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 **NORTON ROSE FULBRIGHT**

# MiFID II Academy - Paris

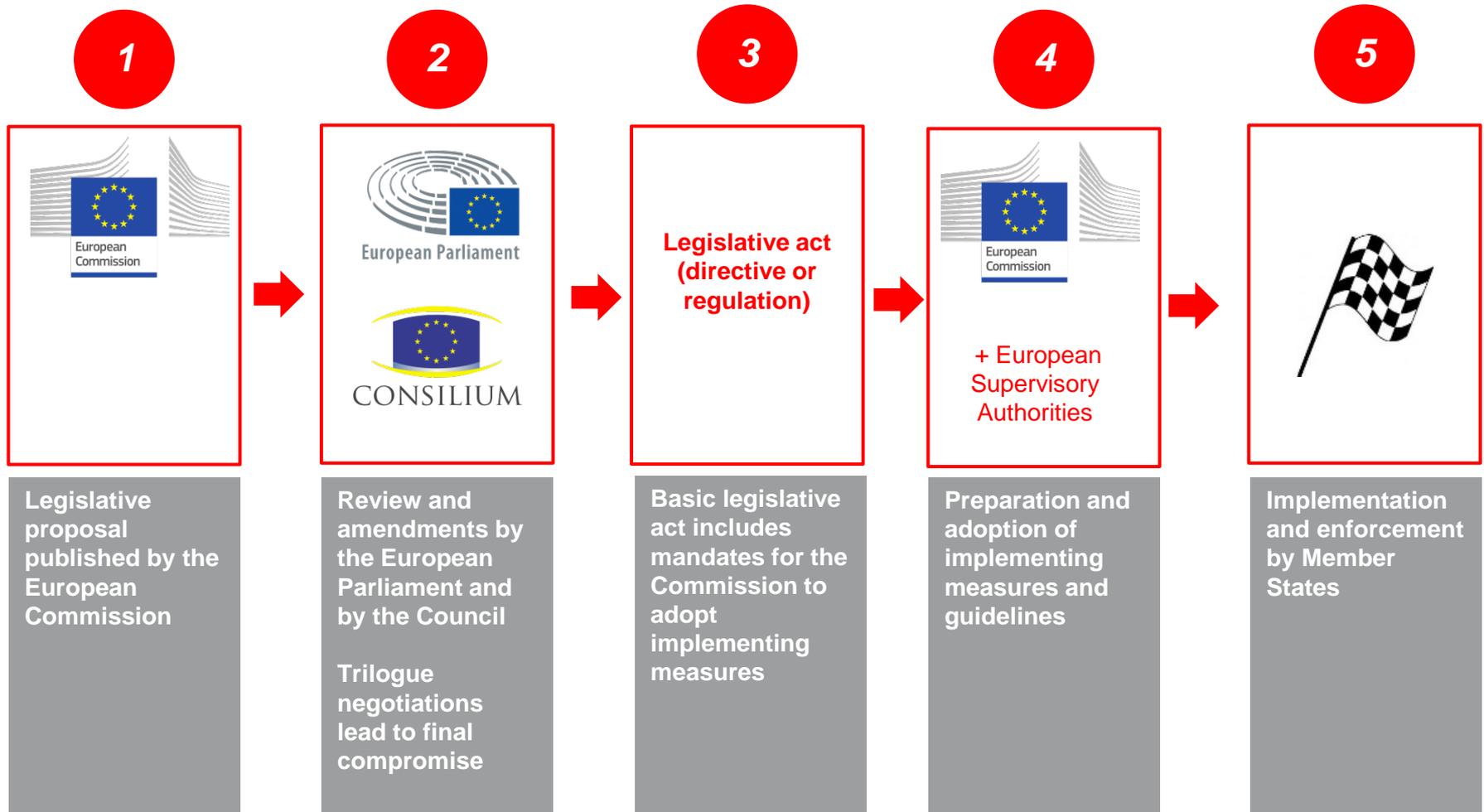
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21 November 2016

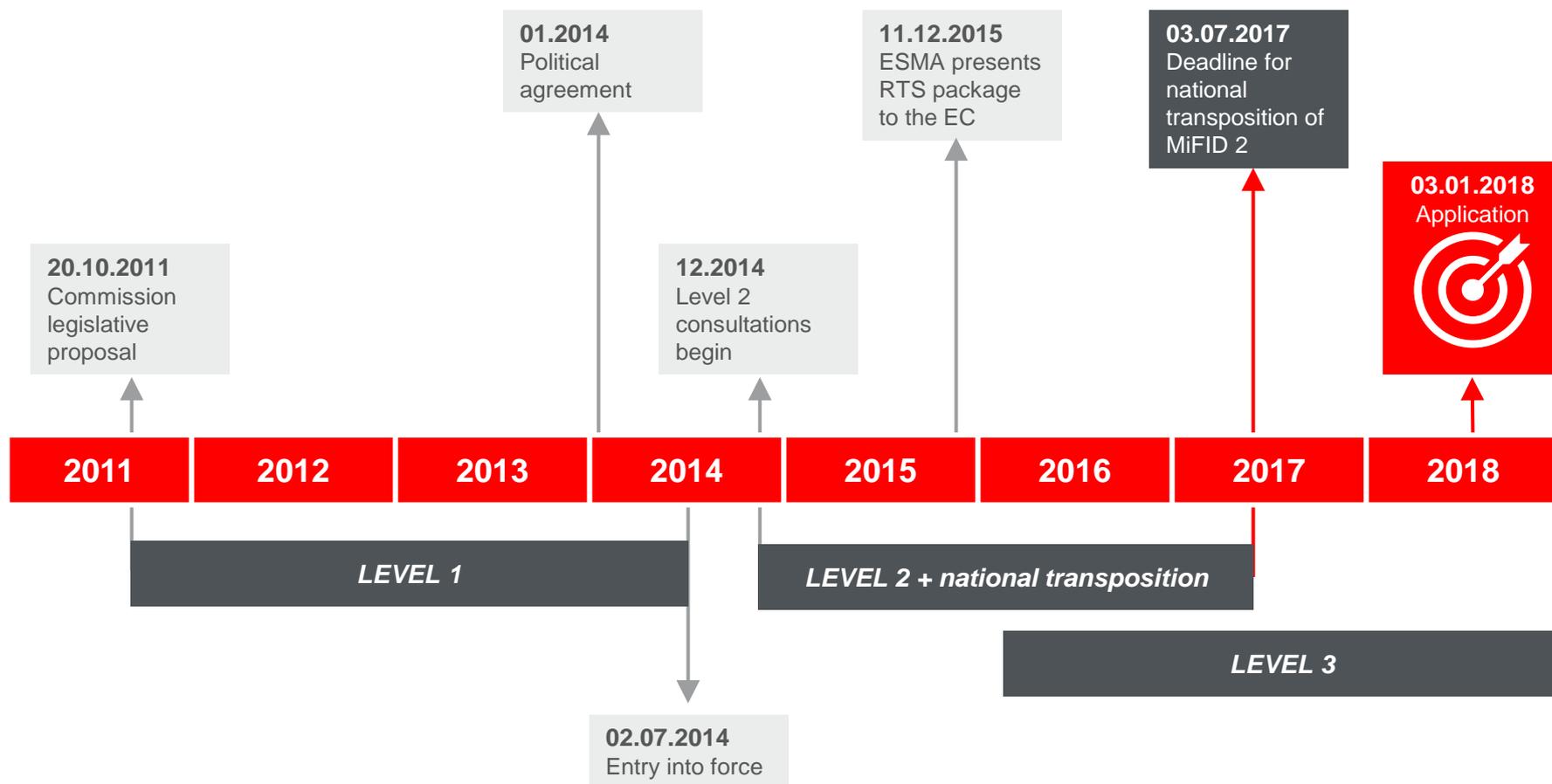
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# Background and process

# Legislative and regulatory process at a glance



# MiFID 2 / MiFIR timeline



# Legal instruments – directive v regulation

## MiFID 2

### Directive

- Requires transposition into national law
- Provides limited discretion and flexibility of application to Member States

## MiFIR

### Regulation

- Directly applicable – no national transposition required
- Usually more detailed, prescriptive than directives
- No discretion for Member States

# Level 2 – Implementing measures / overview

## Delegated Acts

- Implementing legislation which supplements the Level 1 text with greater detail
- Example: *Commission Delegated Regulation (EU) .../... supplementing MiFID 2 as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of MiFID 2*

## Regulatory Technical Standards

- A form of delegated act on purely technical matters
- Example: *Commission Delegated Regulation (EU) .../... supplementing MiFIR with regards to regulatory technical standards on transparency requirements for trading venues and investment firms in respect of bonds, structured finance products, emission allowances and derivatives*

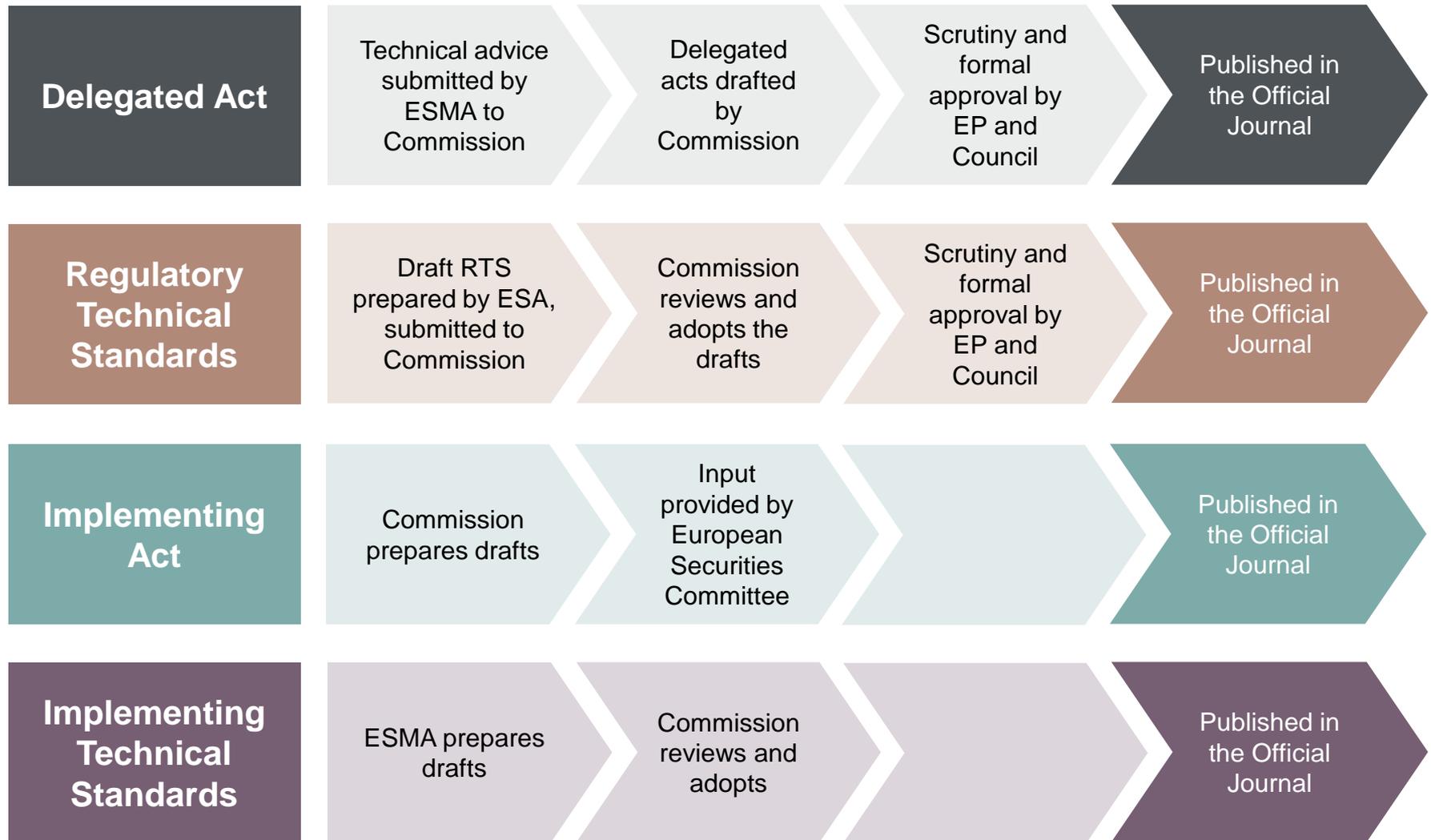
## Implementing Acts

- Supplements Level 1 text to ensure harmonised implementation, non-political issues
- Example: *(future) Commission decision determining that third country trading venue is equivalent for the purpose of trading obligation for derivatives under MiFIR*

