

**MiFID II – An Overview**

The purpose of this document is to provide a brief update to regulated firms, the States of Guernsey and other stakeholders on recent developments relating to the EU’s Markets in Financial Instruments Directive that could have a significant impact of firms located in the Bailiwick who are, or may be in the future, undertaking relevant investment services business with individuals or entities located in the European Union.

**The Markets in Financial Instruments Directive (MiFID)**

**Background and Current Position**

MiFID came into force in November 2007 as part of a plan to create a single market in financial services across the EU by:

* Making cross-border business easier by setting common standards of business practice;
* Drawing a clearer line between the responsibilities of home and host states; and
* Clarifying who has jurisdiction over conduct of business.

MiFID covers investment banks, portfolio managers, stockbrokers and broker dealers, corporate finance firms, many futures and options firms and some commodities firms.

This Directive has had a limited impact on Bailiwick of Guernsey investment businesses. When the Guernsey Financial Services Commission (the GFSC) amended its Licensee Conduct of Business Rules in 2009 it took account of comments from firms that it would be useful to make reference to MiFID in relation to the explicit determination of client classification. This inclusion was specifically made in order that rules did not present difficulties for firms that had to comply with MiFID provisions through, for example, parent and/or group policies.

MiFID does not provide a harmonised approach to Non-EU investment firms (Third Country Firms) providing investment services to, or for, EU clients. Instead, it is left to EU Member States (Member States) to impose limits on such services, subject to the general requirement under EU law not to grant a Third Country Firm more favourable treatment than an EU firm. In most Member States, there are restrictions and requirements on a Third Country Firm offering or promoting investment services.

**The Markets in Financial Instruments Directive II (MiFID II)**

**Background**

Like so many regulations the main catalyst was the global crisis. It exposed fundamental weaknesses in the regulation of financial services.

MiFID II represents the response to the European Commission’s (the Commission) review of (MiFID). MiFID governs those firms that provide defined investment services and products in the European Union (EU) as well as in Iceland, Liechtenstein and Norway (as members of the European Economic Area (EEA)). It also sets out the framework for regulating securities and investment markets and market infrastructure in the EU. MiFID II expands MiFID’s scope particularly with respect to commodity derivatives, adds further investor protections and increases the requirements related to the trading of financial instruments.

The Commission, Parliament and the Council reached agreement on the texts for the new Directive (MiFID II) and the Markets in Financial Instruments Regulation (MiFIR) earlier this summer and the two documents were published in the EU Official Journal on 12 June 2014.

The texts of the Directive and Regulation are available here:

[MiFID II Text](http://register.consilium.europa.eu/doc/srv?l=EN&f=ST%208317%202014%20INIT)

[MiFIR Text](http://register.consilium.europa.eu/doc/srv?l=EN&f=ST%208315%202014%20INIT)

Due to the nature of the two documents and use of terminology between them it is advisable to review them together rather as two separate, distinct sets of legislation.

MiFID II has introduced a regime for Third Country Firms that wish to provide cross-border services to clients established in an EU Member State. The impact of the Third Country regime for Third Country Firms will not be immediate (see below), however Bailiwick firms will need to take account of these recent developments and should consider this note, together with the detailed provisions of both MiFID II and MiFIR.

**The major aspects of MiFID II and MiFIR**

MiFID II will give Member States the power to allow a Third Country Firm to provide investment services to specific types of professional clients as defined in Section II of Annex II to MiFID II (Elective Professional Clients) and Retail Clients, i.e. those clients which are neither Eligible Counterparties nor Per se Professional Clients. The Third Country Firm will need to establish an authorised branch in the relevant Member State (Host State) and comply with the Host State rules which implement MiFID II. Once authorised, the branch will not be able to provide services to Retail Clients and Elective Professional Clients in any other member state. The authorised branch will be permitted to provide services to Per se Professional Clients and Eligible Counterparties across the Europe Union.

MiFIR will permit Third Country Firms to provide investment services to Eligible Counterparties, as defined in MiFID, and the entities identified in Section I of Annex II to MiFID II (Per se Professional Clients) throughout the EU. A Third Country Firm will be able to do so without having to establish a branch in the EU but will have to become registered with the European Securities and Markets Authority (ESMA) and comply with MiFIR. Further comments are set out below regarding the overall process to be undertaken prior to such registration.

Under MiFIR, Third Country Firms will be able to provide investment services to Eligible Counterparties and Per se Professional Clients under the individual Member State rules. A Third Country Firm will be able to do so for a period of three years after a decision by the Commission on whether the regulatory arrangements in the country where that Third Country Firm has its registered office (Home Country) satisfy certain requirements in MiFIR (an Equivalence Decision). The MiFID II provisions on establishing a branch to serve Retail Clients will come into force as soon as MiFID II comes into force. It should be noted that there is nothing in MiFIR or MiFID II to stop an individual Member State from making rules that require Third Country Firms to establish a branch to provide investment services to Eligible Counterparties and Per se Professional Clients as well as to Elective Professional Clients and Retail Clients.

