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 **NORTON ROSE FULBRIGHT**

MiFID II Academy: Spotlight on conduct

Financial Services Team
Norton Rose Fulbright LLP

7 December 2016

WFC 60.66

Agenda

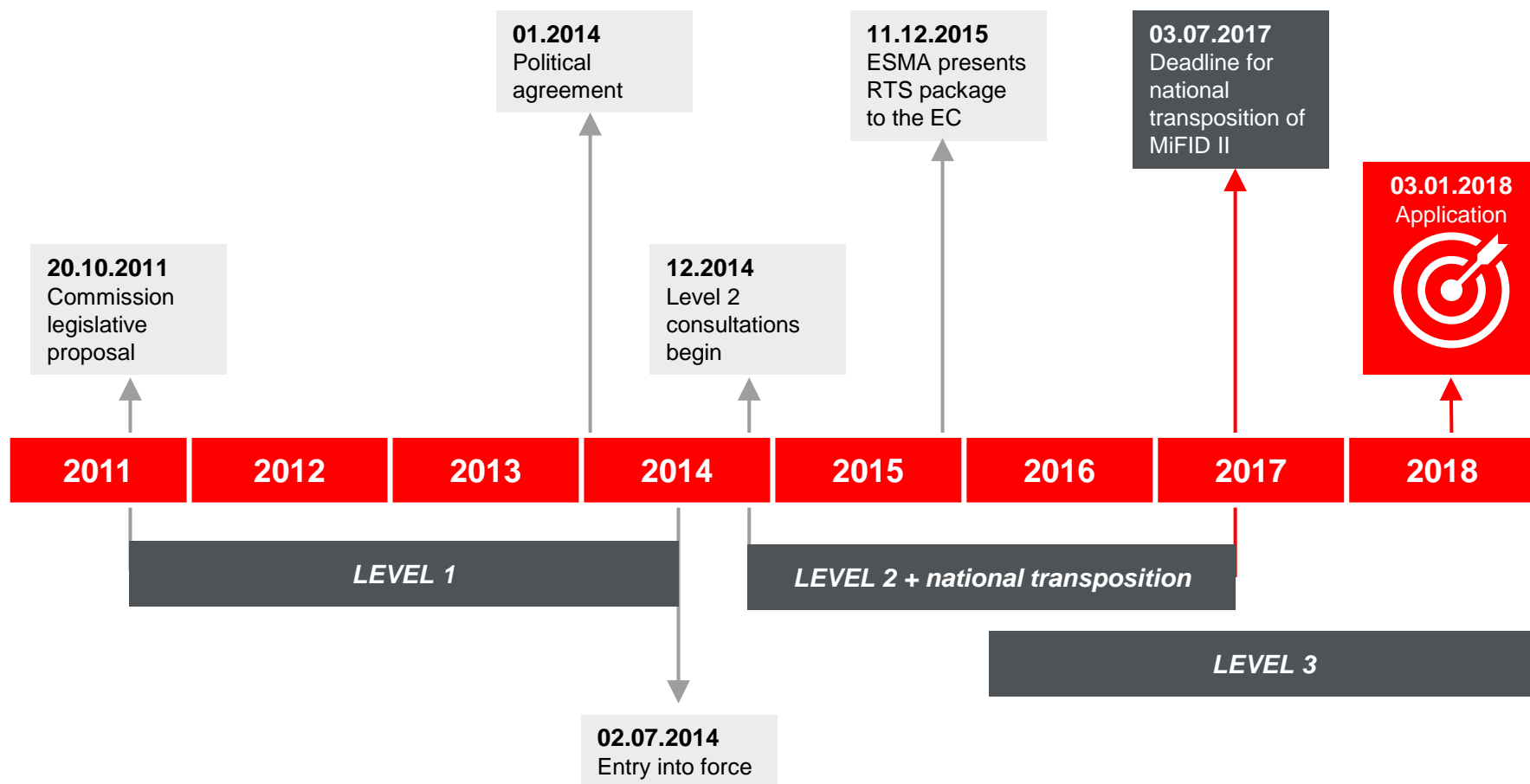
Where are we at?

Wholesale/Retail Conduct: Hot Topics

- **Best Execution**
- **Recording of Calls**
- **Product Governance /
Product Intervention**
- **Disclosure to Clients**
- **Conflicts of Interest /
Inducements /
Research**

Where are we at?

MiFID II / MiFIR timeline



Wholesale/Retail Conduct

Overview

Where are we at?



Level 1:

- Finalised - takes effect from 3 Jan 2018

Level 2:

- Final Delegated Directive (client assets, product governance and inducements)
- Final Delegated Regulation (other topics)

Level 3

- Guidelines on complex debt instruments and structured deposits (4 February 2016)
- Guidelines on cross-selling (22 December 2015)
- Guidelines for assessing knowledge and competence (22 March 2016)
- Consultation on management body for market operators (5 October 2016)
- Consultation on product governance requirements (5 October 2016)
- Q&As on MiFID II and MiFIR investor protection topics (10 October 2016)

Overview of changes



- **Significant number of micro changes** being made to the existing investor protection regime
- **Small number of macro changes** being introduced to the existing investor protection regime
- Together they **SNOWBALL** into **significant regulatory reform** in the way firms conduct their business
- The devil is in the detail!
- Level 2 **significantly alters** the Level 1 landscape
- **Material impact** on all firms – both **wholesale and retail** facing
- Critical to **understand the activities and services** you carry on to get the investor protection provisions right

The UK papers: A quick recap

HM Treasury Consultation Paper on transposition of MiFID II

- Covers third countries, data reporting services, position limits and reporting, unauthorised persons, structured deposits, power to remove board members, OTFs and binary options; draft SIs found in Annexes
- UK Government not currently minded to exercise the discretion to apply the regime specified in Article 39 MiFID II

FCA Discussion Paper on conduct of business and organisational requirements (DP15/3)

- Discusses the implications of certain MiFID II conduct of business and organisational requirements for firms primarily contained within Articles 24 and 25

FCA Consultation Paper on implementing MiFID II and MiFIR – markets issues (CP15/43)

- Consults on issues concerning the regulation of secondary trading of financial instruments
- Appendix II contains draft MiFID II Handbook Guide that will sit alongside the Handbook changes
- Notes that MiFIR and RTS and ITS are directly applicable so it is not consulting on certain issues including the double volume cap mechanism to restrict the 'dark' trading of equity and equity-like financial instruments

PRA Policy Statement: MiFID II: Response to CP9/16 (PS 29/16)