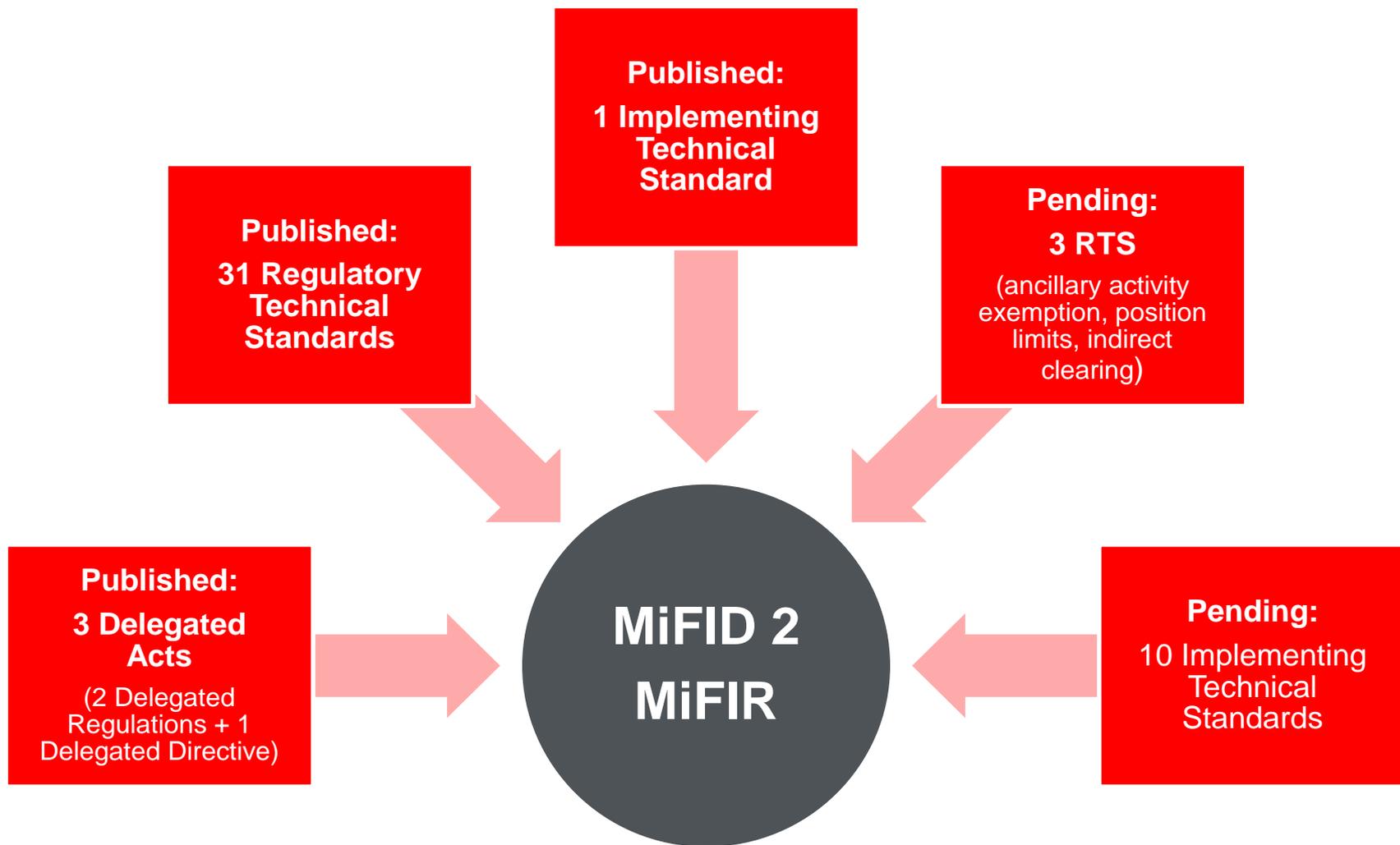
## Implementing Technical Standards

- A form of implementing act on purely technical matters
- Example: *Commission Implementing Regulation (EU) 2016/824 of 25 May 2016 laying down implementing technical standards with regards to the content and format of the description of the functioning of MTFs and OTFs*

# Level 2 – Process for MiFID 2 / MiFIR



# Level 2 – Progress to date



# Level 3 – Guidelines and Q&As

## Guidelines

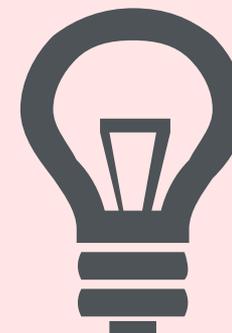
- Developed by ESMA and addressed to the national competent authorities (**NCA**s)
- Non-binding, NCAs must “comply or explain”
- Example: *Guidelines on transaction reporting, order record keeping and clock synchronisation*

## Q&As

- Ongoing process – questions submitted directly to ESMA or via NCAs
- Over 300 questions across all MiFID 2/MiFIR issues received to date
- First sets of Q&As published on pre/post-trade transparency, SI regime and market structures

## Purpose

- Practical guidance on implementation
- Coherent and efficient supervisory practices
- Harmonised interpretation of key regulatory issues



# The trading environment of the future

# Trading obligation: shares and derivatives

## Shares

- **What?** Shares admitted to trading on a regulated market or traded on an MTF
- **Where?**
  - Regulated Market, MTF, SI
  - Equivalent third country trading venue
- **Who?**
  - Investment Firms

- **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

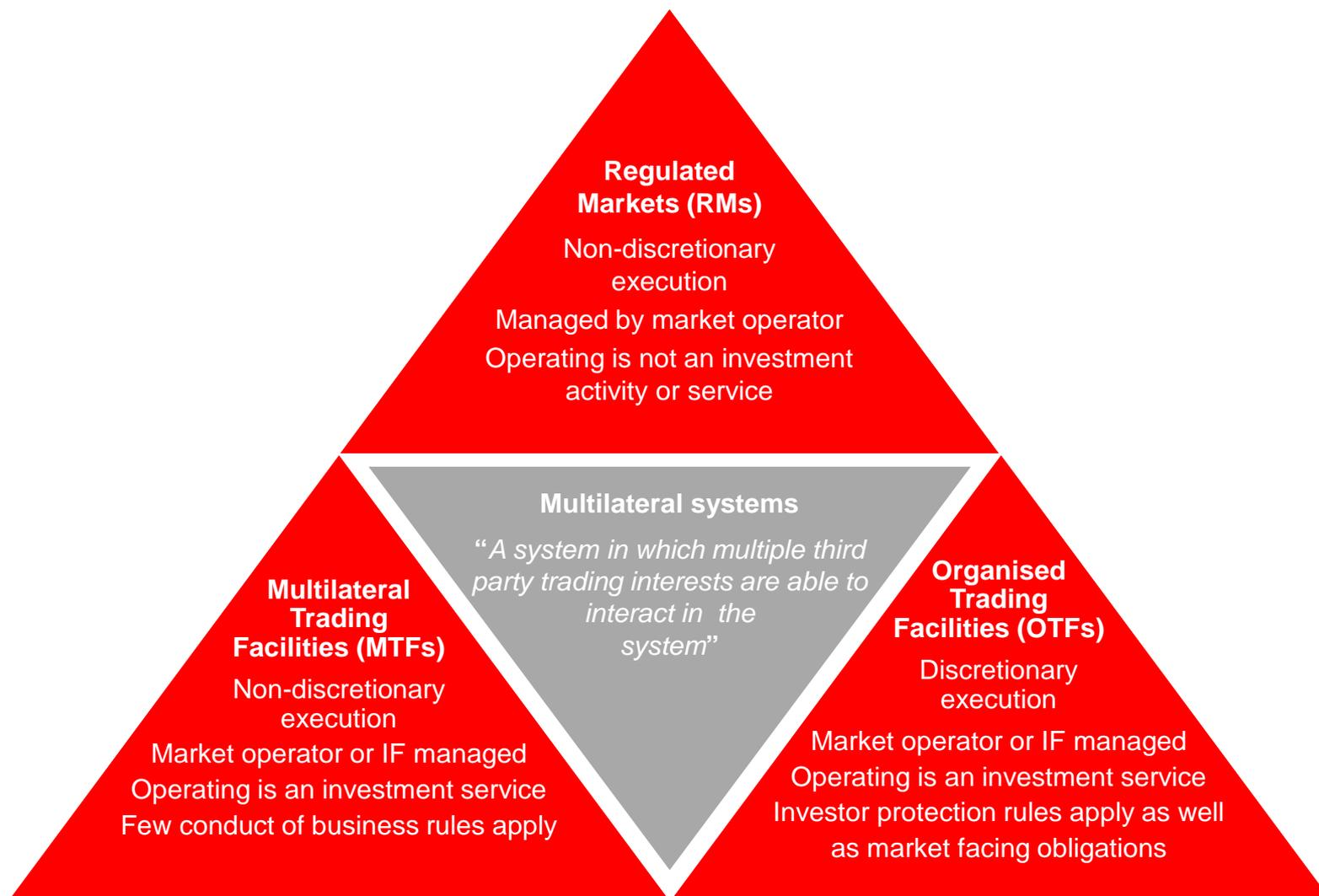
# Trading obligation: Mandated classes



## To determine whether there is sufficient liquidity:

- ESMA must consider these criteria:
  - Average frequency and size of trades
  - Number and type of active market participants
  - Average size of spreads
  - Anticipated impact on liquidity
  - Impact on commercial activities of non-financial end users
- According to the final RTS, while ESMA will take into account whether a derivative class is liquid for transparency purposes, they will not automatically be deemed liquid for these purposes
- ESMA is consulting on various issues including:
  - Link between transparency and trading obligation
  - How to deal with package transactions
  - Phase ins
- It also warns about moving trading into economically equivalent OTC contracts

# Trading venues: New concepts and boundaries



# MTFs

**MTF:** "a *multilateral system*, operated by an investment firm or a market operator, which *brings together* multiple third-party buying and selling interests in financial instruments – in the system and in accordance with *non-discretionary rules* – in a way that *results in a contract*"

## Multilateral system

- Operator can't enter into every (any) trade on own account, even as riskless principal – how far does this extend?
- Multiple third party interests can interact
- Does every order need to interact with all other orders or can there be some segmentation?
- Non-discrimination

## Brings together multiple interests

- To be understood in broad sense
- Includes orders, quotes and indications of interest
- User ratification does not undermine this
- What is a firm quote or an indication of interest?

## In the system

- A set of rules - no need for a technical system for matching orders
- Includes systems where users can execute against multiple quotes requested
- Bring interests together under the rules, protocols or operating procedures
- Could some parts of the functionality fall outside the system?

## In accordance with non-discretionary rules

- Rules leave the operator with no discretion as to how interests may interact
- Limited development on this
- Users can have discretion

# OTFs

**OTF:** "a *multilateral system...* in which *multiple third-party buying and selling interests* in bonds, structured finance products, emission allowances or derivatives are able to *interact in the system* in a way that *results in a contract* in accordance with Title II of MiFID II"

## Markets facing requirements

- Transparency
- Conflicts management
- Monitoring compliance with the rules and orderly trading
- Market surveillance
- System resilience and tick sizes
- Position reporting

## Other differences from MTFs

- Only for non-equities
- Must exercise discretion by deciding to place or retract orders on the OTF and / or deciding not to match an order with other available orders at a given point in time
- Group cannot execute client orders against proprietary capital save in non-liquid sovereign bonds but operator can engage in matched principal trading save for instruments other than mandatory traded derivatives with the client's consent

## Client facing obligations

- Clients' best interests
- Appropriate information requirements
- Suitability and appropriateness
- Best execution
- Prompt and fair execution of orders
- Publication of limit orders in shares

## Questions without answers (yet)

- Who might become an OTF?
- Where is the line between brokerage and being an OTF – OTFs may facilitate negotiation between clients
- What will OTF rules look like?
- How much discretion will clients accept?
- Does fact you cannot order route to SIs and OTFs matter?

