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Game Changer? The Potential Impact of MiFID II on UCITS Distribution

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Over the past 25 years, Europe's Undertakings for Collective Investment in Transferable Securities (UCITS)[1] have grown to become the "gold" standard for cross-border investment funds with assets under management exceeding EUR 9.1 trillion.[2] While UCITS are widely distributed outside of Europe, the UCITS "passport" and the product's distribution within Europe is fundamental to its success.[3] On January 3, 2018, the UCITS fund distribution landscape will be materially altered with the implementation of two linked pieces of legislation—a revised European Union Markets in Financial Instruments Directive (MiFID)[4] and the Markets in Financial Instruments Regulation (MiFIR),[5] which are collectively referred to as MiFID II.[6] This article provides an overview of how UCITS are currently distributed in Europe and examines the key regulatory provisions of MiFID II that could be a game changer for European distribution, including: (i) the need for "retail" investors[7] to seek advice in order to have access to any financial instrument deemed "complex";[8] (ii) new suitability and appropriateness requirements;[9] and (iii) a ban on independent advisers receiving "inducements."[10]

I. Background

In late 1985, the Council of the European Communities adopted a Directive on the Coordination of Laws, Regulations and Administrative Provisions Relating to Undertakings for Collective Investment in Transferable Securities (UCITS Directive).[11] The UCITS Directive established common basic rules for the authorization, supervision, structure and investment activities of collective investment undertakings (mutual funds) situated in the member states of the EU (EU Member States).[12] The original objective of the UCITS Directive was to create a common market for investment funds in Europe that met certain stated criteria, namely a fund that was open-ended, raised assets from the public, and invested those assets in "transferable securities"[13] in accordance with certain prudential investment limits and investor safeguards.[14] The regulatory framework for this highly regulated, retail investment product was also specifically designed to facilitate distribution within Europe through the use of a "passport," which allowed a UCITS authorized in one EU Member State (Home Member State) to be sold in another Member State (Host Member State) without any further authorization upon notification to the Host Member State.[15] This "passport" was at the heart of the UCITS Directive and its single unified market objective.

A. Overview of the Models of European Distribution

As the product has evolved over time, UCITS have slowly become the dominant cross-border

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investment product.[16] This is largely due to the changes that have been made to the original UCITS Directive to address perceived shortcomings in the original legislation.[17] Over the last decade, the UCITS Directive has been amended and/or interpreted several times to, among other things: expand the range of eligible investments for UCITS;[18] expand the range of investment strategies that fit within the UCITS framework, including ETFs and money market funds;[19] provide increased flexibility to management companies of UCITS;[20] improve efficiencies in the practical application of the UCITS "passport" to increase the speed to market on a cross-border basis and decrease the cost of operating a cross-border fund product;[21] and improve the level of investor protection and disclosure to UCITS shareholders.[22]

While these changes and the UCITS "passport" provide a legal framework for cross-border distribution, the actual distribution of a UCITS in practice (that is, raising assets under management in the form of net subscriptions) is something quite different. Like many other investment fund structures globally, UCITS do not have any employees (for example, sales representatives) to offer and sell shares directly to potential investors or indirectly by "wholesaling" the UCITS to third-party intermediaries. Indirect distribution is carried out in Europe through various distribution channels in open, guided, or closed architecture types of environments.[23] These distribution channels vary greatly across European jurisdictions and include, *inter alia*, retail and private banks, financial advisors (independent and non-independent), broker-dealers, fund supermarkets, business to business (B2B) platforms, business to consumer (B2C) portals, and institutions such as insurance companies and pension schemes.[24]

In an open-architecture model, investors can choose from a wide range of third-party funds. The majority of European platforms and private banks, which is the predominant distribution channel in Switzerland and Northern Europe, and fund supermarkets have adopted this format.[25] Many retail banks, which are the predominant distribution channels in Central Europe (for example, Germany) and Eastern Europe, and independent financial advisors, which is the predominant distribution channel in the United Kingdom, use a more guided architecture model whereby such banks and independent financial advisors contract with a *select number* of UCITS and put in place distribution agreements that govern these relationships.[26]

While the distribution model may be different on a jurisdiction-by-jurisdiction basis within Europe, MiFID II will impact all methods of UCITS distribution, albeit in different ways.

