Deloitte.

MiFID II/MiFIR
Implications for Fund Managers

May 2014

Webinar participants

	Manmeet Rana Senior Manager– Audit Deloitte UK mrana@deloitte.co.uk +44 20 7303 8624	Manmeet Rana is a Senior Manager within Deloitte's Risk and Regulation Consulting Practice and has more than 9 years experience of wholesale regulation consultancy work, focussing on MiFID, compliance risk and market abuse. Her areas of expertise include providing senior briefings, as well as tailored regulatory change implementation projects and general assistance to a range of firms, including investment banks and asset managers, in respect of regulatory change. These include designing and embedding conflicts of interest management, control room and market abuse systems and controls. Manmeet co-ordinates Deloitte's EMEA MiFID II Working Group and is actively involved in industry working groups. She has published a number of articles in respect of MiFID II, including an article on the impacts of MiFID II for asset managers in Performance magazine, which was re-printed in Agefi Luxembourg.
	Mike Williams Partner– Audit Deloitte UK mikewilliams@deloitte.co.uk +44 20 7303 5407	Mike is a Regulatory Partner in Deloitte's Banking and Capital Markets team in London and leads the Prudential Regulation team. Mike has over 25 years experience working with client money and assets issues and reporting. He has significant experience working with the FSA on client money issues, has helped banks reengineer client money processes, and has over 12 years experience as a client money audit partner. Mike is one of a number of leading practitioners representing the profession on the CASS Advisory Group, which has shaped the recent guidance on the rules in respect of client money and assets reporting.

MiFID II

Drivers for Policy Change and Key Changes

Earlier this year, political agreement was reached on revisions to the existing MiFID and the creation of MiFIR, a new piece of regulation. More recently, the European plenary released draft texts of the revisions to MiFID and a draft of MiFIR. Together, these are referred to as 'MiFID II'. The changes which MiFID II brings are likely to have a widespread impact across firms and their businesses. MiFID II will bring a wave of changes for markets and market participants.

Key Drivers

MiFID

G20 Commitments

- Enhancements to transparency in both cash and OTC derivatives.
- This was communicated in Pittsburgh 2009 and Washington 2011.

Review of MiFID

- A review of MiFID I was expected to occur.
- There was an industry perception that MiFID I left gaps and did not address some key issues & challenges.

Modernisation

- Desire to address the changing financial landscape, in relation to how firms do business, how markets work and the rate at which financial services are impacted by technology.

MiFID II

Key Areas of Change

Governance	Product Intervention	Pre/Post Trade Transparency	Market Structure
Conflicts of Interest	High Frequency Trading	Transaction Reporting	Venue Regulation
Investor Protection	Algorithmic Trading	Third Country Access Regime	Commodities

MiFID II

Governance

Key Changes

- MiFID II requires all investment firms to comply with the governance requirements set out in the Capital Requirements Directive IV (CRD IV)
- MiFID II limits the number of directorships a management body may hold at the same time in different entities
- ESMA will specify in more detail the standards and criteria for the requirements in relation to governance.

Impact for Investment Management Firms

- *MiFID II formalises the expectations* of regulators and industry best practices that some firms have been adopting with regard to governance.
- *Management bodies should re-assess their governance* structures well in advance of MiFID II. It is likely there will be a greater focus by regulators on individuals within senior management in performing their roles, greater use of attestations etc.

Organisation

- Management bodies need to understand fully its firm's business activities.
- Management bodies need to define the firm's risk profile and appetite.
- Must ensure that the management body is sufficiently diverse regarding age, gender, geographic provenance and educational and professional background.
- Combining too high a number of directorships would preclude the management body from spending adequate time on the performance of that oversight role.

Accountability

The management body:

- Is accountable for defining and overseeing the:
  - Implementation of governance standards including monitoring and assessment of firms business activities against strategic objectives.
  - Organisation of the firm and segregation of duties; including the skills, knowledge and expertise required by personnel and the resources, procedures and arrangements for the provision of services and activities.
  - Effective identification and management of conflicts of interest. With a particular focus on the role management bodies play.

