



ECB Bond Market Contact Group

The first weeks under MiFID II and MiFIR: Buy-side observations

Frankfurt, 6 February 2018 – Christian Kopf, CIO Fixed Income

I would like to thank Christoph Hock, Head of Union Investment's Multi-Asset Trading Desk, for help in preparing this presentation

01

Scope and Timeline of MiFID II

02

Implementation at Union Investment

03

Themes and Impact in Portfolio Management
of Buy-Side Firms

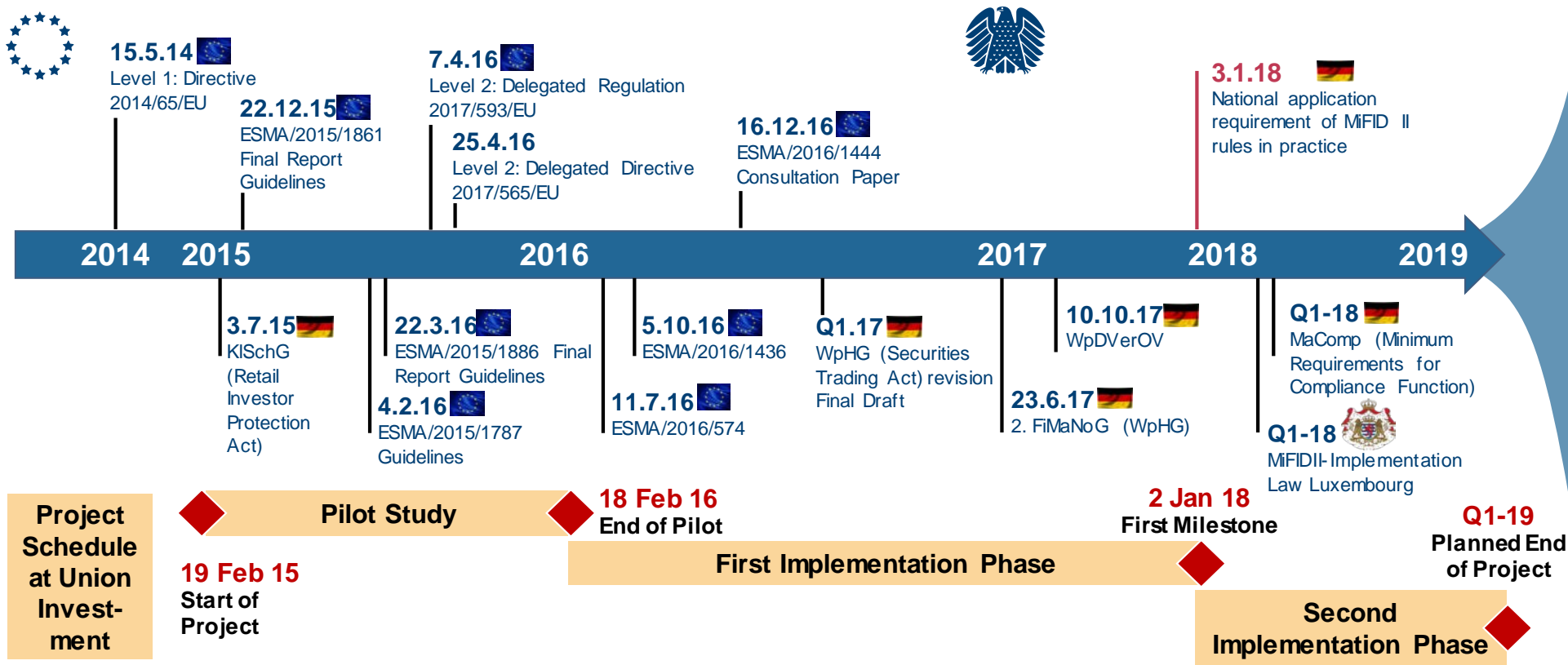
04

Observations – The First Four Weeks

05

Appendix

EU regulation have now been implemented into national legislation, but there's more to come in 2019



ESMA-Guidelines on certain aspects of MiFID II suitability requirements

Ongoing adaption **ESMA-Q&A** on MiFID II/MiFIR Investor Protection

MiFID III ??

