MiFID II FAQs

(October 2017)

*This MiFID II Frequently Asked Questions (***FAQs***)*[1] *gives some background to the MiFID II legislation and its requirements together with an overview of the likely impact of MiFID II on our relationship with you. It is only intended for corporate and individual clients of Customer Treasury Services (***CTS***) whether as a client of Allied Irish Banks, p.l.c. (***AIB***) and/or as a client of AIB Group (UK) plc trading as First Trust Bank and Allied Irish Bank (GB) (***AIB UK***).*

As a client of CTS, you may be affected by a number of the features of the new MiFID II regime. This FAQs is intended to provide you with some guidance on the impact of MiFID II. It is divided into two parts:-

- ***Part I (Introduction)*** *sets out the background to MiFID II and provides an overview of the entities, activities and the products that it applies to.*
- ***Part II (Key Requirements under MiFID II)*** *outlines some of the MiFID II key requirements that will apply when you enter into transactions with us that are within the scope of MiFID II and outlines what these may mean for you in practice.*

This FAQs document is provided for information purposes only and does not constitute legal advice. It provides a simplified overview of the application of MiFID II and does not discuss the detail of the obligations that apply. It focuses on the key obligations that will impact upon your relationship with CTS.

[1] *This FAQs has been prepared based on information generally believed to be reliable and no representation or warranty is given with respect to its accuracy or completeness. The information is not to be construed to be investment, legal or tax advice or an investment recommendation. You should confer with your legal, tax and investment advisers before acting in any way on the information contained herein.*

Part I – Introduction

Part I sets out the background to MiFID II and provides an overview of the entities and products that it applies to. It looks in detail at the treatment of FX transactions under MiFID II.

- ***BACKGROUND***

Q1. What is MiFID II?

The existing European legal framework governing financial markets (being the Markets in Financial Instruments Directive (**MiFID I**)), is being replaced by a revised Directive (the **recast MiFID**) and a new Regulation (**MiFIR**) – in this FAQs we refer to them together as **MiFID II**.

Q2. What is the background to MiFID II?

MiFID II is part of the EU's response to the financial crisis and is intended to strengthen financial markets and address concerns regarding investor protection. The revised law builds on the existing framework to improve the efficiency, resilience and transparency of financial markets, and also to take into account developments in the trading environment since the introduction of MiFID I in 2007.

Q3. When does MiFID II apply?

MiFID II will apply from 3 January 2018. However, some aspects of the new regulatory framework (such as the regime governing the operation of systematic internalisers (**SIs**) – Q17 in Part II (*Key Requirements under MiFID II)* below) will commence at a later date.

Q4. What new requirements does MiFID II introduce?

MiFID II introduces a wide range of changes to the regulatory framework for financial markets in the EU. These include increased protection for investors and additional requirements for information to be provided to clients including information in relation to costs and charges. An enhanced best execution regime is also being introduced. Further, market transparency and governance requirements for firms and their products have been enhanced.

Additional detail on these new requirements that MiFID II introduces and what these may mean for you in practice are set out in Part II (*Key Requirements under MiFID II).*

- ***ENTITIES AND ACTIVITIES SUBJECT TO MIFID II***

Q5. Who and what activities does MiFID II apply to?

MiFID II applies to investment firms and credit institutions like AIB and AIB UK when they undertake **investment activities and services** in respect of **financial instruments**.

MiFID II will apply to the investment activities and services undertaken by CTS. These include execution of client orders, receipt and transmission of orders and dealing on own account, in each case in respect of **financial instruments** (see Q6 below).

- ***PRODUCTS SUBJECT TO MIFID II***

Q6. What products does MiFID II apply to?

MiFID II applies to **financial instruments**. The definition of financial instruments is very broad and includes shares, debt securities, money market instruments and a wide range of derivatives, such as swaps, options, futures, and forwards in relation to FX / currencies, interest rates and inflation rates as well as many other financial and commercial variables including commodities, contracts for differences and emission allowances.

Although structured deposits are not financial instruments under MiFID II, firms selling or advising clients on such products are subject to certain MiFID II requirements.

Loans are not subject to regulation under MiFID II.

- ***THE TREATMENT OF FX TRANSACTIONS UNDER MiFID II***

Q7. Does MiFID II apply to <u>all</u> FX transactions?

