

# **Impact of MiFID II on EU conduct of business regimes**

## **United Kingdom**

May 2016

**DISCLAIMER:** The purpose of this document is to provide information as to developments in the law. It does not contain a full analysis of the law nor does it constitute an opinion of any Norton Rose Fulbright entity on the points covered. In particular, it is not tailored to address questions or points relevant to your specific business model and you must therefore take specific legal advice on any particular matter which concerns you. If you require any advice or further information, please speak to your usual contact at Norton Rose Fulbright.

## HEAT MAP

	Level 1 (final)	Level 2 (final)	Impact in UK
Client categorisation	<span style="color: orange;">●</span>	<span style="color: orange;">●</span>	<span style="color: orange;">●</span>
Client order handling	<span style="color: green;">●</span>	<span style="color: orange;">●</span>	<span style="color: green;">●</span>
Conflicts of interest	<span style="color: green;">●</span>	<span style="color: red;">●</span>	<span style="color: red;">●</span>
Client assets	<span style="color: green;">●</span>	<span style="color: red;">●</span>	<span style="color: orange;">●</span>
Inducements (generally)	<span style="color: green;">●</span>	<span style="color: red;">●</span>	<span style="color: red;">●</span>
Third Party Payments ban	<span style="color: red;">●</span>	<span style="color: red;">●</span>	<span style="color: orange;">●</span>
Record-keeping	<span style="color: green;">●</span>	<span style="color: orange;">●</span>	<span style="color: green;">●</span>
Suitability	<span style="color: orange;">●</span>	<span style="color: orange;">●</span>	<span style="color: green;">●</span>
Complaints handling	<span style="color: green;">●</span>	<span style="color: red;">●</span>	<span style="color: orange;">●</span>
Clear, fair and not misleading communications	<span style="color: green;">●</span>	<span style="color: red;">●</span>	<span style="color: orange;">●</span>
Reporting to clients	<span style="color: orange;">●</span>	<span style="color: orange;">●</span>	<span style="color: orange;">●</span>
Appropriateness / execution-only	<span style="color: orange;">●</span>	<span style="color: red;">●</span>	<span style="color: red;">●</span>
Best execution	<span style="color: red;">●</span>	<span style="color: red;">●</span>	<span style="color: red;">●</span>
Product governance and distribution	<span style="color: red;">●</span>	<span style="color: red;">●</span>	<span style="color: orange;">●</span>
Investment advice	<span style="color: red;">●</span>	<span style="color: red;">●</span>	<span style="color: orange;">●</span>
Product intervention	<span style="color: red;">●</span>	<span style="color: red;">●</span>	<span style="color: green;">●</span>
Recording communications	<span style="color: red;">●</span>	<span style="color: red;">●</span>	<span style="color: red;">●</span>
Remuneration	<span style="color: red;">●</span>	<span style="color: red;">●</span>	<span style="color: orange;">●</span>
Information to clients	<span style="color: orange;">●</span>	<span style="color: red;">●</span>	<span style="color: red;">●</span>
Dealings with eligible counterparties	<span style="color: orange;">●</span>	<span style="color: orange;">●</span>	<span style="color: orange;">●</span>

Key: ● Significant change   ● Moderate change   ● Minor / no change

# Level 1 (Final)

## Client categorisation

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

## Client order handling

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

## Clear, fair and not misleading communications

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

## Inducements (generally)

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

## Suitability

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

## Conflicts of interest

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

## Complaints handling

- No significant change to MiFID I
- Member States to notify ESMA of their out-of-court complaints and redress procedures - ESMA intends to keep a list on its website
- Note: Interaction with Alternative Disputes Resolution Directive (in force from 9 July 2015) and Online Dispute Resolution Regulations (in force from 9 January 2016)

## Client assets

- No significant change to MiFID I

## Third party payments ban

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

## Appropriateness/execution-only

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

Key:



Significant change compared to MiFID I



Moderate change compared to MiFID I



Minor / no change compared to MiFID I

# Level 1 (Final)

## Best execution

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



## Investment advice

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



## Record-keeping

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



## Reporting to clients

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



## Information to clients

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



## Remuneration

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



## Recording communications

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



## Dealings with eligible counterparties

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



## Product intervention

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



## Product governance and distribution

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



Key:



Significant change compared to MiFID I



Moderate change compared to MiFID I



Minor / no change compared to MiFID I

# Level 2 (Final)

## Client categorisation

- No change to existing MiFID I requirements to inform clients about client status, limitations with status and ability to request a different status
- Municipalities and local public authorities are not permitted to be eligible counterparties
- A client who is an elective professional client cannot become an elective eligible counterparty
- New procedure for clients becoming ECPs including written warnings

## Client order handling

- Existing MiFID I requirements have been confirmed
- New requirements for the prompt fair and expeditious execution of client orders and publication of unexecuted client limit orders for shares traded on a trading venue

## Clear, fair and not misleading communications

- Targeted improvements to communications with retail clients (i.e. consistent language, indication of risks, kept up-to-date, performance scenarios)
- All 'retail-like' obligations extended to professional client communications
- Firms just have a general duty to communicate with eligible counterparties in a manner that is fair, clear and not misleading

## Inducements (generally)

- The 'quality enhancement' test is significantly amended - firms must prove quality is enhanced
- Exhaustive list of what constitutes an *acceptable* 'minor non-monetary benefit'
- Inducements to be disclosed, individually priced
- Ability to receive 'free' research severely restricted – now must be paid for
- Research charge to be disclosed to clients
- Strict recordkeeping requirements for inducements

## Suitability

- Prescribed content of suitability reports and periodic reports and their frequency
- Clients to be alerted where suitability may need to be reviewed periodically
- Suitability assessment required for simplified advice (e.g. advice through automated processes)
- Detail included to identify the person subject to the assessment
- More detail on the suitability assessment itself and information requirements

## Conflicts of interest

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

## Complaints handling

- Written complaints handling policy / procedures required and new complaints oversight function (can be provided by compliance)
- Applies to retail / professional / potential clients
- Complaints to be brought free of charge
- No clarity on what amounts to a 'complaint' in the context of professional clients
- Complaints data to be reported to regulators
- Level 3 guidelines may be made

## Client assets

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

## Third party payments ban

- Payments received must be paid over 'as soon as reasonably practicable' (no additional clarity)
- Can pay into client money account
- Policy to be implemented to ensure amounts are paid over to clients
- Clients can be informed of amounts paid to them in regular statements
- *acceptable* minor non-monetary benefits excluded from ban

## Appropriateness/execution-only

- For the separate 'non-complex' test, a further two criteria have been added
- New record-keeping requirements
- ESMA guidelines expected on the warning for clients where there is a "not appropriate" assessment

Key:



Significant change compared to MiFID I



Moderate change compared to MiFID I



Minor / no change compared to MiFID I

# Level 2 (Final)

## Best execution

- Tailored best execution policies needed
- Separate summaries of policy for retail clients
- No clarity on how to satisfy '*all sufficient steps*'
- Information on execution venues/entities to be notified to clients
- Additional disclosure requirements
- Clarity on what constitutes a 'material change' to trigger a review of the policy
- RTS includes the detail of publication requirements
- ESMA's Peer Review Report into Best Execution (2015/494)

## Record-keeping

- List of required records to be kept and content
- Non-exhaustive list of type of records to be kept in writing (regardless of technology used)
- Extended to apply to a wider range of firms and situations
- Content of records prescribed
- Does not apply retrospectively

## Information to clients

- Professional clients and ECPs to receive the same information as retail clients unless they opt out (but opting out not available in certain circumstances)
- Increased requirements for information on:
  - Investment advice: applies to professional clients
  - Costs and charges: significant level of detail
  - Client agreements expanded

