

MiFID II

& financial advisers

Contents

What is MiFID II?	3
iO and MiFID II	3
i. Legal Entity Identifier (LEI)	4
MiFID II requirement:	4
How does this affect advisory firms?	4
iO requirement and Working Group discussion	4
ii. Target market	5
MiFID II requirement:	5
How does this affect advisory firms?	5
iO requirement and Working Group discussion	5
iii. Drop in portfolio value	6
MiFID II requirement:	6
How does this affect advisory firms?	6
iO requirement and Working Group discussion	6
iv. Aggregated costs and charges	7
MiFID II requirement:	7
How does this affect advisory firms?	7
iO requirement and Working Group discussion	7
iv. Call notes	8
MiFID II requirement:	8
How does this affect advisory firms?	9
iO requirement and Working Group discussion	9

What is MiFID II?

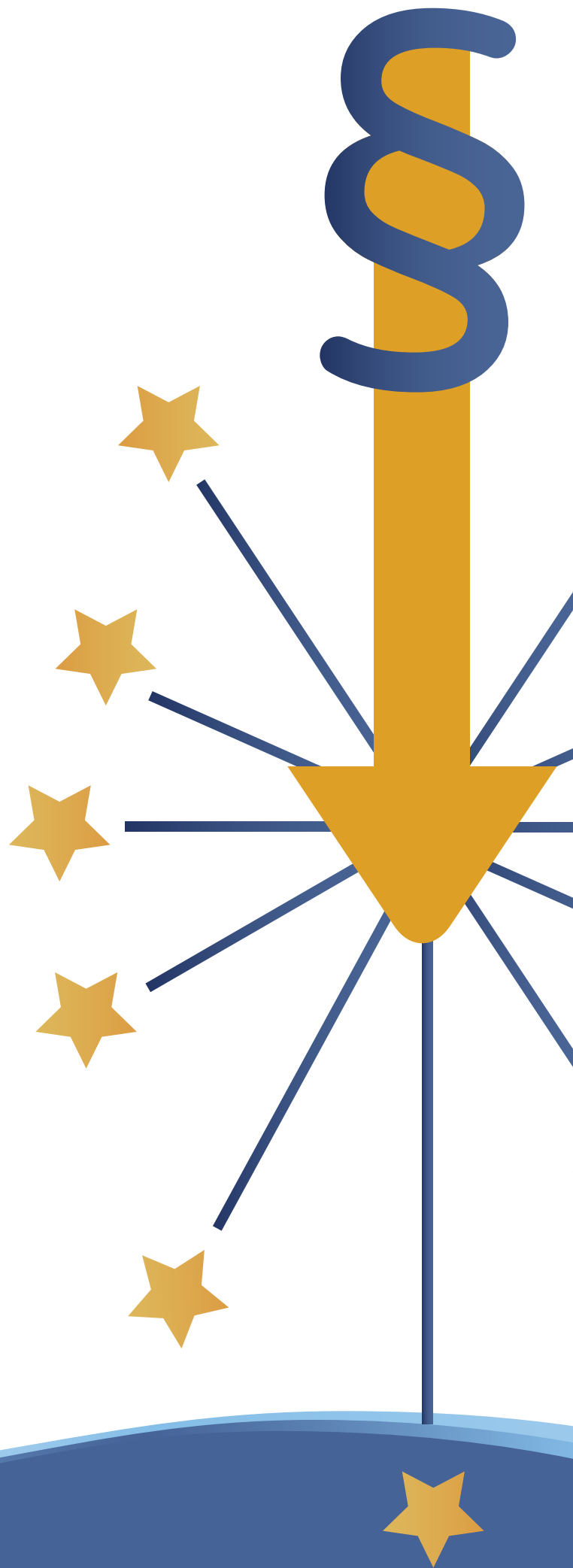
The Markets in Financial Instruments Directive (MiFID) is a legislation that has been in force across the European Union (EU) since 2008 and increases the transparency across financial markets and standardises the regulatory disclosures required. MiFID came into effect prior to the 2008 financial crises - the directive has been revised to consider the financial crises and to improve the functioning of financial markets as well as to strengthen investor protection. This revised and amended legislation is known as MiFID II and includes a new Markets in Financial Instruments Regulation (MiFIR) with the changes set to take effect from 3 January 2018.

