

Breakfast Briefing MiFID Implementation in Ireland



FINANCIAL REGULATOR
Rialtóir Airgeadais

Presenter: Con Horan

Agenda



- Welcome and Introduction Con Horan, Prudential Director
- General Overview Anne Troy, Head of ISPS
- Organisation and Internal
Controls Noel Thompson, Senior
Regulator, ISPS
- Conduct of Business Terry Murphy, Senior
Regulator, CPC
- Questions and Answers

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INTRODUCTION:

- Objectives of MIFID
- Approach to Implementation

Objectives of MiFID

- Completion of single market
- Foster competition and a level playing field
- Enhanced protection of investors and consumers

The principles we followed

- Principles-led approach
 - Responsibility of firms through senior management and Boards of Directors
- Key Objectives –
 - investor protection
 - sound, competitive market of good repute
- Avoid gold plating
- Follow CESR Guidance
- Open, transparent and consultative
(www.financialregulator.ie/investment_services/mifid)
- Proportionate and risk-based

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INTRODUCTION:

- Scope of MiFID
- Prudential supervision – what will change
- What will FR expect from firms from 1 November
- How will FR monitor/supervise adherence to MiFID

Scope of MiFID

- Issues of scope – new services, new instruments
 - (Mapping of current authorisations)
- Prudential, Consumer Protection and Market Transparency/transaction reporting issues
 - (see [www.financialregulator.ie/Investment Services/MiFID](http://www.financialregulator.ie/Investment%20Services/MiFID))

Prudential Regulation – what will change

- No change in many areas
 - Regular contacts – internal audit, fit and proper, changes in ownership as before
 - On and Off-site oversight by Financial Regulator as before
- Organisation and Controls
- Capital requirements and financial reporting – see CRD changes from 1 January 2008

Transaction Reporting

- Who has to report?
 - Market facing firms (firms that execute orders on SX's and regulated markets)
- What is reported?
 - Details of transactions including buy/sell, time and date, for whom (own account or as agent of client).
- How to report?
 - Electronically by online entry or by uploading file
 - OK to use agents – e.g., Crest
- When?
 - By close of day following day of execution

What Firms should do

- Be familiar with MiFID requirements
- Board of Directors to decide
 - how each requirement will be implemented, taking proportionality into account where that is provided for
 - what measures the firm should put in place
- Decisions should be recorded
- Board should consider and review firm's compliance with the requirements regularly
 - At least once per year or
 - in the event of a significant development of the firm
- Board should consider continuing appropriateness of implementation in firm regularly

What Financial Regulator will do

- We will check compliance of all MiFID firms with these requirements on a regular basis.
- Programme of oversight will include:
 - Desk-based review of decisions of Board of Directors
 - Follow-up on site in a sample of cases
- In 2008, good faith standard will be applied
- From 2009, best practice standard will be applied.

Summary



- Get familiar with all MiFID requirements
- Information available on Financial Regulator website
- Keep a watch on CESR website
- Boards of Directors should be reviewing and determining how firm will comply with MiFID
- Supervisors will be reviewing compliance in 2008

MiFID Organisation & Internal Controls



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Implementation of MiFID for Investment Firms – Organisation & Internal Controls

Agenda

- MiFID Workstream Activities
- MiFID Directives & MiFID Regulations 33 to 37
- Books & Records
- New Supplementary Supervisory Requirements
- Financial Regulator contact with firms

Implementation of MiFID for Investment Firms – Organisation & Internal Controls

- **MiFID Workstream Activities - Summary**
 - Membership – Financial Regulator & Industry Participants
 - Scope – to review current Prudential Requirements and relevant Prudential Requirements contained in MiFID
 - Workstream Meetings – Minutes on Website (4 in total)
 - Governance Requirements in CRD - similarities

Implementation of MiFID for Investment Firms – Organisation & Internal Controls

- **MiFID Workstream Activities - Outputs**
 - Develop revised Prudential Requirements in Handbook –
New Supplementary Supervisory Requirements
 - Consider issuing information/guidance to industry
regarding new MiFID Requirements
 - Provide training to all relevant Financial Regulator staff

