COMPLIANCE

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# NEWSLETTER

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## REGULATION UPDATES:

- Draft Banking Law
- Draft AIFM Law
- Draft EMIR Law
- Draft Financial planning Law
- Draft Insurance Law
- Draft Marketing Royal Decree
- Draft FSMA Product Ban Regulation

Dear Members,

Dear Colleagues,

We are delighted to propose you this new issue of the Newsletter which we believe is full of useful information.

The new PRIIPS (this time with two "ii" as insurance based investment products are in scope) has arrived together with its KID (this one with a single "i", the KIID for UCITS remaining separate at least for 5 years). You will find more info on page 5.

This mandatory pre-contractual disclosure document should allow retail investors to better understand and compare the investment products of various providers. The Regulation shall apply 2 years after its entry into force; i.e. mid 2016. Please note that the proposed Directive on UCITS V has also been approved (pages 11 and 12).

MiFID II was also adopted by the EU Parliament on April 15. Pages 10 and 11 refer to this important piece of legislation. You will find a summary below.

MiFID II and especially MiFIR announce in my opinion the beginning of the end of OTC transactions and of execution only.

- The scope is broadened in terms of financial instruments (emission allowances, commodity derivatives) and by restricting exemptions for certain firms.

- A huge impact is expected and therefore strategic decisions will have to be made with regard to investment advice (independent or not with the consequences, periodic assessment of suitability or not) and portfolio management (no inducements).

- The investment advice will be written (in line with the client's preferences, needs and other characteristics).The same goes for the periodic report in portfolio management (the investments meet the client's preferences, objectives and other characteristics).

- The ability of the client to bear losses and his risk tolerance will have to be better taken into account.

- The combination of loans to carry out a transaction in execution only in which the firm is involved is no longer allowed.

- A number of financial instruments become complex (structured UCITS and deposits, bonds and money markets instruments which embed a derivative).

- A general obligation is introduced to act honestly, fairly and professionally and to communicate in a fair, clear and not misleading way towards eligible counterparties (which do not encompass automatically local public authorities anymore).

- Broader information is expected with regard to all services (venues, costs, charges, cross-selling).

- Telephone conversations and face-to-face meetings have to be recorded and kept for 5 to 7 years.

- Remuneration policies have to be reviewed to ensure that the firm acts in the best interest of the client, encourage responsible business conduct and fair treatment of clients.

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## EDITORIAL (PART II)

• Disclosing conflicts of interest in a summary form is no longer allowed.

• The role of the Board of Directors is extended (e.g. define and approve a policy as to services, activities, products, operations in accordance with the risk appetite, including stress testing).

• The product approval process is reinforced for manufacturers (e.g. distribution to identified target market, regular review). The same goes for distributors if different from manufacturers (e.g. understand the characteristics of the instrument, the target, assess the client's needs).

• Following execution (based on total consideration for the retail client), each firm shall inform the client where the order was executed (top 5 venues to be published annually).

• MiFIR introduces the OTF (firms executing internal matching systems between clients'orders need to register either as MTF or OTF with all consequences (no execution against proprietary capital for an OTF except for sovereign debts without liquidity, matched principal trading allowed with the client's prior consent except for derivatives subject to EMIR clearing duty, no combination with an Systematic Internaliser status).

• Systematic internalization is not limited to shares admitted to trading on a RM or a MTF anymore but is also possible for equity like instruments traded on a RM, MTF or OTF and for a.o. bonds traded on a venue where there is a liquid market with the significant extension of the pre-trade transparency obligation as a consequence.

• All investment firms which conclude transactions in equity and non equity like instruments traded on a trading venue outside a trading venue (OTC) will have to disclose as close to real time as possible the volume and the price of the transaction which will be published via an Approved Publication Arrangement. All post trade reporting will be collected in a Consolidated Tape Provider".

• The obligation to report to competent authorities already applicable to all financial instruments admitted to trading on a RM are now broadened to all instruments also traded on a MTF or an OTF.

• Regulators must apply position limits on the size of a net position a person can hold in commodity derivatives traded on trading venues and equivalent OTC contracts at an aggregate group level. Members of RM/MTF and clients of OTC must daily report their positions and those of their clients. Market operators on a trading venue must control open interest positions.

