



AFB

# COMPLIANCE PLATFORM

## COMPLIANCE EXPERT PANEL – OUTPUT PAPER

*\*AFB Expert Panels meet regularly and produce Output Papers on behalf of the whole membership (see Note).*

### EUROPEAN COMMISSION PROPOSED CHANGES TO MIFID II DUE TO COVID-19

*This output paper focusses on the upcoming changes to MiFID II as a result of COVID 19. A full briefing note by Latham & Watkins setting out the key changes proposed as part of the broader MiFID II / MiFIR review can be found [here](#).*

The European Commission (the “**Commission**”) has adopted a legislative proposal for a directive amending Directive 2014/65/EU on markets in financial instruments (“**MiFID II**”) as part of a capital markets recovery package designed to facilitate the economic recovery following the COVID-19 pandemic. The proposed text amending MiFID II was published on 24 July 2020, along with proposals to amend securitisation rules, the Capital Requirements Regulation (575/2013) (“**CRR**”), and the Prospectus Regulation (2017/1129). The consultation closed on 4 September 2020.

Many of the wide-ranging amendments address the perceived barriers MiFID II introduced in capital markets and have been broadly welcomed by industry.

In October 2020 the Council published a press release announcing it had agreed its negotiating position on the proposed Directive plus an “I” item note enclosing the Presidency compromise text of the proposed Directive. In November 2020, the European Parliament’s Committee on Economic and Monetary Affairs (ECON) published its report on the proposed Directive. The European Parliament and Council need to formally approve the final changes, which then must be transposed into national law by each Member State. Therefore, the timing for the implementation of these proposed changes remains uncertain. It is even less clear whether these changes will impact the UK post-Brexit, where the UK government would need to decide to follow suit.

#### A. KEY POINTS

- The amendments aim to remove administrative burdens that result from existing information and disclosure rules.
- Bonds with make-whole clauses are to be exempt from the product governance regime; the amendments represent the first time the European Commission has acknowledged that “simple” bonds with a make-whole should not be a PRIIP.
- The amendments recalibrate the position limits regime for commodity derivatives.

- The European Commission has launched a consultation on the regime for research on small and mid-cap issuers and on fixed-income instruments, including a “research unbundling” exception, to help the recovery from the pandemic.

The Commission is proposing targeted amendments to MiFID II requirements in order to reduce some of the administrative burdens that experienced investors face in their business-to-business relationships.

The amendments refer to a number of requirements that were identified during the Commission’s MiFID/MiFIR public consultation as being overly burdensome or hindering the development of European markets (see link to briefing provided above). The COVID-19 crisis makes alleviating unnecessary burdens and providing opportunities to growing markets even more important. The Commission is also proposing to amend the MiFID rules affecting energy derivatives markets in order to achieve the same aims. Each of these is discussed further in Section B, below.

At the same time, the Commission opened a public consultation on amendments to the MiFID II Delegated Directive (EU) 2017/593 to increase the regime for research on small and mid-cap issuers and on fixed-income instruments to help the recovery from the COVID-19 pandemic. In particular, small and mid-cap issuers need a good level of investment research to give them enough visibility to attract new investors. Notably, the Commission consulted on a “research unbundling” exception under this proposed new alleviated regime, as discussed in Section C, below.

## B. COVID-19 LEGISLATIVE PROPOSAL AMENDING MIFID II

**AMENDMENTS TO INFORMATION AND DISCLOSURE REQUIREMENTS:** The amendment to MiFID II applying to investments in financial instruments aims to remove administrative burdens that result from documentation and disclosure rules that are not counterbalanced by corresponding increases in investor protection. Key changes to information requirements in the legislative proposal include:

<b>Proposed Change</b>	<b>Description of Change</b>	<b>Rationale</b>	<b>Permanent / Temporary Proposal</b>
<b>Phase-out of paper as the default method for communication</b>	Default position will be that documents will be provided in electronic format but retail clients can opt in to paper-based information.	Reduces cost burden and speeds up the investment process.  Aligns with objectives of the Commission’s Green Deal and Digital Finance Agenda.	Permanent
<b>Costs and charges disclosure</b>	Cost and charges disclosure requirements will not apply to services provided to professional clients or eligible counterparties except for investment advice and portfolio management.	By alleviating the requirement for information that is claimed not to be used neither by eligible counterparties nor by professional counterparties, the information will be individualised, and	Permanent