# Systematic Internalisers

## Definition:

“An investment firm which, on an organised, frequent, systematic and substantial basis deals on own account by executing client orders outside a RM, MTF or OTF ”

## Quantitative tests and opt in:

- Firms exceeding both thresholds are caught but others can opt into the regime
- Must notify competent authority

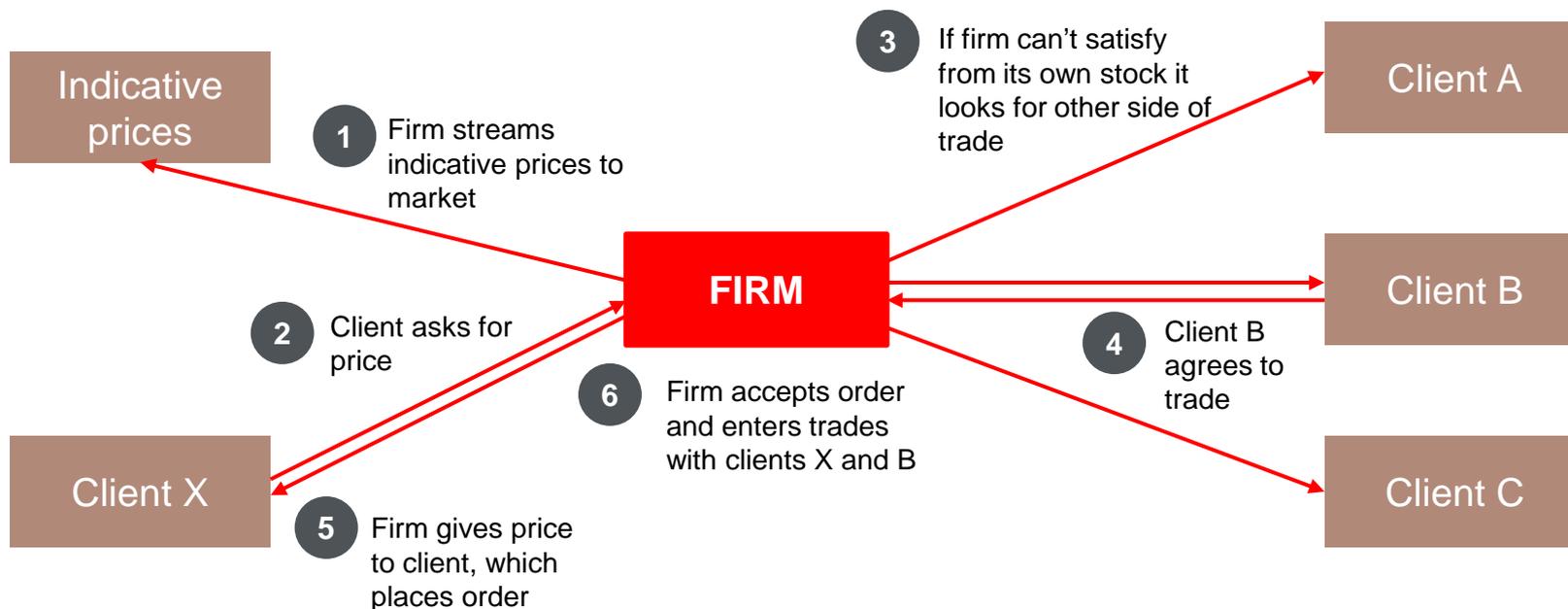
		Equities	Bonds	Structured Finance Products	Derivatives	Emission allowances
Frequent and systematic basis threshold (liquid instruments) OR	Number of transactions executed by the investment firm on own account OTC / total number of transaction in the same financial instrument in the EU	Equal to or more than 0.4% and daily	2.5% and at least once a week	4% and at least once a week	2.5% and at least once a week	4% and at least once a week
Frequent and systematic basis threshold (illiquid instruments) AND	Minimum trading frequency (average during last 6 months)	Daily	At least once a week	At least once a week	At least once a week	At least once a week
Substantial basis threshold criteria 1 OR	Number of OTC trades by investment firm in a financial instrument on own account when executing client orders of equal to or larger than in comparison to the number / nominal amount traded in that financial instrument and executed  This is on own account or on behalf of clients executed on a trading venue or OTC	15%	25%	30%	25%	30%
Substantial basis threshold criteria 2	Number of OTC trades by investment firm in a financial instrument on own account when executing client orders/ total volume / nominal amount in financial instrument executed in the EU with or on a trading venue or OTC	0.4%	1%	2.25%	1%	2.25%

# Systematic Internalisers:

## The future for equities broker crossing networks

- 3 choices for an equities broker crossing network?
  - **MTF**: must be an MTF if operated on a multilateral basis
  - **SI**: must be an SI if not multilateral and exceeds SI thresholds
  - **Neither?**: if multilateral but exercise discretion, i.e. OTF or if deal on own account but below thresholds and don't opt in to SI regime – for use by exempt persons
- An Investment Firm that operates an internal matching system on a multilateral basis should be authorised as an MTF
- Single dealer platform (where trading is always against one firm) v multi-dealer platform, with multiple dealers interacting for same financial instrument
- How bilateral do SIs need to be?
  - Dealing on own account when executing client orders includes matching on a matched principal basis but, Recital 19 of Delegated Regulation 25/4/2016 provide that firms entering into matched principal transactions on a “regular and not occasional” basis should not be considered SIs
  - Does this mean that an SI for non-equities (other than derivatives subject to mandatory trading) could look very similar to an OTF?
- SIs may have more control over access to flow and fewer markets obligations (inc. transparency) but quoting obligations are onerous except in relation to illiquids, where waivers largely remove obligations to publish firm quotes (i.e. pre trade transparency obligations)

# Systematic Internalisers: What would this bond arrangement be?



## Could it be an SI?

- Does firm deal on own account when executing client orders?
- What if it enters both trades as matched principal?
- Is it on an organised, frequent, systematic and substantial basis?
- Are clients A, B and C really clients?

## Could it be an OTF?

- Is it multilateral? Is there interaction?
- Is it a multi-dealer platform?
- Is there a system? Does it matter that firm is liaising between participants?
- Do orders interact in a system in a way that results in a contract?

# Systematic Internalisers: Pre-trade transparency

	Equity like instruments	Non-equity like instruments
<b>Make public quotes for liquid instruments</b>	On a regular and continuous basis during normal trading hours	<ul style="list-style-type: none"> <li>• When prompted by client</li> <li>• When agreed to provide a quote and, if illiquid, on request from the client if they agree to provide a quote</li> </ul>
<b>Quotes requirements</b>	Must achieve best execution and reflect prevailing market conditions	
<b>Update / withdraw</b>	Can update any time but can only withdraw in exceptional conditions. Article 14 Delegated Regulation 18/5/2016 details when exceptional conditions are deemed to exist	
<b>Access to quotes</b>	Must make available to other clients but can have commercial policy on access provided objective and non-discriminatory	
<b>Obligation</b>	Execute at quoted price in sizes up to standard market size – minimum quote size	Enter transactions under published conditions if at or below size specific to instrument
<b>Acceptable limits</b>	Number of trades with same client and total trades at same time provided non-discriminatory and transparent	Number of trades at any quote provided non-discriminatory and transparent
<b>Price improvement</b>	Same but carve out for professional clients where several securities in one trade	Only in justified cases if it falls within public range close to market conditions

# 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

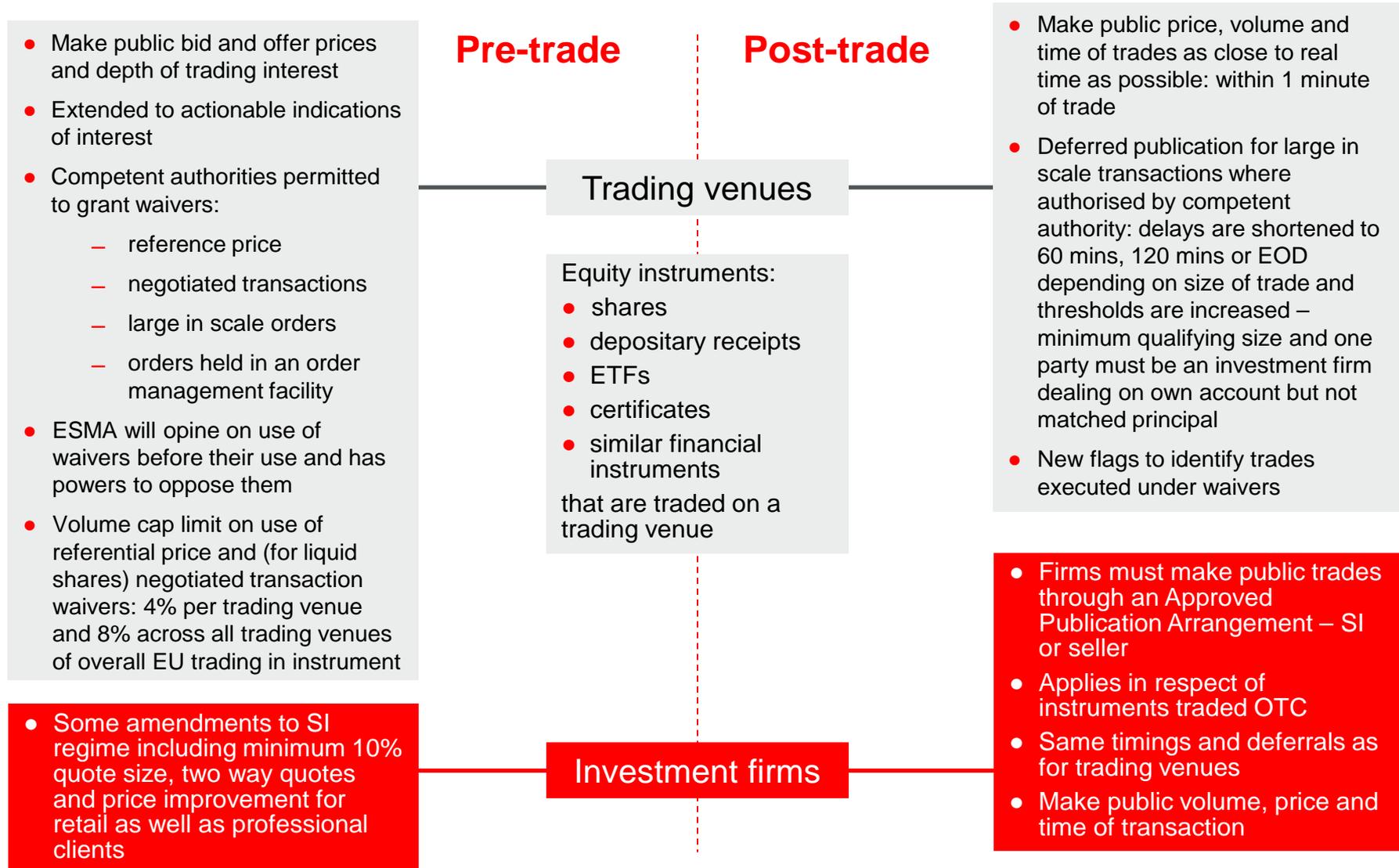
- Subject to transparency for first time and waivers are subject to volume caps
- Volume caps do not apply to negotiated transactions in these instruments for which there is no liquid market in certain cases