• MiFIR imposes to trade on trading venues shares admitted on trading venues unless it is infrequent, or carried out between professionals/eligible counterparties and the trade does not influence the price process. The same is valid for derivatives with a speculative purpose above a threshold.

• Firms engaged in algorithm trading (parameters of orders are established with no human intervention) must have risk controls and systems in place to prevent disruption of the markets and market abuse. Regulators and venues need to be informed of the use of such system. Placed orders need to be recorded in an approved firm in case of high frequency algorithmic trading.

• Pre-set trading and credit thresholds checks must be installed by firms offering direct market access to clients.

• Conflicts of interest and information duties apply to insurance intermediaries and insurance companies with regard to insurance investment based products.

• Last but not least, sanctions are reinforced and include criminal sanctions.

No need to say that the respective managements of the various financial institutions will have to take strategic options taken into account these considerations and (continued on next page)

**MiFID II and MiFIR announce the end of OTC transactions and of execution only**

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## EDITORIAL (PART III)

their consequences which will be further detailed in the 110 ESMA Technical Standards awaited. No need either to say that ICT colleagues should more than ever be ready to start huge developments to be compliant on time. Of course, the role of the Compliance Officer will be crucial both in the interpretation of the provisions with a view on their implementation by the first line of defense (in other words the businesses concerned) making sure that an approach enhancing the protection of the clients is guaranteed as well as in the subsequent monitoring.

Insurance companies are not in a more comfort zone and bank insurers combine both privileges. I draw their attention on the recent FSMA Circular extending the rules of conduct of MiFID I to the insurance sector in Belgium, the so called "AssurMiFID" on which a detailed presentation was given by FSMA's representatives on April 24. The concept of tied agent is quite central in the Circular to determine the responsibilities as to suitability. If categorization, orders, best execution, research, personal account dealing and safeguarding of clients'assets are not relevant, the duty of care, the so called "zorgplicht" is essential. Execution only being out of question, the advisory situation is utmost frequent. If the bank is the tied agent of the insurer, a uniformity of approach is desirable towards the clients in this respect. If the results of the suitability test taking into account the standardized risk profile and the individual answers are sufficiently detailed, materialized and recorded, they should suffice to cover the need analysis ("behoeften en verlangens"). For non-tied agents, the sector might wish to produce a standardized list of questions although not all questions have to be asked on all products if the investment is limited. Insurers should particularly grant attention to conflicts of interest and commissions/inducements for which the current MiFID rules applicable to the banking sector can be useful.

Beside the 3 existing Royal Decrees of 21/02/14, the expected "Transversal" Royal Decree on product sheets, the one on product labelling (both having a broader scope than insurances) and the interdiction of commercialization of certain products to retail clients, three more FSMA "Règlements" are awaited: one on information on costs and charges, one on archiving data and one on reporting. A cartography will follow, work programs provided by the FSMA will certainly be helpful for the further monitoring as it was the case for banks under MiFID. Trainings will also be organized. Finally, FSMA's Inspections initially probably more oriented towards awareness will take place.

All this knowing that IMD II is also on its way and that neither the Codification on Belgian insurance legislation nor the "Economisch Wetboek" might be forgotten.

I would end with two other important topics. One is the draft General Data Protection Regulation voted on March 12 which foresees the right to have data erased, the restricted access to data to a limited number of individuals, the notification of breaches to the regulator, the increased role of the data protection Officer (assessment impact, bi-annual review...) and high sanctions in case of non-conformity (100 millions euros or 5% annual worldwide turnover).

Another one is the new banking law. A recent study day on corporate governance with closing remarks of the Minister Geens was particularly interesting. After the crisis, the responsibility of which was at least partially attributed to a lack of adequate governance, after CRD IV and the fit and proper requirements, the liabilities of board members undoubtedly increase as their oversight on Management becomes deeper. Four committees have to be in place: Audit (split from Risk and Compliance), nomination and remuneration. It will be unusual in practice for a nomination committee, composed of a limited number

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**Beside the 3 existing Royal Decrees more FSMA regulations are awaited**

## EDITORIAL (PART IV)

of Board members to assess the integrity, expertise, reputation and availability of their peers in their absence. The delineation of tasks between the risk committee and the remuneration committee regarding the impact on the remuneration policy on risks will not always be easy to make as there seems to be a partial duplication of tasks (art. 29 par. 4 et art. 30 par. 1).