B. Revenue Sharing and Payment for Distribution

There are generally two ways to structure asset based fees charged by a UCITS to investors for distribution. First, a UCITS could structure the fees for a particular share class of a UCITS whereby distribution fees and investment management fees are embedded (that is, a unified fee), which effectively allows distributors engaged by the UCITS (for example, through its global distributor) to be paid *and* to retain a "rebate" (also referred to as a retrocession) or "trail fee"[27] from the investment manager of the UCITS in return for distribution services. The distributor and/or promoter of the UCITS can then structure share classes with differing other charges (for example, a front-end sales load, contingent deferred sales load, redemption fee, or anti-dilution levy) and characteristics (for example, minimum investment amount, minimum holding amount, different currencies, hedging policies, and differing fees and expenses) within this classic European distribution fee model.

Second, a UCITS could charge a separate management fee and a distribution fee (sometimes referred to as a service fee) that provide transparency on what fees will be paid by the investor for investment management services and separately for asset-based distribution related expenses for client servicing. Like in the classic European fee model

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noted above, the distributor and/or promoter of the UCITS can then structure share classes with differing other charges and characteristics. This second model is very similar to the distribution model utilized in the United States for mutual funds registered under the Investment Company Act of 1940, as amended (1940 Act), that have a "12b-1" fee and a separate investment management fee.

Irrespective of the distribution fee model utilized by the UCITS, the European Commission considers that third-party payments to induce a financial intermediary (that is, an "inducement")[28] to sell shares of a UCITS creates a conflict of interest between the financial intermediary receiving and/or retaining the payment from the investment manager, distributor, sub-distributor, or promoter of the UCITS and the financial intermediary's own client. With recently released data estimating that inducements in the form of revenue sharing paid by fund managers to distributors of European funds is approximately EUR 33 billion per annum,[29] it is not surprising that European regulators attempted to regulate this apparent conflict of interest in MiFID II.

II. MiFID II: Key Provisions Impacting UCITS Distribution

In the aftermath of the financial crisis of 2008, the European Commission deemed it essential to revise MiFID[30] to establish a "safer, sounder, more transparent and more responsible financial system working for the economy and society as a whole."[31] Specifically, MiFID needed to be revised to: (i) regulate opaque parts of the financial system to improve the organization, transparency, and oversight of certain market segments, including with respect to those instruments traded over-the-counter (OTC); (ii) support the original purpose of efficient and integrated financial markets and to take into account rapid changes in technological advancements; (iii) minimize, where appropriate, discretion of national regulators in applying European law to the financial services sector; and (iv) *further strengthen investor protection throughout the EU*.[32]

From this regulatory agenda, MiFID II was proposed in October 2011 as a "single rule book" for financial services in Europe.[33] Political agreement on the European Commission's proposals in a recast MiFID and a new MiFIR was reached on January 14, 2014, after months of negotiations among EU legislatures, and finally adopted on July 2, 2014.[34] Lengthy "Level 2" provisions, in the form of technical standards and delegated acts, have been under consultation since the adoption of MiFID II in 2014 and have been published in the Official Journal in different phases over the last two years.[35]

While the original implementation date for MiFID II was January 3, 2017,[36] the European Commission has formally delayed the implementation date by a year to January 3, 2018.[37] The transposition of MiFID II into national law by European Union Member States has also been extended to July 3, 2017.[38] When enacted, MiFID II will be one of the most ambitious reform proposals to come out of Europe in decades.[39] Within the two thousand pages of legislation, certain key provisions of MiFID II will have an immediate impact on the current distribution models utilized by UCITS, including impacting who is eligible to buy certain types of UCITS and to receive compensation for selling UCITS, as well as the level of compensation and the transparency related to UCITS fees and expenses.

A. Purpose of the Reforms: Investor Protection

One of the goals of the original MiFID was to ensure appropriate levels of protection for investors across the EU.[40] All EU investment firms are required to provide clients with adequate information, to assess the suitability and appropriateness of their products and services, and to comply with best execution obligations.[41] There is also a general duty for firms to act honestly, fairly, and professionally in accordance with the best interests of their clients.[42] Currently, certain of these requirements are applied differently depending on whether the client is a retail or "professional" client.

