital 84, MiFID II:** Provided that the information is communicated to the client in good time before the provision of the service, nothing in MiFID II obliges firms to provide it:
 - immediately
 - at the same time as other information requirements
 - separately or
 - by incorporating the information in a client agreement
- COBS 1.2.5G and COBS 2.2A.3R(1)
- **Plain English meaning:** Before + sufficiently early that there is ‘time to spare’
- Note: **Loss of ‘distance communication’ carve-out** in order to provide information after and not before

Minimum time period

- Based on method of delivery of information

+

Reading time period

- Vary depending on length of document / format

+

**Comprehension
Time Period**

- Vary depending on the target market / complexity of what has been provided

+

**Tailoring to
customer**

- Due to category of customer may need additional time
- Objective assessment on the subjective needs of customer

-

Any set-off factors

Implementation Challenges

Generally



Implementation Challenges

Asset Managers



Investment Association/TISA work

- Frequency of reporting and use of KID/KIID
- Granularity of reporting detailed breakdown of costs and charges
- Use of standardised templates for disclosure of costs and charges ex ante and ex post
- Materiality
- Look through costs
- Commencement of reporting requirements
- Ex ante disclosure for execution-only services
- Disclosing cumulative effect of charges
- Ex ante disclosure requirements for spikes and fluctuations

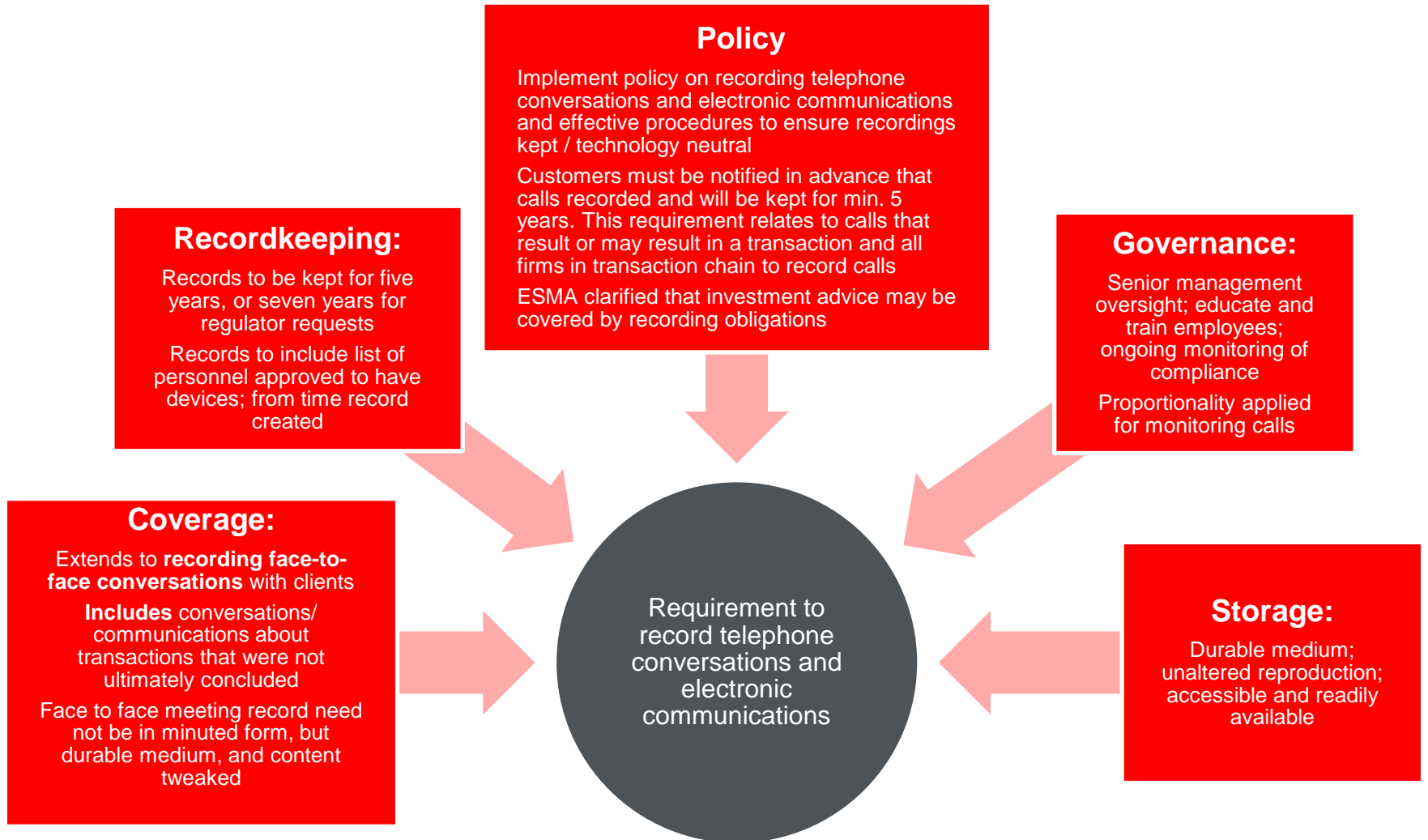
Costs and charges



- **Are UCITS / PRIIPs managers proposing to provide additional costs data to distributors?**
 - A. Yes
 - B. No
 - C. Not sure
- **Are non-UCITS manufacturers on track to product PRIIPs KIDS?**
 - A. Yes
 - B. No
 - C. Not sure

Recording communications

Overview



Level 3

Q1: Which communications re: handling of orders and transactions need to be recorded?

- Expectation that firms will record all internal telephone calls or electronic communications regarding the handling of orders and transactions
- No expectation that persons carrying on back-office functions will be captured by the requirements
- Records of any internal face-to-face conversations that relate to the receipt/transmission of orders, execution of orders and dealing on own account are caught by the general record-keeping requirements

Q2: Can firms charge their clients to access recordings?

- This is at the discretion of the firm
- There is no prohibition
- However, overall responsibility to comply with national laws on whether it is permissible to charge clients to access recordings

Q3: How does proportionality work with monitoring records?

- Means appropriate to the nature, size and complexity of a firm's business
- Consider likelihood of misconduct re: market manipulation or not acting in clients' best interests
- Non-exhaustive list of criteria to take into account: (i) volume and frequency of dealing on own account; (ii) volume, frequency and characteristics of client orders; (iii) characteristics of clients; (iv) financial instruments and services offered; (v) market conditions
- The results of monitoring should also inform the frequency and scope
- Monitoring should be conducted regulatory and ad hoc and taking into account emerging risks

Q4: What are the expectations by competent authorities on the retention of records for 7 years?

- If a competent authority has not made a request to a firm to put aside recordings within 5 years (beginning of the retention period), a firm does not have to keep those recordings for longer than 5 years
- If a competent authority does request them, they should be retained until the competent authority needs them or they indicate that the recordings are no longer of interest
- If a firm is unclear, it should contact the competent authority for confirmation

Level 3 continued

Q5, Q10 and Q11: *What types of communications are covered?*

- Includes (amongst others) video conferencing, fax, email, Bloomberg mail, SMS, business to business devices, chat, instant messaging and mobile devices (including mobile applications)
- Conversations / communications with a client / person acting on behalf of a client
- Relates to an agreement by the firm to carry out one of the covered activities whether as principal or agent, or to reach an agreement to carry out one of the covered activities, even if does not conclude an agreement (including prices, solicitations, bids, offers, indications of interest and requests for quotes)
- Such as transmitting an order to a broker or placing an order with an entity for execution, conversations or communications relating to the handling of the order (including solicitations and acceptance of transactions)

Q6: *Can the monitoring function be done by compliance or does it need to be a separate department?*

- No separate department is required by MiFID II
- However, monitoring is an essential piece of the overall compliance and monitoring system a firm has to implement through governance arrangements

Q7: *Is the recording obligation a critical or important function for outsourcing rules?*

- Taping will be considered to be a critical or important operational function

Q8: *Does the recording need to be from start to end?*

- Yes – firms need to record the entirety of telephone conversations and electronic communications
- This is because it is impossible to appreciate upfront whether the conversation will lead to the conclusion of a transaction

Q9: *Does giving clients access to the recording include a firm's internal communications?*

- Yes. The obligation extends to internal conversations and communications between employees and contractors of the firm which relate to the provision of the order

Taping



- **What approach are firms taking in terms of who to record?**
 - A. All CF30s
 - B. Execution desks only
 - C. PMs but only if they can execute trades
- **Are firms providing unrecorded and recorded lines?**
 - A. Yes
 - B. No
 - C. Undecided