Any firm that meets the definition of an 'investment firm' must comply with all MiFID and MiFID II requirements even if it is a purely domestic business unless they are an 'article 3 exempt' firm. Article 3 of MiFID allows EU member states the option of exempting some firms from authorisation as MiFID investment firms. MiFID II includes the same exemption, but Article 3 firms must now be subject to 'at least analogous' requirements. Many IFAs in the UK are currently known as 'Article 3 exempt' firms. All IFAs, whether they are Article 3 firms or MiFID investment firms, should by now have reviewed the proposed changes to Financial Conduct Authority (FCA) rules, and carried out a Red Amber Green analysis to assess where their business is most impacted.

MiFID II Working Group

Intelliflo's MiFID II Working Group is made up of some of the firm's providers and clients of the firm's Intelligent Office (iO) business management system. The group consists of:

Close Brothers, Intrinsic, Chase de Vere, JLT Group, Birchwood Investment, Lighthouse, Charles Stanley, Sense Network and Mazars.



What is the Working Group?

Intelliflo assembled the Working Group in order to discuss and, ultimately, better understand the challenges that UK financial advice firms are facing in preparing for, and subsequently complying with, MiFID II.

The aim of the Working Group is to formulate a clear understanding and path forward for firms with MiFID II. The assembled Working Group has provided its thoughts and feedback on the topics outlined in this paper. The paper is designed to highlight the key topics that were discussed by the Working Group.

We welcome your feedback on MiFID II and the topics discussed. To get involved in the discussion, visit the Community page on iO and click on the MiFID II box. All thoughts offered will form the basis of future discussions and content produced by Intelliflo pertaining to MiFID II.

iO and MiFID II

The Working Group identified the following areas where iO needs to aid advisers and firms to comply with MiFID II:

- i. LEI
- ii. Target market
- iii. Drop in portfolio value
- iv. Aggregated costs and charges
- v. Call notes

i. Legal Entity Identifier (LEI)

How does this affect advisory firms?

From 3 January 2018 firms subject to MiFID II reporting obligations will not be able to execute a transaction on behalf of a client who is eligible for a Legal Entity Identifier (LEI) and does not have one.

To allow regulators to police market integrity, the reporting firm should obtain an LEI from the relevant entities, before executing a transaction in a financial instrument, so that complete and accurate details of transactions can be reported to the competent authority.

iO requirement and Working Group discussion

- **An LEI field needs to be available on the trust and corporate client records, no requirement to add this to the person client record**
- **The LEI should be renewed yearly, therefore there is a requirement to have the LEI Expiry date recorded**
- **The LEI field to be provided at group level**
- **The LEI field will be provided at UDMI level**
- **The LEI field will be available in the Document Designer**

MiFID II requirement:

The 'Know Your Customer' process is initiated when entering into a business relationship and should be maintained for the duration of these relationships and for as long as any long-term data requirements need to be addressed. Parties involved in financial transactions need to be identified within these transactions and ISO 17442 is the international standard which specifies the elements of a LEI which is used to identify entities entering into a financial transaction. An LEI is specific to legal entities (which may include charities and other not for profit organisations) and must be provided for all relevant transactions (relating to traded financial instruments) and all parties involved.

MiFID II mandates that all entities trading with EU counterparties across all asset classes will be required to obtain an LEI that needs to be renewed yearly.



ii. Target market

MiFID II requirement:

MiFID II requires all manufacturers and distributors of products to define a target market for that product. The European Securities & Market Authority (ESMA) has set out six cumulative criteria to be used by manufacturers to define the target market.