Kay Swinburne, MEP: "See MiFID III around the corner" (Oct. 2017, Dow Jones' Financial News)

Steven Maijor, ESMA Chair: "Obviously, there is no other big reform in the pipeline after Mifid II, but what there will be is further fine-tuning of the existing pieces of legislation." (Nov. 2017, WatersTechnology)

EU-Regulations DE-Regulations LU-Regulations Milestone

Union Investment implementation of MiFID II in figures



* estimated

Impact of MiFID II on buy-side portfolio management

Themes and Topics		Buy-Side Implications
Governance	Investment Research	<ul style="list-style-type: none"> • Separation of research and execution • New budgeting, payment and disclosure regime • Payment for substantive research required • Three different payment models and a requirement to assess research providers
	Best Execution	<ul style="list-style-type: none"> • More detailed execution policy, procedures and monitoring; focus on governance • Intensive use of pre- and post-trade data to improve execution quality • Higher level of transparency with potential use of transaction cost analysis • New disclosure and reporting rules on top 5 venues/counterparties
	Due Diligence	<ul style="list-style-type: none"> • Focus on broker selection • New requirements for due diligence on algo vendors • The likely result will be further market concentration on fewer providers
Trading	Market Structure and Transparency	<ul style="list-style-type: none"> • The likely result will be further fragmentation of trading venues and reduction in overall market liquidity • Higher levels of electronification • Shortening of reporting deadlines will likely reduce the availability of risk pricing
	Microstructure	<ul style="list-style-type: none"> • Algo testing when using vendor provided algos • Stricter rules on tick sizes will likely shift market share from primary markets to systemic internalisers
Operational	Trade Reporting	<ul style="list-style-type: none"> • New reporting requirements on OTC transactions, exceptions for managers that are not defined as investment firms • Numerous additional data fields in regulatory trade reporting
	Transaction Reporting	<ul style="list-style-type: none"> • Substantial increase in extent of data required, incl. personal information • Concerns of confidentiality and accountability

The first four weeks under MiFID II from the perspective of Union Investment (1/3)

Investment Research	<ul style="list-style-type: none">• Union Investment pays from own P&L; contracts signed with around 90 research providers• Equity research carries a substantially larger price tag than fixed income research• "Desk colour" is still provided by broker-dealers and considered as minor non-monetary benefit
Best Execution	<ul style="list-style-type: none">• Full separation of broker research from trade execution• Implementation of permanent Transaction Cost Analysis for fixed income trades• Union Investment reports top five brokers and venues to clients
Due Diligence	<ul style="list-style-type: none">• Broker evaluation process at trading desk is now completely separated from portfolio management• So far no signs of broker industry consolidation, contrary to some market participants' expectations

The first four weeks under MiFID II

from the perspective of Union Investment (2/3)

Market Structure	<ul style="list-style-type: none"> • No material impact on liquidity; good and robust volumes comparable to 2017; huge new issuance calendar also supportive for liquidity situation; brokers' aggressiveness on pricing and risk taking capabilities similar to last years'; dire expectations on liquidity not realized. • Higher proportion of trades executed electronically on trading venues; shift away from OTC. • Higher proportion of processed trades where transactions are negotiated off-venue and then completed on venue. Some brokers no longer accept pre-arranged trades and see price discussion as indicative only.
Transparency / Reporting	<ul style="list-style-type: none"> • Only limited use of additional data resulting from new pre- and post-trade transparency rules so far due to (1) pre-trade transparency only for 803 out of 68,227 issues that are considered as “liquid” by ESMA, (2) data quality, (3) data accessibility (no consolidated tape yet) and (4) trade reporting deferral regime • Venues require delivery of Legal Entity Identifiers (LEIs) but face data processing issues
Technology	<ul style="list-style-type: none"> • Trading in Fixed Income in the spotlight of technology development within Union Investment’s Multi-Asset Trading Desk • Making best use of newly available data for sourcing of liquidity and price discovery, differentiation between high touch- and low touch business with automatization of smaller orders, a further development of “new generation” transaction cost analysis, reviewing the existing execution management system and optimizing the broker scoring analysis are the topics in focus

