MIFID II

A guide to Mifid II in Ireland

Joe Beashel and Louise Dobbyn of Matheson look at how Ireland's direct implementation of Mifid II positions it well for post-Brexit

Mifid II impacts Irish investment firms (including brokers, asset managers, wealth managers and corporate advisory firms), market operators, data reporting service providers, trading venues and banks operate Mifid investment services. Mifid II was implemented into Irish law by the Markets in Financial Instruments Regulations (SI 375 of 2017) (Mifid II Regulations). As a result of Brexit contingency planning for a number of both EU and non-EU headquartered firms, Ireland has recently seen an influx in newly authorised Mifid firms and management companies using a Mifid top-up licence.

Mifid II has indirectly impacted the asset management industry. Undertakings for collective investment in transferable securities (Ucits), management companies (Mancos) and alternative investment fund managers (AIFMs) that are not authorised to carry out Mifid investment services, are now required to comply with certain Mifid II outsourcing provisions in the context of sub-delegation.

Implementation in Ireland

The Mifid II Regulations implement Mifid II directly into Irish law and do not introduce any gold-plated requirements. The National Competent Authority, the Central Bank of Ireland, relies on and follows guidance issued by the European Securities and Markets Authority (Esma).

The Irish Safe Harbour exemption for third countries carrying out wholesale investment services has been substantially maintained. Firms continue to be considered as not operating in Ireland where there is no branch established in Ireland and they provide services to professional clients and eligible counterparties. However, the Safe Harbour exemption does have a more limited scope under the Mifid II Regulations than the previous regime. The narrowing of the Safe Harbour regime means that some third country investment firms, which previously qualified, will no longer do so. To continue providing

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investment services in Ireland, such firms must be authorised by the Central Bank. A number of firms intend to rely on this exemption to provide services to eligible clients post a hard Brexit.

The optional exemption from authorisation is available to firms qualifying under Article 3(1)(a), (b) and (c) of Mifid II (the exempt firms); however, such firms must comply with Article 3(2), which provides that certain analogous requirements to those under Mifid II are imposed on exempt firms.

Third country firms that provide investment services to retail clients and 'elect-up' professionals are required to establish a branch in Ireland.

National discretion will be exercised to implement criminal sanctions for infringements of Mifid II. Maximum fines, of €5 million for natural persons and €10 million for legal persons, will be imposed under the Markets in Financial Instruments Bill 2018 and enacted into Irish law. These sanctions are aligned with fines under the Central Bank's Administrative Sanctions Regime.

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A level playing field

There is a significant discrepancy between the requirements in Article 3(2) of Mifid II and the current domestic provisions under the Investment Intermediaries Act 1995 (IIA) and the Central Bank's Consumer Protection Code (CPC). The Mifid II investor protections do not apply to exempt firms, and these firms are only subject to investor protection requirements under the CPC. To address the potential for any regulatory arbitrage, the CPC has been amended so that exempt firms will be subject to certain enhanced CPC investor protections, similar to the Mifid II Protections. The exempt firms are now held to the same standards as Mifid II in respect of product governance, remuneration requirements, suitability assessments and disclosure requirements, amongst other provisions. This ensures the end client will be afforded sufficient protection regardless of the applicable regulatory regime.

Relating to extraterritorial issues, collective investment undertakings and their managers are exempt from Mifid II. However most Irish Ucits Mancos and AIFMs follow the 'delegated' model, whereby the day-to-day asset management and marketing and distribution of a fund is delegated to third party asset manager(s) or distributors, which are either authorised in the EU to provide Mifid individual portfolio management or advisory services and / or receipt and transmission of orders, or are subject to an equivalent regime outside the EU.

Ucits Mancos and AIFMs are impacted because the relevant service providers need information (such as product costs and charges, and target market information) and other support in order to meet their obligations under Mifid II. Other services providers to Ucits and AIFs not directly affected by Mifid II are being requested to provide information as part of the provision of this support (for example, fund administrators / transfer agents). Therefore, Ucits Mancos and AIFMs and Mifid firms are working together to ensure all the necessary Mifid II information is available so that the end client receives the Mifid II investor protections.

Mifid II outsourcing provisions have had an indirect impact on non-EU portfolio management firms and investment advice firms that act as delegates to Mifid II investment management firms, such as US sub-advisors.

The outsourcing requirements in Article 31 of the Mifid II Delegated Regulation 565/2017 means that a Mifid firm sub-delegating portfolio management must remain fully responsible for discharging all of its obligations under Mifid II, and the end client must receive investor protections to the same extent as if a delegation had not taken place in circumstances where the Mifid firm has delegated portfolio management to a non Mifid firm.

Further clarity is required on the extent of the application of the Mifid II investor protection requirements to non-EEA sub-delegates. The Central Bank has not outlined any interpretative position relating to the delegation by Mifid firms regulated by the Central Bank of portfolio management to such firms specifically in the context of whether there should be a 'pushdown' of Mifid unbundling requirements.

Research: conflicting approaches and guidance

Following the introduction of rules around inducements and research under Mifid II, there has been much debate on this topic within the industry, with concern that the rules are overly burdensome and are impacting upon the provision of research in the sector.