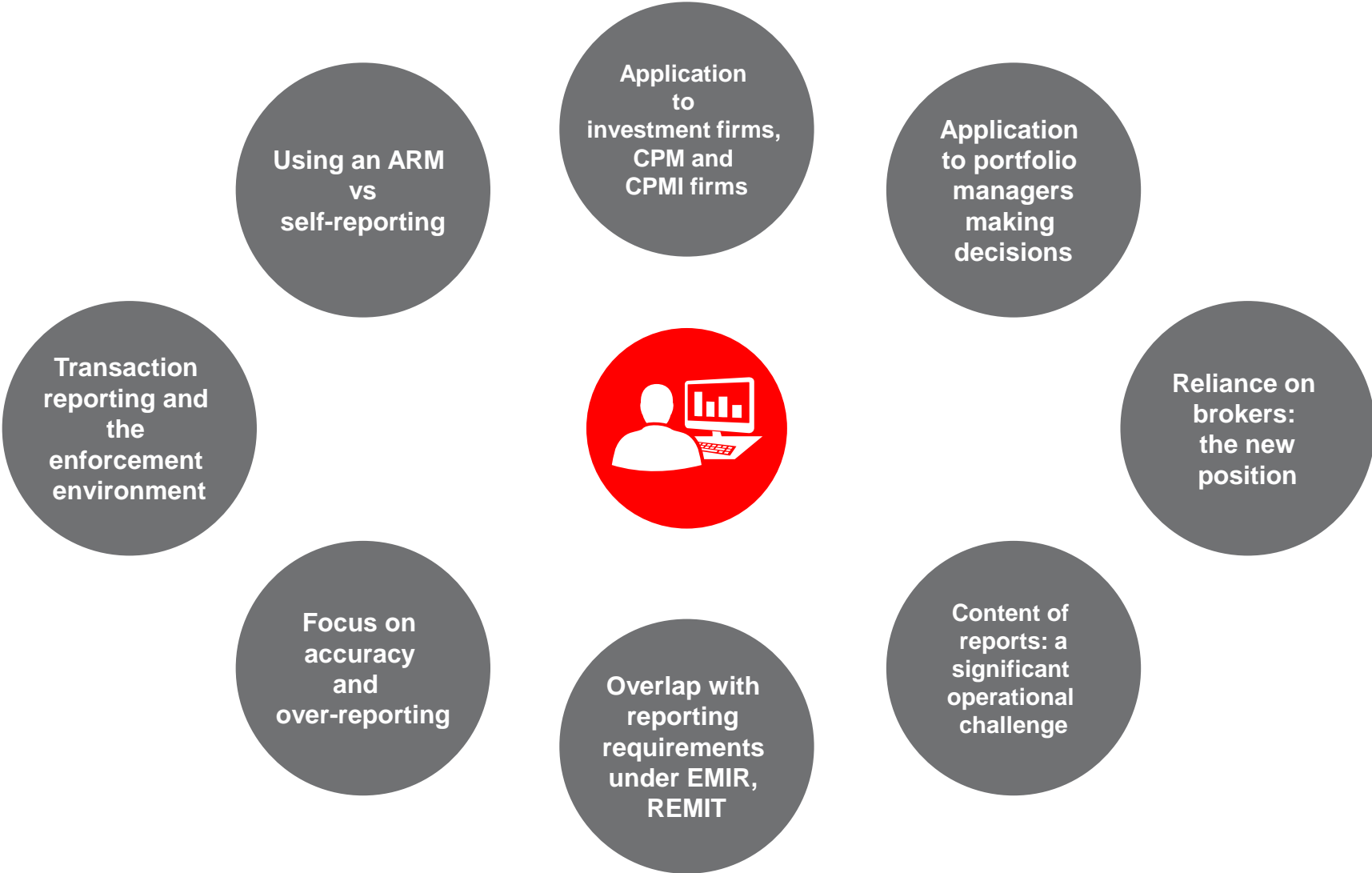


Transaction reporting

Transaction reporting: Investment firms

<p>Which trades?</p>	<p>Investment firms that execute transactions in financial instruments:</p> <ul style="list-style-type: none"> • that are admitted to trading or traded on a trading venue or for which a request has been made • where the underlying is a financial instrument traded on a trading venue • where the underlying is an index or basket of financial instruments traded on a trading venue
<p>Transactions and execution</p>	<p>Transaction means conclusion of an acquisition or disposal subject to various exceptions listed in RTS 22</p> <ul style="list-style-type: none"> • Execute means: <ul style="list-style-type: none"> – reception and transmission of orders in relation to one or more financial instruments; – execution of orders on behalf of clients – dealing on own account – making an investment decision in accordance with a discretionary mandate given by a client – transfer of financial instruments to or from accounts • Acquisition means any purchase, entering into derivative, increase in notional amount • Disposal means any sale, closing out of derivative, decrease in notional amount
<p>Which information?</p>	<ul style="list-style-type: none"> • 65 fields (new fields include client ID, IDs of person or committee that make decision to trade and also responsible for decision and execution) – see ESMA Guidelines for explanations • Legal entities to be identified by LEI codes, simplified concatenation for individuals • Codes for algos and committees must be unique, consistent and persistent • Various new designations – eg. transparency waivers, short sales
<p>How?</p>	<ul style="list-style-type: none"> • Firms can report themselves or through an ARM or trading venue – they must take reasonable steps to ensure compliance where they don't report themselves and remain responsible • Trading venues will report trades executed by firms not subject to reporting obligation
<p>To whom and by when?</p>	<ul style="list-style-type: none"> • Home competent authority of firm, even where a branch executes the transaction • Branch code to be included where it receives order or makes decision, has supervisory responsibility for person responsible for decision or execution or transaction is executed on trading venue outside EU using branch membership • As quickly as possible and no later than end of next working day
<p>Link to EMIR?</p>	<ul style="list-style-type: none"> • Transactions reported to a trade repository under EMIR count provided: <ul style="list-style-type: none"> – that trade repository is also an ARM – the report contains all the required details – trade repository transmits information to competent authority

Transaction reporting: some key angles for the buy-side



Transaction reporting



- **How are firms proposing to approach transaction reporting?**
 - A. Report through brokers
 - B. Use ARM
 - C. Self-report
 - D. Undecided

Upcoming final session

Room details for the final session

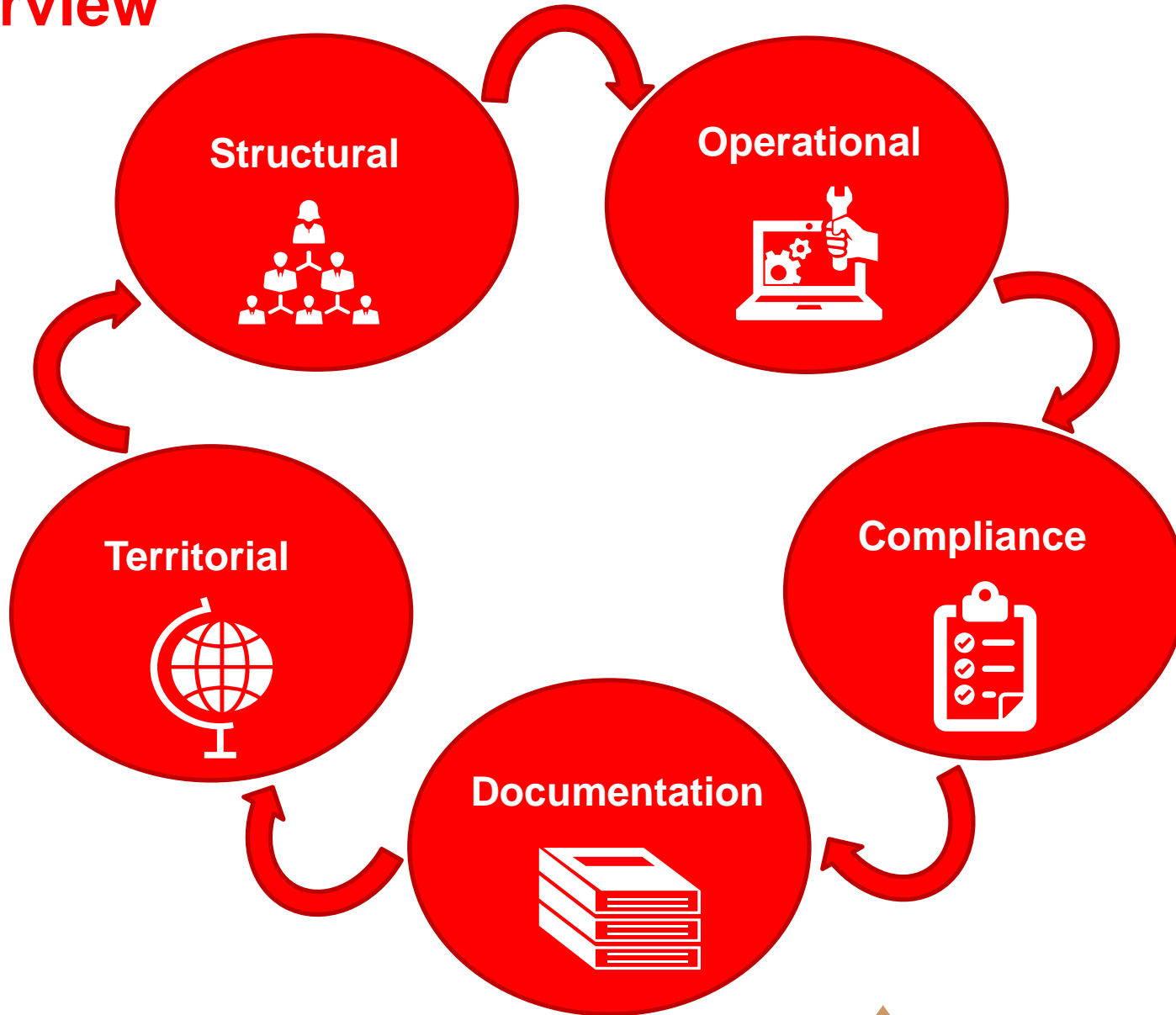
Time	Topic	Room
10:15 – 10:30	Coffee and tea	Terrace Suite
10:30 – 11:15	Practical MiFID II documentation and compliance: <ul style="list-style-type: none">• Compliance documentation challenges• Customer facing documentation• Securing consents from clients	Terrace Suite

