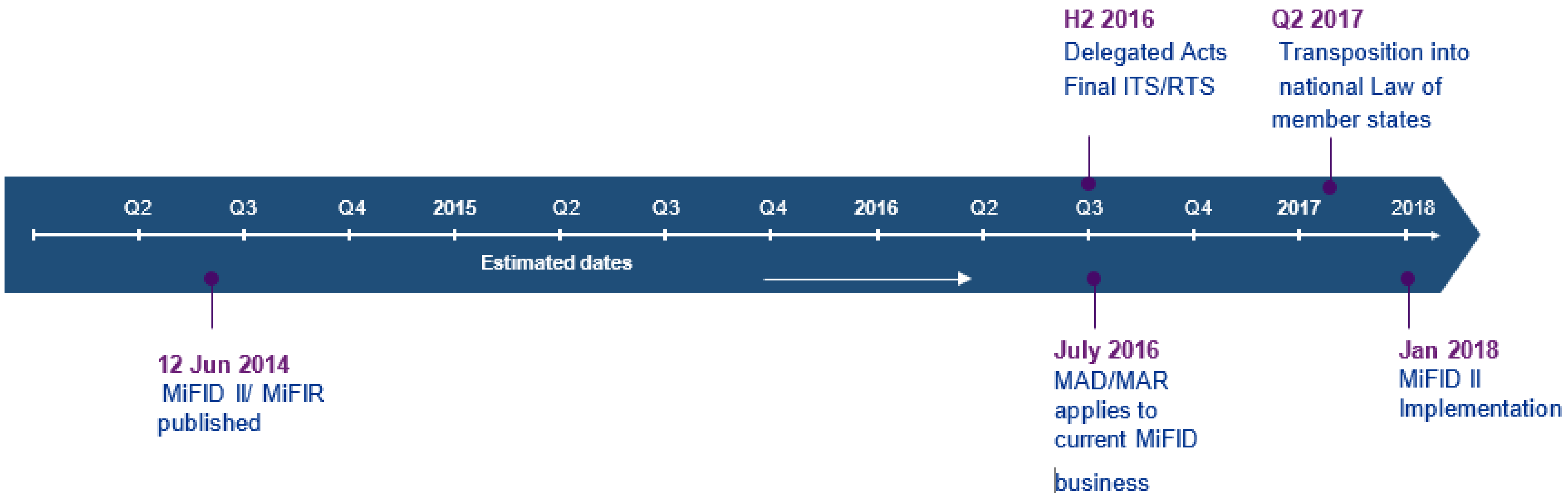
Fintech Open Mic Night - MiFID II
The New Reality

Historical background of MIFID II implementation

- the first Markets in Financial Instruments Directive (MIFID) came into force on 1 November 2007, replacing and expanding upon the Investment Services Directive (ISD).
- The objective was to increase the integration and efficiency of EU financial markets by establishing a harmonised regulatory framework for the provision of investment services in financial instruments across the EU and for the operation of regulated markets by market operators.
- Following the global financial crisis, the European Commission (Commission) decided to review the MiFID framework and on 20 October 2011 published proposals for (i) a revised Directive (MiFID II) and (ii) a new Regulation (MiFIR).
- On 15 April 2014, the Council of the European Union adopted the final texts of MiFID II and MiFIR (Level 1 texts).



MIFID legal regime - regulatory texts

Level 1

- Level 1 - MiFID II / MIFIR
- Level 1 - Directive 2016/1034 delaying the application of MiFID II
- Level 1 - Regulation 2016/1033 delaying the application of MiFIR

Level 2

- Level 2 - Commission Delegated Directive on investors protection
- Level 2 - Commission Delegated Regulation
- Level 2 - Commission Delegated Regulation on transparency and supervisory measures
- Level 2 - Implementing and delegated acts: full list
- Level 2 - Draft RTS amendment - Overview table of national client identifiers for natural persons to be used in transaction reports
- Level 2 - ESMA Final Technical Advice MiFID II / MiFIR
- Level 2 - Draft RTS on MiFID II rules for third country firms and cooperation within competent authorities
- Level 2 - Draft RTS and ITS on MiFID II and MiFIR
- Level 2 - Consultation Paper - Draft RTS on package orders
- Level 2 - Final report - Draft RTS on package orders for which there is a liquid market

