MiFID II

The webinar will begin at 10:00am BST

MiFID II

Zsuzsanna Schiff,
Manager, Auditing and Reporting

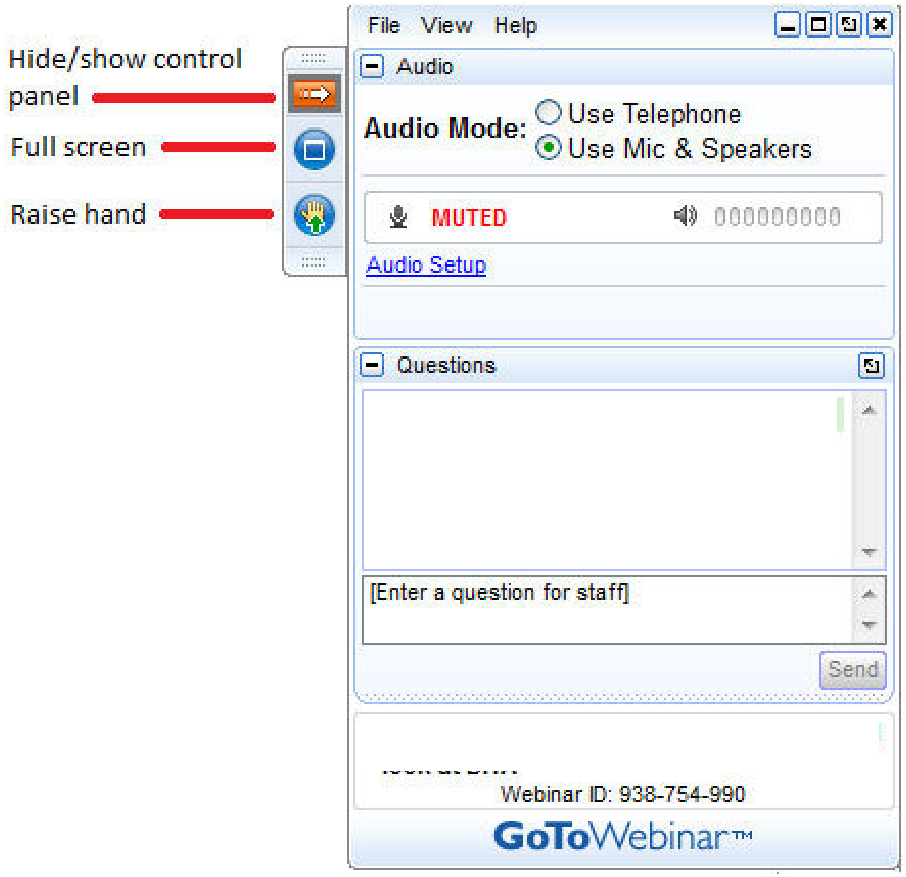
Speakers

Che Sidanius
PwC
Director
Wholesale Banking &
Capital Markets

John Newsome
PwC
Manager

Ask a question

- Participate in today’s webinar – send us a question



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MiFID II
Transforming Europe's Financial System:

