

# MiFID II

## EU access for non-EU portfolio managers

5 July 2017

As of 3 January 2018, the Markets in Financial Instruments Directive II (MiFID II) will significantly amend the way forward for non-EU firms (third country firms) to access the EU market.

In the long run, MiFID II will create a harmonized regime for the provision of investment services, including individual portfolio management services, by non-EU firms to eligible counterparties and professional clients on a cross-border basis. This new regime will apply to firms in non-EU countries once the EU Commission has adopted a so-called equivalence decision confirming a level of regulation and supervision equivalent to MiFID II in that country. MiFID II also provides for some harmonized rules for conducting business with retail clients and elective professional clients from outside the EU.

However, already as of 3 January 2018, MiFID II and the German MiFID II implementation will heavily impact on the rules governing access by non-EU firms into Germany.

This briefing outlines the new regime applicable to portfolio managers rendering services on a cross-border basis into Germany as of 3 January 2018, by the time the EU Commission has adopted its equivalence decision.

### Conduct of business rules and organizational requirements

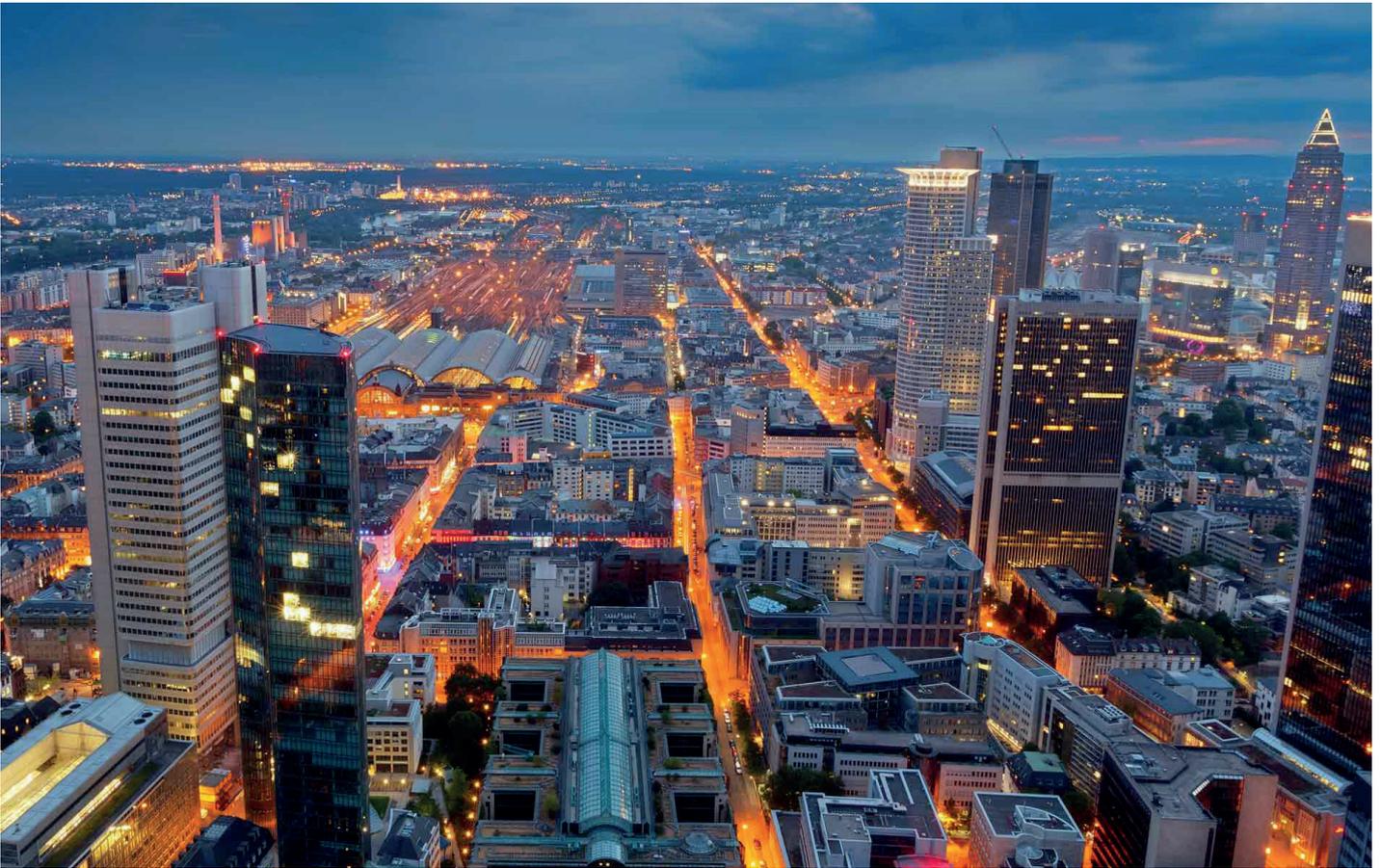
Under current law, the German Securities Trading Act (Wertpapierhandelsgesetz – WpHG) sets out an exhaustive, rather limited list of rules applicable to non-EU firms providing cross-border investment services into Germany. Conversely, all provisions not explicitly referred to in the list do not apply.