Level 3

- Level 3 - Q&A on CFDs and other speculative products (last update: 31/03/2017)
- Level 3 - Guidelines on cross selling practices
- Level 3 - Guidelines for the assessment of knowledge and competence
- Level 3 - Guidelines on complex debt instruments and structured deposits
- Level 3 - Guidelines on transaction reporting
- Level 3 - Guidelines - Calibration, publication and reporting of trading halts
- Level 3 - Guidelines on product governance
- Level 3 - Consultation paper - Consolidated tape for non-equity products
- Level 3 - Consultation paper - Management of trading venues and reporting services providers
- Level 3 - Consultation paper - Trading obligation for derivatives
- Level 3 - Q&A on investor protection (last update: 06/06/2017)
- Level 3 - Q&A on MiFIR data reporting (last update: 03/04/2017)
- Level 3 - Q&A on MiFIR markets structure topics (last update: 05/04/2017)
- Level 3 - Q&A on MiFIR on transparency topics (last update: 05/04/2017)
- Level 3 - Q&A on commodity derivatives topics (last update: 05/04/2017)
- Level 3 - Briefing - MiFID II technical data reporting requirements
- Level 3 - Follow up report to the Peer review on Best execution
- Level 3 - Opinion on traded on a trading venue
- Level 3 - Follow-up Report to the Peer Review on MiFID Conduct of Business rules relating to fair, clear and not misleading information

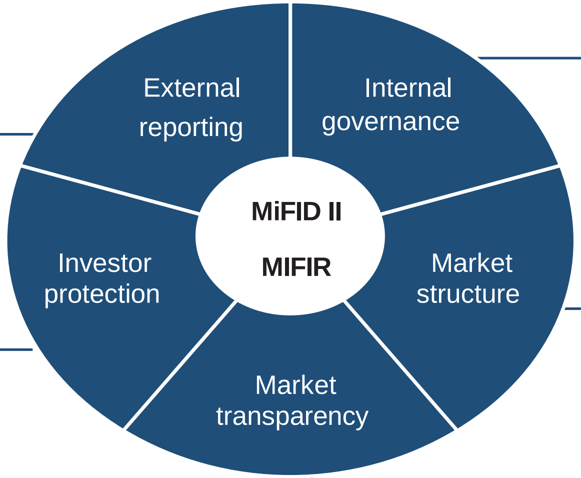
MiFID II objectives and core measures

External reporting

- Restrictions on commodity derivatives positions
- Reporting requirements to regulators
- Third-country regime for professional and eligible counterparties based on equivalence test by EU Commission

Investor protection

- Regulatory oversight of product, including ban or limitations on marketing to retail investors
- Revised suitability and appropriateness especially for “complex” products with embedded derivatives (including UCITS)
- Ban of inducements to independent advisers and discretionary managers and more stringent disclosure regime for payments paid and received



Internal governance

- Enhanced governance with prescription around governing board and committee composition, Õtness and propriety, and time commitment
- “Tone from the top”

Market structure

- Mandatory position limits on commodity derivatives
- Introduction of organized trading facility (OTF) for non-equity instruments
- Limitation on trading away from regulated markets/MTFs (e.g., dark pools)
- More restrictive regime for high-frequency/algorithmic trading
- Open access to trading venues, CCPs and benchmarks

Market transparency

- Increased regulatory and client reporting requirements for all asset classes
- Near-real-time reporting requirements to regulators
- Development of European consolidated tape

Key MIFID II issues:

- Inducements
- Product governance
- Appropriateness of services
- Investment research
- Market structure & transparency
- Transaction reporting
- Best execution
- Costs & charges disclosure
- Algo & HFT
- Internal crossing

MIFID impacts for distribution – client protection

Suitability and Appropriateness

In gernal brokerage services:
Appropriateness test for complex financial instruments
element to assess: Client's knowledge and experience).