3. Session B: Sector focus – Sell-side topics: Trading in the MiFID II world

**Jonathan Herbst and Hannah Meakin
Partners, Norton Rose Fulbright LLP**

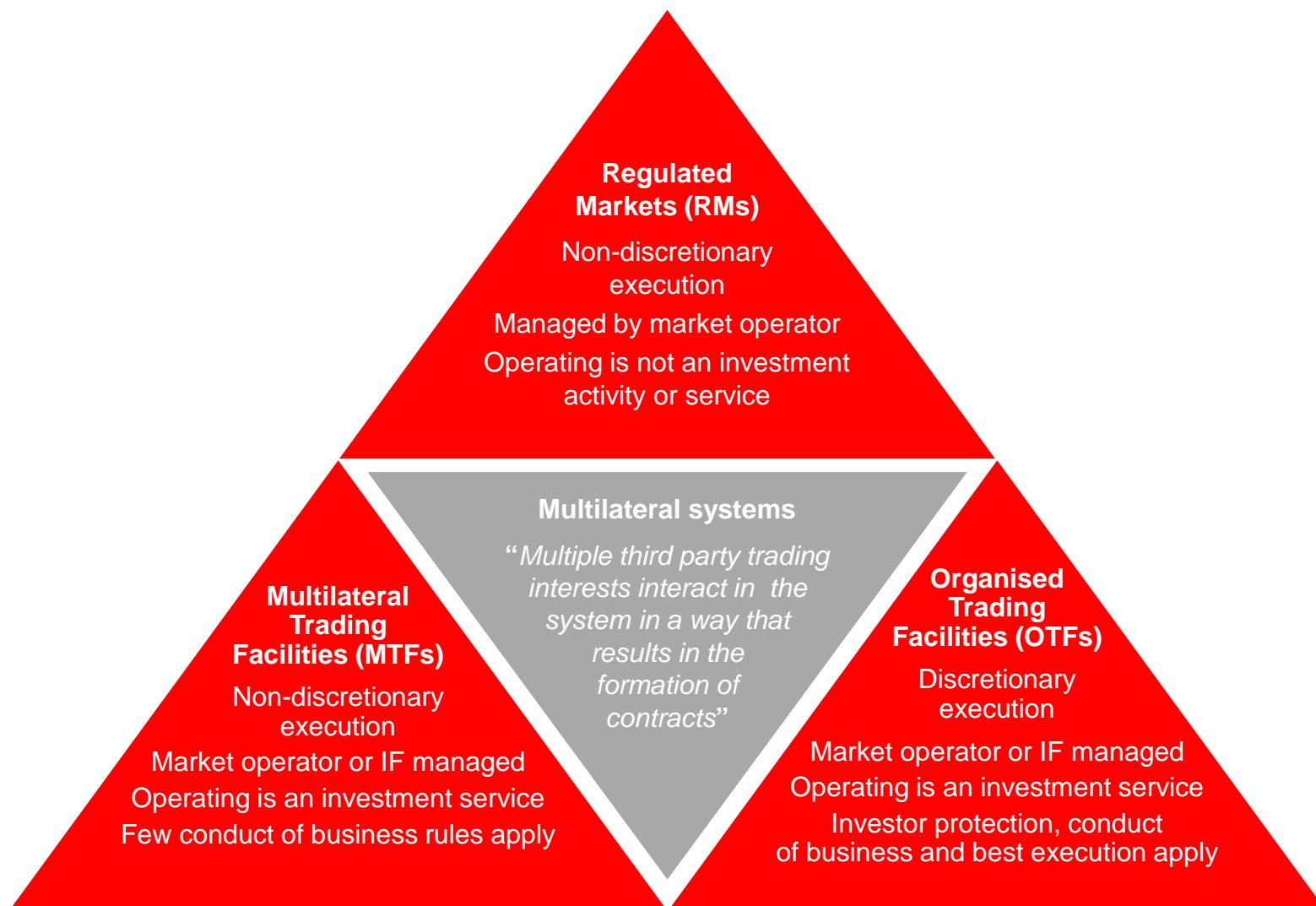


Overview

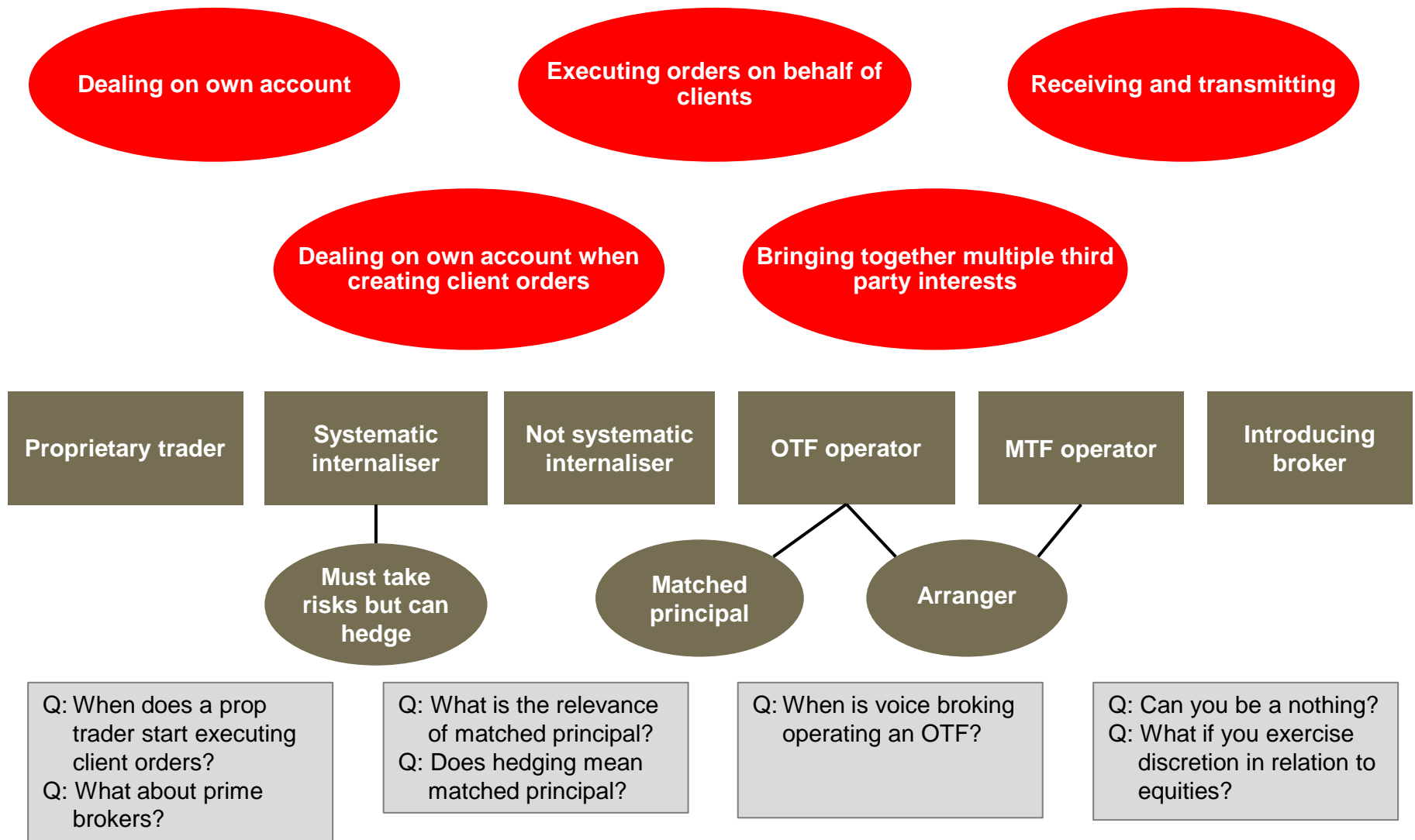


Structural

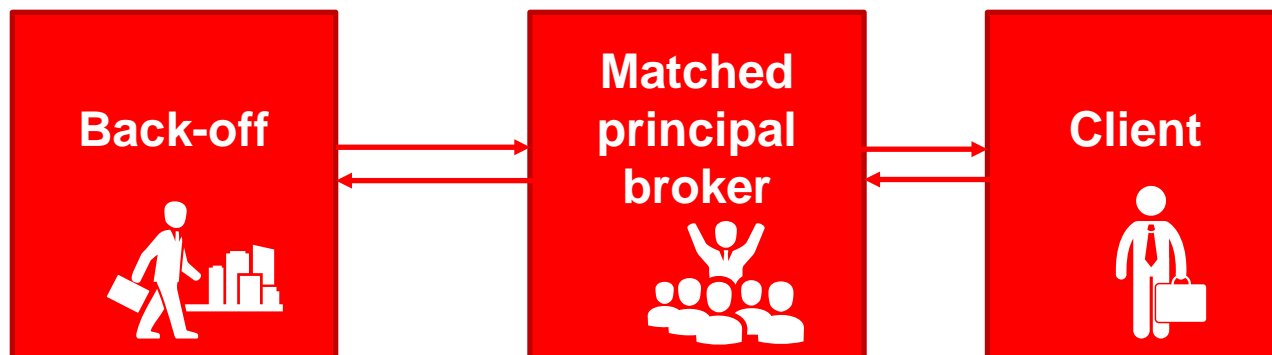
Trading venues: New concepts and boundaries



How do you know what you are?