The first four weeks under MiFID II from the perspective of Union Investment (3/3)

BUY SIDE

The buy-side and MiFID II: It's business as usual

Two weeks after MiFID II was implemented across Europe, The TRADE asks senior buy-siders how much has changed, if anything.

By Hayley McDowell hayley.mcdowell@thetradenews.com January 15, 2018 3:35 PM GMT

....Speaking to *THE TRADE*, various heads of trading explained the first two weeks since implementation have in fact been business as usual with volumes and day-to-day activities relatively unchanged. "To be honest, it feels like business as usual," says Christoph Hock, head of multi-asset trading at Union Investment. "There were not any major disruptions or a drop in facilitation of liquidity across all asset classes in the first two weeks of MiFID II. For me, it's a continuation of recent trends we've seen...."

Christoph Hock, head of multi-asset trading at Union Investment

<https://www.thetradenews.com/Buy-side/The-buy-side-and-MiFID-II--It-s-business-as-usual/>

MiFID II impact turned out to be relatively muted in the first weeks, feels like business as usual

Sources: Union Investment, Bank of America Merrill Lynch, ICMA, The Trade

Appendix

MiFID II / MiFIR is the comprehensive amendment of the Financial Market Directive of 2004 (MiFID I)

Regulation of MiFID II / MiFIR effects:

- **Distribution of Financial Instruments / Investment Services** – operating conditions for investment firms, provisions for transparency, client information, inducements, best execution, appropriateness and suitability tests
- **Trading and Markets** – Provisions for transactions in derivatives and other financial instruments, market infrastructure, venues, obligation to trade on venues, market transparency
- **Corporate Governance** – Provisions for effective checks and balances within financial institutions
- **Powers of Supervisory Authorities**

With the Goal of:

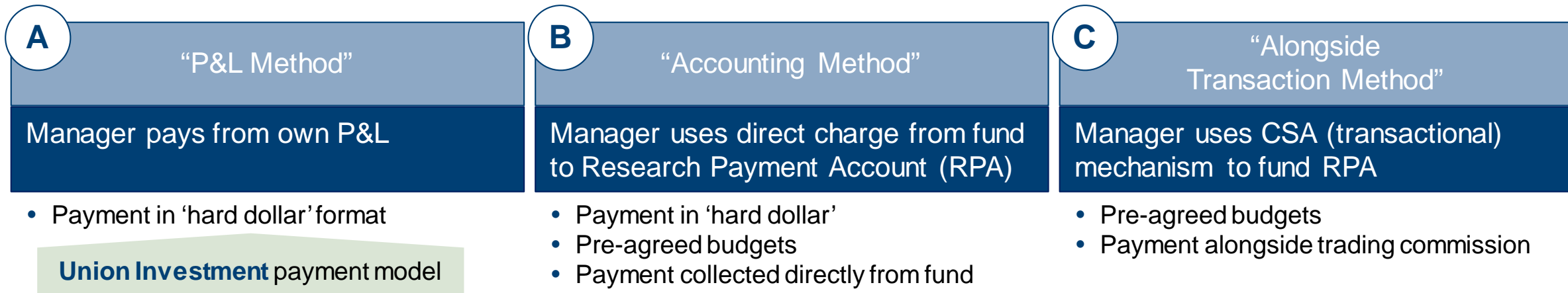
- Strengthen the **protection of investors**
- Strengthen **the functioning of financial markets** in the EU
- **Ensure powers of supervisory authorities** in view of trading of commodity derivatives and others