This regulatory approach will no longer be upheld. The new regime will rather provide for an exemption from certain conduct of business rules and organizational requirements for non-EU firms. This exemption is subject to an application requirement, i.e. will not kick-in automatically. The set of rules third country firms can be exempted from – and vice versa have to abide by where they do not hold such exemption – covers inter alia requirements applicable to:

- **Conflicts of interest:** Firms must maintain and operate effective arrangements to identify, prevent and manage conflicts of

interest. Further, they are required to disclose to the client conflicts of interest and the steps taken to mitigate those risks before undertaking business on the client's behalf.

- **Proper business organization** Firms must have in place a proper business organization and ensure management board's responsibility.
- **Employees with specific functions** Employees entrusted with specific functions, e.g. portfolio management or compliance, must have the necessary skills and reliability for exercising these functions.
- **Senior managers' duties** Senior managers must fulfill the oversight function as regards inter alia employees' skills, knowledge and experience, the firm's policy on investment services and products, and the remuneration rules for persons engaged with the provision of investment services for clients.



- **Outsourcing**

Firms must abide by specific outsourcing rules when relying on a third party for the performance of inter alia financial services.

- **Product governance**

Firms manufacturing, offering, marketing and distributing financial instruments are — depending on the service provided — subject to product governance requirements.

- **Investment recommendations**

Firms producing or disseminating investment recommendations must be organized in a way to keep conflicts of interest to a minimum. Further, they have to provide for appropriate control mechanisms with a view to prevent infringements of market abuse rules on investment recommendations.

Apart from the rules specifically addressed in the exemption, it is yet unclear if further provisions of the WpHG or even the WpHG in toto will apply to non-EU firms providing

investment services into Germany on a cross-border basis. As regards individual portfolio management, this could include requirements on inter alia the suitability assessment of clients and on the reception of inducements.

We expect the German regulator to provide guidance within the next months.

The exemption under the WpHG will be available with the application of the revised WpHG. However, at this stage it cannot be determined with certainty, as of when third country firms will be able to file their application. The exemption will be, in any case, only available to firms also holding an exemption from authorization requirements.

### Authorization requirements

The provision of individual portfolio management services into Germany is usually<sup>1</sup> subject to an authorization requirement as an investment firm under the German Banking Act (Kreditwesengesetz

– KWG). Non-EU firms rendering portfolio management services into Germany to institutional clients on a cross-border basis can— subject to certain preconditions— apply for an “exemption order” (Freistellung), exempting the firm from authorization requirements. With the implementation of MiFID II into German law, the rules governing the exemption order will be slightly amended (and the holding of such exemption order will become a prerequisite for the above-outlined exemption from certain conduct of business rules and organizational requirements under the revised WpHG).

The majority of third country firms providing investment services into Germany on a cross-border basis already hold such an exemption order under the rules currently applicable. At this stage, it cannot be determined with certainty if these existing exemption orders will be grandfathered under the new regime or if a re-application will be required.

However, non-EU firms rendering investment services cross-border into Germany should be reminded that all requirements under the KWG apply to them which are not explicitly addressed by the exemption (order). This particularly includes the rules on the prevention of money laundering, terrorist financing and other criminal actions which might jeopardize the institution's assets. These rules are complemented by further money laundering provisions stipulated outside the KWG. The rules include inter alia requirements applicable to internal controls and safeguards against money laundering and terrorist financing, due diligence, record-keeping, and the provision

of suspicious transaction reports to the competent authority.

### Recommendation

We recommend that non-EU firms providing investment services on a cross-border basis into Germany prepare for the upcoming new regime, in particular for filing new applications for exemptions with the German regulator. They should closely monitor regulatory developments in the upcoming months, in particular with regard to the grandfathering of the existing exemption order and familiarize themselves with the upcoming new business rules and organizational requirements.

**Note:** Please note that new rules, in particular new authorization requirements, also apply inter alia to non-EU firms holding a membership with EU-trading venues and/or trading in commodity derivatives. Furthermore, the issuance of financial instruments by credit institutions will be deemed an investment service also subject to authorization requirements. Any non-EU firm rendering services into the EU should carefully assess the impact of MiFID II (and local implementation) on its regulatory position.

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<sup>1</sup> Some exemptions apply, e.g. with regard to reverse solicitation or for the exclusive provision of services intragroup.