

## **MiFID II – Keynote Speech, PwC Breakfast Briefing “MiFID II – Are you Ready?”**

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### **Introduction**

Good morning Ladies and Gentlemen.

It is a pleasure to be here this morning and I would like to thank PwC for the opportunity to speak with you on the challenges and opportunities that MiFID II presents. As we move into the final 6 months of preparations, the Central Bank maintains its commitment to engage with industry, outline our expectations and gauge preparedness for business in the MiFID II world.

Today I would like to focus on four areas:

- An update on the Central Bank’s own approach to MiFID II implementation;
- Industry’s preparedness;
- A brief summary of some of the relevant European Security Markets Authority’s (ESMA) initiatives; and
- Finally, I will mention the potential impact of MiFID II on Irish Firms which do not currently need but which may require authorisation as a result of MiFID II.

As I begin I’d like to reflect for one moment on what MiFID II/MiFIR seek to achieve – the changes proposed are fundamentally rooted in common sense. They look to achieve more stable, transparent financial markets; to protect investors and to improve client outcomes.

Few of us here today would disagree with these objectives.

As you are all no doubt very much aware, MiFID II represents the most substantial overhaul of EU legislation for markets in financial instruments in more than a decade. It presents a major implementation challenge for firms and Competent Authorities across Europe.

The 'go live' date of 3 January 2018 is fast approaching and as the, the Chair of ESMA<sup>1</sup>, Steven Maijoor has recently again confirmed there will be no further extensions to the implementation deadline.

The last 10 years have been unprecedented in the history of financial markets. The world initially faced a financial crisis, followed by an economic crisis, and since then there has been considerable focus to bring our economies back on a sustainable growth path.

MiFID II/MiFIR are key reform measures, and the most significant piece of level 2 regulation that has ever been undertaken by ESMA. Since 2014, ESMA has been delivering technical advice to the European Commission. In addition, it has issued 47 level two texts covering issues ranging from market microstructure, pre and post-trade transparency, commodity derivatives to authorisations procedures and investor protection. The level two texts were drafted following consultations with stakeholders and with the input of Competent Authority experts, including many colleagues from the Central Bank.

The impact that MiFID II will have on the asset management industry cannot be understated. Firms should fully understand the effect this legislation will have both on their businesses and on the industry as a whole. The landscape is set to change and our asset management industry must stand ready to adapt.

As, Michael Hodson, the Central Bank's Director of the Asset Management Supervision<sup>2</sup>, has previously stated, firms that proactively manage regulatory amendments tend to create opportunities that elude firms who view implementation as merely a compliance task.

Furthermore, firms who willingly engage and adapt are those who benefit most.

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<sup>1</sup> [Steven Maijoor speech at Futures Industry Association IDX Conference, London, 7 June 2017](#)

<sup>2</sup> [KPMG Seminar - Michael Hodson, Director of Asset Management Supervision 7 February 2017](#)

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## Topic One: An update on the preparations of the Central Bank

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Now I would like to discuss the first of the four areas I want to focus on today, the Central Bank's preparedness for MiFID II.

As I mentioned earlier, the implementation of MiFID II is a major challenge for industry and Competent Authorities. I would like to share with you some of the initiatives that our Asset Management Supervision Directorate has undertaken since 2015:

- At the outset, we established an internal MiFID II Implementation Project that has undertaken a review of the primary legislation and all published level 2 & 3 texts. This has comprised of some 152 Articles and as I mentioned already, 47 level two texts, several sets of Guidelines and Q&As. It has involved not just the Asset Management Supervision Directorate resources but also significant staff resources across the organisation.
- We have augmented our supervision system to accommodate the new rules.
- In Q1 and Q2 of this year our MiFID II subject matter experts provided in-depth training to staff on the key changes MiFID II will bring and on how these changes will affect the firms we supervise. This training ensures that our supervisors understand the new regime, allowing them to provide robust challenge to firms in the lead up to implementation and when the new rules come into play.
- Supervisors issued a MiFID II questionnaire to all regulated firms in March, which posed a number of questions on their implementation of MiFID II. The purpose of this exercise was to give us an industry wide snapshot of firms' preparedness. Supervisors have had a number of follow up engagements with firms as a result of this exercise.
- Additionally, we have undertaken a heat-mapping exercise to establish how the new rules will affect the business models of the firms we currently supervise. These heat-maps, along with the outcomes of the MiFID II questionnaire, are currently being used to guide engagements between Supervisors and our Medium High and Medium Low Impact Asset Management Firms.

I will address the general findings of the heat-mapping exercise in a few moments.

Engagement with industry was a key priority for our implementation programme. We are and will continue to participate in industry engagements like this one today, and Central Bank representatives have been speaking at a number of MiFID II round tables and conferences since 2015.

At an EU level, our ESMA representatives are engaged in the negotiation and finalisation of various ESMA measures and we continue to provide technical advice to the Department of Finance as it enters final preparations for the transposition of MiFID II into Irish Law.