July 2, 2015

pwc

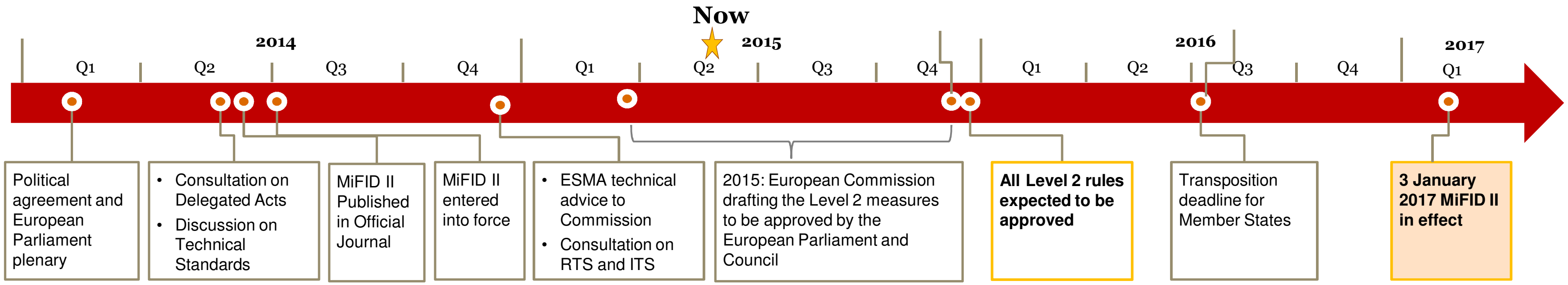
With you today…

		One Firm - Financial Service Advisory	*Contact*
	**Che Sidanius** *Director (UK)*	• A Director in PwC's Financial Services Risk & Regulatory practice. His specialisation includes delivering new operating models and business strategy resulting from regulatory change, including MiFID II, EMIR, Volcker, and Structural reform. • Over 15 years of experience in financial services in both the public and private sector. Prior to joining PwC he worked at the Bank of England, and the Federal Reserve Bank of New York	+44 (0) 780803 5854 che.s.sidanius@uk.pwc.com
	**John Newsome** *Manager (UK)*	• A Manager in PwC's Risk and Regulation Centre of Excellence, focusing on a number of new and emerging regulatory developments impacting banks and asset managers. • Previously John has advised a number of our clients on the impact of new regulations (such as MiFID II and AIFMD) on their business and the options available to them during their implementation programme.	+44 (0)7808 027371 john.newsome@uk.pwc.com

Agenda

MiFID II – Business impact & programme structure

MiFID II Timeline for approval and implementation



2009 G20 commitment

Too big to fail
- Recovery and resolution
- Segregation

Prudential regulations
- Governance
- Capital/liquidity/leverage

Market reform
- Transparency
- Market structure/integrity
- OTC derivatives reform
- Investor protection and choice

Multiple regulations

- Dodd-Frank Act
- EMIR
- MiFID II
- Basel III/CRD IV
- Short-Selling and CDS
- AIFMD
- MAR
- Securities Law Directive
- Solvency II
- PRIIPS
- Central Securities Depositories
- FATCA

Key areas addressed by MiFID II
- Market Structure
- Pre and Post-Trade Transparency
- Data Consolidation
- Transaction Reporting
- Investor Protection
- Convergence of Regulatory Framework
- Commodity Derivatives Market
- Reinforcement of Supervisory Powers

Potential impact of MiFID II
- Client Volumes
- Client Profitability
- Client Interaction Model
- Prop and Prohibited Trading
- Competitive Position

MiFID II will accelerate the evolution of Europe's financial market ecosystem

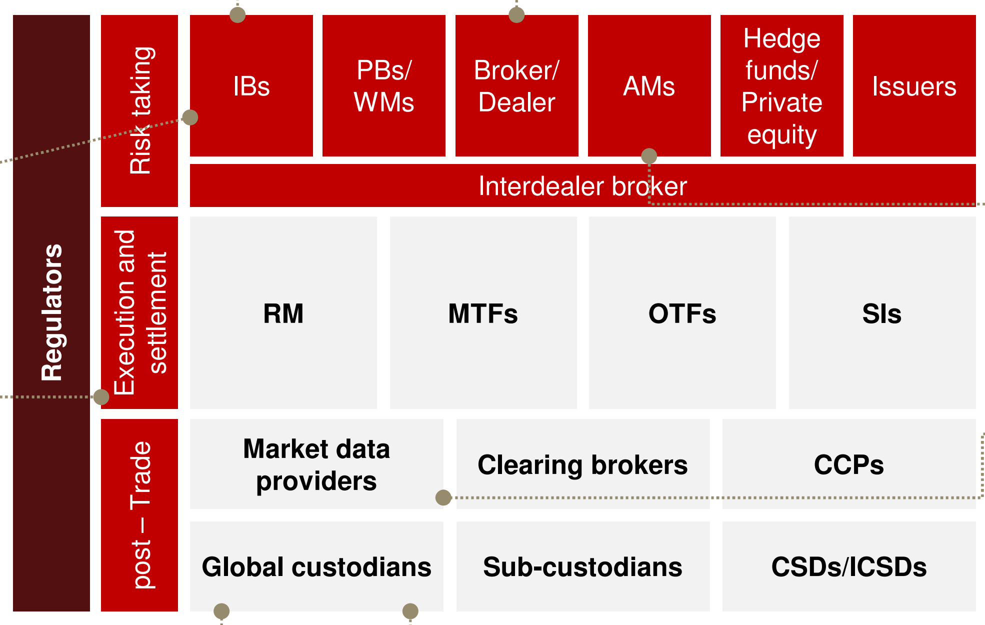
Banks should **optimise execution** of key products. Some large institutions may use their own platforms, some may centralise their T&E platforms (joint-ventures), and some may execute via third-party platforms or halt execution entirely.

Brokerage will shift from voice to hybrid with emphasis on automated processing

Greater emphasis on **Asset Managers' product governance**

Some **banks may specialise more fully as market makers** (principal), versus **facilitators** (agent) with individual coverage & distribution responsibilities.

Trading and execution will be centralised and automated, with a significant volume shift from bilateral trading to regulated trading venues.