Proposed Change	Description of Change	Rationale	Permanent / Temporary Proposal
	<p>In case of distance communication, all clients using all services should be able, under certain conditions, to receive costs and charges information just after the transaction, rather than before the transaction is executed.</p>	<p>thus will provide wholesale clients with the data they need. In practice this already happens, but having an automatic opt- out is helpful to reduce the administrative burden of these requirements, particularly as the opt- out will now apply to products which embed derivatives.</p> <p>The changes to the distance communication requirements are intended to avoid delays to the execution of transactions due to the need to provide costs and charges information.</p>	
<p><b>Alleviate ex-post reporting requirements</b></p>	<p>Eligible counterparties and professional clients will be exempted from receiving ex-post statements produced by investment firms regarding services they have received.</p> <p>Professional clients may, however, choose to opt in.</p>	<p>Post-transaction service reports include the loss-reporting reports which are deemed not useful or even confusing for certain clients and according to the Commission promote a short-term view and foster “herd behaviour”.</p> <p>Allows both firms and clients to focus on providing and receiving the</p>	<p>Permanent</p>

Proposed Change	Description of Change	Rationale	Permanent / Temporary Proposal
		information that is relevant to them.	
<b>Suspend best execution reports</b>	The RTS 27 reporting obligation is temporarily dis-applied, pending a thorough analysis with regard to a possible streamlining of the reports.	<p>In their current form, best execution reports are rarely read by investors, evidenced by very low numbers of downloads from websites, while buy-side investment firms have informed the Commission that they receive all the relevant information on best execution via other means (<i>e.g.</i> via brokerage meetings).</p> <p>Reduces the burden of producing those reports by freeing up resources currently used for production of the reports, without requiring firms and venues to invest in costly implementation.</p>	<p>Temporary — suspended for two years after the amendment enters into force.</p> <p>In the context of the full review of MiFID II in 2021, the Commission will assess whether the requirement to publish the report should be deleted permanently, or whether the reports need to be reintroduced in a revised manner.</p>
<b>Alleviate cost-benefit analysis</b>	An exemption from performing a cost-benefit analysis in case of switching for professional clients, although professional clients may choose to opt in.	As part of the suitability assessment, firms are required to obtain information about the client in order to perform a cost-benefit analysis in case they “switch” between products in the course of an	Permanent

Proposed Change	Description of Change	Rationale	Permanent / Temporary Proposal
		<p>ongoing relationship. For professional clients, this is overly burdensome, and they should therefore be allowed to choose whether this measure applies to them.</p> <p>To make the process as swift as possible for wholesale clients to change their investment strategies.</p>	

AMENDMENTS TO PRODUCT GOVERNANCE: Bonds with make-whole clauses will be exempt from the MiFID II product governance regime in order to facilitate the issuing of capital by making more plain vanilla corporate bonds available to retail investors. The Commission states that the exemption would need to be complemented by a clear rule that such non-complex bonds with make-whole clauses would not be considered a packaged retail and insurance-based investment product (PRIIP). According to the Commission:

*“Stakeholders to the MiFID II consultation have submitted evidence that product governance rules for certain instruments, which are often referred to as ‘plain vanilla’ issuances, have prevented an optimal allocation of capital by means of vibrant secondary markets. In the light of the current crisis caused by the COVID-19 pandemic, it is indispensable to facilitate the issuing of capital. Issuers and investors must be equipped with the right tools to easily issue new capital and to easily get access to an increased investor base.*

*The earlier these tools are operational, the better for companies and investors alike. This proposal is therefore lifting the product governance requirements for simple corporate bonds with make-whole clauses (which are investor-protective features). The aim of this exemption, which would need to be complemented by a clear rule that a make-whole clause does not of itself make these instruments a packaged retail and insurance-based investment product (PRIIP), is to make more plain vanilla corporate bonds available to retail investors. This targeted exemption will allow issuers to tap a broader base of investors, allow sophisticated retail investors’ to access a larger choice of instruments and it will retain protection for all categories of investors, however categorised, when accessing complex products. It is an essential part of a recovery package that retail clients can obtain exposure to fixed income products, as such products are essential for diversification and risk-reduction reasons.”*

The Commission therefore proposes that Article 16(3), subparagraphs 2 to 6, and Article 24(2) of MiFID II will not apply to corporate bonds with make-whole clauses. A corresponding rule that corporate bonds

with make-whole provisions are not a PRIIP will also need to be introduced in the PRIIPs Regulation (1286/2014).