Given this and the Central Bank's interaction with industry in Ireland in the lead up to the implementation of Mifid II, a focused review is currently underway by the Central Bank to assess how investment firms are treating investment research under Mifid II. To date some of the key trend arising is that there has been limited use of the option to use a research payment account (RPA) to charge clients for the cost of research used in the provision of an investment service.

The Central Bank has said it will not be introducing guidance on Mifid II. Firms are required to rely on the guidelines published by Esma and Esma's Q&A tool.

However, currently the Central Bank are in the process of assessing the information received which will enhance its understanding of the impact that the rules are having as industry settles into a second-year cycle post-implementation of Mifid II. This will allow the Central Bank to provide meaningful feedback to Esma on the matter, in keeping with the push towards supervisory convergence across the EU.

Trading and market structure

The pre- and post-trade transparency regime is now applicable to non-equity instruments, including structured finance products, bonds, emissions allowances and derivatives. This has increased the regulatory burden of trading these products.

The continuous supervisory focus on Mifid II implementation is a key priority for the Central Bank's Market Surveillance Team. The Central Bank has carried out an analysis of the vast amounts of data submitted to it as part of firms' compliance with Mifid II.

The analysis of the data has provided the Central Bank with insights into the activities of the firms it supervises, most notably in the areas of transparency, the growth of alternative liquidity sources (such as periodic auctions and systematic internalisers) and the use of algorithmic trading strategies.

In July 2019, Esma also announced that it would not be renewing the temporary restriction on the marketing, distribution or sale of contracts for differences (CFDs) to retail clients in the EU. Prior to Esma announcing this, the Central Bank issued an announcement in June 2019 stating it would be banning the sale of binary options to retail investors and restrict the sale of CFDs. This is not surprising as the Central Bank has consistently followed Esma with its approach on other Mifid II related issues.

Even though there has been no guidance from the Central Bank on the scope of certain transactions and despite the fact that the Central Bank has been delayed in implementing machine to machine transaction reporting systems, firms have gone to great lengths to obtain resources to comply with their transaction reporting and transparency requirements. The Central Bank expects all firms to be in compliance with the requirements at this stage.

As regards trading venues and exchanges, the Share Trading Obligation (STO) has impacted, to some degree, international booking arrangements and the practice of transmitting orders to non-EEA venues/counterparties, where there are deeper pools of liquidity. Under the STO, a Mifid firm has to ensure that the trades it undertakes in shares which are admitted to/traded on a trading venue, will take place on a trading venue, systematic internaliser, or a third-country trading venue assessed as equivalent.

Brexit will have a significant impact on the STO in an Irish context as many Irish companies are dual listed on the London Stock Exchange and the Irish Stock Exchange, (Euronext Dublin). In May 2019, Esma provided updated guidance that no liquid British shares will be subject to the STO. However, all EU shares will still be subject to the STO and therefore execution must happen on an EU venue.

Whilst this is a positive step, it still leaves a number of issues for EU shares. Even though a share has an EU ISIN, it does not necessarily mean that its main pool of liquidity is in the EU.

When it comes to legal entity identifiers (LEI), financial counterparties have proactively sought LEI codes to ensure they can continue to trade with Mifid firms or on Mifid regulated exchanges.

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Boosting investor protection

Mifid II introduced increased investor protections for Mifid firms in Ireland. Due to the CPC amendments incorporating certain Mifid II investor protections, IIA-authorised brokers carrying out similar investment activities in relation to similar products are required to provide equivalent protections to their clients.

Additionally, the Central Bank is very focused on individual accountability for senior management and boards. The Central Bank issued a 'Dear CEO Letter' in April 2019 that reiterated the importance of compliance with the Fitness and Probity Regime (Regime) by regulated financial service providers.

It was intended that Mifid II would iron outsome of the conduct issues in wholesale market activity, however the Central Bank has recognised this not to be the case. In response, it launched a wholesale conduct risk thematic inspection of firms engaged in wholesale market activity.. In its communications with firms, the Central Bank expects firms to have a strong Conduct Risk Framework in place which looks to 'identify, mitigate and manage market conduct risk'.

The Central Bank is also carrying out a best execution thematic inspection of investment firms authorised under Mifid II.

Rules of attraction

Ireland has established itself as a gateway to Europe, particularly from an investment management perspective. As Ireland applies Mifid II directly into law, without any gold plating, and has an engaged and proactive regulator, Ireland is an attractive EU jurisdiction for Brexit contingency plans.

Mifid II will enhance investor protections, market transparency and will strengthen financial services regulation in Ireland. The fact that Ireland has implemented Mifid II directly and that the Central Bank relies on EU guidance means that there is a uniform interpretation of the requirements. As noted above, this is an attractive factor for firms when deciding their Brexit contingency plan and in recent months we have seen a number of newly authorised Mifid firms enter the Irish market.

However, for smaller domestic Mifid II firms the enhanced investor protection and operational requirements exposes these firms to great risk of regulatory non-compliance and makes it more expensive to provide services. Some of these small domestic firms are now merging with bigger firms to ensure their businesses continue to be viable.