MiFID II: key impacts for the retail market

On 3 January 2018, the existing European legal framework governing financial markets in the EU is being replaced with a revised directive and new regulation (together, 'MiFID II').

MiFID II introduces a wide range of changes to the EU regulatory framework and requires investment firms to meet new industry-wide standards. Clients will benefit from high standards of investor protection and market transparency.

We recognise that MiFID II represents a fundamental change for our clients and have set out below certain questions and answers on the issues that we believe will be of most interest to you.

Does MiFID II impact investments in Legal & General unit trust funds?

Yes. MiFID II affects firms such as UCITS management companies and alternative investment fund managers indirectly in areas such as product governance, inducements and client classification. This means that the management company for our unit trusts, Legal & General (Unit Trust Managers) Limited (UTM), will be affected.

When do I need to conduct appropriateness tests?

The MiFID II rules on appropriateness will affect distributors seeking to sell UTM's funds directly or on an execution-only basis.

If funds are deemed complex, distributors will need to conduct an appropriateness test in order to sell the funds.

Are the L&G unit trust funds complex or non-complex?

All UCITS funds are non-complex. The majority of L&G unit trust funds will therefore be non-complex.

Non-UCITS retail schemes (NURS) must be assessed on an individual basis to see if they meet the tests for being non-complex. We believe our NURS are non-complex, but are in the process of analysing whether the Property Authorised Investment Fund (PAIF) is complex or non-complex.

The FCA considers that it should be for the distributor to assess whether a fund is complex or not, however we understand that distributors will look to us to make that assessment and are likely to follow our lead.

Broadly, non-complex products are:

- shares in companies that are admitted to trading on a regulated market or multilateral trading facility (MTF);
- bonds traded on a regulated market or MTF (except certain complicated bonds);
- money market instruments;
- shares or units in UCITS;
- structured deposits (except certain complicated structured deposits).

How is suitability affected?

The suitability obligations have been further strengthened and have become more detailed. This is because of the addition of the following main requirements:

- firms must provide clients with a statement on suitability prior to the conclusion of the recommended transaction;
- there are further details on conduct rules for firms providing a periodic assessment of the suitability;
- firms performing a suitability assessment must assess, taking into account the costs and complexity, whether equivalent products can meet the client's profile; and

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- firms must analyse the costs and benefits of switching from an investment to another.

There is also a strengthened requirement for firms to consider the client's risk tolerance and ability to bear losses.

Suitability requirements have also been extended to structured deposits.

Where can I find your target market?

Distibutors will require information from us on the target market of the funds, ie the types of clients for whose needs, characteristics and objectives the fund is compatible.

We have set a target market and a distribution strategy for each regulated fund that we manage and this will be shown in the fund fact sheets.

We will also send the target market and distribution strategy for each fund to major data vendors and fund platforms using the industry template known as the European MiFID Template (EMT).

Groups like LGIM will need to share the target market of hundreds of funds and advisers will need to report back to fund managers if they have made recommendations outside of the target market. The industry is working on how to manage the huge exchange of information that will be required.

We will communicate our target market by the end of 2017 and earlier if possible.

Do I need an LEI?

We have no requirement to obtain an LEI from any investor in any of our unit trust funds (both UCITS or NURS).

An LEI is a Legal Entity Identifier. Under MiFID II, only clients who wish to trade in certain instruments will have to have an LEI. This is because firms will have an obligation to make transaction reports and will need LEIs to meet this requirement.

What's the position on rebates?

From 3 January 2018, MiFID firms may not accept commissions or rebates in relation to any advised or portfolio management business for retail clients.

For professional clients, the position remains that firms can accept rebates providing they are passed on to underlying clients and are not retained.

Trail commission is not affected, but the FCA has asked whether it should consider stopping the payment of trail commission as part of its work on the Asset Management Market Study.

What will happen to documentation?

We will need to update distribution agreements to include the new MiFID II requirements, including product governance and exchange of information obligations. We will be in touch about these amendments shortly.

We may also need to update our terms of business to reflect certain MiFID II requirements and will be in touch with affected clients.

What's the position on research?

Under the inducements rules in MiFID II, we are prevented from accepting and retaining fees, commissions or non-monetary benefits paid or provided by any third party in relation to the provision of our services to clients.

Research can constitute a non-monetary benefit. Therefore we cannot receive investment research from a third party unless it falls within narrow exceptions (such as certain generic research).

To avoid breaching the inducements rules, payment for research must be paid for either out of our own funds or through a 'research payment account' pre-funded by a charge to clients. In September, our Executive Committee will agree on our approach to FICC research which is likely to be paying for FICC research ourselves from P&L.

What about client disclosure requirements?

We recognise that you will need certain information from us to comply with your MiFID II obligations to provide pre- and post-sale information to your clients.

UTM will disseminate information on costs and charges to underlying investors through the EMT, or the fact sheet.

We are enhancing our conflicts of interest policy and our best execution policy to reflect MiFID II requirements. Our policies will be available to clients on request or through our website.

Disclaimer

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