



luxembourg newsflash 20 february 2013

MiFID II - Presidency's Compromise

I. Scope of MiFID II

1. The Parliament had suggested extending the application of certain MiFID II requirements to insurance undertakings and insurance intermediaries, including tied insurance intermediaries when selling or advising clients in relation to insurance-based investments. The Council's Compromise does not take over this extension of the scope of MiFID II.
2. The MiFID II Proposal upgraded the safekeeping and administration of financial instruments from an ancillary service to an investment service fully subject to MiFID II requirements. The Parliament's Position is to maintain such service as a mere ancillary service. The Council's Compromise now suggests upholding the upgrade provided for in the MiFID II Proposal.

II. Free provision of services by third country firms

The Council's Compromise contemplates substantially amending the regime pertaining to the provision of investment services by third country firms on a cross-border basis or through the establishment of a branch in a Member State.

1. According to the Council's Compromise, third country firms which contemplate providing investment services to retail clients established in a Member State must establish a branch in the relevant Member State pursuant to the same conditions as those set out in the MiFID II Proposal, with one exception: the EU Commission is no longer required to adopt a decision of equivalence relating to the third country of origin in order for investment firms of such third country to be able to provide services in the Member State where the branch is established.

In addition, the Council's Compromise precludes the EU branch of a third country firm from benefiting from the European passport.

2. The Council's Compromise suggests eliminating the harmonised regime pertaining to free provision of services on a cross-border basis by a third country firm to eligible counterparties and professional clients *per se* (i.e. without the establishment of a branch) that was provided for in the draft Commission MiFIR proposal. It seems that the conditions to be complied with by a third country firm in order to provide services on a cross-border basis to eligible counterparties and professional clients *per se* in a Member State will thus have to be defined at the level of each Member State.

3. Finally, the Council's Compromise expressly sets out that a third country firm which provides investment services to clients established in a Member State at their exclusive initiative is not required to establish a branch. This provision was previously only set out in the recitals of the MiFID II Proposal.

III. Corporate governance

The Parliament's Position had softened certain of the new requirements pertaining to corporate governance contained in the MiFID II Proposal and went further in relation to others (e.g. the Parliament's Position introduced specific requirements applicable to "non-executive directors" and imposed a requirement for investment firms to implement gender quota, whereas it softened the rules relating to restrictions on the number and categories of directorship that a member of the management body of an investment undertaking may hold at the same time). The Council's Compromise has not retained certain of the amendments proposed by the Parliament's Position while adding others.

1. The Council's Compromise no longer contains specific requirements applicable to "non-executive directors" or the requirement for investment firms to implement gender quota.
2. The Council's Compromise confirms the Parliament's Position in relation to the holding of positions by members of the management body (i.e. limitation of the number and categories of directorships that a member of the management body of an investment undertaking which is significant in terms of size, internal organisation, nature, scope and complexity of its activities can hold at the same time) and grants the capacity to competent authorities to otherwise authorise such holding of positions.
3. The Council's Compromise defines a series of tasks that must be undertaken by the nomination committee.

IV. Whistleblowing

The MiFID II Proposal provided for mechanisms to "encourage" the external reporting by employees of financial institutions of breaches of the provisions of MiFIR and of national provisions implementing MiFID II. The Parliament's Position had clarified the correlation between such rules and confidentiality rules by providing that employees may not be prevented by any confidentiality rules from disclosing breaches committed within the financial institution. The Council's Compromise does not uphold such clarification.

The Council's Compromise, however, suggests adding a provision pursuant to which employees who report breaches should, at a minimum, have appropriate protection against retaliation, discrimination or other types of unfair treatment.

V. Recording of telephone conversations and electronic communications

The MiFID II Proposal provided for the obligation for investment firms to record telephone conversations and electronic communications regarding at least the services of reception and transmission of orders, execution of orders and dealing on own account.

The Parliament's Position had set out several amendments to the MiFID II Proposal which soften such obligations (e.g. capacity granted to Member States to exempt investment firms which do not, as their main business, provide the services of reception and transmission of orders or execution of orders from the obligation to record telephone conversations and electronic communication,

capacity to rely on minutes of calls which are signed by the client instead of telephone records, reduction of the retention period).

