Asset Management 2020

Opportunities in a challenging world

26 September 2017

Financial reporting update for funds

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Agenda

- FRS 102 and US GAAP updates
- Central Bank (UCITS) Regulations
- Companies (Accounting) Act 2017
- Money Market Regulations (MMR)
- Markets in Financial Instruments Directive II (MiFID II)

FRS 102 updates

- 2016 updates effective for accounting periods beginning on or after 1 January 2017
  - fair value hierarchy classifications A, B and C abolished by the amendment
  - introduces fair value hierarchy levels 1, 2 and 3, consistent with IFRS and US GAAP

FRS 102: FRED 67

- Directors' loans
- Intangible assets
- Investment property
- Financial instruments
- Financial institutions

FRS 102: FRED 67

- Directors loans'
  - small entities will no longer need to estimate a market rate of interest when measuring loans from a Directors who is also a shareholder.
  - those loans can be accounted for at transaction price rather than fair value.
- Intangible assets acquired in a business combination
  - fewer intangible assets will be required to be separately identified from goodwill in a business combination.

FRS 102: FRED 67

- Investment property rented to another group entity
  - entities will now be able to choose to measure these investment properties at cost less depreciation and impairment instead of fair value.
- Classification of financial instruments
  - a new principle-based description has been introduced for the classification of financial instruments which will allow more of them to be measured based on cost, rather than fair value

FRS 102: FRED 67

- Definition of a financial institution
  - Changes have been made to the definition of a financial institution with the result that fewer entities will be classified as such

- FRC expect to finalise these amendments in December 2017, with an effective date for accounting periods beginning on or after 1 January 2019

US GAAP updates

- ASU 2015-07: Disclosures for investments in certain entities that calculate net asset value per share (or its equivalent)
- ASU 2016-18: Statement of Cash Flows
- ASU 2017-08: Premium amortisation on purchased callable debt securities

US GAAP: ASU 2015-07

- existing guidance permits entities to estimate fair value for certain investments using NAV as a practical expedient
- investment measures using the NAV practical expedient are exempted from the fair value hierarchy and related disclosures
- requirement to show carrying amount of these investments as reconciling items between fair value hierarchy and total investments on the face of the financial statements
- effective date: fiscal periods beginning after 15 December 2016

US GAAP: ASU 2016-18

- requires “restricted cash and restricted cash equivalents” to be included within the cash and cash equivalents line in the Statement of Cash Flows.
- guidance also notes that entities shall disclose information about the nature of restrictions on its cash, cash equivalents, restricted cash and restricted cash equivalents.
- effective date:
  – public business entities (as defined in US GAAP): fiscal years beginning after 15 December 2017 and interim periods within those fiscal years
  – all other entities: fiscal years beginning after 15 December 2018 and interim periods within fiscal years beginning after 15 December 2019

US GAAP: ASU 2017-08

- accelerates the amortisation period for certain purchased callable debt securities held at a premium to the earliest call date.
- the impact is likely to accelerate the amortisation of paid premium and therefore reduce the interest income over the callable period.
- securities purchased at a discount are not impacted by these amendments as the discount continues to be amortised to maturity.
- effective date:
  - public business entities (as defined in US GAAP): fiscal years beginning after 15 December 2018 and interim periods within those fiscal years
  - all other entities: fiscal years beginning after 15 December 2019 and interim periods within fiscal years beginning after 15 December 2020

Central Bank (UCITS) Regulations

- UCITS Management Company – requirement for a second set of half-yearly accounts
  - in December 2016, the Central Bank clarified the requirements for the preparation and submission of two separate sets of unaudited financial statements covering:

    (a) the first six months of the financial year; and

    (b) the full twelve months of the financial year,

  both to be filed with the Central Bank within two months of the relevant financial statements period end date.
- no minimum capital requirement report or bank statements will be requested as part of this filing as they are filed with the audited filing for the same period

Central Bank (UCITS) Regulations: S.I. No. 344 of 2017

- Central Bank (Supervision and Enforcement) Act 2013 (Section 48(1)) (Undertakings for Collective Investment in Transferable Securities) (Amendment) Regulations 2017 (S.I. No. 344 of 2017)
  - location rule
  - subsidiaries
  - prospectus disclosure of long/short positions
  - depositary requirement

Central Bank (UCITS) Regulations: S.I. No. 344 of 2017

- location rule
  - expands the requirements for residency in the EEA to include "or such other country as the Bank may, taking into account criteria regarding effective supervision, determine".

- subsidiaries
  - the conditions which must be satisfied by a UCITS when establishing a subsidiary are detailed by Regulation 5 of the Central Bank UCITS (Amendment) Regulations 2017.

Central Bank (UCITS) Regulations: S.I. No. 344 of 2017

- prospectus disclosure of long/ short positions
  - more flexibility regarding prospectus disclosure of long /short positions is now possible by virtue of Regulation 11 of the Central Bank UCITS (Amendment) Regulations 2017.

- depositary requirements
  - rules on depositaries are revised by virtue of Regulations 17 to 23 and 30 of the Central Bank UCITS (Amendment) Regulations 2017.

Companies (Accounting) Act 2017

- effective 9 June 2017
- impacts funds established as UCITS/AIFMD compliant investment companies under the Companies Act 2014 and UCITS/AIFMD compliant management companies established as LTD companies.
- does not apply to funds established as Irish Collective Management Vehicles ("ICAVs"), Unit Trusts or Common Contractual Funds ("CCFs")

Companies (Accounting) Act 2017

- Section 1401 A (1):

  investment companies must now file

- statutory financial statements
- Directors report
- statutory auditors report

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Companies (Accounting) Act 2017

- Section 100 amended the European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations 2011 (S.I. No. 352 of 2011) so that UCITS PLCs must also now file:

- statutory financial statements
- Directors report
- statutory auditors report

Companies (Accounting) Act 2017

- Section 101 of the Act amended the European Union (Alternative Investment Fund Managers) Regulations 2013 (S.I. No. 257 of 2013) so that an Irish or EU domiciled AIF must ensure that the statutory auditors report is in compliance with the relevant requirements noted below:

  - if the Fund is an Irish domiciled AIF, Section 336 of the CA 2014; and
  - if the Fund is a non-Irish but EU domiciled AIF, the statutory audit directive of 2016 of Ireland or of the home member state of the EU AIF

Companies (Accounting) Act 2017

- Impact on the financial statements: All financial statements are required to include the following information:
  - name and legal form of the entity
  - place of registration of the Company and the number under which it is registered
  - address of its registered office
  - where the Company is being wound up, the information required by section 595 of CA 2014, it shall contain a statement to that effect

Companies (Accounting) Act 2017

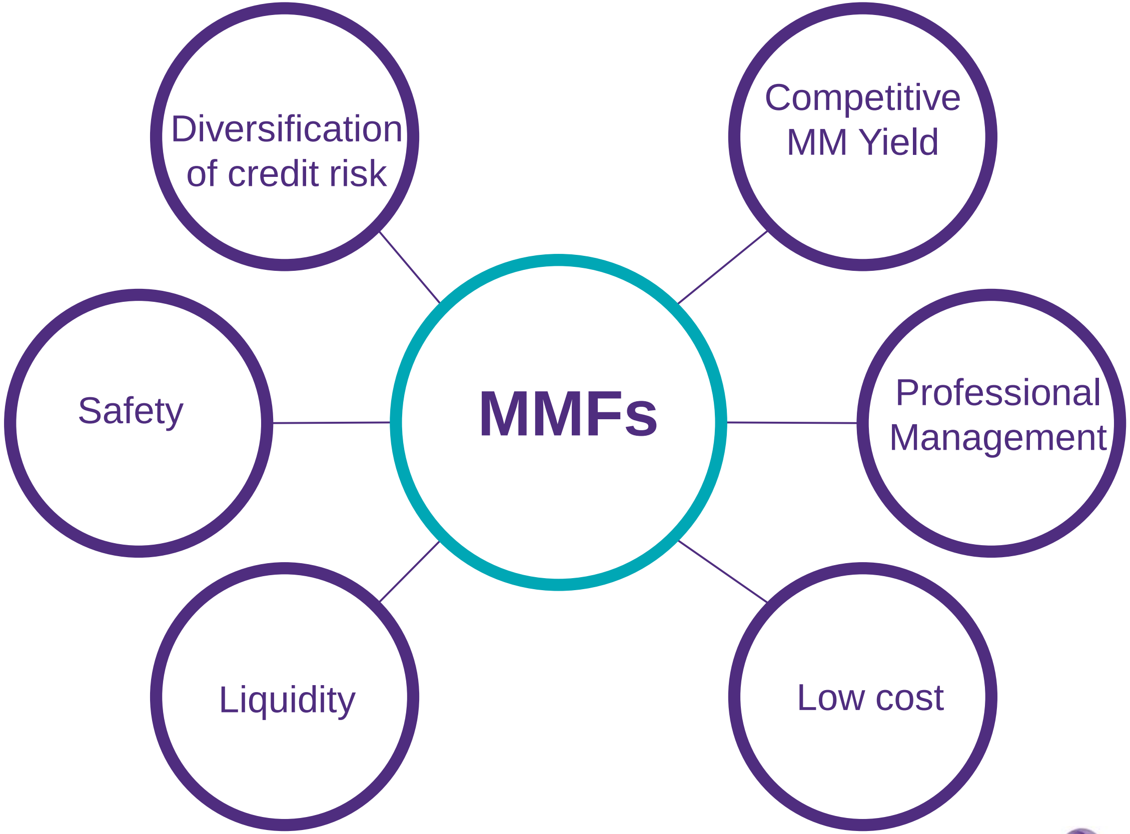
- **payments to third parties for services of Directors**

  Section 305 (a) of the Act introduces a new section to CA 2014 – it is now a requirement in the Directors remuneration disclosure in the financial statements to include any payments to or receivables by third parties for services of Directors of the Company or any of its subsidiaries or otherwise in connection with the management of the Company (or its subsidiaries)

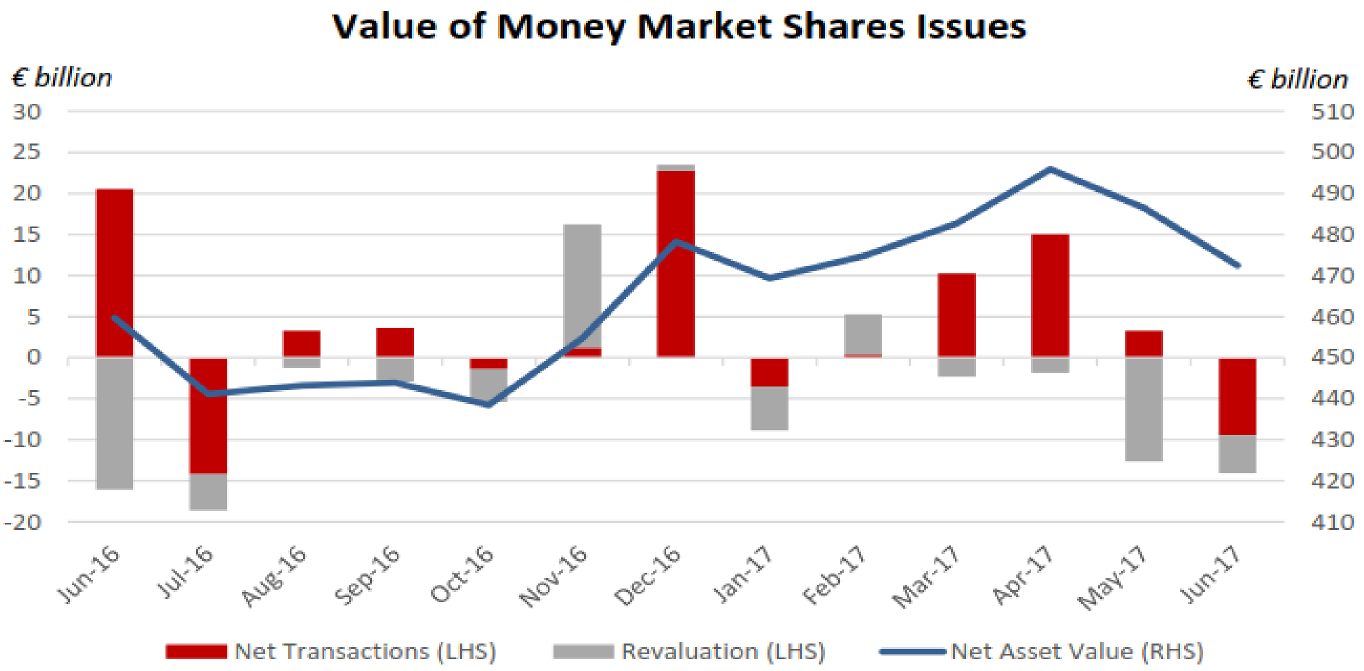
- **change in financial reporting framework and accounting policy**

  Amends Section 290 of CA 2014 so that now even in the absence of a relevant change of circumstances, a company may change its financial reporting framework once every 5 years but also introduces a new requirement to explain in the financial statements the reason for, and any impact of, a change in accounting policy, on this year and any preceding years

Why invest in Money Market Funds (MMFs)?



Money Market Fund Statistics – Q2 2017



Source: Money Market Fund Statistics, Central Bank of Ireland

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Why the need for regulation?

- Ireland is the largest fund domicile in the European Union for MMFs
- the financial crisis showed that some features of MMFs make them vulnerable when there are difficulties in financial markets
- when the prices of assets in which an MMF has invested start to decrease, the MMF cannot always allow immediate redemptions or preserve the principal value of a unit or share issued by the MMF
- this can have a serious effect on constant and stable NAV MMFs as it could trigger sudden and substantial redemption requests
- to preserve the integrity and stability of the MMF market, it was deemed necessary to lay down rules regarding the operation of MMFs

Why the need for regulation?

- the MMF Regulation was published on 30 June 2017 and supplements the existing EU rules in relation to UCITS and AIFs
- purpose is to provide a uniform set of rules across the European Union to ensure MMFs are able to honour redemption requests from investors in stressed market conditions or when there are sudden and substantial redemption requests from a large group of investors
- uniform rules will also ensure the smooth operation of the short-term funding market for financial institutions, corporate issuers of short term debt and governments
- the MMF Regulation will enhance the stability of MMFs as a source of short-term finance across the European Union and ensure MMFs remain a reliable tool for cash management

MMF Regulation permits four types of MMF

Public Debt CNAV MMFs	Invests 99.5% of its assets in public debt instruments and maintains a constant NAV
Low Volatility NAV MMFs	Invests in prime MMF assets and maintains a constant NAV
Short-term variable NAV MMFs	Invests in prime MMF assets and maintains a variable NAV
Standard variable NAV MMFs	Invests in MMF assets with long maturity and maintains a variable NAV

MMF Regulation contains new requirements in relation to:

- eligible assets
- portfolio diversification
- liquidity
- credit quality assessment
- risk management
- valuation
- disclosures and regulatory reporting

A deeper dive – Low Volatility NAV

LNAV

Dealing NAV
Must use MTM NAV where CNAV deviates by 20bps

Valuation
Amortised cost if maturity < 75 days and MTM for others

Daily liquidity
10%

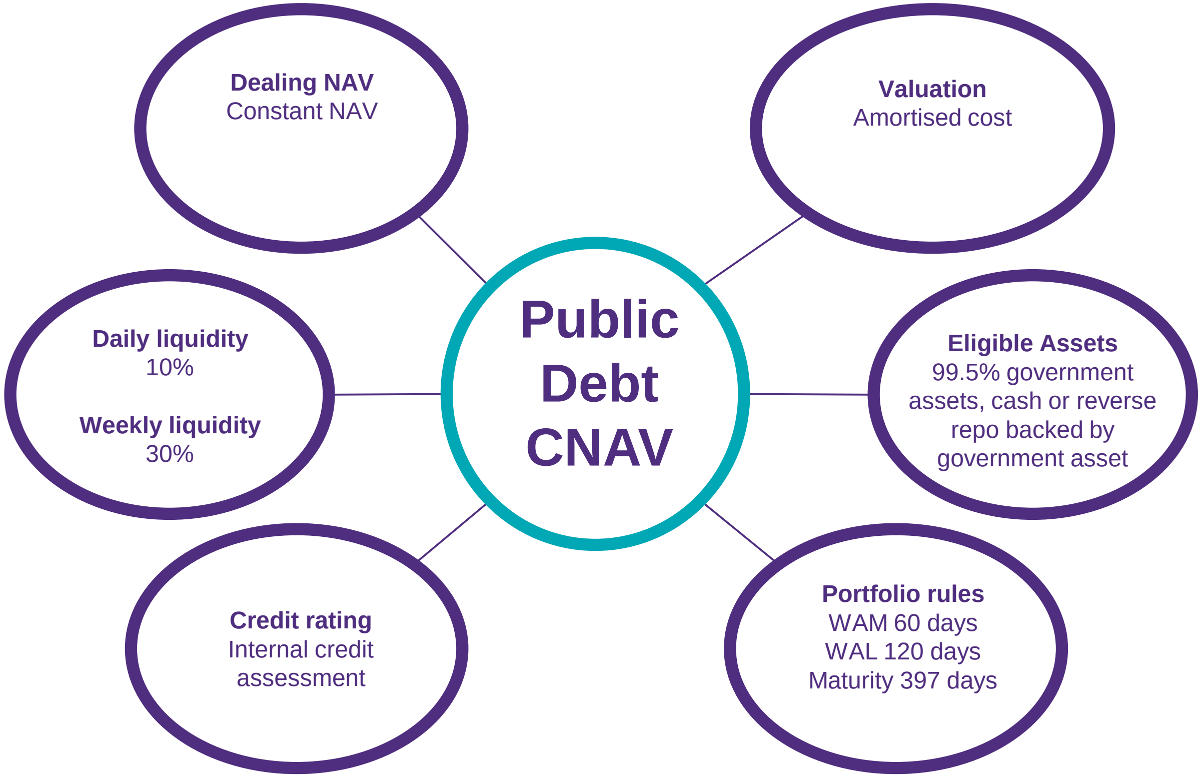
Weekly liquidity
30%

Eligible Assets
MM instruments, overnight deposits reverse repo, other short term MMFs

Credit rating
Internal credit assessment

Portfolio rules
WAM 60 days
WAL 120 days
Maturity 397 days

A deeper dive – Public debt CNAV



ESMA Consultation Paper on MMF Regulation

- Irish Funds response to the ESMA Consultation paper highlighted a number of points;
  - reverse distribution – ESMA stated that destruction of shares is not allowed under the MMF Regulation however Irish Funds highlighted that this practice is widespread and is understood and utilised by investors
  - reverse repurchase agreements and liquidity – Liquidity requirements imposed on LVNAV and CNAV MMFs mean these MMFs will become more reliant on short-term reverse repos
  - regulatory reporting – expansive regulatory reporting template proposed by ESMA
  - stress testing – aggregation of stress testing results
  - credit quality assessment – MMFs obliged to use a scale system for credit rating
- ESMA to finalise technical advice and implementing technical standards for submission to the Commission by the end of 2017

SEC response

- in response to the 2007-2008 financial crisis, the Commission adopted a first series of amendments to its rules on MMFs in 2010
- these were designed to make MMFs more resilient by reducing the interest rate, credit and liquidity risks of their portfolios
- in 2014, the Commission adopted more fundamental changes which require prime institutional MMFs to “float their NAV” (no longer constant) and introduced liquidity fees and redemptions gates
- these changes took effect in October 2016 and investors will need to consider their liquidity management tools and determine the role MMFs should play in their overall short-term allocation

