Welcome to the MiFID II Masterclass Series

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MiFID II - Masterclass Series Session 2
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Overview

- From Delegated Directive (DD) 2031
  - Safeguarding
  - Inducements
- From Delegated Regulation (DR) 2398
  - Costs and Charges
- From Delegated Directive (DD) 2031
  - Product Governance
Safeguarding of Client’s Financial Instruments and Funds

- Record keeping, accuracy and audit, regular reconciliations
- Third party financial instruments to be separately identifiable
- Adequate organisation arrangements to minimise the risk of the loss or diminution of client assets
- There are some differences to the recent CAR / IMR regulations:
  - Art 2(5) – specific list and entities it should be available to
  - Art 3(1) – “expertise and market reputation of the third party”
  - Art 4(3) – 20% limit to group entities
Inducements

- Article 24(9) the fee / commission must be
  
  *Is designed to enhance the quality of the relevant service*
  
  *Does not impair compliance with firm’s duty to act honestly, fairly and professionally in accordance with the best interests of its clients*
  
  *The existence, nature and amount are disclosed (or method of calculating the amount)*
  
  *Or is a fee necessary for the service eg custody costs, settlement and exchange fees – where no conflict possible*
Inducements

- “Paying or being paid a commission or providing or being provided with a non-monetary benefit in connection with the provision of an investment service or ancillary service”
- Condition 1: An additional or higher level of service
  - Wide range of instruments
  - Annual review
  - Added-value tools - information
- Condition 2: Inducement does not directly benefit the recipient firm without benefit to the client
Inducements

- Condition 3: Inducement is justified by the provision of an on-going benefit
- Condition 4: Evidence that it enhances service to client – internal list
- Condition 5: For payments to / from 3rd parties
  - Disclose to client
  - Shall provide exact amount later if initially an estimate is given
  - Annual statement
Inducements – Advice / Portfolio Management

- Fees/ benefits from 3\textsuperscript{rd} parties cannot be retained
- Can only accept “minor non-monetary benefits”
  - Information on instrument / service which is generic or personalised
  - Written material commissioned by an issuer
  - Conferences training for a specific instrument or service
  - Hospitality de minimus
  - Others which a Member State may deem capable of enhancing quality of service
Inducements in Respect of Research

- Not regarded as an inducement, if certain conditions met
  - Condition 1: A direct payment by the investment firm from its own resources
  - Condition 2: Payment from a separate research account paid by client
  - Condition 3: Budget to clients and costs to clients

- Ongoing operational requirements for research account
  - Very specific disclosure of info to clients and / or regulator
  - Defined procedures for operation of the account (can be delegated)
Key Departures from ESMA’s Technical Advice

- UCITS Management Companies and AIFs included
- Research charge can be imposed as part of the transaction costs
- Implied research charges clarified
- Third party material included in list of acceptable non-minor benefits
Information on Costs – DR 2398

- Costs and charges to be disclosed
- Professional client / eligible counterparty waiver narrowed where advice or portfolio management and the instruments “embed a derivative”
- Costs set out per Annex II – itemised
- UCITS KIID may not be full disclosure
- Use “actually incurred costs” as a proxy
- Illustration showing cumulative effect of costs
Product Governance - Manufacturers

- Apply to investment firms which – create, develop, issue and / or design investment products
- New product approval process to include impact assessment
- Conflicts of interest assessment & collaboration agreements
- Staff competence and compliance oversight
- Target market assessment & scenario analysis
- Information for distributors (art. 24 MiFID II)
- Product review
- Crucial event / Scenario analysis
Product Governance – Distributors

- Product governance process to ensure needs, characteristics and objectives of target market are met
- Identify target market the product is not to be sold to
- Provide sales information to manufacturers
- Monitoring and reporting by regular compliance reports
- A firm can be both a manufacturer and distributor under these rules
- The rules only apply to MiFID but can you justify not applying them to other non-MiFID products?
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