## Recording communications

- New policy required with senior management oversight and (proportionate) ongoing monitoring
- Record-keeping obligations
- Content of face-to-face file note prescribed
- To be stored in durable medium
- Must inform clients that calls are being recorded and will be available on request for 5 years (and 7 years for regulatory requests)

## Product intervention

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

## Investment advice

- Change to definition of investment advice - exclusion for where advice given through '*distribution channels*' deleted
- Additional requirements in order to meet threshold for giving 'independent' advice
- Level 3 guidelines anticipated on what amounts to investment advice and to clarify how to meet 'independent' standards
- Obligation to disclose the type of advisory service extends to professional clients

## Reporting to clients

- Same reporting requirements apply to all clients (however ECPs can agree different standards for content and timing)
- New depreciation threshold which triggers reporting requirements (multiples of 10%)
- No reports needed for portfolio management / client asset services where the information is available on a website which is a 'durable medium'

## Remuneration

- New definition of 'remuneration' which includes non-financial benefits
- Senior management to set remuneration policy (with advice from compliance)
- Balance between fixed and variable remuneration must be maintained at all times
- Requirements extended to relevant people who affect a firm's services and its '*corporate behaviour*'

## Dealings with eligible counterparties

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

## Product governance and distribution

- Detailed requirements on manufacturers and distributors in sales chain
- Applies to all clients and MiFID/non-MiFID products and services
- Applies to wholesale products, primary and secondary traded products, shares and bonds
- Non-MiFID entities may come within the regime
- ESMA proposes to eventually harmonise product governance regimes across MiFID / UCITS / AIFMD

Key:

Significant change compared to MiFID I

Moderate change compared to MiFID I

Minor / no change compared to MiFID I

# Impact in the UK

## Client categorisation

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

## Client order handling

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

## Clear, fair and not misleading communications

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

## Inducements (generally)

- End to commission sharing arrangements and 'free' research
- An inducement must enhance quality of service and fit in the narrowed 'permitted benefits' table
- FCA TR: One benefit may enhance the quality of service but a non-compliant additional benefit can't be included
- FCA TR: Provider payments should only cover costs incurred. Excess costs likely to be inducement
- FCA TR: Clients should be given an indication of the value of benefits

## Suitability

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

## Conflicts of interest

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

## Complaints handling

- Extend existing regime to professional clients
- Change operational procedures
- May need to increase staff to deal with more complaints and to deal with FOS
- Regulatory fees likely to increase
- Note: FCA consultation (CP14/30) on improving complaints handling

## Client assets

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

## Third party payments ban

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

## Appropriateness/execution-only

- Firms' 'non-complex' product suite to be reassessed
- Operational change for record-keeping requirements
- Uncertainty on 'complex' / 'non-complex' distinction
  - FCA: "the types of products that are considered 'non-complex' will be significantly limited".
- FCA DP: extending MiFID II appropriateness test to non-MiFID products
- Will impact D2C market significantly
- ESMA Consultation Paper (2015/610) on complex debt instruments and structured deposits

