

MiFID II Extraterritorial Impacts

Product Manufacturing and Distribution

Speakers



Marie Gervacio, Executive Director, EY Advisory Services Limited

- ▶ Marie has over 17 years of advisory and assurance experience in the banking and asset management sectors, and dealing with insurance clients.
- ▶ She has experience in regulatory-driven change as part of a broader focus on helping financial institutions manage risk and respond to regulatory-driven change resulting from regulatory requirements with global reach.
- ▶ She is currently EY APAC MiFID II Leader and also serves as the Hong Kong Financial Services Internal Audit Lead, and is a frequent speaker on risk and compliance themes, including MiFID II, risk culture, Foreign Account Tax Compliance Act (FATCA) and Common Reporting Standard (CRS).



Philip Lee, Manager, EY Advisory Services Limited

- ▶ Philip's focus is experienced in Process Improvement, Finance Transformation, Financial Reporting and Controls, Program and Project Management specializing in Banking & Capital Markets providing assurance and advisory services to financial institutions across Sydney, London and Hong Kong.
- ▶ He has supported large-scale projects for multi-national financial institutions including analyzing operating processes, developing Target Operating Models, systems design and support, remediation and merger integration programs

Product manufacturing and distribution agenda

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MiFID II requirements

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MiFID II requirements



MiFID II requirements

“MiFID II will codify product governance requirements into rules for the first time. And, importantly, it will bring a new focus on management bodies taking responsibility for approving and overseeing policies toward product governance.” — David Geale, Director of Policy, FCA

Product Manufacturers

Category or sub-category	MiFID II articles
Product Governance	
Product approval and monitoring process	16(3)
Product documentation	24(4b/4c), 24(5)
Distribution governance	16(3), 24(2)

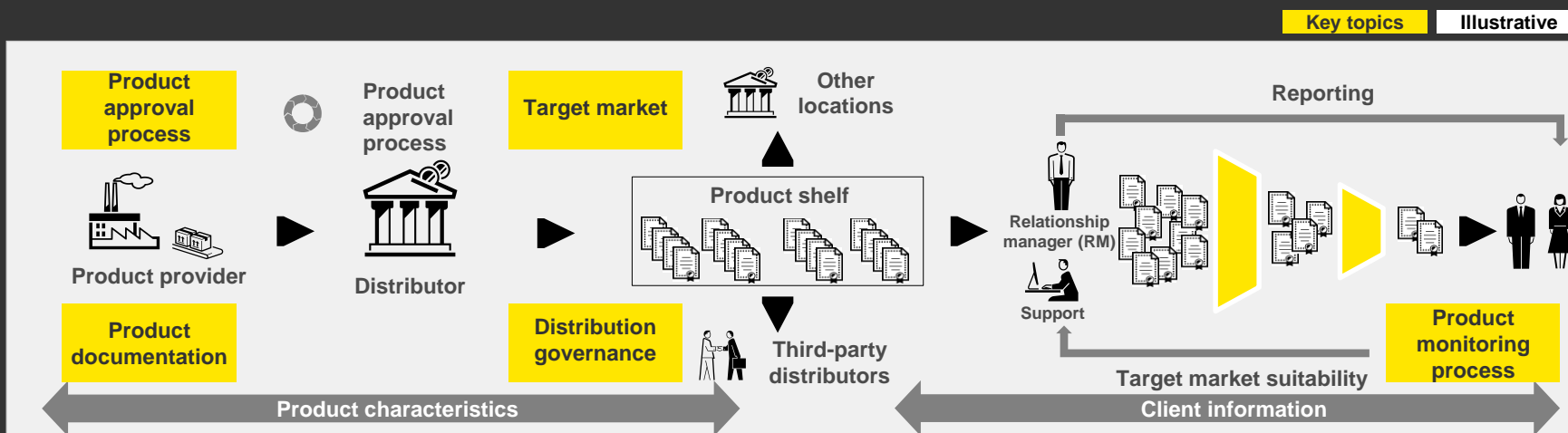
Product Distributors

Category or sub-category	MiFID II articles
Offering and Inducements	
Independent vs. nonindependent	24(4), 24(7), 24(8)
Inducement transparency	24(4), 24(5), 24(7), 24(9), 25(6)
Collaborations with intermediaries	24(7), 24(8), 24(4), 26
Advisory Process	
Client information and reporting	24(3), 24(4), 24(5), 25(6)
Suitability and appropriateness (including advisory protocol)	19, 25

MiFID II requirements

Product manufacturing and distribution

MiFID II brings additional product governance obligations and enhanced investor protection rules.



