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EU Regulatory Update: MiFID II

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EU REGULATORY UPDATE: MIFID II

- MiFID II implementation progress
- Inducements and delegation issues: some market colour
- MiFID II impact on AIFMs and UCITS management companies and gold-plating in general: some market colour
MIFID II IMPLEMENTATION PROGRESS

Key:
- **Green**: Full transposition measures indicated
- **Yellow**: Partial transposition measures indicated
- **Red**: No transposition measures indicated

Source: European Commission: MiFID II directive – transposition status
MIFID II IMPLEMENTATION PROGRESS

- Ireland – committed to supervisory convergence and implementing on time without additional Central Bank of Ireland guidance as ESMA’s authority is recognised
- Luxembourg – some delays in implementation, but we understand that level 2 is likely to be implemented word for word
- Netherlands – appear to be last minute in implementation and concerns as to whether they will implement on time
- Sweden – we understand that the Swedish regulator has said that implementation by 3 January 2018 is unlikely
- UK – fully compliant implementation but acceptance of compliance on a ‘best efforts’ basis
MIFID II IMPLEMENTATION PROGRESS IN ITALY

- **Main Legal Framework**
  - Level 1 measure: Legislative Decree No. 58 of February 24, 1998 (Italian Unified Financial Act)
  - Level 2 measure: Regulation on Intermediaries adopted by the National Commission for Companies and the Stock Exchange (CONSOB) with resolution no. 16190 of 29 October 2007 (Intermediaries Regulation)

- **Implementation Progress**
  - **Italian Unified Financial Act**
    - Amended on August 26, 2017 by Legislative Decree No. 129 of August 3, 2017
    - Amended United Financial Act in force starting from January 3, 2018
    - Final Amended United Financial Act already published
  - **Intermediaries Regulation**
    - A number of public consultation procedures launched by CONSOB (starting from July 6, 2017)
    - No outcome available yet
    - Amended Intermediaries Regulation available only draft form
MIFID II IMPLEMENTATION PROGRESS IN GERMANY

**WpHG-2018**  
(Securities Trading Act)  
- Status: adopted 23/06/2017 and will come into effect on 03/01/2018  
- Implements MiFID II and parts of Delegated Directive  
- Refers to directly applicable Delegated Regulation for details  
- Essentially, 1:1 implementation without gold-plating

**WpDVerOV-2018**  
(Regulation on Conduct Rules and Organisational Requirements for Investment Firms)  
- Status: adapted 27/10/2017 and will come into effect on 03/01/2017  
- Implements Delegated Directive (in particular inducements, clients' assets, product governance) and, where necessary, Delegated Regulation  
- Essentially, 1:1 implementation without gold-plating

**MaComp-2018**  
(Minimum Requirements for Compliance)  
- Status: consultation ended 30/11/2017; responses are currently evaluated  
- Implements Delegated Directive (in particular personal dealings, suitability declarations, inducements) and ESMA-Guidelines
INDUCEMENTS AND DELEGATION ISSUES: SOME MARKET COLOUR

- Clear preference for managers to pay for research from P&L and expect delegates to do the same, but some not making any demands on non-EU delegates.
- More uncertainty amongst fixed income managers who regard the research component of the service received from brokers as being ‘free’ – but in effect they are still likely to be regarded as paying for research by regulators.
- Concern about disclosure issues where MiFID clients treated differently from other clients who might want to opt into the same deal.
- Focus on interaction with non-EU law – e.g. SEC no-action relief.
- Some UK/FCA guidance rather confusing/difficult to apply to practical situations involving international groups: but the overall objective of the FCA is clear.
INDUCEMENTS AND DELEGATION ISSUES: SOME MARKET COLOUR

- Germany - no unique local position on these matters to be expected and BaFin’s approach yet to emerge; national third-country regime does not provide for inducement exemptions and application is questionable; recent BaFin consultation also covered interpretation of inducement provisions

- Luxembourg – typically “seeks most flexible solution”; no unique local position on these matters and CSSF approach yet to emerge; third country regime under MiFID which entails recognition of the equivalence of third country laws may inspire a similar approach before equivalence decisions made

- Ireland – CBI reluctant to express a view and prefer to defer to ESMA/EU Commission; some firms may rely on FCA’s letter to AIMA; Irish MiFID firms to take their own reasoned stance and may be different approaches
INTERACTION OF MIFID II WITH U.S. LAW