Trigger Points: Financial Crisis of 2008; Increasing Complexity of Transactions and Products; G20 Leaders' Summit in Pittsburgh



Investment research

Potential payment models



Categories of Selected Services / Products	Key points
Written research (Tool-access & mail)	<ul style="list-style-type: none"> • Responsibility on buy-side to judge scope and to ‘block’ unsolicited research input
Analyst Access (Calls & meetings)	<ul style="list-style-type: none"> • Trial periods for research allowed (e.g. for new brokers, new products) if limited to 3 months, subject to conditions
Conference / conference calls / seminars	<ul style="list-style-type: none"> • Corporate Access linked to Research when content delivered during conferences
Data request & models	
Tailored research	

Best execution

Best execution approach and execution factors

The obligation to execute a client's orders on terms most favourable to the client. Current best execution evaluation was commonly based on the trades price, but best execution is broader than just "best price"

Formal Order Execution Policy (OEP) detailing, amongst other things, the venues available for execution of orders, various controls and behaviours the client should expect. Also:

- **Price** – what is the best price?
- **Costs** – what is cumulative cheapest cost?
- **Speed** – what execution time constraints apply/how can they be minimized vs urgency?
- **Likelihood of execution and settlement** – where will we get a fill?
- **Size** – how does size impact the best execution strategy?
- **Nature of trade** – what is the underlying purpose for the trade, and does this impact our choices?
- **Any other relevant metrics** – e.g. market conditions

Top 5" Reporting: Complete reporting relating to Top 5 venues/counterparties (i.e. execution platforms including SI) where orders are executed. To be produced annually.

Thematically linked to unbundling of research – execution has to be independent

Client can still give specific instructions on execution that may or may not be consistent with the concept of "best execution"

Best execution disclosure (Regulatory Technical Standard (RTS) 28, annual disclosure)

- Top 5 execution venues (where firm is 'executing') – e.g. SIs, or direct platform memberships
- Top 5 brokers firm transmits orders to
- Separate Top 5 disclosure for Sec. Financing activity
- Disclosures to include volume & number of client orders as % of total, by client type, and for venues % passive/ aggressive,
- Disclose analysis on monitoring of quality of execution obtained

Buy Side To-Do List

Update Order Execution Policy (OEP)

- Scope broadened
- Monitoring to be incorporated
- Metrics/process to support verifiability

Governance framework

- Shows ownership of achieving best execution
- Takes account of existing execution relationships and the process to form new
- Appropriate performance metrics agreed

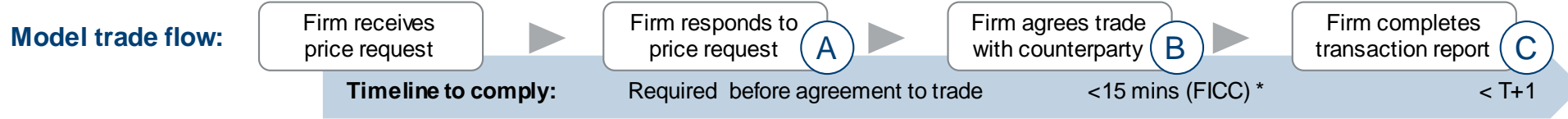
Monitoring framework

- Provides link between OEP and execution performance achieved
- Show trends by counterparty, asset class, trader
- Detects outliers and failures