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The final version of MiFID II will change this paradigm and contains a number of significant changes to the investor protection regime. The new rules will affect the entire lifecycle of investment products and services (including UCITS) in an effort to further strengthen investor protection throughout the EU.[43]

B. Conflicts of Interest Reform: Focus on Inducements

MiFID II requires investment firms to take all appropriate steps to identify and to prevent or manage conflicts of interest between themselves (including their managers, employees and tied agents, or any person directly or indirectly linked to them by control) and their clients (including UCITS) or between one client and another that arise in the course of providing any investment and ancillary services, or combinations thereof, *including those caused by the receipt of inducements from third parties* or by the investment firm's own remuneration and other incentive structures.[44]

In addition, investment firms must follow general principles to act honestly, fairly, and professionally in accordance with the best interests of clients when providing investment services or ancillary services.[45] Investment firms shall be regarded as *not* fulfilling their obligations under these general principles or under their duty to manage conflicts of interest where they pay or are paid any fees or commissions, or provide or are provided with any non-monetary benefits in connection with the provision of an investment service or an ancillary service, to or by any party except the client or a person on behalf of the client, other than, in certain circumstances, where the payment or benefit enhances the quality of the relevant service to the client.[46] The European Commission believes that, by achieving greater transparency as regards to the actual costs of financial products to investors, any conflicts of interest arising from inducements can be resolved.[47] In addition, the European Commission believes that the resolution of such conflicts will create efficiency, resilience, and integrity in the financial markets.[48]

For the current UCITS distribution landscape post MiFID II, this conflict of interest regime practically means that all European investment firms shall be classified as either "independent" or not.[49] The major impact of this distinction will be the ability of investment firms to receive "fees, commissions or any monetary or non-monetary benefits (inducements)" related to UCITS distribution.[50]

C. Application of Reforms to Independent Financial Advisers

Investment firms providing independent advice to clients are *not* permitted to accept and retain fees, commissions, or any monetary benefits paid or provided by any third party (or a person acting on behalf of a third party) in relation to the provision of such services[51] and any such fees should be transferred to the client in full and as soon as possible.[52] Any investment firms providing discretionary investment advice to clients are considered *de facto* independent.[53]

1. Implications of Independence

For those firms that are classified as independent, a defined selection process to assess and compare a *sufficient range of financial instruments available on the market from different product providers* should be implemented.[54] Independence must be demonstrated and if suitable comparisons are not possible due to business model or scope of the service provided, investment firms should *not* present themselves as independent.[55]

An investment firm also will need to inform all clients in *good time* whether or not the advice that is being provided to such clients is on an independent basis.[56] Investment firms will further need to explain to clients in a clear and concise way whether and why they are independent or non-independent.[57]

2. Exceptions to Ban on Receiving Non-Monetary Benefits

Investment firms providing independent advice to clients (including investment firms providing discretionary investment advice) are permitted to

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accept minor non-monetary benefits, provided: (i) such benefits qualify as acceptable non-monetary benefits and (ii) disclosure of such minor non-monetary benefits is made to clients prior to the provision of investment or ancillary services.[58]

The European Commission has provided a list of minor non-monetary benefits, which includes: (i) information or documentation relating to a financial instrument or service that is generic in nature or personalized for the client; (ii) written material that is commissioned or paid for by an issuer provided the relationship is clearly disclosed; (iii) participation in conferences or training events on the features and benefits of specific financial instruments or services; (iv) hospitality of a reasonable *de minimis* value; and (v) other non-monetary benefits that are reasonable and proportionate and of such a scale and nature that they are unlikely to influence the investment firm's behaviour in any way that is detrimental to the interests of the client.[59]

Additionally, investment firms that inform clients that investment advice is being provided on an independent basis must assess a range of financial instruments available on the market which are sufficiently diverse vis-à-vis their product type and issuer to ensure that the client's investment needs are satisfied.[60] The range of suitable financial instruments cannot be limited to those issued by the investment firm providing the advice or to entities with close links (legal, economic, contractual, etc.) to the investment firm so as to pose a risk of impairing the independence of the advice.[61]