Remuneration

The management body is responsible for ensuring remuneration policy is designed to encourage:

- Responsible business conduct.
- Fair treatment of clients.

This must be implemented in line with CRD IV requirements.

MiFID II

Conflicts of Interest

There has recently been an increasing industry focus on conflicts of interests. In the UK, the FCA has conducted thematic reviews and required attestations from firms with regard to their conflict of interest control frameworks. MiFID II seeks to turn up the heat on conflicts of interest by increasing the expectations placed upon firms in how they ensure conflicts are identified and managed appropriately.

Extension of Conflict of Interest Regime

Existing Focus

- Investment Research
- Dealing Commission
- Gifts & Entertainment
- Personal Account Dealing
- Error Correction /Handling
- Cross Fund Sales

MiFID II Focus

- 3rd Party Inducements
- Remuneration Structure

Disclosure Requirements

- MiFID II conflict of interest disclosure requirements will require firms to disclose the steps that were taken to mitigate an identified conflict of interest.
- MiFID II will require firms to make disclosures in sufficient detail; taking into account the nature of the client in order to enable the client to make an informed decision with regard to the identified conflict.
- **The act of disclosure alone will not be acceptable!**

Impact on Investment Management Firms

- Focus on management body to have appropriate oversight of conflicts (i.e. to be in receipt of conflict specific MI).
- Greater focus on identification of key conflicts.
- Greater focus on cross entity/cross fund conflicts.

MiFID II

Market Structure and Market Quality

The creation of MiFID II was partially driven by the desire to create further transparency and stability in common financial markets. As such, MiFID II seeks to change the market landscape by adjusting requirements and scope of market infrastructure firms.

Key Changes

- Creation of a new multilateral trading venue (OTF) for eligible derivatives.
- Requirement to trade certain derivatives on a MiFID trading venue. The scope of this will be determined at level 2.
- Expansion of Systematic Internalisers
- Introduction of algorithmic trading rules
- Trading generally face more regulations
- Commodity position limits and reporting
- Execution quality disclosure

Trading Venues

MiFID I

Regulated Markets

Multilateral Trading Facilities

OTC

Systematic Internalisers

MiFID II

Organised Trading Facilities (OTFs)

MiFID II

High Frequency Trading

High frequency trading has developed as a result of technological advances in the financial sector. These advances bring increases in the speed, capacity and complexity of trading and result in numerous tangible benefits for firms. At the same time, this represents a new challenge for regulation as it generates new types of risks. As a result, MiFID II brings High Frequency Traders and Algorithmic Traders under its purview with new regulation set to mitigate the risks posed by this type of activity.

Organisational Requirements

- Effective systems and risk controls to ensure its systems:
  - Are resilient
  - Have sufficient capacity
  - Have appropriate trading thresholds/limits
  - Prevent sending of erroneous orders
- Effective business continuity arrangements to deal with any failure of trading systems
- Effective testing and monitoring of Systems

Notification Requirements

- Notification to home state regulator of HFT activity
- Notification to trading venue of HFT activity

Disclosure Requirements

- Algorithmic trading strategy
- Trading parameters/limits
- Key compliance and risk controls
- Details of testing arrangements

Record Keeping Requirements

- Must keep accurate and time sequenced records of:
  - All orders
  - Cancellations
  - Executed orders
  - Quotations

Direct Market Access

- Firms providing DMA to clients will be responsible for ensuring clients using that service to conduct HF Algorithmic Trading comply with the above requirements and monitoring transactions from this service

Impact on Investment Management Firms

- Many firms may already have assessed its controls against the ESMA guidance.
- MiFID II does go beyond this and embeds the requirements.
- Firms should be carrying out monitoring of controls and look at segregation of duties