Technology / Operations impact

- Determine appropriate technology to support the process

Market structure

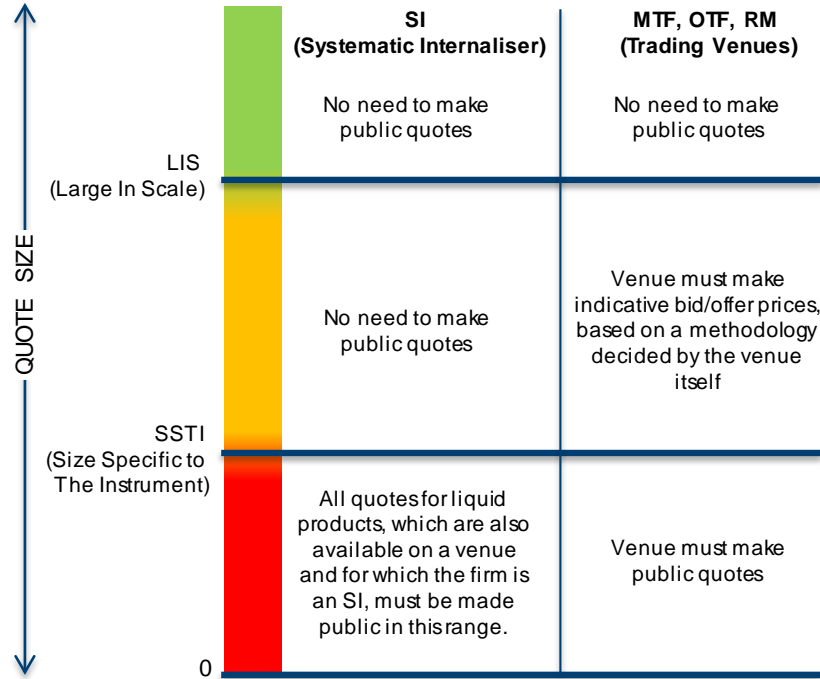


Types of Trading

VENUES (MTF)	BROKERS (OTF)	SYSTEMATIC INTERNALISER (SI)	OTC
MiFID II: Multilateral Trading Facility e.g. TradeWeb, Bloomberg, Xetra	MiFID II: Organised Trading Facility e.g. ICAP	e.g. direct bilateral	e.g. direct bilateral
<ul style="list-style-type: none"> New MTFs (e.g. Bloomberg) may form, pushing more business to be classified as “on venue” Existing MTFs will have to apply for MiFID II recognition. 	<ul style="list-style-type: none"> Inter-dealer brokers (IDB) are expected to register as Organised Trading Facilities (OTFs), hence business on these will count as “on venue”. There are no OTF for equities or equity-like instruments, only for non-equity (FICC) products. 	<ul style="list-style-type: none"> OTC trading over the thresholds, requires firms to become SI (Systematic Internaliser). EU-wide data an issue. SIs are execution venues for pre-trade transparency. OTC trading can continue without pre-trade (but still subject to post-trade) transparency 	

Action	MULTILATERAL		BILATERAL	
A Pre Trade Transparency	Provided by venue	Provided by venue	Provided by SI	N/A
B Post Trade Transparency	Provided by venue	Provided by venue	Provided by SI	Provided by broker-dealer
C Transaction Reporting (only applies to buy-side firms defined as “investment firm”)	Provided by investment firm, may be delegated to venue or third-party reporting service	Provided by investment firm, may be delegated to venue or third-party reporting service	Provided by investment firm, may be delegated to SI or third-party reporting service	Provided by investment firm, may be delegated to broker-dealer or third-party reporting service