These criteria are:

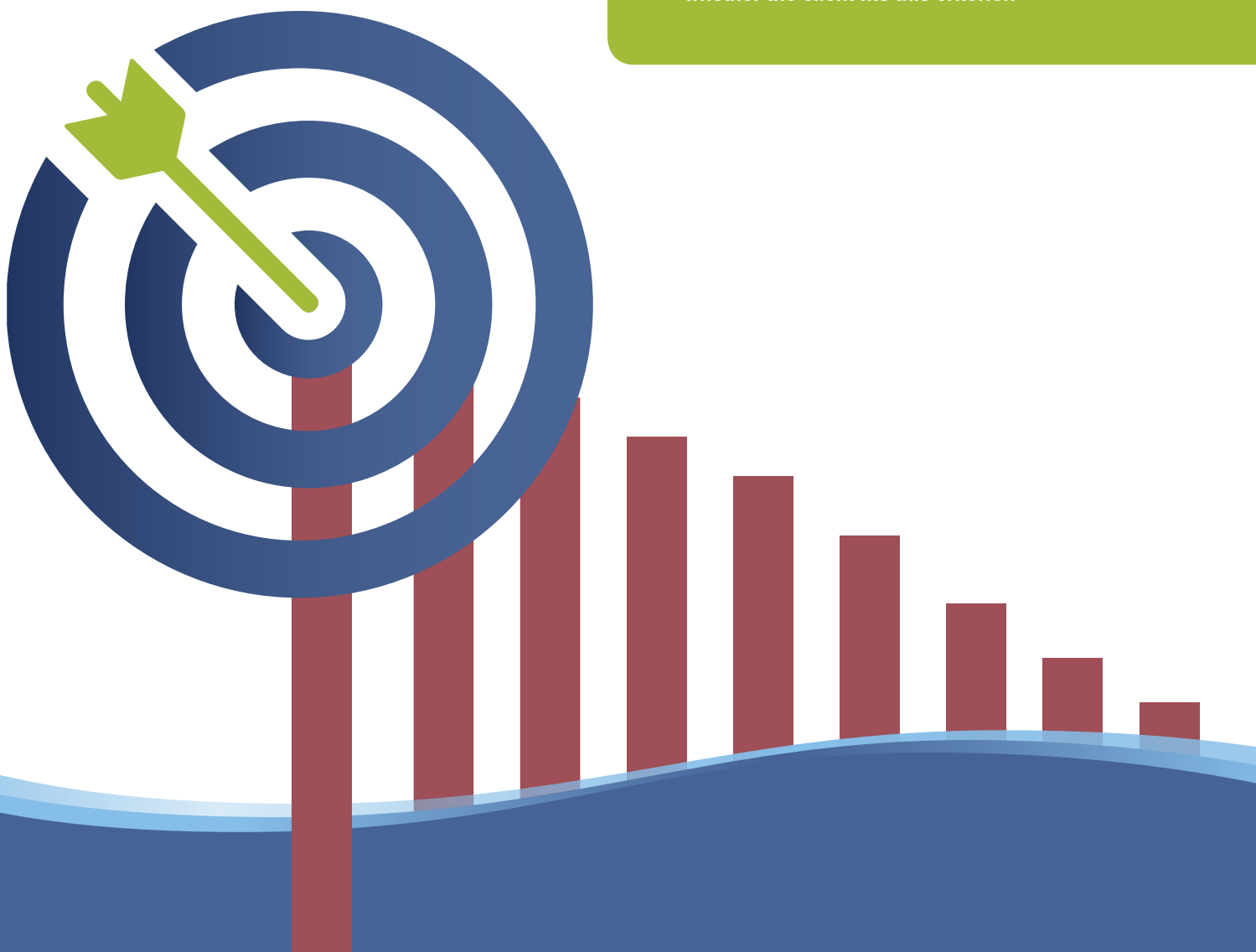
- The type of clients to whom the product is targeted
- Knowledge and experience
- Financial situation with a focus on the ability to bear losses
- Risk tolerance and compatibility of the risk/reward profile of the product with the target market
- Clients' objectives
- Clients' needs

How does this affect advisory firms?