MiFID II

Investor Protection

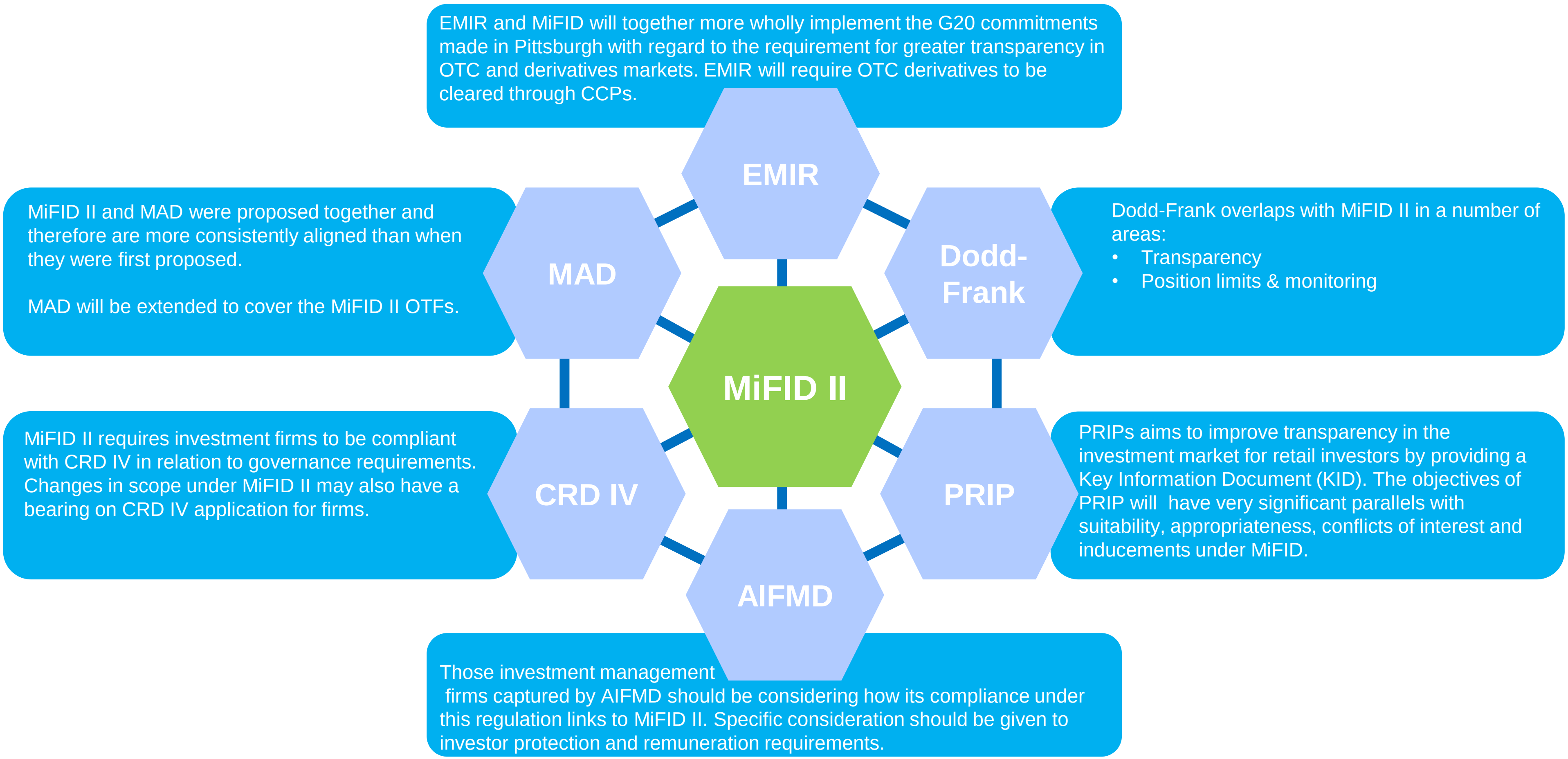
The conduct focus of MiFID has been expanded in MiFID II to strengthen investor protection. The proposed rules reflect requirements found in under the UK's Retail Distribution Review. Investment management firms that have already faced the challenges of implementing the RDR are likely to be a in a better position to absorb changes arising from MiFID II in comparison to EU counterparts.