- Sets out final rules on passporting and algo trading (27 October 2016)
- The PRA intends to publish a further CP in due course to cover other areas of MiFID II

FCA second Consultation Paper on MiFID II implementation (CP16/19)

- Closed for comments on 28 October 2016
- First half of 2017, there will be a Policy Statement to *Consultation Paper 15/43: MiFID II implementation*
- Early 2017, there will be a Policy Statement to *Consultation Paper 16/19: MiFID II implementation*

FCA third Consultation Paper on MiFID II implementation (CP16/29)

- The consultation closes on 4 January 2017, except for chapter 16 (Supervision Manual, authorisation and approved persons) which closed on 31 October 2016

PRA second Consultation Paper on MiFID II implementation (CP43/16)

- Consults on management body and key organisational requirements which will apply to both MiFID and non-MiFID business
- The consultation closes on 27 February 2017

Wholesale/Retail Conduct: Hot Topics

- Best Execution
 - Recording of calls
- Product Governance / Product Intervention
 - Disclosure to clients
- Conflicts of Interest / Inducements / Research

Best Execution

Level 1 and 2

Applies to firms dealing with ECPs?
No

Requirement

- Policies and procedures

- 'All sufficient steps' to be taken to obtain best execution

- Top five execution venues by trading volume
- Information on quality of execution obtained
- Summary of analysis and conclusions from monitoring

- Monitor effectiveness of policy and notify material changes

Before Execution

During Execution

After Execution

At any time

Detail

- Order execution policies to be clear, easily comprehensible and sufficiently detailed
 - Customised to type of service and financial instrument
 - Separate summary for retail clients

- Extended to portfolio managers and RTOs when placing orders with third parties for execution
- Can still follow specific instructions, subject to warning
- Must not use commissions to discriminate unfairly between venues
- Check fairness of price for OTC products by gathering market data and comparing with similar products

- Publish annually on website using templates provided in machine readable electronic format
- Trading venues and systematic internalisers to publish information on quality of execution quarterly

- Best execution to be demonstrated to NCAs on request

Best Execution

Level 3

Question 1

What is the difference between existing requirement of 'reasonable steps' and the new requirement of 'all sufficient steps'?

All sufficient steps

“Should not be interpreted to mean that a firm must obtain the best possible results for its clients on every single occasion.”

- Sets a 'higher bar' for compliance than 'reasonable' steps
- Firms have to ensure the intended outcomes can be successfully achieved on an ongoing basis
- Likely to involve:
 - strengthening of front-office accountability
 - strengthening of systems and controls re: detection capabilities of potential deficiencies
 - monitoring of not only the execution quality obtained but also the quality and appropriateness of execution arrangements and policies on an ex-ante and ex-post basis to identify circumstances under which changes may be appropriate
 - processes might involve some combination of front office and compliance monitoring and could use systems that rely on random sampling or exception reporting
 - channels in place to ensure that the results of ongoing executive monitoring are escalated to senior management and/or relevant committees and fed back into the execution policies and arrangements to drive improvements

Best Execution

UK implementation

The FCA has discussed implementation of the MiFID II best execution requirements in CP16/29. The new standards will be transposed into COBS 11.2A by way of copying the relevant provisions and recitals into the Handbook directly. Some non-MiFID firms will also face changes under MiFID II.

Financial advisors exempted by Article 3

Best execution obligations will be extended, but they will not need to provide annual reports under RTS 28

UCITS management companies

Best execution obligations will be 'levelled up' to MiFID II standards, which will include obligations to produce the RTS 28 annual report

Small UK AIFMs and residual CIS operators

Most rely on the COBS 18.5.4 exemption where they only have professional clients and where their documents note that they are using this exemption – the FCA is going to review whether this is still appropriate

Full-scope UK AIFMs / incoming EEA AIFM branches

Best execution will be expanded to include RTS 28 reporting obligations and some modifications to COBS 18.5.4A

Otherwise, the core AIFMD provisions will still govern AIFMs

Branches of third country firms

The best execution rules under MiFID II will be applied to these branches

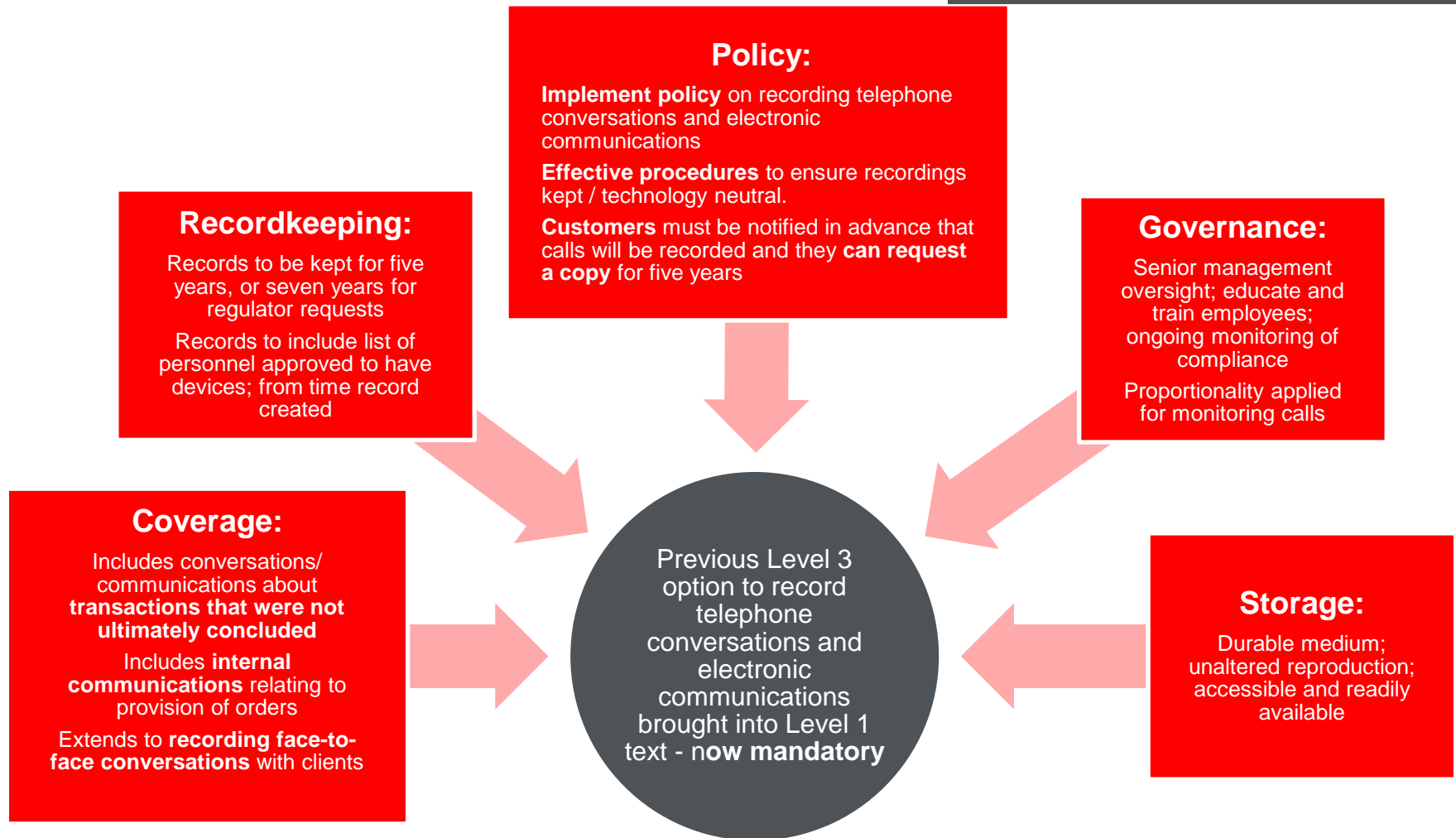
Non-MiFID corporate finance business, non- MiFID EMPs & OMPs