Points to consider

- investment objective of the MMF must adhere to Article 1(c) of the MMF Regulation "have distinct or cumulative objectives offering returns in line with money market rates or preserving the value of the investment"
- investment policy of the MMF must be consistent with the portfolio rules outlined in the MMF Regulation i.e. for a Public Debt CNAV MMF note that the intention to invest a minimum of 99.5% of its assets in government securities
- MMF prospectus should be updated to note the type of MMF, daily and weekly liquidity requirement, clarify internal credit assessments, note redemption gates and specific diversification rules

Timeline

30 June 2017

MMF Regulation

21 January 2019

21 July 2018

MMF Regulation published

New MMFs to comply from inception

Existing MMFs to comply

MiFID II and MiFIR

- the second Markets in Financial Instruments Directive comes into effect on 3 January 2018
- it is regarded as one of the single largest and most significant regulatory initiatives undertaken by the European Union and will have a major impact on investment firms both commercially and operationally
- MiFID II and MiFIR is the European response to manage the risks associated with over the counter derivative ("OTC") trades
- it updates the existing MiFID framework and addresses issues in relation to transparency, investor protection and market infrastructure
- it comprises two components; the Directive (MiFID II) and Regulation (MiFIR)
- there is no phase-in period and investment firms will need to be ready for immediate implementation on 3 January 2018

MiFID II and MiFIR

- MiFID II: A directive addressing issues related to business conduct

- MiFIR: A regulation addressing issues related to transparency and market infrastructure

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MiFID II and MiFIR

Research costs

- MiFID II requires investment managers to pay for research costs separately from brokerage fees
- investment managers will either have to absorb the cost themselves or it will be passed onto the investor
- asset managers such as Baille Gifford & Co and M&G Investments have said they plan to pay for the research costs out of their own profits

MiFID II – So you think your ready

For further information and insights join our breakout session at 11.15am

Contact us

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Asset Management

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Work plan

Current Status	
RS	Research Summary
RFF	Request for Feedback
DP	Discussion Paper
DPF	Discussion Paper Feedback
EDF	Exposure Draft Feedback

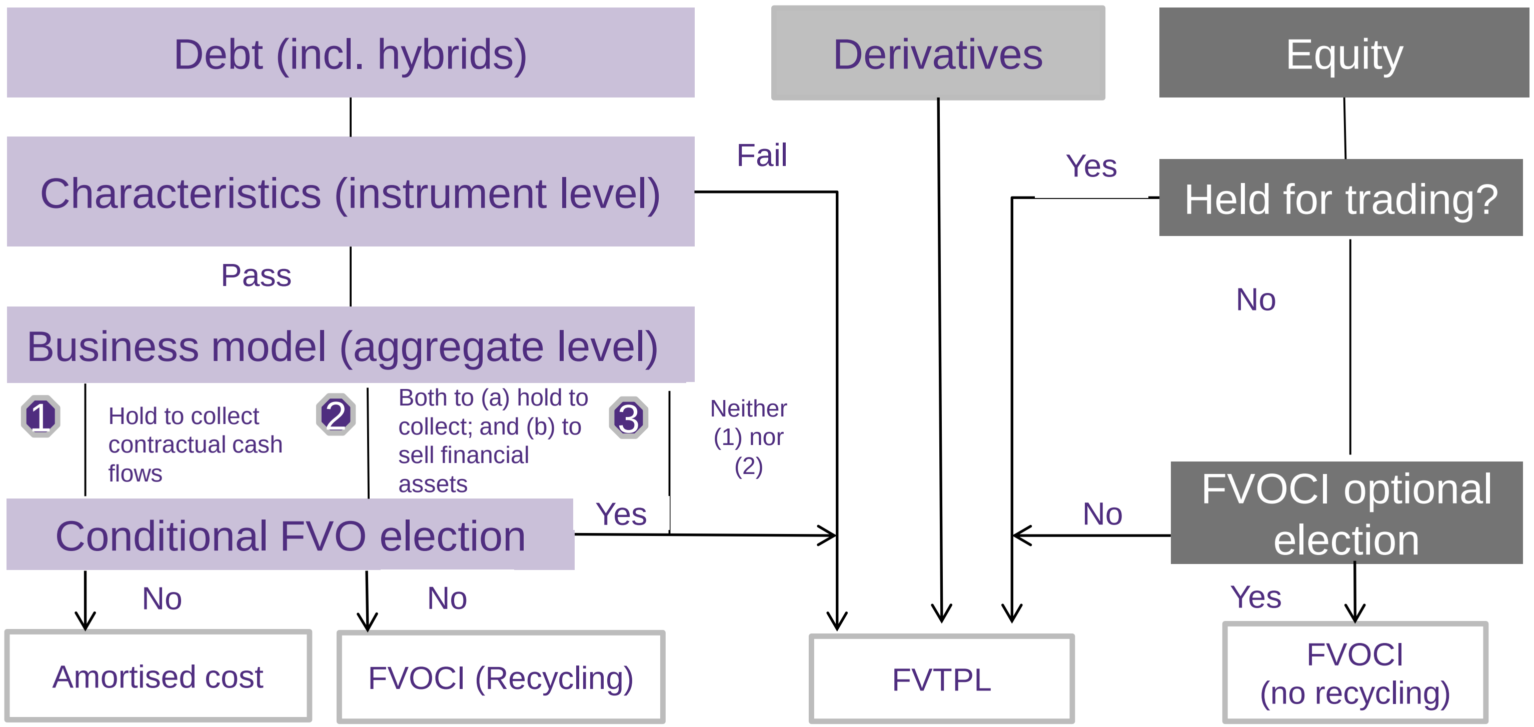
Research Projects	Current Status
Discount rates	RS H1 2018
Post implementation Review of IFRS 13 Fair Value Measurement	RFF H2 2017
Dynamic Risk Management	DP H2 2018
Financial Instruments with Characteristics of Equity	DP H2 2017
Principles of Disclosure	DPF H1 2018
Standard Setting Project	
Definition of Material (IAS 1 & IAS 8)	EDF Q1 2018

Work plan

Current Status	
EDF	Exposure Draft Feedback
ED	Exposure Draft
IFRSA	IFRS Amendment

Maintenance Projects	Current Status
Accounting Policies and Accounting Estimates (IAS 8)	EDF Q1 2018
Accounting policy changes (IAS 8)	ED H1 2018
Fees in the ‘10 per cent’ test for derecognition of a financial liability (IFRS 9)	ED Date TBC
Income tax consequences of payments on instruments classified as equity (IAS 12)	IFRSA H2 2017

IFRS 9 - revised classification and measurement (Effective 1 January 2018) financial assets



*IAS 39's existing categories of financial liabilities largely unchanged

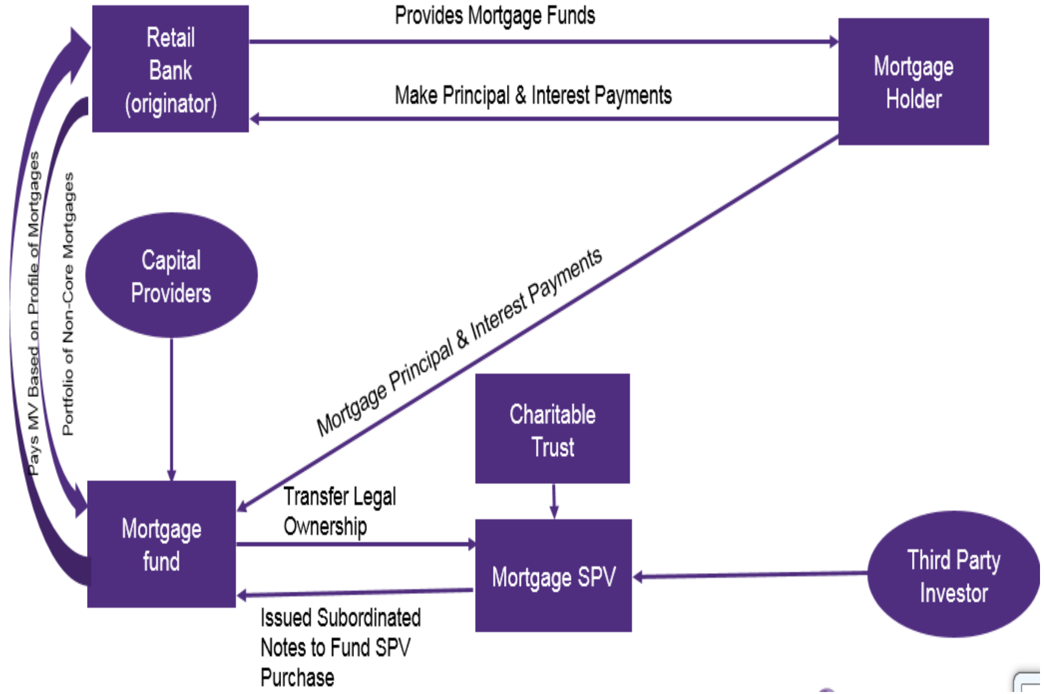
Examples of instruments that pass or fail SPPI

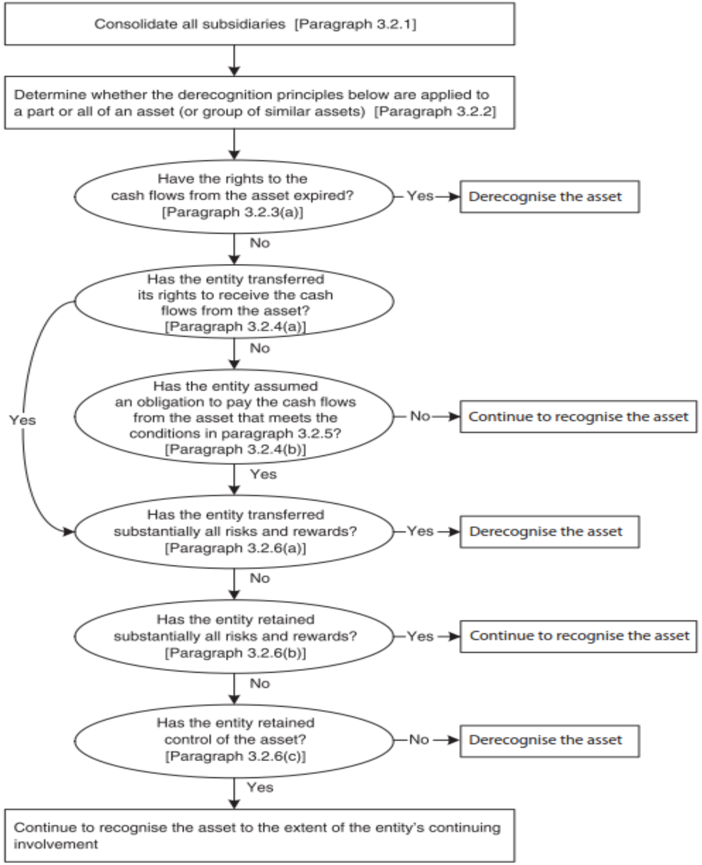
Instrument	SPPI?
Plain vanilla debt instruments acquired at par, have a fixed maturity and pay interest that is fixed at inception	✓
5 year loan that pays variable interest but is capped at 8%	✓
5 year loan issued to fund a specific project. Interest of 5% is charged. In addition the borrower must pay 10% of the final net profits from the project to the lender.	✗
5 year loan that pays interest of 3 month LIBOR + 2% and resets every 12 months	?
5 year loan can be repaid early at an amount = principal + unpaid interest + reasonable compensation	✓
Intercompany loan, interest-free and repayable on demand	✓

Securitisations – a hot topic

Summary of the issues:

- **Why –** increases in collateral value and ability to repay.
- **Cash flows -** does the originator continue to have involvement in the cash flows?
- **Risk -** is the originator still exposed to credit risk?



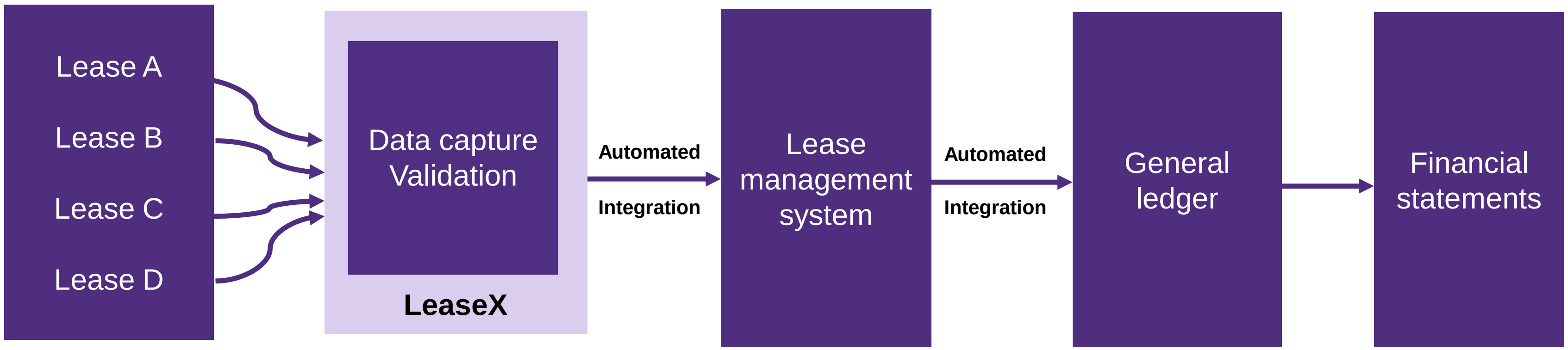


	Question	Answer
Q1	Have the rights to the cash flows from the assets (e.g. mortgage loan portfolios) expired?	No
Q2	Has the entity transferred the rights to receive the cash flows from the asset?	Yes
Q3	Has the entity transferred substantially all the risk and rewards?	No
Q4	Has the entity retained substantially all risks and rewards?	No
Q5	Has the entity maintained control of the asset?	No

IFRS 16 leases

Balance sheet		
	Recognition	All leases on balance sheet – Right of use asset & a lease liability
		Exemption for small leases ($5,000 threshold)
		Exemption for short term leases (less than 12 months)
	Measurement	Lease liability on discounted basis
		Lease asset = lease liability
		Depreciation of lease assets – typically straight-line
	Presentation	Lease liabilities (Per IAS 1, separate line item)
		Lease assets (PPE or own line item)
Statement of profit or loss		
	Operating costs	Depreciation
	Finance costs	Interest
Statement of cash flows		
	Operating activities	Interest
	Financing activities	Principal

Turning leasing into a more sustainable lease process



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Cyber regulation – Negotiating the General Data Protection Regulation

Andy Harbison
Director
Grant Thornton

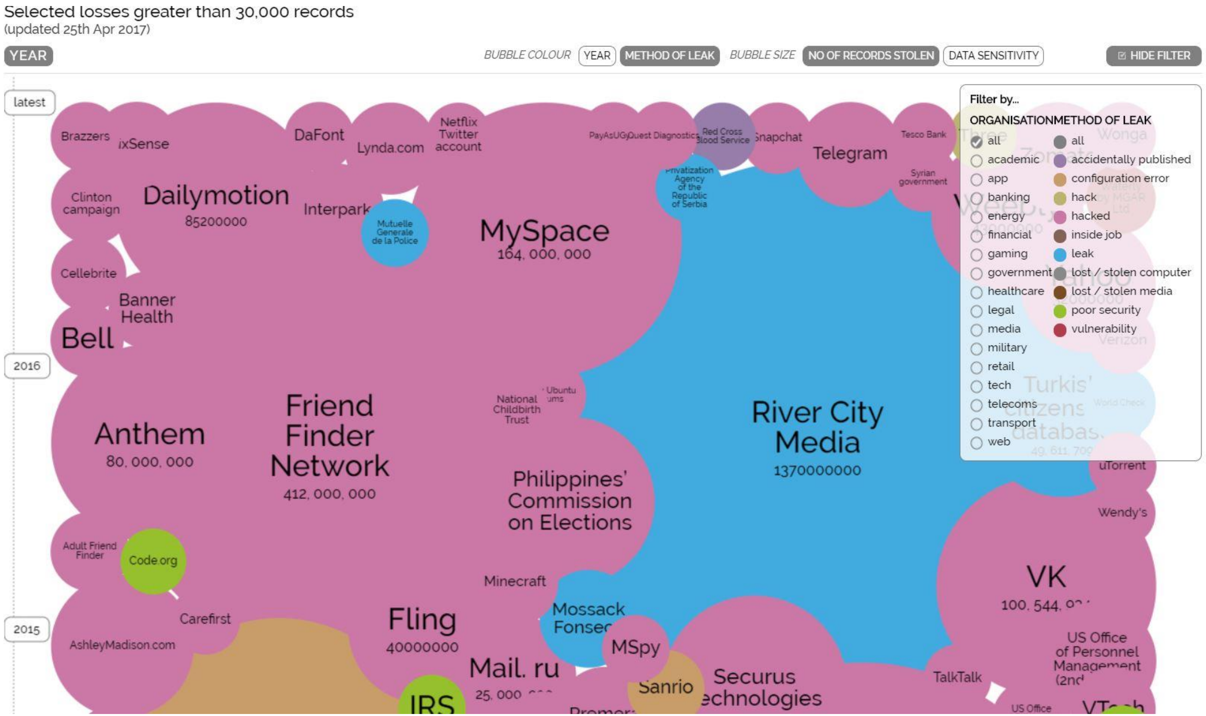
Agenda

- Introduction
- Update on Cyber
- Cyber Regulatory considerations
  - General Data Protection Regulation
- Responses

The first thing to remember…

- Hackers don’t hack computers any more,
- They mostly hack people.

It has been a very successful change for them…



The statistics are awful

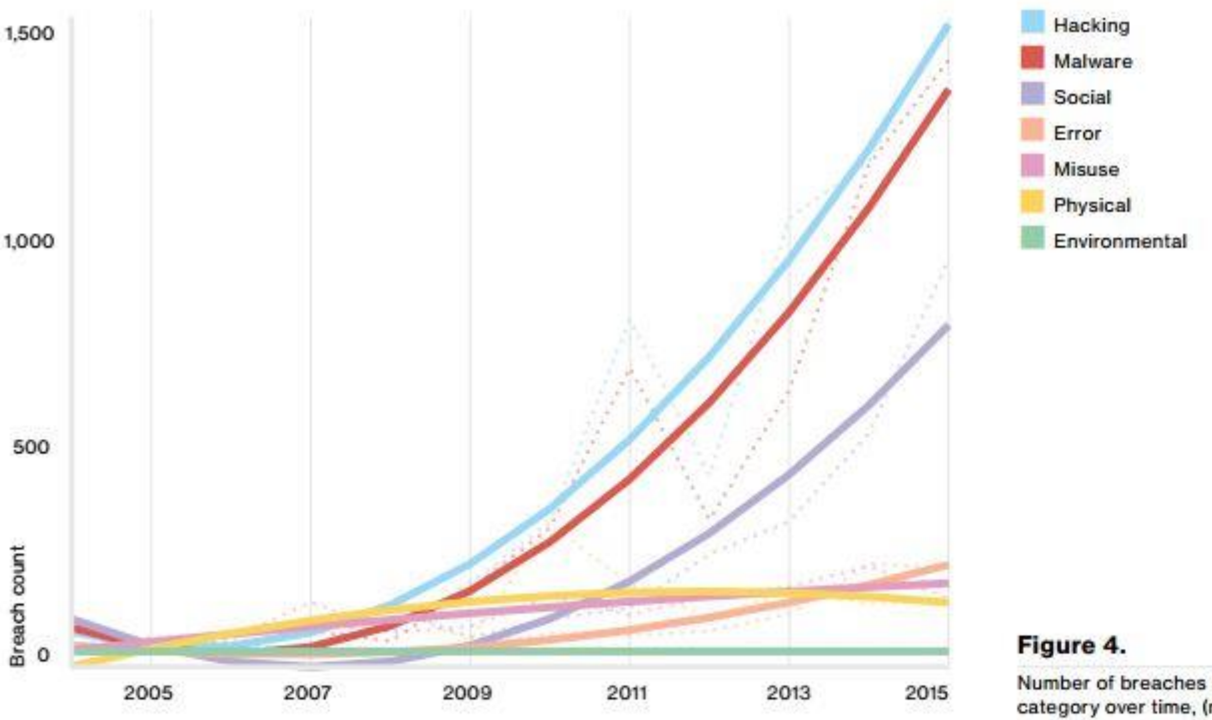


Figure 4.