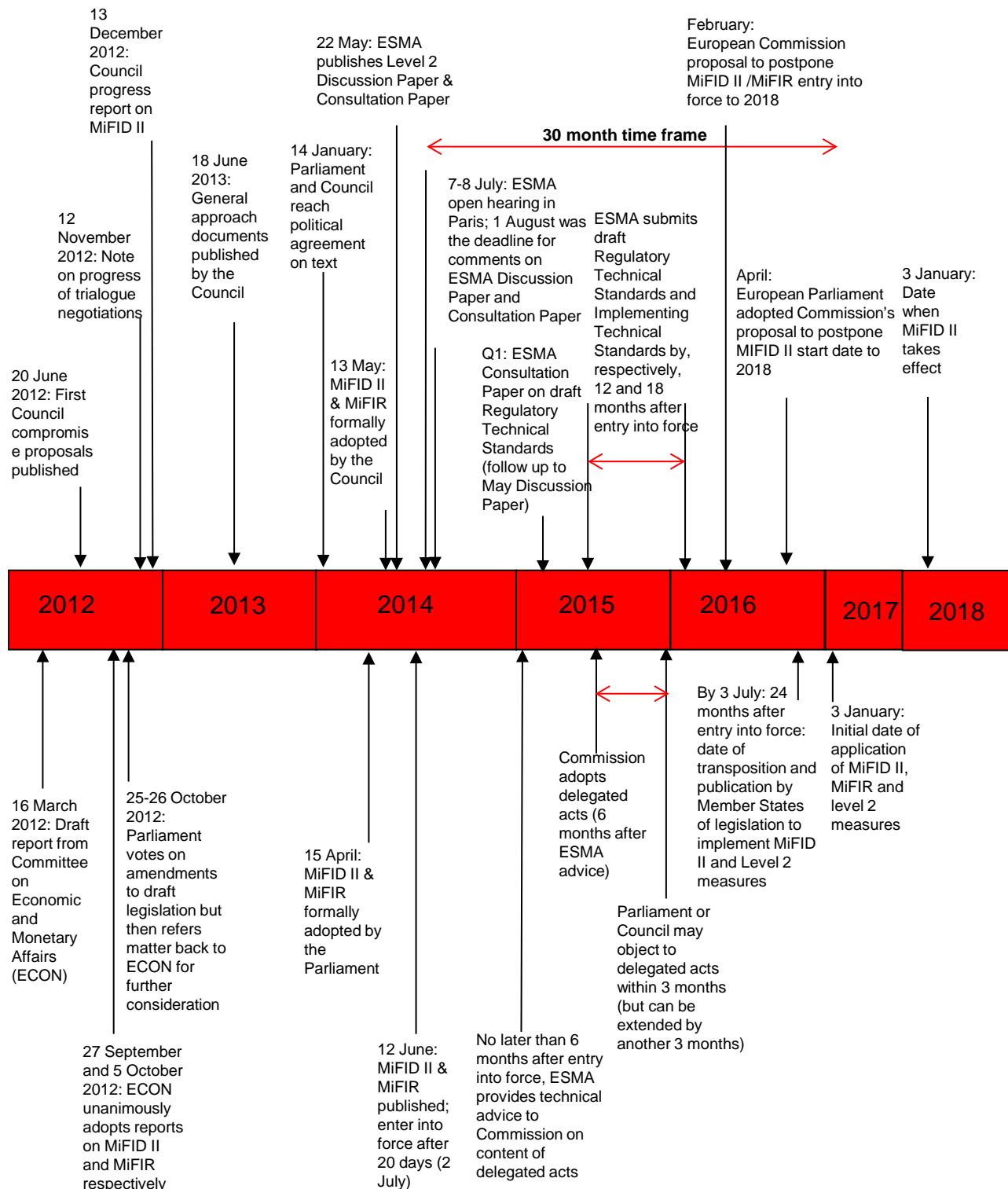
Key:  Significant change compared to MiFID I  Moderate change compared to MiFID I  Minor / no change compared to MiFID I

