Does MiFID II impact APAC?

Extra-territoriality of MiFID II
Overview

The aim of the Markets in Financial Instruments Directive II (MiFID II) is to expand the objectives and address the shortcomings of the first MiFID, implemented in 2007 as a cornerstone of capital markets regulation in Europe. This regulation provides for significant changes in business and operating models, systems, data, people, and processes; and will impact those engaged in the dealing and processing of financial instruments. It is not exclusively a compliance exercise, as it has major strategic implications that may provide market opportunities and competitive advantages for early movers.

MiFID II is being implemented at a time when companies are dealing with a raft of other regulations. To this extent, it is possible to bring MiFID II under a wider regulatory change umbrella to align with related regulations, particularly around trade reporting, and thereby avoid duplication and streamline work streams. With its complexity and broad scope, companies should begin by assessing the impact of MiFID II to determine budgets and timelines, and ensure that their strategy and organization is aligned for compliance by January 2018.

Extra-territorial impact of MiFID II

The following is a non-exhaustive list of the extraterritorial impact of MiFID II on Asia-Pacific ("APAC") clients:

Dealing with European Union ("EU") counterparties and clients:
APAC entities may have to support EU counterparties’ compliance processes by recording a wide range of data at the point of transactions and providing them to the client. While the APAC entity will have no obligation under MiFID II, the EU in-scope counterpart will require data points to complete their own MiFID II reporting requirements. This could require significant changes in the systems and processes of the APAC entity.

Inducements:
MiFID II states that EU firms should not offer or receive prohibited inducements and hence, EU firms will need to start charging for their research publications. EU clients may need to pay separately for research, a change to the current trend of bundled dealing commission. In this scenario, although an APAC entity is not under MiFID II obligations and can thus provide bundled research services, EU clients would not be able to receive research it has not explicitly paid for, and therefore, the APAC entity may be required to carve out research fees and charge them separately.

Trading on an EU trading venue:
An APAC broker-dealer trading on an EU trading venue will not be directly subject to MiFID II but subject to requirements imposed by the trading venue in respect of the venue’s own compliance with MiFID II requirements.

MiFID II scenarios

Discussed below are some selected scenarios to illustrate the impact of MiFID II on APAC entities.

Scenario 1: If you have EU counterparties
Description: An APAC broker-dealer acts as agent for an APAC client to buy an EU stock index option from an EU-domiciled counterparty.

Impact on APAC entities:
- APAC entities may have to support EU counterparties’ compliance processes by recording a wide range of data at the point of transactions and providing them to the client. While the APAC entity will have no obligation under MiFID II, the EU in-scope counterpart will require data points to complete their own MiFID II reporting requirements. This could require significant changes in the systems and processes of the APAC entity.
- Transactions and post-trade reporting requirements under MiFID II that will impact EU counterparties:
  - Expanded scope of transaction reporting taking number of fields up to 65, to be reported T+1
  - Post-trade reporting required within 15 minutes from trade execution
  - Requirement for additional data sourcing across multiple systems
  - For certain pre-and post-trade transparency requirements, a vendor’s ability to support APAC time zones may present additional challenges.
- For dual-listed securities, EU counterparties may request post-trade and transaction reporting from the APAC entity.

Conclusion: APAC entities should conduct an impact analysis of their operating footprint, booking models and trade flows to understand if they are caught under MiFID II obligations.

Level of impact
- Reporting
- Systems and data
- Booking models
- Control framework
- Trade execution
Scenario 2: If your clients include EU retail or elective professional clients
Description: An APAC private bank with EU subsidiaries provides portfolio management services to retail clients and some professional clients.

Impact on APAC entities:
- APAC private bank with EU clients must consider the categorization of their clients and their legal entity structures.
- Under MiFID II, client categorization has been redefined in order to protect different classes of investors according to their knowledge, skill and experience:
  - Retail client: Client which does not meet the definition of a “professional client” or an “elective professional client (EPC),” e.g., an individual
  - EPC: A retail client who has been “elected” to be treated as a professional client and meets both quantitative and qualitative criteria set out in MiFID
- EU Member States may require a non-EU firm to establish a branch in that state in order to:
  - Provide investment services or activities to retail clients and EPCs
  - Provide managed account services to local and municipal authorities (and their pension funds)

Conclusion: APAC entities should conduct an impact analysis of their operating footprint, booking models and trade flows to understand if they are caught under MiFID II obligations.