No. There are two exclusions from MiFID II for certain FX transactions, namely:

- an exclusion from MiFID II for FX spot transactions; and

- an exclusion from MiFID II for certain forward foreign exchange transactions connected to a payment transaction (the "**means of payment" exclusion**).

Further detail on each of these exclusions is set out in the Questions 8 and 9 below.

Q8. What is the exclusion from MiFID II for FX Spot transactions?

An FX Spot transaction will not be a financial instrument and will be excluded from MiFID II if under its terms delivery is scheduled to be made within a specified number of trading days. The number of trading days depends upon the type of contract as set out below:

- 2 trading days for trades between "major currencies". The major currencies for these purposes are euro, US dollar, Japanese Yen, Pound Sterling, Australian dollar, Swiss franc, Canadian dollar, Hong Kong dollar, New Zealand dollar, Singapore dollar, Norwegian krone, Mexican peso, Croatian kuna, Bulgarian lev, Czech koruna, Danish krone, Hungarian forint, Polish zloty and Romanian leu.

- For other currencies, the longer of 2 trading days or the period generally accepted in the market as the standard delivery period for the relevant currency pair.

- Where the contract's main purpose is the sale or purchase of a transferable security or a unit in a collective investment undertaking, the period generally accepted in the market for the settlement of that security or unit as the standard delivery period or 5 trading days, whichever is shorter.

However, a contract would not be a FX spot transaction if, irrespective of its terms, there is an understanding between the parties that delivery would be postponed and not performed within the periods set out above.

Q9 (a). What is the "means of payment" exclusion from MiFID II for FX Transactions?

An FX forward transaction that meets certain conditions set out in MiFID II would not be treated as a financial instrument and would not be within the scope of MiFID II.

For FX forward transactions to benefit from the “means of payment” exclusion from MiFID II, the FX transaction must fulfil each of the criteria set out in the table below.

• It must be entered into in order to facilitate payment for “**identifiable goods, services or direct investment**”; (*See further detail in Q9(b) – Q9(e) below)* • It must be **settled physically**; • It must include one counterparty that is not a “**financial counterparty**”, as defined in EMIR[2]. (*Note: AIB and AIB UK are financial counterparties for the purposes of EMIR*); and • It must not be traded on a **trading venue**. *(See further detail in Q18 below)*

Importantly, the “means of payment” exclusion will not apply to **FX swaps** or **FX options** which will be within the scope of MiFID II regardless of their duration and regardless of whether or not they are traded on a trading venue.

Q9 (b): How can I tell if my FX forward transaction is to facilitate payment for “identifiable goods and services”?

Simple examples of the type of contract that could be a means of payment for identifiable goods or services is where CTS sells currency to a client which the client will use to pay for specific goods or services, or where a client buys currency to achieve certainty about the level of payment that it receives for specific goods or services that it sells.

Goods and services can be considered identifiable for these purpose by a range of factors, including type, price, supplier, and the purpose for which the purchaser is buying them. Goods and services can also be identifiable by reference to an established practice or needs, or an established project and a particular purpose within that project.

In general, there is no requirement for a contract to have been concluded with the buyer / seller of the goods and services, or for an invoice to have been issued, before the FX forward transaction is entered into. There is also no requirement that the amount to be paid under the FX forward matches exactly the amount paid for the goods and services - an estimate is sufficient.

Q9 (c): Can you provide some examples of FX forward transactions in respect of “identifiable goods and services”?

Examples of transactions that could potentially benefit from the “means of payment” exclusion include the following (assuming the importer is euro based):

• An importer buys US$100,000 worth of goods. The supplier has not yet issued an invoice. The importer **knows the price** and buys the euro FX forward in anticipation. • An importer buys a quantity of goods. The supplier will charge in US$ but has not yet issued an invoice, and the exact price of the goods has not yet been fixed. The importer **estimates the price** and buys the euro FX forward in anticipation.

[2] (Regulation 648/2012 on OTC derivative transactions, central counter parties and trade repositories)

- An importer wants to buy £100,000 worth of goods from a specific UK supplier in the next quarter, but has **not yet concluded a contract** with the supplier. The importer buys the euro FX forward in anticipation. In this example, the importer could still benefit from the exclusion even if the importer did not know which specific supplier it wanted to purchase the goods from.