## Other derivatives and non-liquid financial instruments

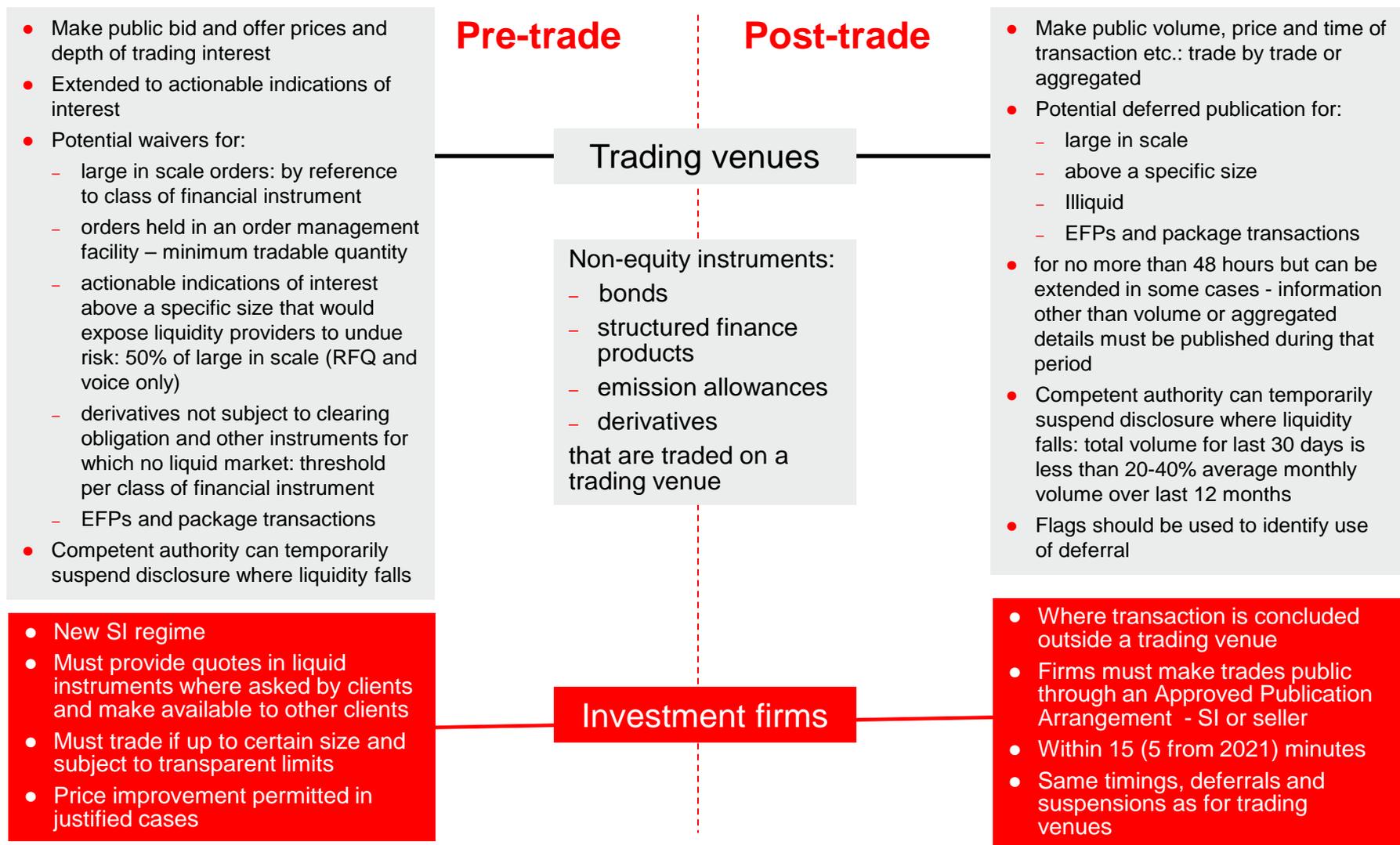
- Seemingly wide waiver from pre-trade transparency so this can remain dark
- Competent authorities can withdraw waivers where they think they are being abused

# Trading information

# Transparency regime: Equity instruments



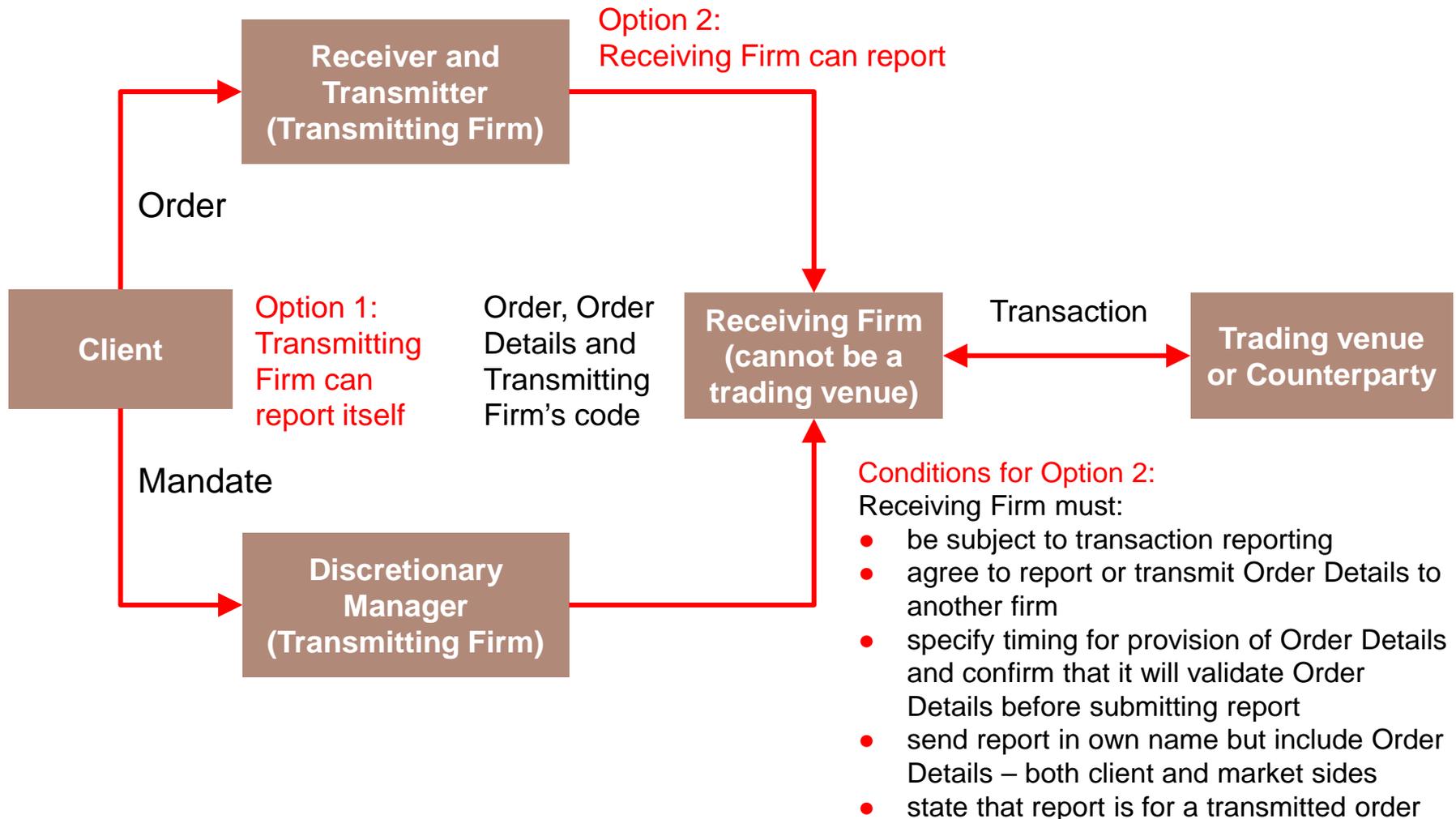
# Transparency regime: Non-equity instruments



# Transaction reporting: Investment firms

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

# Transaction reporting: Transmission of orders



# Trading obligation: FX derivatives

Options, futures, swaps, forward rate agreements and any other derivative contracts relating to securities, currencies, interest rates or yields, or other derivative instruments, financial indices or financial measures which may be settled physically or in cash

## Two types of derivative contract are not covered:

A **means of payment** that:

- (a) Must be settled physically otherwise than by reason of a default or other termination event
- (b) Is entered into by at least a person which is not a financial counterparty under EMIR
- (c) Is entered into in order to facilitate payment for goods, services or direct investment; and
- (d) Is not traded on a trading venue

Why is this important?

- Previously no guidance or standardisation on what is an FX derivative
- Critical for EMIR obligations
- What does means of payment really mean?
- What is physical settlement?

A **spot contract**:

A contract for the exchange of one currency against another, where delivery is to be made within the longer of:

- (a) 2 trading days in respect of any pair of major currencies
- (b) Where at least one is not a major currency, the longer of 2 trading days or the period generally accepted in the market as the standard delivery period for that currency pair; or
- (c) Where the main purpose is the sale or purchase of a transferable security or a unit in a collective investment undertaking, the period generally accepted as standard delivery period or 5 trading days if shorter

NDFs, options and swaps are never spot contracts

# Algorithmic trading and direct electronic access

# Algorithmic trading

*“Trading where a computer algorithm automatically determines ... parameters of orders such as whether to initiate the order, the timing, price or quantity ... or how to manage the order after submission, with limited or no human intervention”*

It does not include a system only used to:

- Decide which venue(s) to send an order to
- Process orders where there is no determination of parameters other than venue
- Confirm orders or process transactions post-trade

## Delegated regulation:

- A system has no or limited human intervention where:
  - Automated system makes decisions at any of the stages of initiating, generating, routing or executing orders or quotes according to pre-determined parameters
  - Includes both automatic generation of orders and optimisation of order execution
  - Includes smart order routers (which use algorithms to optimise order execution where they determine parameters other than just venue) but not automated order routers (that determine venue but don't change any other parameters of order)
  - Algorithmic trading and DEA are not mutually exclusive

# Algorithmic trading: Market making strategy

*“An investment firm that engages in algorithmic trading shall be considered to be pursuing a market making strategy when, as a member or participant of one or more trading venues, its strategy when dealing on own account, involves posting firm, simultaneous two-way quotes of comparable size and at competitive prices relating to one or more financial instruments on a single trading venue or across different trading venues, with the result of providing liquidity on a regular and frequent basis to the overall market”*

## RTS 8

- Market making strategy is a strategy where, during half of the trading days over a one month period, the firm:
  - Posts firm, simultaneous two-way quotes of comparable size and competitive prices
  - Deals on their own account in at least one financial instrument on one trading venue for at least 50% of the daily trading hours of continuous trading at the respective trading venue, excluding opening and closing auction
- **Firm** – orders and quotes that under the rules of a trading venue can be matched against an opposite order or quote
- **Simultaneous, two-way** – posted in such a way that both the bid and the ask-price are present in the order book at the same time
- **Comparable** – size of each quote does not diverge by more than 50% from each other
- **Competitive** – posted at or within the maximum bid-ask range set by the trading venue and imposed on investment firms that have signed a market making agreement

# Algorithmic trading: HFT

## High frequency algorithmic trading technique (HFT)

- Infrastructure that is intended to minimise latencies, including at least one of:
  - Co-location
  - Proximity hosting; or
  - High-speed direct electronic access
- System determination of order initiation, generating, routing or execution without human intervention for individual trades or orders
- High message intraday rates which constitute orders, quotes or cancellations

## Why is this important?

- Keep accurate and time sequenced records of orders, cancellations, executions and quotes
- Cannot rely on exemptions so will need to be authorised

## A high message intraday rate consists of the submission on average of:

- At least 2 messages per second for any single financial instrument
- At least 4 messages per second for all financial instruments traded on a trading venue

## Delegated regulation:

- Only liquid instruments
- Include market making activity
- Only proprietary orders and orders structured to avoid this
- Don't include messages from DEA clients
- Trading venues must make available monthly estimates of the average messages per second taking into account the preceding 12 months
- Engaging in HFT on one trading venue or through one trading desk triggers requirements

# Direct electronic access

*“An arrangement where a member or participant or a client of a trading venue permits a person to use its trading code so the person can electronically transmit orders relating to a financial instrument directly to the trading venue and includes arrangements which involve the use by a person of the infrastructure of the member or participant or client, or any connecting system provided by the member or participant or client, to transmit the orders (direct market access) and arrangements where such infrastructure is not used by a person (sponsored access)”*

## Delegated regulation

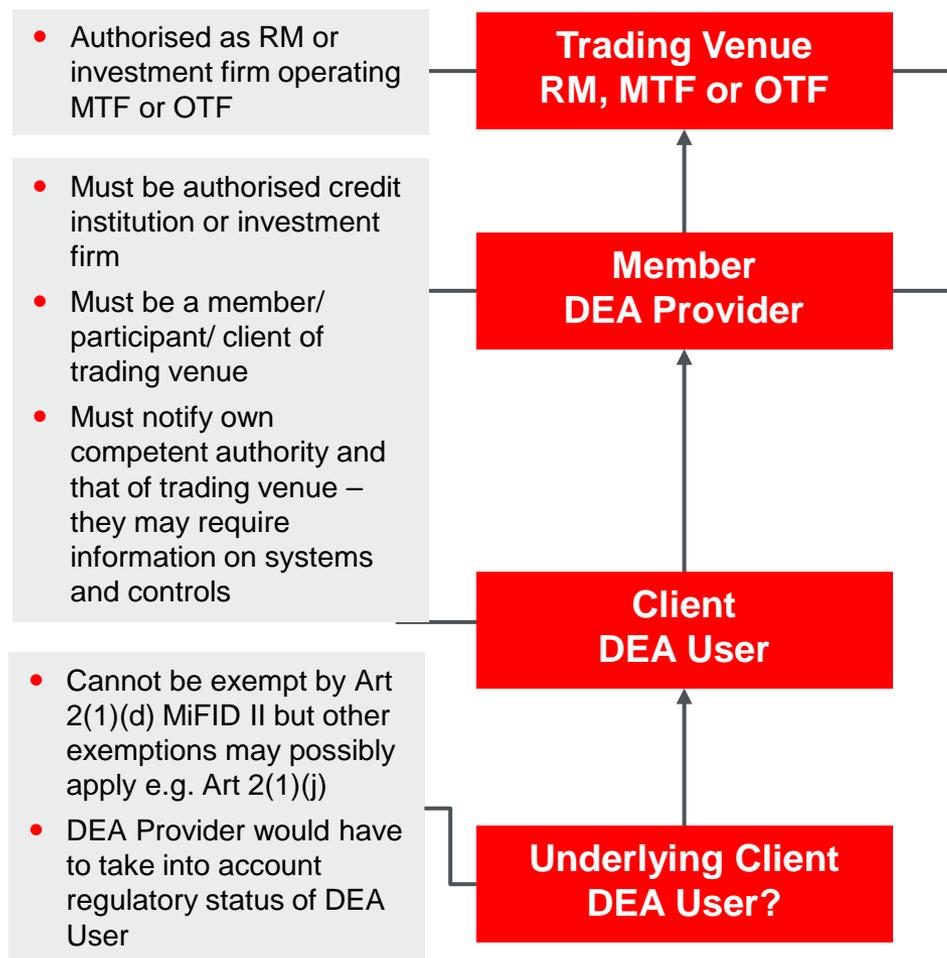
- Critical test is ability to exercise discretion regarding exact fraction of second of order entry and lifetime of orders within that timeframe
- Not where it takes place through optimisation of order execution processes that determine the parameters of the order other than the venue, unless these arrangements are embedded into the clients' systems and not into those of the member