Continue to disapply best execution obligations

Recording of Communications

Levels 1 and 2

Applies to firms dealing with ECPs?
Yes



Recording of Communications

Level 3

Q1: Which communications re: handling of orders and transactions need to be recorded?

- Expectation that firms will record all internal telephone calls or electronic communications regarding the handling of orders and transactions
- No expectation that persons carrying on back-office functions will be captured by the requirements
- Records of any internal face-to-face conversations that relate to the receipt/transmission of orders, execution of orders and dealing on own account are caught by the general record-keeping requirements

Q2: Can firms charge their clients to access recordings?

- This is at the discretion of the firm
- There is no prohibition
- However, overall responsibility to comply with national laws on whether it is permissible to charge clients to access recordings

Q3: How does proportionality work with monitoring records?

- Means appropriate to the nature, size and complexity of a firm's business
- Consider likelihood of misconduct re: market manipulation or not acting in clients' best interests
- Non-exhaustive list of criteria to take into account: (i) volume and frequency of dealing on own account; (ii) volume, frequency and characteristics of client orders; (iii) characteristics of clients; (iv) financial instruments and services offered; (v) market conditions
- The results of monitoring should also inform the frequency and scope
- Monitoring should be conducted regularly and ad hoc and taking into account emerging risks

Q4: What are the expectations by competent authorities on the retention of records for 7 years?

- If a competent authority has not made a request to a firm to put aside recordings within 5 years (beginning of the retention period), a firm does not have to keep those recordings for longer than five years
- If a competent authority does request them, they should be retained until the competent authority needs them or they indicate that the recordings are no longer of interest
- If a firm is unclear, it should contact the competent authority for confirmation

Recording of Communications

Level 3

Q5 and Q11: What types of communications are covered?

- Includes (amongst others) video conferencing, fax, email, Bloomberg mail, SMS, business to business devices, chat, instant messaging and mobile device applications
- Conversations / communications with a client / person acting on behalf of a client
- Relates to an agreement by the firm to carry out one of the covered activities whether as principal or agent, or to reach an agreement to carry out one of the covered activities, even if does not conclude an agreement (including prices, solicitations, bids, offers, indications of interest and requests for quotes)
- Such as transmitting an order to a broker or placing an order with an entity for execution, conversations or communications relating to the handling of the order (including solicitations and acceptance of transactions)

Q6: Can the monitoring function be done by compliance or does it need to be a separate department?

- No separate department is required by MiFID II
- However, monitoring is an essential piece of the overall compliance and monitoring system a firm has to implement through governance arrangements

Q7: Is the recording obligation a critical or important function for outsourcing rules?

- Taping will be considered to be a critical or important operational function

Q8: Does the recording need to be from start to end?

- Yes – firms need to record the entirety of telephone conversations and electronic communications
- This is because it is impossible to appreciate upfront whether the conversation will lead to the conclusion of a transaction

Q9: Does giving clients access to the recording include a firm's internal communications?

- Yes. The obligation extends to internal conversations and communications between employees and contractors of the firm which relate to the provision of the order

Recording of Communications

UK implementation

Where?

- The FCA will delete existing rules in COBS 11.8 and replace with a new chapter in SYSC, copying the provisions of the Directive and cross-referring to Delegated Regulation

Who?

Extend to:

- Discretionary investment managers – without reliance on broker carve out
- Collective portfolio managers
- EMPs and OMPs
- Corporate finance business
- All firms which benefit from Art.3 exemption – subject to an alternative approach for smaller firms

Conduct and passporting

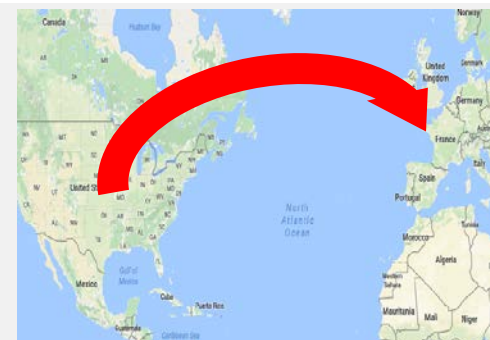
Subject to Brexit



- ESMA's new passport notification (to replace existing 'Protocol on Passporting Notifications') will be uploaded by the FCA to Connect and changes made to SUP 13, 13A, 14 and Annex 3 (for firms that are not dual-regulated)
- UK remains prudential regulator for UK firms passporting out
- UK remains conduct regulator for UK firms passporting out without a branch or where the home state services passport is being relied upon subject to next slide
- UK firms need to review their existing passported notifications to ensure they do not need to be amended with the change in scope between MiFID 1 and MiFID 2 – new activities or new instruments



- UK remains the conduct regulator for EEA firms passporting into UK with a branch unless the UK branch is relying on the home state services passport (i.e. not conducting activities in the UK) subject to the next slide
- The range of provisions that a host country regulator (i.e. UK) is responsible for where a firm is passporting through a branch has expanded to match the increased scope of MiFID 2 – i.e. the requirement for transactions in liquid shares to be concluded on a trading venue or through a SI; obligations to provide data for transparency calculations; requirements to keep order book data and provide it to regulators on request



- As much of MiFID's expanded requirements are laid down in directly applicable regulations which do not apply to non-EEA branches, the FCA is introducing a new rule in GEN to extend the expanded MiFID requirements to non-EEA branches in the UK
- UK is prudential regulator and conduct regulator
- Non-EEA firm branches in the UK need to have regard to the MiFID 2 directly applicable regulations when they undertake investment services and activities in the UK
- Conduct matters will continue to be applied as rules; organisational matters will continued to be applied as guidance

Conduct and passporting

The previous slide represents the legal theory. Member States have done, and can do funny things...