MiFID II requires that there is ongoing, two-way information sharing between advisers and product providers on the intended target market to ensure that products end up being marketed to the intended target market.

iO requirement and Working Group discussion

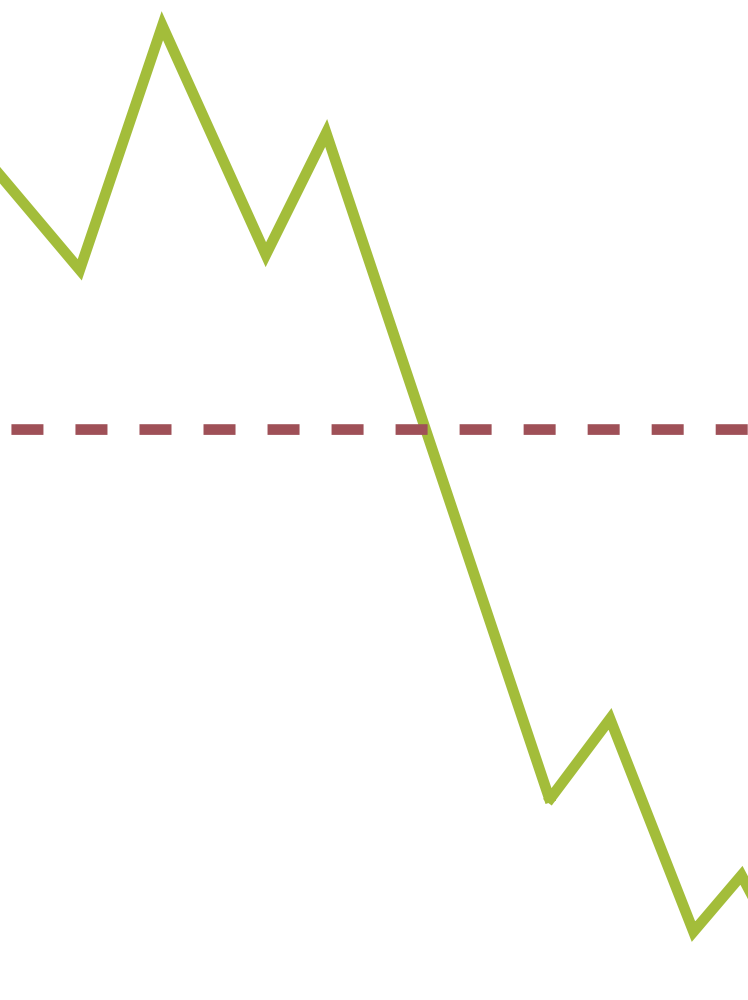
- Ability to record at plan level that the product is in line (or not) with the provider's target market
- Ability to record at plan level why the product was selected if outside of the provider's target market
- There is an assumption that the target market should be provided by the provider, and it is up to the adviser to indicate whether the client fits this criterion



iii. Drop in portfolio value

MiFID II requirement:

In line with the Article 25(6) of MiFID II, to provide clients with adequate reports on the service provided, the MiFID II delegated regulation sets out the requirement for investment firms that provide the service of portfolio management shall meet additional reporting obligations in the form of 'depreciation reporting'. Clients should be notified when the overall value of their portfolio, relative to the value at the beginning of each reporting period, depreciates by 10% and multiples of 10% thereafter. Clients should be notified no later than the end of day in which the threshold is exceeded.



How does this affect advisory firms?

Firms providing the service of portfolio management need to ensure that clients' portfolios are being valued and reported on as set out by MiFID II. The main challenge is the notification of the client 'no later than the end of the business day in which the threshold is exceeded'.

Firms will also need to check how frequently they are reporting to clients on the value of their portfolios. Is it daily, weekly, monthly, quarterly, biannually or annually? This is important because the 10% drop in value pertains directly to the reporting frequency. If you report daily, for example, it's implausible that a 10% drop in value would be experienced, so therefore implausible that firms will be submitting such reports to clients. If a firm reports on an annual basis, however, then this raises the likelihood of a 10% drop in portfolio between reports.

