MiFID2 comes into force on 3 January 2018. As the deadline looms, the financial services industry in the EU is gearing-up for implementation. However, the impact of MiFID2 will be felt in Asia-Pacific, far beyond the EU. APAC firms should also pay close attention to the new regime, as there are a number of areas of MiFID2 which could have a direct or indirect impact on them.

The majority of the MiFID2 Level 2 implementing measures have now been published, so we have a much clearer understanding of the practical implications of MiFID2 on APAC firms.

In this briefing, we focus on the issues that are most likely to have an impact, which include product governance, inducements and dealing commission, trading obligations, position limits for commodities derivatives and the new regime for accessing the EU market.

Impact of MiFID2

APAC firms could be impacted by MiFID2, either directly, because the relevant obligations under MiFID2 have extraterritorial application, or indirectly, because they are doing business with firms in the EU that are subject to MiFID2, even though they themselves are not, and this affects the way the business must be done.

Direct and Indirect Impact

- **Direct impact**: markets related obligations under MiFID2, such as the trading obligation in respect of derivatives and a new position limits regime for commodities derivatives, can apply to firms outside the EU

- **Indirect impact**: APAC firms, when interacting with EU firms (such as using EU placement agents or distributors) will be indirectly impacted

Product governance

Product governance is one of the MiFID2 topics attracting much attention at the moment. In particular, there is a lot of discussion on the concept of a “target market” and how MiFID2 will impact the distribution of products and financial services in the EU.

These requirements apply to the distribution in the EU of investment services and products, and so can be relevant to the offering of services or investments to EU-based clients.

The product governance requirements provide a good illustration of the indirect impact of MiFID2 on APAC firms: although an APAC firm might not itself be subject to MiFID2 requirements, EU firms that it interacts with, such as placement agents for example, are likely to be MiFID firms, and will probably require certain information from the APAC firm in order to comply with their MiFID2 obligations. A placement agent needs to obtain certain information on the proposed target market for an investment or a fund in order to sign-off internally that it is comfortable with that target market and to ensure that it only markets to that investor group. Consequently, placement agents will need to request specific information on an investment or a fund from the APAC firm and will likely seek to embed rights to that information in distribution agreements and engagement letters.
The same requirements will also apply more broadly, as distributors will likely seek the same information from manufacturers of investment products and services.

APAC firms will need to give careful thought to how the “target market” concept applies to their business. This may not be straightforward, as it is a concept that is more readily understood in the context of retail business than it is in the professional/institutional investor market.

Proposed guidance requires target market analysis to take into account a minimum of six factors, including the client’s objectives and experience. MiFID2 also requires that a “negative” target market be identified, meaning a group of investors that the particular fund is not appropriate for. This also needs to take into account the relevant factors, so it will not be sufficient to apply a blanket “not for retail” legend. An interesting example being debated in the asset manager space at the moment concerns the scenario where a fund is designed for capital-generation, whereas the investor is seeking income-generation; under the new rules the investor (despite being appropriately experienced in the investment) may still fall into the “negative” target market for that particular fund. This brings into sharp focus the degree of analysis that is required on investor intentions when marketing an investment or a fund, and importantly, how this analysis is recorded internally.

Product intervention
Interestingly, MiFID2 introduces new product intervention powers for EU national regulators. Although there has been recent experience in the EU of market intervention by national regulators (such as the UK in respect of the sale of CoCos and unregulated funds), this is the first time giving such powers to national regulators has been “hard-wired” into EU legislation. The guidance accompanying these powers suggests that the intention is not to turn national regulators into product-approval authorities. However, there is a sense that regulatory scrutiny and challenges to product design will increase before a product is brought to market, and this will be as relevant for APAC firms looking to access the EU market as it is for EU firms.

Inducements and dealing commission
MiFID2 tightens the rules on inducements by introducing an absolute ban on an EU firm from accepting or receiving any fees, commissions or any monetary benefits paid or provided by a third party in relation to the services the EU firm provides to clients, unless the third party fees and commissions are transferred to the relevant client.