Implementation of MiFID for Investment Firms – Organisation & Internal Controls

■ MiFID Directives

- Level 1 Directive 2004/39/EC – Article 13 Organisational Requirements
- Level 2 Directive 2006/73/EC - Articles 5 to 9 General Org/Compliance/Risk Man/Int Audit/Senior Management
- Level 2 Directive 2006/73/EC - Article 51 Retention of Records

Implementation of MiFID for Investment Firms – Organisation & Internal Controls

■ MiFID Regulations 33 to 37

- 33 – Organisational Requirements
- 34 – Business Procedures/Internal Control/Reporting
- 35 – Monitoring & Evaluating Systems/Control Mechanisms

Compliance Function/Officer

- 36 – Risk Management Function

Risk Management Policies/Function

- 37 – Internal Audit Function/Senior Management

Internal Audit Function/Controls

Implementation of MiFID for Investment Firms – Organisation & Internal Controls

■ MiFID Regulations 33 to 37 - Interpretation

- 34(3)(b) – Business Continuity Policy (in the case of an interruption ... preserve essential data and functions... maintain investment services or where not possible... the timely recovery and resumption of such)

Query regarding 'timely resumption' ? Timeframe?

- Firms must have a BCP in place to ensure continuity of operations
- Where that is not possible (exceptional circumstances) all reasonable efforts must be made to resume investment services i.e. therefore timely recovery/resumption

Implementation of MiFID for Investment Firms – Organisation & Internal Controls

■ MiFID Regulations 33 to 37 – General Issues

- MiFID framework is built upon a platform that emphasises the importance of the firm's Board & Senior Management assuming responsibility for assessing and reviewing the effectiveness of its Organisation & Internal Controls
- Therefore, it is for a firm's Board & Senior Management to decide how best their firm will comply with MiFID requirements
- MiFID allows flexibility of approach and there is a need to take into account the nature, scale and complexity of business activities. This necessitates firms considering the issue of proportionality to ensure compliance with the requirements in relation to the risks posed

Implementation of MiFID for Investment Firms – Organisation & Internal Controls

- **MiFID Regulations 33 to 37 – General Issues cont'd**
 - There is no doubt that certain investment firms had a significant amount of work to do (internal/client facing)
 - It is necessary for all firms to undertake their own internal reviews to assess the state of their readiness for the introduction of MiFID and the consequent changes that the new legal regime may bring to their business activities
 - Immediately post MiFID implementation, it is not envisaged there will be a rigid enforcement of the new requirements where firm's can demonstrate a genuine and reasonable attempt to comply with the requirements
 - Currently, no Level 3 – CESR guidance on organisation and internal controls (may not be any)

Implementation of MiFID for Investment Firms – Organisation & Internal Controls

■ Books & Records

- Regulation 40(5) sets out that the Financial Regulator shall prepare and maintain a list of minimum records firms are required to keep under the Regulations
- Following consultation, CESR issued a list of minimum records that must be maintained and the list issued by the Financial Regulator mirrors the CESR list
- In general, the purpose of the list is to outline those areas where records are required to demonstrate compliance
- All policies must be maintained in writing and the minimum list of records contains issues relating to organisation & internal controls

Implementation of MiFID for Investment Firms – Organisation & Internal Controls

- **New Supplementary Supervisory Requirements**
 - Derived from a review of the General Supervisory & Reporting Requirements contained in the Handbook
 - Each requirement assessed individually and then either retained, amended or deleted
 - New document now primarily relates to the submission of information by firms to the Financial Regulator
 - New requirements are not going to be imposed on a statutory basis and therefore, failure to comply will not be considered to be a prescribed contravention for the purposes of the Administrative Sanctions Procedure

Implementation of MiFID for Investment Firms – Organisation & Internal Controls

- **New Supplementary Supervisory Requirements – cont'd**
 - Firms will be expected to comply in full with the requirements and non-compliance with the requirements could indicate a more fundamental failing with a firm, requiring supervisors to conduct investigations into the circumstances surrounding the reasons for non-compliance
 - Most of the changes to the existing requirements relate to requirements being deleted
 - Requirement 1.5 – Regulatory Status
 - Requirement 3.1 – Parent Company Accounts
 - Requirement 4.6 – Irish Stock Exchange Member Firms Weekly Reports