3. Practical Implications

Post implementation of MiFID II, the ban on inducements will have a material impact on distribution of UCITS to independent financial investment advisors (IFIAs). IFIAs, which will no longer be compensated from UCITS product providers, will need to change their business model and receive fees directly from clients (for example, through a wrap account service). Without the additional compensation from UCITS product providers, many IFIAs may be unwilling to take on clients with smaller account balances (for example, with an account balance less than Euro 100,000) leaving many high net worth and retail clients without the ability to obtain professional advice. This may directly result in a market opportunity for UCITS product providers that invest in direct to consumer technology, including robo-advice.

In an environment that is already difficult for active management, the ban on inducements may also lead to an increased use of passively managed products by IFIAs, which may create an opportunity for exchange-traded funds. This trend may be accelerated by the MiFID II requirement for retail customers to obtain professional advice to invest in "complex" UCITS.[62]

On a product level, UCITS may be required to move away from the classic European distribution fee model (discussed above) in those markets in Europe that have a large IFIA community (a practice that has already accelerated due to similar MiFID II type inducement legislation in the United Kingdom and the Netherlands). It is likely that a "clean" share class, which only charges shareholders a management fee, will be necessary for all UCITS targeting the IFIA channel in Europe.

For US managers that offer UCITS as "clones" of 1940 Act mutual funds, offering a "clean" share class, which provides institutional type pricing to retail clients, may create issues for an investment manager in the "15c" process with board of directors of a mutual fund—that is, the process by which the board of a 1940 Act fund annually evaluates the advisory contract with advisers, including the level of compensation paid to advisers.[63]

D. Application to Non-Independent Investment Firms

Investment firms that do *not* provide independent advice (including firms that do not provide discretionary portfolio management services) can pay or receive a fee or commission, or provide or be provided with a non-monetary benefit in

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connection with the provision of an investment service or an ancillary service if the payment or benefit *enhances the quality* of the relevant service to the client and does not impair compliance with the investment firm's duty to act honestly, fairly, and professionally in accordance with the best interest of its clients.[64] Payments or benefits necessary for the provision of investment services such as custody costs, settlement and exchange fees, regulatory levies, or legal fees are not subject to this requirement as by their nature they cannot give rise to conflicts of interest.[65]

1. Quality Enhancement Requirement

The quality enhancement test has evolved since the European Securities Market Authority's (ESMA) initial technical guidance[66] was published and now includes an exhaustive set of criteria, of which *all* ligaments must be satisfied.[67] Fees, commissions, or non-monetary benefits will only be deemed to enhance the quality of a service if: (i) they are justified by the provision of an additional or higher level service to the client; (ii) they are proportional to the level of inducements received (For example, the provision of non-independent advice on a wide range of suitable financial instruments including an appropriate number of instruments from third party product providers with no close links with the investment firm) or the provision of access, at a competitive price, to a wide range of financial instruments likely to meet the client's needs (including an appropriate number of instruments from third party product providers with no close links with the investment firm), together with the provision of value-added tools or provision of periodic reports of the performance and costs and charges associated with the financial products; (iii) they do not directly benefit the investment firm (or its shareholders or employees) without a tangible benefit to the client; and (iv) they are justified by the provision of ongoing benefits to the client (in relation to an ongoing inducement only).[68] Fees, commissions, or non-monetary benefits are not acceptable if the provision of the service to the client is distorted or biased because of it.[69]

Once an investment firm has fulfilled the quality enhancement criterion, it must *maintain* this enhanced level of quality[70] on an ongoing basis as long as the firm continues to pay or receive the fees, commissions, or non-monetary benefits.[71] There is, however, no requirement to continuously enhance the quality over time.[72]

2. Record-Keeping Requirements

Investment firms paying or receiving fees, commissions or non-monetary benefits that meet the quality enhancement criterion will need to keep records by maintaining an internal list of all fees received, recording how fees paid or received enhanced the quality of the service and describing steps taken in order to comply with the investment firm's duty to act honestly, fairly, and professionally in accordance with the client's best interests.[73]

