

How will MiFID II impact Australian firms?

September 2017



Introduction

What is MiFID II?

The Markets in Financial Instruments Directive (MiFID II) is a regulatory framework of the European Union (EU) legislation for investment firms that provides certain services linked to “financial instruments” (e.g. shares, bonds, derivatives). Its aim is to improve the functioning of financial markets and strengthen investor protection.

Non-European Economic Area (EEA) institutions will be impacted both, directly by virtue of having a licensed branch in the EEA, and indirectly through dealing with EEA parties, products and venues. In addition, branches of EEA firms operating in non-EEA countries will have to comply with certain MiFID II requirements.

It is therefore critical for firms to understand the new rules and implement the necessary changes on time for the January 3, 2018 deadline.

Australian MiFID II?

In December 2016, the Federal Government released a proposals paper entitled "Design and Distribution Obligations and Product Intervention Power" this picks up much of the content of MiFID II's Product Governance topic. The Treasury confirmed that they expect legislation to be passed in 2017.

Scope of MiFID II?



Trading or servicing EU clients



Trades booked on EEA entity directly or back to back or remote



Trading on EEA venues / EEA underlyings on non-EEA venues



Distribute products in the EEA



Distribute EEA manufactured products in Australia



Provide execution and research to EEA managers

Interactions with the EEA

The branch or subsidiary of a non-EEA firm is required to be authorised in order to perform its investment activities and services within the EEA. Without an authorisation, third country (non-EEA) firms are limited in the direct activity they can undertake in the EEA on a cross border basis.

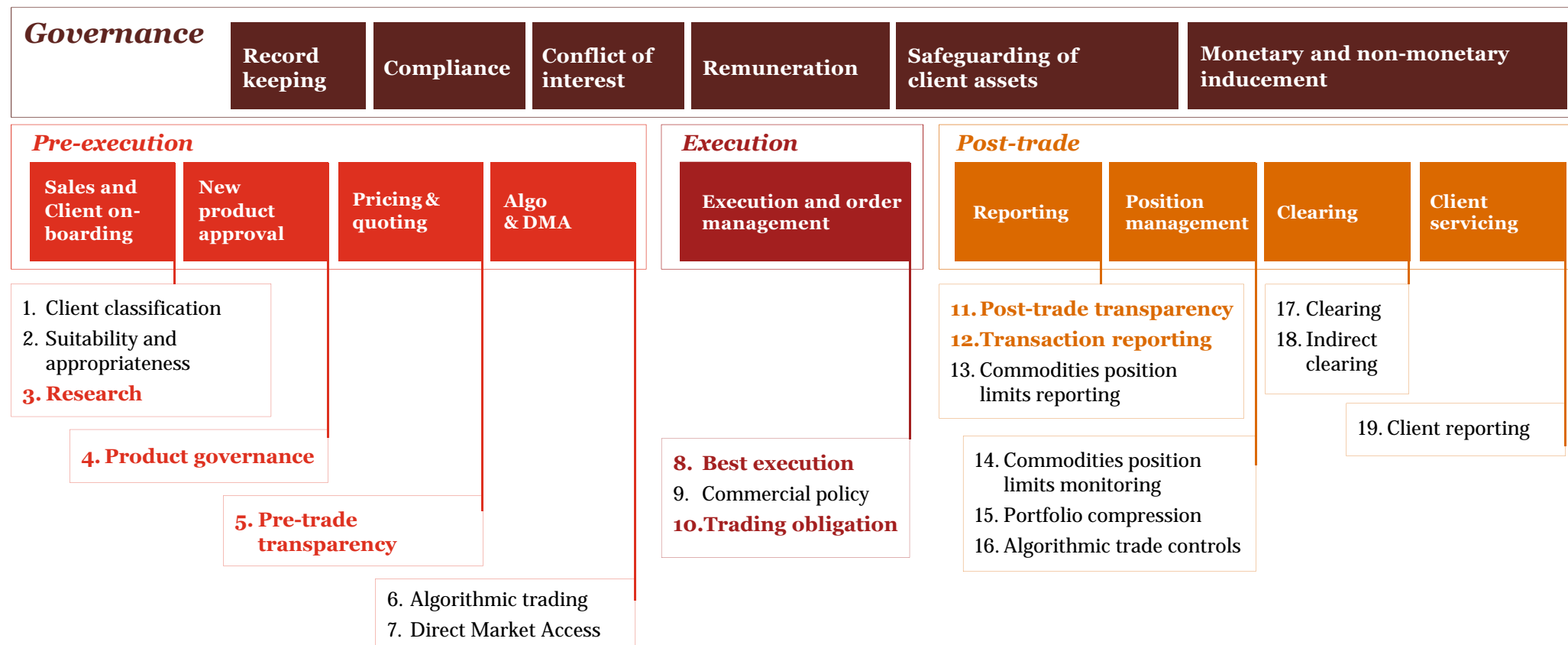
Australian firms can gain access to the EEA in three different ways:

- Through the operation of a **branch**
- Through a **subsidiary**
- Through **limited direct activity** from entities **outside the EEA** with EU clients (e.g. online access, direct client orders)

Authorised branches or subsidiaries are subject to the requirements of MiFID II.

Impacts of MiFID II

MiFID II will significantly impact upon a firm's business model, product lifecycle and technology infrastructure.