Implementation of MiFID for Investment Firms – Organisation & Internal Controls

■ Financial Regulator contact with Firms

- Extent of internal review undertaken by the firm
- Results/outcome of the internal review undertaken
- Details of the changes identified from the internal review
- Progress made by firm in implementing necessary changes
- Regulation 37(4) – Assess/Review Policies & Procedures
- Regulation 37(5) – Written Report to Senior Management

Markets in Financial Instruments Directive [MiFID]

Conduct of Business



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Presenter:
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Conduct of Business

- **Client categorisation**
- **Suitability and appropriateness**
- **Information to clients**
- **Reporting to clients**
- **Best execution**
- **Client order handling**
- **Inducements**
- **Conflicts of interest**
- **Complaints handling**
- **Personal transactions**
- **Investment research**



Client categorisation

■ Retail

- Highest level of protection

■ Professional

- Regulated entities
- Large institutions
- Governments
- Retail clients that meet certain criteria, i.e., two of the following:
 - Carried out average 10 relevant transactions per quarter over previous four quarters
 - Relevant portfolio exceeding €500,000
 - Worked for at least one year in a relevant professional position in financial sector

Client categorisation

- **Eligible counterparty**
 - **General conduct of business obligations do not apply**
 - **Some professional clients may automatically be treated as eligible counterparties [Regulation 111(1)]**
 - **The facility to categorise a client as eligible counterparty is limited to the following transactions**
 - Executing orders
 - Dealing on own account
 - Receiving and transmitting orders

Client categorisation



- **Clients may request a change of categorisation**
 - **Retail client may request change to professional**
 - **Professional client may request change to retail or eligible counterparty**
 - **Eligible counterparty may request change to retail or professional**
- **Firm is not obliged to accede to such requests**



Suitability

- Applies when firms provide investment advice or portfolio management services
- Firm must obtain necessary information to ensure the transaction satisfies the following:
 - Meets the investment objectives of the client
 - Client is financially able to bear any related investment risks
 - Client has necessary knowledge and experience to understand the risks



Know your client: Investment advice or portfolio management services

- **Retail clients: firms must obtain information about the client's:**
 - Knowledge and experience
 - Financial situation
 - Investment objectives
- **Professional clients: firms can assume:**
 - the client has the necessary knowledge and experience
 - The client is able to financially bear any investment risks [only applies to certain types of professional client and to the service of investment advice]

Appropriateness



- **Applies when firm is providing services other than investment advice or portfolio management**
- **Firms must determine whether the client has the necessary knowledge and experience to understand the risks in relation to a product or service**



Know your client: services other than investment advice or portfolio management

- **Retail clients: firms must obtain information about the client's knowledge and experience**
- **Professional clients: firms can assume the client has the necessary knowledge and experience**



Non-complex instruments

- **No information is necessary when executing orders and/or receiving and transmitting orders in non-complex instruments if the following conditions are met:**
 - **The service relates to non-complex instruments**
 - **It is provided at the initiative of the client**
 - **The client has been informed that the firm is not required to assess suitability**
 - **The firm complies with the conflicts of interest requirements**



Non-complex instruments

- **In order to be considered non-complex, a financial instrument must meet the following criteria:**
 - **The instrument is not a derivative**
 - **The instrument is highly liquid**
 - **The instrument does not involve an actual or potential liability that exceeds the cost of acquiring it**
 - **Adequate information on the instrument is publicly available and easily comprehensible**



Information to clients

- **Firms must provide clients with information in relation to:**
 - Their categorisation
 - The firm and its services
 - Financial instruments
 - Costs and charges
 - Best execution policy
- **The firm must also disclose information in relation to:**
 - Conflicts of interest
 - Inducements

Reporting to clients

- **Execution of orders other than portfolio management**
 - Contract notes [content set out in Regulation 96(6)]
- **Portfolio management**
 - **Periodic statements every six months, except**
 - Where client requests, every three months
 - Where client elects to receive contract notes and does not trade in derivatives, every 12 months
 - Where firm is authorised to manage leveraged portfolio, every month

Best execution

- **Firms must take all reasonable steps to obtain best possible result for clients**
- **Factors to be taken into account include:**
 - **Price, costs, speed, likelihood of execution and settlement, size, nature or other relevant considerations**
- **Firms must determine the relative importance of the factors by taking into account the characteristics of:**
 - **The client, the client order, the financial instruments and the execution venues**