Exclusions

- ▶ Undertakings for the collective investment in transferable securities (UCITS) management companies and alternative investment fund managers (AIFMs) are governed by their own set of directives and fall outside the MiFID II framework.
- ▶ For a UCITS management company and an EU AIFM that is a manufacturer, but is not involved in MiFID business, the product governance provisions will apply as guidance and not as rules.
- ▶ For a UCITS management company and an EU AIFM that is authorized to conduct activities of an MiFID firm, the UCITS and AIFM will be subject to MiFID II.

What does it mean?

MiFID II formalizes the marketing process by creating distinct and detailed MiFID II activities for manufacturers and distributors.

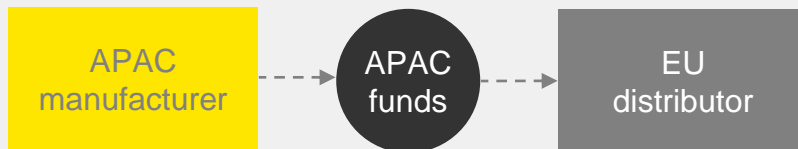
Product Design	Product Marketing	Distribution (3rd-party distributor)	Monitoring
<ul style="list-style-type: none"> ▶ Target market identification (types of clients compatible vs. not compatible) ▶ Distribution strategy compatible with the target ▶ Stress-tested against different scenarios ▶ Adequate fees structure (understandable, does not offset tax advantages, benefit the client, etc.) ▶ Qualified and trained staff for manufacturing 	<ul style="list-style-type: none"> ▶ Investment product is marketed and distributed to clients within the target group. ▶ Investors need appropriate information about products. ▶ Information must be provided to any third-party distributor on the intended target market for the product. 	<ul style="list-style-type: none"> ▶ Responsibility to market or distribute the product within the target market identified by the producer ▶ Responsibility to inform the client ▶ Responsibility for suitability and appropriateness ▶ Regular review of consistency ▶ Support their reviews by providing manufacturers with sales information 	<ul style="list-style-type: none"> ▶ Periodically review the performance of the products to assess whether the products have performed in accordance with their design and to establish whether the target market for the product remains correct ▶ Ongoing identification of events that could affect the product's purpose



Extraterritorial impacts

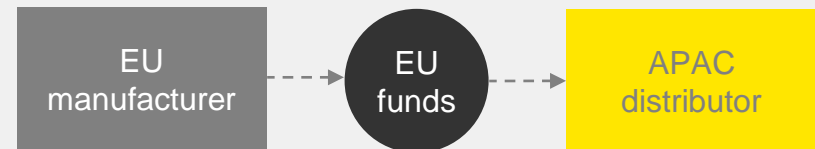
Impact on APAC manufacturers

- ▶ The limited third-country accesses include:
 - ▶ APAC firms are limited from accessing retail or elective professional clients unless a branch is established in an EU country
 - ▶ Eligible counterparties and professional clients per se can be served by APAC firms on the European Securities and Markets Authorities (ESMA) third-country firm register
- ▶ Although APAC manufacturers are out of scope, there will be an indirect impact as EU distributors will require product and target market information from the manufacturer to satisfy their own MiFID II requirements around review of product, target market and distribution strategy.
- ▶ APAC managers who sub-advise EU MiFID-licensed firms may be subject to MiFID II as EU firms will impose obligations on a look-through basis.
- ▶ Terms of business are required when co-manufacturing, including with a non-EU entity.
- ▶ Changes to manufacturer-distributor roles and responsibilities will need to be reflected in updated distributor agreement or addendum.