Liquidity aggregators sweep prices from multiple sources. Allows client orders to be allocated across venues that offer best price

Post-trade service providers (e.g. brokers, clearing providers, custodians) **may choose to enhance infrastructure** to fulfil reporting, collateral and clearing requirements.

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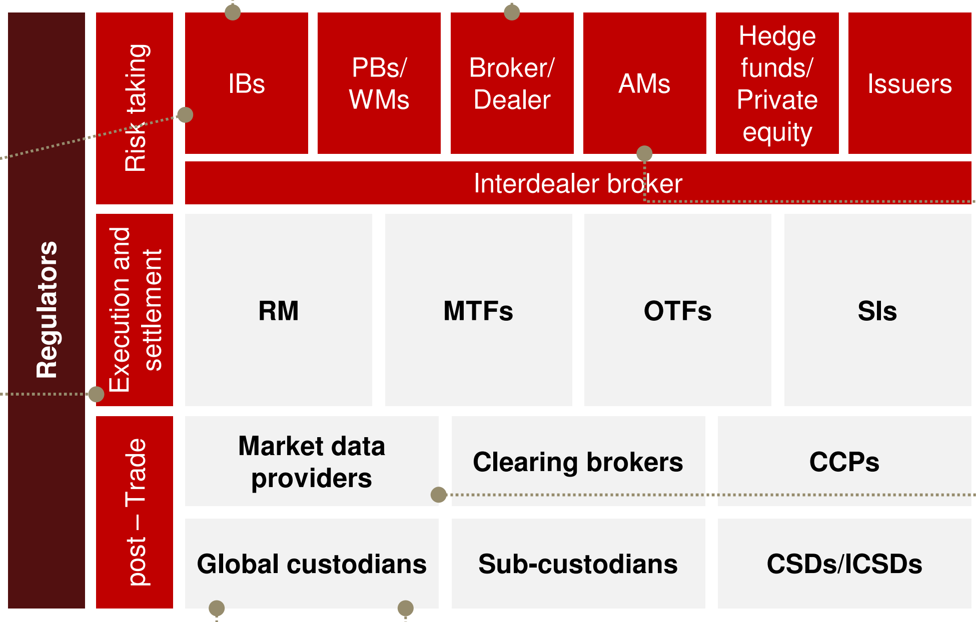

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Product standardisation and industry bifurcation will further separate flow and exotic businesses.

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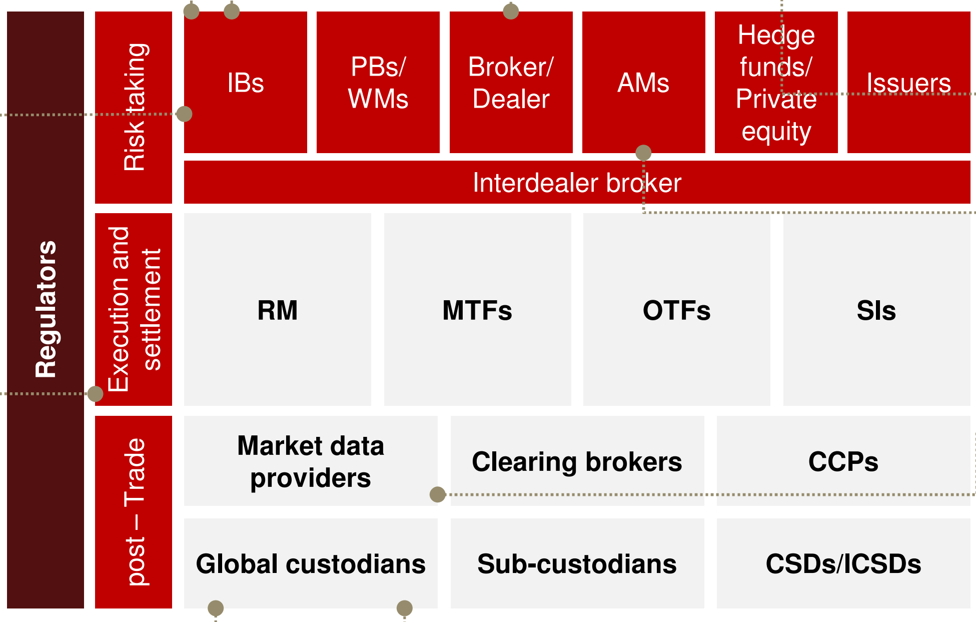