Pre-trade transparency



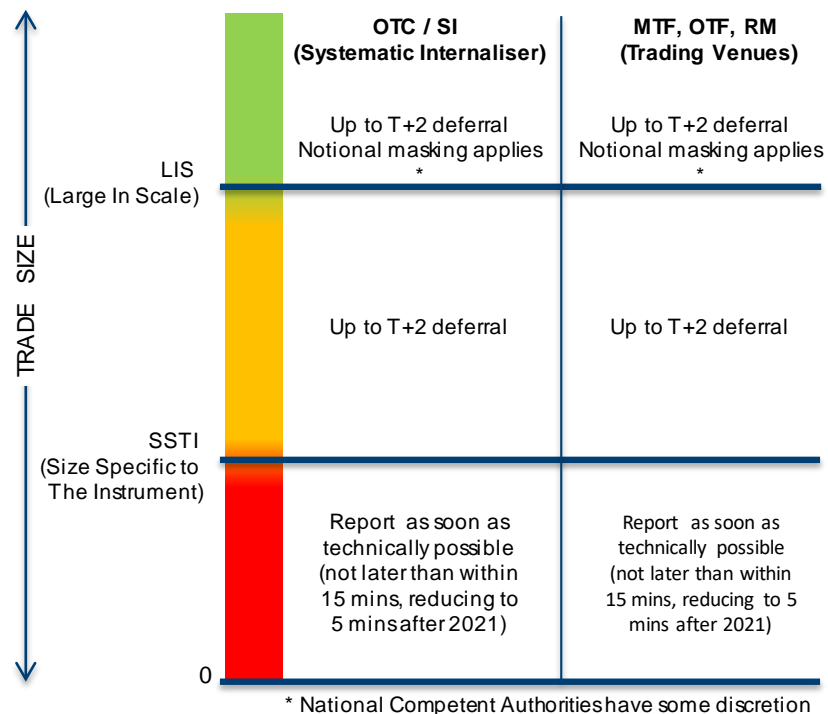
Key Facts

- Systematic internalisers (**SIs**) for liquid products in specific notional size below a threshold (SSTI) must **publish the volume and price quoted**. Those prices need to be **made available to other clients**, and SIs are expected to honour the price with other clients (based on commercial policy) unless conditions have changed. Some waivers exist.
- Broker-dealers that seek status as SI in a given asset or asset class must act as market makers and must provide continuous firm quotes in that asset.
- **Trading Venues** – for liquid (as defined by ESMA) products in scope, in notional sizes below a threshold (SSTI – Size Specific to the Instrument for FICC / SMS – Standard Market Size for Equities), the venue must **make public the volume and price quoted**. Some waivers exist. No need to make price available to other clients.
- **OTC** – no need to perform pre-trade transparency.

Waivers are available:

	Where does it apply?	
	SI	Trading Venue
Large In Scale waiver	✓	✓
Above SSTI waiver	✓	✗
Illiquid instruments waiver	N/A	✓

Post-trade transparency



The following deferrals/waivers are available to limit the post-trade transparency required:


1. **Large In Scale deferral**
2. **Above SSTI deferral.**
3. **Illiquid instruments deferral**
4. **Supplementary Deferral Period** – NCA can permit masking of notional for up to 4 weeks (ESMA proposal) or indefinitely for sovereign debt

Key Facts

- **Reportable Products:** Transparency regime under MiFID I only applied to shares traded / admitted to trading on a regulated market. MiFID II extends this scope to cover ‘equity-like instruments’ (e.g. ETFs) as well as ‘non-equity instruments’ (e.g. bonds, structured finance products, emission allowances, derivatives).
- **SIs / OTC** – for all traded products in scope (whether traded as an SI or OTC) will need to be published as soon as technically possible but not later than within 15 minutes
- **Trading Venues** – for all traded products in scope, the venue will need to publish (as soon as technically possible but not later than within 15 minutes of tracing) a brief report. The 15 min limit reduces to 5 min in 2020.
- **Some deferrals exist** – specifically notional masking and delays to publication. Data reported includes time, date, size, product and various flags to indicate any waivers used etc but no counterparty identification .