Impact on APAC distributors

- ▶ Although APAC entities are out of scope, there will be an indirect impact, as EU firms may use distribution agreements to impose responsibilities on non-EU distributors to ensure that their obligations to meet EU standards are met:
 - ▶ Conduct ongoing target market assessments to support target market requirements of manufacturer
 - ▶ Ensure consistency with regular product reviews to target market needs and distribution strategy
- ▶ Distributors need to assess the manufacturer's target market against their client base and determine their own target market.
- ▶ Satisfy EU product manufacturer's due diligence that APAC distributor is:
 - ▶ Nonindependent (i.e., restricted advice)
 - ▶ Disclosed with inducements information
 - ▶ With high quality of client service
- ▶ Changes to manufacturer-distributor roles and responsibilities will need to be reflected in updated distributor agreement or addendum.



Operational aspects



Operational aspects

Impacts for APAC manufacturer

Product approval & monitoring process

- O** Amend policies and processes to address product approval, monitoring and information exchange
- O** Implement tools to store and send third party product related information
- E** Provide EEA distributors with product governance compliant material
- E** Collaborate with EEA distributors on indirect capture
- E** Account for indirect obligations to provide EEA distributors with compliant material

Level of impact ●

Potential impact

- Low
- Medium
- High

- O** Operational impact
- E** Extraterritorial impact

Product documentation

- O** Establish policies to address product documentation and processes for product approval, monitoring and information exchange
- O** Implement tools to store and disseminate product documentation
- E** Provide compliant documentation to investors via EEA distributors