Number of breaches per threat action category over time, (n=9,009)

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Technology can only get us so far…

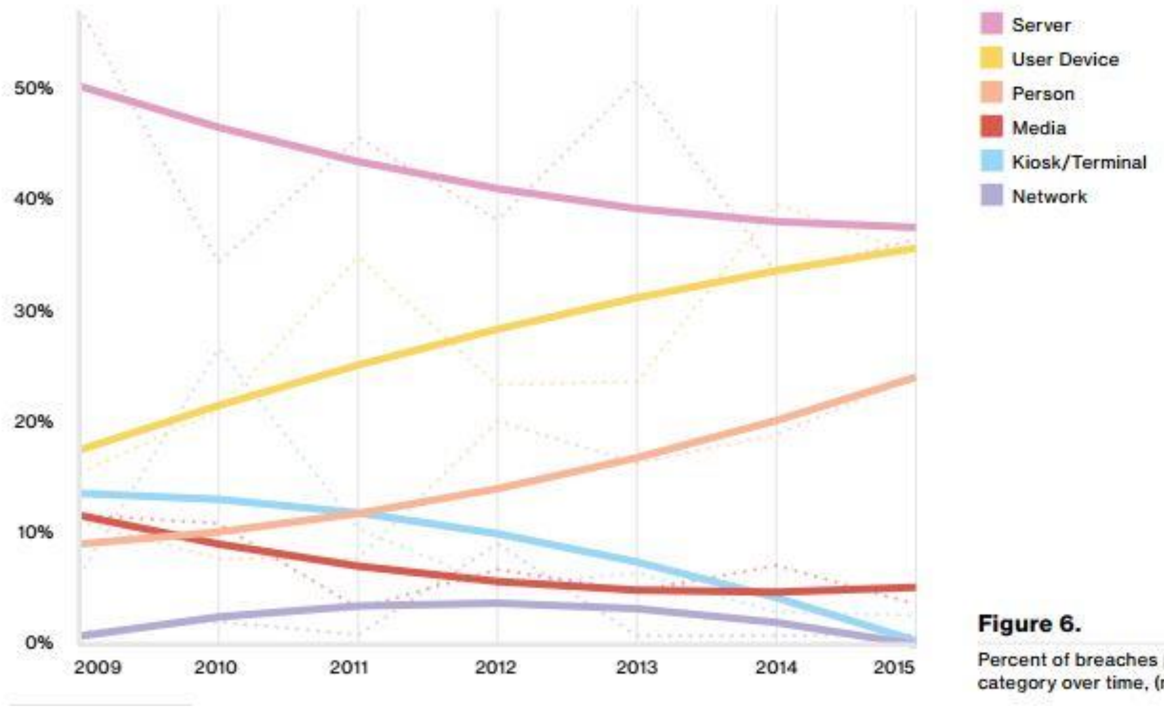

Figure 6.

Percent of breaches per asset category over time, (n=7,736)

Breaches are very difficult to detect…

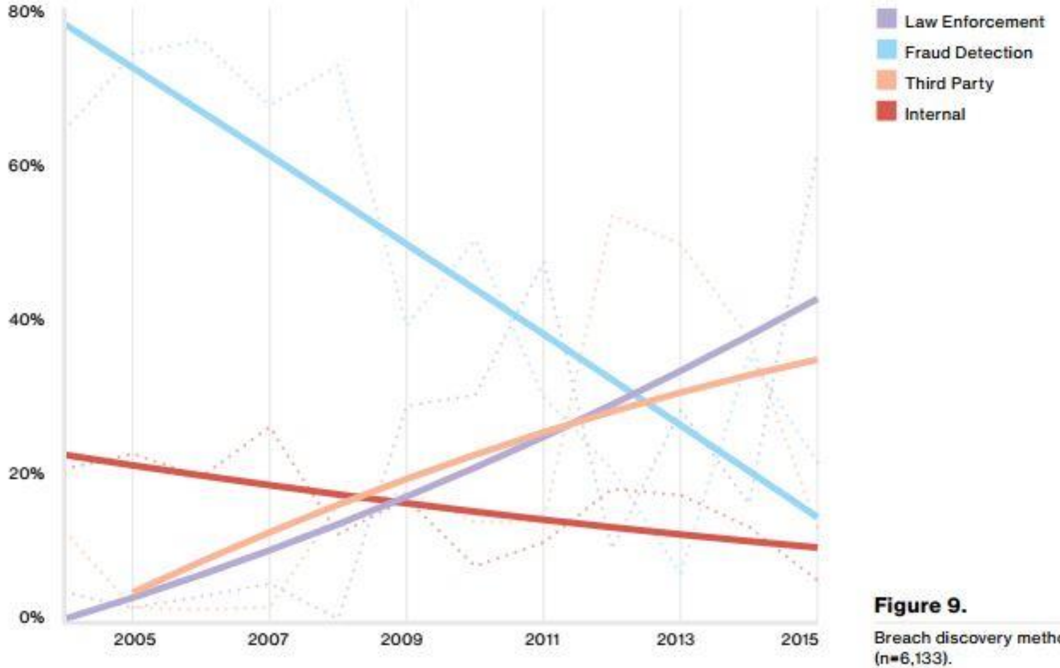

Figure 9.

Breach discovery methods over time, (n=6,133).

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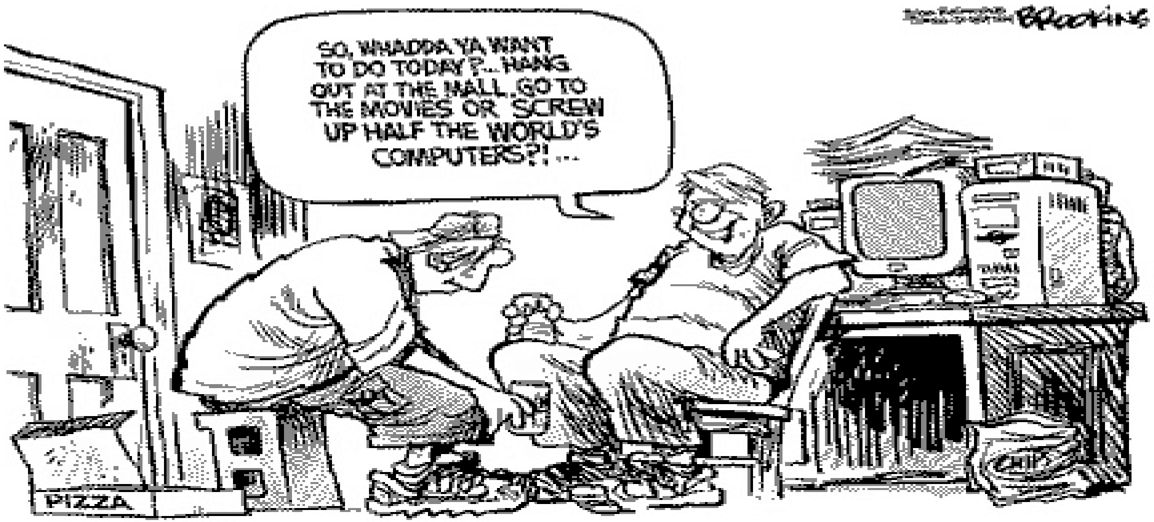
The Bad Guys have changed…

- 15 years ago, they looked like this…



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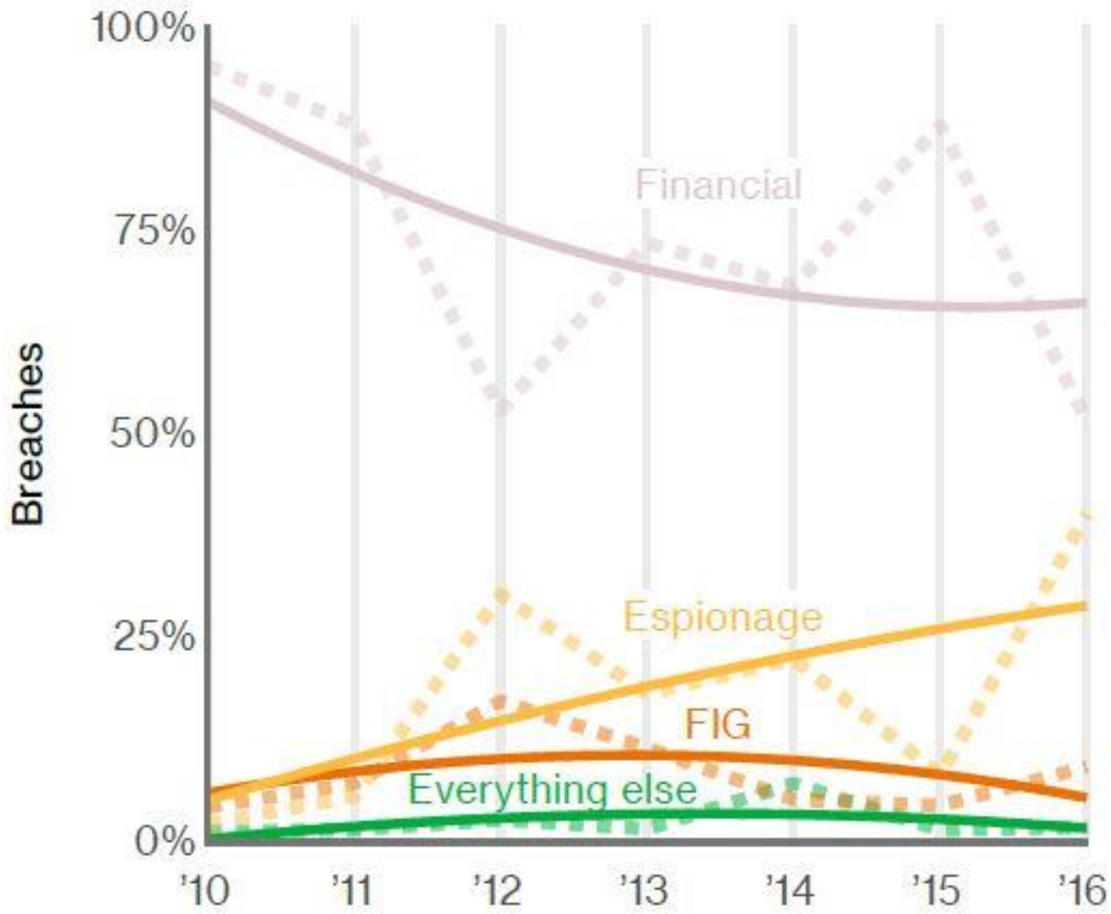
The Bad Guys have changed…

- Nowadays they usually look like this ….

"Do you think now that we're doing fewer illegal things we can scale back the legal department?"


100%
75%
50%
25%
0%
Breaches
Financial
Espionage
FIG
Everything else
'10
'11
'12
'13
'14
'15
'16

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Hello,

To introduce ourselves first:

https://blogs.akamai.com/2014/12/dd4bc-anatomy-of-a-bitcoin-extortion-campaign.html

http://bitcoinbountyhunter.com/bitalo.html

http://cointelegraph.com/news/113499/notorious-hacker-group-involved-in-excoin-theft-owner-accuses-ccedk-of-withholding-info

Or just google “DD4BC” and you will find more info.

Recently, we were DDoS-ing Neteller. You probably know it already.

So, it’s your turn!

<site> is going under attack unless you pay 20 Bitcoin.

Pay to 18NeYaX6GCnibNkwyuGhGLuU2tYzbxvW7z

Please note that it will not be easy to mitigate our attack, because our current UDP flood power is 400-500 Gbps, so don't even bother.

Right now we are running small demonstrative attack on your server.
Don't worry, it will stop in 1 hour. It's just to prove that we are serious.

We are aware that you probably don't have 20 BTC at the moment, so we are giving you 48 hours to get it and pay us.

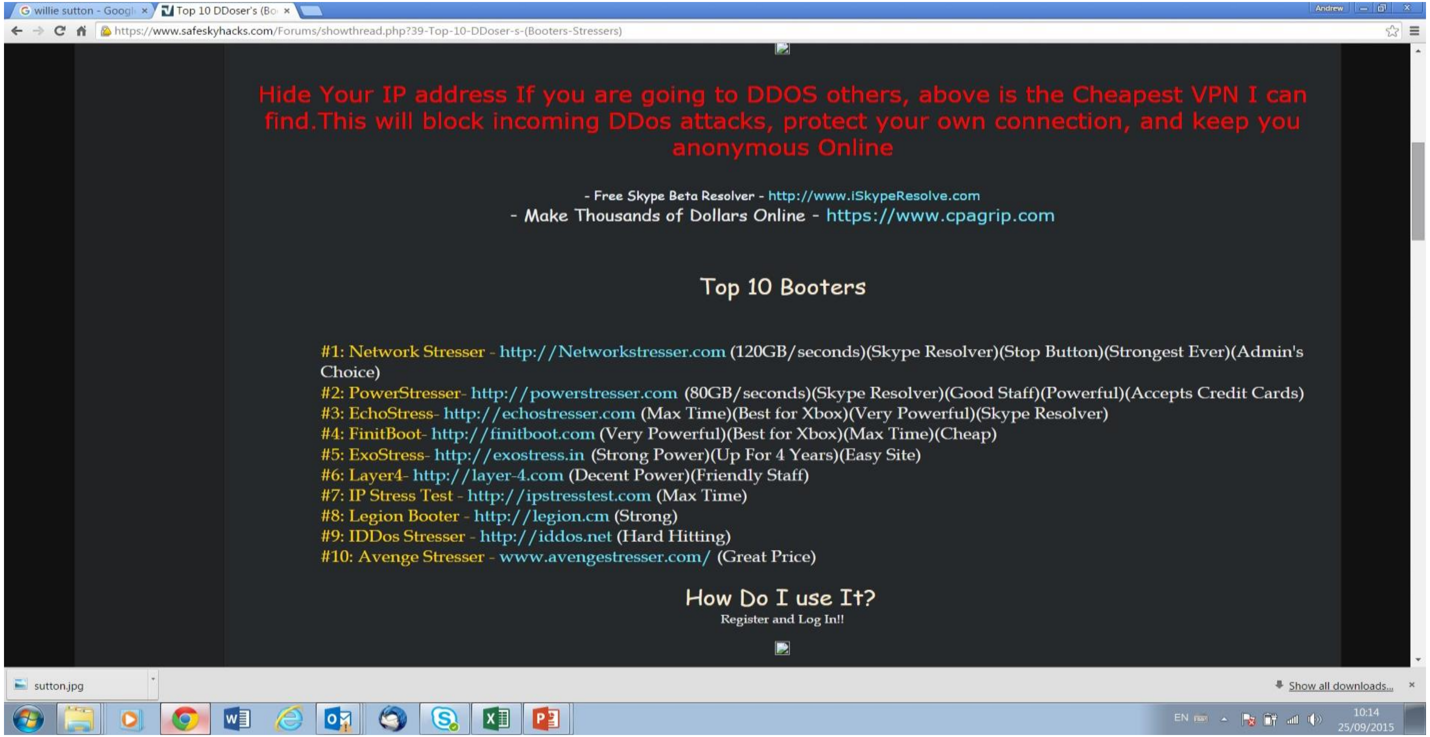
We do not know your exact location, so it's hard to recommend any Bitcoin exchanger, so use Google.

Current price of 1 BTC is about 250 USD.

IMPORTANT: You don’t even have to reply. Just pay 20 BTC to 18NeYaX6GCnibNkwyuGhGLuU2tYzbxvW7z – we will know it’s you and you will never hear from us again.
We say it because for big companies it's usually the problem as they don't want that there is proof that they cooperated. If you need to contact us, feel free to use some free email service.

But if you ignore us, and don't pay within 48 hours, long term attack will start, price to stop will go to 50 BTC and will keep increasing for every hour of attack.

ONE MORE TIME: It’s a one-time payment. Pay and you will not hear from us ever again!


willie sutton - Google
Top 10 DDoser's (Bo
https://www.safeskyhacks.com/Forums/showthread.php?39-Top-10-DDoser-s-(Booters-Stressers)
Hide Your IP address If you are going to DDOS others, above is the Cheapest VPN I can find.This will block incoming DDos attacks, protect your own connection, and keep you anonymous Online
- Free Skype Beta Resolver - http://www.iSkypeResolve.com
- Make Thousands of Dollars Online - https://www.cpagrip.com
Top 10 Booters
#1: Network Stresser - http://Networkstresser.com (120GB/seconds)(Skype Resolver)(Stop Button)(Strongest Ever)(Admin's Choice)
#2: PowerStresser- http://powerstresser.com (80GB/seconds)(Skype Resolver)(Good Staff)(Powerful)(Accepts Credit Cards)
#3: EchoStress- http://echostresser.com (Max Time)(Best for Xbox)(Very Powerful)(Skype Resolver)
#4: FinitBoot- http://finitboot.com (Very Powerful)(Best for Xbox)(Max Time)(Cheap)
#5: ExoStress- http://exostress.in (Strong Power)(Up For 4 Years)(Easy Site)
#6: Layer4- http://layer-4.com (Decent Power)(Friendly Staff)
#7: IP Stress Test - http://ipstresstest.com (Max Time)
#8: Legion Booter - http://legion.cm (Strong)
#9: IDDos Stresser - http://iddos.net (Hard Hitting)
#10: Avenge Stresser - www.avengestresser.com/ (Great Price)
How Do I use It?
Register and Log In!!
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Show all downloads...
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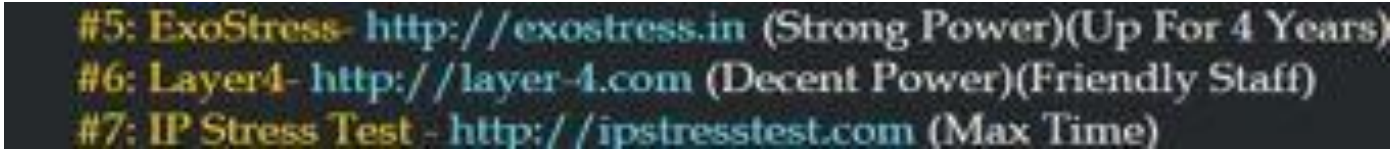

#5: ExoStress- http://exostress.in (Strong Power)(Up For 4 Years)
#6: Layer4- http://layer-4.com (Decent Power)(Friendly Staff)
#7: IP Stress Test - http://ipstresstest.com (Max Time)

“There’s a sucker born every minute.”

