

MiFID II – Global Game Changer

PRESENTED BY: IMDDA
SEPTEMBER 27TH, 2017

IMDDA
Investment Management
Due Diligence Association



Our Cause

The Investment Management Due Diligence Association is the voice of the individual professionals of the investment management industry. Our goal is to advance the knowledge and skills of the due diligence community through continuing education and world-class information resources and the establishment of industry standards for conducting due diligence on potential and ongoing investments.

Our Promise

IMDDA provides exceptional experiences, a vibrant community, and essential tools that make you and your organization more successful.



Meet the Experts

IMDDA
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OUR EXPERTS

MARK RUBIN

Mr. Rubin has extensive experience developing, implementing and managing all aspects of technology for financial services firms. During the past 13 years he served as CTO and a member of the operating committee for Trilogy Global Advisors managing a 10-person staff with a \$2 million annual budget. He previously spent some years at Fidelity Investments in Boston and grew a multi-million-dollar consulting firm, working in the financial vertical, until the early 2000's. Mr. Rubin has a BS and MS in Aeronautical Engineering at Rensselaer Polytechnic Institute in Troy, NY. Today Mark is the Chief Executive and Founder, of Global Commission Systems LLC.



THOMAS KYLE

Mr. Kyle currently serves as COO of Global Commission Systems LLC which provides a cloud based MiFID II compliant commission management and research payment system (RPS). GloComm and its affiliate Defined Scope also provide outsourced CIO and consulting services primarily focused on the financial services industry. His senior roles span chief executive, chief technology, operations and compliance management positions. Most recently, Mr. Kyle was both COO and CCO of a financial technology startup, Vestwell Holdings, LLC. Mr. Kyle attended Harvard University and is a Fellow of the Life Office Management Institute.



CRAIG PERETZ

Mr. Peretz is the CFO, COO and CCO to Sierra Global Management LLC. Mr. Peretz is responsible for the non-portfolio management side of the business at Sierra, including operations and risk monitoring. Mr. Peretz joined Sierra in 1998 from International Fund Administration (1995-1998), where he was in charge of client administrative operations, financial review/preparation and investor/manager relations. Mr. Peretz worked in the corporate finance and investment recovery divisions of Equitable and Alliance Capital Management for seven years (1988-1995), also serving as a member of Equitable's demutualization team. Mr. Peretz completed his undergraduate studies at Alfred University in 1988 and received his MBA from The Stern School of Business at New York University in 1993.



The information presented here is the opinion of Global Commission Systems LLC and its presenters. The interpretation of these regulations continue to develop. We encourage you to contact your legal council and regulators to review the specifics of these regulations and how they would apply to your Firm and products.

HIGHLIGHTS

1. Know Your Customer
2. Distribution
3. Cost and Budget for Research / Services
4. Pre-Trade Transparency
5. Post-Trade Transparency / Transaction Reporting
6. Commission Accounting / Research Payments
7. MiFID II Best Execution
8. Algorithmic / High Frequency Trading
9. Dark Pools
10. Record-keeping

History of MiFID II Regulation

A European Directive – a Global Impact



Biggest difference between the two regulations:

MiFID I: Only Equities

MiFID II: All Securities

How are non-EU firms affected?

**Applies to
Non-EU
Buy-Side
Firms which**

	<i>Know Your Customer</i>	<i>Distribution</i>	<i>Cost and Budgeting of Research/Services</i>	<i>Pre-Trade Transparency</i>	<i>Post-Trade Transparency</i>	<i>Commission Accounting/ Transaction Reporting</i>	<i>MiFID II Best Execution</i>	<i>Algorithmic / High Frequency Trading</i>	<i>Dark Pools</i>	<i>Record-Keeping</i>
Trade in EU Securities with no EU clients	Yes	No	Maybe	Yes	Yes	Maybe	No	Yes	Yes	Yes
Trade in EU Securities with EU domiciled clients	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Do not trade in EU Securities and have no EU clients	Maybe	No	Maybe	No	No	No	No	No	No	Maybe
Do no trade in EU Securities and have EU domiciled clients	Yes	Yes	Yes	No	No	Yes	Yes	No	No	Maybe
Which have a European Branch with Institutional Clients	Yes	Maybe	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Which have a European Branch with Retail Clients	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

How are EU firms affected?