Scenario 3: If you are a market maker
Description: A market's trading desk of an APAC subsidiary of an EU bank performs market-making activities for APAC clients in EU-listed securities.

Impact on APAC entities:
- MiFID II introduces new laws addressing various structural and other issues relating to the operation of trading venues. Market-making activity on such venues will now be subject to extensive regulation. This includes a commitment by the market maker to the trading venue to make available prices for particular minimum times and to abide by various related systems and controls obligations.
- If the APAC entity is a branch or subsidiary of a European entity, the volumes of over-the-counter (OTC) trading need to be monitored to check if it leads to triggering the Systematic Internalizer (SI) limits for the European entity. If firms want to avoid becoming an SI, they will need to build pre-trade controls to prevent the SI limit from being triggered.
- Trading venues and SIs must also publish information annually on the quality of execution for certain types of financial instruments.
- MiFID II forces dual-listed securities back onto EU trading venues or onto a third-country venue which is deemed equivalent by the European Commission. APAC entities should identify the dual-listed instruments it trades to determine the impact to its trading activity and workflow.

Conclusion: APAC market makers should understand which aspects of their activities qualify them for MiFID II obligations, and perform an impact analysis on trade activity and volumes to ascertain the full extent of relevant impact.

Scenario 4: If you are a distributor of EU funds in APAC
Description: An APAC bank distributes EU-manufactured funds to APAC clients.

Impact on APAC entities:
- MiFID II requirements around product distribution increases the responsibilities of APAC fund distributor to perform distribution activities on behalf of EU fund manager.
- EU product manufacturer distribution agreement considerations under MiFID II include the following:
  - Ensuring that distribution is only to the target market
  - Providing sales information to the manufacturer to assist in meeting their post-sale responsibilities
  - Providing a statement on suitability to the investor on how investment advice meets the preferences, objectives and other characteristics of the client
Our approach

EY is recognized as a market leader in Banking Capital Markets and Wealth and Asset Management regulatory change implementation. We offer exceptional depth of experience through a worldwide network of multidisciplinary teams of regulatory, process, systems and industry professionals who can harness their experience to bring their focus to your unique needs in APAC.

Our approach to addressing and resolving MiFID II challenges for our clients follows these guiding principles:

- Practical: Providing support through achieving internal buy-in from key stakeholders
- Forward-looking: Reflecting our clients’ business objectives, while taking into account known future developments in the international regulatory regime
- Integrated: Working together with our cross-functional and cross-border professionals to give timely, up-to-date support to our clients

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- Satisfaction of EU product manufacturers’ due diligence that the APAC distributor:
  - Is non-independent (i.e., restricted advice) or independent; while possible to be both, subject to strict requirements
  - Has enhanced Know Your Customer and Know Your Product requirements
  - Discloses inducements and demonstrates that inducements enhance client service quality

Conclusion: APAC entities should conduct an impact analysis of their operating footprint, booking models and trade flows to understand if they are caught under MiFID II obligations.

Scenario 5: If you conduct both underwriting and placing services

Description: A corporate finance desk of an APAC subsidiary of an EU bank conducts underwriting and placing of financial instruments.

Impact on APAC entities:

- MiFID II introduces new requirements on the identification, management and disclosure of conflicts of interest for corporate finance desks before accepting a mandate. This includes prescribed disclosures to clients of specific conflicts of interest regarding fees, underwriting and placing operations, targeted investors, and clients and individuals involved.
- Firms must consider the contractual clauses for corporate finance services. For instance, where the bank enters into contractual obligations with a client which preclude business with other clients, or ties a client into restrictive clauses, such as accepting ancillary products or services.
- Firms must enhance management of internal conflicts arising from serving multiple clients, where competing client interests do not align and, therefore, the bank’s behavior in one role could adversely affect client outcomes from the other role.

Conclusion: APAC entities should conduct an impact analysis on the investment banking business, and identify documentation, contracting and operational impact involving investment banking stakeholders, and legal and compliance teams.
MiFID II quick assessment

The diagram below provides a high-level illustration of potentially impacted areas under MiFID II.

How EY can help

We have a six-step approach to guiding through your MiFID II impact analysis, which can improve the scoping and implementation components of your MiFID II journey.

1. Detailed impact analysis by business area
2. Summary impact analysis by business
3. Potential options for closing gaps
4. Market insights
5. High-level implementation road map
6. Pragmatic next steps
About EY
EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

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