FCA: Consultation Paper CP16/40: Enhancing conduct of business rules for firms providing contract for different products to retail clients, (December 2016)

Proposed new COBS 22.4.23R:



A firm, including an *incoming EEA firm*, must not *communicate* or *approve* a *financial promotion* relating to *contracts for differences* traded on a leveraged basis, *spread bets* or *rolling spot forex contracts* that is addressed to, or is disseminated in such a way that it is likely to be received by, a *retail client* unless:

- (1) the *retail client* will be subject to minimum *margin* requirements equivalent to or higher than those set out in COBS 22.4.11R to COBS 22.4.13R; and
- (2) a risk warning equivalent to that specified in COBS 22.4.3R will appear on any version of the website or mobile application accessible to the *retail client* or otherwise be provided to the *retail client* in accordance with COBS 22.4.3R(3).



Product Governance / Distribution

Levels 1 and 2

Whats new?

Completely new regime (level 1)

- Introduction of **product approval process** (with associated policies and procedures) overseen by senior management
- **Identify target market** for product and tailor products to that market
- Ensure **distribution strategy** is consistent with target market
- **Periodic review** of product, target market and distribution channels
- **New requirements** on distributors / sales intermediaries to understand product, target market, features and risks
- Information flow through distribution chain

Moderate extension (Level 2)

- Regime extended to apply to **services (not just products)**
- **Proportionality** applies
- **Two sets** of policy proposals:
 - **product manufacturers**
 - **distributors** (someone who offers and/or recommends products to clients)
- Introduction of **specific oversight, control and governance obligations** on firms
- **Final distributor** in the chain has the obligation to comply with the requirements
- **Intermediate distributors** also have certain obligations
- Consider threat to **orderly functioning / stability** of market when developing products
- Only **one target market** assessment required
- **Additional steps** prescribed which manufacturers might take when an event occurs which affects the potential risk / return of the product
- Products manufactured by **non-MiFID entities** not exempt
- **Compliance oversight** needed
- Firms that **create, issue, design products** are themselves manufacturers
- Pure manufacturers to assess target market on '**theoretical basis**'

Product Governance / Distribution

Level 3: ESMA Consultation Paper (2016/1436)

Six categories to consider	ESMA's guidance
Type of clients to whom the product is targeted	At least to match MiFID client categorisation; may also specify additional descriptions, e.g. 'private wealth clients' or 'sophisticated clients', but must specify criteria to be met by clients in each case
Knowledge and experience	Manufacturers should specify the knowledge clients are expected to have about the product type, product features and/or knowledge in related areas. Manufacturers must also specify the extent of practical experience target clients are expected to have (e.g. in terms of time period of activity in financial markets, or with relevant product type). The requirements are inter-related; clients with no experience but extensive knowledge may be a valid target client
Financial situation	Manufacturers should specify the amount of losses target clients should be able and willing to afford
Risk tolerance and compatibility of product risk/reward profile	Manufacturers should specify the general risk attitude of target clients, as well as setting out criteria by which firms should assess target clients to determine risk tolerance. Risk indicator required by PRIIPS Regulation to be used where applicable to fulfil this requirement
Client's objectives	i.e. wider financial goals, or overall strategy adopted when investing, e.g. 'liquidity supply', 'retirement provision' or investment horizon
Client's needs	These may vary from specific to generic, as relevant (e.g. age, country of tax residence), and special product features (such as 'currency protection' or 'green investment' as relevant)

- Closes 5 January 2017
- Final report will be published in Q1/Q2 2017

Product intervention



- Powers to **ESMA / EBA / EIOPA** to temporarily ban products
 - Max of 3 months, can be renewed, on EU wide basis or in particular Member State
 - Powers to EIOPA are contained in PRIIPs
- Power for national regulators to ban products
- Prescriptive factors that national regulators need to consider before exercising powers
- Pursuant to a recent ECJ court case: ESMA advises Commission to consider whether list of criteria should be exhaustive when it applies to ESMA/EBA exercising powers. It is non-exhaustive when Member State NCAs use their powers

Product Governance / Distribution / Intervention

UK Implementation – Scope and Territoriality

Verbatim copy out but wider applicability

- Applied as **rules** for UK firms undertaking MiFID business (including appointed representatives)
- Applied as **rules** for UK firms manufacturing structured deposits (this will include banks)
- Applied as **rules** for EEA firms undertaking MiFID business from an establishment in the UK (but not where the EEA firm is undertaking business on a cross-border basis only into the UK)
- Applied as **rules** for UK firms undertaking MiFID business into other EEA states (whether on a cross-border basis or from an establishment in that member state) but not where the business is provided from an establishment in that member state to clients in that member state (as then the rules of the host member state apply)
- Applied as **rules** for Article 3 MiFID exempt firms
- Applied **by contract** to in-scope firms dealing with out-of-scope firms (i.e. in-scope distributor dealing with out-of-scope manufacturer)

“

an evolution of existing standards rather than requiring significant change

”

- Applied as **guidance** for other non-MiFID firms that manufacture or distribute MiFID financial instruments (UCITS, AIFMs) or structured deposits (but note the application of PROD as rules for banks manufacturing structured deposits)
- Applied as **rules** for UK branches of third country firms and to third country firms (even if no UK branch) where there is a UK client unless they are relying on the Overseas Person Exclusion or are otherwise not ‘doing business’ in the UK

Product Governance / Distribution / Intervention

UK Implementation



• **PROD** includes:

- ✓ Existing statement of policy on FCA's use of FSMA temporary product intervention rule-making power
- ✓ MiFID II provisions as rules or guidance (see earlier slide)
- ✓ Additional information copied from RPPD to 'explain certain concepts'
- ✓ In due course, a new chapter will be included to implement the Insurance Distribution Directive which will contain additional product governance obligations for insurance products

• **PROD** does not include:

- ✗ Will not include rules in relation to product intervention as these will be scattered throughout the FCA Handbook where relevant (i.e. similar to COBS 14.2 which restricts the sale of Cocos to retail clients)
- ✗ Will not yet cover other market sectors – so RPPD will remain for those other market sectors
- ✗ Blanket requirements for in-scope firms - the requirements are to be applied "*in a way that is appropriate and proportionate*" (PROD 3.1.2R) which takes into account the nature of the financial instrument/structured deposit/investment service and the target market

New rules in PROD will require existing distribution agreements to be reviewed/amended

New rules in PROD will require new distribution / co-manufacturing agreements to be entered into (i.e. in-scope firms manufacturing with out-of-scope firms)

Product Governance / Distribution / Intervention

UK Implementation – Key differences between RPPD and PROD

Manufacturers

- Product design (including charges) must meet the needs of the target market and firms need to identify groups for whom the product is unlikely to be suitable
- Firms to consider the impact of new products on the orderly functioning of the market
- Distribution strategy needs to meet the needs of the target market
- Firm's compliance function should monitor product governance
- Firm's management board should have effective control and oversight over the process

Co-manufacturers

- Firms working together to manufacture a single product should have a written agreement setting out their share of these responsibilities

Distributors

- Before distributing products **OR** services, firms should consider the target market (who it is likely and unlikely to be suitable for)
- Distribution strategy should meet the needs of the target market
- Products reviewed regularly to confirm it remains consistent with the target market's needs and make changes to the distribution strategy or other processes if problems identified
- Provide manufacturers with information on sales and, where appropriate, the regular reviews mentioned above
- Firm's compliance function should monitor product governance
- Firm's management boards should have effective control and oversight over the process
- Firms working together to distribute a single product should share information with other firms in the chain

Product Governance / Distribution / Intervention

UK Implementation – Uncertainties

Manufacturers

- Products must go through a product approval process before being distributed. PROD states that 'significant adaptations' of products need to go through the product approval process as well – no clarity on scope of 'significant adaptations' – firms have freedom to define what that means?
- What if manufacturers cannot obtain the required information from historic distribution channels?

Out-of-scope firms

- What if an out-of-scope firm does not agree, contractually, to take on certain obligations from PROD? Where does that leave the in-scope firm?
- How much due diligence do in-scope firms need to do on out-of-scope firms and their products?

Application

- As currently drafted in the consultation paper (CP16/29), it is being applied to firms that deal with eligible counterparties
- Application to existing products – Is an assessment of the historic target market needed? Are ongoing reviews of products switched off for existing products?
- Application to existing distribution channels – Do existing distribution channels need to be revisited?

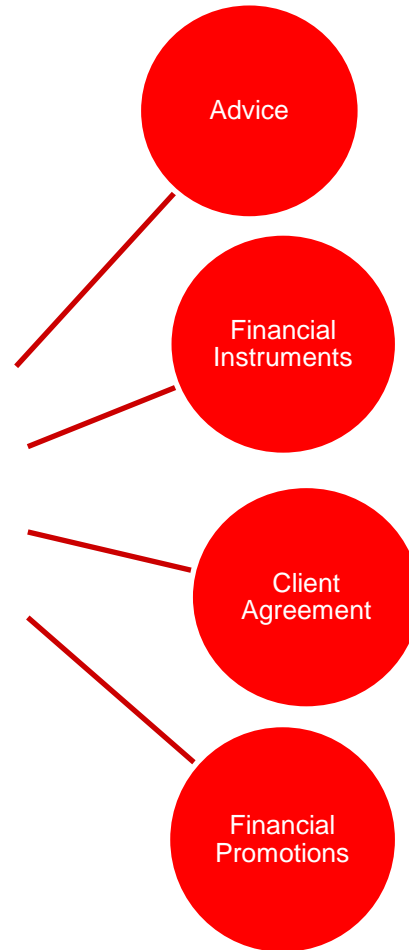
Distributors

- How does product governance apply to execution-only business, particularly with instruments traded on the secondary market? *“Where an execution-only service is offered without client appropriateness tests, the distributor role may be more about communicating the target market to the investor than imposing any additional point-of-sale requirements.”*
- Ability for distributors to share information on end clients while preserving data protection laws and client confidentiality

Disclosure to clients

Levels 1 and 2

Applies to firms dealing with ECPs?
Yes unless ECPs opt-out of certain permitted aspects



- Must provide information on **investment advice**
- Detailed requirements to explain **scope** and **features** of advice
- Applies to **professional clients** as well


-
- Must provide Information on **financial instruments** – e.g. Warnings, Risks
 - Information to be tailored for the target market
 - Information on how the instrument operates in **negative** market conditions
 - Where the **risks** are being disclosed that as well as explaining leverage and its effects, firms are also required to explain risks with **insolvency** of issuer or related events such as bail-in

-
- Also applies to **professional clients**, in ongoing advisory relationships and custody relationships and scope expanded significantly
 - No **distance communicating exemption** to providing terms of business before providing a service

-
- Fair, clear and not misleading communications also applies to **eligible counterparties**

Disclosure to clients

Levels 1 and 2



Costs and Charges

- Must provide information on **costs / charges** of **services, advice, product** and how to pay the costs and charges / must disclose inducements
- Costs and charges must be **aggregated** so client understands the **overall cost** and **cumulative effect** on return (with **itemised breakdown** on request) and firms are to provide their clients with an **illustration of the cumulative effect** of costs on return when providing investments (both pre and post-sale)
- Delegated Regulation has not adopted ESMA's advice that firms should be allowed to provide clients with separate figures comprising the aggregated initial costs and charges, the aggregated ongoing costs and charges and the aggregated exit costs.
- Must be provided "in good time" ex-ante and ex-poste annually
- Disclosure to all clients (including ECPs) but professional clients and ECPs can **agree to receive** more limited information but not for portfolio management OR where there is an embedded derivative OR (for ECPs) where a product will be on-sold
- Level 2 includes prescriptive examples



Reports

-
- Firms to provide clients with adequate reports in a **durable medium**
 - Trade confirmations to be sent to **professional clients** like they already are for retail clients
 - Portfolio management statements to be sent at least **every quarter** (unless a client has online access and has actually accessed their statement)
 - Reporting applies to ECPs unless they agree to receive reports in a different way / different content / timing

Disclosure to clients

Level 3: ESMA Final Report: Guidelines on cross-selling practices (ESMA 2015/1861)