Our experience suggests that most Australian operations will be impacted in the areas of transaction reporting, pre-/ post-trade transparency, trading obligation, research and best execution. It should be noted that buy vs sell side will have different priorities. In addition, in quite a few cases whilst non-EA firms do not have a direct obligation to meet MiFID II requirements they might have to do so in order to allow their EU counterparts to meet their compliance obligations.

Sample scenarios and possible impact on Australia market players

All Australian firms should have obtained a Legal Entity Identifier (LEI) and performed a review of their counterparty relationships and trade booking flows. Enhancements in systems and controls should have been implemented and firms should be in the process of testing for completeness and accuracy. The cases below are just a few examples of where Australian firms operating in the EEA or branches of EEA firms in the region will have to satisfy a number of MiFID II requirements.

Buy side		Sell side	
Scenario	Impacted Areas	Scenario	Impacted Areas
<p>Australian AM trades with EEA counterparty in the EEA on behalf of Australian clients</p>	<p>Transaction reporting – Australian AM will be required to provide specific information such as LEI to the EEA counterparty for the purpose of regulatory reporting.</p> <p>Research – Under the ban of inducements buy side firms must separately pay for investment research and demonstrate that research contributes to better investment decisions and is therefore not an inducement. The EEA broker will not be able to continue providing execution and research as a bundled service.</p> <p>Commodity derivatives – National regulators will set position limits for commodity derivatives traded on Regulated Markets, Multilateral Trading Facilities, Organised Trading Facilities as well as economically equivalent OTC derivatives. Limits will apply on fund level. Australian managers managing EEA funds or Australian funds with EEA counterparties, the position limits may have an impact on the portfolio management for commodity related strategies</p>	<p>Australian firm trading/ executing on Australian market on behalf of EEA sell side broker for EU clients</p>	<p>Transaction reporting – Australian firms will be required to provide specific information such as LEI to the EEA counterparty for the purpose of regulatory reporting.</p> <p>Best execution – EEA brokers will require Australian firms to demonstrate that orders are handled in the best interest of the client, e.g. through an order execution policy.</p> <p>Trading obligation for shares – MiFID II requires financial instruments to be traded on an EEA venue or an equivalent third-country venue. For Australian firms to execute trades in dual listed instruments in Australia, the local market has to be deemed equivalent.</p>
<p>Australian AM with EEA subsidiary/ branch servicing EU clients</p>	<p>Establishment of a branch – Under MiFID II, Australian firms will have to establish a branch in the EEA in order to provide MiFID activities and services (e.g. investment advice, dealing on own account) to EU clients.</p> <p>While the subsidiary/ branch will be subject to direct MiFID II impact in the EEA, the Australian parent company may be indirectly impacted in various areas, such as Transaction Reporting, Recordkeeping, Dissemination and Consumption of Research, depending on the operating model of the subsidiary/ branch, and level of operational support it receives from the parent company.</p>	<p>Australian AM with EEA subsidiary/ branch servicing EU clients</p>	<p>Product governance – Australian firms manufacturing products that are distributed in the EEA are required to offer and recommend products and services in accordance with the needs, characteristics and objects of an identified target market. Further, they may also be required to provide sales information and target market analysis to the assist in meeting their post-sale responsibilities of distributors.</p>
<p>Australian AM provides advisory services to EEA AM</p> <p>Illustrative</p>	<p>Indirect impact</p> <p>Australian AM without a physical presence in the EEA is not regulated under MiFID II, however, it may be indirectly impacted through its sub-advisory relationship with the EEA firm which has to comply with MiFID II.</p>	<p>Australian firm provides services to EU</p> <p>Illustrative</p>	<p>Research – Brokers will need to unbundle the costs of research from execution so that European buy-side firms can make explicit payments for research received. Australian brokers may be required from their EEA counterparties to unbundle payments for execution and advisory services, value their research or manage the dissemination of valuable/ non-valuable research to them/ their clients.</p>

How can PwC help?

PwC has a global MiFID II delivery team that has supported a number of institutions with their compliance efforts. Our unique insights and delivery tools can help you focus on the right priority areas.

1 *Rules interpretations for Australia*

We have significant insights into the legal entity and business impact of MiFID II requirements and have supported a number of institutions (asset managers, retail and investment banks) with the interpretation of the extra-territorial aspects of the rules. In particular, we have a strong understanding of the impact of these rules and how they affect Australian firms that want to provide services within the EEA as well as the impact of the rules for EEA firm branches or subsidiaries operating in Australia.

2 *Implementation health check review and testing*

MiFID II has had a long implementation timeline with various updates on the regulatory expectations having occurred. As such, business requirements would have gone through a number of iterations. Our industry experts can review your implemented solutions and test completeness against latest regulatory requirements to assess health of the program. In addition, we can support your efforts in conducting implementation tests before January 2018.

3 *Controls testing*

MiFID II implementation requires significant number of changes in firms' data, system and process infrastructures. Firms will need to ensure the appropriate controls have been put in place to monitor and manage those changes moving forward. Our experts can help with controls and governance testing of your front office, compliance and operational risk functions.

4 *Post go-live remediation*

Regulators will expect financial institutions to be able to demonstrate compliance. We can support you with performing an assessment of your Day 1 compliance and help you identify, prioritise and remediate areas post go-live.



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