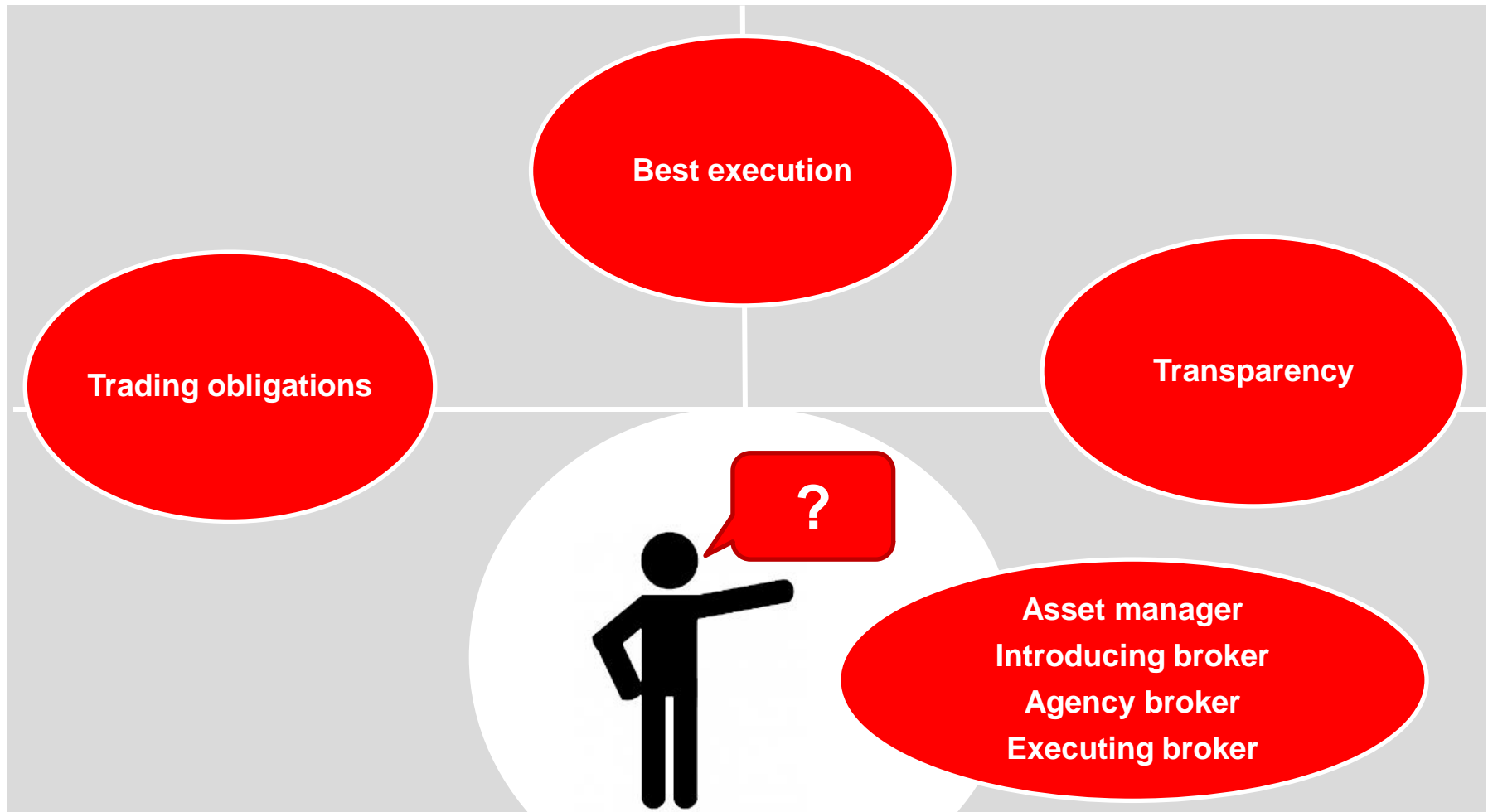
What becomes of matched principal?



- Need to navigate OTF: are you bringing together multiple buy and sell interests?
- Who is the back-off? What if it is another trading venue?
- Are we precluded from being an SI because we're not taking risk?
- Should we read the definition of matched principal literally?
- Does the new Article 16A on matching arrangements change any of this?

Operational

What do I need to consider when deciding where to execute?



Trading obligation: Shares and derivatives

Shares

- **What?** Shares admitted to trading on a regulated market or traded on an MTF
- **Where?**
 - Regulated Market, MTF, Systematic Internaliser (SI)
 - Equivalent third country trading venue
- **Who?**
 - Investment Firms
 - Only Investment Firms can be direct members of trading venues

- **Trading obligation does not apply to trades that are:**

- Non-systematic, ad hoc, irregular and infrequent;
- Carried out between eligible and / or professional counterparties and do not contribute to price discovery;
- In shares or equity instruments not admitted to trading on a regulated market or traded on an MTF; or
- By non-Investment Firms (only)

These parties / instruments can trade OTC

Derivatives

- **What?** Derivatives that are traded on a trading venue that are sufficiently liquid and declared subject to the trading obligation
- **Where?**
 - Regulated Market, MTF, OTF
 - Equivalent third country trading venue
- **Who?** Transactions between:
 - An FC and another FC
 - An FC and an NFC+
 - An NFC+ and another NFC+

(and third country entities that would be subject to clearing obligation in certain cases)

- **Trading obligation does not apply to:**

- Non-equity instruments that have not been declared subject to the trading obligation
- Any trade with an NFC- (including if it trades with an FC or NFC+)

These parties / instruments can trade OTC or on an SI

Does it matter what you're trading on?

	Regulated market	MTF	OTF	Systematic internaliser
Advantages	<ul style="list-style-type: none"> • Good for shares and derivatives trading obligation • Likely to have liquidity • Will have CCP clearing • May offer additional services – e.g. reporting • Well established 	<ul style="list-style-type: none"> • Good for shares and derivatives trading obligation • Potentially simpler to become a participant • Potentially more flexibility than a regulated market • Same trading protections as a regulated market 	<ul style="list-style-type: none"> • Good for derivatives trading obligation • Good for gas, power, coal and oil derivatives that must be physically settled • Discretion? • Rulebooks may be lighter than MTFs / may have more flexibility 	<ul style="list-style-type: none"> • Good for share trading obligation • You get quotes • Quotes should provide for best execution • Orders are not made public • Not subject to double volume cap • Bilateral relationship may allow more flexibility
Disadvantages	<ul style="list-style-type: none"> • Not everyone can trade directly on a regulated market • Excludes own account dealing exemption, although overseas persons may be able to overcome this for UK markets 	<ul style="list-style-type: none"> • Excludes own account dealing exemption • May not have a CCP clearing solution • Some flexibility may diminish as regulators start treating them more like regulated markets 	<ul style="list-style-type: none"> • Cannot use for equities • Once an order has gone into the pool, it cannot be executed elsewhere unless taken out again • Discretion? • Less likely to have a clearing solution 	<ul style="list-style-type: none"> • Cannot use for derivatives under trading obligation • Quoting obligations only apply up to SMS or SSTI • Commercial policy may allow SI not to trade on any occasion

Best execution

Question

How does the best execution duty relate to other obligations under MiFID II, particularly for OTFs and SIs?

Obligations

- *Best execution*
- *Trading obligation for shares*
- *Trading obligation for derivatives*
- *SIs making firm quotes*

- MTFs do not have to provide best execution; OTFs and SIs do
- OTFs have to exercise discretion but they cannot connect with an SI or another OTF in such a way that enables orders to interact. How limiting is this?
- An SI's quotes must reflect prevailing market conditions, and they can only price improve where the better price falls within a public range close to market conditions
- Best execution must be subject to the trading obligations, where these apply
- Where a firm is acting as agent for a client which is subject to best execution, the trading obligations should be observed

Transparency regime: Dark pool trading?

Shares

- Dark pools continue in theory but volume caps will make unlit trading unpredictable in practice for all but block trades
- Moving to another dark pool could result in a market wide suspension
- Scope for trading elsewhere is limited by trading obligation but could SIs be an alternative?
- Venues and firms will need to be ready to “light up” – will they be expected to have arrangements in place?