Investment firms must disclose payments made to or received from any third parties.[74] Disclosure of the existence, the nature, and the amount of the payments or benefits should be made *ex-ante* to the provision of the service, and must be clear, accurate, and understandable to the client.[75] Minor non-monetary benefits may be disclosed in a generic way while non-minor non-monetary benefits must be priced and disclosed separately.[76] Where the amount of the payment or benefit cannot be ascertained *ex-ante*, the method of calculation must be disclosed prior to provision of the service[77] and the exact amounts of the payments or benefits must be provided to clients on an *ex-post* basis.[78] Further, so long as inducements are ongoing, investment firms must report to clients on at least an annual basis the exact amounts of payments or benefits received or paid.[79]

3. Practical Impact on Distribution in Certain Markets

In an effort to retain the current revenue sharing paid to many investment firms in Europe (for example, outside of the UK and the Netherlands), many

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investment firms may look to classify themselves as non-independent. In order to meet the MiFID II quality enhancement and suitability requirements noted above, UCITS product providers should expect that non-independent investment firms will conduct due diligence on all UCITS, perhaps trim the number of UCITS sold through the firm as well as require changes in offering materials to provide more disclosure on the types of services for which fees will be paid to third parties. In certain jurisdictions, retail banks and other firms also may move away from open-architecture and favor proprietary funds.

E. Application to Execution Only Platforms

MiFID II leaves open the possibility to "self-advise" and for the public to invest in UCITS on an execution only basis. Unfortunately, MiFID II will allow execution only for investors in "non-complex" instruments. Any structured UCITS or complex UCITS will not be eligible for execution only.[80]

While MiFID firms providing execution only services to investors are required to determine if the service and products available via the execution only service are appropriate for the investors, such appropriateness checks are not required for investment in non-structured UCITS. This would seemingly create an opportunity for UCITS providers to invest in technology and offer directly to consumers share classes via the UCITS website.

F. Disclosure Requirements/Obligations

Disclosure requirements and obligations on investment firms to provide information on costs and associated charges are expanded under MiFID II. Investment firms providing investment advice will be required to provide appropriate information in good time on an *ex-ante* basis to clients or potential clients so they may reasonably understand the nature and risks of the investment service and the financial instruments being provided or offered and make informed investment decisions.[81]

Information on all costs and charges (expressed as both a percentage and a monetary amount) relating to investment and ancillary services, including the cost of advice, the cost of the financial instrument recommended or marketed, and how it will be paid for must be provided to clients in a comprehensible form on at least an annual basis.[82] As noted above, information in relation to third party payments and inducements received by investment firms must also be provided[83] and must be itemized and disclosed separately.[84]

Information on costs and charges shall be aggregated so that clients can understand the overall cost as well as the cumulative effect on return of their investment and, upon request from a client, an itemized breakdown of all costs and charges must be provided.[85] In order to calculate costs and charges on an *ex-ante* basis, investment firms shall use actually incurred costs as a proxy for the expected costs and charges and, where precise information is not available, reasonable estimates should be disclosed and then adjusted as necessary.[86] Information on costs and associated charges contained in a UCITS Key Investor Information Document (KIID) or, when applicable, a Key Investor Document (KID) to be introduced by the PRIPS Directive[87] does not need to be re-disclosed. Information not included in the KIID (for example, quantitative information on transaction costs) must be separately obtained by liaising with the UCITS provider and disclosed.[88]

Conclusion

The investor protection and inducement provisions of MiFID II will change the distribution landscape for UCITS in Europe. It remains to be seen what the indirect impact of these changes on the market will be. The inducement ban on independent financial advisors may create opportunities for new market entrants, including robo-advisors, as well as other direct to consumer web-based distribution solutions. For other market participants, it may mean a reshaping of their business model completely. For product providers, there likely will be an increased need to more carefully structure share classes for the ultimate distribution channel. Only

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time will tell, including whether the pendulum of regulatory reform has again swung too far.

Mr. Christian is a partner and **Ms. Cronin** is an associate in the Financial Services Group of Dechert LLP. The views expressed herein are based on the legislation in force as of the date of this Article.