Level of impact ●



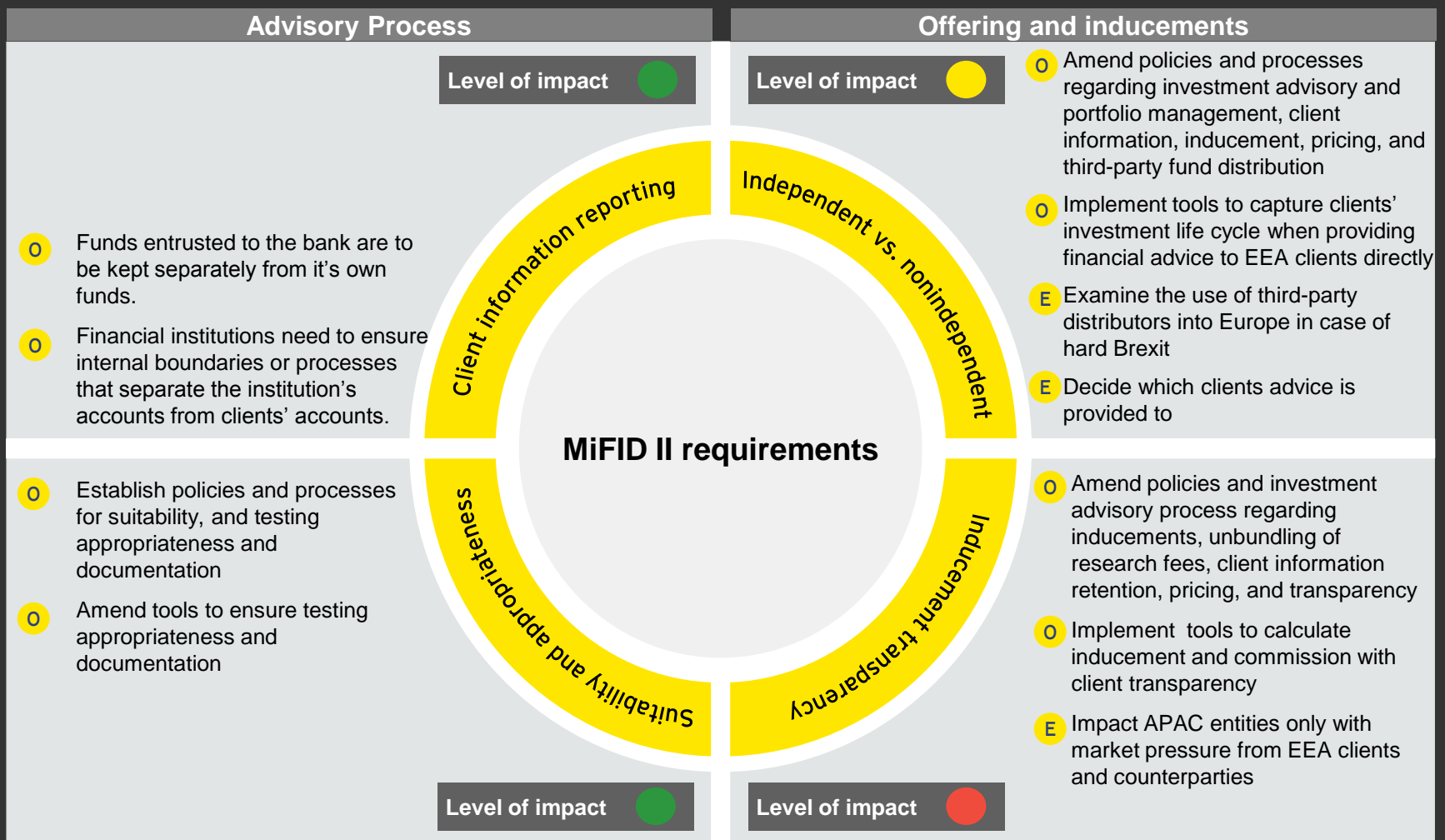
Distribution governance

- O** Establish policies to include target market identification and monitoring as part of in-house product approval
- O** Establish processes for third-party product approval, monitoring and information exchange

Level of impact ●

Operational aspects

Impacts for APAC distributor



Potential impact ■ Low ■ Medium ■ High

○ Operational impact

E Extraterritorial impact

Market implications for APAC



Market implications for APAC manufacturers

1 Third-country access

- ▶ APAC firms will need to assess the categorization of their client base under MiFID II
- ▶ Third-country firms must have an EU branch established in order to conduct business with retail and elective professional clients.
- ▶ Third-country firms are able to conduct business with per se professional clients and eligible counterparties from their home country.

2 Understanding institutional target market

- ▶ EEA distributors must satisfy their home regulators that funds are distributed in accordance with the target market characteristics.
- ▶ APAC firms need to apply the “target market” concept to their products and businesses
- ▶ This concept is not easily replicated to institutional investors.

3 Product review

- ▶ Firms need to review appropriateness of product for target markets.
- ▶ APAC fund managers that use multiple channels and multiple distributors need to collect management information (MI) from multiple sources to conduct periodic reviews.

Market implications for APAC distributors

Distribution agreements

- ▶ APAC firms who distribute funds for different EU fund managers will have to act on inconsistent instructions on the target market classifications.
- ▶ Distributors will be required to sign an addendum to the existing Master Distribution Agreement (MDA) to assist compliance with feedback loop requirements and outline their roles and responsibilities, such as providing product feedback to support product reviews.

Target market checklist

- ▶ APAC distributors are not as familiar with the MiFID II rules as their EU counterparts.
- ▶ APAC distributors will need to understand the requirements of EU fund managers and become familiar in the language in which EU fund managers now view their target market under MiFID II.
- ▶ Distributors will need to assess the manufacturer's target market against their client base and determine their own target market.