**Applies to
EU Buy-Side
Firms which**

	<i>Know Your Customer</i>	<i>Distribution</i>	<i>Cost and Budgeting of Research/Services</i>	<i>Pre-Trade Transparency</i>	<i>Post-Trade Transparency</i>	<i>Commission Accounting/ Transaction Reporting</i>	<i>MiFID II Best Execution</i>	<i>Algorithmic / High Frequency Trading</i>	<i>Dark Pools</i>	<i>Record-Keeping</i>
Trade in EU Securities with no EU clients	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Trade in EU Securities with EU domiciled clients	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Do not trade in EU Securities with no EU clients	Yes	Maybe	Yes	Maybe	Maybe	Yes	Yes	Yes	Yes	Yes
Do not trade in EU Securities with EU domiciled clients	Yes	Yes	Yes	Maybe	Maybe	Yes	Yes	Yes	Yes	Yes

1. Know Your Customer

Additional requirements around identifiers and registrations.

- Requires development of additional policies and procedures.
- Non-EU third party managers with professional investor clients will need to register with ESMA similar to AIFMD.
- Firms must have a branch in the EU to have retail clients.
- Requires firms and each Client/Fund to be identified by a Legal Entity Identifier (LEI).

Action Items / Global Effect

- Check if you need to modify your sell/buy side documents.
- Obtain LEI's for your firm and all your Clients/Funds.

2. Distribution

New disclosures, updated documents, increased transparency.

- New Disclosure Requirements - product awareness, risk, return to clients, trading venues.
- Must explain Firm policy on charges and research breakdowns.
- Assign complexity levels to Clients/Funds.
- Establish target market definition for each product.
- Marketing materials must have specific performance and other disclosures.
- Retail disclosure requirements now apply to professional Clients as well.

Action Items / Global Effect

- Determine research charge policies; amounts to be paid by the Firm; MiFID II compliant order execution policy; and related disclosures.
- Review your marketing materials for compliance.
- Setup procedures for reviewing third party marketing materials.

3. Cost and Budget for Research / Services

Determine the actual costs and allocate projected cost to Clients/Funds.

Under MiFID II Investment Managers have four payment options:

1. Investment Manager pays for all research.
2. The Client/Fund pays for research as an expense.
3. Clients/Funds can still pay via commission.
4. A combination of the above.

Action Items / Global Effect

- Determine which option you are going to elect.
- Contact your Clients/Funds to determine what they need/want.
- Gather research/service price sheets from your counterparties and research service providers.
- Establish a research/service budget.

Things that were of no cost in the past, may need to be paid for by the Investment Manger in the future.

- Implement the rating of research and services.

4. Pre-Trade Transparency

Record reference data, market status and order construction.

- Pre-trade is about recording the state of the market at the time of the order.
- Recording the lifecycle of the order prior to the execution.
- Non-equity securities are now in scope.

Action Items / Global Effect

- Establish Trading Desk Policies and Procedures for all asset classes. (i.e. *Enhanced need for two sided market information.*)
- No matter your individual requirements, check to see if your OMS will gather and track the following:
 - The LEI
 - Date and **time stamping** of all your orders.
 - Required information on all your orders.

(Some reporting protocols now requiring up to 120 additional fields.)

5. Post Trade Transparency / Transaction Reporting

Transaction reporting and when necessary additional data required for all asset types.

- Ultimately, it is the responsibility of the seller to sure the execution details reach the Approved Publication Arrangement (APA), however your counterparty may be contracted to perform this function.
- Number of fields required can vary based upon asset type, and can be up to an additional 120 fields.
- Must use LEI's and national ID's.
- Tight time limits of one (1) minute for equity reporting, fifteen (15) minutes for other asset types and seconds for volume trading.

Action Items / Global Effect

- Determine which entity is going to be responsible for the reporting by asset type and trading venue.
- Should you use any counterparties for reporting, ensure that they will be in compliance for reporting, otherwise it will be your responsibility.
- Determination of these counterparties should be completed by January 3, 2018.

