



# MiFID II - Introduction & Investor Protection Q&A

## Background

MiFID II contains significant changes to the framework set out in MiFID I, including in relation to investor protection and the functioning of financial markets. This document is intended to provide a high level overview of MiFID II with a focus on the changes related to investor protection and conduct of business requirements.

### 1. What is MiFID I?

MiFID I is the Markets in Financial Instruments Directive (Directive 2004/39/EC, "MiFID I"). It has been in force since November 2007. MiFID I set out the framework for the provision of investment services and activities in Europe. It aimed to improve the competitiveness of EU financial markets by creating a single market for investment services and activities and ensuring a high degree of protection for investors in financial instruments, such as shares, bonds and derivatives.

### 2. What is MiFID II?

Following a review, MiFID I is being significantly revised through the implementation of MiFID II. MiFID II consists of a Directive 2014/65/EU ("Recast MiFID") and a Regulation (EU) No 600/2014 ("MiFIR"), together "MiFID II". Recast MiFID needs to be transposed into national law by each Member State by 3 July 2017; whereas MiFIR will have direct effect without needing to be transposed. There is also some "level two" legislation (Regulatory Technical Standard "RTS" and Delegated Acts "DA") supporting MiFID II, some of which is still being finalised (RTS related to commodities and ancillary services).

The European legislation currently available for MiFID II is available on the European Commission's [website](#).

### 3. When does MiFID II apply from?

As a result of the legislative delay, MiFID II will now apply from 3 January 2018 (instead of 3 January 2017).

### 4. What are the key topics of MiFID II?

MiFID II introduces:

- **Stronger investor protection:** MiFID II introduces stronger organisational requirements around conflicts of interest, client asset protection and product governance. It also strengthens conduct requirements (for example extending the scope of appropriateness tests and the type of information that needs to be provided to clients). Independent advice is distinguished from non-independent advice and limitations are imposed.



Regulation **MiFID II**  
November 2016

#### Key Dates

##### 20 October 2011

The European Commission adopted a legislative proposal for the revision of MiFID in the form of a revised Directive (Recast MiFID) and a new Regulation (MiFIR), together MiFID II.

##### 15 April 2014

MiFID II was adopted by the European Parliament.

##### 12 June 2014

MiFID II was published in the EU Official Journal - level 1 publication.

##### 3 July 2017

Deadline for transposition of MiFID II into national law by member states.

##### 3 January 2018

Application of MiFID II within all Member States

- **More robust and efficient market structures:** MiFID I introduced Multilateral Trading Facilities (“MTFs”) as a trading venue and covered regulated markets, but MiFID II introduces a new type of trading venue: the Organised Trading Facility (“OTF”) for non-equity instruments. MiFID II also seeks to further align the requirements applicable to regulated markets and MTFs. The obligations of a systematic internaliser “SI” (a firm which on an organised, frequent, systematic and substantial basis, deals on own account when executing client orders outside a regulated market, an MTF or an OTF) have been expanded to non-equity instruments.
- **Increased transparency:** Pre- and post-trade transparency requirements are being extended (subject to certain available waivers) under MiFID II to non-equity instruments (for example bonds, structured finance products and derivatives) and equity like instruments (for example depositary receipts, ETFs and certificates). Under MiFID I, transparency requirements were limited to shares admitted to trading on a regulated market. As a result of these extended transparency requirements, more information will be available to the public on trading in financial instruments.
- **New on-venue trading obligations:** For the European implementation of the G20 commitment in relation to on venue trading, MiFID II introduces a trading obligation for certain derivatives, i.e. classes (or subset of such classes) of derivatives that have been mandated as subject to the mandatory clearing under EMIR and admitted to trading / traded on a trading venue and considered sufficiently liquid to trade only on the specified trading venues. In addition, a new trading obligation has been introduced for shares admitted to trading on a trading venue. This will mean that more trading takes place on trading venues rather than OTC.
- **A stricter framework for commodity derivatives markets:** MiFID II introduces new position reporting, position monitoring and position limit regimes in relation to commodity derivatives. Certain of these regimes can extend to firms not authorised under MiFID II.
- **Reinforced supervisory powers:** MiFID II reinforces the role and powers of regulators, who, in coordination with the European Securities and Markets Authority (ESMA), will be able to ban specific products, services or practices that threaten investor protection, financial stability or the orderly functioning of markets.
- **Transaction Reporting:** Under MiFID II, the obligation to report transactions to the relevant competent authority increases in scope and prescription. The reporting obligation would apply to all financial instruments admitted to trading or trading on a trading venue, whose underlying is such a financial instrument or is an index of a basket composed of such financial instruments under MiFID II. To meet their reporting obligations, firms will be required to collect more information from their clients such as legal entity identifiers (LEIs).

## 5. Who does MiFID II apply to?

MiFID II applies to investment firms, market operators, and data reporting services providers. Certain provisions are also applied to credit institutions providing investment services / activities.

In some cases firms / entities may be subject to certain MiFID II requirements even if they are not authorised in a European Economic Area member state under MiFID II (e.g. their trades may become subject to the derivatives on venue trading obligation or fall within the commodity derivatives position limits regime).