The role of the control functions is also reinforced. Regarding the Compliance function, the provisions of art. 87bis of the law dated 02.08.02 and of the current Circular with its rights and duties remain fully applicable. Once a year, a report will be addressed to the Board. In principle, "la fonction de gestion des risques est dirigée par un membre du comité de direction dont c'est la seule fonction particulière pour laquelle il est individuellement responsable." Although no exception was foreseen in the draft version, the final text mentions: " In afwijking van..., kan de toezichthouder, met het oog op de versterking van de autonomie en de onafhankelijkheid van de risicobeheer functie en de compliance functie..., toestaan dat het lid van het directiecomité dat verantwoordelijk is voor de risicobeheerfunctie, ook verantwoordelijk is voor de compliancefunctie, op voorwaarde dat de twee betrokken functies los van elkaar worden uitgeoefend."

In my personal opinion the argument seems fallacious. I do not see why the risk function would be more or less independent if the compliance function is also supported by the CRO at Management Committee level as the risk management function is already under the governance of the CRO anyway as per art. 37. I do not see either why the Compliance function would gain independence in such a situation as the CRO being a Management member is finally bound by the solidarity in the collegial decision process governing a Management body which is by definition not the case of the Compliance Officer.

His/her independence remains however guaranteed by his/her current faculty to address himself /herself directly to the Chairman of the Board and by the necessary approval of the Board in case of dismissal (with prior information to the regulator).

Finally, do you know Thomas Haider? He is the former Chief Compliance Officer (COO) of MoneyGram , a company which admitted having criminally aiding wire fraud and failing to maintain effective AML program. The company paid 100 millions $ to the US Treasury Department. It is said that Thomas Haider might also now face a fine in the amount of 5 millions $.

In February FinCen also suspended the CCO of Brown Brothers Harriman fining him 25k $ and assessing a record 8 millions $ fine against the firm for AML failures.

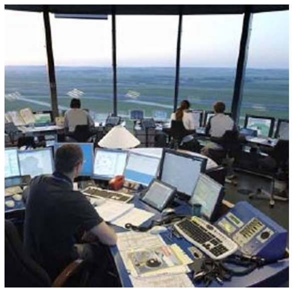
That is probably what individual liability truly means in the States at least...for the time being... And for sure, this is not fallacious.

If you have had the courage to read this long Editorial which I hope you will still have found useful, I wish you a pleasant reading of the other articles.

With kind regards.

Marie-France De Pover

Chairwoman



**The new banking law reinforces the role of the control functions**

## FATCA: LATEST DEVELOPMENTS IN BELGIUM

On 23 April 2014, Minister of Finance, Koen Geens and US Ambassador, Mark Storella signed the bilateral Intergovernmental Agreement (IGA) intended to implement the Foreign Account Tax Compliance Act (FATCA). You can find the press release of the Minister of Finance by clicking on this link. Febelfin, Beama and Assuralia are currently finalizing the Belgian Guidance Notes in close cooperation with representatives of the SPF/FOD Finance. These Notes will help the financial sector to interpret and implement the IGA.

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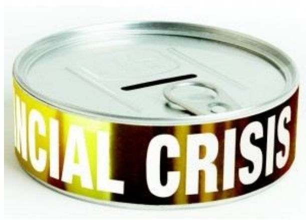
## EBA GUIDELINES ON THE APPLICABLE NOTIONAL DISCOUNT RATE FOR VARIABLE REMUNERATION




On March 27, 2014, the European Banking Authority (EBA) published its final Guidelines for the calculation of the discount rate for variable remuneration and clarifying how it should be applied. These Guidelines will support EU Member States in the calculation of the ratio between the variable and fixed component of total remuneration and refer to services or performances provided from 2014 onwards.