6. Commission Accounting / Research Payments

Track commission accumulation and expenditures by Client/Fund.

- Commission unbundling required for EU and may be needed in the US and Asia for transparency, separating execution costs and research costs.
- Reporting capabilities will be needed to track by client, broker and strategy.
- If you use Commission Sharing Arrangements (CSA), you must track by client.
- CSAs can only pay into a Research Payment Account (RPA).
- Research/Service Providers must price their products explicitly.
- Payment is required for research/services for all asset types.
- Investment Manager must report budget to EU Clients / Funds.

Action Items / Global Effect

- Determine your payment architecture and policies.
- In determining your policies and architecture, you are no longer allowed to cross-subsidize between EU clients and/or EU clients and other Clients/Funds of the Firm.
- Periodic budget to actual reporting, if required.

7. MiFID II Best Execution

Explicit requirements for an Order Execution Policy (OEP), additional reporting.

- Firms must develop an order execution policy (OEP).
- Firms must prove OEP is being followed.
- Additional reporting is required.
- Maintain an annual list of the top five locations at which Client/Fund orders were executed.

Action Items / Global Effect

- Ensure your existing Best Execution policy meets the MiFID II requirements. Disclosure is not an option.
- Update annual reporting compliance reviews ensuring the aforementioned requirements are being complied with.
- Potential disclosure requirements arise for those Firms with both Non EU and EU clients with different Best Execution Policies.
- Negotiate in advance with your counterparties execution cost by asset type.

8. Algorithmic / High Frequency Trading

Testing and audit records, circuit breakers, BCP/DR and disclosures.

- New requirement to test algorithms at least annually.
- Maintain proof of such testing.
- Need to disclose trading venues targeted by the trading desk.
- Need to disclose strategies used, risk controls that are in place.
- The establishment of circuit breakers.

Action Items / Global Effect

- Ensure your documentation and procedures are in effect.
- Establish the aforementioned as part of the annual review process.

9. Dark Pools

Volume caps, large transaction waivers, the role of Systematic Internaliser (SI).

- Volume caps on a trading vendor and global basis are meant to bring trading back into the light.
- Once 8% of a stock's trading volume, over the past 3 months, has been away from public venues, the stock can no longer trade in the dark.
- An individual dark venue can no longer trade a stock if that venue has had more than 4% of the stock's volume.
- There will be a waiver for the Large in Size (LIS) trades under the SI regime.

Action Items / Global Effect

- The 8% and 4% trading volume are estimated to block 75% or more of big EU stocks from trading in the dark.
- Restrictions can last six (6) months.
- Have discussions with your PM / Trading Desk on how this might effect your liquidity and execution.

10. Record-keeping

Storage of pre- and post- trade information, voice and time stamp requirements.

- Requirements to store all pre- and post- details for a minimum of five (5) years on immutable storage.
- Be able to record and the storage of all voice communications related to all aspects of trading.
- Record and retain all decisions related to research and services, including internal communications.

(i.e. the Portfolio Manager gives an order to the Trading Desk.)

Action Items / Global Effect

- Determine if you have immutable storage capability.
- Review need and cost of voice recording hardware and software.
- Review with your legal council your local regulations regarding voice recording.

Immutable: unchanging over time or unable to be changed.

Regulatory Update

- **SEC recent responses to No Action Requests:**
 - US Broker Dealers may now take hard dollars for payment of research, if the Investment Manager is subject to MiFID II requirements. However, the SEC made this a temporary ruling for thirty (30) months.
 - RPAs are now covered under the 28(e) Safe Harbor Rule if the Registered Investment Advisor is using such account to pay for research.
 - Transactions can be executed on a bundled basis, with the non-execution commission varying by Client/Fund.
 - The SEC still has not commented on the No Action Request regarding custody.
- **ESMA recent Q & A publication reported specifically with respect to MiFID II Portfolio Managers and their third country sub-advisors:**
 - A third country broker dealer may receive bundled commissions as long as the research portion is identified.
 - A third country broker dealer must identify a separate charge for research no matter how it is paid.



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