MiFID II

Conflicts of interest

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MiFID II planning and implementation is a top priority for asset managers affected by European regulations and brings with it both challenges and opportunities.

What are the new conflict of interest requirements under MiFID II?

The requirements under MiFID II relating to conflicts of interest imposed on investment firms remain substantially the same as those imposed under MiFID I. However, while MiFID I emphasised the requirement to identify and manage conflicts of interest, MiFID II puts new emphasis on the obligation to prevent conflicts of interest. MiFID II also provides for more extensive disclosure and oversight requirements.

The FCA, in line with its practice under MiFID I, will apply certain of the MiFID II conflicts of interest rules more broadly, including generally to UCITS management companies, UK AIFMs and incoming branches of EEA AIFMs which manage or market a UK AIF.

Over-reliance on disclosure

Under MiFID II, over-reliance on disclosure without taking account of how conflicts can be prevented or managed is discouraged and will be perceived as evidence that the conflicts of interest policy in place is deficient and inadequate. Investment firms must take all "appropriate" steps (rather than "reasonable") to identify, prevent and manage conflicts of interest. The FCA has confirmed that this sets a higher bar for compliance and firms must be more active in identifying which changes to their operations may be necessary to prevent or manage conflicts of interest.

Disclosure to clients is a measure of last resort to be used only where the organisational and administrative arrangements established by an investment firm are "not sufficient to ensure, with reasonable confidence, that risks of damage to client interests will be prevented". Firms will however still need to address their common law fiduciary obligations, where the EU regulatory "management" approach does not satisfy common law requirements.

Disclosure of conflicts of interest

MiFID II introduces more prescriptive requirements when disclosing conflicts of interest which have arisen to clients. Such disclosures, which apply irrespective of the categorisation of the client, should:

- Specifically describe the conflict.
- Explain the general nature and/or source of the conflict.
- Explain the risks that arise to the client as a result of the conflict.
- Note the steps taken to mitigate the risks.
- Be made in a durable medium.
- Include detail sufficient for the client to make an informed decision on whether to proceed with the service giving rise to the conflict of interest.
- Clearly state that the organisational and administrative arrangements established by the

2007	2011	2014-2015	2016	3 July 2017	3 January 2018
MiFID in force	Proposal for MiFID II	ESMA consults on implementation	MiFID II application delay confirmed	Deadline for incorporation of MiFID II into EU Member State national law	**MiFID II and MiFIR apply**

investment firm to prevent or manage that conflict are not sufficient to ensure that the client's interests will be protected.

The description of the conflict should also take into account the nature of the clients to whom the disclosure is made. ESMA has noted in its initial consultation paper that disclosures under the current regime have been very generic and not appropriate for retail clients.

Implementation and review of conflicts of interest policies

An investment firm's management body is responsible for ensuring that appropriate governance arrangements, policies and processes are put into place to ensure the prevention of conflicts of interest in a manner that promotes the integrity of the market and interests of its clients. Conflicts addressed should include those arising out of third party inducements and the firm's own remuneration policies and incentive structures.

In creating its conflicts of interest policy, an investment firm is required to identify conflicts of interest on the basis of the specific services/activities undertaken by the firm. In addition to specific requirements relating to the provision of investment research addressed in MiFID I, the Delegated Regulation provides for additional requirements relating to conflicts of interest in respect of certain activities which may be undertaken by investment firms in the context of underwriting and placings, including (i) the acquisition of the issuance by the placing firm for its clients or its own account, (ii) the pricing of offerings of financial instruments, (iii) distribution of own or group issuances, and (iv) lending to an issuer.

The conflicts of interest policy is to be reviewed at least annually and all appropriate measures must be taken by the firm to address any deficiencies. Investment firms must keep and regularly update a record of investment services and activities likely to give rise to conflicts of interest and senior management must receive a written report, at least annually, where conflicts of interest have arisen.

Next steps for investment firms

An investment firm should consider whether its approach to conflicts of interest is overly reliant on disclosure as a method of managing its conflicts and whether it has taken adequate steps to prevent such conflicts (this will include considering whether an investment manager's duty to disclose conflicts of interest under its investment management agreements needs amending). At the same time UK investment firms will need to retain sufficient disclosure to comply with potential fiduciary conflicts arising as a matter of common law.

An investment firm should also ensure that it complies with the requirements under 'Disclosure of conflicts of interest' above when making conflicts of interest disclosures. Firms which engage in placements and underwriting should also consider whether their conflicts of interest policies and procedures are consistent with the requirements set out in the Delegated Regulation.

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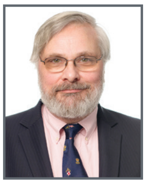

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