NOTES

1 UCITS or "undertakings for the collective investment in transferable securities" are investment funds regulated on a European Union level. The legislative instrument covering these European funds is European Union (EU) Directive 2014/91/EU. *See* Directive 2014/91/EU, of the European Parliament and the Council of 23 July 2014 on the Coordination of Laws, Regulations and Administrative Provisions Relating to Undertakings for Collective Investment in Transferable Securities (UCITS) As Regards Depositary Functions, Remuneration Policies and Sanctions, 2014 O.J. (L 257) 186 [hereinafter UCITS V Directive] Amending Directive 2009/65/EC of the European Parliament and the Council of 13 July 2009 on the Coordination of Laws, Regulations and Administrative Provisions Relating to Undertakings for Collective Investment in Transferable Securities, 2009 O.J. (L 302) [hereinafter UCITS IV Directive].

2 S*ee* European Fund and Asset Management Association (EFAMA), Asset Management in Europe: An Overview of the Asset Management Industry with a Special Focus on Capital Markets Union 2 (Apr. 2015).

3 *See* Irish Funds Industry Ass'n, Global Distribution, *Irish Funds*, *http://www.irishfunds.ie/distribution* (last visited Sept. 13, 2016) (noting that there are more than 63,000 UCITS funds registered for public offer and sale as of April 2015).

4 Directive 2004/39/EC, of the European Parliament and of the Council of 21 April 2004 on Markets in Financial Instruments Amending Council Directives 85/611/EEC and Directive 2000/12/EC of the European Parliament and of the Council and Repealing Council Directive 93/22/EEC, 2004 O.J. (L. 145) 1 [hereinafter MiFID Level 1 Directive]. MiFID originally comprised three main pieces of legislation: the Level 1 Directive 2004/39/EC, the Level 2 Directive 2006/73/EC and Regulation 1287/2006 [hereinafter MiFID I].

5 Regulation No. 600/2014, of the European Parliament and of the Council of 15 May 2014 on Markets in Financial Instruments and Amending Regulation (EU) No 648/2012, 2014 O.J. (L. 173) 84 [hereinafter MiFIR].

6 Directive 2014/65/EU, of the European Parliament and of the Council of 15 May 2014 on Markets in Financial Instruments and Amending Directive 2002/92/EC and Directive 2011/61/EU, 2014 O.J. (L 173) 349 [hereinafter MiFID II].

7 *See id*. at art. 4.1(11).

8 *See id.* at art. 25.4.

9 *See id.* at art. 25.

10 *See id.* at art. 24(7)(b) and 8.

11 Council Directive 85/611/EEC, of 20 December 1985 on the Coordination of Laws, Regulations and Administrative Provisions Relating to Undertakings for Collective Investment in Transferable Securities, 1985 O.J. (L 100), 3 (EC) [hereinafter UCITS I Directive].

12 *See id.* at Recitals.

13 As UCITS I did not define the term "transferable securities," such term was interpreted to mean listed bonds and equities. UCITS I required UCITS to invest 90 percent of their assets in transferable securities while the remaining 10 percent could be invested in certain other investments. *See id.*

14 *See* Commission of the European Communities, Green Paper on the Enhancement of the EU Framework for Investment Funds, at 24, COM 314 final (July 12, 2005); *see also* UCITS I Directive, *supra* n.11, at art. 1(2). For example, UCITS could not invest for speculative purposes in, among other instruments, shares of other funds, derivative products or money market instruments. Moreover, generally no more than five percent of a UCITS' assets could be invested in a single issuer, absent an increase in this level authorized by an individual Member State.

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15 *See* UCITS I Directive, *supra* n.11, at art. 2.

16 *See* Christopher D. Christian et al., "Offering UCITS to US Institutional Investors, A Post Dodd-Frank Overview – Part I of 2," The Investment Lawyer, Vol. 19, No. 8 (2012).

17 *See* UCITS I Directive, *supra* n.11, at art. 2.

18 *See* Directive 2007/16/EC, of 19 March 2007 Implementing Council Directive 85/611/EEC on the Coordination of Laws, Regulations and Administrative Provisions Relating to Undertakings for Collective Investment in Transferable Securities as Regards the Clarification of Certain Definitions, 2007 O.J. No. (L 79) 11.