Phineas Taylor Barnum

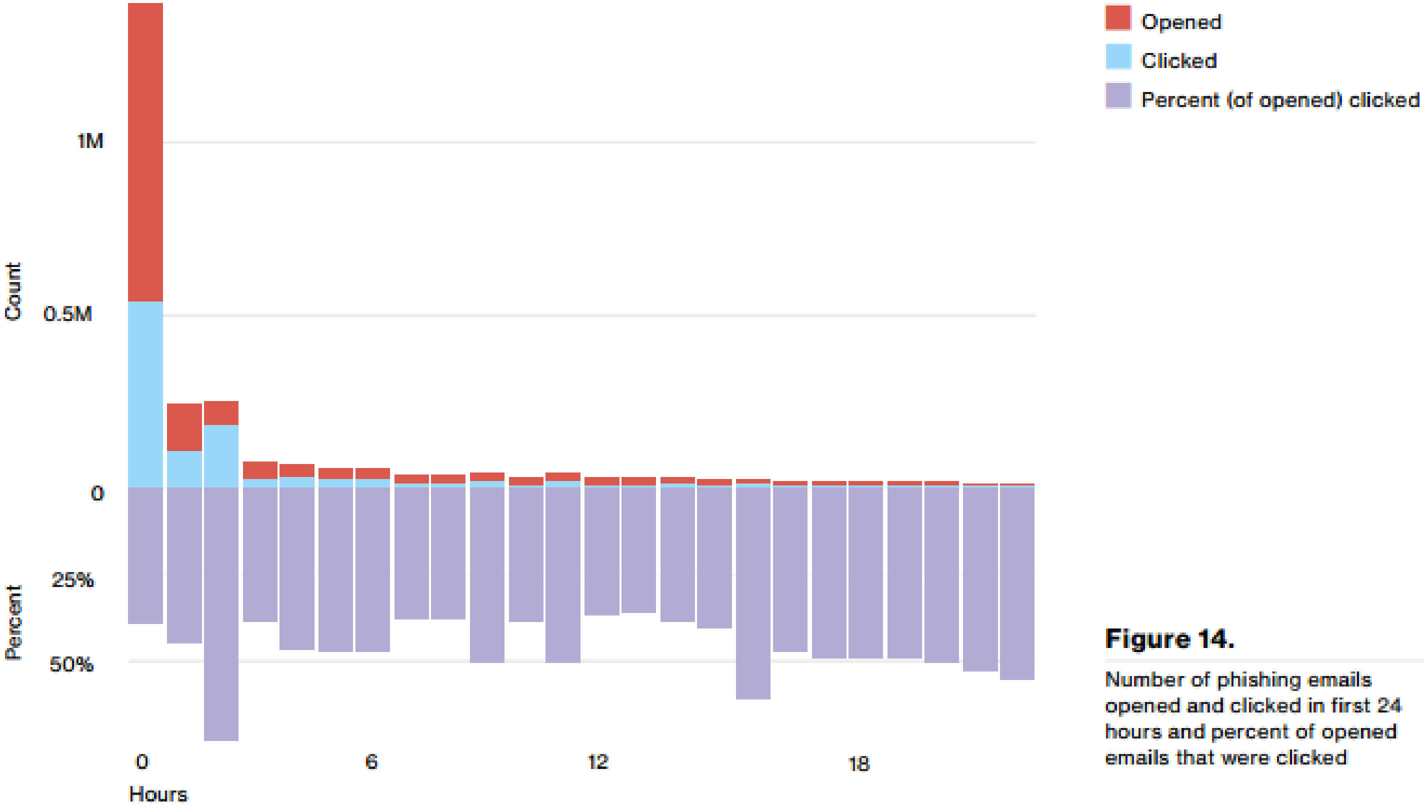


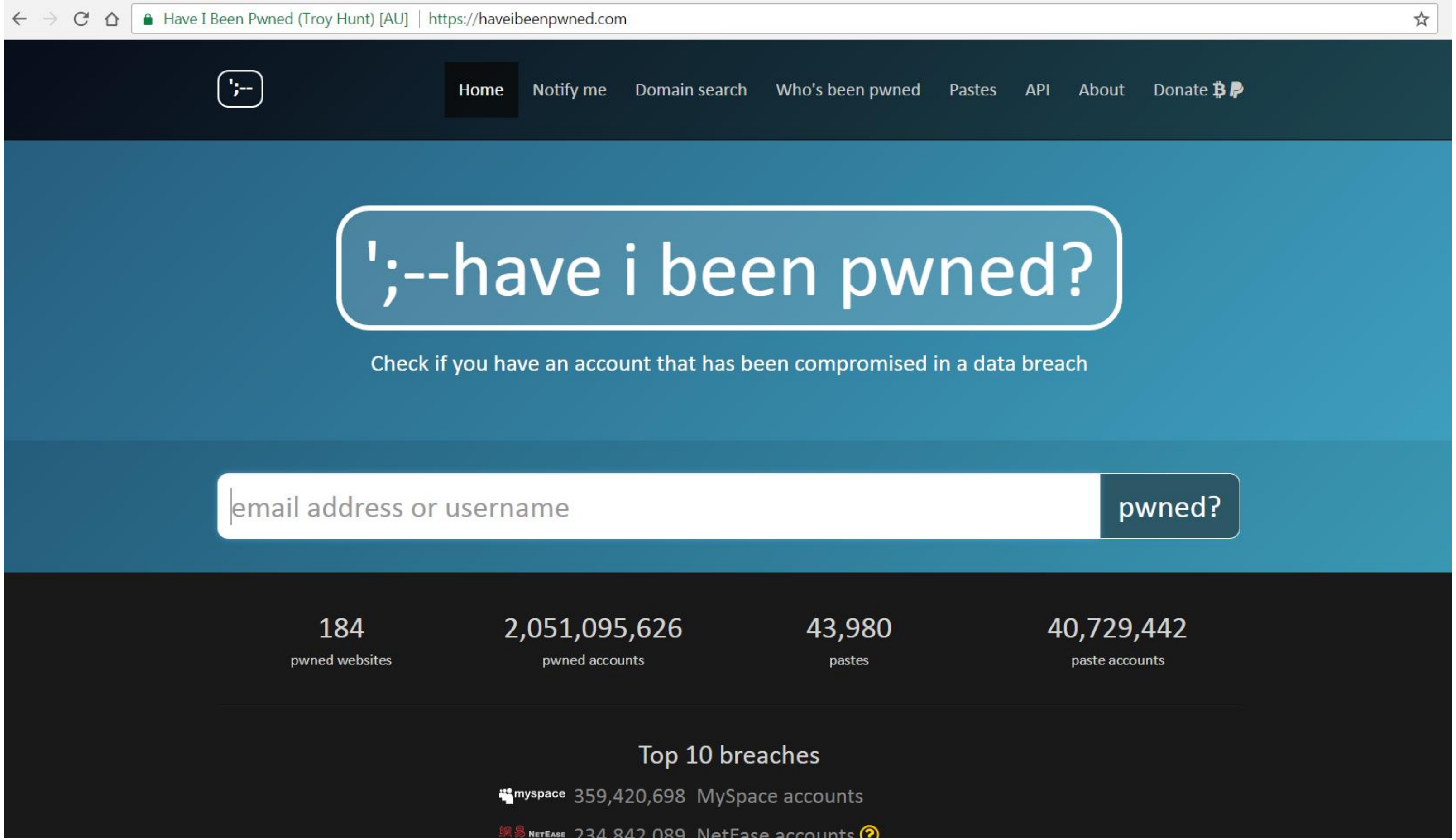
Figure 14.

Number of phishing emails opened and clicked in first 24 hours and percent of opened emails that were clicked

What do they do with access?

- Subvert banking apps
- Fake money transfer orders
- Steal financial data
- Steal proprietary data
- Steal personnel data

Ruin Reputations.



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Cyber extortion - Ransomware

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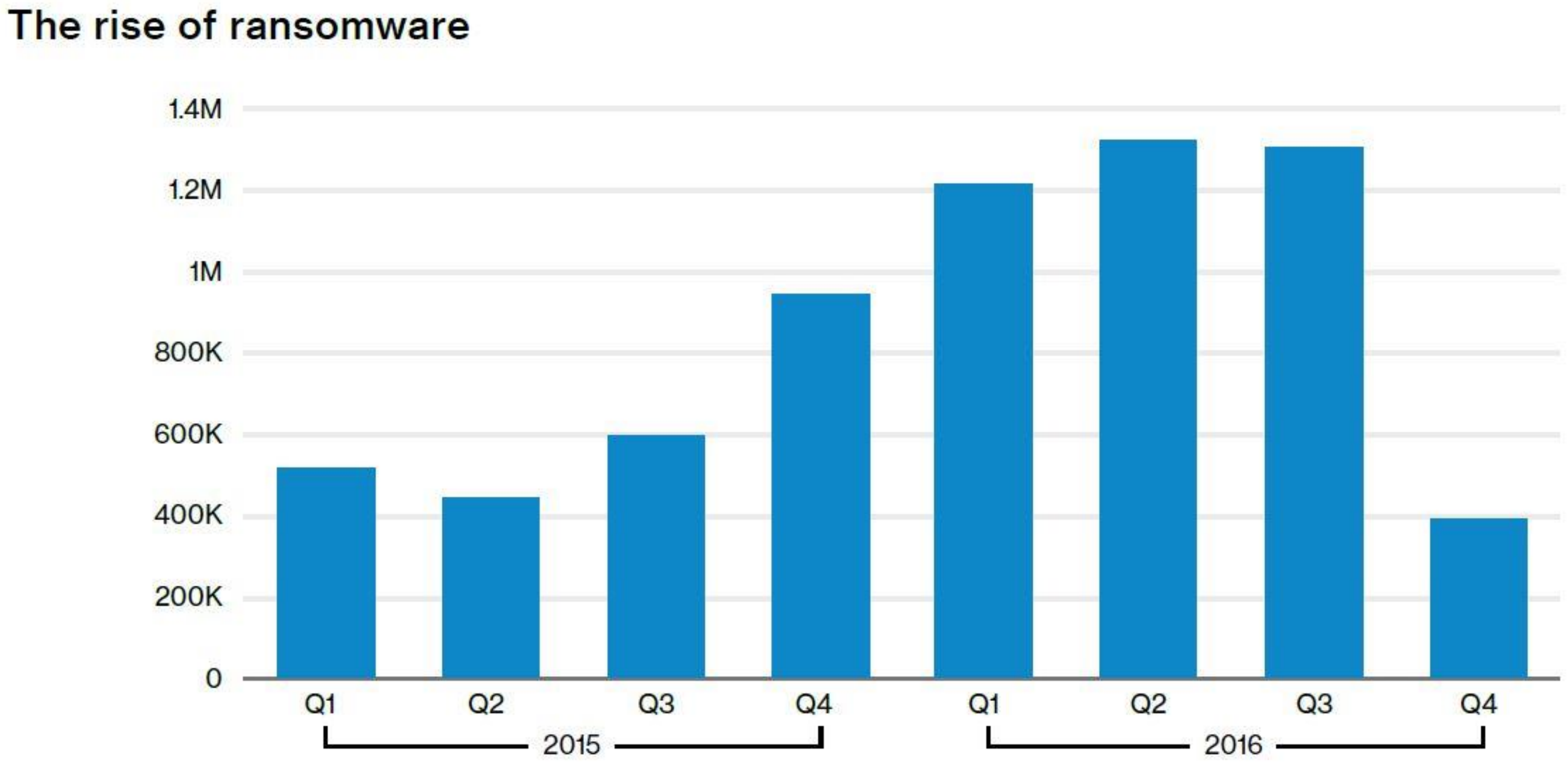
Cyber extortion - Ransomware



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WannaCry

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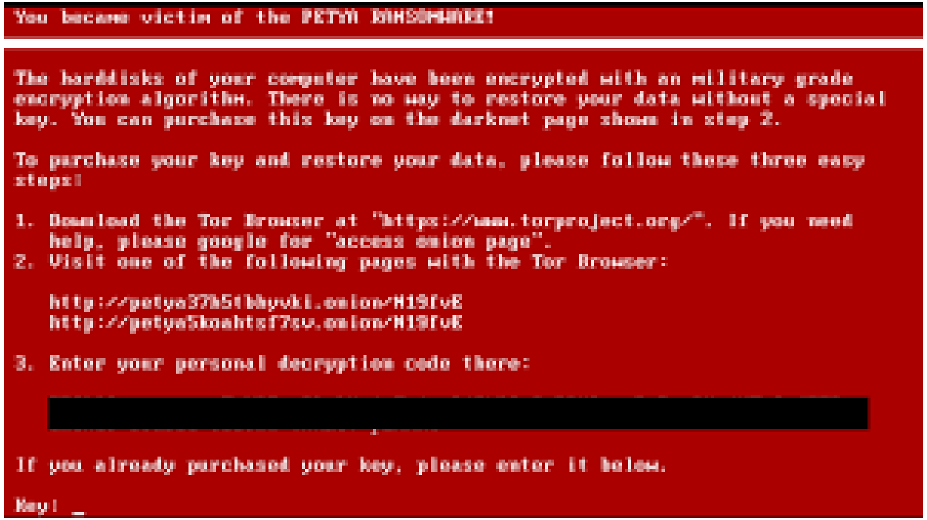
Petya



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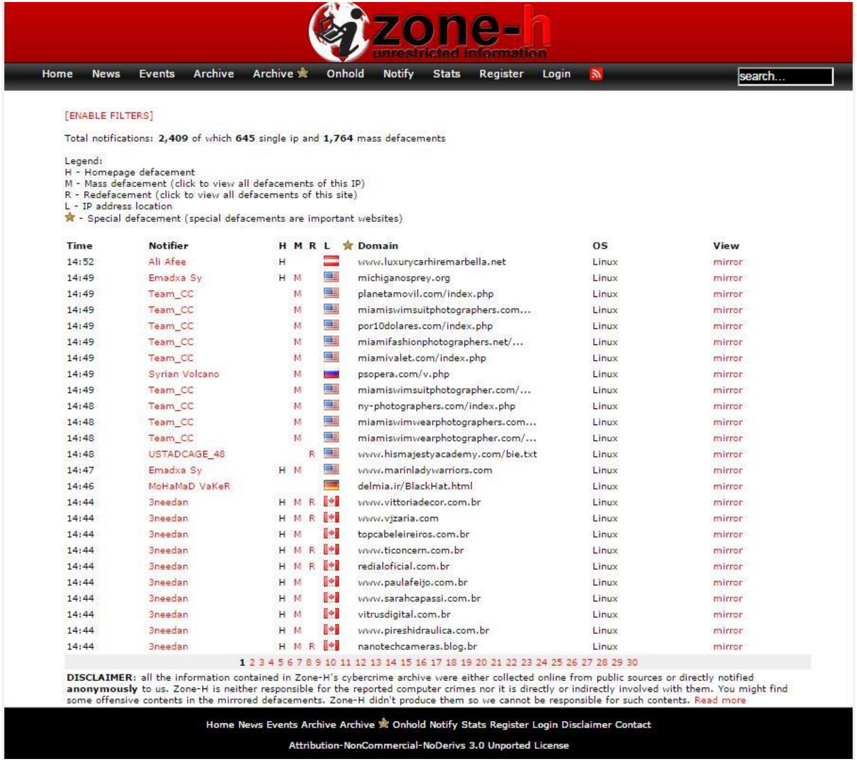
Solutions

- Up-to-date, offline backups
- Up to date anti-virus
- File integrity software
- Restricted web-access
- **Awareness**
- **Training**

Web-Site Compromise


zone-h
unrestricted information

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search...

[ENABLE FILTERS]

Total notifications: **2,409** of which **645** single ip and **1,764** mass defacements

Legend:
H - Homepage defacement
M - Mass defacement (click to view all defacements of this IP)
R - Redefacement (click to view all defacements of this site)
L - IP address location
★ - Special defacement (special defacements are important websites)

Time	Notifier	H	M	R	L	★	Domain	OS	View
14:52	Ali Afee	H					www.luxurycarhiremarbella.net	Linux	mirror
14:49	Emadxa Sy	H	M				michiganosprey.org	Linux	mirror
14:49	Team_CC		M				planetamovil.com/index.php	Linux	mirror
14:49	Team_CC		M				miamiswimsuitphotographers.com...	Linux	mirror
14:49	Team_CC		M				por10dolares.com/index.php	Linux	mirror
14:49	Team_CC		M				miamifashionphotographers.net/...	Linux	mirror
14:49	Team_CC		M				miamivalet.com/index.php	Linux	mirror
14:49	Syrian Volcano		M				psopera.com/v.php	Linux	mirror
14:49	Team_CC		M				miamiswimsuitphotographer.com/...	Linux	mirror
14:48	Team_CC		M				ny-photographers.com/index.php	Linux	mirror
14:48	Team_CC		M				miamiswimwearphotographers.com...	Linux	mirror
14:48	Team_CC		M				miamiswimwearphotographer.com/...	Linux	mirror
14:48	USTADCAGE_48			R			www.hismajestyacademy.com/bie.txt	Linux	mirror
14:47	Emadxa Sy	H	M				www.marinladywarriors.com	Linux	mirror
14:46	MoHaMaD VaKeR						delmia.ir/BlackHat.html	Linux	mirror
14:44	3needan	H	M	R			www.vittoriadecor.com.br	Linux	mirror
14:44	3needan	H	M	R			www.vjzaria.com	Linux	mirror
14:44	3needan	H	M				topcabeleireiros.com.br	Linux	mirror
14:44	3needan	H	M	R			www.ticoncern.com.br	Linux	mirror
14:44	3needan	H	M	R			redialoficial.com.br	Linux	mirror
14:44	3needan	H	M				www.paulafeijo.com.br	Linux	mirror
14:44	3needan	H	M				www.sarahcapassi.com.br	Linux	mirror
14:44	3needan	H	M				vitrusdigital.com.br	Linux	mirror
14:44	3needan	H	M				www.pireshidraulica.com.br	Linux	mirror
14:44	3needan	H	M	R			nanotechcameras.blog.br	Linux	mirror

1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24 25 26 27 28 29 30

DISCLAIMER: all the information contained in Zone-H's cybercrime archive were either collected online from public sources or directly notified **anonymously** to us. Zone-H is neither responsible for the reported computer crimes nor it is directly or indirectly involved with them. You might find some offensive contents in the mirrored defacements. Zone-H didn't produce them so we cannot be responsible for such contents. Read more

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…So Web-Site Defacement is the only issue?

No. Emphatically...

- Stolen Data Transfer / Warehousing
- Conversion to a Spam Zombie
- Conversion to a malware emitter
- Blocking by search engines
- Full compromise to steal clients' data

We have seen all of these in the last 6 months

Online Mail Scams

#GTfinserv

Grant Thornton An instinct for growth™

GDPR – A snapshot

- the General Data Protection Regulation (GDPR) will come into force on May 25, 2018
- the GDPR applies to organisations if they: (i) offer goods or services to EU residents; or (ii) monitor the behavior of EU residents (e.g., organisations that offer online businesses)
- for the most serious violations, privacy regulators will be able to impose penalties of up to €20m or 4% of global revenue (whichever is higher)
- organisations will be under greater obligations to provide assurance to their boards, customers and regulators that their data protection processes and procedures are fit for purpose. We can help provide this assurance, and also explain what good data protection practices look like.

Key features of the regulation

Accountability

New rights for individuals	Fair processing notices	Consent	Data protection officers	Wider scope	Data processors	Breach reporting	Privacy impact assessments

Key GDPR issues

Multiple factors are driving the need for a defensible privacy program – customer expectations, regulatory needs, reputational and operational focus have created an explosive demand to streamline privacy and data protection capabilities.

Data processing arrangements

Security and data breach notifications

Employee data

Consent

Data access requests

Cross border data flow

Becoming compliant – an approach

Organizations should consider implementing data privacy program to meet GDPR requirements.

The scope should include:

Phase 1 "Plan"	Phase 2 "Implement"	Phase 3 "Sustain"
Assess GDPR readiness and developing an implementation plan	Implement the privacy programme based on the plan	Sustain the privacy practice in compliance with EU GDPR regulations

From a priority and sequencing standpoint, we recommend to focus on the Phase 1 effort first; as this will drive the implementation plans going forward, along with the focus areas for sustaining compliance post-programme.

However security is key:

The boring stuff…

- Breach response
- Proper passwords – no special cases
- Secure web-design
- Secure network design
- Logging and log review
- Minimum privilege, minimum access
- Staff training
- And never let anything on your network you do not own

No Silver Bullets

Brexit – the view from London

September 2017

Paul Garbutt
Partner
Grant Thornton UK

The Brexit challenge

To date, even the quality press has generated a lot of "noise" around Brexit, much of it conflicting.

