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From MiFID I to MiFID II, what are the main changes?

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Extended scope of products and activities

Products and activities

Additional financial instruments will be brought into the scope of MiFID II, such as:

- Structured deposits issued or sold by credit institutions
- Certain packaged retail investment products (PRIPs)
- All emissions allowances (such as carbon)
- The sale of financial instruments issued by the investment firm.

Insurance-based Investment products

Insurance-based Investment products will remain regulated under the current version of IMD (Insurance Mediation Directive) that will be updated after new parliament is in place.

Nevertheless, MiFID II introduces specific rules on conflict of interest on Insurance-based Investment products and give the possibility to EU Member States to introduce inducement restrictions on those products.

Prohibited payment and retention of inducements (MiFID article 24)

Out of the whole MiFID package, a single article has sent shockwaves throughout the industry: article 24, which prohibits the common practice of retrocessions (inducements) for discretionary asset management and 'independent' advice.

Article 24 creates significant difference between MiFID I and MiFID II: while the first generated compliance costs, the second puts significant revenue at risk. In other words, MiFID I was mainly a compliance matter for the financial industry, but MiFID II poses challenges on revenue and therefore on organisations strategy and business model.

By end-2016, all 28 EU member states will be on a level playing field, unless certain countries go for more stringent rules (gold plating). In the meantime, national regulators throughout Europe have already taken tough measures to either ban trailer fees or strictly limit them. A number of countries, including the United Kingdom, Italy, Netherlands and Germany, already have requirements that go beyond MiFID II.

Enhanced investor protection

A series of measures will reinforce investor protection, including the following:

- Advice from investment firms must meet two criteria in order to be 'independent': (i) assess a sufficient range of financial instruments (i.e. not limited to in-house products and (ii) refrain from accepting or retaining inducements from third parties).
- Discretionary portfolio management will also refrain from accepting or retaining inducements from third parties.
- Advisory and portfolio management clients will receive a detailed suitability assessment in a periodic performance report.
- Pre- and post-trade information to clients will be enhanced, in particular detailed information on fees and commissions paid and received by the investment firm.

- Definition of non-complex instruments will be amended and exclude structured UCITS. This implies that an assessment of appropriateness will be required before selling any structured UCITS. In other words, 'execution only' will not be possible anymore for structured UCITS, regardless of the product risk profile.

Creation of a new execution venue - the OTF

- In order to capture 'dark pool' operators and other alike trading systems (e.g. inter-broker dealing systems), a new category of trading venue called Organised Trading Facility (OTF) will be introduced for non-equity instruments (e.g. bonds, derivatives, structured products).
- Derivatives, which are sufficiently liquid and eligible for clearing, will need to be traded on eligible platforms: OTFs, MTFs (Multi-lateral trading facilities) or RMs (Regulated Markets) instead of OTC trading.
- Requirements will be imposed on operators of OTFs (e.g. clients orders on an OTF cannot be executed against proprietary capital) and transactions concluded on an OTF will be submitted to pre- & post-trade transparency provisions similar to RM and MTF, creating a level-paying field.
- The scope and obligations of systematic internalisers will be amended

Stricter governance requirements and more accountability on Senior Management

- New requirements for corporate governance and (non-) executive directors, in addition to other texts (e.g. CRD IV or CSSF circular 12/552).
- Introduction of the new concept of "management body": governing body of an investment firm or a data services provider, including the supervisory and the managerial functions (i.e. all persons who effectively direct the business).
- Strengthened criteria for qualified senior management, the role of directors and supervisors who must commit sufficient time to perform their function and take into account diversity in their composition.
- Stricter control of remuneration of staff (e.g. bonus criteria) advising or selling to clients, which cannot prevent staff from complying with obligations to act in the best interest of clients.
- Strengthened role of the compliance officer

Product intervention & strengthened supervision with stricter sanctions

- In coordination with ESMA, national regulators (i.e. CSSF in Luxembourg) will have powers to permanently ban financial products, activities or practices.
- Administrative sanctions, fines and penalties will be made public, sufficiently high to offset any benefit and to be dissuasive also for larger institutions.
- Position limits for products, such as commodity derivatives, will be introduced. This will include powers for regulators to require existing positions to be reduced or to limit the ability of any person from entering into commodity derivatives.

Harmonised regime for third country firms

- When serving retail or professional clients on request in the EU, third-country firms will have to establish a branch in each EU country where they operate. Branches will be subject to authorisation and supervision in the member state.
- When serving eligible counterparties or per se professional clients in the EU, investment firms will directly register with ESMA. This registration will be first subject to the third country receiving a positive equivalence assessment from the European Commission. No EU branch is required. The EU passport will be available.

Extended market transparency and transaction reporting

- Transparency requirements will be extended to additional instruments, such as bonds and derivatives.
- Trade reports will need to be published through Approved Publication Arrangement (APA) firms, which will also be subject to authorisation and certain organisational requirements.
- Transaction reports will need to capture additional information (including identification of individuals – or computer algorithms where relevant – responsible for the investment decision).
- Key system changes will be required to capture additional reporting requirements (including new instruments). Static data may require cleansing in order to ensure additional information is reported correctly.
- As such, the reporting will be impacted in 4 dimensions ◦the format – to be aligned with EMIR
    - the frequency (i.e. near real time)
    - the content
    - the audit trail

Contact

Benjamin Collette
Partner - EMEA AIFMD Leader
bcollette@deloitte.lu

Martin Flaunet
Partner - Banking Leader
mflaunet@deloitte.lu

Basil Sommerfeld
Partner - Operations & Human Capital Leader
bsommerfeld@deloitte.lu

Pascal Eber
Partner - Operations Excellence & Infrastructure Operations
peber@deloitte.lu