19 *See* Directive 2001/108/EC, of the European Parliament and of the Council of 21 January 2002 Amending Council Directive 85/611/EEC on the Coordination of Laws, Regulations and Administrative Provisions Relating to Undertakings for Collective Investment in Transferable Securities, with Regard to Investments of UCITS, 2002 O.J. No. (L 041), 35.

20 *See* UCITS IV Directive, *supra* n.1.

21 *See* Directive 2001/107/EC, of the European Parliament and of the Council of 21 January 2002 amending Council Directive 85/611/EEC on the Coordination of Laws, Regulations and Administrative Provisions Relating to Undertakings for Collective Investment in Transferable Securities with a View to Regulating Management Companies and Simplified Prospectuses, 2002 O.J. (L 41) 20.

22 *See generally* UCITS IV Directive, *supr*a n. 1 (implanting many of the investor protection requirements required by MiFID I).

23 *See* MiFID II: Practical Impact on Investment Managers and Distributors, Panel at the 27th Annual Conference on the Globalization of Investment Funds (May 10, 2016).

24 *See* J.P. Morgan, Changing Dynamics of European Distribution, A Report from JP Morgan's Roundtable (pub. avail., at *https://www.jpmorgan.com//Changing_Dynamics_of_Global_Distribution.pdf*).

25 *See* PricewaterhouseCoopers, Distributing Our Knowledge: Fund Distribution – UCITS and Alternative Investment Funds, 25 (2014).

26 *See id*.

27 A "trailer" or "trail" fee is an annual service commission paid to a sales representative either out of fund assets or indirectly out of a management fee for a UCITS manager. This fee is paid to the sales representative as long as the investor associated with the sales representative hold shares in the UCITS (or otherwise until agreed). A trail fee is a service commission, which means that it is meant to compensate the sales representative for actual services (*e.g.*, shareholder inquiries on performance, account balance information, etc.).

28 *See* MiFID II, *supra* n.6, at art. 24(7)(b) and 8.

29 *See* Deloitte, MiFID II: What will be its Impact on the Investment Fund Distribution Landscape? 8 (2016).

30 *See* European Commission, Public Consultation, Review of the Markets in Financial Instruments Directive (MiFID) (Dec. 8, 2010) [hereinafter MiFID I Consultation Paper]. MiFID came into force on November 1, 2007 as part of the European Single Market Programme to remove barriers to cross-border financial services within Europe, foster a competitive and level playing field between trading venues for financial instruments in the European Economic Area (EEA) and to improve investor protection across the EEA.

31 *Id.* at 6; *see also* Communication from the European Commission to the European Parliament, the Council, the European Economic and Social Committee and the European Central Bank: Regulating Financial Services for Sustainable Growth COM (2010) 301 final (June 2, 2010).

32 *See* MiFID I Consultation Paper, *supra* n.30, at 6-7.

33 *See id*. at 7.

34 *See* European Securities Market Authority (ESMA), Final Report: ESMA Technical Advice to the Commission on MiFID and MiFIR 10 (Dec. 19, 2014).

35 *See id.*

36 *See* Directive 2016/1034, of the European Parliament and of the Council of June 23, 2016 Amending Directive 2014/65/EU on Markets in Financial Instruments, 2016 O.J. (L 175) 8 (EU) [hereinafter Directive 2016/1034].

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[37] European Commission Press Release IP/16/265, Commission Extends by One Year the Application Date for the MiFID II Package (Feb. 10, 2016).

[38] *See* Directive 2016/1034, *supra* n.36.

[39] *See* Jim Brunsden and Phillip Stafford, *What is a 'Mifid' and Why Care About its Delay?*: FIN. TIMES, (Nov. 10, 2015, 2:58 P.M.), *http:www.ft.com/cms.*

[40] *See* MiFID I, *supra* n.4, at Recitals.

[41] *See id*.

[42] *See* UCITS IV Directive, *supra* n.1 at art. 24(1).

[43] *See generally* MiFID II, *supra* n.6.