Brexit will cause carnage for fund managers

By CITY AM

Asset managers could be surprise winners from Brexit

By DAILY TELEGRAPH

Brexit: Asset managers retreat from the City of London

By FINANCIAL TIMES

EU regulations cost UK asset managers two billion pounds a year says report

By REUTERS

Danish government expresses caution

By W SHAKESPEARE

In the first official public comment on Brexit, a Danish government official stated "the undiscovered country from whose bourn no traveller returns, puzzles the will and makes us rather bear those ills we have than fly to others that we know not of".

The Brexit challenge

Our analysis suggests that a number of firms reliant on passporting for provision of services into the EU or UK, such as investment banks, prime brokers, lenders and deposit takers may be poorly positioned for Brexit, unless they implement material changes to their business models or footprint.
Given the lead times required to move complex infrastructure, decisions will be needed shortly in order to guarantee continuity of service for customers. Well ahead of any likely clarity from the UK government, the European Commission or EU27 countries on either party's negotiating stance or eventual agreed outcomes.

Many business models are reliant on passporting or equivalence for provision of services into the EU or UK

- Many capital markets and wholesale banking activities are highly reliant on passporting or equivalence for provision of services in the UK and EU
- Significant parts of EU Banking Regulation (for example the Capital Requirements Directive) are silent on equivalence
- Equivalence does not cover Corporate Banking, Deposit Taking & Lending activities and is unlikely to provide a long term solution as it may be withdrawn at relatively short notice

Political, rather than economic or business considerations are likely to drive exit negotiations

- There is a lack of clarity or unity within both the UK government and the EU 27 on negotiating approach and target outcomes
- Domestic political agendas in the UK and across the EU27 may adversely shape the course of negotiation ahead of pragmatic economic considerations
- In our view, complete clarity on the outcome of exit negotiations is unlikely until the very end of the two year period specified under Article 50

Potential cliff edge to continuity of service on withdrawal of passports without transition agreement

- Meeting customer demand for certainty on continuity of service and minimum disruption is of primary importance to firms
- A triggering of Article 50 in March 2017 could present a potential cliff edge to continuity in customer service in March 2019 if agreement is not reached
- WTO rules are largely silent on services. The UK may have to negotiate its own schedules which would then need to be agreed by 163 WTO members

Changes to business models and footprint will require early decisions to allow time to execute

- For infrastructure that will be difficult to move, relocation decisions will have to be made long before clarity on negotiation outcomes are clear
- There is likely to be increasing competition to secure limited suitable office space in many alternative locations
- Given the scale and cost of the change effort to move infrastructure, some Investment Banks are close to making decisions to move now, in order to guarantee continuity of service for their customers

The Brexit challenge – Grant Thornton approach

Our approach is to focus on the underlying drivers and WHY a particular development is important.

Two key exam questions:

1) What does this mean for my clients, markets and the macro economy?

2) What does this mean for HOW I best arrange my legal entities, governance, financial resources and geographic footprint?

What does Brexit mean for the City and capital markets?

Our analysis suggests that investment banks and prime brokers reliant on passporting are poorly placed for Brexit. Decisions to move infrastructure in order to guarantee continuity of customer service will be needed shortly, well ahead of likely clarity on either party's the negotiating stance or the eventual agreed outcome.

Strengths

- Regulation in part driven by global agenda for convergence. EU becoming a law taker not maker
- London is a strategic asset for Europe, as well as UK, managing access to global capital flows
- City is highly efficient at matching capital & liquidity to those who need it across Europe under a single regulatory regime
- Cluster economics and critical mass
- Protectionist moves by EU against UK such as Euro clearing will impact global centres in US & Asia

Weaknesses

- Over-estimation by City of the amount of political capital UK government is willing to spend.
- Role of the City in underpinning the real economy is not well understood by either UK or European politicians and electorates
- Misunderstanding and confusion on Brexit among US and Asian decision makers
- Lack of clarity or unity within both UK government and EU 27 on negotiating approach and target outcomes
- Capital markets infrastructure is difficult to move
- Capital markets are highly reliant on passporting. **Equivalence does not cover Corporate Banking, Deposit Taking & Lending** and may be withdrawn at short notice
- WTO rules are largely silent on services. The UK may have to negotiate its own schedules which would then need to be agreed by 163 WTO members

Opportunities

- **Brexit as a catalyst for transformational change**
  - Firms could gain first mover advantage
  - Opportunity to review business models:
    - De-centralisation, outsourcing, nearshoring and offshoring
    - Downsizing: re-focus on profitable areas and voluntary exit
    - Adoption of new technology
- **Challenger institutions** could increase market share while larger banks are focused on Brexit
- **Global opportunities:** Capital and market activity will flow to areas of highest growth in Asia, India and the US

Threats

- **Balkanisation** of capital markets across European capitals result in a less efficient model:
  - Cost of capital will increase, with trapped pockets of ring-fenced capital required to set up extra Branches and Subsidiaries
  - Cost of liquidity will increase, due to 2 sets of ring-fenced liquidity. In adverse markets, liquidity will dry up more quickly, with disproportionate impact on weaker links in the system across Europe such as Italian and German Banks
  - Businesses in the real economy across Europe will pay higher costs for capital and liquidity, impacting long term economic growth
  - Costs associated with regulatory compliance across 2 regulatory systems will increase
  - Constraints in access to talent will erode competitiveness and efficiency
  - Global firms may exit Europe altogether when weighing costs and benefits of relocation and increased capital requirements
- **Cliff Edge to continuity of service** on withdrawal of passporting without transition agreement:
  - Clients demand certainty, continuity of service and minimum disruption while timeline presents potential cliff edge c30 months
  - Relocation decisions must be made before clarity on negotiation outcomes are clear. Given scale and cost of change effort to move infrastructure, Investment Banks close to making decisions to move now in order to guarantee continuity of service
  - Limited ability to back out of a relocation decision based on worst case contingency plan if negotiated outcome is better than expected
- Todays consensus on eventual outcome may be proved to be completely wrong:

What does Brexit mean for investment management?

Our analysis suggests that many investment managers with exposure to European clients are relatively well placed for Brexit:

- Delegation models will allow high value portfolio management activity to continue in London, New York and other global centres
- European distribution models already feature Dublin and Luxembourg domiciled Funds, TA and related admin services
- Positive impact on cost-income ratios as £ costs fall relative to fee revenues derived from $ and € denominated assets

Strengths

Regulation

Much of the current and proposed EU Regulation will support current business models post Brexit:

- UCITS: Portfolio Management can be delegated to Third Countries. This gives The City an advantageous position provided Delegation Agreement in place. Any EU driven change would disrupt funds with portfolio management provided from the US and other global centres
- MIFIR: contains Equivalence Provisions for Third Country Firms on ESMA Register, potentially mitigating loss of passports for distribution of wholesale services
- MiFID II: Many asset managers with retail distribution within the EEA already have branch networks in order to harness local knowledge and accommodate national variations in language, culture, tax and law
- GDPR: Many asset managers with retail distribution within the EEA base Transfer Agency in Luxembourg or Dublin. Customer data will not cross UK-EU borders

Economics

- London is a strategic asset management centre for Europe, as well as UK
- Cluster economics and critical mass

Social

- London/Edinburgh are attractive places for high value front office staff to live

Technology

- London currently emerging as Fintech hub. Firms increasingly focused on new Fintech solutions

Weaknesses

Regulation

- Ability of UK Regulators to influence future EU Regulation
- MIFIR Equivalence regime not tested and is relatively narrow
- Reliance on Equivalence may not provide a secure long term solution although it is likely to play a key part in any transitional agreement

Economics

- £1.2 out of £1.7 trillion of the Assets managed in The City are managed on behalf of EU firms.

Social

- Reliance on EU talent for high value front office jobs

Technology

- Rapid growth in alternative Fintech clusters such as Berlin

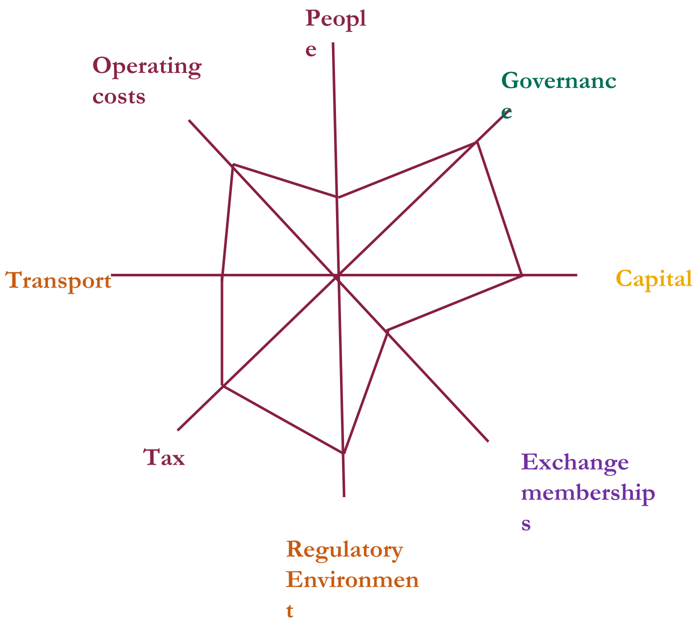
Opportunities

- **Improvement in cost-income ratios from fall in £ costs relative to $ and € assets**
- Probability that firms will be able to continue with current **Delegation Models** and EU distribution based on **Equivalence**
- Opportunity to review business models:
  - Catalyst for focus on profitable customers, investment strategies and voluntary exit from poor value added strategies or geographies
  - De-centralisation of activities away from high cost central London locations
  - Outsourcing, nearshoring and offshoring to third country locations are already prevalent
  - Catalyst for transformational adoption of new technology
- EU push to harmonise taxes could make UK more attractive

Threats

- Increasing cost of compliance with two Regulatory Regimes
- Equivalence route risks imposition of poorly thought out EU Regulation such as financial transactions tax
- New EU Regulation hinders adoption of new technology such as Blockchain
- Regulatory Divergence prompts **withdrawal of Equivalence** decision at short notice
- Repatriation of Assets back into the EU. For example loss of EU Government mandates to National Asset Managers
- Change of strategic focus away from Europe by Global Managers to other regions in North America and Asia
- Attrition of high value European front office talent back into EU

What does Brexit mean for how firms should position themselves?



The question of HOW – what corporate and other structures to use – has many similarities to legal entity optimisation issues we have seen before.

a) What are the correct decision making criteria to apply

b) What are the red lines? Where do these fall?

c) Define measurement criteria

d) There are likely only a handful of realistic options; identify those

The "trick" is to cut through the "noise"!

Brexit contingency planning framework

Grant Thornton's Financial Services Group has the appropriate blend of specialist advisory capability, sector insight and credentials to support clients through Brexit.
Our approach is designed to bring an appropriate blend of strategic analysis, regulatory, tax and risk expertise and complex change capability to bear at each stage of the process.

Governance and mobilisation

Governance:
- Understand emotional biases within decision makers and team
- Establish robust governance across geographies
- Embed objectivity and independence within governance and decision making
- Programme and PMO

Gap analysis to understand Brexit exposure

Footprint analysis:
- Strategic clients
- Scope of services
- Legal and contracts
- Counter-parties
- Operations
- Client data

Revenue analysis:
- Revenue exposures
- Cost of capital
- Cost of funding

EU regulatory analysis

Apply relevant EU regulation:
- CRD IV
- GDPR
- UCITS
- MiFID II/MIFIR
- PRIIPS
- AIFMD

Assess potential outcomes: Probability and impact

Scenario analysis:
- Political risks can't be modelled, therefore plan on a scenario basis
- Determine central scenario, eg hard Brexit
- Add back most likely alternatives and disruptors, eg another state leaves the EU
- Include Regulatory outcomes

Business model adjustment opportunities

Business case assessment:
- Exit or stop marginal activities
- Ops model rationalisation
- Adjustments to footprint, incl. branch establishment and talent
- Risks and Assumptions
- Future proofing
- Reversibility

Prioritised contingency plan

Contingency plans:
- Prioritised around probability and impact of outcome
- Change programme and timeline
- Key decision timeline working backwards from UK exit date
- Risk assessments
- Off ramps: Checkpoints and plans to reverse decisions if negotiation outcomes are better than expected

Grant Thornton Capabilities

	Governance and mobilisation	Gap analysis to understand Brexit exposure	EU regulatory analysis	Assess potential outcomes: Probability and impact	Business model adjustment opportunities	Prioritised contingency plan
Business Consulting	✓	✓	✓	✓	✓	✓
Regulatory Advisory			✓	✓	✓	
Risk Advisory		✓		✓	✓	✓
Tax Advisory					✓	✓

Brexit contingency planning framework

There may well be only a handful of mitigating actions firms can take in the face of any number of Brexit stress scenarios. Our approach is to undertake a rapid stress testing exercise that aims to identify the actions the firm might take and the early warning indicators (EWI) to invoke those actions at the right time.

Gap Analysis to Understand Brexit Exposure

Footprint Impact Analysis

Product

- Fund domicile?
- Fund Status e.g. UCITS, Master - Feeder

Distribution

- Market access exposure
- Strategic EEA clients
- Impact of loss of passporting?
- Split of retail vs institutional distribution into the EEA?
- What adjustments to pricing strategies will be required?

People

- What is your key man risk and level of reliance on EU talent?

Legal

- What is the impact on legal contracts and mandates? What documentations needs changing / novating and what resources will be required to do this?

Operations and Location Strategy

- Reliance on delegation model?
- Level of contingency planning required to adjust geographic footprint to retain EEA access?

IT and Data Management

- What client data currently moves cross-border between the EU and UK?
- What adjustments may be required to IT infrastructure to support a revised footprint?

Finance Impact Analysis

- Revenue analysis
- How will investment decisions and the ability to raise capital from EU investors be impacted?
- Impact on capital requirements?
- Impact on the firm's cost base and cost-income ratio?

Apply Relevant EU Regulation

MiFID II*

AIFMD*

GDPR*

* Asset Manager Example. Dependent on Sector / Firm

Assessment of Potential Brexit Outcomes / Probability & Impact / Prioritised Contingency Plan

Apply Relevant EU Regulation	Assessment of Potential Brexit Outcomes	Prioritised Contingency Plan
MiFID II*	The UK remains a member of the EEA. Firm retains passports and can continue providing investment services without change.	• Contingency Plan 4 • Business Case
MiFID II*	The UK becomes a third country and is granted equivalence. Firm applies for ESMA registration & continues providing investment services to eligible investors. Firms with retail investors may be required to establish an EU branch.	
MiFID II*	The UK becomes a third country without equivalence. Firm loses passports and will need to obtain local licenses or establish EU operations in order to continue providing services to EEA clients.	• Priority 2 Contingency Plan • Business Case
AIFMD*	The UK remains a member of the EEA. Firm retains passports and continues providing investment services without change.	
AIFMD*	The UK becomes a third country and is granted equivalence. Firm retains passport. UK domiciled AIFs marketed in the EU; UK UCITS marketed to EU professional investors as AIFs. Additional requirements need to be satisfied where UK AIFs marketed to EU retail investors.	• Contingency Plan 5 • Business Case
AIFMD*	The UK becomes a third country without equivalence. Firm loses passport. Investment services to EEA will occur under national regimes or funds will be re-domiciled in the EU. UK firms managing EU funds appoint EU UCITS management company or an AIF to become self-managed.	• Priority 3 Contingency Plan • Business Case
GDPR*	The UK remains a member of the EEA. Data transfers carry automatic safeguard. Firm permitted to process retail client data without additional measures.	• Contingency Plan 6 • Business Case
GDPR*	The UK becomes a third country and listed as a Commission approved country. Firm permitted to collect and process personal data of retail clients with minor change.	
GDPR*	The UK becomes a third country outside the EU safe zone for personal data. Firm must adopt codes of conduct and model clauses in contractual arrangements to ensure safeguards for personal data flows.	• Priority 1 Contingency Plan • Business Case

EU Regulation impacting Brexit scenarios

Implemented | In Flight | Proposed

Implemented

- Payment Services Directive (2007/64/EC)
- Solvency II Directive (2009/138/EC)
- Second Electronic Money Directive (2009/110/EC)
- Alternative Investment Fund Managers Directive (2011/61/EU)
- Capital Requirements Directive (2013/36/EU)

In Flight

2016 | 2017 | 2018 | 2019

Securities Financing Transaction Regulation
Q1 2017 +

Payments Services Directive II
January 2018

EUBR
June 2018

End of transitional period for UCITS
Q4 2019

MiFIR/MiFID II
January 2018

PRIIPS
January 2018

GDPR
May 2018

ESMA opinion on AIFMD passport
Q4 2018

Proposed

- Money Market Funds Regulation
- UCITS VI Directive

Vote | Brexit Negotiation | EU27 Ratification?

UK Referendum
23 June 2016

Article 50 triggered
End Q1 2017

UK exit from EU
End Q1 2019

Transitional arrangements ?
Unknown

Contingency planning considerations and decision criteria

Decision Criteria

Ability to guarantee continuity of customer service delivery

Minimise short term disruption to customers

Protect strategic contracts, sources of revenue and profit

Protect key talent

Seize opportunity to improve profitability, business model or operational effectiveness

Ability to guarantee long term access to target markets

Ability to support customers who need to change their business models

Ability to reverse decisions if UK-EU negotiation outcomes are better than expected

How easy will it be to communicate decision to strategic customers or partners?