- An importer wants to buy foreign currency in respect of the expected costs of certain goods and services that it means to obtain in the next quarter. The importer does not know what the exact costs of such goods and services will be, or what exact goods and services it wants. However, because the importer has an **established practice** of buying these goods and services, it is able to give an accurate estimate of the quantity and price of the goods and services. As a result, the importer buys the euro FX forward in anticipation.

Q9 (d): Can you provide examples of FX forward transactions that would NOT be for "identifiable goods and services"?

The "means of payment" exclusion will **not** be available if the purpose of an FX forward is for a person to hedge its balance sheet generally against a particular currency exposure. It will also not be available if part of the currency bought under the FX forward is used for a purpose that does not meet the conditions of the "means of payment" exclusion.

Examples of transactions that would **not** benefit from the "means of payment" exclusion include the following:

- A purchaser of an FX forward wants to **hedge its balance sheet** because it has a euro exposure but reports financially in sterling.

- An importer buys EUR100,000 worth of goods. The UK importer buys a EUR200,000 FX forward, and **uses the difference** for a purpose that does not fulfil the exclusion conditions.

- An importer buys EUR100,000 worth of goods. The supplier of the goods has not yet issued an invoice. The UK importer buys the EUR100,000 FX forward. Later, the UK importer buys a **second FX forward** for EUR100,000. In this example, the second FX forward would not benefit from the "means of payment" exclusion.

*Please note that the examples in Q9 (c) and Q9 (d) have been adapted from the best guidance available to the market at this stage. Further guidance may follow from the European Securities and Markets Authority (**ESMA**) or regulators. If further guidance is issued on the treatment of FX forwards under MiFID II, we will contact you separately should there be any changes to the information provided in these FAQs. You are responsible for assessing whether the "means of payment" exclusion applies to your specific circumstances on a trade-by-trade basis.*

Q9 (e): If I have a large portfolio of contracts and do not enter into separate currency contracts for each import or export contract, can the "means of payment" exclusion still apply?

Yes, potentially. It is still possible to benefit from the "means of payment" exclusion from MiFID II by looking at all of the incoming and outgoing payments and currency resources each time you enter into a new FX forward transaction to ensure all the relevant conditions of the "means of payment" exclusion are fulfilled.

Q9 (f): What does it mean if my FX forward transactions satisfy the "means of payment" exclusion from MiFID II?

Where FX forwards satisfy the "means of payment" exclusion, those FX forwards would not be considered financial instruments, and therefore would fall outside the scope of MiFID II. This means that the requirements set out in Part II **(***Key Requirements under MIFID II)* in this FAQs may not apply to such FX transactions.

Additionally, from 3 January 2018 FX forward "means of payment" transactions will be outside the scope of EMIR, as there is a link between EMIR and the list of financial instruments under MiFID II. This means that clients would not be subject to the EMIR transaction reporting requirements in respect of such FX forward transactions. (For further details on EMIR transaction reporting requirements, please refer to Questions 9 – 12 of our EMIR and Dodd-Frank FAQs. If you require a copy of the EMIR and Dodd-Frank FAQs, your Treasury Relationship manager will be happy to provide one to you on request.)

Q9 (g): Will you require anything from me if all of my FX forward transactions will satisfy the "means of payment" exclusion from MiFID II?

Yes. In order to ensure the correct treatment under MiFID II and EMIR of any FX forward transactions which you may enter into with us, we will need confirmation from you that the FX transactions which you enter into with us will meet the "means of payment" exclusion from MiFID II. Our new Treasury Services Registration Form includes a section on the "*means of payment*" exclusion for FX Forward Transactions.. **Q9 (h): What is the position if only some (but not all) of my FX forward transactions will satisfy the "means of payment" exclusion or if I enter into other transactions that fall within the scope of MiFID II?**

If only **some** of your FX forward transactions will satisfy the "means of payment" exclusion but others will not, then we will treat all of your FX forward transactions as subject to the requirements of MiFID II. Similarly, if all of your FX forward transactions satisfy the "means of payment" exclusion but you also intend to enter into other transactions that are within the scope of MiFID II, such as FX swaps or FX options or interest rate derivatives, then we will treat all your FX forward transactions as subject to MiFID II.

Part II – Key Requirements under MiFID II

Part II outlines some of the key MiFID II requirements that will apply when you enter into transactions that are within the scope of MiFID II and outlines what these may mean for you in practice.