New Guidelines	Detail
Guideline 1	Full disclosure of price and cost information
Guidelines 2, 3 and 4	Prominent display and timely communication of price and cost information
Guideline 5	Full disclosure of key information on non-price features and risks, where relevant
Guideline 6	Prominent display and timely communication of key information on non-price features and risks, where relevant
Guideline 7	Prominent display and communication of 'optionality of purchase'

Disclosure to clients

UK Implementation – Scope and Application

Verbatim copy out but wider applicability

Also copying out MiFID II level 2 even though it is already directly applicable to UK firms being an EU regulation

- Applies to all ‘clients’ which, for MiFID business, includes professional clients and ECPs (subject to ECPs being able to switch off certain requirements)
- Applies to MiFID business (including of Article 3 exempt firms)
- Changes not applied to non-MiFID business, so no extension of retail-like disclosure obligations to professional clients or ECPs however:
 - existing domestic requirements will continue to apply: TCF, post-sale reporting and record-keeping
 - where the existing domestic requirements for non-MiFID business are similar to those for MiFID business, the changes being introduced to those for MiFID business to implement MiFID II will also apply to non-MiFID business



Current disclosure provisions apply differently depending on who receives the information, and whether or not the disclosure requirement relates to MiFID business. MiFID II changes this



What's new?

- Introduction of new requirements in the directly applicable MiFID II delegated regulation
- Apply in relation to cross-selling/bundled products or services
- Some more detailed post-sale reporting requirements
- Revised requirement to retain records for at least 5 years

Disclosure to clients

UK Implementation: Overview of changes to information requirements

Fair, clear and not misleading

- COBS 4.2.1R to be amended to apply this requirement to firms dealing with ECPs for MiFID business but not non-MiFID business
- New COBS 4.5A to implement MiFID II delegated regulation for when firms communicate with clients.

General requirements and financial promotions

- New COBS 2.2A, COBS 6.1-A and COBS 14.3A – apply to all clients including ECPs
- Amending COBS 4.5 and 4.6 (i.e. past and future performance rules) to introduce new detail for both MiFID and non-MiFID business

Information about firm and services

- New COBS 6.1-A to reproduce MiFID II delegated regulation for MiFID business and apply it to ECPs (excluding when a firm does portfolio management)

Information about financial instruments

- New COBS 14.3A to reproduce MiFID II delegated regulation and existing rules to be amended to only apply to non-MiFID business

Information about safeguarding client assets and money

- New COBS 6.1-A to reproduce MiFID II delegated regulation requirements for MiFID business and existing rules to be amended to only apply to non-MiFID business

Information on costs and charges

- New COBS 2.2A and COBS 6.1-A to contain detail on costs/charges disclosures
- Can agree a more limited application of the requirements applying to disclosure of costs and charges to professional clients / ECPs, subject to restrictions
- As there are significant differences between current requirements and MiFID II, current requirements will be maintained for non-MiFID business

Disclosure to clients

UK Implementation: Overview of changes to reporting requirements

Periodic Reports	<ul style="list-style-type: none">• New COBS 16A.1.2R – firms doing MiFID business to provide periodic reports in a durable medium.• New COBS 2.2A – firms doing MiFID business to provide information on cost and charges on a regular basis
Reporting obligations re: execution of orders (excluding portfolio management)	<ul style="list-style-type: none">• New COBS 16A.2.1 – Content and timing of essential information must give clients post-sale• Non-MiFID business, or business relating to UCITS schemes, must still comply with COBS 16.2 so no requirement to provide trade confirmations to professional clients.
Reporting obligations for portfolio management	<ul style="list-style-type: none">• New COBS 16A.3.1 to reproduce MiFID II delegated regulation for MiFID business but it does not apply to ECPs• Existing COBS 16.3 retained for non-MiFID business and existing requirements retained (e.g. reports every 6 months, not 3 months as there is for MiFID business)• Introducing new exemption that switches off non-MiFID business requirements if the client has online access
Reporting obligations to ECPs	<ul style="list-style-type: none">• New COBS 16A.5.1 to require reports for ECPs unless firms enter into agreements with them to determine the content and timing of reporting.
Additional reporting for portfolio management / contingent liability transactions	<ul style="list-style-type: none">• New COBS 16A.3.3 EU and 16A.3.4R to reproduce MiFID II delegated regulation requirements for MiFID business and existing rules to apply to non-MiFID business as they currently do.
Statements on client assets	<ul style="list-style-type: none">• New COBS 16A.4.1 EU to reproduce MiFID II delegated regulation requirements for MiFID business.• Existing rules to apply to non-MiFID business as they currently do but new exemption to be introduced where statements are switched off if clients access the information online.

Applies to firms dealing with ECPs?
Yes

Conflicts of Interest

Levels 1 and 2

Policies and procedures

- Review conflicts policies – at least annually
- If having to disclose frequently, *presumption* that conflicts policy is deficient
- Procedures are required to address both how conflicts are *managed* and *prevented*
- Any risk of damage to the interests of one or more clients' needs to be considered (regardless of its materiality)

Disclosure

- Limitations on use of disclosure – disclosure is to be used as a *'last resort'*
- Prescribed content of disclosure – *tailored* and *new warning* to be included in disclosures