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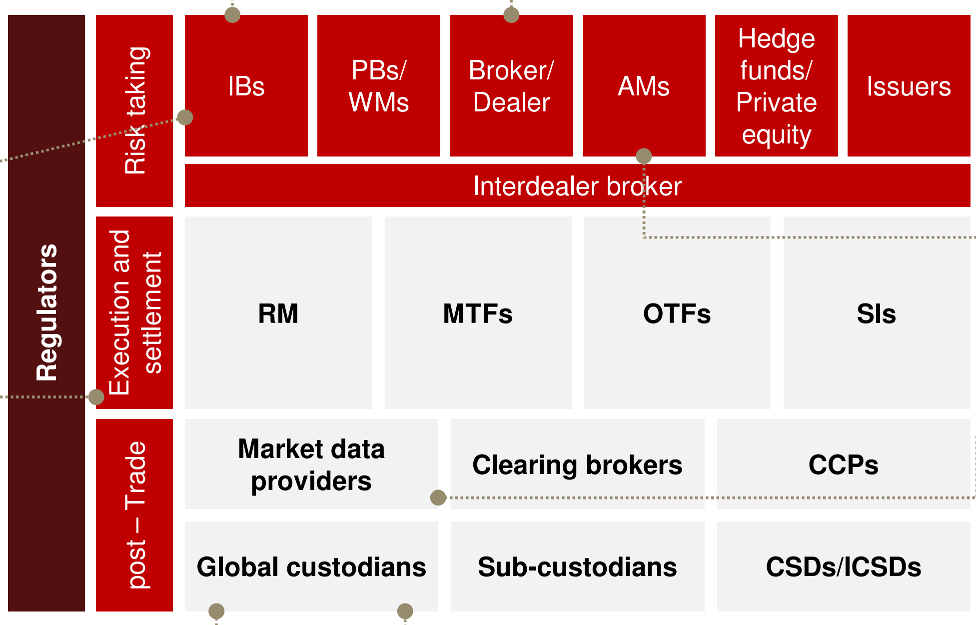

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The framework for determining business impact is multidimensional

Legal	• MiFID II requirements relating to asset class scope and geography • Third country considerations • Impact of Passport within EU • Licensing requirements due to changes in business
Tax	• Firms will need to decide how to manage the obligations resulting from MiFID II and any change in operating model is likely to have tax consequences. For example, outsourcing functions needs to be considered from a VAT perspective. • Tax consequences of business model changes, such as moving to new trading venues or establishing OTFs • Local tax consequences such as filling obligations on third country firms establishing a local presence
Commercial	• Decline in revenues for dark pool/crossing network operators • Decline in revenues for high-frequency and algorithmic trading firms • Reduced bid-offer spreads as pre and post trade price transparency increases • Reduction in block trades as delays on post-trade reporting are reduced. • Reduced revenues from higher margin structured product sales • Spreads on OTC derivatives trades to decline • Enhanced powers for Supervisors including ability to intervene on products
Operational	• Understanding if the required changes in operating model would be incremental or new • Assess synergies between functions from a people, systems and processes perspective • Determining best principles for future operating model • Suitability of operating model to support future business from a cost efficient and efficiency

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Some strategic implications to consider…