**Registration with ESMA and Jurisdictional Equivalence under MiFIR**

As noted above, under MiFIR, a Third Country Firm will have to apply to ESMA to become registered in ESMA’s register of Third Country Firms (the ESMA Register). In order to register the Third Country Firm, ESMA will need to satisfy itself that: (a) the Commission has made an Equivalence Decision with respect to the Third Country Firm’s Home Country, in this case the Bailiwick of Guernsey (b) the Third Country Firm is authorised to provide the relevant investment services in its Home Country and subject to effective supervision and enforcement and (c) appropriate cooperation arrangements are in place between ESMA and that Home Country. The Third Country Firm will also have to make certain disclosures to those Per se Professional Clients or Eligible Counterparties to whom it markets its investment services and agree to submit to the jurisdiction of court or tribunal in a Member State.

Under MiFIR, a Third Country Firm entered on the ESMA Register will have the freedom to provide investment services to Per se Professional Clients or Eligible Counterparties in any Member State. Member States will not be able to impose any additional requirements on any Third Country Firm entered on the ESMA Register. The Third Country Firm will benefit, in effect, from a MiFIR Third Country Firm Passport.

If ESMA refuses to admit a Third Country Firm to the ESMA Register, MiFIR still permits an individual Member State to allow Third Country Firms to provide investment services to Eligible Counterparties and Per se Professional Clients under rules made in that Member State. These Third Country Firms will, however, not have the benefit of the MiFIR Third Country Firm Passport resulting from entry on the ESMA Register.

**Establishment of branches within Member States**

In order for a Host State competent authority to authorise a branch of a Third Country Firm, the authority would need to satisfy itself that: (a) the Third Country Firm is appropriately authorised in its Home Country; (b) there are appropriate co-operation arrangements between the Host State and the Third Country Firm’s Home Country, dealing with the exchange of information, including an effective exchange of information on tax matters; (c) the Third Country Firm has adequate regulatory capital; (d) the Third Country Firm’s senior management systems and controls are sufficient; and (e) the Third Country Firm belongs to an authorised or recognised investor compensation scheme. The Third Country Firm will have to comply with the Host State rules giving effect to many of the provisions in MiFID II governing conduct of business.

MiFID II does not give the branch of a Third Country Firm authorised in a Host State the freedom to provide investment services to Elective Professional Clients and Retail Clients in other Member States, therefore no form of passporting occurs.

**Reverse Solicitation**

Both MiFIR, in the context of Per se Professional Clients or Eligible Counterparties, and MiFID II, in the context of Elective Professional Clients and Retail Clients recognise the concept of reverse solicitation. The Directive and the Regulation provide that where a Third Country Firm provides services at the “own exclusive initiative” of an EU investor, the requirement to become registered or authorised, as the case may be, should not arise. Limits on this are set by MiFID II and MiFIR in that an own initiative approach by an EU investor will not entitle the Third Country Firm to market new categories of investment products or investment services to that individual.

**Promotion or Advertising of MiFID Related Services**

The Recitals to MiFID II state that where a Third Country Firm solicits clients or potential clients in the EU or promotes or advertises investment services in the EU, that service should not be deemed as a service provided at the own exclusive initiative of the client. This suggests that there is a distinction between offering and providing on the one hand and promoting and advertising on the other. However, even if there is an argument under MiFID II and MiFIR that merely promoting or advertising an investment service which causes an investor to approach the Third Country Firm does not attract an authorisation or registration requirement (subject, of course, to any national Member State rules), a Third Country Firm will not be able to provide the service without being authorised or registered. Moreover, Member State laws, implementing MiFID II or otherwise, may prohibit Third Country Firms from promoting or advertising investment services without being authorised or registered.

**MiFID II, MiFIR and the Alternative Investment Fund Managers Directive (AIFMD)**

AIFMD governs the marketing and managing of Alternative Investment Funds (AIF) (that is non-UCITS investment funds). Where a Third Country Firm wishes to offer services which are not treated as managing an AIF, AIFMD would not apply. Moreover, where a Third Country Firm wishes to provide sub-management or sub-advisory services for an EU manager managing an EU UCITS fund or EU AIFs, under a UCITS Directive or AIFMD compliant delegation arrangement, these services should fall within the definition of a MiFID II investment service and be subject to the MiFID II regime.

Where a Third Country AIFM seeks to offer/market an investment service, such as providing segregated mandates, which is not treated as managing a collective investment undertaking, the offering/marketing of that service will be governed by the relevant Non-AIFMD related Member State rules.

**What next?**

As was the case with other relevant Directives ESMA will be responsible for drafting a large number of Level 2 Measures before the end of 2016, when the Member States are required to implement MiFID II and MiFIR comes into effect.

In terms of specific responses the GFSC has already begun working with industry bodies to consider the approach required to address the issues resulting from MiFID II and MiFIR. In that respect the GFSC, together with government and the Channel Islands Brussels office will seek to engage from the autumn with EU officials. That engagement, which will build upon the work undertaken during the implementation of the AIFMD regime, will seek to both educate those officials in respect of the regulated financial services sectors in the Bailiwick as well as obtaining a better understanding of the practical and operational issues arising from these changes.

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