Another area, which will see significant change, is Transaction Reporting. As you know, a standardised reporting regime is provided for across Europe, with new standards and formats prescribed in legislation.

To that end, the Central Bank is building and enhancing its systems to receive, validate, store, and exchange transaction reports with other Competent Authorities.

We have a number of projects in train to manage these significant IT developments.

The Central Bank has issued communications (which are available on our website) regarding the operational and technical arrangements, for submitting transaction reports and the proposed testing timeframes.

Under MiFID II, Competent and European Supervisory Authorities will have the power to prohibit or restrict the sale of any financial instrument or structured deposit that causes serious concerns regarding investor protection, orderly functioning of the market or the stability of the financial system.

Interventions may take the form of restricting how products can be marketed, distributed or sold to certain client groups.

The powers also allow Competent Authorities and the European Supervisory Authorities to prohibit or restrict 'types of financial activities or practices' carried out by those firms within the scope of the legislation.

The Central Bank recently published a Consultation Paper on the *protection of retail investors in relation to the distribution of Contracts for Difference*. The Central Bank has engaged extensively with industry on this topic, and we are participating at European level, where there has been an ever-increasing focus on this matter with many Competent Authorities taking action.

We are the first Competent Authority in Europe to consult on the potential use of this new product intervention supervisory power. The Consultation closed on 29 May and we received a number of responses, which we are currently considering.

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### **Topic Two: Firms' preparedness**

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Having discussed with you how the Central Bank has prepared and continues to prepare for MiFID II implementation, I would now like to move closer to home and speak to firms' preparedness.

The Central Bank expects that firms are now well advanced in their MiFID II implementation projects; in particular, we expect that there has been considerable advances by those firms, which did not have a project plan in place when we issued our industry questionnaire in March.

As I mentioned previously our supervisory teams are using heat-maps to inform their engagement with firms, we have focused on the potential impact of MiFID II on business models. We have initially prioritised meetings with the compliance officers of the higher impact firms.

One of the most notable outputs from this exercise was that firms and the Central Bank were very much aligned in terms of the key impacts of MiFID II.

Additionally, it is clear that industry is working hard to be compliant on the implementation deadline, by for example, increasing dedicated MiFID II resources. It may be worth flagging some of the general themes, which emerged from this exercise:

- Some firms noted that despite the fact that they have significant MiFID II budgets, they shall face time pressures to ensure that all systems and processes are fully compliant by the implementation deadline.
- Some firms, which are part of wider international groups, have broader group-wide MiFID II projects and have the additional challenge of ensuring that the Irish firms take appropriate steps to implement and ultimately own MiFID II initiatives at a local level.
- The majority of the firms we engaged with have indicated that they will provide non-independent advice only. The firms that have indicated that they intend to provide both, independent and non-independent advice have outlined that they will have the required processes in place for implementation.
- MiFID II also introduced product governance requirements for firms who manufacture or distribute financial products. Throughout the heat-map engagements, questions arose as to the practicalities of the manufacturer's responsibility to perform a target market assessment. However, the recent publication of ESMA's guidelines on 2 June, which are focussed on this assessment process, should address these queries.
- Supervisors had a lot of discussions with firms on the new rules in relation to investment research. On the Buy-side, the issues, which we discussed, included whether firms will pay for research directly or establish Research Payment Accounts (RPAs). Whilst on the Sell-side firms have advised that they still need to determine whether they will pay for research or if the cost shall be passed on to their clients.
- Firms through the heat mapping exercise also drew attention to the changes MiFID II brings to the concept of the Systematic Internaliser and the new Organised Trading Facility or "OTF".
- In the market infrastructure space, firms are coming to terms with for example pre-trade transparency requirements, waivers and the Double Volume Cap. Firms that operate such venues are currently having their waiver applications assessed by ESMA.
- As the scope of transaction reporting requirements has been extended to include firms who receive and transmit orders. Some firms have highlighted uncertainty in

relation to the extent of their responsibilities and whether or not they can avail of exemptions outlined in the level 2 texts.

- Other challenges that firms are facing include uncertainty as to whether or not brokers will transaction report on their behalf, or whether they will need to engage the services of an Approved Reporting Mechanism (ARM). Some firms were not as advanced in their decision-making as we would have expected, in relation to how the enhanced transaction and indeed trade reporting responsibilities are going to be managed.

In terms of our next steps, having completed the first phase of the MiFID II heat-map project, supervisors will utilise the outputs from these meetings, to further frame engagement with firms throughout the second half of 2017 and into 2018. The heat-map project will also continue for the remainder of the year, with supervisors meeting with firms not as heavily impacted by the new legislation as those included in the initial phase.

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### **Topic Three: Brief summary of some of the relevant European Security Markets Authority's initiatives**

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Turning to the third topic, which centres on updates from ESMA. As the Central Bank remains fully committed to the principle of supervisory convergence, we engage with and rely on ESMA to produce the level 2 and level 3 guidance on all aspects of MiFID. The Central Bank will therefore not be issuing guidance on particular areas of MiFID II over and above what is provided by ESMA.