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

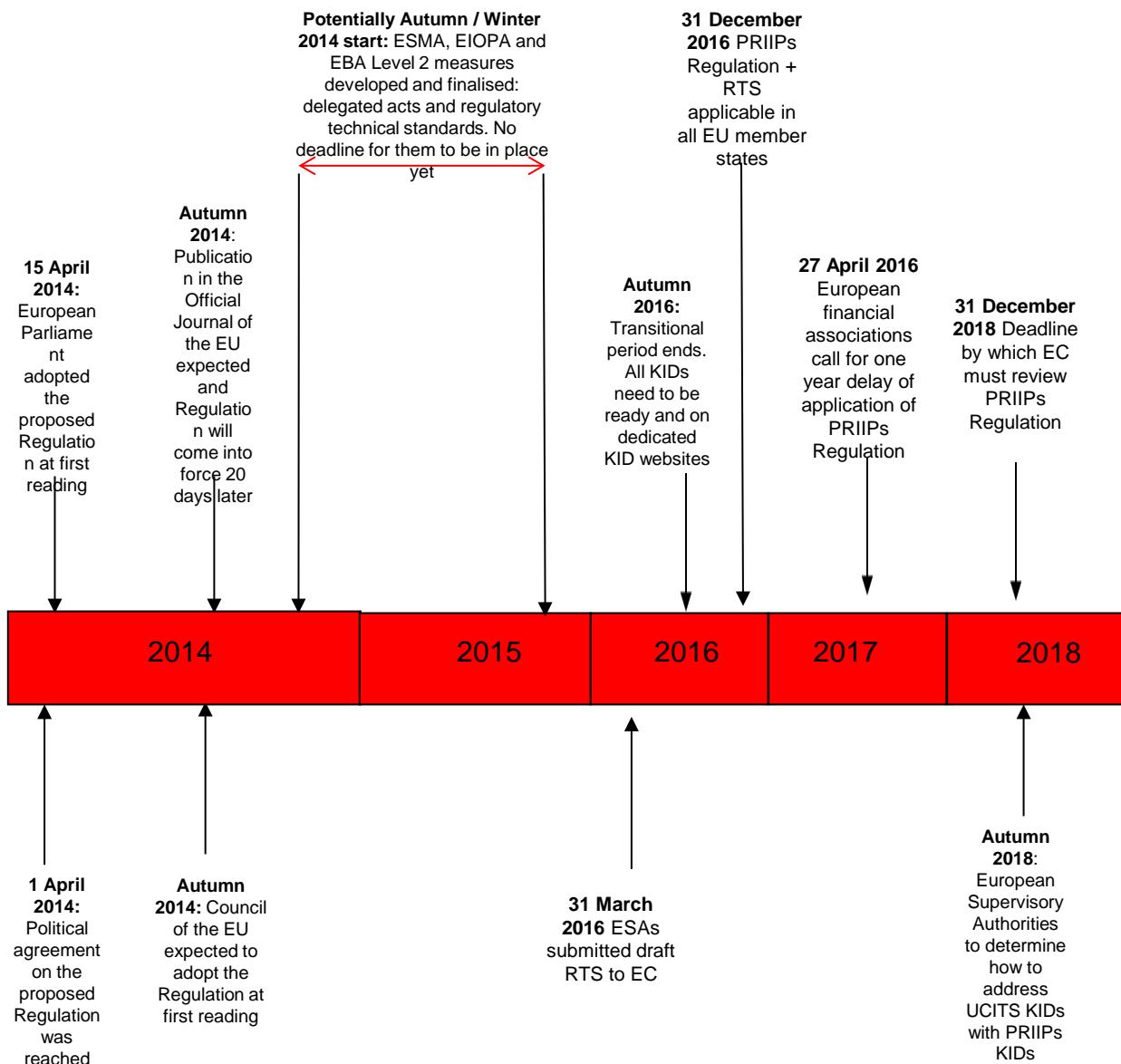
# Impact in the UK

<h2>Best execution</h2> <ul style="list-style-type: none"> <li>Reconsider entire best execution process</li> <li>Redraft policies / create retail summaries</li> <li>Evidence best execution, "all sufficient steps"</li> <li>Publish top 5 venues</li> <li>Publish required information in standardised form but with sufficient granularity</li> <li>Alignment with FCA paper on best execution</li> </ul>	<h2>Record-keeping</h2> <ul style="list-style-type: none"> <li>UK regime super equivalent in some scenarios but not in others</li> <li>Additional records may need to be kept</li> <li>Member States can gold-plate</li> </ul>
<h2>Information to clients</h2> <ul style="list-style-type: none"> <li>Firms will need to negotiate the information ECPs / professional clients do not wish to receive</li> <li>Significant amount of new information to clients</li> <li>New KID for PRIIPs will represent significant operational projects for firms creating packaged products and firms distributing them</li> <li>DP: FCA seeks views on technical challenges with aggregating costs and costs/charges disclosures and on the extent of standardisation</li> </ul>	<h2>Reporting to clients</h2> <ul style="list-style-type: none"> <li>UK regime super equivalent but updating exercise needed</li> <li>Professional clients to receive what retail clients receive</li> <li>Negotiate with ECPs what reports they receive and record what is agreed</li> <li>May need to update terms of business</li> <li>If reporting online, need to ensure website is a 'durable medium'</li> </ul>
<h2>Remuneration</h2> <ul style="list-style-type: none"> <li>UK already super-equivalent to MiFID requirements for many firms with SYSC 19</li> <li>May need to revisit who is caught by the new rules after there is clarity on who affects a firm's 'corporate behaviour' – delegates? contractors?</li> <li>Increased focus for FCA - clients' best interest rule and link between conflicts and financial incentives (FG13/1) and recent FCA/PRA consultation on changing SYSC 19 (CP14/14)</li> <li>FCA DP: Considering extending MiFID II requirements to non-MiFID firms</li> </ul>	<h2>Recording communications</h2> <ul style="list-style-type: none"> <li>UK implemented optional regime from MiFID I</li> <li>Policies and procedures will need to be updated</li> <li>FCA proposing to remove current UK duplication exemption for discretionary managers and to subject those firms exempt under Article 3 of MiFID II to the regime.</li> <li>Extent of recording internal communications?</li> <li>Storage requirements to be updated so records can be kept for 7 years (not 6 months)</li> <li>Firms to determine if records kept in 'durable medium' that allows for immediate reproduction</li> </ul>