The variable component of remuneration for categories of staff whose professional activities have a material impact on the risk profile of the institution is capped at 100% of the fixed remuneration or at a maximum of 200%, subject to shareholders' approval. EU legislation foresees that when calculating the ratio between variable and fixed component, Member States may allow institutions to apply a discount rate of 25% (or less subject to national laws) of the variable remuneration, provided the latter is paid in instruments that are deferred over a period of not less than 5 years.

The discount rate consists of the national annual inflation rate and the average interest rate of EU government bonds, as well as and an incentive factor linked to the use of long-deferred instruments which increases with the length of the actual deferral period. The discount rate is calculated taking into account the length of the period between the award and the vesting of variable remuneration.

The notional discount rate, if the Member State has implemented this national discretion, can be applied to the variable remuneration for the performance year 2014 and onwards. For this purpose, institutions will be able to use the same discount rate in all relevant institutions at a group level.

The Guidelines have been developed on the basis of Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 (CRD) on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms.

**Investment product manufacturers could be liable for loss caused by inapproriate KIDs**

## EU PARLIAMENT APPROVED THE PROPOSED REGULATION ON KEY INFORMATION DOCUMENTS

On April 15, 2014 the EU Parliament approved the new rules on the information that small investors must be given before they sign a contract.

Clear, comparable and complete information on investment products is to be provided in a mandatory, three-page A4 Key Information Document (KID).

### Easy-reading KIDs

Before signing a contract, all small (non-professional) investors should be given three-page A4 standard format KIDs to help them to understand and compare packaged retail and insurance-based investment products (PRIIPs), estimate the total cost of their investment as well as be aware of its risk-reward profile.

KIDs should be clearly separate from advertising materials, consistent with any binding contractual documents and prepared by a clearly identifiable entity.

Where applicable, the KID should also include a "comprehension alert" warning that "you are about to purchase a product that is not simple and may be difficult to understand".

### Products covered...

The new rules would apply to all investment products intended for small investors.

### ...and not covered

However, they would not apply to non-life insurance products, life insurance contracts where the benefits under the contract are payable only on death or in respect of incapacity due to injury, sickness or infirmity, or deposits other than structured deposits and securities. Officially recognised pension schemes would be also exempted from the scope of the legislation.

## ESMA ISSUES GOOD PRACTICES FOR STRUCTURED RETAIL PRODUCT GOVERNANCE

On March 27, 2014 the European Securities and Markets Authority (ESMA) has published an opinion on structured retail products, setting out good practices for firms when manufactu-ring and distributing these products.

These good practices that product providers could put in place to improve their ability to deliver on investor protection in particular focus on:

- the complexity of the structured retail products they manufacture and distri-bute;
- the nature and range of investment services and activities undertaken in the course of business; and
- the type of investors they target.

ESMA expects national com-petent authorities to embed these good practices in their supervisory approaches to structured retail product providers.

ESMA considers these good practices will bridge the gap until the MiFID II product governance requirements are further developed and in place. The good practices cover the following areas:

- general organisation of product governance arran-gements;
- product design;
- product testing;
- target market;
- distributing strategy;
- value at the date of is-suance and transparency of costs;
- secondary market and redemption; and
- review process.

Although the good practices focus on structured pro-ducts designed for retail customers, they may also be a relevant reference for other types of financial ins-truments such as asset-backed securities, or contin-gent convertible bonds, as well as when financial ins-truments are being sold to professional clients.

MEPs push for card payment fee caps and online payment safeguards

## PSD II AND REGULATION ON INTERCHANGE FEES FOR CARD-BASED PAYMENT TRANSACTIONS

On April 3, 2014, the EU Parliament's plenary session has voted on the EU Com-mission's proposals for a new Payment Services Di-rective (PSD II) and a regula-tion on interchange fees for card-based payment tran-sactions.

**Fees: clear and capped**

The service or "interchange" fees that banks charge for processing transactions under schemes such as Visa and MasterCard, would be capped at 0.3% of the tran-saction value for credit card transactions and 7 euro cents, or 0.2% of the tran-saction value (whichever is lower), for debit card ones.

**Online payment safeguards**

Online payment security rules would be updated to keep pace with technical progress, market develop-ments and the constantly growing number of pay-ments made online. Online payment service users would also get a uniform set of information for example all charges, execution times, contact information and where applicable exchange rates, would have to be clearly stated.