Derivatives that are mandated for trading and other liquid non-equities

- Subject to transparency for first time
- Dark pools can exist if trading venues get waivers
- No volume cap
- If transparency drops, competent authorities can suspend pre-trade transparency obligations for up to 3 months but extendable

Whenever instruments are executed on trading venues

Other equity instruments

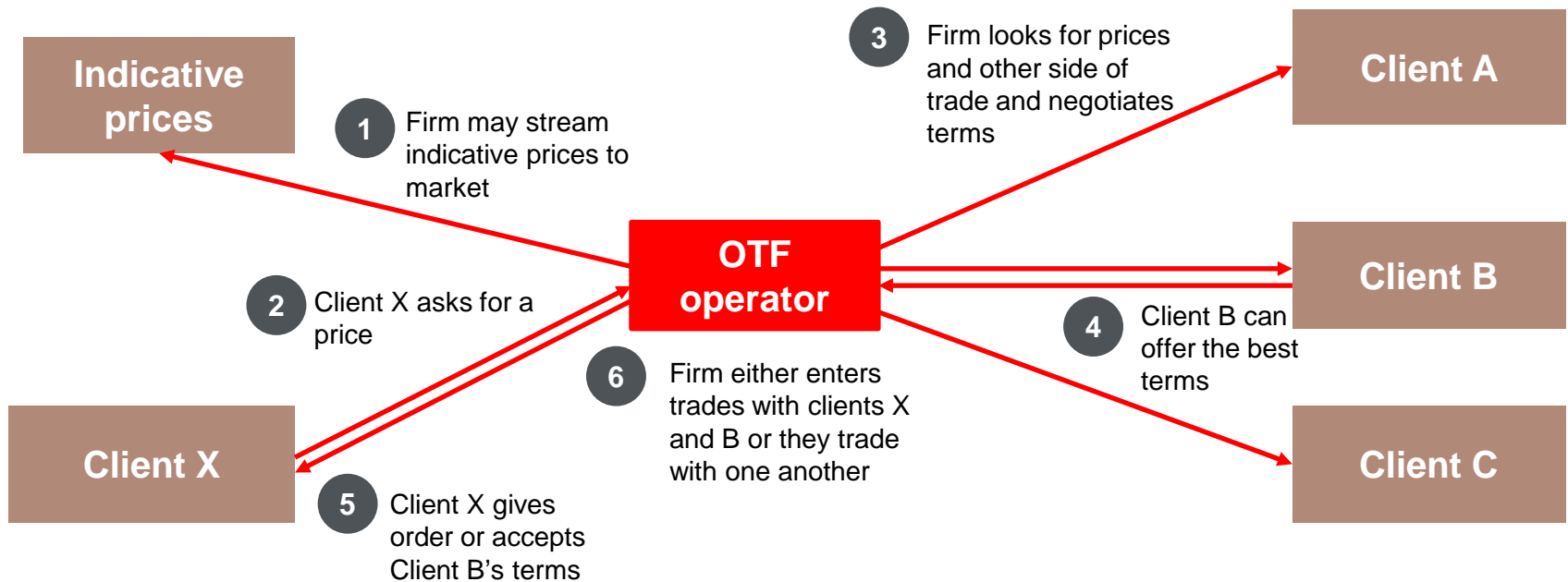
- Subject to transparency for first time and waivers are subject to volume caps
- Volume caps do not apply to negotiated transactions in these instruments for which there is no liquid market in certain cases

Other derivatives and non-liquid financial instruments

- Seemingly wide waiver from pre-trade transparency so this can remain dark
- Competent authorities can withdraw waivers where they think they are being abused

Compliance

OTFs: discretion and conflicts



OTF operator must exercise discretion

- Clients on both sides – can you act in both their interests (even if one is an eligible counterparty)?
- Requirement to prevent conflicts and use disclosure as a last resort only
- How much does each side pay? Need transparent fee structures
- Payment for order flow warnings: also best execution and inducements

OTFs: discretion and best execution

Discretion

=
?

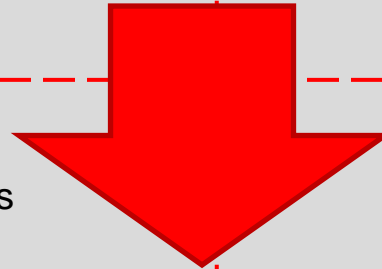
Best execution (not for ECPs)

Order level discretion:

whether to place order on OTF;
how much and when; when and
how to retract order from OTF

Firm level policy: showing
execution venues and factors
for deciding which to use

No discretion if the client gives specific instruction



Execution level discretion: if,
when and how much of the orders
to match; when an order may be
retracted from OTF - must be able
to explain rationale and logical
basis – cannot be random

Separate (part of) policy: how best
result for client is achieved taking
account of interests in system and
any different execution mechanisms
(e.g. voice, electronic, RFQ, order
book)

Documentation

What should we look for in MTF and OTF rules?

Practical

- How can I give orders?
- Who will be my counterparty? Who will I settle against and take risk on? Do I need agreements/ credit lines with other participants or a clearing member?
- How do I sign up to the Rules and how can they be amended? Are there any other arrangements I need?



Commercial

- Does this venue have transparency waivers and deferrals I want?
- How does the charging structure work?
- Are there any incentive arrangements – what are the benefits and obligations?
- Has the broker changed its limits on liability?

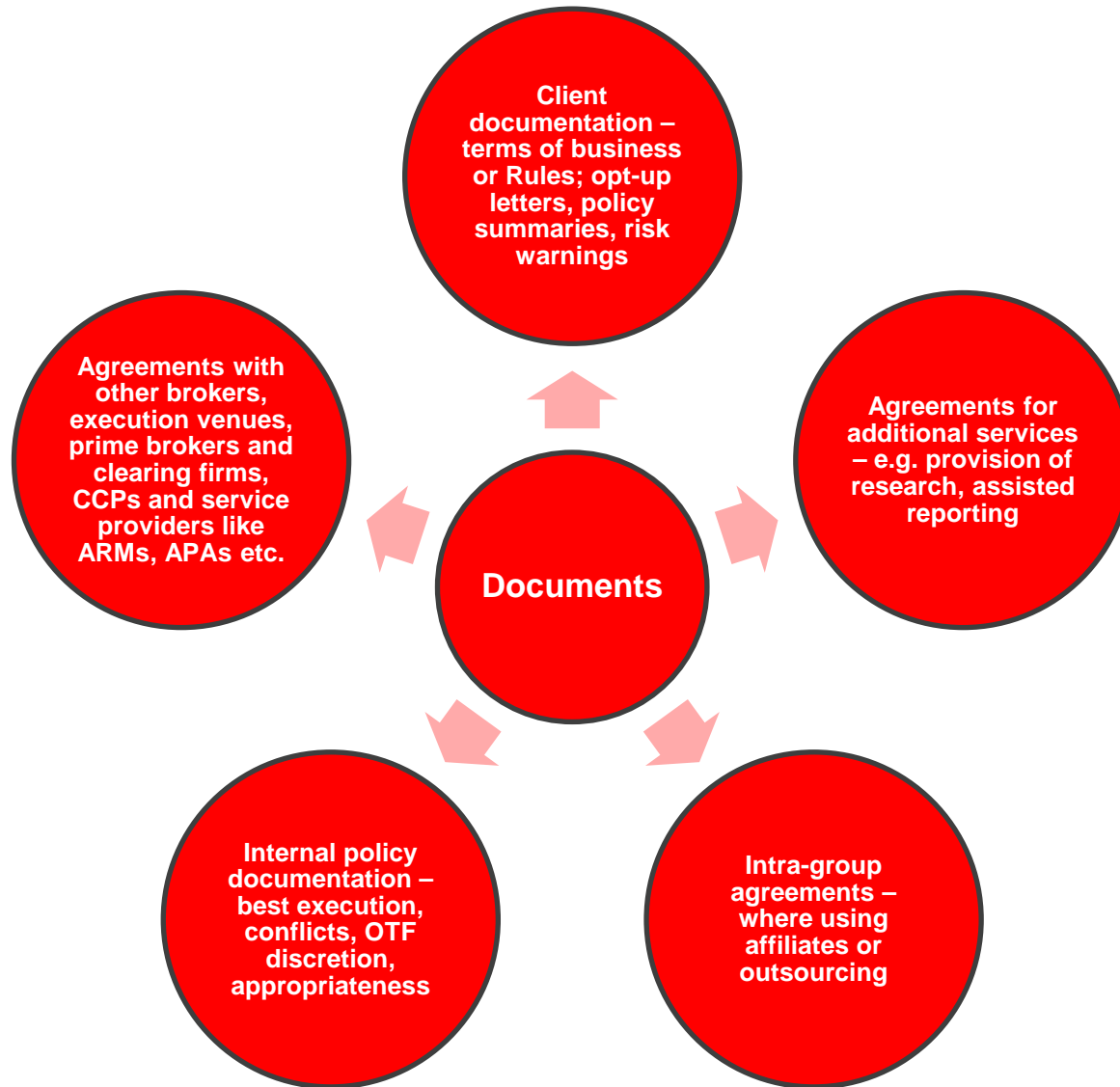


Regulatory

- Who decides whether my order goes into the OTF and how is best execution achieved?
- Am I allowed to interact using an algorithm and on what terms? Am I allowed to offer DEA?
- Is this venue going to report for me? Will it provide any information I need to report myself?

