MARKETS IN FINANCIAL INSTRUMENTS DIRECTIVE II (MIFID II)

Frequently Asked Questions

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Background

What is MiFID?
The Markets in Financial Instruments Directive (MiFID) is the EU legislation that regulates firms who provide services to clients trading in ‘Financial Instruments’ (shares, bonds, units in collective investment schemes and derivatives), and the venues where those instruments are traded.

MiFID I was applied in Germany from November 2007, but was revised to improve the functioning of financial markets in light of the financial crisis and to strengthen investor protection.

The changes took effect in Germany on 3 January 2018, with the new legislation being implemented in different domestic German laws. This includes a revised Markets in Financial Instruments Directive (Directive 2014/65/EU, “MiFID II”) and a new Markets in Financial Instruments Regulation (MiFIR).

The general objectives of MiFID II are to:
1. Strengthen investor confidence;
2. Increase market transparency;
3. Increase investor protection;
4. Increase integrity of the market and financial stability;
5. Increase supervisory powers;
6. Technological innovations;
7. Reduce the risks of market disorder;
8. Reduce systemic risks; and
9. Increase efficiency of financial markets and reduce unnecessary costs for participants.

How was the need for MiFID II identified?
The EU Commission has argued that MiFID I was successful in its aims, although they thought change was needed to develop the existing regulatory framework to address weaknesses highlighted by the financial crisis.¹

The main changes introduced or strengthened by MiFID II are:
1. Extended scope of legislation
2. Authorisation and operating conditions
3. Enhanced investor protection
4. Creation of a new regulated trading venue (OTF)
5. Extended market transparency
6. Stricter corporate governance requirements
7. Harmonised EU approach, i.e. passporting
8. Enhanced powers of competent authorities
9. Broader coverage of Financial Instruments and markets previously not covered by MiFID.

MiFID II and MiFIR will ensure fairer, safer and more efficient markets and facilitate greater transparency for all participants. New reporting requirements and tests will increase the amount of information available, and reduce the use of dark pools and OTC trading. The rules governing high-frequency-trading will impose a strict set of organisational requirements on investment firms and trading venues, and the provisions regulating the non-discriminatory access to central counterparties (CCPs), trading venues and benchmarks are designed to increase competition.

The protection of investors is strengthened through the introduction of new requirements on product governance and independent investment advice, the extension of existing rules to structured deposits, and the improvement of requirements in several areas, including on the responsibility of management bodies, inducements, information and reporting to clients, cross-selling, remuneration of staff, and best execution.

How is MiFID II changing the scope of the existing regulation?
MiFID II widens the scope of MiFID I by introducing a new type of trading venue called an Organised Trading Facility (OTF) and creating a new set of data service activities. Most other changes fall within the existing scope of the regulation.

What is an Organised Trading Facility?
An Organised Trading Facility (OTF) is a platform for multilateral trading interests to interact, leading to transactions in financial instruments. However, in contrast to a Multilateral Trading Facility (MTF) where the operator of the platform plays a neutral role in bringing about transactions, the operator of an OTF plays an active role. It does this by exercising discretion in bringing together buying and selling counterparties and helping them negotiate the terms of a trade.

What are the new data service activities?
There are three new data service activities being introduced:
1. Approved Publication Arrangements (APAs): Firms who make public the details of transactions in financial instruments.
2. Approved Reporting Mechanisms (ARMs): Firms who report details of transactions to regulators for the purposes of market abuse surveillance.
3. Consolidated Tape Providers (CTPs): Firms who publish details of all transactions in certain financial instruments so the market can have an overview of trading.

APAs, ARMs and CTPs have been introduced to ensure a) the market as a whole has high quality information on which to make trading decisions and b) regulators have high quality information to use for market abuse surveillance purposes.

What are the changes to the authorisation and operating conditions?
To gain authorisation, firms are required to have suitable management and controllers, and for any changes to management and control to be notified to a firm’s regulators. The provisions dealing with management and governance in MiFID II are a significant development on those in MiFID I. They specify in much greater detail the requirements of management bodies and the way in which they will operate.
What are the changes to investor protection?  
MiFID II makes significant revisions to the existing investor protection obligations. The new rules will affect the entire lifecycle of investment products and services:

- The design, marketing and distribution of products by investment firms must be tailored to the target market;
- Firms must understand the products they sell, and ensure that they are appropriate for the client;
- Remuneration and sales targets should not incentivise staff to recommend inappropriate financial instruments to clients; and
- Going forward Investment Firms are required to provide clients with much more detailed disclosure around cost and charges, the risks, and other features of investment products.

What are the new trading venues being introduced under MiFID II?  
MiFID II will introduce a new type of EU-regulated trading venue – Organised Trading Facilities (OTFs). This is in addition to the EU-regulated trading venues known as Regulated Markets (RMs) and Multilateral Trading Facilities (MTFs) that are currently regulated under MiFID I.

Firms will choose the status that best fits their business model. MTFs, OTFs and Systematic Internalisers (SIs) will not be permitted to operate within the same legal entity, nor will they be permitted to share orders and/or quotes.

What are the changes to market transparency and integrity under MiFID II?  
MiFID II revises the transparency regime on trading venues for shares and introduces a new transparency regime for instruments like shares (such as exchange traded funds) and bonds and derivatives. For shares, the existing waivers have been narrowed to provide for greater transparency and it is likely that post-trade delays will be reduced.

What is passporting?  
A key purpose of MiFID was to facilitate cross-border activity within the EU. It provides that firms have rights to do business outside of the member state in which they are authorised without being subject to additional approval requirements.