Unauthorised payments would have to be refunded within 24 hours of their being noticed and clients could be obliged to bear losses resulting from the illegal use of a lost or stolen payment card or device up to a maximum of €50.

**Lower costs and wider choice of payment services**

A payer using an online ac-count would have the right to use payment software or devices provided by an au-thorised third party of his choice and have his pay-ments executed on his be-half by this provider without extra charges to be added by the payee. Payment ser-vice providers would be required to disclose the actual cost of processing payments on request.

## EU PARLIAMENT APPROVES DIRECTIVE ON PAYMENT ACCOUNTS

The Directive passed by EU Parliament on April 15, 2014 is all about empowering users of common standard payment services.

### Open access

Anyone legally residing in the EU, even with no fixed address, would be able to open a basic account. However, member states could require would-be customers to explain their interest and purpose in opening such an account in a specific country, provided they fully respect the customer's fundamental rights and do not make this request too difficult or burdensome.

### Clear Information

The law should ensure that anyone who opens a payment account is able to understand its fees and interests rates and to compare account offers – this information should be clear and standardised across the EU.

To benefit from the best offers, customers should be able to switch to another bank account in the EU for a reasonable fee. Switching between bank should be done by a receiving bank at the request of the account holder

### Basic account

“Basic” payment accounts would enable customers to pay in and withdraw cash and execute payment transactions within the EU, including transactions through a payment card and online.

To take effect, the new rules must be officially approved by the member states.

## REFORMING EU AUDIT SERVICES TO RESTORE INVESTORS' CONFIDENCE

A draft agreement with the Council of Ministers on legislation to open up the EU audit services market beyond the dominant "Big Four" firms and remedy auditing weaknesses revealed by the financial crisis was endorsed by Parliament on April 3, 2014. The draft also aims to improve audit quality and transparency and to prevent conflicts of interest.

The role of auditors has been called into question due to the financial crisis. The “audit reform package” consists of a regulation and a directive.

### Better quality auditing

The legislation requires auditors in to publish audit reports according to international auditing standards. For auditors of public-interest entities (PIEs), such as banks, insurance companies and listed companies, the text requires audit firms to provide shareholders and investors with a detailed understanding of what the auditor did and an overall assurance of the accuracy of the company's accounts.

### Opening up the EU audit market to competition and improving transparency

As one in a series of measures to open up the market and improve transparency, the approved text prohibits "Big 4-only" contractual clauses requiring that the audit be done by one of these firms.

To ensure that relations between the auditor and the audited company do not become too cosy, MEPs agreed on a “mandatory rotation” rule whereby an auditor may inspect a company's books for up to 10 years, which may be increased up to 14 additional years in the case of joint audits, i.e. when a firm is being audited by more than one audit firm.

### Independence of non-auditing services

To preclude conflicts of interest and threats to independence, EU audit firms will be required to abide by rules mirroring those in effect internationally. EU audit firms will moreover be prohibited from providing several non-audit services to their clients, including tax advisory services that directly affect the company's financial statements or services linked to the client’s investment strategy.

The publication of the new rules is foreseen for the second quarter of 2014.

**European Parliament backs Commission proposals on new rules to improve the quality of statutory audit**

## FCA PUBLISHES THEMATIC REVIEW ON ADVISER CHARGES AND SERVICES OF RETAIL INVESTMENT FIRMS

Too many advisory firms are not being clear with consumers on how much advice costs, the type of service they offer (whether it is restricted and the nature of the restriction) and what on-going services they provide. The Financial Conduct Authority's (FCA) latest review into disclosure by financial advisers found that 73 per cent of firms failed to provide the required information on the cost of advice.

The first cycle of research was published in July 2013 and found that progress had been made and there was a general willingness to adapt to new rules. However, common issues were uncovered and further examples of good and poor practice were produced to help firms.