- U.S. law provides a safe harbour from claims that a manager has breached its fiduciary duty on account of:
  - Paying more than the lowest available commission for eligible research and brokerage services
  - Using research for the benefit of other clients for whom the manager exercises investment discretion
- Manager must make a good faith determination that the value of research and brokerage services is reasonable in relation to the amount of commissions paid
- The economics of RPAs are largely indistinguishable from CSAs/CCAs, which are consistent with the Section 28(e) safe harbor
- Problem: Payments for research from P&L and from RPAs are not “commissions”
INTERACTION OF MIFID II WITH U.S. LAW

- Payment of “hard dollars” for research creates several issues under U.S. law
  - Regulation of research providers as “Investment Advisers”
    - SEC relief – brokers will not need to register for 30 months
  - Safe harbor from liability for “paying up” for and sharing research
    - SEC relief – RPAs treated as “commissions”
  - Aggregation of trade orders
    - SEC relief for disparate expense allocation, if attributable solely to research
  - Custody of RPA funds
    - Presently unresolved
INTERACTION OF MiFID II WITH U.S. LAW

- U.S. Market Responses and Open Issues
  - Fully abandon use of “soft dollars” and pay for research from P&L – global managers with robust internal research groups
  - Administer CSAs and RPAs side-by-side – possible, but technically challenging
  - Reliance on FCA letter to AIMA and similar positions outside the UK – inconsistent guidance from EU managers regarding MiFID II compliance by non-EU delegates
    - Treatment of credit spreads
    - Enhanced reporting
    - Commission sharing arrangements
  - “No Soft” orders and reimbursement of research costs – balancing “free rider” concerns of other clients and fund boards
MIFID II IMPACT ON AIFMS AND UCITS MANCOS AND GOLD-PLATING IN GENERAL: SOME MARKET COLOUR

- UCITS and AIFs may have MiFID-licensed manager: some anomalous differences in seemingly similar scenarios both for this reason and between jurisdictions.

- In the UK there is gold-plating in this area – e.g. rules on payments for research and telephone taping are being applied to AIFMs and UCITS ManCos; MiFID II product governance rules applied as guidance to AIFMs/UCITS ManCos; MiFID II best execution rules applied to UCITS ManCos but not AIFMs.

- But transaction reporting not being extended to AIFMs/UCITS ManCos, even if they are carrying on MiFID activities e.g. separate account management.
MIFID II IMPACT ON AIFMS AND UCITS MANCOS AND GOLD-PLATING IN GENERAL: SOME MARKET COLOUR

Collective Portfolio Management
- No gold-plating of MiFID II

Ancillary Services
- Marketing of third-party funds
- Investment Advice
- Portfolio Management
- Safekeeping and Administration

Portfolio Managers and Sub-Advisors
- Authorisation
- Business Organisation
- Conduct of Business

Dealing with Distributors
- Definition of Target Markets
- Cost Transparency
- Complex Products
- Product Intervention
- Information Obligations regarding Sales, Product Intervention, Customer Complaints

Selected Items
- Model Distribution Agreement by BVI, MiFID II side-letter, MiFID II commitment letter
- Model Outsourcing Agreement by BVI
- EMT-Mapping
- Trail Commissions, Clean Share Classes
- Taping
- Model Wording for Research Costs
MIFID II IMPACT ON AIFMS AND UCITS MANCOS AND GOLD-PLATING IN GENERAL: SOME MARKET COLOUR

- **Investment Services**
  - When providing portfolio management, investment advice and (AIFMs only) reception and transmission of orders, Italian ManCos and EU ManCos acting through an Italian branch shall **fully comply with MiFID II** (and level 2 measures).

- **Marketing of own and third-party funds**
  - When marketing own and third-party funds, Italian ManCos and EU ManCos acting through an Italian branch shall **comply with MiFID II** (and level 2 measures) governing:
    - Product governance requirements for distributors
    - Knowledge and competence requirements for personnel involved in the marketing activities

- **Collective Portfolio Management**
  - When performing collective portfolio management service (no matter if they also provide other investment services) Italian ManCos shall **comply with MiFID II** (and level 2 measures) governing:
    - General organisational requirements and clients’ complaints handling
    - Investment research and marketing communications
THANK YOU