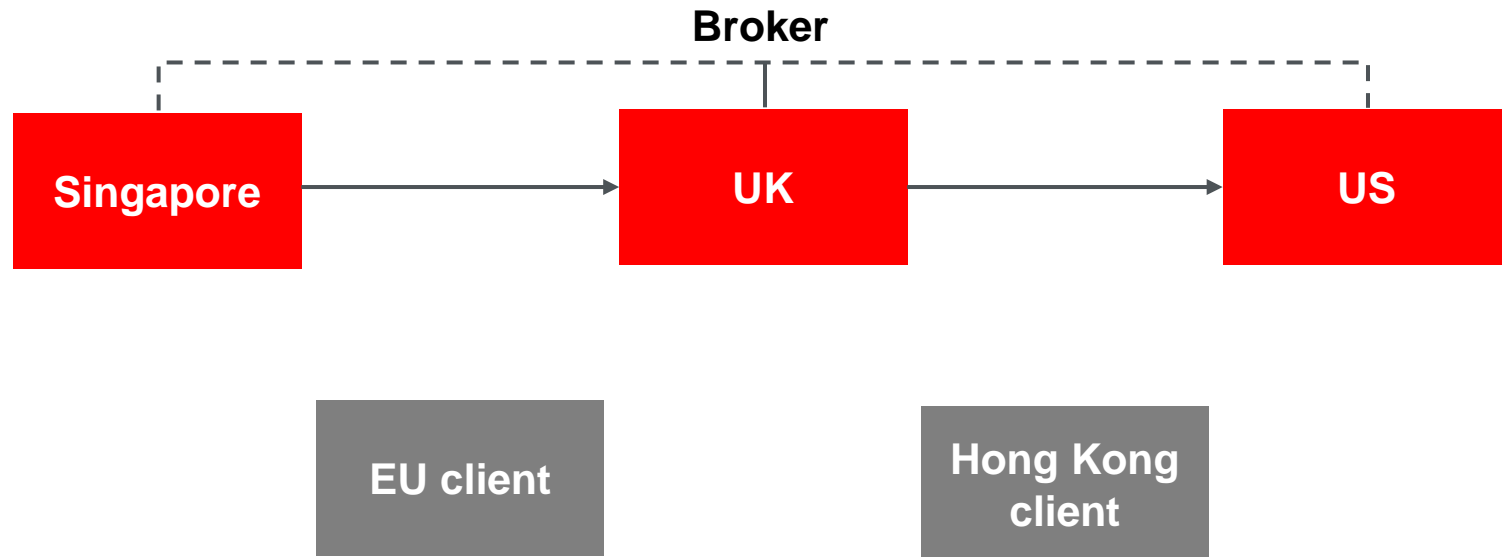


Other documents not to forget



Territorial

Follow the sun models



- When do MiFID II conduct rules apply?
 - EU client
 - Non-EU client
 - Separate legal entities and branches
- Who is a client of which entity/branch?
- What does the client think is happening?

Is it any easier to do business outside the EU?

	Advantages	Disadvantages
<p>Radical: move business to outside the EU and provide services back in</p>	<ul style="list-style-type: none"> • In theory can work for services provided to per se professional clients and eligible counterparties 	<ul style="list-style-type: none"> • Complicated from countries that haven't been declared equivalent as reliant on MiFID II exemptions or national regimes • Numerous carve outs from dealing on own account exemption make it difficult to use • May still be impacted by certain obligations such as derivatives trading obligation and position limits • Some clients may require the same benefits they get from EU firms, like trade reporting • If seen as an avoidance route, EU regulators may impose pressure • Local requirements may be no easier • This may work for the UK but not necessarily for the rest of Europe
<p>Half way: retain client facing entity such as RTO in EU but book trades from other countries</p>	<ul style="list-style-type: none"> • Obligations applicable to RTO are fewer and more manageable • RTO may be able to perform some functions (e.g. client relationship) for non-EU entities on an outsourced basis • It may be possible for overseas providers to treat the RTO as their client 	<ul style="list-style-type: none"> • RTO must still comply with conduct requirements like best execution and reporting • Local law may require overseas providers to treat the client as such and paper the relationship • If seen as an avoidance route, EU regulators may impose pressure • Local requirements may be no easier

Thinking ahead to Brexit

Scoping the scale of the issue: How much trading do you do with EU counterparties or on EU markets?

Alternative solutions:

- Create an EU front end trading vehicle and do back to back trade back into UK: capital efficiency
- Marketing vehicle in EU and rely on reverse solicitation
- Rely on local exemptions, e.g. German exemption for trading on German markets
- Separate question of how much outsourcing will be allowed: how many people will you need onshore?
- Important not to forget the inward UK analysis as well

Upcoming final session

Room details for the final session

Time	Topic	Room
10:15 – 10:30	Coffee and tea	Terrace Suite
10:30 – 11:15	Practical MiFID II documentation and compliance: <ul style="list-style-type: none">• Compliance documentation challenges• Customer facing documentation• Securing consents from clients	Terrace Suite

4. Practical MiFID II documentation and compliance

Hannah Meakin and Charlotte Henry – Partners
Lara White – Senior Associate
Norton Rose Fulbright LLP



In this session we will cover:



Compliance documentation challenges

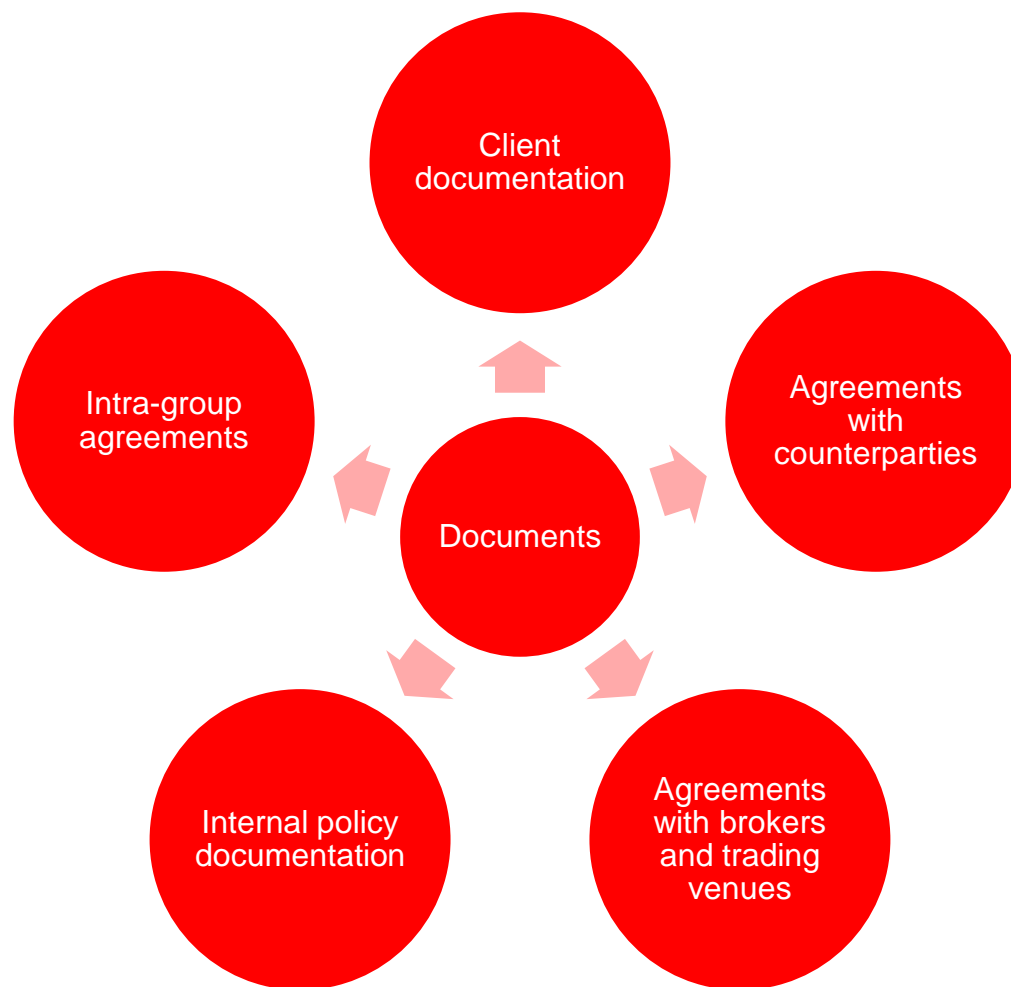


Customer facing documentation



Securing consents from clients

What documents might need to be amended?



Question 1



- **Have you started reviewing your client documentation?**
 - A. Yes
 - B. No

Question 2



- **Do you need to make changes and re-send to clients?**
 - A. Yes
 - B. No

Question 3



- **When are firms intending to communicate changes to client documentation to clients?**
 - A. Already done it
 - B. September
 - C. October
 - D. November

Question 4



- **How are you approaching changes?**
 - A. Just sending additional information
 - B. Amending terms of business
 - C. Getting consents where needed without amending terms

MiFID II requirements

Agreement

- Requirement for a written basic agreement, in paper or another durable medium
- Set out essential rights and obligations of firm and client including: (i) description of services; and (ii) specific requirements for investment advice, portfolio management and custody

Information

- Requirement to provide information to all types of client about: (i) the firm and its services; (ii) financial instruments and proposed investment strategies, especially risk warnings; (iii) execution venues; and (iv) costs and charges
- Can be in standardised format but must allow clients to understand risks

Consent (examples)

- Prior consent required for order execution policy
- Prior express consent required for trading outside a trading venue and the safeguarding of client assets
- Specific consent required for providing information to clients on a website which is not a durable medium
- Explicit consent is required for depositing funds with a qualifying money market fund

Options for amending client documentation

Amend the existing agreement

- **Pros:**
 - Legal certainty
 - Should be able to get consents and include information
 - Might indicate that firm is only amending what is necessary
- **Cons:**
 - Need to amend according to agreed terms and contract law requirements
 - Can be difficult to follow a series of amendment agreements

