MiFID II: Conduct of Business Requirements

Joe Beashel, 8 October 2014
Introduction

MiFID I came into force on 1 November 2007
Objective – harmonise investment firms (IF)
– initial authorisation & on-going operating requirements
– Including conduct of business rules

Implemented in Ireland by
– European Communities (Markets in Financial Instruments) Regulations, 2007
Introduction

MiFID I applies to:
- IFs
- Stockbrokers
- Credit institutions when providing investment services,
- Firms / market operators running Multilateral Trading Facilities;
- Futures firms
- Options firms
- Some commodities firms
Introduction

MiFID I – Conduct of Business Rules

Objective – increase investor protection
– Continuous relevance of personal recommendations for clients

Articles 19 - 22
Introduction

MiFID I – Conduct of Business Rules (Article 19)

IF must:
- act honestly, fairly and professionally and in accordance with clients’ best interests
- ensure information addressed to clients is fair, clear and not misleading
- provide clients with specified info regarding the firm and its services, costs and charges and risk information
- assess suitability and appropriateness of investment service for client (unless within execution only exemption)
MiFID I

MiFID I - Conduct of Business Rules – IF must:
– Execute orders on terms most favourable to client
  Article 21
– Comply with specified client order handling rules
  Article 22
– Observe requirements when appointing tied agents
  Article 23

COBR of limited application to “eligible counterparties”
Changes introduced by MiFID II

MiFID II
– MiFID II Directive – amends and restates MiFID
– MiFID II Regulation – sets out requirements relating to trade transparency and the mandatory trading of derivatives on organised venue

MiFID II Directive
– Amends COBR: Articles 24, 25 and 29
– More extensive scope (firms covered and types of products covered)
  Enhance investor protection due to increased product complexity
Changes introduced by MiFID II

Changes to COBR - MiFID II
– Strengthens obligation to act in clients “best interests”
– Enhances disclosure requires when providing investment advice
– New requirements apply to advice provided on independent basis
– New rules on inducements
– New requirements regarding investment advisors knowledge and competence
Changes introduced by MiFID II

Changes to COBR - MiFID II:
– Limits execution only derogation
– Imposes new disclosure requirements when cross-selling
– Imposes more onerous conditions when determining suitability / appropriateness
– Extends requirements relating to best execution
– Reduces scope of eligible counterparty exception
Best Interests of Clients

**IFs who market financial instruments for sale must ensure:**
- They are manufactured to meet needs of identified target
- Are distributed in a manner compatible with identified target

**IFs that offer / recommend other financial instruments must:**
- Have relevant info concerning product approval process including identified target market and product characteristics
Information to Clients

• **Information must be provided “in good time” about:**
  
  – Whether the instrument is for retail or professional clients
  – All costs and charges related to both investment or ancillary services

• **Firms required to provide this information at least annually**

• **Upon client request, firms will be required to provide an itemised breakdown of costs**

• **Regulators have flexibility to impose additional information requirements, where these can be justified**
Advice Provided on Independent Basis

In order to provide advice on independent basis, must:

– Assess a sufficient range of different product providers’ products

– Products should not be limited to financial instruments issued or provided by entities with links capable of putting independent basis of advice at risk
Inducements

Firms who provide advice on an independent basis or provide portfolio management are banned from receiving benefits from third parties in relation to the provision of services to clients

Minor non-monetary benefits allowed if the ability of firms to act in client’s best interests is not impaired

Firms must not remunerate or assess the performance of their own staff in a manner which may conflict with duty to act in client’s best interests
Knowledge and Competence

Staff who advise and sell investment products to retail staff must have an appropriate level of knowledge and competence in relation to product offered.
Execution-only Services

Scope of execution only derogation limited

– Excluded

  • Certain non-UCITS investment undertakings
  • Structured UCITS
  • Financial instruments which embed a derivative
  • Financial instruments which incorporate a structure which make it difficult for client to understand risk
Cross Selling

**When an investment service is offered as part of a package, the firm must:**

- Inform the clients whether it is possible to buy the different components separately
- Where the risk of the package is different to the risk of the components offered separately, the way in which the interaction modifies the risk must be explained to the client
Suitability and Appropriateness

Information required regarding cost and basis of advice

Firms may be required to provide information regarding:

– The range of products considered in providing personal recommendations
– Whether advice is provided on an independent basis
– Whether a periodic assessment of suitability of recommendations will be provided
– Firms must be able to demonstrate to the regulator reasons for advice provided
Best Execution

When executing client orders:

- The execution policy must be provided in sufficient detail, and in easy to understand language
- Firms must disclose the top five execution venues where they executed client orders on an annual basis

Firms should not receive remuneration for routing customers to a specific execution venue
Eligible Counterparties

• Obligation to act honestly, fairly and professionally extended to Eligible Counterparties ("ECPs")

• New reporting obligation on firms dealing with ECPs

• Harmonisation of regulatory requirements applicable to ECP’s and professional clients

• Municipalities and local authorities may no longer be treated as ECP’s

• Suitability / appropriateness required for professional clients
Product Intervention

Member State Regulators may ban or restrict the sale of certain products where:

– There is a significant investor protection concern; or a
– Threat to orderly functioning of the markets

Where Member State regulators exercise such powers, they are obliged to inform ESMA in advance
Packaged Retail and Insurance-based Investment Products (“PRIIPS”)

All PRIIPS will be required to a Key Information Document (“KID”)

KIDs aim to addresses transparency in relation to retail product disclosure

PRIIPS include:

- investment funds
- all structured products
- insurance products
- derivative investments & structured deposits