Key Changes

Area	Requirement
Suitability & Appropriateness	▪ **Knowledge & Competence of Portfolio Managers -** must be able to ensure and demonstrate to the competent authorities, upon request, that the natural persons giving advice possess the necessary knowledge and competence to fulfil their obligations. ▪ **Suitability of Packed Products –** suitability must be considered for on an overall basis. ▪ **Linkages to PRIPs** - appropriateness regime will continue under MiFID II and should be considered alongside EU's initiative on Packaged Retail Investment Products (PRIPs). ▪ **Appropriateness of UCITS** - Firms will need to apply the appropriateness test when selling structured UCITS.
Remuneration	▪ **Ban on third-party remuneration for independent investment advice** - whereas adviser charging under the RDR applies to all retail investment advice. ▪ **Ban on third-party remuneration for portfolio management** - Where portfolio management is typically remunerated through client fees, a ban on commission is unlikely to raise too many eyebrows.
Best Execution	▪ **Continued Focus on Best Execution.** Given that a wider range of execution venues are now available in the Union, it is appropriate to enhance the best execution framework for retail investors.
Governance	▪ **Product Approval Process.** Firms must have a product approval process that identifies a target market of end clients and has an appropriate distribution strategy.

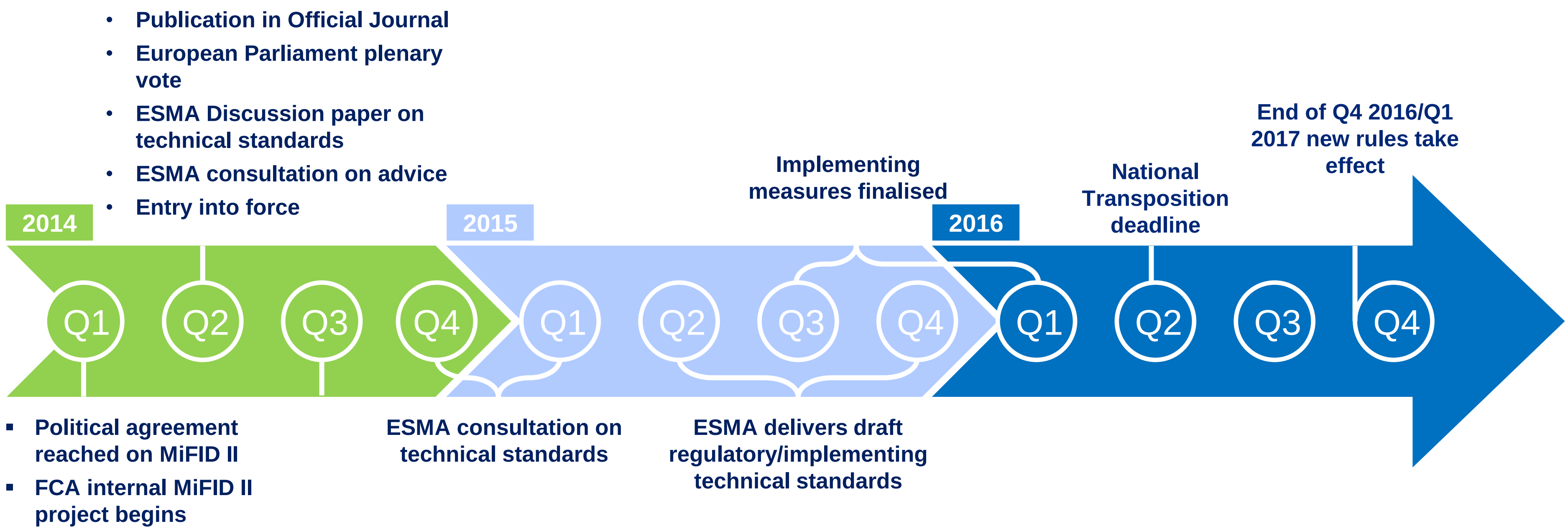
MiFID II
Joining the Dots

- MiFID II can be thought of as a regulatory nexus, sitting between a number of other European regulation, and even non-European regulation.
- Firms should consider the synergies during implementation.