If implemented, the exemption should remove the lingering uncertainty as to whether the presence of a make-whole provision brings a corporate bond into the scope of the PRIIP's Regulation, with focus instead switching to the concept of "complexity" of the corporate bond in these circumstances.

**MEASURES AFFECTING ENERGY DERIVATIVES MARKETS:** The proposed amendments in relation to energy derivatives markets recalibrate the position limit regime and the scope of the hedging exemption in order to ensure that growing euro-denominated markets are able to foster and allow producers and manufacturers to hedge their risks whilst safeguarding the integrity of commodity markets. Proposed measures include:

**Amending position limits:** Position limits are to be limited to agricultural commodity derivatives or commodity derivatives designated as significant or critical. ESMA will be mandated to develop draft regulatory standards to define those agricultural derivatives subject to position limits and to define critical or significant derivatives subject to position limits.

**Deleting the concept of "same contract":** The concept of "same contract" for commodity derivatives is to be deleted and replaced with a more cooperative approach between competent authorities.

**Reinforcing position management controls:** Significant dissimilarities exist in the way positions are managed by trading venues. Therefore, position management controls will be reinforced where necessary and ESMA will be mandated to further clarify the content of position management controls taking into account the characteristics of the relevant trading venues.

**Introducing a narrowly defined hedging exemption:** This exemption would be available where, within a predominantly commercial group, a person has been registered as an investment firm and trades on behalf of the group. A position limit exemption is also to be introduced for financial and non-financial counterparties for positions resulting from transactions undertaken to fulfil mandatory liquidity provisions. ESMA will be mandated for the narrowly defined hedging exemption and the liquidity provision exemption to determine a procedure setting out how persons may apply the respective exemption. Securitised derivatives are to be excluded from the position limit regime as the current position limit regime fails to recognise the unique characteristics of those instruments.

**Simplifying the ancillary activity test:** The quantitative tests of the ancillary activity test are particularly complex and present a significant burden. Therefore, the ancillary activity test will be considerably simplified.

## C. CONSULTATION ON AMENDMENTS TO MIFID II DELEGATED DIRECTIVE

### 1. Alternative Alleviated Research Regime

The Commission is consulting on alleviating the research requirements lying on investment firms in order to encourage research coverage of small and mid-cap issuers and on fixed-income instruments.

Investment firms would have the choice to either follow the rules currently in place or follow an alternative alleviated regime when the research is provided exclusively on small and mid-cap issuers or fixed-income instruments. The Commission proposes that this alternative regime should be optional, so that investment firms, even when executing trades in small and mid-cap issuers, would not be forced to make IT changes to their order and accounting systems if they do not want to do so.

### 2. "Research Unbundling" Exception

Under this new alleviated regime, the Commission is proposing a narrowly defined "research unbundling" exception under which investment firms would be allowed to pay jointly for the provision of research and for the provision of execution services on small and mid-cap issuers or fixed-income instruments. This

joint payment would only be allowed under certain conditions related to the information of the research provider as well as the clients of the investment firms in order to ensure transparency.

Small and mid-cap issuers would be defined as “issuers that did not exceed a market capitalisation threshold of EUR 1 billion over a period of 12 months”. This targeted exemption would be achieved with amendments to Article 13 of the MiFID II Delegated Directive.

## NOTE

Meetings of AFB Expert Panels are held in compliance with AFB’s Competition Law Guidance. All issues discussed are included in the relevant Output Paper. AFB holds a central record of all attendees at Expert Panel Meetings. AFB Expert Panel Output Papers are intended as general guidance and no action should be taken in reliance on them without specific legal advice.

## QUERIES AND FOLLOW-UP

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*In partnership with*

*Issued December 2020*

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