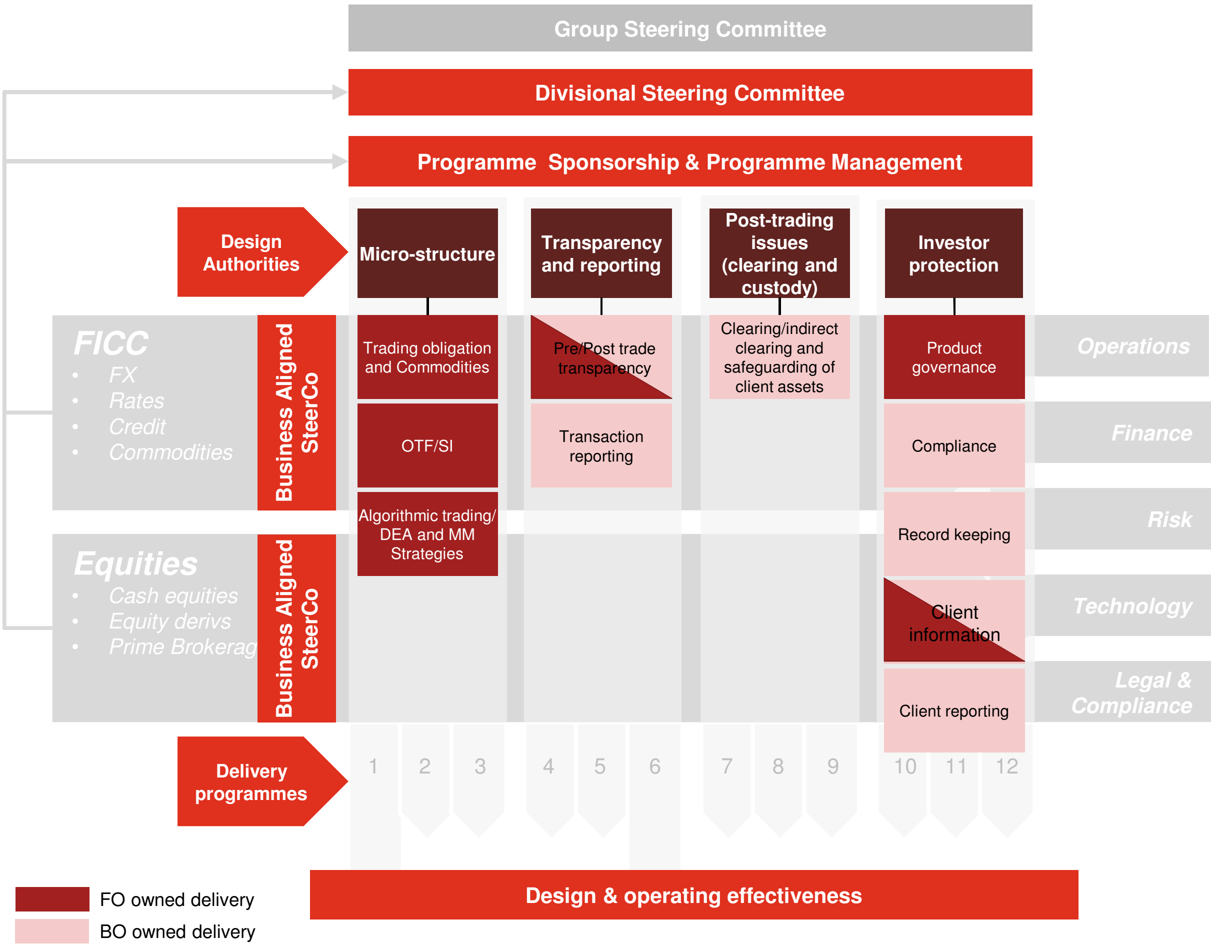
Potential client demand and product landscape as a result of the industry reform

Themes	Assessment	Implications
1 Transparency	• New reporting requirements lead to higher price transparency and decreased profit margins in particular for more standardised, vanilla instruments	• **Higher reporting frequencies, costs** • **Lower trading profits**
2 Product standardisation	• Higher standardisation requirements across series of characteristics lead to commoditised product offerings and their listening at public exchanges to attract liquidity	• **Reduced complexity** • **Lower trading profits**
3 Microstructure	• Regulatory classification and stricter rules around dedicated trading venues lead to more centralised and automated execution	• **Electronification**
4 Non-discretionary execution	• Limited discretion in trade execution narrows trading profits in particular for standardised products (e.g. equities)	• **Lower trading profits**
5 Liquidity	• Requirements on trading venues as well as the separation of infrastructure and execution (market making) lead to a fragmentation of liquidity across markets and platforms	• **Higher trading costs** • **Need for single access points**

Source: PwC analysis

Programme structure - Option 1: Federated by MiFID II theme

Some large banks are federating responsibility for delivery by MiFID II theme, but accountability still needs to reside with the relevant Front Office or Back Office functions.



Benefits:

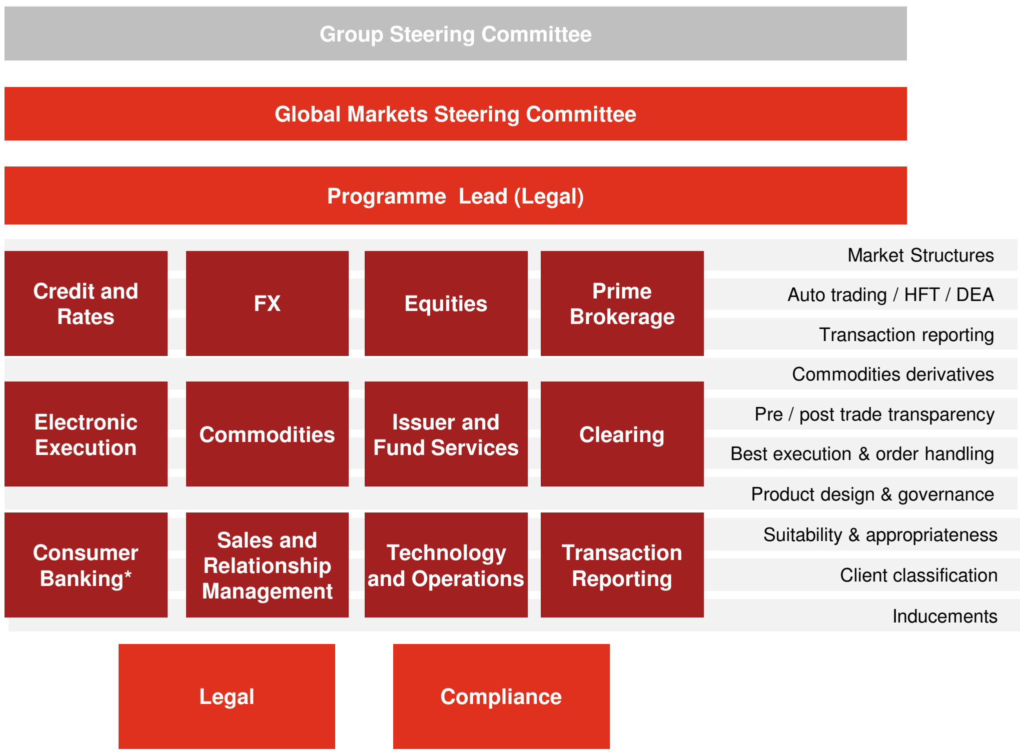
- Accountability and direction rests with the division and businesses
- Programme Management role is to facilitate delivery, provide challenge, and MI to SteerCo
- Ownership of business issues with front office expertise e.g. Algo, DMA, Venues
- Ownership of operational issues with back office expertise e.g. reporting
- Independent team responsible for design effectiveness and operational effectiveness testing prior to reporting requirements as closed