Investment advice (independent or not independent) Portfolio management

Suitability test for all financial instruments 3 elements to assess:
- Client's investment objectives
- Client's financial situation
- Client's knowledge and experience

Execution-only regime for non-complex financial instruments

Obligation to periodical update the client's risk profile

Information to be obtained	Requirements for suitability test
Client's knowledge and experience	▪ the types of service, transaction and the regulated investments with which the client is familiar; ▪ the nature, volume, frequency of the client's transactions with regulated investments; and ▪ the level of education, profession or (if relevant) former profession of the client.
Client's financial situation	▪ the source and extent of the client's regular income; ▪ the client's assets, including liquid assets, investments and real property; ▪ the client's regular financial commitments; ▪ the ability to bear losses.
Client's investment objectives	▪ the client's investment horizon; ▪ the client's risk preferences, risk profile and risk tolerance; and ▪ the purposes of the investment.

Information to be obtained	Requirements for appropriateness test
Client's knowledge and experience in order to enable the firm to determine whether the financial instruments and services are appropriate.	• the types of financial service, transaction and regulated financial instruments the client is familiar with;
	• the nature, volume and frequency of the client's transactions in regulated financial instruments; and
	• the client's level of education and profession (or former profession).

MIFID impacts for distribution – client protection

- **Recordkeeping**

- the result of the appropriateness assessment;
- any warning given to the client that the investment service or product purchase was assessed as potentially inappropriate for the client,

- **Calculating the maximum loss capacity** (Financial planning)

- **Collection of reliable information (KYC)**

- **Investment advice reports**

- **Portfolio management reports**

MIFID research approach

Investment Research

The European Commission adopted its final MiFID II delegated acts covering Research Payment Accounts. This delegated act sets out the final structure and rules concerning research consumption and payment that will be used by EU member states when implementing MiFID II

„there ain't no such thing as a free lunch"

- under MIFD II buy side firms must not link the amount paid for research to the volume or value of transactions,
- Buy side firms they must agree a budget to be paid for research up front and pay an amount that correlates to the quality and value that it would provide to the end investor.

definition of investment research (defined by MIFID II) applies to independent investment research but it also to advisory services as:

- materials or services that could inform an investment strategy, adding value to an investment decision
- provides opinion as to the present or future value of the given asset, instrument or issuer

Difficult to distinguish marketing material from Investment Research

MIFID research approach

To avoid the receipt of research being considered an unacceptable inducement, a research recipient must decide whether to:

- Directly from their own account; or
- By commissions, using a Research Payment Account (RPA) supported by a Commission Sharing Agreement (CSA), which codifies how execution costs are split into execution costs and research costs and how commissions are to be shared amongst research providers.

Requirements:

- firms must set research budget on both the aggregate and client level
- firms must regularly assess the quality of research and its ability to contribute to the investment process
- firms must provide the total cost of research to its clients, annually

- Sell side firms are required to review and identify services provided that could be categorised as research and therefore for which payment would be required.
- Sell side firms need to provide clients unbundled costs of trading, separately identifying and charging for execution, research and other advisory services.
- Buy side firms have to make explicit payments for research, and demonstrate that research contributes to better investment decisions and is therefore not an inducement.
- Investment firms need to provide better reporting to facilitate payments being made for research and to help demonstrate the value that research is providing

MIFID research approach

Investment Research regime impact:

- Investments firms need to build pricing and commissions systems to provide reporting showing unbundled costs (splitting advisory and execution services)
- buy side firms need to build systems such that the sell side can provide aggregate and cumulative cost reporting to the buy side at least annually.
- infrastructure will be required for sell side firms to monitor research payment accounts versus agreed budgets.
- investment firms need to build systems to meet the requirements around disclosures of costs and charges which will allow investment firms to demonstrate that they are not being induced to trade to the regulators and to their clients

MIFID our expectation

We assume:

- increase in D2C chanelles of distribution.
- increase the costs of doing business and margins reduce
- development of structures as markets of funds.
- increase in „traditional” distribution via digital platforms
- decrease in distribution shall be an opportunity for investment products as ETF
- model portfolios are expected to be a greater feature.
- independents may find distribution more challenging
- technology will open up new distribution and advice models