Part II will only be relevant where you enter into transactions which will be within the scope of MiFID II. If you only enter into transactions which are outside the scope of MiFID II such as spot FX transactions and/or FX forward transactions which you have confirmed to us will satisfy the "means of payment" exclusion, these key requirements will not apply to such transactions.

- ***SUMMARY OF NEW REQUIREMENTS***

Q10. What new requirements does MiFID II introduce?

MiFID II introduces a wide range of changes to the regulatory framework for financial markets in the EU. A summary of the more significant changes is set out in the box below. Further detail on some of the requirements which will be of relevance to your relationship with CTS are also set out in subsequent questions in this Part II.

- *Enhanced Investor Protection Requirements* – MiFID II introduces enhanced conduct of business requirements for firms around client classification, additional requirements for information to be provided to clients including information in relation to costs and charges, the appropriateness and suitability of products, conflicts of interest and inducements.

- *Enhanced Execution Quality* – MiFID II requires that firms take all sufficient steps to achieve best execution when trading with or for their clients. This imposes a more stringent obligation on firms than was the case under MiFID I. Firms are also required to publish annually the top 5 execution venues in terms of trading volumes where client orders have been executed in the preceding year.

- *Transaction Reporting* – MiFID II introduces changes to the existing transaction reporting regime including an expansion of products, client and transactional data fields together with new rules governing a firm's obligation to report.

- *Enhanced Market Transparency* – Market transparency is increased by expanding the pre– and post-trade transparency regimes that existed under MiFID I such that they apply to almost all financial instruments under MiFID II.

- *Trading Outside of Trading Venues – Systematic Internalisers* – Where firms continue to trade on a frequent and substantial basis outside of a trading venue, more conditions and requirements will apply in the form of the SI regime. MiFID II widens the definition of an SI so that it includes more objective criteria than those under MiFID I. SIs must now also comply with pre-trade transparency requirements to publish quotes in certain instruments on an on-going basis.

- *New Mandatory Trading Obligation* – Certain market participants and firms will be subject to an obligation to trade certain derivatives and equities on a regulated trading venue, rather than on an OTC basis.

- *Changes to Market Structures* – MiFID II introduces a new type of multilateral trading venue namely an organised trading facility (**OTF**), to add to the existing categories of a regulated market and a multilateral trading facility (**MTF**).

- *Enhanced Governance including product governance* – MiFID II enhances the governance requirements for firms and their products.

- ***CLIENT CATEGORISATION***

Q11: How are clients categorised under MiFID II and what does this mean for me in practice?

There are three categories of client under MiFID II:

- **Eligible counterparties (ECPs):** such as investment firms, credit institutions, insurance companies, certain funds and their managers, other financial institutions regulated under EU law. Other entities may elect to be treated as ECPs with a firm's permission.

- **Professional clients:** Certain types of entities automatically qualify as professional clients by meeting any of the various qualitative and quantitative requirements set out in MiFID II. Other entities may elect to be treated as professional clients with the other party's permission.

  Professional clients are subject to fewer investor protection provisions (for example, in relation to the appropriateness of investment services) as MiFID II entitles firms to assume that professional clients have substantially more experience and knowledge than retail clients, and therefore have a greater understanding of the risks involved.

- **Retail clients:** This is the default category for clients that are not, or do not elect to be treated as, a professional client or an ECP. Other entities may elect to be treated as retail clients with a firm's permission.

All clients who engage in MiFID II impacted transactions with CTS will be notified of how we have categorised them under MiFID II.

- ***INFORMATION TO CLIENTS***

Q12. What does MiFID II say about information to clients?

Under MiFID II, firms are obliged to provide clients with a very broad and detailed set of information including details on their agreement with the client, the firm itself and the services it agrees to provide to the client, the investments into which firms may enter with or for their clients, the costs and charges that may be incurred by or for the client and the firm's execution policy.

- ***BEST EXECUTION***

Q13. What does MiFID II say about best execution and what does this mean for me in practice?

Best execution refers to firms taking all sufficient steps to obtain the best possible result for their clients (taking account of factors such as price, costs, speed, likelihood of execution and settlement, size, nature of trading or any other consideration relevant to the execution of the order).