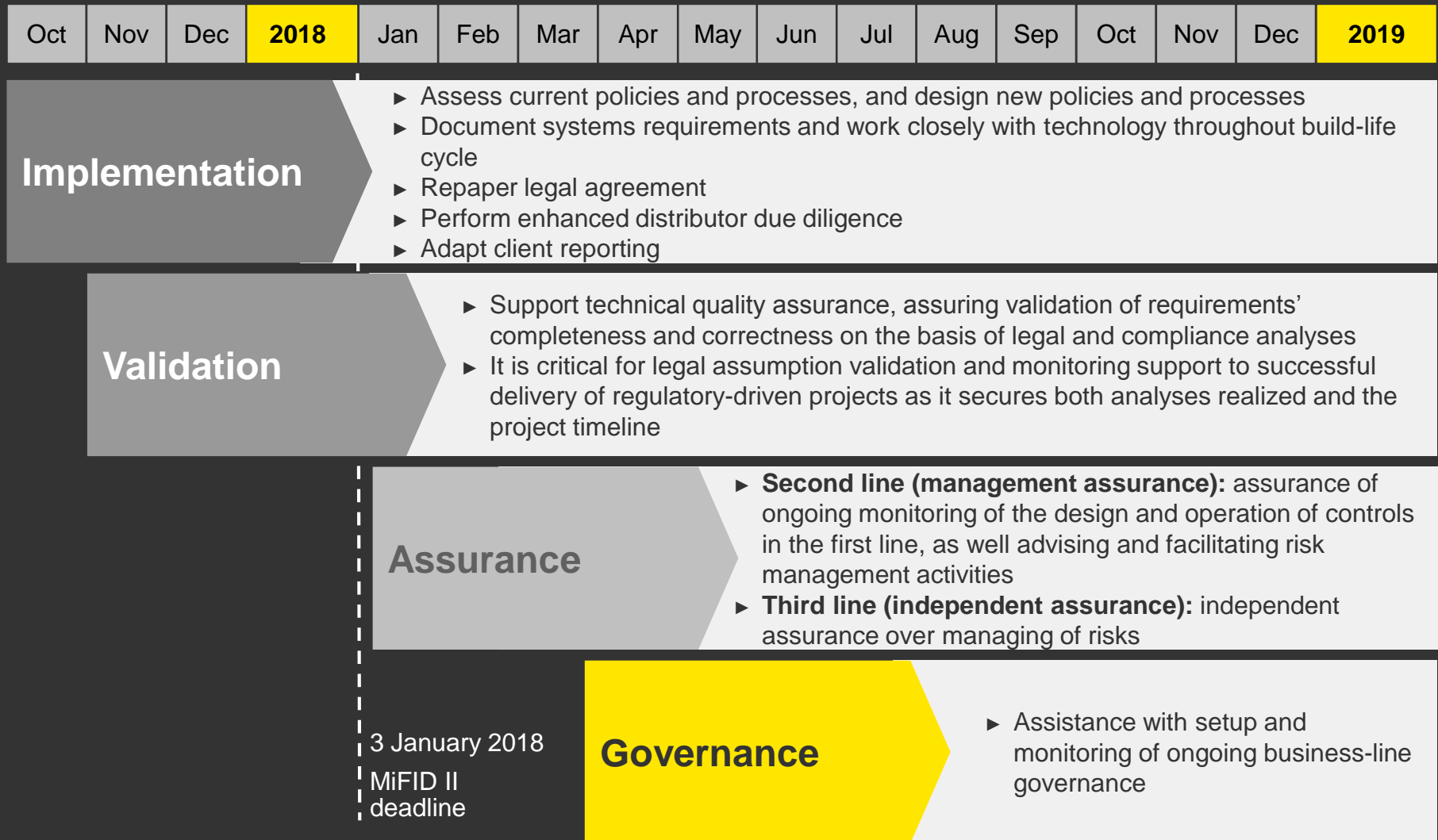
Information sharing agreements

- ▶ Where material information is not publicly available from manufacturers for distributors to ensure products are distributed in accordance with characteristics, the objectives and needs of the target market will need to be assessed by the distributor to ensure that arrangements are in place to exchange the necessary information.

Actions to take now



Upcoming



Actions to take now

1

Review EU access

Understand ability to access existing client base (retail vs. professional) under MiFID II third-country regime

4

Review distribution agreements

Finalize roles and responsibilities through review of Master Distribution Agreement (MDA) addendum

2

Share product governance data

Define and provide product, target market and distribution strategy information with EEA distributors

5

Review infrastructure

Distributors must build sufficient infrastructure to monitor and report client data to support manufacturers' target market requirements

3

Review inducements

Ensure inducements do not incentivise distribution outside of target market group

6

Review client base

Distributors must assess their own client base to identify coherence with manufacturer's target market

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