Challenges:

- Complexity given large number of businesses
- Potential duplication of effort – multiple businesses looking into the same issues
- Potential misalignment across divisions with the group

Programme structure - Option 2: Federated by business

However, some we have seen other banks adopting a business led model…



Benefits:

- Accountability rests with the underlying businesses – relevant given extent of front office change and decision making required by MiFID II
- Availability of front office expertise on technical issues e.g. Algo, DMA, Venues

Challenges:

- Complexity given large number of businesses
- Quality Assurance requirement – how to confirm businesses are in reality compliant
- High duplication of effort – multiple businesses looking into the same issues

2015 Regulatory Focus: Investor protection

Investor protection themes

Investor protection is a key component of the MiFID II package and will alter the dynamics of retail product distribution across the EU.

Key pillars of MiFID II investor protection requirements

Enhanced information

- Firms required to disclose whether bundled products can be obtained cheaper separately
- Information regarding cost must relate to investment and ancillary services and the cost of advice
- Itemised breakdown of costs provided to clients on request
- Firms must indicate whether they will provide a periodic assessment of suitability

Inducements

- Fees, commissions and non- monetary benefits must be designed to enhance client service
- Firms providing independent advice or providing portfolio management cannot receive fees, commissions or non-monetary benefits from third parties in relation to the advice or service. Minor non-monetary benefits permitted, provided they are disclosed.

Independent advice

- Firms are required to inform clients in advance whether advice is given on an independent basis and whether it is based on a broad or more restricted analysis of the market.
- In particular, firms must state whether their analysis is limited to products provided by related entities.
- In order to be termed 'independent', firms must a sufficiently large and diverse number of instruments on the market.

Suitability

- Firms must consider clients' risk tolerance and ability to bear losses.
- When bundled packages are presented to clients, firms must ensure that the overall package is suitable.
- Firms must provide suitability statements if they are providing advice, setting out how the advice meets the preferences, objectives and other characteristics of the retail client.

Additional important considerations

- Changes to execution only regime
- Best execution
- Product governance

MiFID II Requirements Breakdown

***Extent of Gaps** for each area will depend on the number of applicable requirements*

- *New: New requirements introduced in MiFID II*
- *Enhanced: Expansion of scope of previous requirements from MiFID I*

	Product Governance	Compliance	Record Keeping	Client Information	Best Execution
Total	43	76	32	131	62
Requirements applicable to XYZ Bank	43	76	32	131	62
New	42	52	31	103	36
New – L1	14	6	7	22	29
New – L2	28	46	22	81	7
Enhanced	1	4	1	16	12
Enhanced – L1	1	4	1	16	12
Enhanced – L2	0	0	0	0	0
Existing	0	20	0	12	14

MiFID II implementation complexity for investor protection expected across business functions

