

MiFID II Alert for Non-EU Firms

A bi-weekly publication from the Accordo Team

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MiFID2 will take effect on **Jan 3rd, 2018** for all EU firms. However, the impact of MiFID2 will also be felt by U.S. and other non-EU firms because of a number of areas of MiFID2 that could have a direct or indirect impact on them. Markets related obligations under MiFID2, such as the trading obligation in respect of derivatives and a new position limits regime for commodities derivatives, can have a direct impact on non-EU firms. Similarly, non-EU firms, when interacting with EU firms (such as using EU placement agents or distributors) will be indirectly impacted. Some of the activities of non-EU banks and broker dealers that will come under MiFID II scope:

- Booking trades with an EU Broker;
- Cross-border trading on an EU-venue; and
- Non-EU instrument access and services to an EU regulated entity.

On Oct. 26, 2017, SEC issued three related no-action letters that provided temporary relief to investment managers if all of the following four conditions are complied under Section 28(e) of the 1934 Securities Exchange Act:

1. Payments are made to the executing broker-dealer out of client assets for research alongside payments to that executing broker-dealer for execution;
2. The research payments are for research services that are eligible for the safe harbor;
3. The executing broker-dealer effects the securities transaction for purposes of Section 28(e);
4. The executing broker-dealer is legally obligated by contract with the IA to pay for research through the use of a Research Payment Account (RPA) in connection with a Client Commission Arrangement (CCA).

MiFID's Dark-Trading 'Loophole' Has New Stock Exchange Opponent

Bloomberg (Nov. 13 2017)

Systematic Internalizers, also known as SIs, are dark pools that offer flexible pricing, don't have to reveal order size and are exempt from MiFID's "tick-size" rules, which require that trading platforms price certain financial instruments using the same increments. Critics claim that the exemption will create a blatant price advantage over exchanges. One prediction estimated that dark trading of EU-regulated stocks would triple as a result. EU regulators have since proposed changes to MiFID II to require that SIs follow the same rule. [Link](#)

MiFID's Pay-to-Parlay Rule Will Have a Nasty Side Effect: Gadfly

Washington Post (Nov 16, 2017)

The revised Markets in Financial Instruments Directive requires investors to pay brokers the "commercial" rate for corporate access. The pay-to-parlay rule affects the bottom line, and firms, like Crux Asset Management, are raising their fees in response. Larger firms will be able to bear the cost, however smaller investment management firms will likely be forced to limit new stock additions. The rule will not affect meetings either arranged directly or through a third-party provider. [Link](#)

Key Considerations for U.S. based Investment Managers and Non-EU affiliates:

- Cross-border dealings among EU and US affiliates operating on a "pass through" basis managing client accounts under sub-advisory arrangements or involve delegated investment discretion and trading authority in the US.
- Trading of both U.S. and EU MiFID II accounts for aggregated trading purposes would complicate compliance with fiduciary obligations and regulatory requirements (commissions, soft dollar arrangements, etc.).
- US Investment Managers relying on Section 28(e) of 34'Act with a hybrid-RPA model should assess impact of MiFID II adherence in terms of potential conflicts and cross-subsidization when imposing research costs on clients outside bundled commissions and the treatment of such research expenses for reporting purposes.
- Potential custody issues under Rule 206(4)-2 for RPAs and the treatment of unspent balances in them under MiFID II while considering U.S. law implications, including custody, required Form ADV Part 2A disclosure of fee arrangements, refundability of prepaid fees, and insolvency risk.
- Complications stemming from cross-subsidization and conflicting research valuations when funding research across EU and US accounts with RPA balances.
- Consistent and scalable approach in addressing potential fiduciary obligations in treatment of U.S. and EU clients that reject RPA funding or Soft Dollars and associated disclosures.
- Ring-fence MiFID II's strict research requirements while reconciling the differences between corresponding requirements under MiFID II and the Investment Advisers Act of 1940.