Managing techniques

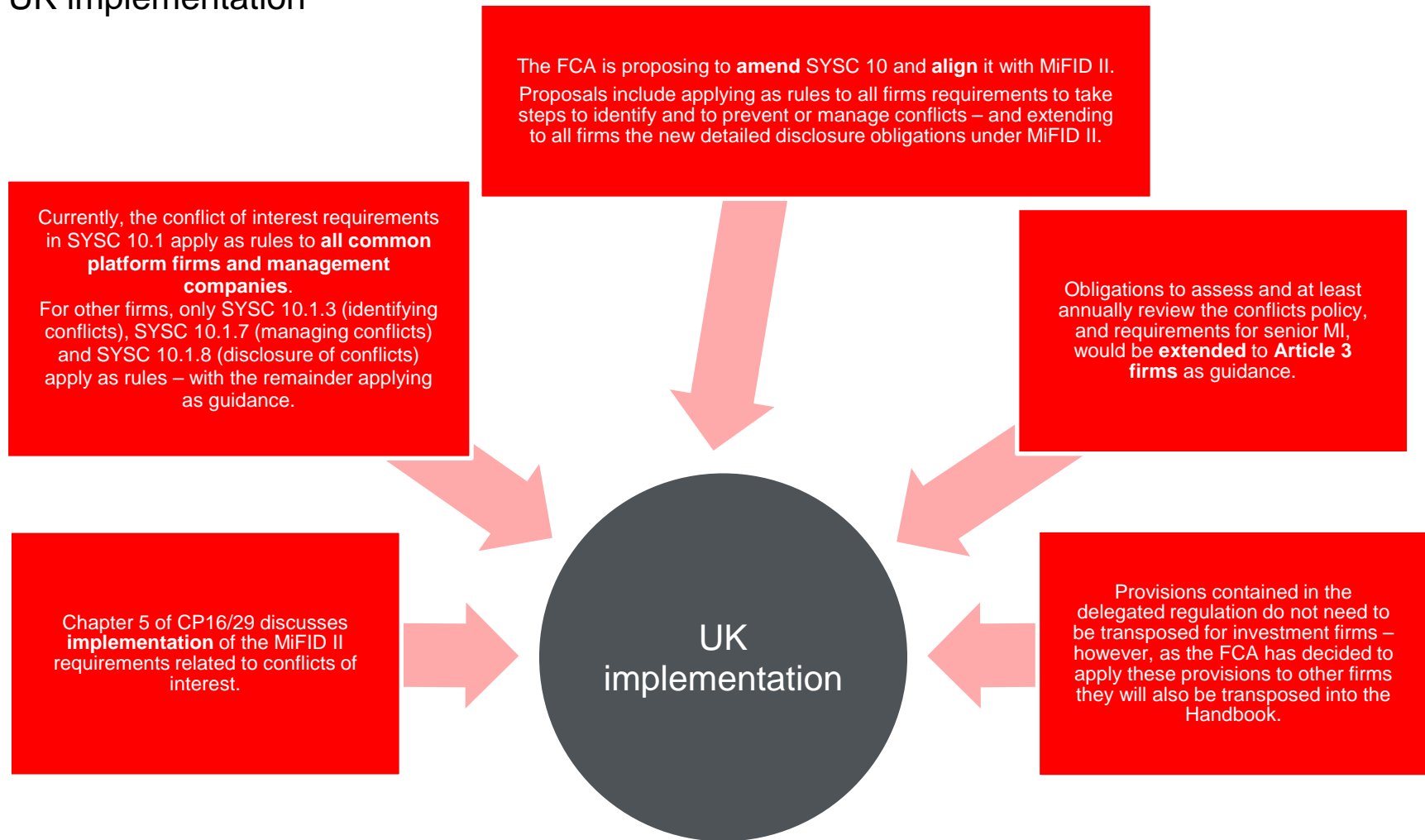
- The same independence and operational separation requirements which apply to investment research now also apply to *'recommendations'* (i.e. 'non-independent research')
- Requirement for physical separation of analysts producing investment research
- If physical separation is disproportionate, need alternative information barriers (potentially extremely broad)
- Senior managers are to receive frequent reports (at least annually) on conflicts recorded in the conflicts log
- **Guideline 9:** Firms that distribute tied or bundled packages to ensure suitable remuneration models and sales incentives encouraging responsible business conduct, fair treatment of clients and avoidance of conflicts of interest for staff selling packages are in place and are monitored by senior management - **3 illustrations** provided
- Detail on managing when underwriting and placing

Additional material (Level 3):

- ESMA's Final Report: Guidelines on cross-selling practices – Guideline 9
- ESMA Q&A on MiFID II: Section 6

Conflicts of Interest

UK implementation



Inducements

Levels 1 and 2

Applies to firms dealing with ECPs?
No

If firm pays or is paid any fee or commission or provides or is provided with any non-monetary benefit to or by any person other than the client or someone acting on its behalf

Must be designed to enhance quality of service to client, which is met when all of the following are satisfied:

Satisfied by the provision of an additional or higher level service to the client, proportional to level of inducements received

Does not directly benefit firm, its shareholders or employees without tangible benefit to client

If it is an ongoing inducement there must be an ongoing benefit to client

Must not impair compliance with firm's duty to act in honestly, fairly and professionally in accordance with client's best interest

Custody costs, settlement and exchange fees, regulatory or legal fees are exempt

Existence, nature and amount of payment must be clearly disclosed

Before provision of service, disclose information – minor non-monetary benefits can be described generically

If firm only disclosed method of calculating before service, provide information on exact amount

At least annually, inform clients individually of actual amount received or paid

Inducements

Levels 1 and 2: Independent advisors and portfolio managers

- Cannot accept and keep any third party payments other than acceptable minor non-monetary benefits
- Must be reasonable and proportionate and of a scale that is unlikely to influence firm's behaviour to detriment of client's interests
- Must disclose before providing service

- Return to clients fees, commissions and monetary benefits ASAP after receipt
- Policy to ensure that amounts are allocated and transferred
- Inform clients through periodic statements

Acceptable minor non-monetary benefits:

- (a) Information or documentation relating to products or services which is generic in nature or personalised
- (b) Issuer commissioned/paid third party new issuance material provided relationship disclosed and made available at the same time to other investment firms or general public
- (c) Participation in conferences, seminars and other training events
- (d) Hospitality of a reasonable de minimis value
- (e) Other minor non-monetary benefits which a Member State deems capable of enhancing the quality of service and are of a scale and nature that are unlikely to impair compliance with duty to act in client's best interest

Inducements

UK implementation

Inducements
(including advisor
charging)

- Retain existing RDR standard set out in adviser charging rules
- Extend inducement ban for firms providing investment advice and portfolio management services to **retail clients** by applying it to restricted **and** independent advice, banning rebating of inducements and amending the adviser charging rules by applying the ban to the provision of advice (rather than only inducements provided re a personal recommendation)
- Transpose, but not extend, inducement ban for firms providing independent investment advice and portfolio management services to **professional clients**
- Apply the same inducements requirements to Article 3 firms as to MiFID firms
- For personal recommendations on RIPs to retail clients, retain existing RDR standard and apply it to the wider business of providing advice

Inducements and
research

- Replace dealing commission rules with transposition of MiFID II rules
- Implementation of Level II provisions on receipt of research and those applicable to firms that provide investment research
- Apply MiFID II rules to firms carrying out collective portfolio management (including UCITS management companies and AIFMs not subject to MiFID II)

Inducements – research payment account

Provision of research is not an inducement if paid for through:

Own resources

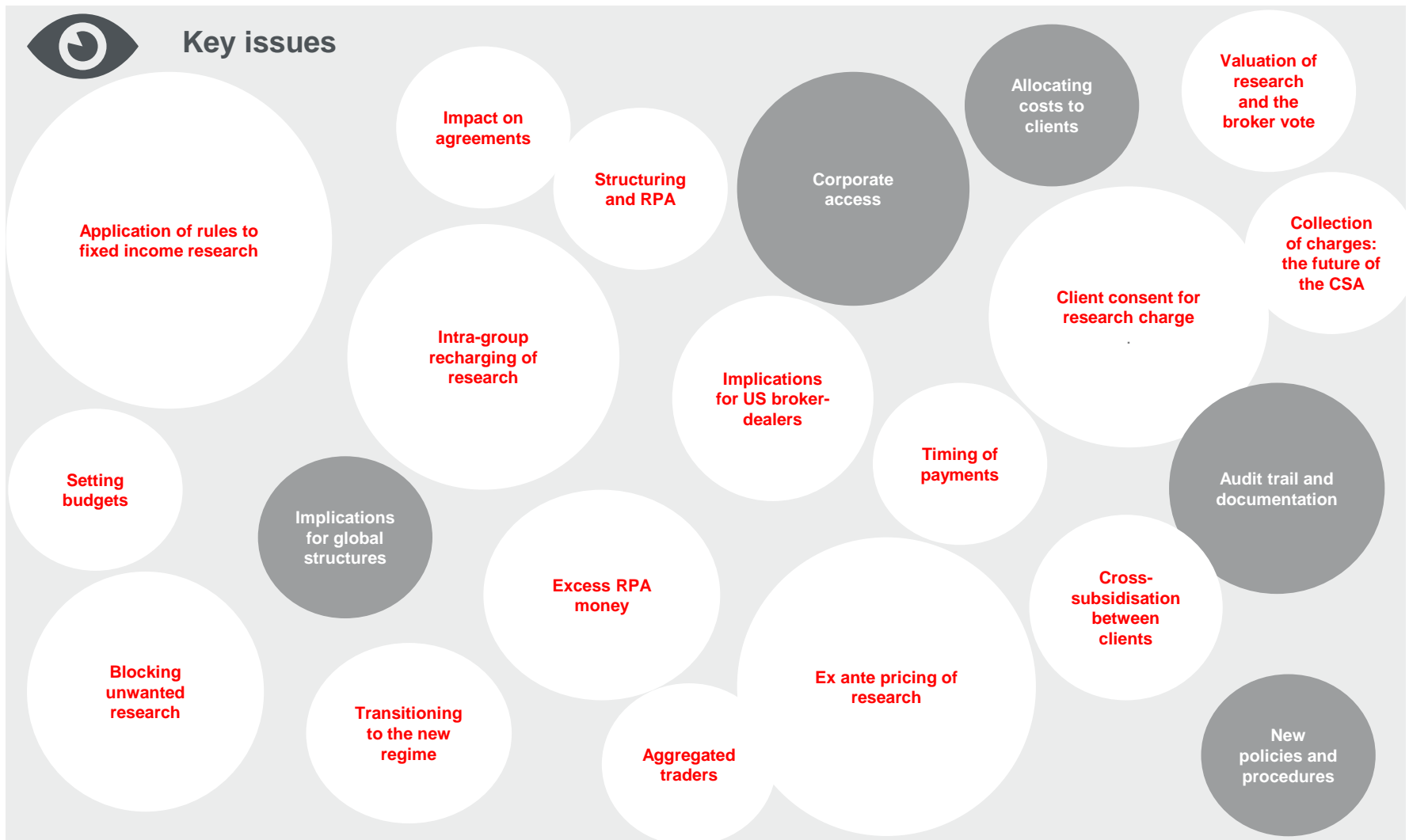
OR

Research payment account provided:

- The account is funded by a specific research charge to client
- Set and regularly assess a research budget
- Firm is responsible for research payment account
- Firm regularly assesses quality of research against robust quality criteria set out in a policy
- Firm assesses its ability to contribute to better investment decisions
- Before providing service, tell clients of budgeted amount and charge and agree research charge and frequency in terms and conditions
- Provide annual information on total costs incurred by client for research
- If required by client or competent authority, provide further information
- All operational arrangements must identify research charge separately
- Tell clients about any increase in advance
- Any surplus at end of period must be rebated or offset against research budget for following period
- Allocation of budget is subject to appropriate controls and senior management oversight
- Cannot use to fund internal research
- Firm providing execution services must identify separate charges that only identify execution costs

Inducements – unbundled research

UK implementation: some key hot topics



Publications

Events

Learning and development

Online services

Technical resources

The Eurozone

Banking reform - Our guide to Banking reform

Capital Markets Union

AIFMD insight - Our guide to the AIFMD

Re:insurance - Our guide to reform affecting the insurance industry

Phoenix - Our guide to UK regulatory reform

The UK Corporate Governance Portal - access to the latest corporate governance developments

Blockchain, distributed ledgers, smart contracts and cryptocurrencies

OTC Oracle - Our guide to OTC derivatives regulatory reform

Legal privilege

UCITS insight

Pegasus - Preparing for MiFID II

Our products and experience

Legislation tracker

Legislation and

Pegasus

Preparing for MiFID II



MiFID II and MiFIR (together 'MiFID II') will underpin the provision of investment services across and into Europe, both in terms of how trading is carried on and how firms organise and conduct themselves. They will affect both the wholesale and retail sides of the industry, in relation to both securities and derivatives. Nor should MiFID II be seen as solely European, as its effect will be far reaching and influence all firms dependent on the European client base.

Recently legislation delaying the implementation of MiFID II to 3 January 2018 was published in the Official Journal of the EU. Despite the delay, firms need to continue to press ahead with their implementation work. There is still a lot to do to be ready in time for the new implementation date. In addition, the UK's referendum vote to leave the EU should not be taken as a sign for firms to stop their work as it is expected that MiFID II will be implemented before the UK concludes its exit negotiation. The FCA's statement on the EU referendum result stated: "Firms must continue to abide by their obligations under UK law, including those derived from EU law and continue with implementation plans for legislation that is still to come into effect."

To say that MiFID II / MiFIR will change the way European markets operate in the future is without doubt hugely underplaying the likely impact of this legislation and staying on top of developments will be crucial for firms. Our blog, [Regulation tomorrow](#), tracks global regulatory developments. In particular the EU pages track materials published by the European authorities, as well as various member states' regulators, including those relating to MiFID II / MiFIR. Subscription to the blog is free and updates can be received on a daily or weekly basis.

We are committed to helping firms keep on top of MiFID II

Pegasus is our dedicated online resource housing all our MiFID II know-how and links to other resources clients will need for any MiFID II project.

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The logo consists of a stylized, upward-pointing chevron shape in a gold color, positioned above the first letter of the text.

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