MiFID II strengthens the current best execution requirements in a number of ways. For example, firms must now adhere to a stricter standard for best execution and take "all sufficient steps" to obtain best execution (as opposed to "all reasonable steps"). In addition, a firm's order execution policy must now be clear, easily comprehensible and sufficiently detailed.

In addition to delivering best execution, MiFID II also requires firms to produce public data about executed transactions. Firms must summarise and publish annually their top five execution venues by trading volume for each class of financial instrument, as well as information on the quality of execution obtained. Trading venues, SIs, market makers and liquidity providers must also publish information on a quarterly basis on quality of execution for certain types of financial instruments.

In practice, the increased data available in relation to best execution will allow firms and clients to better evaluate execution quality.

- ***TRANSACTION REPORTING AND LEGAL ENTITY IDENTIFIERS (LEIs)***

Q14 (a). What is MiFID II transaction reporting?

Transaction reporting is the sharing of data about individual trades with the regulators. This is mandatory as it provides regulators with data that describes what is happening at the point of execution and it enables regulators to oversee the markets for matters such as market abuse. Transaction reports must be made to relevant regulators as soon as possible and at the latest by the close of business on the next business day after the relevant transaction is entered into.

MiFID II expands the transaction reporting regime under MiFID I. The list of financial instruments covered by MiFID II transaction reporting has been extended and now includes, for example, some OTC derivative transactions.

The new transaction reporting regime also captures a much broader data set to ensure regulators have sufficient information to oversee markets. However, it is important to note that a transaction report is made to regulators only and is not made public.

Q14 (b). Do I need to report transactions under the MiFID II transaction reporting regime?

You will not be required to make a transaction report unless you are the type of entity that falls within the scope of MiFID II. Only firms which are directly subject to MiFID II such as AIB and AIB UK need to report transactions under MiFID II. In this regard, MiFID II transaction reporting is different from EMIR's trade reporting regime which requires both parties to a transaction to report if both parties are located in the EU. Please refer to our EMIR and Dodd-Frank FAQs for further information.

Q14 (c). Will you require anything from me in relation to the MiFID II transaction reporting regime?

Yes. Although you may not be required to make a transaction report yourself, we will require certain information from you in order to allow us to submit complete transaction data to regulators in compliance with the MiFID II transaction reporting requirements. Transaction data includes details about you, whether as an individual or legal entity and, where relevant, includes your Legal Entity Identifier (**LEI**) **-** see further below.

We will obtain some of this data from you in our new Registration Form in advance of trading. Other transaction-specific data will be obtained at the time of entering into transactions.

Q14 (d).What is a Legal Entity Identifier (LEI) and why do I require one?

MiFID II explicitly states that a firm will be unable to transact with a client until they have a Legal Entity Identifier (LEI) in place for that client.

An LEI is a 20-digit alpha-numeric reference code which is unique to each counterparty. The LEI is designed to enable the identification and linking of parties to financial transactions in order to manage systemic and counterparty risk.

LEI codes are issued by appointed Local Operating Units (**LOUs**) such as the Irish Stock Exchange and London Stock Exchange.

If you are a legal entity and do not already hold a valid LEI, you will require one from 3 January 2018 if you enter into transactions in MiFID II financial instruments. The term "legal entity" includes, but is not limited to, unique parties that are legally or financially responsible for the performance of financial transactions or have the legal right in their jurisdiction to enter independently into legal contracts, regardless of whether they are incorporated or constituted in some other way (e.g. trust, partnership, or contractual arrangements). It excludes natural persons, but includes governmental organisations and supranationals.

Q14 (e). How can I get my LEI?

LEI codes are issued by appointed LOUs. In Ireland you can apply for a LEI code through the Irish Stock Exchange at www.ISEdirect.ie. In the UK, the London Stock Exchange at https://www.lseg.com/LEI has been sponsored to issue LEIs.

When applying for a LEI you will be required to provide certain information such as the legal name of the undertaking, address, country of incorporation, company registration number, and VAT number. Fees apply to the issuance of an LEI initially and there is also an annual renewal fee payable.

Q14 (f). By when must I obtain my LEI?

You may already require an LEI under existing regulation, such as EMIR.

If you will enter into transactions with us that are impacted by MiFID II (i.e. any transactions other than FX spot and FX forward "means of payment" transactions) then you are required to hold a valid LEI for MiFID II transaction reporting purposes. You must obtain this LEI and notify it to us in advance of **3 January 2018**. Our new Treasury Services Registration Form will include a section for you to complete on your LEI.