### Why is this important?

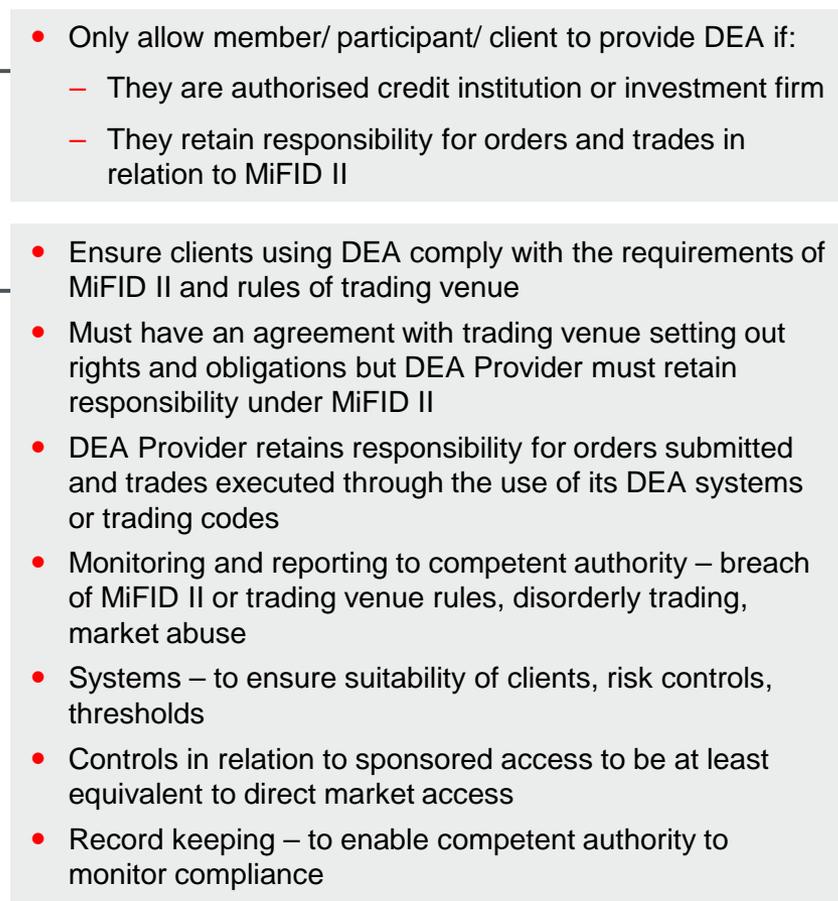
- Firms using DEA cannot rely on own account dealing exemption
- Additional due diligence obligations
- Does this provide easy avoidance mechanisms?
- Is electronic brokerage DEA?

# DEA: The chain

## Regulatory status



## Main responsibilities



# Investor protection: hot topics

# Overview

## Where are we at?



### Level 1:

- Finalised - takes effect from 3 Jan 2017

### Level 2:

- Final Delegated Directive (CASS, product governance and inducements)
- Final Delegated Regulation (other topics)

### Level 3

- Guidelines on complex debt instruments and structured deposits (4 February 2016)
- Guidelines on cross-selling (22 December 2015)
- Guidelines for assessing knowledge and competence (22 March 2016)
- Consultation on management body for market operators (5 October 2016)
- Consultation on product governance requirements (5 October 2016)
- Q&As on MiFID and MiFIR investor protection topics (10 October 2016)

## Overview of changes



- **Significant number of micro changes** being made to the existing investor protection regime
- **Small number of macro changes** being introduced to the existing investor protection regime
- Together they **SNOWBALL** into **significant regulatory reform** in the way firms conduct their business
- The devil is in the detail!
- Level 2 **significantly alters** the Level 1 landscape
- **Material impact** on all firms

# Client categorisation

## Professional clients and eligible counterparties

### Per Se ECPs

- Municipalities and local authorities can no longer be per se ECPs

### Opted Up ECPs

- Removed ability for opted up professional clients to become opted up ECPs
- **Specific procedure** for the opting up process
- Includes **warning** to ECPs that they are losing protection
- ECP to provide **written confirmation** that they are requesting ECP status either **generally** or for **specific service**
- Acknowledgment that ECPs are **aware of consequences**

### Per Se Professional

- Municipalities and local authorities can no longer be per se professionals
- A public body can only be treated as per se professional client if managing public debt at a national or regional level

### Opted up Professional

- Municipalities and local authorities can be opted up to be professional clients
- Competent authorities can introduce qualitative or quantitative measures for this assessment

# Communications

To:

## Retail or Professional Clients

Delegated Regulation states that all communications to professional clients now the same as for retail clients (save for one rule which is retail only) – this contradicts the recitals and ESMA's technical advice. To be confirmed if this will be amended.

### New requirements:

- **Same language** to be consistently used across information. 'Language' refers to language of a Member State
- Must be a fair and prominent indication of **risks** (where benefits also referenced) with **equal font size**
  - Information to be kept **up-to-date**
  - Requirements when mentioning **future performance**

## Eligible Counterparties

- Must communicate in a way that is '*fair, clear and not misleading*'
- Firms have flexibility about how to comply with the fair, clear and not misleading test for ECPs

# Product governance / distribution

## Whats new?

### Completely new regime (level 1)

- Introduction of **product approval process** (with associated policies and procedures) overseen by senior management
- **Identify target market** for product and tailor products to that market
- Ensure **distribution strategy** is consistent with target market
- **Periodic review** of product, target market and distribution channels
- **New requirements** on distributors / sales intermediaries to understand product, target market, features and risks
- Information flow through distribution chain

### Moderate extension (Level 2)

- Regime extended to apply to **services (not just products)**
- **Proportionality** applies
- **Two sets** of policy proposals:
  - **product manufacturers**
  - **distributors** (someone who offers and/or recommends products to clients)
- Introduction of **specific oversight, control and governance obligations** on firms
- **Final distributor** in the chain has the obligation to comply with the requirements
- **Intermediate distributors** also have certain obligations
- consider threat to **orderly functioning / stability** of market when developing products
- only **one target market** assessment required
- **additional steps** prescribed which manufacturers might take when an event occurs which affects the potential risk / return of the product
- products manufactured by **non-MiFID entities** not exempt
- **compliance oversight** needed
- Firms that **create, issue, design products** are themselves manufacturers
- Pure manufacturers to assess target market on '**theoretical basis**'

# Product governance / distribution

## ESMA Consultation Paper (2016/1436)

Six categories to consider	ESMA's guidance
<b>Type of clients to whom the product is targeted</b>	at least to MiFID client categorisation; may also specify additional descriptions, e.g. 'private wealth clients' or 'sophisticated clients', but must specify criteria to be met by clients in each case.
<b>Knowledge and experience</b>	manufacturers should specify the knowledge clients are expected to have about the product type, product features and/or knowledge in related areas. Manufacturers must also specify the extent of practical experience target clients are expected to have (e.g. in terms of time period of activity in financial markets, or with relevant product type). The requirements are inter-related; clients with no experience but extensive knowledge may be a valid target client.
<b>Financial situation</b>	manufacturers should specify the amount of losses target clients should be able and willing to afford.
<b>Risk tolerance and compatibility of product risk/reward profile</b>	manufacturers should specify the general risk attitude of target clients, as well as setting out criteria by which firms should assess target clients to determine risk tolerance. Risk indicator required by PRIIPS Regulation to be used where applicable to fulfil this requirement.
<b>Client's objectives</b>	i.e. wider financial goals, or overall strategy adopted when investing, e.g. 'liquidity supply', 'retirement provision' or investment horizon.
<b>Client's needs</b>	these may vary from specific to generic, as relevant (e.g. age, country of tax residence, and special product features such as 'currency protection' or 'green investment' as relevant).

- Closes 5 January 2017
- Final report will be published in Q1/Q2 2017

# Product governance / distribution

ESMA Consultation Paper (2016/1436)

## Guidelines on product governance requirements: guidelines for distributors – key themes

Timing and relationship of target market assessment by distributor with other product governance processes

Review by manufacturer and distributor to assess whether products and services are reaching the target market

Identification of target market: differentiation on the basis of investment service provided

Distribution strategy of distributor: taking account of manufacturer's distribution strategy

Relation between product governance requirements and the assessment of suitability or appropriateness

Identification of target market: differentiation on the basis of the nature of the product distributed

Identification of "negative" target market, and sales outside the positive target market

# Suitability

<b>Suitability assessment</b>	<ul style="list-style-type: none"><li>• Where products are packaged or bundled, the overall package must be suitable</li><li>• Responsibility for carrying out assessment lies with firms</li><li>• If switching, benefits must outweigh costs</li><li>• Maintain adequate and up-to-date information in an ongoing relationship</li><li>• Firms need to ensure the information they obtain from clients reliable</li><li>• Firms need to satisfy themselves that they have obtained sufficient information from a client to determine that the recommendation will not only meet the investment objectives of the client but also their risk tolerance</li><li>• Need to consider whether alternative financial instruments are more suitable</li><li>• Suitability assessments apply to simplified advice models (e.g. through automated systems) but not where a firm executes orders or transmits orders to another firm to execute where there has been pre-agreed signals</li><li>• Firms should not recommend instruments where they are not suitable, regardless of whether this is derived from a firm having limited access to instruments or not</li><li>• Firms providing periodic suitability assessments must provide these at least annually, with the frequency of the assessment being increased depending on the risk profile of the client and the types of financial instruments recommended</li><li>• Firms need to satisfy themselves that they have obtained sufficient information from a client to determine that the recommendation will meet the investments objectives and risk tolerance of the client</li></ul>
<b>Suitability reports</b>	<ul style="list-style-type: none"><li>• New requirement that firms must provide retail clients with a suitability report specifying how the advice meets the client's preferences, objectives and other characteristics</li><li>• Contents of reports not prescribed</li><li>• Must be personalised</li><li>• Identify if periodic review needed (i.e. in an ongoing service) – policies and procedures needed on this item</li></ul>
<b>Policies and procedures</b>	<ul style="list-style-type: none"><li>• Policies and procedures needed so firms understand the products being recommended taking into account whether other equivalent products could be better.</li><li>• The policies and procedures must include their understanding of investment services (not just products) offered to clients and also consider whether an equivalent investment service could be better.</li></ul>

# Suitability: Level 3

## ESMA Q&A on MiFID II: Section 2

*Q1 and Q5: Does the suitability report only have to be provided if the investment advice leads to a transaction?*

- No.
- A report must be provided to a retail client when that client has been provided with advice regardless of whether a transaction occurs or not.
- This includes where the advice is not to buy or sell an investment.
- Although MiFID II refers to *'before the transaction is made'* this is when the report has to be made, but does not mean that the advice has to be followed by a transaction.

*Q3: Can reports be made available through a website?*

- Yes.
- However, provided the website is a durable medium which means:
  - Where it is included in the secured area of the firm's website
  - The website is specifically dedicated to that client
  - The client receives a notification (via email or another means of communication) of the availability of the document
  - The choice of this medium is consistent with MiFID II requirements (i.e. website conditions).

*Q6: What is the obligation when a client wishes to proceed to invest in an unsuitable instrument?*

- These are called 'insistent clients'
- Must clearly inform the client of the fact that the course of action that he/she wishes to undertake is not suitable for him/her

AND

- a clear explanation of the potential risks he would incur by doing so
- Firms need to have procedures to ensure they know when an investment was originated at client or firm's initiative

*Q2: Should the report include the date when the advice was given?*

- Yes.
- The date and time of the day when the advice was given should be included.
- Also the date and time when the report is given
- ESMA recommends a 'time stamp' on reports.