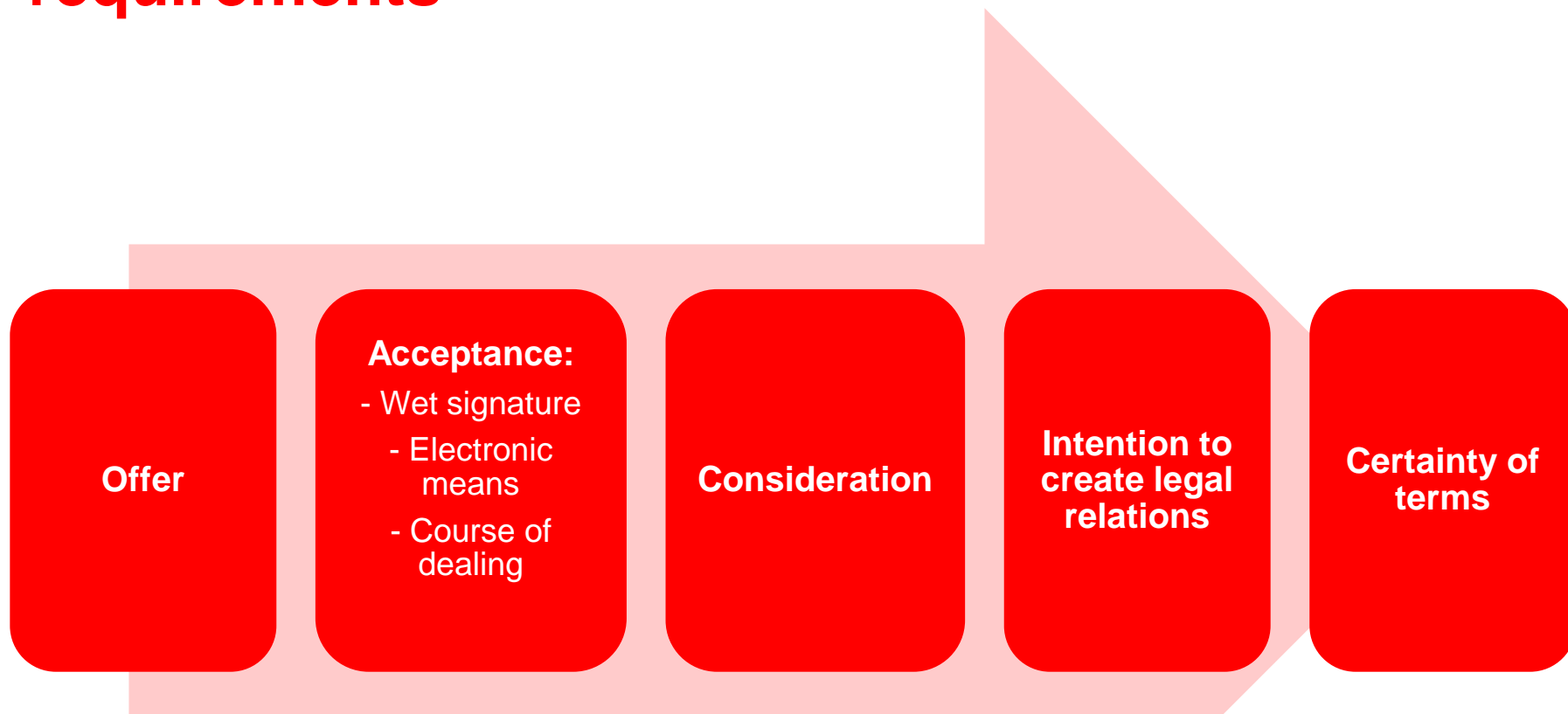
Create a new agreement

- **Pros:**
 - Opportunity to start from scratch
 - Can include consents and information
 - Legal certainty
- **Cons:**
 - Need to terminate old agreement in accordance with its terms
 - Clients may not want to review a new agreement or may want to reopen negotiations on closed points

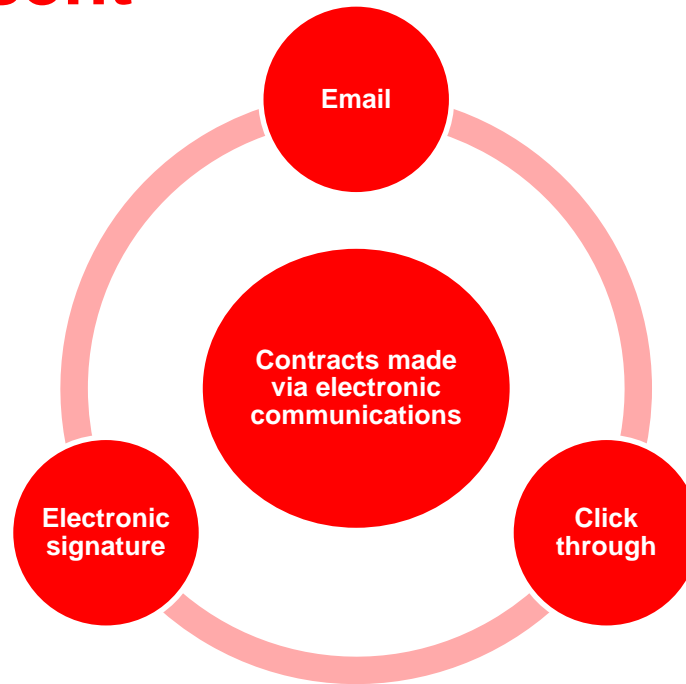
Providing information without contractual effect

- **Pros:**
 - No contractual requirements, quick
 - Could be a client relationship opportunity
 - Good for information requirements
- **Cons:**
 - No legal status
 - Will not work where you need to agree or get consent
 - Difficult for firm and clients to maintain audit trail and for clients to understand implications

Creating or amending contracts – legal requirements

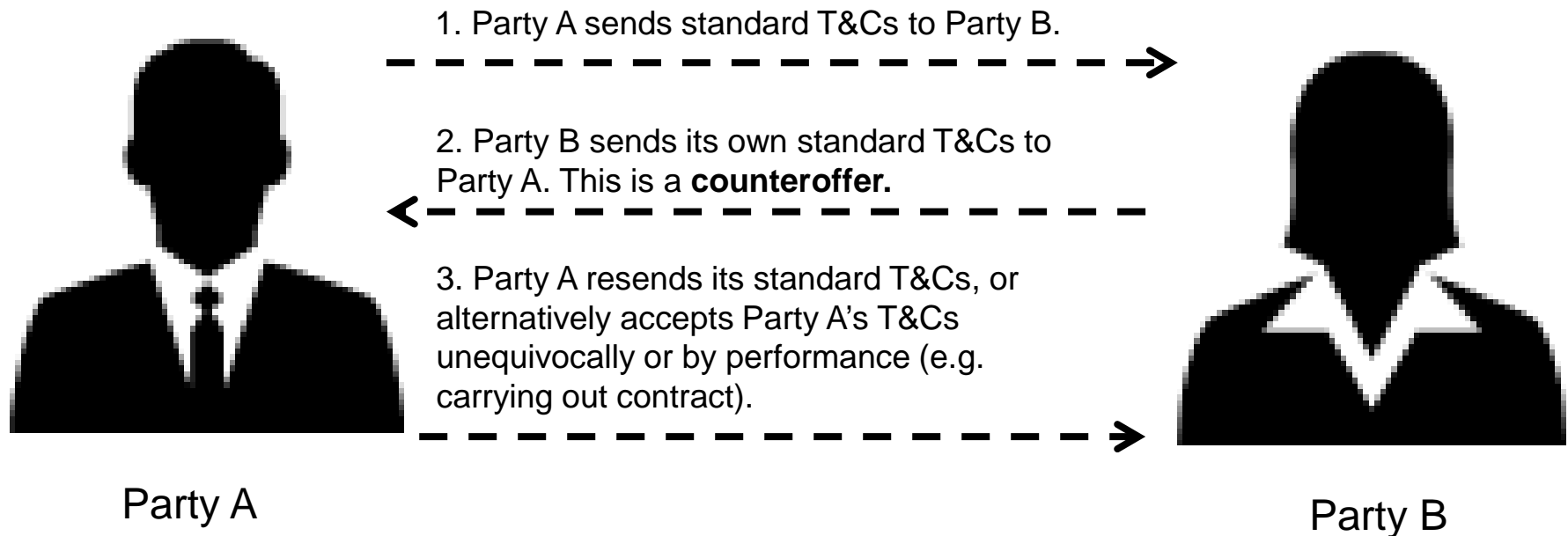


Electronic consent



- Traditional rules of contract (offer and acceptance) still apply to electronic communications
- Under English law, writing includes emails and use of websites provided this is not excluded by statute or agreement – timing of email acceptance does not follow postal rule and is not certain
- To be effective, an electronic signature must demonstrate the party's intention to be bound by the terms – this can be done by typing name on electronic documents; scanned manuscript signature; biodynamic digitised version of manuscript signature; clicking "I accept" button on website; use of cryptography to include digital signature (e.g. can be proven that the sender has adopted/approved the contents of the digital message)
- However, exercise extra caution with deeds

Battle of the forms



The last set of terms despatched before acceptance or performance wins

However, certain exceptions may apply and, in some instances, neither party's T&Cs will be incorporated into the contract. Party A's standard T&Cs will not be incorporated unless it has given Party B reasonable notice of its T&Cs and indicates that it intends to rely on them

What are we seeing in other parts of the market?