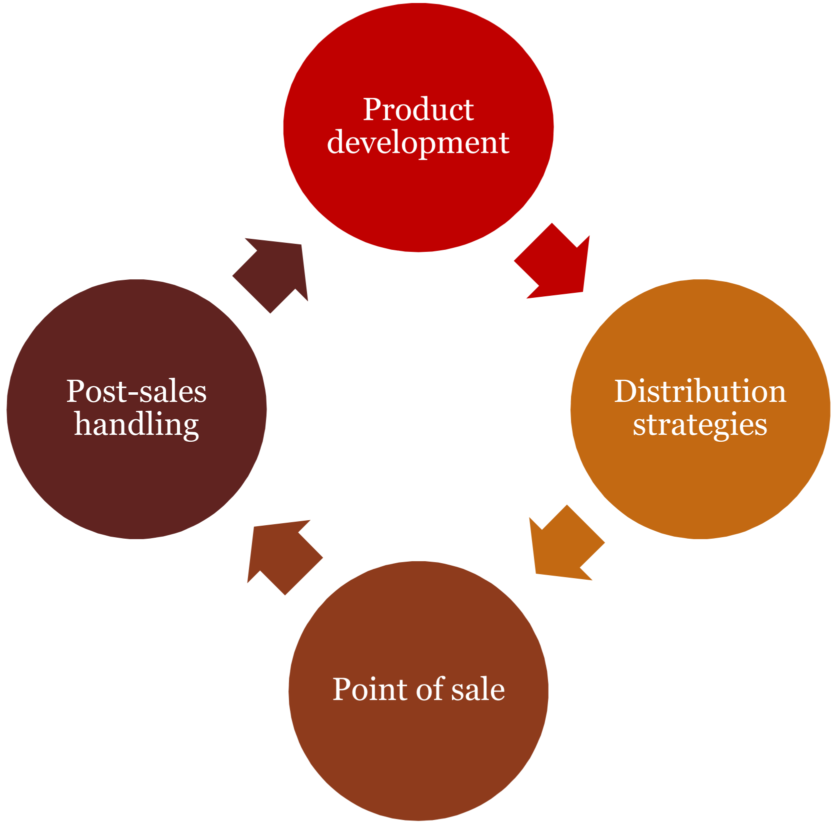
Themes	High level requirements	Implementation Complexity
Product governance	• New requirements covering product design and internal approval process, risk assessment as per client classification, distribution strategies and periodic reviews	R
Compliance	• Stricter complaint handling procedures, mitigation and disclosure of conflict of interests, oversight of remuneration policies, and control of marketing materials	A
Recordkeeping	• Recordkeeping requirements for 5-7 years of all services and transactions including recorded telephone conversations and electronic communications	R
Client information	• Suitability of provision of services to clients, and information on costs and risks	R
Client reporting	• Provide best execution and reporting that ensures sufficient transparency and takes into account type and complexity of financial instruments involved and costs associated with the transaction	R

Product governance – splitting the risk?

Both product manufacturers and product distributors are caught by new MiFID II requirements capturing their role during the product lifecycle. Firms need to understand when they are the manufacturer or the distributor (or both) and the different impacts this will have on their operations and their role in getting products to the right target investors.

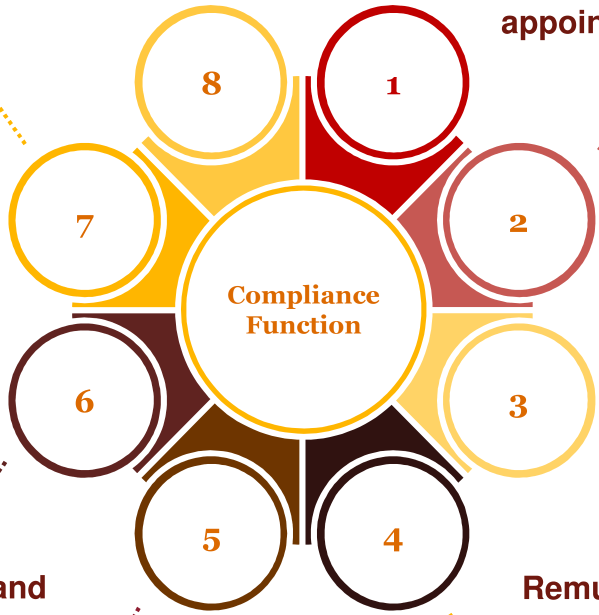
Product manufacturer – ESMA defines this as firms that "create, develop, issue and/or design investment products", such as an investment firm advising a corporate issuer on the launch of new securities – but not managers of UCITS/AIFs

Product distributor – ESMA states this is a firm that offer/recommends investment products and services to clients



Increased role of compliance

Under MiFID II there is an overall requirement that firms should have policies designed to detect any risk of failure to comply with the regulations and reduce those risks where identified.