# Appropriateness and non-advised sales

## Whats new?

- List of non-complex products **narrowed**.
- The following are included as automatically deemed to be complex:
  - **AIFs,**
  - **Units in a structured UCITS,**
  - **Shares embedding a derivative;**
  - Debt/money market instruments
  - Structured deposits
  - any products with a structure that makes it **difficult for clients to understand risks of return** or the **cost of exiting the product**
- Instruments which are **not 'expressly specified'** in the non-complex list can go through the additional assessment criteria

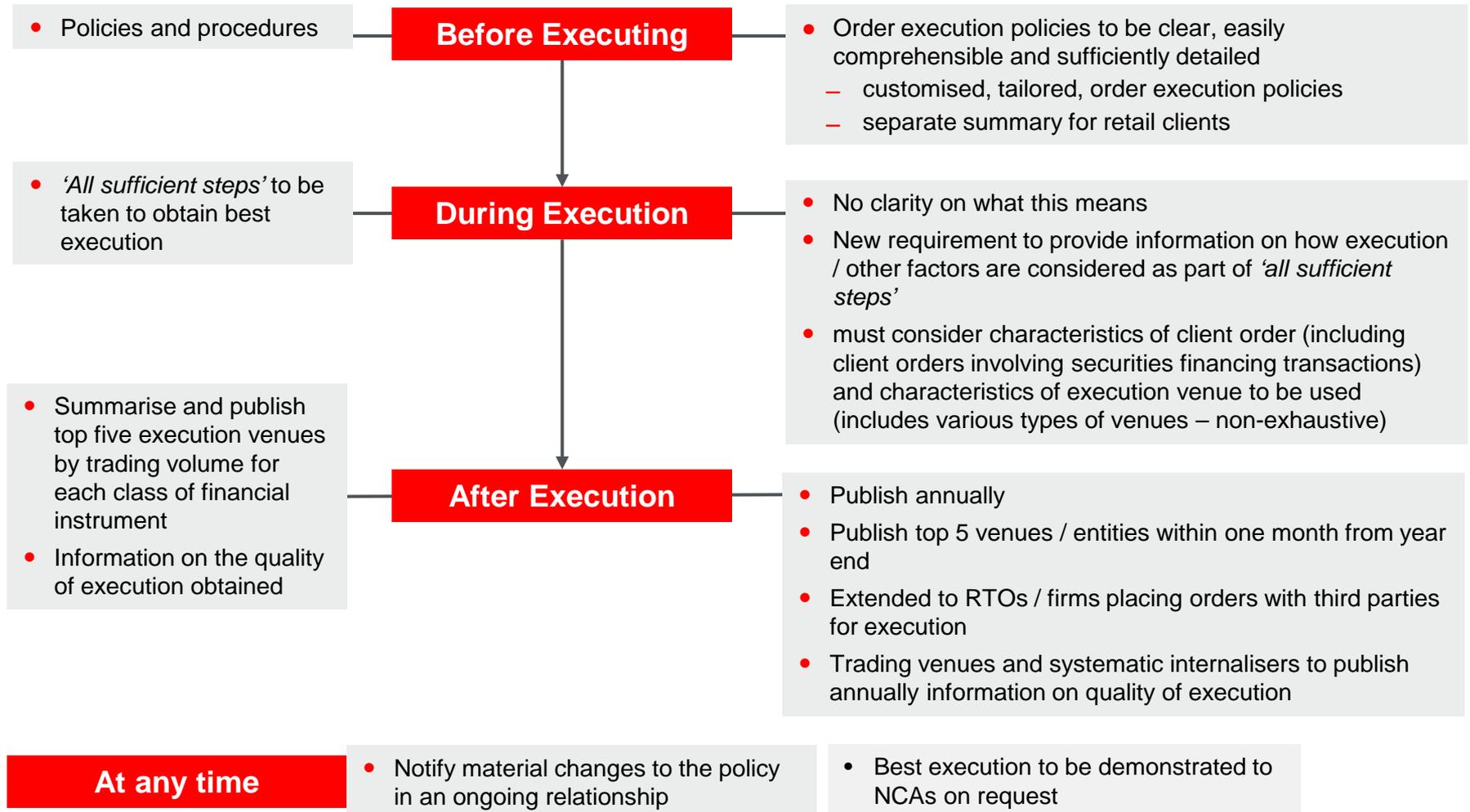
- **Change to test for non-complex products:**
  - (1) clause / condition / trigger that **fundamentally alters the nature** or **risk** of the investment or **pay out profile**
  - (2) explicit or implicit **exit charges** with the effect of making the investment illiquid
- Products not falling within the above test **are considered to be complex**
- New **record keeping requirements** in relation to the assessment of appropriateness (where appropriate, not appropriate, insufficient information, etc.)
- Appropriateness always required where **credit** is provided
- Appropriateness required on an **overall bundled package**

ESMA's Final Report: Guidelines on complex debt instruments and structured deposits  
(ESMA/2015/1783)

# Best execution

## Requirement

## Detail



# Best execution: Level 3

## Question 1

*What is the difference between existing requirement of 'reasonable steps' and the new requirement of 'all sufficient steps'?*

### All sufficient steps

*“Should not be interpreted to mean that a firm must obtain the best possible results for its clients on every single occasion.”*

- Sets a 'higher bar for compliance than 'reasonable' steps
- Firms have to ensure the intended outcomes can be successfully achieved on an ongoing basis
- Likely to involve:
  - strengthening of front-office accountability
  - strengthening of systems and controls re: detection capabilities of potential deficiencies
  - monitoring of not only the execution quality obtained but also the quality and appropriateness of execution arrangements and policies on an ex-ante and ex-post basis to identify circumstances under which changes may be appropriate
  - processes might involve some combination of front office and compliance monitoring and could use systems that rely on random sampling or exception reporting
  - channels in place to ensure that the results of ongoing executive monitoring are escalated to senior management and/or relevant committees and fed back into the execution policies and arrangements to drive improvements

# Conflicts of interest

## Policies and Procedures

- Review conflicts policies – at least annually
- If having to disclose frequently, *presumption* that conflicts policy is deficient
- Procedures are required to address both how conflicts are *managed* and *prevented*
- Any risk of damage to the interests of one or more clients' needs to be considered (regardless of its materiality)

## Disclosure

- Limitations on use of disclosure – disclosure is to be used as a *'last resort'*
- Prescribed content of disclosure – *tailored* and *new warning* to be included in disclosures

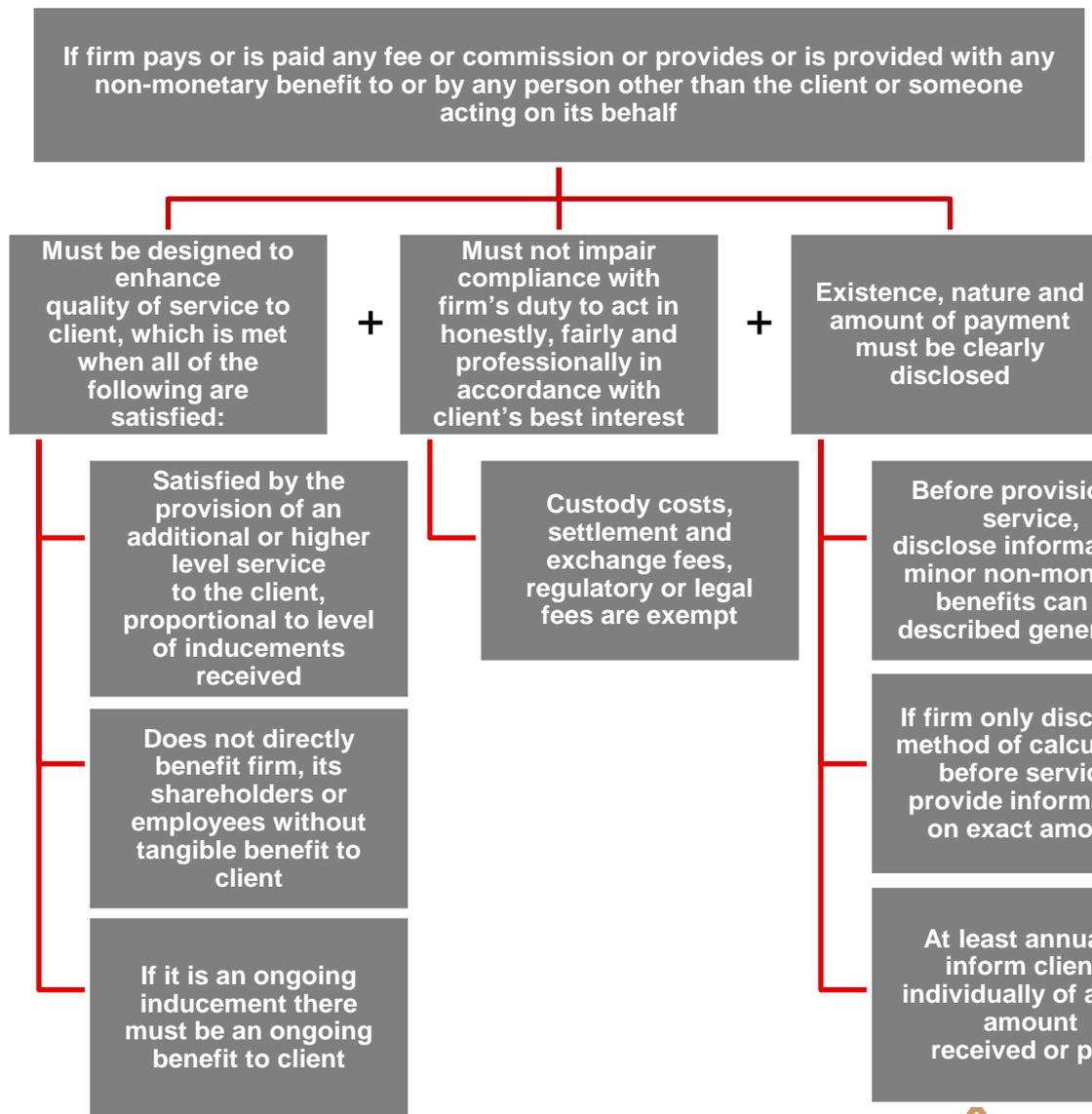
## Managing techniques

- The same independence and operational separation requirements which apply to investment research now also apply to *'recommendations'* (a broader category than 'investment research')
- Requirement for physical separation of analysts producing investment research
- If physical separation is disproportionate, need alternative information barriers (potentially extremely broad)
- Senior managers are to receive frequent reports (at least annually) on conflicts recorded in the conflicts log
- **Guideline 9:** Firms that distribute tied or bundled packages to ensure suitable remuneration models and sales incentives encouraging responsible business conduct, fair treatment of clients and avoidance of conflicts of interest for staff selling packages are in place and are monitored by senior management - **3 illustrations** provided
- Detail on managing when underwriting and placing

## Additional material (Level 3):

- **ESMA's Final Report: Guidelines on cross-selling practices – Guideline 9**
- **ESMA Q&A on MiFID II: Section 6**

# Inducements



## Why is this relevant?

- Considerable detail at level 2
- Qualitative v quantitative evidence of enhancement of quality
- How will firms demonstrate it?

# Inducements: independent advisors and fund managers

- Cannot accept and keep any third party payments other than acceptable minor non-monetary benefits
- Must be reasonable and proportionate and of a scale that is unlikely to influence firm's behaviour to detriment of client's interests
- Must disclose before providing service

- Return to clients fees, commissions and monetary benefits ASAP after receipt
- Policy to ensure that amounts are allocated and transferred
- Inform clients through periodic statements

## Acceptable minor non-monetary benefits:

- (a) Information or documentation relating to products or services which is generic in nature or personalised
- (b) Issuer commissioned/paid third party new issuance material provided relationship disclosed and made available at the same time to other investment firms or general public
- (c) Participation in conferences, seminars and other training events
- (d) Hospitality of a reasonable de minimis value
- (e) Other minor non-monetary benefits which a Member State deems capable of enhancing the quality of service and are of a scale and nature that are unlikely to impair compliance with duty to act in client's best interest

## Why is this relevant?

- Full price unbundling mandated
- No reference to execution-related services
- Where does this leave current permissible services?
- How will the FCA exercise its power?