However, in the latest research, despite sufficient time and the straightforward nature of the requirements, issues remain. In particular, the second cycle found that:

- 58% of firms failed to give clients clear upfront generic information on how much their advice might cost
- 50% of firms failed to give clients clear confirmation on how much advice would cost them as individuals
- 58% of firms failed to give additional information on charges, for example not highlighting that on-going charges may fluctuate
- 31% of firms offering a 'restricted' service (they cannot advise on the full range of financial products and providers available) were not being clear they were restricted, or the nature of the restriction; and
- 34% of firms failed to give clients a clear explanation of the service they offer in return for an ongoing fee and/or their right to cancel this service.

Whilst failings appear widespread across the industry, wealth managers and private banks performed poorer than other firms in nearly all aspects.

The failings identified in the FCA's review suggest some consumers could be unaware of, or even mis-led, in relation to the cost of advice (both initial and ongoing), the type of service offered by a firm (i.e. whether it's independent or restricted), the nature of a firm's restriction (if applicable), or the service they can expect to receive in return for the on-going fee.

**FCA review shows too many advisory firms are not yet clear enough with their customers on their charges and services**

## US SEC CHARGES HEWLETT-PACKARD WITH FCPA VIOLATIONS

On April 9, 2014, the US Securities and Exchange Commission charged Hewlett-Packard with violating the Foreign Corrupt Practices Act (FCPA) when its subsidiaries in three different countries made improper payments to government officials to obtain or retain lucrative public contracts.

The SEC's order instituting settled administrative proceedings finds that the Palo Alto, Calif.-based technology company's subsidiary in Russia paid more than $2 million through agents and various shell companies to a Russian government official to retain a multi-million dollar contract with the federal prosecutor's office.

In Poland, Hewlett-Packard's subsidiary provided gifts and cash bribes worth more than $600,000 to a Polish government official to obtain contracts with the national police agency. And as part of its bid to win a software sale to Mexico's state-owned petroleum company, Hewlett-Packard's subsidiary in Mexico paid more than $1 million in inflated commissions to a consultant with close ties to company officials, and money was funneled to one of those officials.

According to the SEC's order, the scheme involving Hewlett-Packard's Russian subsidiary occurred from approximately 2000 to 2007. The bribes were paid through agents and consultants in order to win a government contract for computer hardware and software. Employees within the subsidiary and elsewhere (continued on next page)

## US SEC CHARGES HEWLETT-PACKARD WITH FCPA VIOLATIONS (PART II)

raised questions about the significant markup being paid to the agent on the deal and the subcontractors that the agent expected to use. Despite the red flags, the deal went forward without any meaningful due diligence on the agent or the subcontractors.

The SEC's order finds that bribes involving Hewlett-Packard's subsidiary in Poland occurred from approximately 2006 to 2010. Acting primarily through its public sector sales manager, the subsidiary agreed to pay a Polish government official in order to win contracts for information technology products and services. The official received a percentage of net revenue earned from the contracts, and the bribes were delivered in cash from off-the-books accounts.

According to the SEC's order, Hewlett-Packard's subsidiary in Mexico paid a consultant to help the company win a public IT contract worth approximately $6 million. At least $125,000 was funneled to a government official at the state-owned petroleum company with whom the consultant had connections. Although the consultant was not an approved deal partner and had not been subjected to the due diligence required under company policy, HP Mexico sales managers used a pass-through entity to pay inflated commissions to the consultant. This was internally referred to as the "influencer fee."

Hewlett-Packard has agreed to pay more than $108 million to settle the SEC's charges.

## US SEC ANNOUNCES ADDITIONAL $150,000 PAYMENT TO RECIPIENT OF FIRST WHISTLEBLOWER AWARD

On April 4, 2014 the Securities and Exchange Commission announced that the whistleblower who received the first award under the agency's new whistleblower program will receive an additional $150,000 payout after the SEC collected additional funds in the case.

The whistleblower, who the SEC did not identify in order to protect confidentiality, has now been awarded a total of nearly $200,000 since the award was announced on August 21, 2012. The award recipient helped the SEC stop a multi-million dollar fraud by providing documents and other significant information that allowed its investigation to move at an accelerated pace and prevent the fraud from ensnaring additional victims.

The award represents 30 percent of the amount collected in the SEC enforcement action against the perpetrators of the scheme, the maximum percentage payout allowed under the law. The additional payout comes after the SEC collected an additional $500,000 from one of the defendants in the case.