Board is responsible for appointing Compliance Officer

Report directly to Board whenever a significant risk is detected

Report at least annually on overall effectiveness

Remuneration must not compromise objectivity

Oversee complaints process and use this as a source

Must be permanent, effective and independent

Must conduct risk assessment before putting in place a risk-based monitoring programme

Must not be involved in performance of services

Significant changes to inducements

Investment firms cannot accept or retain fees, commissions or any monetary on non-monetary benefits paid or provided by third party financial advisors and intermediaries

- Cost to client must be based *solely* on the value of the product or service
- No commission or rebates can be kept by independent advisors and portfolio managed services
- Payments by distributors to platforms or manufacturers can be made provided they do not breach the inducement rules.
- Firms must pay for research separately from execution services
- Reflects duty to act fairly in the interest of clients even the most sophisticated ECPs
- Applies to choice of venue for best execution
- Requires policies, procedures and controls to ensure no inducements paid

Impact

- Separates advisors into independent and non-independent distribution channels
- Reconsider distribution channels and approach to drive sales
- Quality of products and investment advice are key differentiators in portfolio management and independent distribution
- Shift in balance of power between manufacturers and distributors striving to extract the most margin from the reformed value chain.
- Research paid for directly by asset managers or pre-funded by investors
- Non-EU firms will need to adapt approach for EU and non-EU clients

Best Execution – getting it right

Firms must

- take all **sufficient** steps when **executing client orders** to obtain the **best possible result** for their clients
- taking into account
  - price
  - costs
  - speed
  - likelihood of execution and settlement
  - size
  - nature
  - any other factors
- Where there is a specific instruction from the client the firm must execute the order following the instruction.

- Receive any payment, discount or non-monetary benefit for routing orders to a particular trading or execution venue which create a conflict of interests.

Firms must not

For retail clients:

- The relevant factors are:
  - price
  - costs
- Costs should take into account the total consideration, including execution venue fees, clearing and settlement fees and any other fees paid to third parties.

For professional clients:

- All factors are applicable
- Specific instructions in relation to one factor do not negate the obligation to ensure that other factors are considered when executing the order.

What’s next?

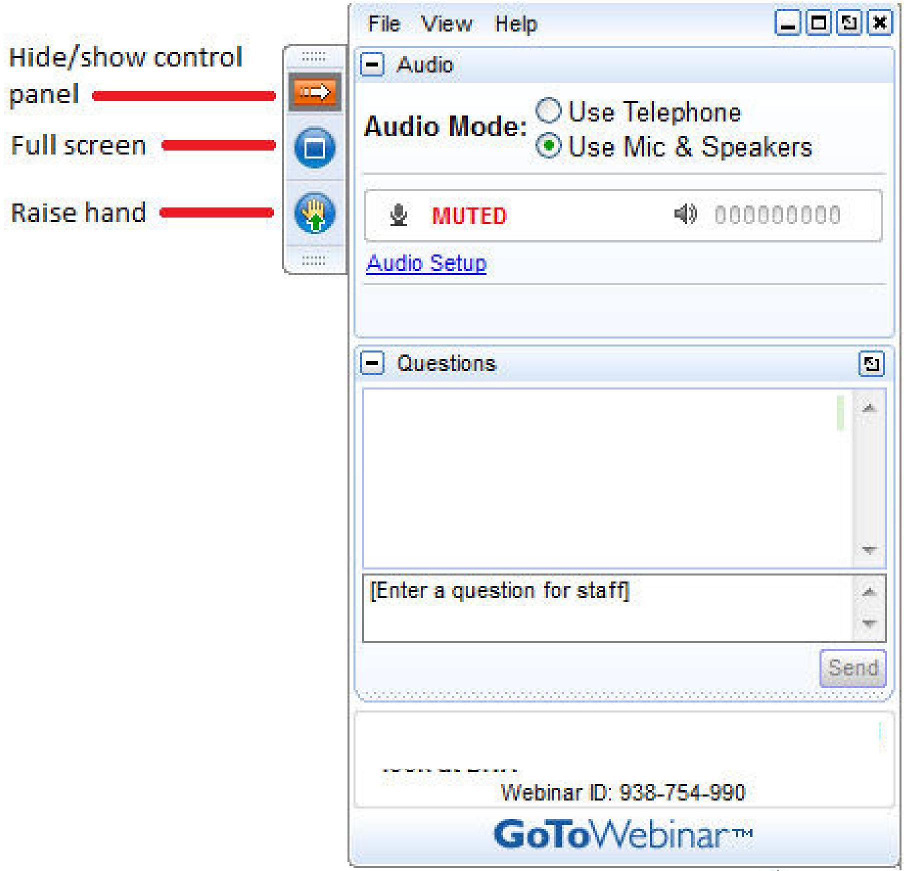
What's next?

- Further ESMA technical advice
- Final Level 2 measures
- National implementation
- Embedding MiFID II in the business

Thank you!

Ask a question

- Participate in today's webinar – send us a question



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Questions

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John Newsome
Manager
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THANK YOU FOR ATTENDING

Financial Services Faculty

☎ +44 (0)20 7920 8685

✉ fsf@icaew.com

icaew.com/fsf

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