MiFID II
Key Next Steps

MiFID II requirements are not likely to ‘bite’ until Q1 of 2017. However, during Q2 of 2014, ESMA will publish a discussion paper regarding its approach to MiFID II Level 2 measures and will invite participants to submit comments. Following this, in Q4 of 2014, ESMA will take the feedback from this discussion paper and publish several consultation papers containing the draft technical standards and invite participants to submit comments.



Dates are estimates only

MiFID II

Implementation Challenges for Asset Management

Although there is some time until the MiFID II officially comes in to effect, firms should be taking action now to understand how they will be impacted by MiFID II, taking in to consideration the nature, size and coverage of its business activities.

Investment Management Firms

Industry Participation

Firms should ensure they are active in ESMA discussion process to help shape the level 2 texts. Firms should also consider how they will be able to assist ESMA in gathering data.

Business Activities

Firms should review their business activities to understand the impacts of MiFID II and where changes will be required.

Internal Initiatives & Key Stakeholders

Firms will need to identify internal key stakeholders who have the knowledge of the firm and MiFID II requirements to drive internal initiatives. This will also include identifying budget requirements.

Client Profiles

Firms should review their client base to understand how MiFID II will impact the way in which they do business with clients.

Systems & Operational Processes

As with any new regulation, this often requires significant changes to operational processes, including updating IT systems. Firms cannot leave this until near the start date for MiFID II.

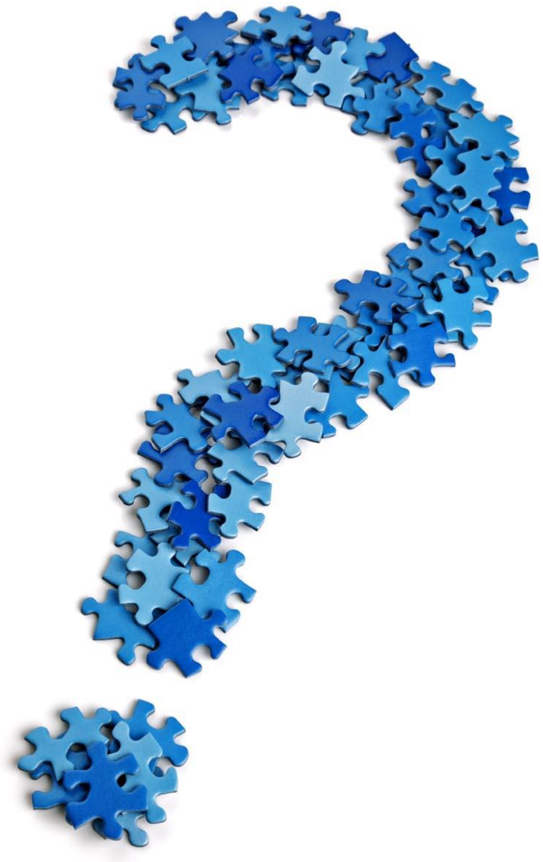
Governance Review

Firms should re-review their governance arrangements and start to identify any material changes that may be required. Firms should be aware that organisational and cultural changes can be challenging and may take many years.

Strategy

Firms will need to start considering the strategic implications of MiFID II *now.* However, it is important that this is done in relation to the firm's longer term strategy i.e. changes to type of business, client coverage etc.

Questions



Deloitte LLP is a limited liability partnership registered in England and Wales with registered number OC303675 and its registered office at 2 New Street Square, London EC4A 3BZ, United Kingdom. Tel: +44 (0) 20 7936 3000 Fax: +44 (0) 20 7583 1198.