If you require an LEI but do not currently have one, we would recommend that you obtain one as soon as possible. It is anticipated that there may be delays in the issuing of LEIs by the LOUs in advance of the MiFID II mandatory requirements.

You do not need to hold an LEI if all your transactions satisfy the FX "means of payment" exclusion criteria and you provide the necessary confirmation in the new Treasury Services Registration Form. .

- ***MARKET TRANSPARENCY***

Q15 (a). Is there any other reporting under MiFID II that I should be aware of?

Yes. MiFID II will enhance the transparency regime that existed for shares transactions under MiFID I by expanding it to cover other MiFID II financial instruments including certain derivatives. The general transparency requirements under MiFID II can be separated into pre-trade and post-trade disclosure of the details of certain orders and transactions.

- *Pre-trade transparency requirements* apply to trading venues and SIs. The potential impact on AIB and AIB UK if they were categorised as SIs are set out in Q16 below.

- *Post-trade transparency requirements* apply to firms in addition to trading venues and SIs. The post-trade transparency requirements will apply to AIB and AIB UK.

Under the new MiFID II transparency regime, it is expected that EU markets will become much more transparent as there is improved knowledge in the market of the latest prices available.

Q15 (b). What is the post-trade transparency regime under MiFID II?

Under the post-trade transparency regime, firms are required to publicly disclose the volume and price of transactions and their time of execution. Reports must be made through an approved publication arrangement (**APA**) as close to real-time as is technically possible and, for derivatives, within 15 minutes of the execution of a trade at the latest (reducing to 5 minutes from 2021). Deferral of publication of all or some information may be authorised in certain circumstances by the regulator.

The transparency requirements differ from transaction reporting (see Q14) as trade data is made public, though it requires the publication of a significantly smaller data set than transaction reporting. Further, post-trade transparency data is anonymous: a client's identity will not be disclosed publicly under the post-trade transparency regime.

Q15 (c). Do I need to comply with the MiFID II post-trade transparency requirements?

Only firms that are subject to MiFID II need to comply with the MiFID II transparency requirements. CTS will be subject to the post-trade transparency regime and will be required to report details of impacted transactions through an APA. Clients that are not subject to MiFID II will not be required to report impacted transactions.

- ***SYSTEMATIC INTERNALISER REGIME***

Q16 (a). What is the Systematic Internaliser (SI) regime under MiFID II?

An SI is a firm that, when executing client orders in certain financial instruments, deals on its own account on a frequent and substantial basis, rather than dealing on a trading venue. MiFID II includes both qualitative and additional quantitative criteria under MiFID II for determining whether a firm will be an SI or not. It is expected that this will result in more firms being treated as SIs under MiFID II for a much wider range of instruments.

The expanded SI regime under MiFID II is designed to increase the level of transparency around trading activity taking place away from a trading venue and within an investment firm or credit institution. In addition to post-trade transparency obligations (see Q15 above), an SI is required to comply with certain pre-trade transparency requirements under MiFID II. The pre-trade transparency requirements vary depending on the financial instrument and whether the financial instrument is deemed to be liquid or illiquid.

At present, the SI regime will take effect from September 2018 although it is possible to opt-in to this regime at an earlier stage.

Q16 (b). Will AIB or AIB UK become an SI under MiFID II?

Neither AIB nor AIB UK currently intend to opt-into the SI regime.

At present, based on the MiFID II qualitative and quantitative criteria, AIB and AIB UK may operate as an SI in certain FX derivatives which have been categorised by ESMA to be illiquid products. The obligations on a firm where it operates as a SI in derivatives where there is an illiquid market are limited to an obligation to disclose quotes to a client on request if the SI agrees to provide a quote to that client.

There remains some uncertainty in the market as to the precise scope of what constitutes an SI. CTS will continue to monitor this developing area and will update you as necessary when further detail emerges.

- ***NEW MANDATORY TRADING OBLIGATION FOR DERIVATIVES***

Q17. What is the new mandatory trading obligation for derivatives?