Planning Considerations

Robust governance

- Emotional bias
- Attaining and maintaining consensus
- Robust stakeholder management
- Managing competing agendas across EMEA geographies
- Strong PMO in order to maintain single audit trail

Objectivity

- Independent assessment of Regulatory and Legal drivers
- Decisions based on objective fact based analysis

Negotiation timescale and lead times for implementing change

- Tension between negotiation dynamics and timing of business planning decisions
- Unlikely to be any clarity on outcomes until the very last stages of negotiation. **Plan for Cliff Edge outcome**
- Decisions to implement material operational or structural change may be required before there is clarity or certainty of outcome

Rapidly changing geopolitical landscape

- Politics around negotiation impossible to predict
- Re-location decisions may be overtaken by events (for example, other countries may hold their own referendums to leave EU)
- WTO rules are largely silent on export of services

Opportunity cost

- Wait and see decisions may prove advantageous.
- If a more favourable deal is achieved than central scenario, firms could avoid management focus, business disruption and costs. Ability to reverse early decisions

Contingency planning observations

A "hard Brexit“ scenario is having the largest impact on the contingency planning activities of wholesale banks and prime brokers

- It is thought that large wholesale banks, based out of London, typically rely on passports for 20% to 30% of revenues
- For these firms, key concerns centre around the ability to provide services to clients residing in the EU and also what market infrastructure can be accessed as a "third country“, e.g. clearing houses, exchanges, etc. One such concern regards the ability to access cash products exchanges in the EU (a small number of derivatives exchanges already permit third country membership).
  - *Many of the larger firms already have at least one licensed small subsidiary on the continent - scenario planning is likely to follow where they already have a license (e.g. thought that BAML and Citi are looking at Ireland, Goldmans looking at Paris / Frankfurt). For smaller operations (e.g. Japanese subs) there is likely to be a bigger impact as they lack significant presence within the EU and required licensing / permissions*
  - *Branches may offer partial mitigation but only for those jurisdictions in which they are established, the ability to passport from a branch across the EU is highly unlikely*
  - *It is thought that the ideal contingency entity would be a subsidiary with a full EU banking license based in the EU27, as these entities are able to perform the majority of sales/trading, investment banking and corporate banking activities and crucially, passport these across the remaining EU. With a license already in place, the time taken to shift and scale out operations should be reduced, as establishing a fully licensed subsidiary from scratch may take years*
  - *There may be constraints to having a single EU subsidiary which provides most services across banking / capital markets (e.g. traditionally the US firms separate the banking and broker dealer sides of the firm to comply with US regulations)*
- Firms are looking to action their plans in Q1 2017

Deposit taking, transactions services and lending are key areas of focus as there is no equivalency provision under CRD

- Firms are typically assessing the following options:
  - *Utilise existing branch presence and then seek jurisdiction specific licenses for anything outside this OR;*
  - *Establish fully licensed subsidiary in the EU*
- If pursuing the latter, firms are primarily looking at using the "cross border merger" process as a mechanism for effectively re-domiciling their existing UK licensed bank. Estimates suggest that this process could take 1.5 to 2 years depending on the complexity of operations and regulator capacity
  - *The process will require significant programme management and change effort, including loan documentation due diligence, client contact and legal reviews*
- Anecdotes suggest that the people perspective is not such a concern as bankers are already placed across the EU under coverage models

Taxing Times

Irish and International Tax Developments

Billy McMahon
Tax Director
Grant Thornton Ireland

Anne Stopford
Head of Investment Funds Tax
Grant Thornton London

Brian Moore
US Tax Partner
Grant Thornton US

Agenda

1. Finance Act 2016 – one year on

2. BEPS

3. Other section 110 developments

Finance Act 2016 – one year on

Recap

Irish property related changes in 2 broad areas

1. Section 110 – restriction of interest deductibility on PPNs related to Irish property business

2. Irish property funds (‘IREFs’) – 20% WHT on IUT-exempt investors (including non-residents)

A key element of reducing uncertainty in tax matters is pro-active consultation regarding proposed measures

Seamus Coffey *Review of Irish Corporation Tax Guide*, 30 June 2017

Finance Act 2016 – one year on

Section 110

- targeted (excludes loan origination, CLO, CMBS/RMBS transactions)

- concept of 'reasonable commercial return' – this amount of interest remains deductible

- 2 approaches to calculation
1. IRR at outset
2. Transfer pricing study

- market reaction

Finance Act 2016

Irish Property Fund (‘IREF’)

- operationally challenging

- complex formula to work out IREF taxable profit

- key mechanisms being put in place – slowly!

1. Payment to Revenue (still awaiting details – first return due 30 June 2018)
2. Refund to exempt investors direct from IREF

- Definition of key concepts e.g.

1. ‘PPIREF’ (Revenue Guidance published just last week!)
2. ‘Equivalence of supervision/regulation’ – no Revenue Guidance yet

BEPS

(1) Multilateral Instrument ('MLI')

- 7 June 2017 – historic day
- 68 countries signed up (including Ireland), more to follow
- range of options for countries to choose from
- novel approach - Tinder for tax treaty negotiators?

BEPS

(2) Treaty Access

- BEPS Action Point 6 *'Prevent Treaty Abuse'*

- collective investment vehicles present particular issues in designing suitable anti-avoidance clauses in treaties

- distinction between;

1. CIVs (widely held, regulated funds), and
2. non-CIVs (all other investment vehicles, including section 110s etc)

- work ongoing in relation to both

BEPS

(2) Treaty Access (cont)

- CIVs - definition of qualifying CIVs likely to be included in future new/renegotiated Irish treaties. Will increase certainty in the future for e.g. Irish UCITS, ETFs etc

- Non-CIVs – limited examples of non-CIVs which might qualify (although note that widely held securitisation companies should qualify)

- looking into crystal ball;

1. Continued uncertainty for Irish regulated funds
2. Greater certainty for CIVs in the future
3. May be more difficult for many non-CIVs to access treaties in the future

Other section 110 developments
(1) EU ATAD

- EU Anti-Tax Avoidance Directive (‘EU ATAD’)
- interest limitation rules of most concern to section 110
- restricts deduction for net borrowing costs (i.e. excess of interest expense over interest/interest equivalent income) to 30% of EBITDA (subject to certain exceptions)
- unlikely to be any change in our interest deduction rules until at least 2024 (noted in *Coffey* report)
- potential impact on certain section 110 structures

Other section 110 developments

(2) miscellaneous

- revenue preparing ‘Tax and Duty Manual’ in relation to section 110s
- tax briefing 2012 (on Finance Act 2011 measures) due to time out this year and will be revised
- IDSA consultation

UK tax update

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Email: anne.stopford@uk.gt.com

Reporting funds

- no changes in legislation in the last year
- each share class needs to be registered separately and remember: each new share class needs to be registered before the end of its first accounting period, or within 3 months of launch if later

Reporting funds – Other practical issues

- investments in other offshore funds/partnerships
- treatment of reportable income from reporting funds
- treatment of non-reporting funds:
  - either movement in market value in the year treated as income or
  - treat as a deemed reporting fund if sufficient information is available
- treatment of investments in limited partnerships and transparent funds
- effective yield adjustments

Master/feeder arrangements

- where a feeder fund holds > 95% of a master fund, the master fund is treated as a subsidiary and the feeder fund's share of income and expenses are brought into the calculation of the feeder fund's reportable income
- if the holding drops below 95% the feeder fund has a holding in a reporting or non-reporting offshore fund
- if non reporting, can treat as reporting
- but, need to bring in excess income for the reporting period for which the distribution date falls in the accounting period

Example

Y/E 31/12/15

Feeder

98%

Master

98% of Master Fund's income/expense brought into Feeder Fund's calculations

Y/E 31/12/16

Feeder

94%

Master

Excess income arising on 30/6/16, in respect of year ended 31/12/15 brought into calculations.

- Double counting?

Taxation of capital gains

- capital gains tax rate reduced to 20%/10% from 6 April 2016
- rates remain at 28%/18% for property and carried interest
- gains from property funds taxed at 20%/10%
- compares to income tax rate of up to 45% so reporting fund status even more beneficial

Criminal Finances Act 2017

CFA Part III – two new 'failure to prevent tax facilitation' offences

UK TAX EVASION

- **IN SCOPE:** **ALL** companies and partnerships – regardless of the jurisdiction they are formed in
- **STAGE 1:** An act of criminal tax evasion takes place under UK law (conviction for tax evasion is **NOT** required)
- **STAGE 2:** An **associated person** of the firm criminally facilitates this tax evasion, while performing services on behalf of the firm

EQUIVALENT OFFENCE UNDER FOREIGN LAW

- **IN SCOPE:** UK companies and partnerships **AND**

  Foreign companies, with a place of business in the UK **OR** where the act of facilitation has taken place in the UK
- **STAGE 1:** An act of criminal tax evasion takes place which is an offence under both relevant foreign **AND** UK law
- **STAGE 2:** An associated person of the firm facilitates this tax evasion and this is an offence under both relevant foreign **AND** UK law

STAGE 3

The firm is guilty if it cannot prove the **statutory defence**

STATUTORY DEFENCE

Demonstrate **reasonable procedures** were in place to prevent facilitation **OR** demonstrate that it was **not reasonable** for the firm to have such procedures

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Asset management

- HMRC guidance considers the financial services sector to be high risk
- in HMRC’s view, *“it cannot readily be conceived that there is any circumstance in which it would be reasonable for a financial institution to fail to conduct a risk assessment and maintain a record of that assessment*.”
- both UK managers and the offshore funds they manage need to be considered

‘Associated persons’ – a deliberately broad concept

An associated person of a firm is defined as an employee, agent or other person who performs services for or on behalf of the company or partnership

- may include suppliers, contractors, subcontractors and intermediaries
- for funds, includes investment managers, prime brokers, custodians, distributors, administrators directors, lawyers, accountants and advisers
- a contract is not necessarily required – the legislation makes clear association will be defined based on actual events and behaviour
- an associated person can only implicate a firm if they facilitate tax evasion by a third party whilst performing services for the firm

HMRC Guidance

Although reasonable procedures will change over time and will need to be tested by the courts, HMRC have provided guidance to support firms in their preparation, including 6 guiding principles

Brexit - Impact for funds and management entities

- AIFs
  - UK manager should be able to manage EU AIF as a third country AIFM
  - passporting where “equivalence of regulation” can be proved
- UCITS
  - depends on whether passporting arrangements maintained
  - if not, a UCITS with a UK Manco may need to appoint a Manco in the EU (but could retain UK investment manager)
  - UK investment manager may not have benefit of EU passport for distribution so may need local distributors
  - may need mirror structures – EU funds for EU market and UK funds for UK market
  - potential impact for investment mandates

Brexit - tax implications

Relocation of management entities

- transfer pricing
- personal and corporation tax implications for relocating staff
- exit taxes
- impact of VAT relief eg. on management charges

Restructuring and relocation of funds

- impact for investors –
  - impact for investing in funds of different domicile
  - ensure no tax event for investors
- treaty access and withholding tax
- use of SPVs

Other issues

- FTT and common consolidated tax base
- VAT – EU tax but implemented into UK law, therefore changes could be made
- EU Merger Directive, EU Parent-Subsidiary Directive, EU Interest and Royalty Directive

Other tax developments not covered here

- Base Erosion and Profit Shifting (BEPS)
- FATCA
- Common Reporting Standards

US Asset Management Tax Update

Brian Moore
US Tax Partner
Grant Thornton US

Is tax reform still possible?

- glass half empty?
  - It's already taken too long
  - Too many hurdles remain
  - Health care hit wall, tax reform now faces revenue challenge, will hit same wall
- or half full? <u>Historic opportunity for tax reform!</u>
  - Right on track: August time-frame was never realistic
  - Hiccups expected: 1986 declared dead many times
  - Republicans' last chance for a significant legislative win before 2018 elections

Where are we in the process?

- BIG SIX: Ryan, Brady, McConnell, Hatch, Cohn, Mnuchin:
  - Framework to be released week of Sept. 25
  - 'Template' taxwriters will use to write bill
- will it disappoint again?
  - Need to show House Republicans details before they approve budget as vehicle for reform
  - Hatch already warning he will not be bound by it

What is the way forward?

- With only 52 Senate votes, 3 options for enactment:
  1. Get at least 8 Democratic votes
  2. Revenue-neutral using the reconciliation process
  3. Break or bend the rules

What about timing and effective date?

- goal is to achieve enactment before year-end
- debt limit, DACA, budget, appropriations could push it into early 2018
- too far into 2018, and it runs into midterms
- most likely effective date: Jan. 1, 2018 or Jan. 1, 2019
  - Mnuchin 'open' to retroactive date
  - Phase-ins more likely
  - Limited provisions could retroactive to date of introduction to prevent gaming

What will tax reform actually look like?

- most likely to survive:
  - Rate cut (Corporate rate much lower than 25% less realistic without border adjustability as a pay-for)
  - Loss of special credits/deductions/incentives
  - One-time tax on repatriated earnings
  - Territorial system
- on the fence:
  - Full expensing/loss of interest deduction

Why do anything until I know more?

- proposals still evolving and success not guaranteed, but still need to understand and plan now
- considerable risk in making business decisions without analyzing impact tax reform would have
- many planning techniques need to be implemented BEFORE tax reform is effective

Key considerations for rate cut

- big opportunity for arbitrage
  - CBO says tax receipts are down in 2017 because so many taxpayers are deferring into 2017
- turn a timing benefit into permanent benefit
- big upside, little downside because still get cash flow
- accelerate deductions and defer income:
  - Benefit plans and bonus pools
  - Fixed assets/repairs
  - Accounting method reviews

Key considerations for repatriation

- reduced rate for unreptriated earnings, but could you do better than the mandatory tax?
  - Depends on final repatriation rate rate
  - Depends on foreign tax credit position
  - Depends on whether earnings will net for companies with common ownership
- don't act until outlook is more clear, but prepare now so you can act quickly before effective date if needed:
  - Under stand E&P and FTC positions
  - Consider reorganizing to maximize netting potential

Other considerations?

- wait for full expensing on large capital purchases?
- load up on long-term debt that will be grandfathered?
- renegotiate import agreements so you get benefit of any currency valuations?
- discuss risk on in MD&A on financial statement?
- extra due diligence/modeling on acquisition targets
- reconsider long-term M&A plans for debt v. equity, asset v. stock?
- prepare for entity choice analysis?

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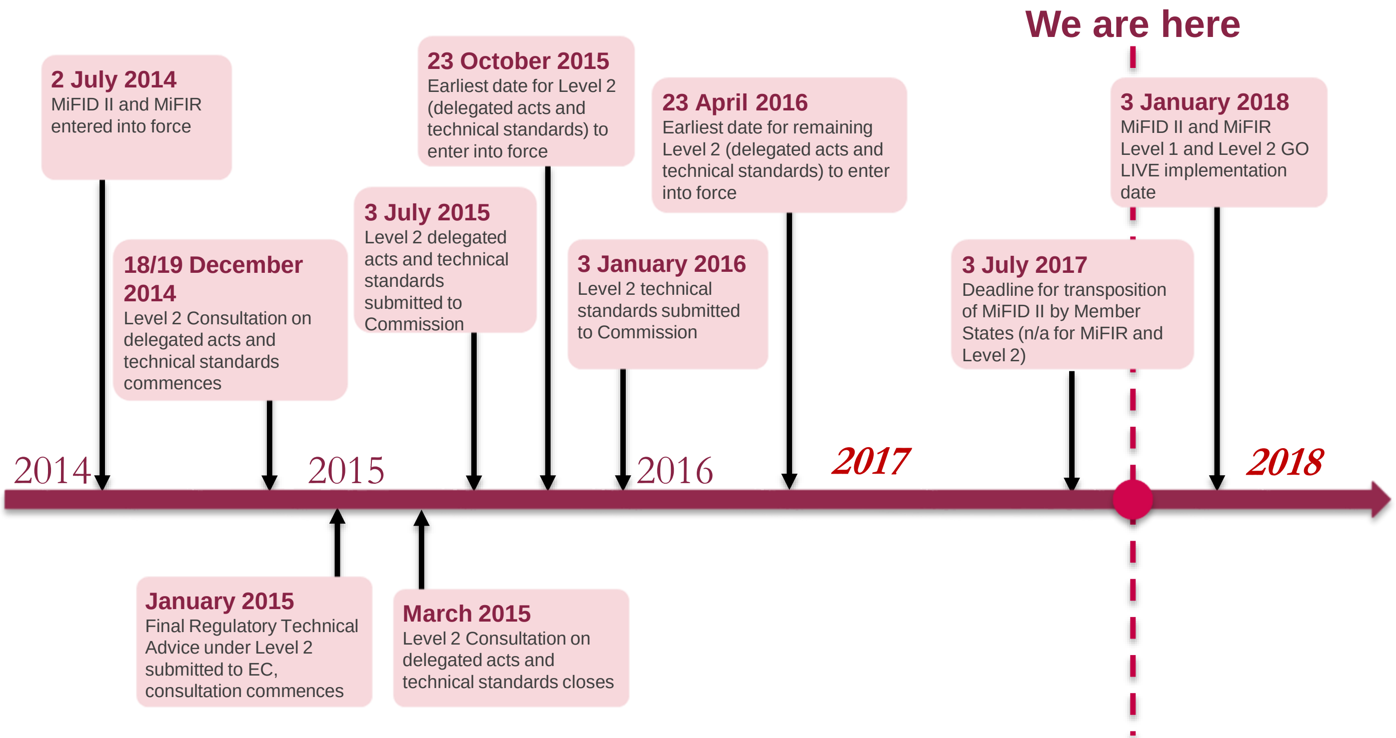
Other considerations

- new partnership audit rules
- fee compression leading to cost reductions
- continuing state pressure on PE structures

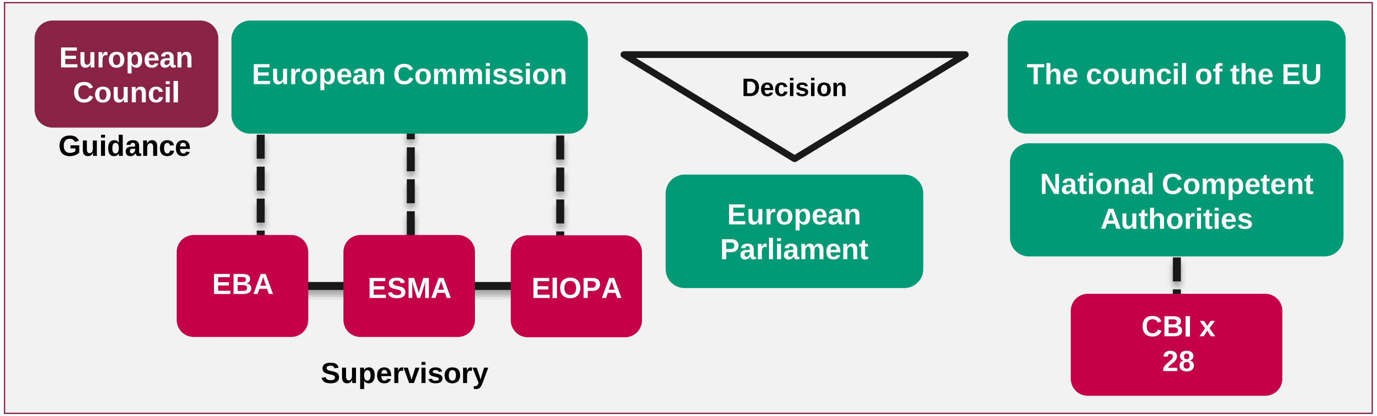
MiFID II – four month warning

David Morrey
Partner
Grant Thornton UK

MiFID II Timeline



EU Mechanics

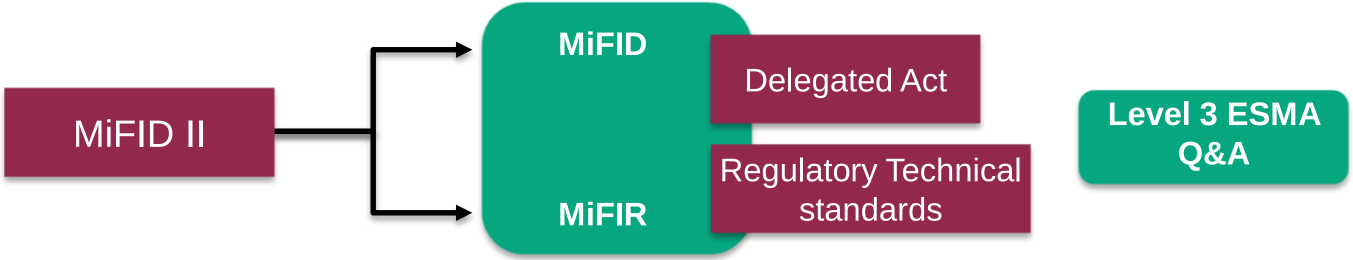


- **Regulation (EU) No. 600/2014 of the European Parliament and of the Council 15 May 2014 on Markets in financial instruments and amending Regulation (EU) No 648/2012**
- **Directive 2014/65 of the European Parliament and of the Council 15 May 2014 on Markets in financial instruments and amending Directive – 2002/92/EC and Directive 2011/61/EU. Associated Delegated Regulation**
- **ESMA's Technical advice to the commission on MiFID II**
- **Regulatory and Technical Implementing Standards on MiFID II and MiFIR**
- **The Financial Services and Markets Act 2000 (Regulated Activities) Order 2001**
- **FCA Handbook**
- **Financial Conduct Authority** – Markets in Financial Instruments Directive II Implementation – Consultation Paper 1-4

Key Features of MiFID II – Regulation & Directive

- **The Markets in Financial Instruments Directive** (MiFID), first introduced in November 2007, governs the provision of investment services in financial instruments by Investment Firms within the EEA.
- The second MiFID directive (MiFID II) together with the **Markets in Financial Instrument Regulation** (MiFIR) aims to reinforce and replace the current European rules on securities markets.