The Council's Compromise provides more details on the requirements relating to the recording of telephone conversations or electronic communications that must be complied with by investment firms.

1. An investment firm shall take all reasonable steps to record relevant conversations and communications made with, sent from or received by equipment provided by the investment firm to an employee or contractor or the use of which by an employee or contractor has been sanctioned or permitted by the investment firm.
2. The relevant conversations shall include conversations or communications intended to result in transactions even if those conversations or communications do not lead to the conclusion of such transactions.
3. Finally, an investment firm shall take all reasonable steps to prevent an employee or contractor from making, sending or receiving relevant telephone conversations and electronic communications on privately-owned equipment which the investment firm is unable to record or copy.

VI. Rules of conduct

The Parliament's Position provided for several amendments to the MiFID II Proposal which, overall, are not supported or which have been softened by the Council's Compromise.

1. Inducements

The Council's Compromise maintains the prohibition for an investment firm which provides investment advice on an independent basis or which provides portfolio management from accepting and retaining¹ fees, commissions or any monetary benefits paid or provided by any third party or a person acting on behalf of a third party in relation to the provision of the service to clients. The Council's Compromise broadens the scope of application of such prohibition by including non-monetary benefits, unless such non-monetary benefits are minor, in the interest of the client and are clearly disclosed to the client.

2. Remuneration policies

The Parliament's Position provides for several obligations relating to the manner in which an investment firm remunerates its staff, appointed representatives or other investment firms which were not set out in the initial MiFID II Proposal.

The Council's Compromise suggests similar but simplified obligations. The Council's Compromise sets out a general requirement for investment firms to ensure that they do not (i) remunerate or assess the performance of their staff in a way that conflicts with its duty to act in the best interest of their clients and, in relation to retail clients, (ii) make any arrangement by way of remuneration or otherwise that could incentivise their staff to recommend a particular financial instrument when the investment firm could offer a different financial instrument which would better meet the client's needs.

*

¹ The Council's Compromise sets out a prohibition on accepting and retaining fees, commissions etc. while the MiFID II Proposal prohibited investment firms from accepting or receiving fees, commissions, etc.

The Council's Compromise adds the capacity for Member States, in exceptional circumstances only, to impose additional requirements (gold plating) relating to remuneration and inducement policies where these requirements are objectively justified and proportionate so as to address specific risks to investor protection or market integrity.

In such case, the relevant Member State must notify the Commission prior to the entry into force of the additional requirement and the Commission shall provide its opinion on the proportionality of and justification for the additional requirements.

3. Appropriateness assessment

The Council's Compromise does not follow the Parliament's Position which suggested waiving the requirement of an appropriateness assessment for structured undertakings for collective investment in transferable securities (UCITS) in case of execution only services.

4. Pre- and post- service information obligation

The Parliament's Position had subjected investment firms to more stringent information obligations, both prior to and following the provision of certain services especially in relation to investment advice and portfolio management services.

The Council's Compromise does not follow the Parliament's approach with the exception of an obligation relating to the provision of investment advice to retail clients. Prior to the transaction or immediately thereafter, in the event that the transaction has been concluded by means of distance communication, the investment firm is required to provide a written statement on suitability to its client specifying how the advice given meets the preferences, needs and other characteristics of the client.

VII. Miscellaneous

We have highlighted in this newsflash the main amendments to the initial MiFID II Proposal and the Parliament's Position by the Council of the European Union that are particularly relevant for private bankers and investment firms involved in the placement of financial instruments. The Council's Compromise also adds a series of requirements in relation to market transparency and integrity, sanctions and other areas which are not covered herein.

Next steps

The onus will be on the European Parliament to take a position once the final version of the Council's Compromise paper will be adopted.

For further information please contact:



Philippe Dupont
Partner,
Head of Banking &
Insurance
Tel : +352 40 78 78 205
philippe.dupont@arendt.com



Glenn Meyer
Partner,
Banking & Financial
Services
Tel : +352 40 78 78 352
glenn.meyer@arendt.com