ESMA has made significant progress over the last number of months, undertaking a broad range of activities aimed at supporting market participants and competent authorities in their preparations for implementation.

This has included work on providing Q&As across a broad range of issues related to transparency requirements, commodity derivatives, data reporting and market structures topics.

14 Q&As were recently added covering ‘information on costs and charges’, ‘post-sale reporting’, and ‘appropriateness.’

I also want to remind firms that ESMA has launched its Q&A tool, which allows interested stakeholders to submit questions directly for consideration. This is an excellent resource and we encourage you to take advantage of this direct line to ESMA. The Q&As will continue to be updated with the aim of promoting common supervisory approaches and practices.

ESMA has also submitted two draft regulatory technical standards on package orders and the non-equity consolidated tape to the European Commission. These level two texts are expected to be adopted in the coming weeks.

Additionally, ESMA has published opinions on transparency and position limit regimes for instruments traded on non-EU trading venues. These opinions should:

- Clarify which transactions executed on non-EU trading venues will be subject to the post-trade transparency rules; and
- Whether positions held in contracts traded on non-EU trading venues will be subject to the position limits regime.

ESMA has devised the procedures described in the opinions to provide legal certainty to market participants and to find a pragmatic way forward in two highly technical areas of MiFID II/MIFIR framework.

ESMA has also published an opinion clarifying the concept of Traded on a Trading Venue, in particular for OTC-derivatives, following many requests for clarifications from stakeholders. Again, the opinion provides for, a pragmatic approach ensuring that MiFID II/MIFIR are implemented in an expedient manner.

And I might take this opportunity to remind you that the Central Bank continues to communicate significant EU and domestic developments in relation to MiFID II to industry via its ‘Markets Update’ bulletin. Interested parties can subscribe to receive this publication on the Central Bank’s website.

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## **Topic Four: Unauthorised Business**

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Before I conclude, I would like to spend a few moments speaking about the expanded scope of MiFID II and in doing so draw industry's attention to the possibility that this may necessitate some firms requiring the Central Bank's authorisation on the implementation deadline.

The Central Bank is responsible for preventing unauthorised financial services business. It is a criminal offence for an unauthorised firm or person to provide financial services in Ireland that require authorisation under legislation.

MiFID II removes and narrows certain exemptions from authorisation that were available under MiFID. A full discussion of this is outside the scope of today's speech but I would like to draw the wider market's attention and in particular those proprietary traders and other businesses that deal in financial instruments on their own account in the course of an otherwise unregulated business model.

If you are unsure as to whether or not your firm's activities fall within the scope of MiFID II, you should consult legal representatives who are familiar with the regime. The Central Bank expects firms who require authorisation from the implementation deadline to apply in sufficient time so that applications can be assessed and a determination made prior to 3 January 2018.

Additionally, under MiFID II, the Ancillary Activity Exemption continues to apply for firms whose investment services and activities are ancillary to the business of the main group; but this exemption has significantly narrowed.

MiFID II places an obligation on all firms who wish to take advantage of the Ancillary Activity Exemption to notify the Central Bank that they make use of the exemption.

Notification forms are available on the Central Bank's website as are all MiFID application forms.

We are asking all firms who come within the scope of this exemption to submit this notification in good time.

I want to urge all firms who currently engage in investment services or activities but who, because of the exemptions under MiFID, have not applied for authorisation, to review their activities in light of MiFID II.

For those firms operating in this space, the Central Bank is warning that firms must have a valid authorisation or completed the notification process to comply with MiFID II.

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## Conclusion – Key Messages

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To conclude, I want to reiterate that, yes MiFID II represents the most substantial overhaul of EU legislation for markets in financial instruments in more than a decade. But at its core is the key objective of making financial markets more stable, transparent and cognisant of investor protection obligations, which will ultimately benefit all of us; regulators, firms and clients alike.

The key messages, which I hope you all take away from my remarks this morning, are:

We understand the challenge that MiFID II has presented to your businesses, as competent authorities have had similar challenges to overcome. However, as I stated earlier there will be no further extensions to the implementation date.

We expect Irish firms to:

- Be fully resourced to meet their regulatory obligations;
- Be advanced in terms of implementing their project plans, with key decisions made at this point; and
- Have fully considered the implications of MiFID II on their businesses and have made the changes to their systems, policies and procedures.

It is currently not our intention to issue guidance to industry beyond what is produced by ESMA. This aligns with the Central Bank's approach to supervisory convergence.

We strongly urge firms, which may not currently require a MiFID authorisation to consider the impact of MiFID II. Firms, which require authorisation or to complete the notification process, should apply in good time to the Central Bank so that we may review applications by 3 January 2018.

Finally, I would like to thank you for your attention this morning and your continued engagement on this topic. MiFID II will bring momentous and positive change to financial

services – taking advantage of this change will bring opportunities and give the best chance of success in the new regulatory regime.