<h2>Dealings with eligible counterparties</h2> <ul style="list-style-type: none"> <li>UK regime already super equivalent in some respects</li> <li>Firms subject to Principles for Businesses, which require them to communicate with ECPs in a way that is not misleading</li> <li>Information and reporting to ECPs is a more significant change</li> </ul>	<h2>Product intervention</h2> <ul style="list-style-type: none"> <li>Nothing for firms to do in practice</li> <li>UK already super equivalent although there are differences between the UK and EU regimes</li> <li>Ensure compliance monitoring programme monitors for FCA bans</li> </ul>
<h2>Investment advice</h2> <ul style="list-style-type: none"> <li>definition of investment advice – no impact. UK regime has both advice and personal recommendations and substantial PERG guidance</li> <li>'independent' advice – UK proposing to gold-plate test for being 'independent' to mirror the wider test introduced by the UK RDR (which also considers non-MiFID products and to bring structured deposits within the UK RDR net) but to have separate MiFID II independence tests for (1) shares and bonds and (2) derivatives)</li> <li>DP: FCA proposing two 'independence' regimes - one for retail clients (mirroring the RDR test) and one for professional clients (mirroring the MiFID II test)</li> <li>DP: FCA considering changing 'restricted advice' label – further DP coming</li> </ul>	<h2>Product governance and distribution</h2> <ul style="list-style-type: none"> <li>UK regime super equivalent</li> <li>Current UK guidance (in the RPPD and Product Governance Guidance) to be elevated to rules</li> <li>Differences between UK and EU regimes to be aligned – EU regime more detailed on: (i) target market specification; (ii) management oversight; (iii) distributor obligations</li> <li>This will impact on firm's product governance policies and procedures and committees</li> <li>Note: FCA thematic review of Product Development Guidance – Structured Products (March 2015)</li> <li>FCA DP: potentially extend MiFID II requirements to a wide range of non-MiFID firms</li> </ul>

## Timing: MiFID II and MiFIR



## Timing: PRIIPs\*



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