# Inducements – research payment account

Provision of research is not an inducement if firm pays through:

**Own resources**

**OR**

**Research payment account provided:**

- The account is funded by a specific research charge to client
- Set and regularly assess a research budget
- Firm is responsible for research payment account
- Firm regularly assesses quality of research against robust quality criteria set out in a policy
- Firms assesses its ability to contribute to better investment decisions
- Before providing service, tell clients of budgeted amount and charge and agree research charge and frequency in terms and conditions
- Provide annual information on total costs incurred by client for research
- If required by client or competent authority, provide further information
- All operational arrangements must identify research charge separately
- Tell clients about any increase in advance
- Any surplus at end of period must be rebated or offset against research budget for following period
- Allocation of budget is subject to appropriate controls and senior management oversight
- Cannot use to fund internal research
- Firm providing execution services must identify separate charges that only identify execution costs

**Why is this relevant?**

- **Where does it leave the CSA model?**
- **How do you make a research payment account work?**
- **Client money account implications**
- **Shutting off nil value service agreement**

# Inducements: Level 3

## ESMA Q&A on MiFID II and MiFIR – Section 7

### Question

When using a research payment account can the research budget be set for more than one client's portfolio when:

- determining the specific research charge to a client; and
- establishing the need for third party research?

### Answer

**Yes.** Can set budget at a desk or investment strategy level PROVIDED:

- Clients' portfolios must have sufficiently similar mandates and investment objectives (such that investment decisions relating to those portfolios are informed by the same research inputs)
- Firms can clearly evidence and demonstrate their approach
- Using the budget in this manner must be in the best interests of clients
- Firms must describe their approach in a written research policy
- still need to identify a specific research charge for individual clients to fund the research payment account, even where a budget is set for several portfolios
- Allocation of costs must be fair and transparent (e.g. pro-rata allocation of the cost)
- Cannot set a budget for a group of portfolios/accounts that do not share sufficiently similar investment objectives and research needs i.e. portfolios have material differences in the types of financial instruments and/or geographic regions or market sectors they invest in

Firms can also set a firm-level research budget to help control overall costs, but this does not replace the need to set budgets for discrete groups of client portfolios/accounts

# Information to clients



- Must provide information on **investment advice**
- Detailed requirements to explain **scope** and **features** of advice
- Applies to **professional clients** as well

- 
- Must provide Information on **financial instruments** – e.g. Warnings, Risks
  - Information to be tailored for the target market
  - Information on how the instrument operates in **negative** market conditions
  - Where the **risks** are being disclosed that as well as explaining leverage and its effects, firms are also required to explain risks with **insolvency** of issuer or related events such as bail-in

- 
- Also applies to **professional clients**, in ongoing advisory relationships and custody relationships and scope expanded significantly
  - No **distance communicating exemption** to providing terms of business before providing a service

# Information to clients



## Costs and Charges

- Must provide information on **costs / charges** of **services, advice, product** and how to pay the costs and charges
- Must disclose inducements
- Costs and charges must be **aggregated** so client understands the **overall cost** and **cumulative effect** on return (with **itemised breakdown** on request) and firms are to provide their clients with an **illustration of the cumulative effect** of costs on return when providing investments (both pre and post-sale)
- Delegated Regulation has not adopted ESMA's advice that firms should be allowed to provide clients with separate figures comprising the aggregated initial costs and charges, the aggregated ongoing costs and charges and the aggregated exit costs.
- Must be provided ex-ante ("***in good time***") and ex-poste (**annually post-sale**)
- Disclosure is needed to all clients (including ECPs) but professional clients and ECPs can **agree to receive** more limited information but not:
  - For portfolio management
  - Where there is an embedded derivative
  - (for ECPs) not where a product will be on-sold
- Level 2 includes prescriptive examples

# Information to clients: Level 3

ESMA Final Report: Guidelines on cross-selling practices (ESMA/2015/1861)

Guideline 1

- Full disclosure of price and cost information

Guidelines 2, 3 and 4

- Prominent display and timely communication of price and cost information

Guideline 5

- Full disclosure of key information on non-price features and risks, where relevant

Guideline 6

- Prominent display and timely communication of key information on non-price features and risks, where relevant

Guideline 7

- Prominent display and communication of 'optionality of purchase'

# Reporting to clients

## What's new?

### To Retail

- **Portfolio Management Reports:**
  - minimum quarterly intervals
  - further report where portfolio depreciates by (multiples of) 10%
  - no report where client accesses online system / 'durable medium'
- **Client Asset Reports:**
  - minimum quarterly intervals
  - statements to identify protected assets, assets subject to liens, market / estimated value of assets (on a 'best efforts' bases) and indicate "***a lack of a market price is likely to be indicative of a lack of liquidity***"
  - no report where client accesses online system / 'durable medium'
  - provide ad hoc reports on request (can charge for ad hoc reports)

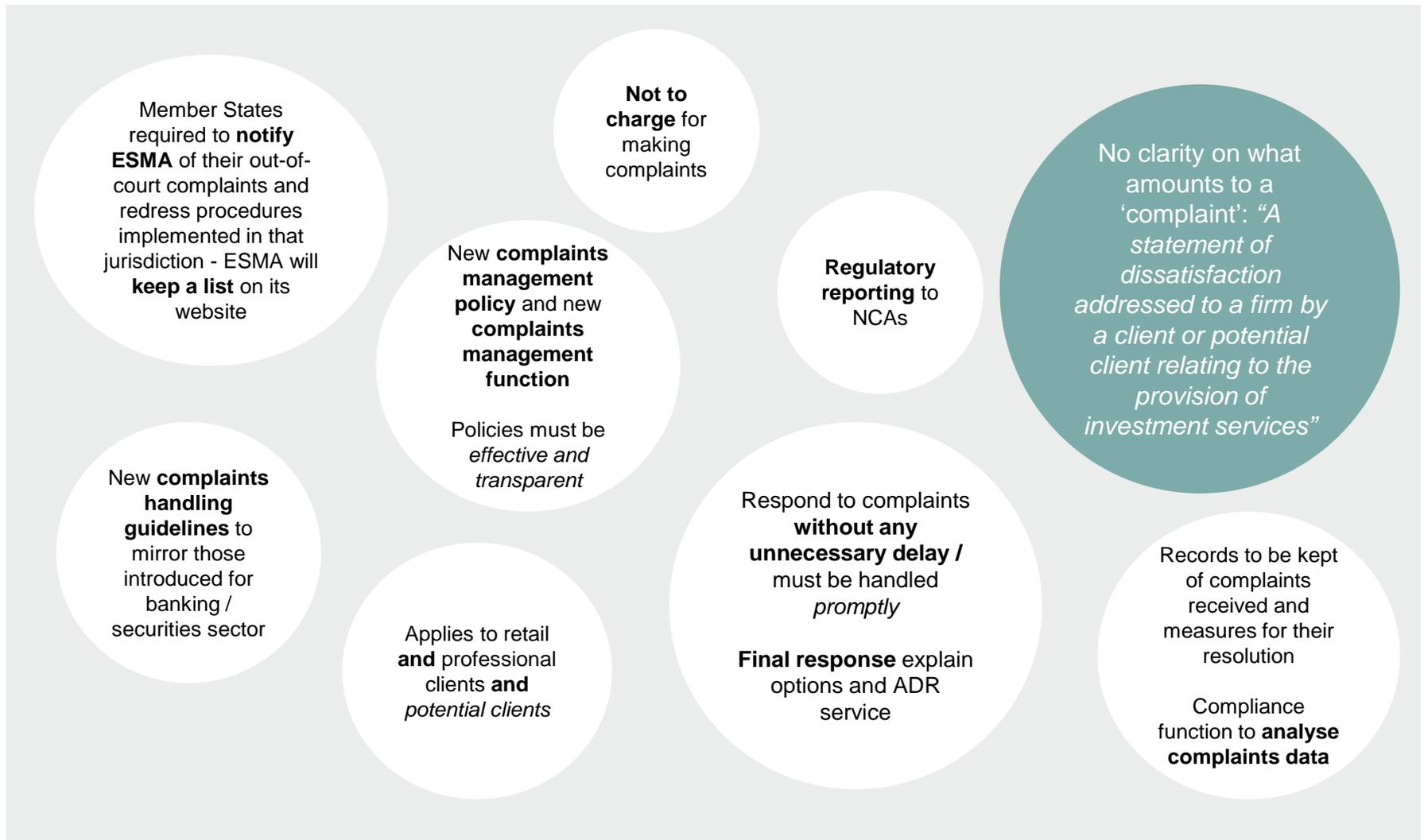
### To Professional

- **Trade Confirmations**
  - Must provide trade confirmations at T+1
  - Must have same content as for retail confirmations
- **Portfolio Management Reports:** Do not apply to professional clients

### To ECPs

- Reporting obligations **apply to all clients** including ECPs
- However, ECPs are able to agree **different standards for content and timing** of reports

# Complaints handling



# Product intervention



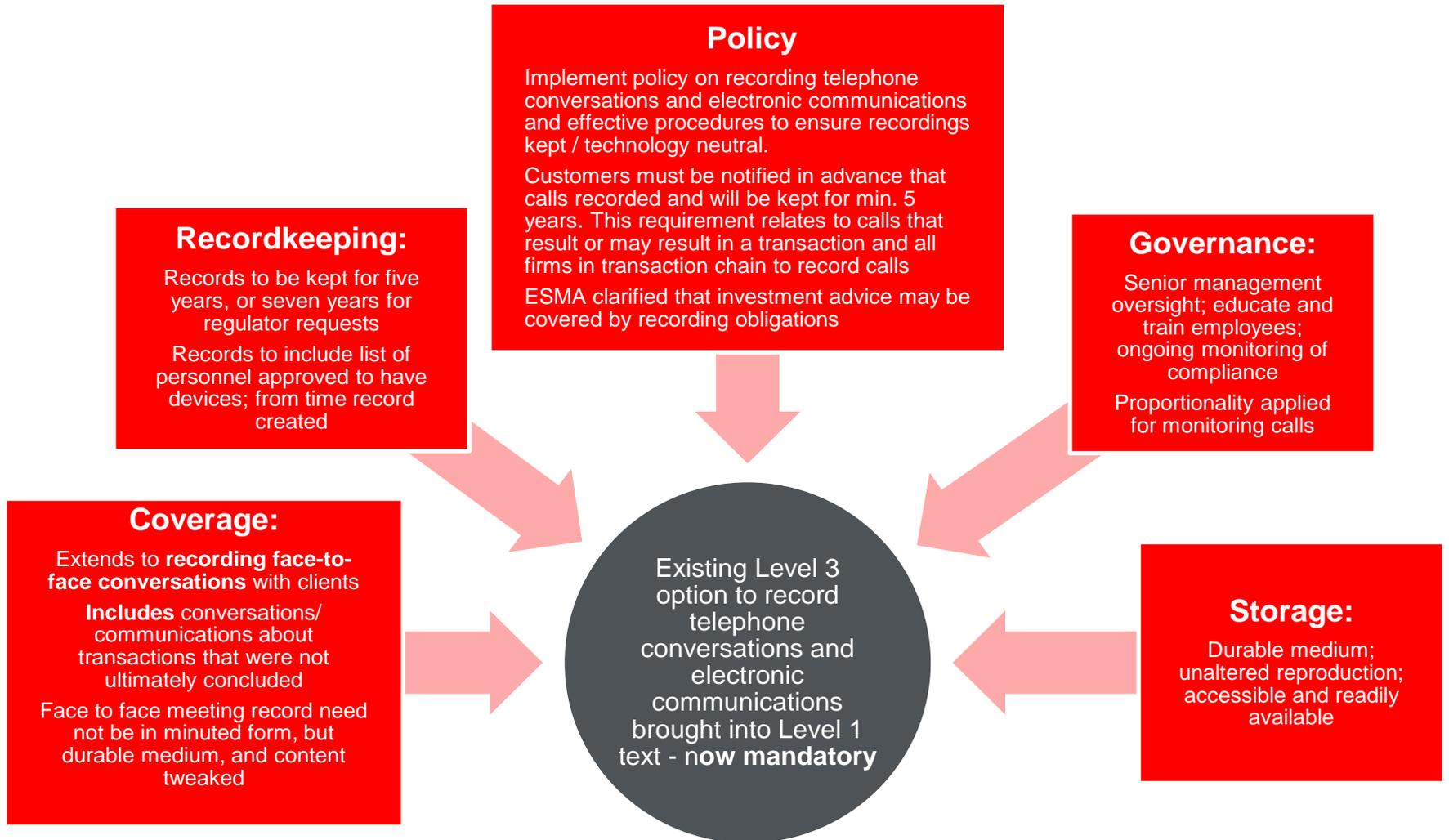
# Client assets

## What's new?

### Significant changes

- A single **officer with sufficient skill and authority to be responsible** for compliance with client asset protection obligations – firms to decide whether they can also perform other roles
- **Ban on custody liens**, security interests and rights of set-off that enable a party to dispose of client assets to recover debts not related to the client, save when required in a specific jurisdiction; **disclosure** to clients and **warnings** of the risks; associated **record-keeping obligations**
- Make **information available** to NCAs / insolvency practitioners and resolution authorities
- Firms to consider **diversification** when holding client monies with third parties but no specific limit; and **20% limit** on intra-group deposits subject to proportionality
- Clients to give **explicit consent** to placement of funds in **money market deposits**
- Measures to **prevent unauthorised use of client assets** including agreement on actions to take in event of insufficient settlement assets, monitoring client's ability to settle and of settlement failures
- Ensure **continued appropriateness** and amount of **collateral** for borrowed assets
- **Ban on use of TTCAs for retail clients**; need to demonstrate **appropriateness of TTCAs for other clients** taking account of extent of each client's assets versus obligation to firm; **disclosure** of risks
- Only deposit assets in a **jurisdiction where safekeeping is regulated** with a third party that is regulated unless certain conditions are met

# Recording of communications



# Recording of communications: 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 five 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

# Recording of communications: Level 3

Q5 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 device 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.