The evolution of markets infrastructure



Key Documents for MiFID II

Level 1	Level 2	Level 3
• MiFID • MiFIR	• Delegated regulation • Delegated Directive • Regulatory Technical Standards • Implementing Technical Standards • FCA consultation papers (15/43, 16/19, 16/29, 16/43, 17/8, PS17/5)	• ESMA guidelines on transaction reporting • ESMA Q&A on investor protection • ESMA guidelines on the assessment of knowledge and competence Others can be found on R^2 and also on support sites such as Practical Law

Implementation Hotspots

Implementation Hotspots

- Product Governance
- Inducements and payments for research
- Information to clients on costs and charges
- Remuneration
- Market Micro-structure
- Algorithmic Trading
- Transaction reporting
- Best Execution

Product Governance

- Manufacturer and Distributor information sharing
- Target market write ups
- Appropriateness testing

Inducements and payments for research

- To absorb or not to absorb
- RPAs budgeting and allocation complexity

Information to clients on costs and charges

- Aggregate costs disclosures where recommended or market someone else's products
- Investment firms illustrate the cumulative effect of costs on return when providing investment services

Remuneration

- Remuneration policy designed to prevent conflicts of interest and with compliance criteria
- Relevant individuals outside of RemCode

Market Micro-structure

- SI, MTF, OTF
- Clock synchronisation
- Trading obligation
- Pre and post trade transparency

Algorithmic Trading

- Identification of relevant activity

Transaction Reporting

- Changing accountabilities
- Completeness

Best Execution

- Meeting regulatory expectations
- Top 5 venue reporting

Detailed Requirements

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Conduct and Investor Protection

- Product governance
- Appropriateness
- Suitability
- Inducements
- Information to clients on costs and charges
- Governance
- Remuneration

Product Governance

- MiFID II will introduce extensive and prescriptive product governance requirements for both manufacturers and distributors of investment products.
- A key challenge will be managing the dual responsibility between manufacturers and distributors to exchange the necessary information about target market distribution and product performance. This will be particularly challenging where the distributor is a non-MiFID or third country firm. While ESMA set out to make the rules proportionate, there is also still uncertainty around how the rules should be applied in the context of execution-only business.

Definitions

- A product **manufacturer** includes all firms that **"create, develop, issue and/or design products**”.
- **Distributors** are defined as firms that **make a decision over “the range of products** (issued by themselves/other investment firms/non-MiFID entities) and services they intend to offer to clients …”
- The definition of manufacturer is intentionally wide and will encapsulate many firms that don't currently consider themselves primary producers of products. It will, for example, include firms advising corporate issuers on the structure of a new financial instrument.

Product Governance - manufacturers

Article 16(3) MiFID II

- Firms that manufacture instruments for sale to clients shall maintain, operate and review a process of the approval of each financial instrument and significant adaptions of existing instruments before they are marketed or distributed to clients.
- The product approval process shall specify the identified target market of end clients, include a detailed risk assessment process and assess the intended distribution strategy

Article 24 MiFID II

- Firms that manufacture financial instruments for sale to clients shall ensure that those financial instruments are designed to meet the needs of identified target market of end clients and that the strategy for distribution is compatible with the target market. In addition, firms must understand the instruments they offer/recommend, assess the compatibility of the financial instruments with the needs of end clients (taking into account identified target market) and ensure that products are only offered/recommended only when it is in the best interest of the client.

Delegated regulation - Product governance obligations for manufacturers

- Firms shall maintain procedures and measures to ensure the design of the product complies with the requirements relating to the proper management of **conflicts of interest** (including remuneration). In particular, when an investment firm develops a new product it must ensure that the product is **designed to meet the needs of an identified target market group**.

- Firms must also conduct **scenario testing** to identify market conditions which may lead to poor customer outcomes and ensure that the product does not undermine market integrity, for example by being a vehicle primarily intended to mitigate and/or dispose of the firm's own risks or exposure to the underlying assets of the product in situations where the investment firm already holds the underlying assets on own account.

- Firms should also consider **charging structures** to ensure they do not undermine the financial instrument’s return expectations (eg where they may outweigh any tax or other key advantages linked to the product) and are appropriately transparent for the target market. Criteria for defining the target market and distribution strategy should be sufficiently granular taking into account product complexity.

- Firms' **management bodies must have control** over the governance process but compliance functions will need to monitor developments and periodically review governance arrangements.

Product Governance - distributors

Delegated Regulation - Product governance obligations for distributors

- The obligations for distributors shall apply to investment firms when deciding the range of products (financial instruments and structured deposits) issued by itself or other investment firms and services they intend to offer to clients. These **proposals also apply to distributors selling investment products issued by entities that do not fall under MiFID scope** (eg if they distribute shares or bonds issued by a car company or a supermarket). In such circumstances, where the manufacturer is not a MiFID firm and therefore has no obligation to define the target market, the target market assessment must be carried out by the distributor.
- When deciding the range of investment products and services that it will offer, an investment firm must have in place adequate product governance arrangements to ensure that **products and services they intend to offer are compatible with the needs, characteristics, and objectives of an identified target market** and that the **intended distribution strategy is consistent with the identified target market**. In this regard, investment firms shall identify and assess the circumstances and needs of the clients that they intend to focus on, so as to ensure that clients' interests are not compromised as a result of commercial or funding pressures.
- As part of this process, the firm shall identify any groups of investors for whose needs, characteristics and objectives the product or service is not compatible.
- Distributors shall use information on their own clients and the information obtained from manufacturers to identify the needs, characteristics and objectives of the group of clients to whom they are going to offer the product or service, as well as define how they are going to distribute it.
- Distributors should put in place processes to **periodically review product governance procedures**, investment products offered or recommended and services to ensure they remain robust and fit for purpose. As with manufactures, firms' management bodies will have control over the governance process, but compliance functions will need to monitor developments and periodically review governance arrangements.
- Where firms work together with regard to distribution, the firm with the direct client relationship remains responsible for the product governance obligation.

Appropriateness

- The requirement to conduct an appropriateness test **currently applies when firms provide services other than investment advice or portfolio management in relation to certain 'complex' assets**. The test applies to ensure that clients have the appropriate degree of knowledge and understanding to enter in to certain transactions, or to warn them if they do not.

- The assets which can be sold on a non-advised basis without an appropriateness test are **becoming more restricted under MiFID II**. For example:
  - shares are restricted to shares in companies, and specifically exclude shares in non-UCITS collective investment schemes
  - bonds and money market instruments are likely to be deemed complex if they embed a derivative or "incorporate a structure which makes it difficult to understand the risks"
  - structured deposits incorporating a structure which makes it difficult for the client to understand the risk of return or the cost of exiting the product before term
  - certain structured UCITS will now require an appropriateness test

- In addition to specific instruments, such as non UCITS collectives being brought within the appropriateness testing requirements, for other instruments **two tests need to be met**:
  - The instrument does not incorporate a clause, condition or trigger that could fundamentally alter the nature or risk of the investment or pay out profile. For example, investments that incorporate a right to convert the instrument into a different investment.
  - The instrument does not include any explicit or implicit exit charges that have the effect of making the investment illiquid even though technically frequent opportunities to dispose or redeem it would be possible.

- Whilst some of these new provisions may appear to be restrictive the FCA has, in its most recent discussion paper, explained that it expects **appropriateness tests to be applied proportionately**. Some instruments will be far less complex than others and indeed may be very similar to other instruments that are considered non-complex and that many customers would be familiar with. Firms therefore need to develop sensible and proportionate means for dealing with these new requirements whilst ensuring they give the required level of investor protection.

Suitability

- For the UK, the MiFID II **detailed requirements around suitability do not represent a significant change** – the FCA confirmed as much in its March 2015 Discussion Paper. Perhaps the **most significant change is the explicit requirement to assess a customer's risk tolerance and ability to bear losses**. However, those in the retail advice market will know that whilst this may not previously have been an explicit rule risk profiling has been commonplace, and indeed a key expectation of the FCA, for many years.
- The requirement to ensure a personal recommendation or a decision to trade on a customer's behalf is suitable has not changed. MiFID II does, however, also introduce the **requirement to ensure suitability when advising on bundled services**. MiFID II makes it explicit that when giving advice on bundled services (ie packages of investment and non-investment products or services) firms have an obligation to ensure the whole package is suitable.
- MiFID II will also require firms to **consider whether other instruments could meet clients' needs taking account of cost and complexity**. Where firms segment their customer base and tailor solutions accordingly they should take care to ensure that higher net worth customers, for example, are not automatically provided with a higher cost solution without consideration of whether they require additional features or benefits of such as solution. On the face of it the requirement to consider lower cost or simpler solutions could be potentially onerous. However, ESMA has clarified in its technical advice that it will not expect firms to survey the whole of the market.
- Under MiFID II where there is an on-going relationship between the client and the firm, the firm must be able to **demonstrate on-going suitability**. Whilst in our experience it is standard practice for financial advisers to regularly update fact finds at each advice point, portfolio managers will need to ensure that client information on suitability is reviewed regularly and kept up to date.
- For firms already operating or considering a robo-advice proposition, MiFID II makes it clear that **automated or semi-automated systems attract the same suitability obligations as other advice channels**.
- Although changes to suitability requirements aren't transformational, firms should be taking this opportunity to work through the detailed requirements and ensure their processes around suitability are fit for purpose.

Inducements and payments for research

- In accordance with Articles 24 (7), (8) & (9) of MiFID, an investment firm is prevented from accepting and retaining fees, commission or non-monetary benefits paid or provided by any third party in relation to the provision of the services to clients.
- However, there are potential carve-outs for firms providing independent investment advice and portfolio management when:
- ***"Minor non-monetary benefits that are capable of enhancing the quality of service provided to a client and are of a scale and nature such that they could not be judged to impair confidence with the investment firm's duty to act in the best interest of the client should be clearly disclosed and excluded from this paragraph"***
- Investment firms providing the service of independent investment advice and portfolio management are not allowed to receive non-monetary benefits that do not qualify as minor. The FCA is proposing to extend this restriction to all firms providing advice on retail investment products (regardless of whether that advice is independent or not).

Minor non-monetary benefits

- The Commission Delegated Regulation (EU) of 7 April 2016 introduces a list of non-monetary benefits that can be considered to be minor and therefore 'acceptable'. These benefits should only qualify as minor when they are reasonable and proportionate and of such scale that they are unlikely to influence the recipient's behaviour in any way that is detrimental to the interests of the client.
- This list includes the following benefits:
  - information or documentation relating to a financial instrument or an investment service, which is generic in nature or personalised to reflect the circumstances of an individual client
  - written material from a third party that is commissioned and paid for by a corporate issuer or potential issuer to promote a new issuance by the company, or where the third party firm is contractually engaged and paid by the issuer to produce such material on an ongoing basis, provided that the relationship is clearly disclosed in the material and that the material is made available at the same time to any investment firms wishing to receive it or to the general public
  - participation in conferences, seminars and other training events on the benefits and features of a specific financial instrument or an investment service
  - hospitality of a reasonable de minimis value, such as food and drink during a business meeting or a conference, seminar or other training events mentioned under point (c)

Inducements and payments for research

Unbundling Research and Dealing Commissions

- Despite significant concerns previously expressed by the industry, under MiFID II investment firms are permitted to accept third party research **only** where:
  - they pay for it directly out of its own resources (which they may choose to reflect in an increase to the firm's portfolio management or advice fees), or
  - it is paid from a ring-fenced research account that is funded by a specific charge to their clients, subject to certain conditions.

- When an investment firm uses a transaction to fund an **RPA**, then a number of conditions must be met, including:
  - **Budget** - The investment firm must set and regularly assess a research budget as an internal administrative measure
  - **Quality Assessment** - The investment firm is responsible for the RPA and should therefore assess the quality of the research purchased based on qualitative criteria and demonstrate the contributions to the investment decisions.
  - **Reporting** - On an ex-ante basis the investment firm must provide information about the budgeted amount for research and the amount of the estimated research charge for each client (or fund). On an ex-post basis, the investment firm must provide annual information on the total costs that each client (or fund) has incurred for third party research.

Separation of costs/charges

- Any firm providing execution services should identify the charge for these services that reflect only the cost of executing the transaction (buying or selling a financial instrument). Any other goods or services rendered should be subject to a separately identifiable charge. The supply of these goods or services should not be influenced by (or be conditional on) levels of payment for execution services.

- Furthermore, any investment firm that provides execution and research services, and also carries out underwriting and placing activities, should ensure adequate controls are in place to manage any potential conflicts of interest between these activities and between their different clients receiving those services.

- These current proposals make it clear that there should be **no payment for third party research linked to the payments made for execution of orders**. This will address the potential inducements and conflicts of interest that currently exist for portfolio managers when they receive third party research linked to execution arrangements with their brokers. The proposed approach will also create more transparency over spending on research to improve outcomes for consumers.

Information to clients on costs and charges

- MiFID II requires firms to provide significantly more detailed information about costs and charges in cases where they **recommend or market** financial instruments to clients, or are also required to provide a UCITS or PRIIPs KIID/KID.

- In these cases **firms will be required to aggregate all costs and charges relating to both their own services and the underlying instruments** and explain to customers how this would impact performance.
- For ex-ante and ex-post disclosure of information on costs and charges to clients, investment firms that recommend or market financial instruments to clients need to aggregate the following:
  - all costs and associated charges charged by the investment firm or other parties where the client has been directed to such other parties, for investment services and/or ancillary services provided to the client; and
  - all costs and associated charges associated with the manufacturing and managing of financial instruments
- For the purposes of (a), third party payments received by firms in connection with the investment service provided to the client should be itemised separately and the aggregated costs and charges must be totalled and expressed both as a cash amount and as a percentage.
- Where any part of the total costs and charges is to be paid in or represents an amount of foreign currency, firms should provide an indication of the currency involved and the applicable currency conversion rates and costs.

- Investment firms shall provide their clients with an **illustration showing the cumulative effect of costs on return when providing investment services**. Such an illustration shall be provided both on an ex-ante and ex-post basis. Investment firms shall ensure that the illustration meets the following requirements:
- - the illustration shows the effect of the overall costs and charges on the return of the investment
- - the illustration shows any anticipated spikes or fluctuations in the costs, and
- - the illustration is accompanied by a description of the illustration

Governance

MiFID II contains a number of new requirements for the sound governance of investment firms.

NB: European legislation, such as MiFID II, often refers to ‘management bodies’ to ensure it is fit for purpose across all jurisdictions. In the UK, it is clear that the FCA and PRA expect the Board to have overall responsibility for the running of a legal entity. Boards can delegate day to day management to an Executive Committee, which may delegate further down, but the Board must maintain control and oversight of the business. Boards can also delegate their responsibilities to specialist committees of the Board, where appropriate.

Board oversight

- The provisions set out in CRD IV as they relate to management bodies have effectively been applied to investment firms under MiFID II. Many of these requirements are in line with the FCA's current expectations in relation to good governance. The new requirements for management bodies include:
  - having overall responsibility for the firm and overseeing the implementation of strategic objectives, risk strategy and internal governance
  - ensuring integrity of financial reporting systems and operational/compliance controls
  - overseeing the process of disclosure and communications
  - having responsibility for providing effective oversight of senior managers
  - monitoring/periodically assessing the adequacy and implementation of strategic objectives, effectiveness of governance arrangements and adequacy of policies relating to the provision of services to clients

- The management body must have adequate access to information and documents which are needed to oversee and monitor management decision making.

Other relevant elements of MiFID II include:

Remuneration
Conflicts of interest
Compliance function

Policy oversight

- MiFID II requires that the management body of a firm should define, approve and oversee the following:
- the organisation of the firm for the provision of investment services/activities, including the skills knowledge and expertise required by personnel and the resources and procedures required
- a policy as the services, activities and products provided in accordance with the risk tolerance of the firm and needs of its clients (i.e. a product governance policy)
- a remuneration policy for persons involved in the provision of services to clients

Board members – skills and experience

- Firms that are not significant IFPRU firms must ensure that members of the management body do not hold more directorships than is appropriate taking account of individual circumstances and the nature scale and complexity of the firm's activities. Individuals must commit sufficient time to performing their functions for the entity.

- Members of the management body must:
  - be of sufficiently good repute
  - possess sufficient knowledge, skills and experience to perform their duties both on an individual basis and collectives to understand the firm's activities and key risks
  - reflect and adequate broad range of experience
  - act with honest integrity and independence of mind to effectively assess and challenge the decision of senior management where necessary

Remuneration

- The firm must have in place a **remuneration policy which applies to all 'relevant persons'** (including employees, contractors and tied agents) with an impact, directly or indirectly, on investment services provided by the firm or on its corporate behaviour.
- This requirement applies regardless of the type of clients, to the extent that the remuneration of those individuals may create a conflict of interest that encourages them to act against the interests of any of the firm's clients. The application of the remuneration rules under MiFID II are wider than under previous regimes (eg CRD IV) which have focussed primarily on senior managers and/or material risk takers.
- Firms should conduct an analysis to determine which individuals/groups will be caught by this new requirement. It is likely to capture individuals on the management body who are not caught by the current remuneration code.
- The **remuneration policy** must:
    - be **designed to prevent conflicts** of interests between employees/the firm and clients
    - ensure that **remuneration and similar incentives are not solely or predominantly based on quantitative commercial criteria**, and take fully into account appropriate qualitative criteria reflecting compliance with the applicable regulations, the fair treatment of clients and the quality of services provided to clients.
    - **ensure that a balance between fixed and variable components of remuneration is maintained at all times**, so that the remuneration structure does not favour the interests of the firm or individuals against the interests of any client.

Trading and Markets

- Market micro-structure
- Trading obligation
- Pre-trade transparency
- Post-trade transparency
- Algorithmic trading
- Transaction reporting
- Best execution

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Market Micro-structure

Microstructure – RM / MTF / OTF / SI

- MiFID II introduces a **new category of trading venue called an Organised Trading Facility (“OTF”)** that will sit alongside Regulated Markets (RMs), Multilateral Trading Facilities (MTFs) and the amended scope of Systematic Internalisers (SIs).
- Only non-equity instruments, namely bonds, derivatives, emission allowances or structured finance products, will be eligible for trading on an OTF. Whilst firms are unable to operate both an OTF and act as an SI, the operator of an OTF may also operate a RM or MTF. Additionally, operators of OTFs will be prohibited from allowing the interaction of orders between two separate OTFs.

Consistency of Application

- To ensure consistency amongst the different types of trading venues, MiFID II **extends the requirements that were previously applied to RMs and MTFs to OTFs**. For instance, operators of an MTF or OTF are required to establish transparent rules regarding the criteria for determining which financial instruments can be traded on their platform and ensure fair and orderly trading with objective criteria for the efficient execution of client orders.
- MiFID II imposes a number of requirements upon trading venues that largely mirror those imposed upon investment firms, namely relating to governance and accountability, staff competency and training.

Market Abuse and Surveillance

- Operators of an MTF and OTF are required to **immediately inform the regulator of any instances of significant infringements of its rules**, disorderly trading conditions or conduct issues that may indicate potential market abuse.
- Firms must ensure that they have sufficiently **effective monitoring arrangements in place to assess and record any potential instances of market abuse**.
- Should a trading venue **remove or suspend a particular instrument** due to suspected market abuse, it **must make its decision to do so public** and other trading venues must also remove or suspend this instrument (unless doing so would likely cause significant damage to investors or the orderly functioning of markets).
- To help ensure that orderly trading conditions are maintained, regulated markets are required to have in place processes to reject orders that exceed pre-determined volume and price thresholds, or orders that are clearly erroneous. They must also halt or constrain trading if there are significant price movements in financial instruments in a short period of time. There are also new requirements relating to the **standardisation of tick sizes** for certain financial instruments, as well as the **synchronisation of business clocks**.