Best execution



- **Firms must establish and implement effective arrangements and an order execution policy to allow them to obtain the best possible result for their clients**
- **Arrangements are the means the firm employs to obtain best possible result**
- **Policy describes the most important/relevant elements of the arrangements**

Best execution: content of execution policy

- **Strategy and key steps to obtain best possible result and how those steps enable the firm to obtain best possible result**
- **Account of relative importance of best execution factors, or process for determining relative importance**
- **Venues/entities the firm uses**

Best execution

- Appropriate information must be provided to clients, to enable them to make informed decision about whether to use the services of the firm
- Where firm executes orders, obtain prior consent of clients to the execution policy
- Obtain prior express consent before executing orders outside a regulated market or MTF
- Monitor on a regular basis to ensure firm has complied with its policy/arrangements and delivered best possible result
- Review at least annually, and when material change occurs

Client order handling

- **Ensure orders promptly and accurately recorded and allocated**
- **Inform clients of any difficulty in carrying out orders**
- **Accounts settled promptly and correctly**

Inducements

- Includes all fees, commissions and non-monetary benefits
- In order to be regarded as acting honestly, fairly and professionally in the best interests of a client, firms may only receive or pay the following:
 - Fee, commission or non-monetary benefit paid to or by the client or a person on behalf of the client
 - Proper fees, e.g., settlement and exchange fees, regulatory levies, legal fees

Inducements

- **Fee, commission or non-monetary benefit paid to or by a third party if:**
 - **The existence, nature and amount, or method of calculation, is clearly disclosed**
 - **It is designed to enhance the quality of the service**
 - **It does not impair compliance with the firm's duty to act in the best interests of clients**



Conflicts of interest

- Firms must take all reasonable steps to identify conflicts of interest that may damage the interests of clients
- Maintain effective arrangements with a view to taking all reasonable steps to prevent conflicts of interest adversely affecting the interests of clients
- Establish, implement and maintain written conflicts of interest policy

Conflicts of interest



- Policy should identify circumstances that give rise to a conflict of interest and specify procedures and measures to manage such conflicts
- Where such arrangements are not sufficient, firms must disclose the general nature and sources of conflicts
- Firms must keep a record of activity where conflict of interest has arisen or may arise

Complaints handling

- **Firms must:**
 - **Maintain effective and transparent procedures for reasonable and prompt handling of complaints, and**
 - **Keep a record of the complaint and measures taken for its resolution**

Personal transactions

- Firms must have arrangements aimed at preventing certain activities in the case of relevant persons
 - who are involved in activities that may give rise to a conflict of interest or
 - have access to inside information or other confidential information

Personal transactions



- **The arrangements must be designed to ensure that**
 - **Each relevant person is aware of the restrictions**
 - **The firm is informed promptly of personal transactions**
 - **Record is kept of personal transactions**

Investment research



- **Firms must have arrangements restricting financial analysts and other relevant persons from:**
 - **Undertaking personal transactions**
 - **ahead of publication of investment research**
 - **without prior approval of firm's legal or compliance function**
 - **Trading ahead of publication of investment research**
- **And prohibiting:**
 - **Acceptance of inducements**
 - **Promising issuers favourable research coverage**
 - **Reviewing draft of investment research where the draft includes a recommendation or target price**



MiFID Regulations

- **The conduct of business requirements are set out in**
 - **Part 7**
 - **Regulations 74 to 78**
 - **Regulations 80 to 87**
 - **Regulations 92 to 103**
 - **Regulations 106 to 108**
 - **Regulation 111**
 - **Part 5, Regulations 38 and 39**
 - **Part 12, Regulations 151 to 155**



Committee of European Securities Regulators [CESR]

- **CESR has issued guidance on two conduct of business issues:**
 - **Best execution**
 - **Inducements**
- **To ensure consistent implementation and supervisory convergence**
- **Financial Regulator intends to follow CESR guidance**

Industry Working Group



- Financial Regulator invited industry representatives to participate on Working Group to discuss conduct of business issues
- Feedback on these discussions, in a questions and answers format, was issued on 11 July and 15 October
- Feedback document to be issued by end week
- Also available on web-site www.financialregulator.ie

Feedback



- **Firms are encouraged to read the document, which should provide clarification in relation to many of the most common conduct of business questions**
- **If questions remain or issues arise, firms should address to:**
mifidconductofbusiness@financialregulator.ie

Questions



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