The SEC expects to collect additional money from defendants in this case as some are making payments under a periodic payment schedule ordered by the court.

The 2010 Dodd-Frank Act authorized the whistleblower program to reward individuals who offer high-quality original information that leads to an SEC enforcement action in which more than $1 million in sanctions is ordered.

Awards can range from 10 percent to 30 percent of the money collected. The Dodd-Frank Act included enhanced anti-retaliation employment protections for whistleblowers and provisions to protect their identity.

The law specifies that the SEC cannot disclose any information, including information the whistleblower provided to the SEC, which could reasonably be expected to directly or indirectly reveal a whistleblower's identity.

**The SEC's aggressive collection efforts pay dividends not only for harmed investors but also for whistleblowers**

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## EU PARLIAMENT VOTED ON UPDATED RULES FOR MARKETS IN FINANCIAL INSTRUMENTS (MIFID II)


On April 15, 2014, the European Parliament adopted in plenary session updated rules for markets in financial instruments (MiFID II).

Key elements :

• MiFID II introduces a **market structure framework** which closes loopholes and ensures that trading, wherever appropriate, takes place on regulated platforms. To this end, it subjects shares and non-equity instruments to a trading obligation. It further ensures that investment firms operating an internal matching system which executes client orders in shares, depositary receipts, exchange-traded funds, certificates and other similar financial instruments on a multilateral basis have to be authorised as a Multilateral trading facility (MTF).

It also introduces a new multilateral trading venue, the Organised Trading Facility (OTF), for non-equity instruments to trade on organised multilateral trading platforms.

These rules ensure a level playing field with Regulated Markets (RMs) and MTFs. The neutrality of OTF operators is ensured through restrictions on the use of own capital, including matched principal trading, and discretion in their execution policy.

MiFID II introduces a trading obligation for shares as well as a trading obligation for derivatives which are eligible for clearing under the European Markets Infrastructure Regulation (EMIR) and are sufficiently liquid. This will move trading in these instruments onto multilateral and well regulated platforms in accordance with the G20 commitments.

• MIFID II increases **equity market transparency** and for the first time establishes a principle of transparency for non-equity instruments such as bonds and derivatives. For equities a double volume cap mechanism limits the use of reference price waivers and negotiated price waivers (4% per venue cap and 8% global cap) together with a requirement for price improvement at the mid-point for the former. Large-in-scale waivers and order management waivers remain the same as under MiFID I.

MiFID II also broadens the pre- and post-trade transparency regime to include non-equity instruments, although in view of the specificities of non-equity instruments, pre-trade transparency waivers are available for large orders, request for quote and voice trading. Post trade transparency is provided for all financial instruments with the possibility of deferred publication or volume masking as appropriate.

Rules have also been established to enhance the effective consolidation and disclosure of trading data through the obligation for trading venues to make pre- and post-trade data available on a reasonable commercial basis and through the establishment of a consolidated tape mechanism for post-trade data. These rules are accompanied by the establishment of approved reporting mechanism (ARM) and authorised publication arrangement (APA) for trade reporting and publication.

• To meet the G20 commitments, MiFID II provides for **strengthened supervisory** powers and a harmonised position-limits regime for commodity derivatives to improve transparency, support orderly pricing and prevent market abuse. Under this system competent authorities will impose limits on positions in accordance with a methodology for calculation set by the European Securities and Markets Authority (ESMA).

It also introduces a position-reporting obligation by category of trader. This will help regulators and market participants to have better information on the functioning of these markets.

• A new framework will improve conditions for **competition in the trading and clearing** of financial instruments. This is essential for the integration of efficient and safe EU capital markets. For this purpose, MiFID II establishes a harmonised EU regime for non-discriminatory access

(continued on next page)

**The new rules will improve the way markets function in order to serve the real economy**

## EU PARLIAMENT VOTED ON UPDATED RULES FOR MARKETS IN FINANCIAL INSTRUMENTS (PART II)

to trading venues and central counterparties (CCPs). Smaller trading venues and newly established CCPs will benefit from optional transition periods. The non-discriminatory access regime will also apply to benchmarks for trading and clearing purposes.

