MiFID II/MiFIR
Implications for Fund Managers

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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 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

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.

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

MiFID II
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.

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**Extension of Conflict of Interest Regime**

- Investment Research
- Dealing Commission
- Gifts & Entertainment
- Personal Account Dealing
- Error Correction /Handling
- Cross Fund Sales
- 3rd Party Inducements
- Remuneration Structure

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**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!

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**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.
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)
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 in a better position to absorb changes arising from MiFID II in comparison to EU counterparts.

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<thead>
<tr>
<th>Area</th>
<th>Key Changes</th>
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<tbody>
<tr>
<td><strong>Suitability &amp; Appropriateness</strong></td>
<td>- <strong>Knowledge &amp; Competence of Portfolio Managers</strong> - 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.  &lt;br&gt; - <strong>Suitability of Packed Products</strong> – suitability must be considered for on an overall basis. &lt;br&gt; - <strong>Linkages to PRIPs</strong> - appropriateness regime will continue under MiFID II and should be considered alongside EU’s initiative on Packaged Retail Investment Products (PRIPs). &lt;br&gt; - ** Appropriateness of UCITS** - Firms will need to apply the appropriateness test when selling structured UCITS.</td>
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<td><strong>Remuneration</strong></td>
<td>- <strong>Ban on third-party remuneration for independent investment advice</strong> - whereas adviser charging under the RDR applies to all retail investment advice.  &lt;br&gt; - <strong>Ban on third-party remuneration for portfolio management</strong> - Where portfolio management is typically remunerated through client fees, a ban on commission is unlikely to raise too many eyebrows.</td>
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<td><strong>Best Execution</strong></td>
<td>- <strong>Continued Focus on Best Execution.</strong> 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.</td>
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<td><strong>Governance</strong></td>
<td>- <strong>Product Approval Process.</strong> Firms must have a product approval process that identifies a target market of end clients and has an appropriate distribution strategy.</td>
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### MiFID II/MiFIR - Implications for Fund Managers
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 and MAD were proposed together and therefore are more consistently aligned than when they were first proposed.

MAD will be extended to cover the MiFID II OTFs.

MiFID II requires investment firms to be compliant with CRD IV in relation to governance requirements. Changes in scope under MiFID II may also have a bearing on CRD IV application for firms.

EMIR and MiFID will together more wholly implement the G20 commitments made in Pittsburgh with regard to the requirement for greater transparency in OTC and derivatives markets. EMIR will require OTC derivatives to be cleared through CCPs.

Dodd-Frank overlaps with MiFID II in a number of areas:
- Transparency
- Position limits & monitoring

PRIPs aims to improve transparency in the investment market for retail investors by providing a Key Information Document (KID). The objectives of PRIP will have very significant parallels with suitability, appropriateness, conflicts of interest and inducements under MiFID.

Those investment management firms captured by AIFMD should be considering how its compliance under this regulation links to MiFID II. Specific consideration should be given to investor protection and remuneration requirements.
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.

- Publication in Official Journal
- European Parliament plenary vote
- ESMA Discussion paper on technical standards
- ESMA consultation on advice
- Entry into force

Dates are estimates only
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.

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.

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

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

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.

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.

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