Post-trade transparency and transaction reporting

	Post Trade Transparency	Transaction Reporting
Summary	Designed to provide the market with near real-time broadcast of basic trade data to promote price transparency.	Designed to provide National Competent Authority (NCA) with information required to facilitate monitoring of market abuse, insider dealing and market manipulation.
Key Differences	<p>Type of Data: Basic trade data</p> <p>Report Timing: Near real-time (under 15 minutes, down to 5 minutes in the future to non-Equities)</p> <p>Reported to: Approved Publication Arrangement (APA) who collates multiple data feeds and publishes to the market in real-time</p>	<p>Type of Data: Trade, Client, Product & HR data</p> <p>Reportable Fields: Increase from 25 from MiFID I to 65 now</p> <p>Report Timing: T+1</p> <p>Reported to: Approved Reporting Mechanism (ARM) who sends it in a prescribed format to the NCA</p>

 **Where firms fall into the ESMA classification of an „investment firm“, they are subject to MiFID II and may be required to comply with the transaction reporting and post trade transparency obligations. For most of its legal entities Union Investment is not considered to be an „investment firm“ by definition.**

Please contact us with follow-up questions

Christian Kopf

Head of Fixed Income and FX

Tel. +49 69 2567-2647

christian.kopf@union-investment.de

Christoph Hock

Head of Multi-Asset Trading Desk

Tel. +49 69 2567-1078

Christoph.hock@union-investment.de

Union Investment Group

Weissfrauenstrasse 7

60311 Frankfurt/Main, Germany

Disclaimer

- This advertising material is intended only for professional clients as described in section 31a, paragraph 2 of the German Securities Trading Act (WpHG). The present document has been prepared and issued by Union Investment Institutional GmbH. The document does not constitute a binding offer. Union Investment does not assume any obligation or liability for this document. The document is no substitute for the individual advice by Union Investment Institutional GmbH. Union Investment Institutional GmbH is not responsible for disadvantages that may arise directly or indirectly from the distribution of this document or its contents. For extensive product-specific information and details of the opportunities and risks presented by the respective fund, please refer to the latest sales prospectus, the Bank's terms and conditions or the annual and half-yearly reports that can be obtained free of charge from Union Investment Institutional GmbH, Weissfrauenstrasse 7, 60311 Frankfurt am Main, Germany, telephone +49 69 2567-7652. These documents constitute the sole legally binding basis for the purchase of fund units. Unless otherwise noted, all information, illustrations and explanations are as at 6 February 2018.
- **Origins of Data:**
Despite our effort and care no liability or guarantee can be assumed for the timeliness, accuracy or completeness of the data provided. Where data has been obtained from external sources, this is explicitly stated. We consider data obtained from external or publicly available sources to be reliable. Data obtained from external sources or contained in our own calculations may be incorrect.
We assume no liability for any errors that may occur when data is passed on, recorded or entered or when calculations are made using this data.
- **Historical performance:**
Performance data shown is historical. Past performances can not be taken as a reliable guide for future investments. The BVI method (time-weighted return) is used for these calculations. Where the gross method has been used for such calculations (adjusted for management fees and depositary fees), this is explicitly stated. Data calculated and presented using either the BVI method or the gross method does not include any front-end fees or product-specific costs (fees, commissions and other charges).
- **Compliance with Global Investment Performance Standards (GIPS®) and the BVI-Rules of Conduct:**
Union Investment claims of compliance with GIPS® has undergone the verification process and has been verified by an independent third-party „verifier“. The Composite-Performance calculation and presentation comply with the GIPS® guidelines. The composite allocation of individual funds, or all Composites complying with GIPS® are available upon request. Union Investment Institutional GmbH has committed to comply with BVI's code of conduct. In consequence, Union Investment Institutional GmbH employs the code's standards for performance illustrations. Cases of deviation will be individually indicated.
- **Future assessment:**
Any opinion expressed in this document (including estimates and forecasts) is solely for information purposes and does not constitute an individual offer or a guarantee for future performance. Any opinion contained herein was given at the date of publication and may be subject to change without notice.
- **Use of Union Investment's country ratings:**
The country ratings devised by Union Investment are merely the outcome of its assessment of the creditworthiness of sovereign issuers for internal purposes, and they are intended to be used purely as quality appraisals of a certain selection of sovereign issuers. The ratings represent Union Investment Institutional GmbH's own assessment and do not constitute a recommendation to take a particular course of action.