Trading obligation

Derivatives

- MiFID II introduces a requirement that **specific in-scope OTC derivative contracts must be traded on a RM, MTF, OTF or equivalent third-country trading venue**, and not executed on a bilateral basis. This requirement applies to financial and non-financial counterparties that are subject to the clearing obligation under EMIR.

- ESMA's Regulatory Technical Standard 4 provides further details to those outlined within MiFID on which derivatives are subject to these new trading obligations. It should be noted that any intragroup transactions are exempt from this trading obligation.

- In summary, **there are three conditions that, if all are met, will determine whether a derivative is subject to the trading obligation**. These are:
  - the derivative, or subset thereof, must be admitted to trading on at least one trading venue
  - the derivative or subset thereof, is considered sufficiently liquid (determined by frequency and size of trades, the number of market participants and the average size of spreads)
  - ESMA has deemed the contract in question subject to the Clearing Obligation, as outlined under EMIR.

Equities

- In order to ensure more trading takes place on regulated trading venues, a **trading obligation for shares admitted to trading on a regulated market or trading venue is being introduced**. This obligation will require investment firms to undertake all trades, including trades dealt on their own account and trades dealt when executing client orders, on a RM, MTF or SI (or equivalent third-country trading venue).

- There are, however, **exclusions from this obligation that can be applied when there are "legitimate reasons"**. These reasons are where trades are non-systematic, ad-hoc, irregular and infrequent, or are technical trades such as give-up trades which do not contribute to the price discovery process. Such an exclusion from the trading obligation should not be used by firms to circumvent the restrictions introduced on the use of the reference price waiver and the negotiated price waiver, or to operate a broker crossing network or other crossing system.

Pre-trade transparency

- The financial crisis exposed weaknesses in the way information on trading opportunities and the pricing of financial instruments (other than shares) is made available to market participants, namely in terms of timing, granularity, equal access, and reliability. MiFID II brings into force pre and post-trade transparency rules that aim to address these issues.

- In order to provide a sound transparency framework for all relevant financial instruments, these requirements have been **extended from just equity instruments and will now apply to bonds, structured finance products, emission allowances and derivatives which are traded on a trading venue**. Whilst some pre-trade transparency exemptions do exist, these are only available in a specific number of pre-defined cases (outlined below). The transparency requirements will be calibrated for different types of trading systems, including order-book, quote-driven, hybrid and periodic auction systems.

- Furthermore, in order to ensure conditions are uniform between trading venues, **the same pre and post-trade transparency requirements will apply to different types of venues**. The transparency requirements will also be calibrated for different types of financial instruments, including equities, bonds, and derivatives, and will take into account the interests of investors and issuers, including government bond issuers, and market liquidity.

Specific Requirements

- Market operators and investment firms operating a trading venue are **required to make public current bid and offer prices, and the depth of trading interest at those prices**, which are advertised through their systems for shares, depositary receipts, ETFs, certificates and other similar financial instruments traded on that venue. This requirement will also apply to actionable indication of interests (IoIs).

- Market operators and investment firms operating a trading venue will need to **make this information available to the public on a continuous basis during normal trading hours**. Furthermore, this information is to be made public **in a manner that is easily accessible to other market participants** on a reasonable commercial basis. MiFID II extends these requirements to non-equity instruments including bonds, structured finance products, emission allowances and derivatives traded on a trading venue.

- **Competent authorities will have discretion to waive these obligations if certain criteria are met**. These include:
  - block trades (trades that are large in scale compared to normal market size)
  - actionable IoIs in request-for-quote and voice trading systems that are above a size threshold specific to that instrument which would expose liquidity providers to undue risk
  - derivatives not subject to the trading obligations
  - other financial instruments for which there is no liquid market.

Post-trade transparency

- Post-trade transparency is an **extension of the current regime for shares to a wider range of instruments** including: ETF's, depositary receipts, non-equity instruments, emission allowances and derivatives. It involves the publication of data on the trades once these are executed for investment firms and trading venues. ESMA's Technical Standards (RTS) 1 and 2 outline additional requirements in relation to post-trade transparency for financial products.

Equity instruments RTS 1

- Post-trade transparency requirements have been extended and will now include 'equity like instruments' such as exchange traded funds (ETF's) and depository receipts.
- All investment firms (including SIs) as well as the relevant regulated trading venues (MTFs and RMs) will be subject to post-trade transparency reporting.
- Regulated markets and multilateral trading facilities are required to **publicise the price, volume and time of transactions traded on the trading venue as close to real-time as technically possible** unless the transaction falls under the deferred publication regime.
- Where a transaction takes place on a trading venue outside its normal trading hours it should be made public before the opening of the next trading day of the relevant trading venue.
- Where firms conclude transactions outside of a venue either on own account or on behalf of clients, these must be reported via an Approved Publication Arrangement (APA) unless for example it falls under those items defined under Article 13 (eg give up). Reports will need to be sent within time limits specified by the party obligated to report.
- MiFIR provides a **deferral regime based on the type or size of transaction and, in particular, for large in scale transactions**. Prior approval and clearance should be provided for deferred publication by national competent authorities. Matched principle transactions do not benefit from deferral.

Post-trade transparency (cont)

Non-equity Instruments RTS 2

- MiFID II introduces post-trade transparency requirements for non-equity instruments covering bonds, structured finance products, emission allowances and derivatives, which apply to all

- investment firms (including SIs) as well as trading venues, ie MTFs, OTFs and RMs. The information that should be published is similar to that for equity instruments. Likewise, publication should be made as close to real time as possible no later than 15 minutes. This time period will reduce to 5 minutes after 3 years. Publication is required unless the transaction benefits from the deferred publication regime. As for equity instruments, where firms conclude transactions outside of a venue either on own account or on behalf of clients these must be reported via an Approved Publication Arrangement (APA).

- Information relating to individual components of a package must also be provided.

- When granted by the relevant competent authority, deferred publication will be based on whether the instrument is deemed liquid, the transaction is large in scale, or above size specific to instrument or is a packaged transaction meeting certain criteria. In general the maximum deferral is set to 7pm local time two working days after the transaction. Matched principle transactions do not qualify for deferral.

Data to be made public

Below is a list of some of the information that should be made public:

- Execution date and time
- Publication date and time
- Venue
- Instrument type code
- Instrument identification code
- Price
- Notional
- Transaction identification code
- To be Cleared or Not

Algorithmic Trading

- **Algorithmic trading** is defined as trading in financial instruments where a computer algorithm automatically determines individual parameters of orders such as whether to initiate the order, the timing, price or quantity of the order or how to manage the order after its submission, with limited or no human intervention, and includes smart order routers (SOR) where algorithms are used for optimisation of execution by determining order parameters. It does not include automatic order routers (AOR) that do not change order parameters and only determine which venue(s) the order should be routed to or systems using algorithms for the purpose of post-trade processing of executed transactions.

- **HFT** is a subset of algorithmic trading which is characterised by:
  - infrastructure intended to minimise network and other types of latencies, including at least one of the following facilities for algorithmic order entry: co-location, proximity hosting or high-speed direct electronic access
  - system-determination of order initiation, generation, routing or execution without human intervention for individual trades or orders, and
  - high message intraday rates which constitute orders, quotes or cancellations.

  Intraday message rates include those associated with following a market making strategy under MiFID article 17(4). Recital 24 of the Delegated Regulation and Recital 61 of MiFID II also explain that the definition of HFT is designed to capture proprietary trading in liquid markets and not messages related to receiving and transmitting orders, or executing orders, on behalf of clients.

- **Direct electronic access (DEA)** means an arrangement where a member or participant or client of a trading venue permits a person to use its trading code so the person can electronically transmit orders relating to a financial instrument directly to the trading venue and includes arrangements which involve the use by a person of the infrastructure of the member or participant or client, or any connecting system provided by the member or participant or client, to transmit the orders (direct market access) and arrangements where such an infrastructure is not used by a person (sponsored access). This is further clarified within the Delegated Regulation. DEA does not include the transmission of orders that are intermediated (eg online brokerage) where the client does not have the ability to determine the exact time associated with order entry and lifetime.

Algorithmic Trading (cont)

Article 17 MiFID and RTS 6 Investment firms engaged in algorithmic trading

- Firms engaged in algorithmic trading must **notify the relevant competent authority and trading venue** where it is a member or participant of that venue.
- Firms' **governance structures** should set out clear lines of accountability and separation of trading and risk functions and implement clearly delineated testing methodologies, including sign off for systems, algorithms or strategies to be used before initial deployment or subsequent update.
- **Conformance testing** is required to be undertaken and these are to be concluded outside of production environments.
- Deployment of algorithms must be **controlled using pre-defined limits**.
- Firms must implement **pre and post-trade risk controls** including price collars, maximum order values and volumes and market and credit risk limits. Controls should also include 'kill' functionality.
- Firms must **monitor in real time for signs of disorderly trading**. As well as trading staff, this monitoring should also be conducted by independent persons within risk or compliance functions.
- Firms should provide **staff training** and conduct monitoring associated with the detection and prevention of market abuse. Monitoring should also cover DEA clients where that service is provided. Systems associated with market abuse monitoring should be automated.
- Firms must implement **effective business continuity arrangements** to deal with any failure of its trading systems, ensuring that they are fully tested and properly monitored.
- Additionally, firms **must ensure compliance staff have at least a general understanding** of the way in which the algorithm trading systems and algorithms operate. They must be adequately trained to manage and monitor algorithms.

Algorithmic Trading (cont)

- Firms must establish a process for the **annual self-assessment of algorithms** utilised within the firm, including stress testing, procedures and controls and an annual validation to ensure compliance with Article 17 of MiFID II. The annual validation report and supporting documentation must be approved by the firm's senior management.
- Material changes to algorithms shall be subject to review by responsible persons within a firm. Firms must implement robust security controls around trading access.
- Firms engaged in HFT must **store time sequenced records of all orders whether placed or executed**. This also covers order amendments and quotes on trading venues. These have to be retained for at least 5 years.
- When engaged in market making strategies, firms will be required to enter into binding written agreements with venues. The agreement will outline its obligations and firms must have effective systems and controls in place to ensure that these obligations are met.

Article 17 MiFID and RTS 6 Direct Electronic Access (DEA)

- Firms that offer DEA access must implement **appropriate policies and procedures to ensure clients comply with venue rules**.
- Prior to providing DEA access, firms must conduct **due diligence exercise on these clients including the types of strategies to be undertaken**. DEA providers will remain responsible for these clients' trading and this assessment process must be reviewed annually. DEA providers should apply pre and post-trade controls to client orders and must have the ability to monitor, block, cancel or amend orders and suspend DEA services.

Transaction reporting

- Transaction reporting is not a new requirement under MiFID II, instead it can be seen as a **review, modification and expansion of existing rules**. Currently under MiFID, transaction reporting only applies to financial instruments traded on a regulated market. The introduction of MiFID II will now capture:
  - financial instruments traded on an EU trading venue including Multilateral Trading Facilities (MTF) and Organised Trading Facilities (OTF)
  - Financial instruments where the underlying instrument is traded on a trading venue. Likewise where the underlying is an index or a basket of financial instruments traded on a trading venue.

- There are a number of exclusions from the transaction reporting regime including:
  - securities financial transactions i.e. stock lending (SBL) and repurchase agreements (repo)
  - portfolio compressions
  - the creation, expiration or redemption of instruments resulting from pre-determined contractual terms or mandatory events where no investment decision is occurring
  - a change in the composition of an index after a transaction has taken place.

Order Transmission

- In order to avoid non-reporting or duplication of reporting transactions, investment **firms who transmit orders to each other should agree whether the firm receiving the transmitted order will report all the details in its transaction report** of the resulting transaction or transmit the order onwards to another investment firm.

- If no agreement is in place, the transmitting firm should submit its own transaction report which includes all the details of the resulting transaction and the receiving firm should submit a transaction report which does not include the transmitted details.

- **Firms may be exempt from the requirement to submit transaction reports if they have 'transmitted an order' in compliance with Article 4 of RTS 22**. If firms wish to make use of Article 4 they must fulfil all the criteria set out in that Article, including to ensure there is a written agreement in place with the 'receiving firm', that the order contains **all** the required details and that there is appropriate monitoring of clients positions in real-time to flag if they are a short-sell, or to identify underlying clients if an order is aggregated. Article 4 only applies where the order is being transmitted to a firm subject to MiFID II transaction reporting requirements set out in Article 26 of MiFIR.

Transaction reporting (cont)

Data fields

- The number of data fields required under MiFID II that a firm is required to submit as part of a transaction report will rise significantly: from **23 fields under MiFID, to no fewer than 81 under MiFID II**. Only 13 of the 23 existing fields remain unchanged.

- There are additional fields for whether a transaction in shares or sovereign bonds is a short sale, whether a transaction took place under an applicable pre-trade transparency waiver and identification for traders and/or algorithms making the investment decisions.

Timing of Reporting and Responsibility

- Where an investment firm reports directly to the regulator it accepts the responsibility for completeness, accuracy and timely submission of the reports.

- **When submissions are completed through an ARM** or a trading venue, the investment firm will not be responsible for failures in the completeness, accuracy or timely submission of the reports which are attributable to the ARM or trading venue. However, investment firms **must take reasonable steps to verify the completeness, accuracy and timeliness of the transaction reports**.

- Article 15 of RTS 22 sets out a number of key controls firms should have over their transaction reporting arrangements, including mechanisms to ensure **security of data**, methods to ensure **completeness and accuracy and avoid duplication**, as well as robust **business continuity plans**.

- These requirements are in addition to general SYSC requirements and firms should also make sure they undertake on-going monitoring & reconciliations, have escalation procedures for duplicate or incorrect reports and failures to report, compliance and/or audit reviews and robust change management procedures for any upstream technology changes. Firms must ensure they have completed comprehensive testing prior to rule changes (with comprehensive test scripts, reviews and sign offs).

Comparison of reporting requirements

	Trade Reporting	Transaction Reporting	EMIR	SFTR	REMIT
Regulation	MAR 5.9, Art 20, 21 MiFIR	SUP 17, Art 26, MiFIR	ESMA, Art 9	ESMA, Art 4	ESMA, Art 8 (October 2015)
Purpose	Post trade transparency	Policing market abuse	Monitoring Systemic Risk	Monitoring Systemic Risk (Shadow Banking)	Policing Market Abuse
Frequency	T+1 (minutes)	T+1 (day)	T+1 (day)	T+1 (day)	T+1 (day)
No of Fields	15 and any flags 18 and any flags	65	83	18?	58 or 45 – standard contracts/non standard contracts – gas/electricity
Scope	Investment firms which either on own account or on behalf of clients conclude transactions in financial instruments traded on a trading venue.	• MiFID investment firms and credit institutions conducting investment services/activities • EU branches of non-EU firms • Trading Venues to report transactions executed through their systems by firms not subject to MiFIR	Financial counterparties and non-financial counterparties. CCPs (as defined in Article 2(1) of EMIR) are also subject to the reporting obligation.	Financial counterparties, non-financial counterparties, CCPs and central securities depositories which are established: (i) In the EU; and (ii) In a third country, if the SFT is concluded in the course of the operations of an EU branch.	Market participants, including TSOs, who enter into transactions, including the placing of orders to trade, in one or more wholesale energy markets.
Reportable Instruments /Product	Equity & Equity like instruments, bonds, structured finance products, emission allowances and derivatives	• Financial instruments admitted to trading/trading on trading venue • Financial instruments where underlying instrument is trading on a venue • Financial instruments where underlying is an index/basked composed of instruments trading on a venue.	Any derivative contract including both exchange-traded and OTC derivatives. Give ups - Where a give-up occurs from the firm to a clearing member within the reporting deadline and no changes to the economic terms of the original trade have been made, the trade should be reported in its post give-up state.	(i) Repurchase agreements; (ii) Securities or commodities lending/ borrowing; and (iii) Buy-sell back / Sell-buy back transactions or collateral swap transactions..	(i) Contracts & Derivatives for the supply of electricity or natural gas where delivery is in the EU; (ii) Contracts & Derivatives relating to the transportation of electricity or natural gas in the EU; Implementing Regulation further specifies the above classes and divides them into: (i) Standard contracts - contracts concerning a wholesale energy product admitted to trading at an organised market place; and (ii) Non-standard contracts
Over Reporting	Transactions that do not contribute to price formation process should not be reported.	No over reporting	Not specified	Not specified	Not specified

Best Execution

Summary of MiFID II requirements

- Under MiFID II firms must adopt a best execution governance framework to ensure implementation of any enhancements to best execution requirements, including updating and monitoring of adherence to its Order Execution Policy (OEP). Recital 99 of the Delegated Regulation states "*An investment firm should apply its execution policy to each client order that it executes with a view to obtaining the best possible result for the client in accordance with that policy".* Firms will need to conduct a **review of execution procedures in accordance with requirements at least annually, or where there is a material change, and make public results of its best execution analysis.**

- Firms should implement processes and procedures to enable them to **publish their top 5 execution venues (per asset class)** using the relevant templates. These will also require separate reports depending on retail , professional clients and securities financing transactions (SFT). This does not preclude firms from choosing a single execution venue within their policy, on the basis it will provide best execution on a consistent basis. Where applicable, venues associated with SFT should be identified separately. Reports are to be published annually on websites in a machine readable format.

- Analysis of data produced by venues will be crucial when conducting reviews of best execution. Firms will need to access and utilise data from relevant venues to ascertain changes to policy and to identify venues that provide the highest quality of execution.

- Firms should also ensure that best execution **monitoring is extended to other asset classes and, where applicable**, gather market data and comparable or similar product information associated with OTC execution. Firms should also identify business models that result in operation of a venue and therefore subject to MiFID Article 27 (3) and RTS 27.

- Those firms who only provide services in relation to receipt or transmission of orders, and portfolio management without execution, must ensure that those providing execution services have arrangements that allow them to comply with MiFID Article 27 and identifies those entities within its OEP

- Training must be provided to all employees on changes to best execution requirements. Best execution has been a hot topic for the FCA and firms should take this opportunity to consider and review existing rules under COB 11 and FCA Thematic Review R14/13 – Best Execution and Payment for Order Flow

Best Execution (cont)

MiFID Article 27 RTS 27

- The **OEP should be reviewed and updated to include applicability of scope per asset class and type of instruction**, including any 'legitimate reliance'. Firms must review and ensure that they have in place the prior consents required by their clients to the OEP and express consent to execute orders outside a trading venue.
- Best Execution monitoring should be enhanced for other asset classes, **not just equity trading**. Additionally firms must establish processes to retrieve and consolidate data to ensure annual publication of best execution venues in terms of trading volumes and information on the quality of executions on those venues for professional clients for each class of financial instrument (excluding SFT).
- They must establish processes to retrieve and consolidate data to ensure annual publication of the top 5 execution venues in terms of trading volumes and information on the quality of executions for securities financing transactions.
- Moreover, firms must ensure a publication of a summary of the analysis and conclusions from detailed monitoring for each class of financial instrument.
- The **information on the top 5 venues must be published by each class of financial instrument (ie equities, bonds etc) and they must consider commissions and costs associated with the execution of a client order on each of the execution venues**
- In order that firms may review execution quality, **venues will be obligated to provide data in a machine readable format for firms to download** and use for execution analysis. This will need to be produced quarterly. Firms should review their current operating model to identify areas of their business that may be defined as execution venues. Data to be published will depend on several factors including market mechanism, trading mode and transaction type.
- Where firms operate a venue, they will need to establish the model under which it operates and comply with requirements within RTS 27 where applicable. Venues should give consideration to procedures associated with data collection requirements, and where applicable, the interaction of different models with other requirements such as when operating a voice OTF and clock synchronisation for example.

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