Firms will need daily bulk valuations to satisfy this part of MiFID II. This can be done within iO. The accuracy of the data is also imperative. Intelliflo's Flashlight data service, which ensures accuracy in bulk valuation reporting from provider to adviser, will help with compliance since firms will be able to trust their data.

Alongside aiding MiFID II compliance, Flashlight also helps firms with the compliance obligations under the General Data Protection Regulation (GDPR). Data accuracy is growing in importance for a multitude of reasons, so we strongly advise all firms engaged with iO to utilise our free Flashlight service and ensure that their data is as accurate as possible.

iO requirement and Working Group discussion

- This area is still being discussed
- Expecting to utilise the existing PFP mechanisms for portfolio movement including the necessity to create an alerting mechanism and to define reporting frequency

iv. Aggregated costs and charges

MiFID II requirement:

MiFID II requires investment firms to provide information about all costs and charges, in connection with the investment service and the financial instrument. This information should be aggregated to allow the client to understand the overall cost as well as the cumulative effect on return of the investment. Where the client requests an itemised breakdown it should be provided and, where applicable, such information shall be provided to the client on a regular basis during the lifetime of the investment.

How does this affect advisory firms?

All identified costs need to be disclosed, and where post-sale disclosure is to be provided on a regular basis it should also be provided on a personalised basis. These figures need to include the following costs and are to be broken down into the following sub-sections:

Costs relating to the service:

- All one-off costs paid at the beginning or end of an investment service
- All ongoing charges paid to firms for their services
- All costs relating to transaction as performed by the firm or third parties
- Any costs and charges that are included in ancillary services that are not included in the above
- Incidental service costs

Costs relating to the financial instrument:

- All costs relating to the management of the financial instrument
- All costs paid at the beginning or end of an investment
- Costs associated with the acquisition or disposal of investments (broker commissions, exit charges paid by the fund, stamp duty etc.)
- Performance fees

iO requirement and Working Group discussion

- **Costs relating to the service are currently retrievable from the income/fees area within iO**
- **There is a requirement for providers to supply cost and charges information and new fields will be made available to record provider charges at plan level within iO**
- **All fields associated with costs and charges should be made available in Document Designer**



v. Call notes

MiFID II requirement:

MiFID II states that, “records shall include the recording of telephone conversations or electronic communications relating to, at least, transactions concluded when dealing on own account and the provision of client order services that relate to the reception, transmission and execution of client orders.”