These requirements have received much attention in the market, particularly the requirement on EU firms, going forward, to pay for research (and the unbundling of research from the price of execution). These new requirements could be relevant to APAC firms on both the sell-side and buy-side. On the sell-side, APAC firms providing execution and research services to EU firms might be asked to trade at an execution only rate, restricting, for example, commission generating opportunities. The requirements on EU firms to pay for research may also be inconsistent with the local rules of the APAC firm, and might result in APAC firms having to separate order flow from EU clients (which would need to be factored into best execution, amongst other things). On the buyside, many EU firms are part of global groups, so the ways in which research is used and shared within a global group will need to be considered.

Trading obligations and commodities position limits
Certain obligations within MiFID2 apply more broadly than just to EU firms as they apply to particular products. For example, a new trading obligation will be introduced, so that derivatives which are subject to the EMIR clearing obligation can be made subject to a requirement to trade the relevant derivative on an EU market or equivalent third country market. Like EMIR, this obligation can apply to financial and non-financial counterparties, including counterparties outside the EU.

This trading obligation is part of a package of requirements under MiFID focussed on transparency, including new pre- and post-trade transparency requirements for equities and equity like instruments such as ETFs and depository receipts, as well as introducing such transparency requirements for non-equities such as bonds and derivatives. These requirements will be applicable to non-EU instruments traded on EU exchanges, and include obligations on venues to make available depth of

Target market requirements
- products must be designed to meet the needs of an identified target market of end investors
- the distribution strategy must be appropriate to that target market
- reasonable steps must be taken to ensure that the products are actually distributed to the target market
interest information, as well as post-trade information on the price, volume and timing of transactions. A developing area of focus is which Asian instruments may not meet the liquidity and other thresholds to qualify for the transparency requirements under MiFID2, and so might be exempted, although this is a developing area. Dual-listed instruments can also be further impacted under MiFID2. For example, EU MiFID firms may only trade EU listed equities on an EU exchange, which could have a knock-on effect for the liquidity of dual Asian and European listed equities. The ability of EU firms to trade on Asian exchanges will also be dependent on an equivalence assessment for those venues.

MiFID2 will also require firms to report details of their commodities positions (in commodities derivatives and OTC economically equivalent commodity contracts) on a daily basis. This is to ensure that firms do not exceed the position limits of a commodity or contract for a given month. The requirement applies to trading in commodity derivatives listed or tradable in the EU, and disclosure can also capture the positions of end clients of EU firms, even if the end clients are outside the EU.

**APAC firms accessing the EU**

Currently, when accessing the EU, APAC firms face a patchwork of rules, with some EU jurisdictions being relatively flexible in allowing APAC firms to do business on a cross-border basis, and other EU jurisdictions being much more restrictive.

MiFID2 provides for a new “third country regime”, which includes the possibility of APAC firms being able to provide services to professional clients on a cross-border basis across the EU, subject to a registration requirement with the EU regulatory bodies. Registration is contingent on the APAC firm being licensed in its home country, and the legal and supervisory framework in the home country having been determined by the EU to be “equivalent” to the requirements applicable to an EU firm. As our experience from EMIR has taught us, such an equivalence decision may not be speedily forthcoming.

MiFID2 also has a narrower concept of reverse-enquiry, referring to services requested at the “exclusive initiative” of the EU client being outside of scope of MiFID. The addition of “exclusive” is in line with the trend in the EU over the last few years to take a more conservative interpretation of what is “in-scope” for reverse-enquiry, putting more pressure on relationships established on a reverse-enquiry basis, but under which firms might go on to actively solicit EU clients. APAC firms may need to revisit the basis on which they have established relationships with EU clients and whether they can continue to interact with clients in the same way following MiFID2.

**Next steps**

Now that the majority of MiFID2 implementing measures are known, and the timing for the go-live date gets ever closer, firms are proceeding with detailed implementation planning. For APAC firms, this should include considering how they may be affected by the issues raised in this briefing. In particular, APAC firms will need to consider how they interact with the EU at the moment, whether that is with EU clients or trading EU products, and the MiFID2 related issues that triggers.
This publication does not necessarily deal with every important topic nor cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

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