Transitional rules will ensure the smooth application of these provisions.

• MiFID II will introduce trading **controls for algorithmic trading activities** which have dramatically increased the speed of trading and can cause systemic risks. These safeguards include the requirement for all algorithmic traders to be properly regulated and to provide liquidity when pursuing a market-making strategy.

In addition, investment firms which provide direct electronic access to a trading venue will be required to have in place systems and risk controls to prevent trading that may contribute to a disorderly market or involve market abuse.

• **Stronger investor protection is** achieved by introducing better organisational requirements, such as client asset protection or product governance, which also strengthen the role of management bodies. The new regime also provides for strengthened conduct rules such as an extended scope for the appropriateness tests and reinforced information to clients.

Independent advice is clearly distinguished from non-independent advice and limitations are imposed on the receipt of commissions (inducements).

MiFID II also introduces harmonised powers and conditions for ESMA to prohibit or restrict the marketing and distribution of certain financial instruments in welldefined circumstances and similar powers for the European Banking Authority (EBA) in the case of structured deposits.

Concerning Packaged Retail Investment and Insurance Products (PRIIPS II), the new framework also covers structured deposits and amends the Insurance Mediation Directive (IMD) to introduce some rules for insurance-based investment products.

• The agreement strengthens the existing regime to ensure **effective and harmonised administrative sanctions**. The use of criminal sanctions is framed so as to ensure the cooperation between authorities and the transparency of sanctions. A harmonised system of strengthened cooperation will improve the effective detection of breaches of MIFID.

• A harmonised regime for granting access to EU markets for **firms from third countries** is based on an equivalence assessment of third-country jurisdictions by the Commission. The regime applies only to the cross-border provision of investment services and activities provided to professional and eligible counterparties.

For a transitional period of three years and pending equivalence decisions by the Commission, national thirdcountry regimes continue to apply.

The publication of the new rules in the Official Journal of the European Union is foreseen for the second quarter of 2014.


**The new rules will restore investor confidence in the wake of the financial crisis**

## EU PARLIAMENT HAS APPROVED UCITS V

The EU Parliament's has approved on April 15, 2014, the proposed directive amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities as regards depositary functions, remuneration policies and sanctions (UCITS V).

Small investors will be better protected against

(continued on next page)

## EU PARLIAMENT HAS APPROVED UCITS V (PART II)

investment funds that take excessive or unnecessary risks with their money.

The new rules clarify who is liable for mismanagement of funds and tailor fund managers' remuneration rules to encourage them to take reasonable risks and a long-run view.

**Depositary**

To clarify who is responsible for small investors' funds, the agreed rules will require UCITS fund or UCITS fund manager to appoint a single independent "depositary" (credit institution or authorised legal entity with sufficient own funds), to oversee investor payments to the fund and act as a custodian of its assets. No management company should act as both a management company and depositary.

Depositaries will be required not to act without authorisation and will have to keep investors' money clearly separate from their own assets. They will be barred from investing these funds on their own account. Depositaries will also be deemed liable for any loss of assets, even if they delegate custody of them to a third party.

**Pay**

Fund managers will be required not to take investment risks beyond what is accepted by their UCITS investors. At least half of the variable part of their remuneration will be paid in the assets of their UCITS, unless the management of UCITS accounts for less than half of the total portfolio.

Payment of at least 40% of variable remuneration will be deferred for at least 3 years. Where the variable share of remuneration is particularly high, at least 60% of this share is to be deferred, to encourage managers to take a long-run view.

**Penalties and whistle-blowers**

EU member states will have to provide in their laws for harmonised administrative penalties for funds that fail to comply with organisational, risk management, and other requirements. Administrative penalties will include issuing a public statement identifying the person responsible and the nature of the breach,suspending authorisation and temporarily or permanently banning the perpetrators from fund management.

Companies may be also fined up to 10% of their annual turnover or €5 million. Individuals may be fined up to €5 million. Alternatively, individuals and companies may be fined up to twice the amount of profits made, even if that exceeds the €5 million or 10%.

The new rules still need to be officially endorsed by the member states, which will have 18 months to put them into effect.

**Small investors protected against reckless risk taking by investment funds**

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