Making sense of MiFID II

How will MiFID II address concerns about protecting investors and the provision of investor services?

The MiFID framework is likely to apply to some service providers that have previously been exempt from specific regulation, with the greatest impact on small and medium sized investment firms or individual financial advisors on the high street.

The aim is to increase protection for the end investor but let's hope the rules are proportional!

There are proposals around extending MiFID to cover the sale of structured deposits by credit institutions and to cover those credit institutions and investment firms selling their own issued financial instruments. But the biggest change is likely to be with regard to conduct of business (COB) obligations. These rules, in summary, concern information to be given to clients before and after the provision of financial services as well as 'know your client' (KYC) tests adapted to the type of client and type of investment service.

In 2007 the MiFID regulations imposed a new COB regime on trading firms to ensure that they only trade appropriate instruments (graded as complex or not) with their clients. Mostly this impacted retail brokers taking client orders or trading their client portfolios.

So, how far are the COB obligations likely to be extended?

MiFID II suggests that certain categories of instruments should be classed as *complex* and thus not be allowed in the context of clients using an execution-only service. It is even being suggested that 'in light of the intrinsic complexity of investment services' the execution-only regime should be abolished altogether! This has caused huge waves of concern from market participants who believe this will remove choice and drive up costs, making it very difficult for ordinary people to own shares directly, even if they are demonstrably capable of assessing the pros and cons of investing on their own behalf.

MiFID II looks set to improve the quality of investment advice with more COB rules introduced for intermediaries around information to be provided to their clients and counterparties, for example risk/gain instrument profiles prior to transactions taking place and quarterly valuation reports on complex products.

What impact are we likely to see in terms of the eligible counterparty regime?

There will be both improvements and limitations in the eligible counterparty's regime. Eligible counterparties could potentially be excluded from dealing in complex products. Certain non-financial undertakings and institutions would be excluded from the eligible counterparty regime, on the basis of size or nature of business for example, in order to protect the investor. The presumption that a professional client has the necessary experience and understanding of the risks he is taking would be abolished or limited to less complex instruments.

Will buy-sides ultimately benefit from better execution services?

There may be changes to the requirements around executing brokers' disclosure to their buy-side clients in respect of venue of execution. This additional venue information could help the buy-side achieve a more complete picture of their execution quality using TCA.

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