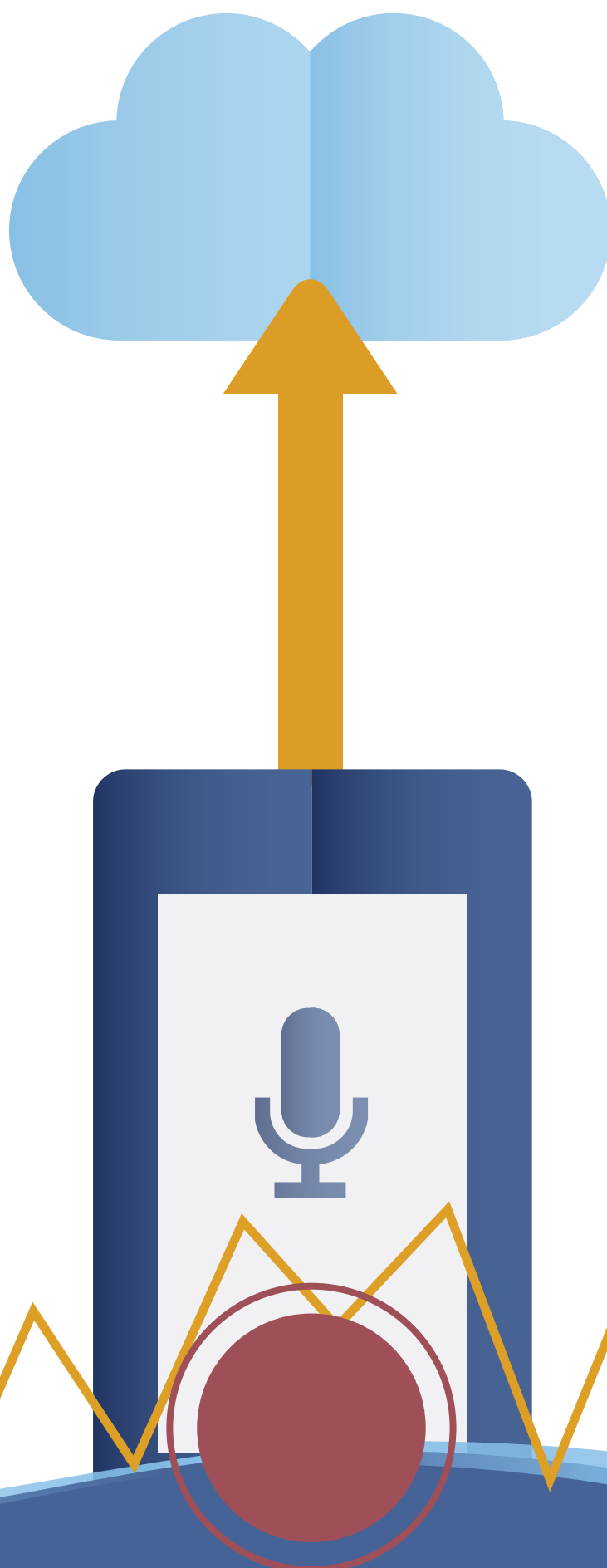
These recorded telephone conversations or electronic communications intending to result in transactions or in the provision of client order services that relate to the reception, transmission and execution of client orders are also included (even if the transaction is not concluded).

Investment firms should take reasonable steps to record relevant conversations and electronic communications made with, sent from or received by clients and prospects. This includes all equipment and devices provided by the investment firm to an employee or contractor.

If clients place orders through other channels, these communications must be made in durable media such as:

- Mails
- Faxes
- Emails or
- Documentation of orders made at meetings (face to face)

The records kept should be provided to the client involved upon their request and should be kept for a period of up to seven years.



How does this affect advisory firms?

Telephone calls are to be taped or, at the very least an analogous written note should be recorded of these calls. According to the FCA, firms are required to record, as a minimum under EU rules:

- The date and time of the meeting
- The location of the meeting
- The identity of the attendees
- The initiator of the meeting
- Relevant information about the client order (including type, price, volume of order and when it shall be transmitted or executed)

These are specific requirements around what must be included within these notes so that they are at least equivalent to what might have been captured if the call had been recorded.

This aspect of MiFID II has become somewhat vague owing to an industry backlash against FCA proposals to implement a full call recording obligation, i.e. that firms should have digital recording measures in place for all conversations with clients. It was felt, particularly among smaller firms, that this was an overly onerous requirement, so the rule has been diluted.

Digital recording, whilst seeming like a major undertaking, can be implemented fairly easily and cost efficiently. Dictaphone recordings, for example, are cheap and easy to plug in to phone calls and use at face to face meetings. They do, however, require manual storage against client records.

Outside of any regulatory obligations, digital call recording should be viewed as beneficial to financial advisory firms since it provides indisputable proof in the event of litigation.

iO requirement and Working Group discussion

- RingCentral integrates with iO so that calls to clients can be made through iO and the conversation automatically saved against that client's record
- SaleMove, which enables virtual face to face meetings, also records conversations and any documents shared over the computer. Further integrations with DocuSign mean that signatures and agreements can be approved instantaneously via secure online portals, with a fully traceable audit trail
- Separate to this, interactions/calls with clients can be recorded within activities, specific task types can be configured according to needs (e.g. client call, client meeting) and associated notes or documents can be attached to the activity

For more information on MiFID II and UK financial advisers, please [click here](#)