[44] *See id.*

[45] *See id.*

[46] *See id.*

[47] *See generally* Commission Delegated Regulation of Apr. 25, 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards Organizational Requirements and Operating Conditions for Investment Firms and Defined Terms for the Purpose of that Directive, C(2016) 2398 final [hereinafter MiFID II Delegated Regulations].

[48] *See id.* at Explanatory Memorandum.

[49] *See* MiFID II, *supra* n.6, at art. 24(4)(a)(i).

[50] *See id.* at art. 24(7)(b).

[51] *See id.* at art. 24(7)(b) and 8.

[52] *See* Commission Delegated Directive of Apr. 7, 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with Regard to Safeguarding of Financial Instruments and Funds Belonging to Clients, Product Governance Obligations and the Rules Applicable to the Provision or Reception of Fees, Commissions or Any Monetary or Non-monetary Benefits, Recital 24, art. 12(1), C(2016) 2031 final (July 4, 2016) [hereinafter MiFID II Delegated Directive].

[53] *See* MiFID II, *supra* n.6, at art. 24(7)(b) and 8.

[54] *See* MiFID II Delegated Regulations, *supra* n.47, at art. 53; *see* MiFID II, *supra* n.6, at Recital 73.

[55] *See* MiFID II Delegated Regulations, *supra* n.478, at art. 53(1).

[56] *See* MiFID II, *supra* n.6, at art. 24(4)(a)(i).

[57] *See* MiFID II Delegated Regulations, *supra* n.47, at art. 52(1).

[58] *See* MiFID II Delegated Directive, *supra* n.52, at art. 12(3).

[59] *See id.* at art. 12(3)(a)-(e).

[60] *See* MiFID II, *supra* n.6, at art. 24(4)(a)(i).

[61] *See* MiFID II, *supra* n.6, at art. 24(7)(a).

[62] *See id.* at art. 25.4.

[63] One of the most important responsibilities of the independent directors of 1940 Act mutual funds is to annually review and approve the advisory contract, including the advisory fees paid to the fund's investment manager. This process is known as the 15(c) process, after the section of the 1940 Act that requires a majority of a fund's independent directors to annually approve the fund's advisory contract at an in-person meeting called for that purpose. Section 15(c) requires the board to "request and evaluate," and the adviser to furnish, "such information as may reasonably be necessary" for the board "to evaluate the terms" of the advisory contract. As part of the 15(c) process, an adviser is required to provide information on "similarly situated accounts," which could include UCITS.

[64] *See* MiFID II, *supra* n.6, at art. 24(9).

[65] *See id.*

[66] *See* ESMA, *supra* n.34, at 134-37.

[67] *See* MiFID II Delegated Directive, *supra* n.52, at art. 11(2)(a)-(c).

[68] *Id.*

[69] *Id.* at art. 11(2)(c).

[70] *See id.* at Recital 23.

[71] *See id.* at art. 11(3).

[72] *See id*.

[73] *See id.* at art. 11(4)(a)-(b).

[74] *See id.* at art. 11(5).

[75] *See* MiFID II, *supra* n.6, at art. 24(9).

[76] *See* MiFID II Delegated Directive, *supra* n.52, at art. 11(5)(a).

[77] *See* MiFID II, *supra* n.6, at art. 24(9).

[78] *See* MiFID II Delegated Directive, *supra* n.52, at art. 11(5)(b).

[79] *See id.* at art. 11(5)(c).

[80] *See id.* at art. 25(3)-(7)).

[81] *See id.* at art. 24(5).

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[82] *See id.* at art. 24(4)(c); *see* MiFID II Delegated Regulations, *supra* n.47, at art. 50(2).
[83] *See supra* n.71 and accompanying text.
[84] *See* MiFID II Delegated Regulations, *supra* n.47, at art. 50(2).
[85] *See* MiFID II, *supra* n.6, at art. 24(4).
[86] *See* MiFID II Delegated Regulations, *supra* n.47, at art. 50(8).
[87] The proposed directive for the marketing of "packaged retail and insurance-based investment products."
[88] *See* MiFID II Delegated Regulations, *supra* n.47, at art. 50(4).

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