# Record keeping generally

- Records should allow NCAs to fulfil their **supervisory tasks under other EU measures**, such as the Market Abuse Directive and Regulation
- Records should also be able to be used to demonstrate compliance with rules on **market integrity**
- Member States can **gold plate**

## ESMA Q&A on MiFID II – Section 4

*How should firms prepare copies of records that have been encrypted?*

- Expectation that firms will have the organisational and administrative capabilities to convert any encrypted data to an unencrypted format
- Expectation that firms will deliver or make available copies of records in an unencrypted and easily analysable format OR provide the means to unencrypt the data

- For **harmonisation**, the records that need to be kept have been specified
- **Codifies CESR's previous Level 3 recommendations** from 2007
- List is **non-exhaustive** and their **content** has been prescribed
- All policies maintained under **MiFID II, MiFIR, MAD and MAR** must be kept in **writing**
- Applies to **client orders, decisions to deal, transactions, dealing on own account, order processing**
- Applies even if no transaction results
- Record-keeping requirements apply **regardless of technology** used to keep the record
- Only applies to records **from 3 Jan 2017**
- The requirement to keep records for at least 5 years (as is currently in MiFID I, Level 2 text) is not contained in the MiFID II Regulation. There is only a requirement to keep the record which sets out the respective rights and obligations of the firm and the client for at least the duration of the client relationship (*it is assumed that this is an error on the part of the Commission and will be corrected*)

# Remuneration

**New remuneration policies**  
Required  
Policy to be defined, approved, overseen by **senior management**

Applies to “relevant persons”  
Which are “any person that has an impact on the services provided by the firm or on its corporate behaviour all “

Remuneration’ includes **non-financial remuneration** which includes:  
- **in-kind benefits**  
- **career progression**

Staff must not be **remunerated, incentivised** or their performance **assessed** in a way that conflicts with **their duty to act in the best interests of their clients**



Sits alongside  
CRD IV / AIFMD etc

**Criteria for designing remuneration policies**  
Using Level 3 Guidelines from 2013

Management bodies to seek involvement from compliance function

Balance between fixed and variable remuneration which must fully take account of appropriate criteria i.e. qualitative criteria (not commercial)

# The third country provisions

# The MiFID II / MiFIR third country regime

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

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

# Third countries: Access to the EU

## Professional and Eligible Counterparties

### ESMA Register

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

### Authorised branch

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

### National regime

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

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

## Retail and Opt Up Professional

### Authorised branch

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

### National regime

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

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

# Third countries: Recognition and equivalence

Equivalence decisions will be key:

## Required for:

- Third country firms to use the ESMA Register for business with per se professional clients and ECPs only (automatic passport)
- Authorised branches of third country firms to use the passport (applies to per se professional clients and ECPs only)
- Third country trading venues to be used to meet the on platform trading obligation
- Third country CCPs recognition, to allow third country CCPs to clear for EU trading venues or clearing members

## Conditions:

### **Reciprocity:**

Determinations of equivalence all require that the third country has an equivalent system for recognising foreign firms / trading venues / CCPs

### **Cooperation Agreements:**

Required with third country regulators (except for access for third country trading venues)

# Focus on MiFID II / MiFIR equivalence provisions

Sector/ Legislation	Requirements	Consequences of failure to achieve equivalence
<p><b>Investment firms</b> <b>Articles 46 and 47 of MiFIR</b></p>	<p>Under MiFID II, the third country access regime depends on the type of clients an investment firm intends to provide services to.</p> <p><i>Retail and elective professional clients</i></p> <p>Third country investment firms may provide services subject to the relevant national regime provided that:</p> <ul style="list-style-type: none"> <li>(a) the third country is not listed as a non-cooperative country and territory by the Financial Action Task Force;</li> <li>(b) a co-operation agreement is in place;</li> <li>(c) tax agreements are in place; and</li> <li>(d) the services will be subject to on-going supervision by the third country regulator.</li> </ul> <p>No passport to provide services through the EU will be available. Member states have the option to require the establishment of a branch.</p> <p><i>Per se professional clients and eligible counterparties</i></p> <p>Third country investment firms may provide services without establishing a branch in the EEA, provided that they register with ESMA and provide certain information to EU clients. Such registration is subject to the following conditions :</p> <ul style="list-style-type: none"> <li>(a) an equivalence decision;</li> <li>(b) the firm is authorised in its country of establishment to provide investment services; and</li> <li>(c) co-operation arrangements between ESMA and the third country regulator are in place.</li> </ul> <p>If there is no equivalence decision, national EU authorisation regimes remain valid.</p>	<p>UK investment firms would not be able to provide investment services to any EEA clients, to the extent that services or activities are truly cross-border and are locally regulated under a relevant national EU law, without subsidiarisation or obtaining state-by-state licences for local EU branches.</p>
<p><b>Trading platforms, including exchanges – Derivatives trading obligation</b> <b>Article 28 MiFIR</b></p>	<p>Derivatives trading for instruments subject to mandatory trading venue execution requirements may be carried out on a third country trading venue provided that the following conditions are satisfied:</p> <ul style="list-style-type: none"> <li>(a) an equivalence decision;</li> <li>(b) the third country provides for an effective equivalent system for the recognition of trading venues authorised under MiFID II; and</li> <li>(c) the trading venue has clear, transparent rules on the admission of financial instruments to trading.</li> </ul>	<p>UK trading venues, including exchanges, would not be suitable trading venues and therefore may not benefit from possible business resulting from the introduction of the mandatory trading in Europe or may cease to be used by existing EU customers.</p>

# Focus on MiFID II / MiFIR equivalence provisions

Sector/ Legislation	Requirements	Consequences of failure to achieve equivalence
<p><b>Trading platform, including exchanges – Investment firm trading obligation for shares</b></p> <p><b>Article 23 of MiFIR</b></p>	<p>Investment firms may trade shares that are subject to mandatory trading venue execution requirements on a third country market provided that an equivalence decision has been adopted which confirms that:</p> <ul style="list-style-type: none"> <li>(a) The third country markets are subject to authorisation and effective supervision and enforcement on an ongoing basis (equivalent to MiFID II);</li> <li>(b) The trading venue has clear, transparent rules on the admission of securities to trading (equivalent to MiFID II);</li> <li>(c) Securities issuers are subject to disclosure obligations (equivalent to the Prospectus Directive); and</li> <li>(d) Market transparency and integrity is ensured by the prevention of market abuse by insider dealing and market abuse (equivalent to the Market Abuse Regulation (MAR)).</li> </ul>	<p>UK trading venues, including exchanges would not be suitable trading venues and therefore may not benefit from possible business resulting from the introduction of the mandatory trading requirement in Europe or may cease to be used by existing EU customers.</p>
<p><b>Derivatives trading and clearing</b></p> <p><b>Article 28 of MiFIR</b></p>	<p>If a non-EU entity is established in a jurisdiction which has been determined as equivalent, EU or non-EU brokers could comply with the equivalent rules in that country rather than the MiFID II trading and clearing requirements for derivatives.</p> <p>No co-operation agreement is required. However, the third country will need to assist ESMA in preparing its technical advice on equivalence.</p>	<p>EU financial counterparties would need to apply EU standards when trading with UK counterparties until the UK's regulatory regime was determined to be equivalent. Given the regulatory standards in the UK, it would likely only be a matter of time whilst negotiations are undertaken with the EU to ensure that an equivalence decision is rendered.</p>

# Focus on MiFID II / MiFIR equivalence provisions

Sector/ Legislation	Requirements	Consequences of failure to achieve equivalence
<p><b>Trading venues and CCPs – Access rights</b></p> <p><b>Article 38 of MiFIR</b></p>	<p>A third country trading venue may only request access to an EU CCP if an equivalence decision relating to the trading obligation for derivatives has been made.</p> <p>A third country CCP may only request access to an EU trading venue if it has been recognised by ESMA under the European Market Infrastructure Regulation (EMIR).</p> <p>Third country trading venues and CCPs may only make use of the access rights under MiFIR if the following conditions are satisfied:</p> <ul style="list-style-type: none"> <li>(a) an equivalence decision;</li> <li>(b) the third country provides for mutual access for foreign trading venues and CCPs to its trading venues, CCPs, benchmarks and licenses; and</li> <li>(c) the third country regime provides for authorisation, supervisions and enforcement for trading venues on an ongoing basis.</li> </ul> <p>No co-operation agreement is required. However, the third country will need to assist ESMA in preparing its technical advice on equivalence.</p>	<p>UK trading venues and CCPs would not have rights of access to EU trading venues, CCPs, benchmarks and licenses.</p>
<p><b>Exchanges for shares, bonds and certain securitised debt instruments</b></p> <p><b>Article 25 of MiFID II</b></p>	<p>Investment firms may make use of the exemption from certain of the appropriateness and suitability requirements in relation to shares, bonds or other securitised debt admitted to trading on a third country exchange provided that an equivalence decision has been adopted which confirms that:</p> <ul style="list-style-type: none"> <li>(a) the third country markets are subject to authorisation and effective supervision and enforcement on an ongoing basis (equivalent to MiFID II);</li> <li>(b) the trading venue has clear, transparent rules on the admission of securities to trading (equivalent to MiFID II);</li> <li>(c) securities issuers are subject to disclosure obligations (equivalent to the Prospectus Directive) ; and</li> <li>(d) market transparency and integrity is ensured by the prevention of market abuse by insider dealing and market abuse rules (equivalent to MAR)</li> </ul> <p>No co-operation agreement is required. However, the third country will need to assist ESMA in preparing its technical advice on equivalence.</p>	<p>UK exchanges would potentially lose business where EU investment firms wished to make use of the exemptions.</p>

## Publications

## Events

## Learning and development

## Online services

## Technical resources

The Eurozone

Banking reform - Our guide to Banking reform

Capital Markets Union

AIFMD insight - Our guide to the AIFMD

Re:insurance - Our guide to reform affecting the insurance industry

Phoenix - Our guide to UK regulatory reform

The UK Corporate Governance Portal - access to the latest corporate governance developments

Blockchain, distributed ledgers, smart contracts and cryptocurrencies

OTC Oracle - Our guide to OTC derivatives regulatory reform

Legal privilege

UCITS insight

**Pegasus - Preparing for MiFID II**

Our products and experience

Legislation tracker

Legislation and

## Pegasus

### Preparing for MiFID II



MiFID II and MiFIR (together 'MiFID II') will underpin the provision of investment services across and into Europe, both in terms of how trading is carried on and how firms organise and conduct themselves. They will affect both the wholesale and retail sides of the industry, in relation to both securities and derivatives. Nor should MiFID II be seen as solely European, as its effect will be far reaching and influence all firms dependent on the European client base.

Recently legislation delaying the implementation of MiFID II to 3 January 2018 was published in the Official Journal of the EU. Despite the delay, firms need to continue to press ahead with their implementation work. There is still a lot to do to be ready in time for the new implementation date. In addition, the UK's referendum vote to leave the EU should not be taken as a sign for firms to stop their work as it is expected that MiFID II will be implemented before the UK concludes its exit negotiation. The FCA's statement on the EU referendum result stated: "Firms must continue to abide by their obligations under UK law, including those derived from EU law and continue with implementation plans for legislation that is still to come into effect."

To say that MiFID II / MiFIR will change the way European markets operate in the future is without doubt hugely underplaying the likely impact of this legislation and staying on top of developments will be crucial for firms. Our blog, [Regulation tomorrow](#), tracks global regulatory developments. In particular the EU pages track materials published by the European authorities, as well as various member states' regulators, including those relating to MiFID II / MiFIR. Subscription to the blog is free and updates can be received on a daily or weekly basis.

### 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.

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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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