



# LINARI LAW FIRM

AVOCATS À LA COUR

## MiFID II countdown – Last things to know before it goes “live”

The Markets in Financial Instruments Directive 2014/65/EU (“MiFID II”) is supposed to come into effect in the national laws of the European Union member states on January 3, 2018. Supplemented by the Regulation (EU) No. 600/2014 on market in financial instruments (“MiFIR”) and the related delegated acts, MiFID II will significantly and profoundly affect the operations, conduct and governance structure of investment service providers in the European Union and beyond. The main objectives pursued by MiFID II are declared to be (i) increased transparency of the European Union financial markets, (ii) enhanced level of protection granted to investors (both retail and professionals), and (iii) increased attractiveness of regulated trading venues so as to channel significant trading volumes onto such venues.

Specific MiFID II topics relevant to the activities of the Luxembourg investment services providers are as follows:

### **Universe of Investment Services Providers Subject to MiFID II Requirements**

MiFID II will clearly apply to investment firms, market operators, data reporting services providers, and third-country firms providing investment services or performing investment activities through the establishment of a branch in a member state of the European Union. However, a limited number of exempted entities will be out-of-scope of MiFID II, as listed in article 2 of MiFID II.

### **(Indirect) Effect on Undertakings for Collective Investments (“UCIs”) and their Management Companies**

As a matter of principle, UCIs and their management companies exercising collective portfolio management activity are excluded from the scope of application of MiFID II. However, the management companies of those UCIs providing any of the non-core services (e.g. portfolio management on a discretionary basis, investment advice, etc.) will be subject to MiFID II requirements and thus should be ready to comply with MiFID II starting 3 January 2018.

Despite the aforementioned exclusion in respect of collective portfolio management activities, the mode in which “exempted” UCIs/management companies operate and how their products are distributed is expected to be profoundly affected by MiFID II, mostly due to the fact that the distributions networks of Luxembourg UCIs are typically composed of local and foreign investment advisers, UCI distributors, portfolio managers and brokers (all subject to MiFID II requirements). As a result, the products offered by Luxembourg UCIs/management companies might need to be carefully reviewed and the case being, (re-)structured taking into consideration the MiFID II requirements. Otherwise, the employed distribution models might prove to be incapable of ensuring the effective marketing of products offered by the relevant UCIs/management companies.

## **Channeling More Trades onto Organized Trading Venues**

MiFID II expects to channel more trades into organized trading facilities and introduces a new type of trading facility – an “Organized Trading Facility” (“OTF”). It will capture trading in non-equity instruments that previously operated outside the scope of MiFID I. In addition, MiFID II will bring more consistency to the rules in respect of Regulated Markets (“RM”) and Multilateral Trading Facilities (“MTF”), the traditional Luxembourg markets for bonds and structured finance products.

MiFID II is expected to provide for increased transparency including mandatory pre-trade and post-trade disclosures of the details of orders submitted to, and transactions conducted on, a trading venue. It also prescribes transaction reporting which involves notifying the competent authority of identifying reference and post-trade data (including positions in commodity derivatives).

## **More Stringent Product Manufacturing and Governance Rules**

MiFID II will significantly increase the responsibilities of both product manufacturers and distributors in respect of the products they sell to investors. Specifically, investment firms subject to MiFID II requirements, acting in their capacity as product manufacturer or product distributor, will have to ensure that their products meet the needs of an identified target market of investors and that their distribution model is compatible with that specific market, among others, by contractually managing the allocation of responsibilities between the manufacturers and distributors (including arrangements aimed at defining the flows of information between the parties so that such information allows distributors to comply with MiFID II requirements).

## **Mandatory Unbundling of Investment Research and Trading Execution Fees**

MiFID II aims at providing more transparency to investors in respect of the costs of research and trading execution. Such enhanced level of transparency is expected to be achieved by requiring the firms to unbundle payments for research and trading execution services provided by brokers to investment firms. Specifically, the currently wide-spread practice, where investment firms pay a single “bundled” fee for research and trading, will constitute an "inducement" and thus caught by a prohibition. However, an exception will apply whereby the investment firm pays for the research: (i) directly out of its own resources; (ii) through a so-called "Research Payment Account" (established by the investment firm on behalf of its clients); or (iii) a combination of i) and ii).

## **Increased Reporting Obligations**

Under MiFID II investment firms will now be required to report in real-time more information about executed transactions, including price and volume information. In addition to this increase in the amount of reportable data (with the number of data fields required for MiFID II transaction reporting almost doubled in comparison to MiFID I), such information must also be stored for even longer period of time. Given the new more-encompassing scope and nature of data to be reported and disclosed, MiFID II will certainly require employment of significant IT resources, hence presenting unparalleled opportunities for niche Fintech companies.

## **Best Execution**

Under MIFID II, the “best execution” concept has seen an important upshift in terms of intensity of efforts an investment firm must apply in executing trades for the benefit of its clients. In particular, investment firms will now be required to take all sufficient steps (previously in MIFID I: “reasonable steps”) to obtain, when executing orders, the best possible result for their clients taking into account price, costs, speed, likelihood of execution and settlement, size, nature or any other consideration relevant to the execution of the order, with a notable exception though. Under the exception, where there is a specific instruction from the client, the investment firm shall execute the order following the specific instruction.

Furthermore, investment firms will be required to publish data relating to execution quality (i.e. cost, speed, etc.) at least annually without charge. Investment firms will have to publish, on an annual basis, their top five execution venues for the previous year, along with specific data relating to the quality of execution of transactions on that venue.

## **Next steps**

In the coming days before the MiFID II “go-live” date, the concerned market participants might deem it useful to perform the ultimate checks to ascertain their MiFID II compliance “readiness”, among others, in respect of the following items: (i) evaluation of the policies, procedures, processes and identification of any potential compliance gaps, (ii) review and re-alignment of the existing business models (e.g. distribution networks), (iii) review and drafting of the additional documentation required under MiFID II (e.g. client disclosures), (iv) putting in place of appropriate IT infrastructure to comply, notably, with new reporting requirements. Last but not least, the concerned market participants should not lose track of the legislative process in Luxembourg, since the national MiFID II implementation legislation is yet to come (Bill nr. 7157).