Brokerage terms

- Many brokers base their terms on FIA Professional Client Agreement
- This is being updated but, in the meantime, FIA has created a regulatory patch
- This enables firms to update for various regulatory changes including MiFID II by sending a letter attaching amended terms which take precedence over existing terms
- Clients are asked to sign and return but consent is deemed through conduct

MTF and OTF rules

- No standard has emerged so far but normal approach is a short agreement that binds participants to more detailed rules and operating procedures which can be amended on notice, sometimes after consultation
- However, OTFs in particular, may take different approaches given their existing relationships and client-facing obligations
- Rules must be transparent and non-discriminatory

Investment Management Agreements

- Asset managers are now considering how their IMAs need to be updated with client contact anticipated in September
- Investment Association Model IMA is used as a point of reference by many – asset managers do not tend to simply use this document 'as is'
- A suite of MiFID clauses has been developed to meet the September timeframe, with a broader update also underway ahead of January 2018

Question 5



- **How are you proposing to deal with new clients between now and 3 January 2018?**
 - A. Putting new clients on M2 terms early
 - B. Putting new clients onto interim terms
 - C. Giving new clients both current and M2 terms to sign up to

Additional considerations for retail clients

Additional information and consents in MiFID II

E.g., prohibition on title transfer collateral arrangements with retail clients

Consent to communicate by electronic means

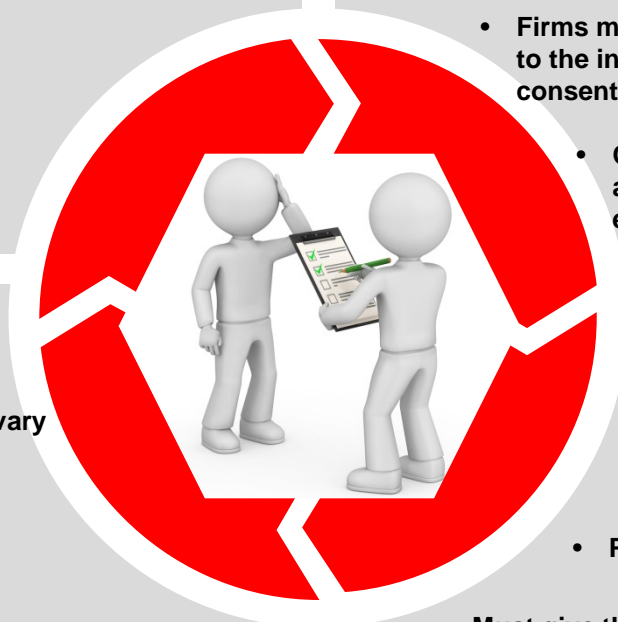
- Providing information through a website in a 'durable medium' requires compliance with the 'website conditions'
- Firms must have evidence of a customer's access to the internet and customers need to have consented to being contacted by electronic means
- Obtaining an email address in an application form is used as a form of evidence of this

Treating customers fairly

- Applies to consideration of whether to vary or obtain consent
- Applies to time period provided for variation/obtaining consent
- Applies to communication to clients in relation to changes
- Applies to method used to obtain consent (e.g. deemed consent)

Consumer Rights Act

- Can only vary for the reasons stated in the variation term
- Prescribed prior notice periods
- Must give the customer the option to withdraw from the service/product 'without penalty'



Question 6



- **Are you doing more than one communication exercise in relation to the changes in the terms?**
 - A. Yes
 - B. No

Documentation with counterparties

Co-manufacturers Agreements

- Difficulties with in-scope/out-of-scope co-manufacturers
- Contractually dividing up regulatory responsibilities
- Increased regulatory risk for out-of-scope co-manufacturers
- Outsourcing/delegation
- Operates as an SLA
- Legal liability

Distribution Agreements

- Existing distribution agreements to be amended.
- Make sure the contractual aspects that reflect product governance requirements are clearly signposted
- Think about what to do with costs and charges disclosures
- Think carefully about sub-distributors and ability to sub-distribute

Research Payment Account Administration Agreement

- Client money issues
- Additional fees to administer the account

A quick word on costs and charges

Disclose aggregated costs and charges for services and financial instruments

Showing the impact of upfront/initial costs, ongoing costs and any exit costs on investment

Disclose a single figure

Disclose in both percentage terms and monetary terms together with a separate illustration (graph, table, etc.)

Primarily for greater transparency and price comparison between services/products, greater investor protection

Disclose pre-sale and, in certain circumstances, post-sale to all client types

Impact on documentation

- Disclosing separately from client agreement / terms of business but ensure retain ability to vary costs and charges
- Explaining what costs and charges disclosure the client will receive / see
- Explaining what other separate documentation will also be disclosed and why – e.g. KIIDs, KIDs

Single disclosure document

Using a single document for all costs and charges disclosures under MiFID II / PRIIPs / UCITS, etc.?

- Possible for certain disclosures (i.e. MiFID II, other UK measures)
- Will assist with mitigating the fact that customers will potentially receive multiple disclosure documents on costs and charges under different regimes (which potentially detracts from being helpful for a customer to understand the investment)
- Using a single document for all disclosures (including those that have prescribed form and content) comes with risks, including:
 - ✗ Risk of non-compliance with prescriptive form and content (and length) requirements in PRIIPs KID and UCITS KIID – strict liability
 - ✗ Risk of making it unclear to customers whether what has been disclosed to them is the KID/KIID or something else
 - ✗ Risk of accepting regulatory burden for the KID/KIID it when may not have intended to disclose it
 - ✗ Risk of not being ‘fair, clear and not misleading’ without industry-wide use

Compliance policy documentation: examples

Order execution policy

- Changes need to be made because, e.g.
 - Policy should be customised and provide sufficient information to be easily understood by clients
 - To reflect new trading venues and trading obligations
 - Granular requirements include new requirements such as explaining risks of trading outside venues and differences in fees charged by firm
- Detailed requirements to be provided by durable medium or website satisfying website conditions in good time before service is provided
- Firms must notify clients of material changes
- Should they be treated as amendments or new policies?
 - MiFID I requires firms to notify clients of material changes but firms may have agreed more
 - Impacts on consents required – but distinguish between consent to policy and consent to off-venue trading

Conflicts policy

- Should be reviewed against enhanced requirements, particularly:
 - Requirement to take all appropriate steps to prevent or manage conflicts
 - More explicit links with inducements and remuneration
 - Requirements for corporate finance activities
- Consider whether and how to provide further details on request
- Consider whether to remove generic disclosures from agreements if not being relied on as means of last resort
- Where last resort disclosures are made, comply with requirements including:
 - Durable medium
 - Clear warning that arrangements are not sufficient to prevent risk of damage to clients
 - Sufficient description of conflicts
 - Explain risks in sufficient detail for type of client to understand and make informed decision

General Data Protection Regulation – Headline Issues

Comes into effect 25 May 2018

It replaces current data protection laws (e.g. Data Protection Act 1998)

It is a Regulation, so applies directly to Member States

Text finalised – although guidance will keep coming

More onerous obligations in number of areas

Fines of *up to* greater of EUR 20 million or 4% worldwide turnover if organisations breach

Key changes that impact client terms – Transparency and Notice

Organisations must give individuals information about how their personal data is used – “privacy notice”

Amount of information that must be included in a privacy notice has increased:

- Include more information about data uses and possible recipients
- Include the legal grounds that organisation relies on to process personal data
- Include details of data storage / retention periods
- Include information about export solutions for transferring personal data outside EEA
- Information about increased rights that individuals have over their personal data

Not enough to just say: “You acknowledge that we may use or otherwise process any personal data you provide to us to provide the services to us, including assessing any credit limit”

Instead, clause likely to include more detailed information and link to privacy policy that contains full details, e.g.:

- “This clause [] summarises key elements of our data processing. Further details of our data processing, the legal basis for such processing, our contact details, data storage periods, data export practices, data subject rights and how to raise concerns to us or the data protection authority can be found at [*insert link*]”
- Update data protection section of Client Terms to include more detailed information and make more GDPR-compliant
- Develop GDPR-compliant Privacy Notice to link to

Easy for new terms, but consider change process for existing agreements

- What does the contract change clause require?
- Is deemed acceptance of change permitted / feasible?

Consider how to flow notice down to client's client, if applicable.

- Representation and warranty?

Key changes that impact client terms – Consent

Organisations commonly seek to rely on consent, e.g. “you agree that we may...”

- Consent is only one legal basis that can be relied on to process personal data
- It is only *strictly required* in limited circumstances, e.g. processing sensitive personal data, use of data for email marketing

GDPR includes much stricter rules on the use of consent as grounds for processing personal data

- Consent language must be “distinguishable from other matters” in an “intelligible and easily accessible form”, using “clear and plain language”
- Consent must be freely given
- Consent can be withdrawn at any time

Therefore, advisable to rely on other grounds , unless consent is strictly required

Consent may be required, where sensitive personal data / criminal data is collected in connection with KYC / AML (e.g. fraud offences)

Very limited collection of sensitive personal data in other circumstances

Recommendations:

- Ensure terms are drafted as a notice, rather than agreement
- Only rely on consent and include consent language where required, e.g. KYC checks
- Consider whether any of the service is conditional on consent, and include appropriate information
- Ensure consent language is prominent in terms
- Consider how to flow down to client’s clients

Other important points/practical considerations

What do your agreements say? Do you have different standard forms with different amendment clauses and means of acceptance? Organise into groups and check requirements for each



Are your agreements English law governed? If not, you need to check requirements under relevant governing law



Also consider requirements applicable to your counterparties - are you asking them to do anything they cannot? Do they recognise electronic contract formation?



Plan whole process at start, including what happens if/when nobody replies/you receive bounce backs – FCA will expect to see record of what has been communicated and when, and your plan to track down responses, including in 2018



Consider sending an explanatory cover email/video/webinar, depending on complexity of amendments



Ensure legal changes align with operational reality and do not forget record keeping requirements



Any questions?

If you have any further questions, please email us at financial.services@nortonrosefulbright.com

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The logo consists of a stylized, upward-pointing chevron shape in a gold color, positioned above the first letter of the text.

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