Certain exemptions from authorisation in MiFID I are also being narrowed, for example in relation to commodity dealer exemptions and exemptions available to algorithmic traders. Therefore, more firms / entities may fall within the scope of authorisation and regulation under MiFID II.

## 6. What are the services and activities that are in scope of MiFID II?

Investment services and activities within scope of MiFID II include inter alia dealing, underwriting, placing, portfolio management and investment advice and ancillary services such as investment research. A full list of in scope services and activities is set out in Sections A and B of Annex I of Recast MiFID.

## 7. What products are in scope of MiFID II?

In summary, products within scope of MiFID II include transferrable securities (e.g. bonds and shares negotiable on the capital market), derivatives (including commodity derivatives), and units in collective investment schemes.



Emission allowances have been added in MiFID II as financial instruments.

In addition certain MiFID I obligations are extended to structured deposits under MiFID II.

A full list of financial instruments in scope of MiFID II is set out on Section C of Annex I of Recast MiFID.

## **8. Are there changes to client classification categories?**

MiFID I recognised that investors have different levels of knowledge, skill and expertise and that client categories should reflect this. MiFID II only makes limited changes to the client categories set out in MiFID I. There are still three categories of client: retail clients, professional clients and eligible counterparties (Note that eligible counterparties can be categorised as such in relation to a limited range of business: predominantly dealing services). The main change in MiFID II relates to the categorisation of municipalities and local public authorities (i.e. reclassified as retail clients with the possibility to ask for treatment as professional clients on request). It will be for each member state to determine any criteria for being able to treat these clients as elective professional clients.

## **9. Will MiFID II have impact on the documentation provided to clients by firms providing investment services?**

There will likely be an impact on client facing documentation which may result in a repapering exercise with clients. However, the impact on client facing documentation will need to continue to be assessed in light of European and national legislation.

## **10. What are the key elements of the investor protection framework under MiFID II?**

The investor protection framework set out in MiFID II aims at ensuring that investment firms act in the best interest of clients through a number of requirements, including but not limited to: (i) product design and governance; (ii) suitability and appropriateness; (iii) inducements; and (iv) disclosure on costs and charges requirements.

## **11. What are the enhancements to product governance introduced by MiFID II?**

Under MiFID II, firms will need to make specific arrangements for product governance, and establish effective policies and arrangements to identify the category of clients to whom products and services are provided. Firms that manufacture financial instruments will need to identify the target market of end clients, ensuring that these are distributed to the identified target market and periodically review such identification and the performance of the products they offer. Firms that offer or recommend financial instruments not manufactured by them will also need to obtain and understand the relevant information concerning the product approval process, including the identified target market and the characteristics of the product.

## **12. Are there any changes to the suitability and appropriateness requirements?**

**Suitability of investment advice:** As under MiFID I, when providing investment advice or portfolio management, suitability requirements apply when providing a client with a personal recommendation. There have not been significant changes to the suitability assessment obligation under MiFID II although new criteria (e.g. client's ability to bear losses and risk tolerance) and new obligations (e.g. to provide additional information in suitability reports) have been added.

**Appropriateness:** MiFID I currently requires firms, when providing an investment service other than investment advice / portfolio management, to obtain information regarding a client's knowledge and experience relevant to a specific service or product, to enable the firm to assess whether it is appropriate for the client. Firms are not required to carry out this appropriateness assessment where the service provided is execution-only and the financial instruments are "non-complex." MiFID II decreases the scope of financial instruments deemed to be "non-complex" (for example, structured UCITs) thereby requiring an appropriateness assessment for additional financial instruments.

## **13. Is the best execution obligation changing under MiFID II?**

The best execution obligation set out in MiFID I is not being significantly amended in MiFID II.

MiFID II is, however, introducing new disclosure requirements, under which a firm will be required to make



public annually, for each class of financial instruments, the top five execution venues in terms of trading volumes where they executed client orders in the preceding year and information on the quality of execution obtained. In addition, firms will be required to publish on a quarterly basis execution quality data in relation to the execution venues which they use.

#### **14. Is the inducements rule changing under MiFID II?**

MiFID II introduces more prescriptive requirements in relation to the payment / receipt of inducements by investment firms (e.g. in relation to the meaning of the quality enhancement test). MiFID II also introduces new restrictions in relation to inducements received by firms providing independent investment advice or portfolio management, where MiFID II prohibits payments from third parties apart from certain “minor non-monetary benefits”. This has an impact, in particular for European independent investment advisers and portfolio managers, on how they can receive research.

#### **15. What does MiFID II require in relation to cost and charges disclosure?**

MiFID I currently contains requirements for firms to disclose costs and charges information to clients. Under MiFID II, costs and charges disclosure requirements are expanded to cover all client types. There is also more prescription under MiFID II in relation to the information required to be provided.

### **FURTHER QUESTIONS**

If you have any other comments or questions, please contact the BNP Paribas European Regulatory Reform Team ([regreform.eu@uk.bnpparibas.com](mailto:regreform.eu@uk.bnpparibas.com)) or your usual relationship or sales contact.

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