Under MiFID II there will be an obligation for certain standardised and liquid derivatives to be traded on a trading venue. For details on what constitutes a trading venue, please see Q18 below. The mandatory trading obligation will apply to clients who are categorised as financial counterparties (FCs) or non-financial counterparties above the clearing threshold (NFC+s) for the purposes of EMIR.

MiFID II does not itself set out the classes of derivatives that will be subject to the mandatory trading obligation. This will be determined by additional measures which ESMA is currently consulting on. We are continuing to monitor this obligation and will update you as necessary when further detail emerges.

- ***TRADING VENUES***

Q18. What are Trading Venues for the purposes of MiFID II?

Under MiFID II, there are now three types of trading venues: a regulated market, a multilateral trading venue (**MTF**) and, new under MiFID II, an organised trading venue (**OTF**). Unlike regulated markets and MTFs, operators of OTFs must exercise judgement as to whether to place or retract orders from the OTF and when deciding whether to match specific client orders. The purpose of OTFs is to enhance market transparency by enabling more on-platform trading in bonds, structured finance products, emission allowances or derivatives (OTFs cannot be operated in other instruments).

A full list of trading venues under MiFID II will be published on the website of ESMA.

- ***APPROPRIATENESS***

Q19. What are firms' obligations in relation to appropriateness under MiFID II?

MiFID II requires firms, when providing investment services other than investment advice or portfolio management, to obtain information regarding their existing or potential clients' knowledge and experience relevant to a specific service or product, to enable the firm to assess whether it is appropriate for the client. This applies only to retail clients and clients who have elected to be treated as professional clients; other professional clients and ECPs are assumed to have sufficient knowledge and experience.

Firms are not required to carry out this appropriateness assessment where the service being provided is on an "'execution only" basis and relates to non-complex financial instruments.

MiFID II requires firms to keep records of appropriateness assessments. These must include the result of the assessment, any warning given, whether the client asked to proceed despite the warning, and whether the firm accepted this request.

- ***RECORDING COMMUNICATIONS***

Q20. Does MiFID II require us to record communications?

Yes, MiFID II introduced the obligation on firms to record telephone conversations or electronic communications when they:

- receive and transmit orders;
- execute orders on behalf of clients; and
- deal on own account.

The requirements cover all telephone conversations and electronic communications that relate to activities that are intended to result in the conclusion of a transaction or the provision of client order services, even if they in fact do not. MiFID II also requires records to be kept for five years, and potentially a further two years where the Member State national competent authority (**NCA**) requests.

- ***RECORD KEEPING***

Q21. What are the requirements under MiFID II regarding record keeping?

MiFID II requires firms to keep records in a significant number of areas, including in relation to:

- client orders;
- decisions to deal;
- transactions (both where executed by a firm or passed to another to execute); and
- client files (including client agreements, information to assess suitability).

The main purpose of such records is to enable NCAs to fulfil their supervisory tasks and perform enforcement actions under MiFID II and market abuse legislation.

The records are required to be kept for a period of 5 years or for the duration of the client relationship (if longer).

- ***INDUCEMENTS***

Q22. What does MiFID II say about inducements?

MiFID II prohibits the payment or receipt of fees or commissions and other non-monetary benefits between firms and persons other than their clients (e.g. advisory firms and distributors), unless certain criteria are met. This prohibition is intended to ensure such payments and benefits are not inducements and, as such, do not introduce conflicts with clients' interests.

Minor non-monetary benefits are excluded from the prohibition but they must not impair a firm's duty to act in the best interests of its clients, must be capable of enhancing the quality of client service and must be disclosed.

- ***CONFLICTS OF INTEREST***

Q23. What does MiFID II say about conflicts of interest?

MiFID II requires firms to take all appropriate steps to identify conflicts of interests between themselves and their clients, and also among their clients. If there are conflicts of interest that cannot be prevented, firms must also put systems and controls in place to manage these unpreventable conflicts.

Where it is impossible to prevent such conflicts from having an adverse impact on client interests, firms are required to make an enhanced disclosure of the conflict, and take certain steps in order to mitigate the risks of that conflict before undertaking any business on the client's behalf. Such disclosure must be in a durable medium, and include enough detail to allow the client to make an informed decision regarding the service to which the identified conflict relates.

Firms must keep and regularly update a record of all actual and potential conflicts, and must also have a conflicts of interest policy which they review and update periodically (at least annually).

Please note that telephone calls may be recorded in line with market practice.