The cross-border regime remains unchanged under MiFID II. However, MiFID II requires standardised forms including standardised MiFID II investment services for passporting applications. Also, additional information will have to be provided to host regulators in certain circumstances when banks are providing investment services and activities.

What are the powers of Competent Authorities?  
Regulation cannot operate effectively simply on a Member State by Member State basis. The Directive’s key purpose is to foster cross-border activity. Cross-border activity in the EU inevitably requires competent authorities in different Member States to co-operate, both to facilitate the operation of the single market and to protect its integrity. MiFID set out a framework to ensure that competent authorities in different Member States are obliged to co-operate and have the ability to do so by passing on information. This framework remains in MiFID II.
What are the German Competent Authorities?
Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) and Deutsche Bundesbank (Bundesbank).

Are there any new requirements under MiFID II?
There are several key areas where MiFID II does not build on MiFID as such but introduces wholly new requirements. These include:
- Position limits and position reporting for commodity derivatives;
- Trading obligations for shares and derivatives;
- Inducements & research;
- Access to market infrastructure and benchmarks; and
- Access of firms from outside the EU providing investment services and activities to clients in the EU.

What will it mean in practice?
The key benefits of MiFID II will include increased trade transparency, investor protection and greater market resilience and integrity.

What are the main changes you may be impacted by?
We’ve talked about the main regulatory changes above, but what are the main changes you may be interested in? We have split these into five key areas:
1. Research & Inducements;
2. Appropriateness;
3. Transaction Reporting;
4. Post Trade Transparency; and
5. Systematic Internaliser

1. Research & Inducements

Overview
MiFID II seeks to regulate the provision of inducements to third parties, in order to avoid conflicts of interest arising within the third party. Investment Research is categorised as a non-monetary benefit and should be paid for either out of the third parties’ own funds, or a research payment account with a defined budget that has been agreed or funded by the end clients. There are, however, certain circumstances where the provision of relevant information would constitute a minor non-monetary benefit, such as where it has been made publicly available.

Recipient investment firms are responsible for determining whether the information they receive constitutes research. The firm must have a mechanism in place to pay for the research received, if they don’t they must refuse to accept the research. It is our responsibility to ensure all materials provided to clients pass the quality enhancement test (QET) and comply with the MiFID II inducement rules. We will not provide non-monetary benefits to third parties unless it is carried out as part of a separate, chargeable service, with the exception of minor non-monetary benefits which will be provided free of charge. Where we are acting as a third party, such as when we are supporting a primary bond issuance, we
will disclose any fees that are paid or received to you prior to providing any associated MiFID product or service.

What does an “unbundled” payment for research mean?
Payments for investment research purchased from third parties will have to be fully “unbundled” (i.e. separated) from payments for execution (or other) services. In practice, this means it must be paid for:
- directly by the recipient firm out of its own resources; or
- from a so-called separate Research Payment Account (RPA) which meets certain conditions.

What will it mean in practice and are there any cost implications?
We produce a range of standard publications covering recent economic announcements and general market commentary. These are generally short term in nature, do not contain significant analysis and are made available publicly to anyone that requests them, subject to the document being suitable for the client’s regulatory classification. We have determined these publications constitute a minor non-monetary benefit, as defined by MiFID II and there is no charge for these publications unless requested by clients due to regulatory requirements.

Where we agree to provide a one off service to you which would constitute a non-monetary benefit, we will also agree a fee with you for the provision of this service. Prior to the provision of this service, such as a piece of bespoke analysis or insight, we will agree a chargeable fee and the scope of the service to be provided. The fee will be dependent on our estimate of the amount of resources required.

We may also produce investment recommendations that will be distributed to all relevant entities. As these investment recommendations will be publicly available, subject to regulatory restrictions, we believe they would constitute a minor non-monetary benefit and will not be chargeable.

We are able to provide bespoke analysis, research and insight (“ARI”) when required and have experts who specialise in market, economic, and solution structuring. The ARI can take the form of material produced by us, or a session with one of our experts who will share their insight and expertise. Any requests for bespoke pieces of ARI will be charged separately and on a request basis. There may be times when we believe that certain ARI proposals or ideas would be valuable for your business and give you the opportunity to obtain this additional ARI for a separate fee. From time to time we may also present you with ARI proposals or ideas that we believe may be valuable for your business. We would provide you with an unsubstantiated summary of the ARI and only provide you with bespoke analysis if we believe that it passes the QET and complies with the MiFID II inducement rules.

If you feel at any point that our interaction with you would constitute a non-monetary benefit, or does not comply with your internal inducement policies, please inform us immediately. At this point we will either stop providing this information or agree a fee for the provision of the non-monetary benefit.
2. Appropriateness

Overview

Appropriateness is an assessment of our clients’ (or potential clients’) knowledge and experience in order to determine their ability to understand the risks involved in relation to certain products and/or services.

It is applicable to Non-Advised investment services (other than for a narrow range of non-complex financial instruments), as opposed to Advised services where a more in-depth suitability assessment is conducted. We provide Non-Advised services only.

What are Advised Services vs. Non-Advised Services?

MiFID II defines nine (9) investment services as follows:

1. Reception and transmission of orders in relation to one or more financial instruments;
2. Execution of orders on behalf of clients;
3. Dealing on own account;
4. Portfolio management;
5. Investment advice;
6. Underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis;
7. Placing of financial instruments without a firm commitment basis;
8. Operation of an MTF; and
9. Operation of an OTF.

The services of portfolio management (4) and investment advice (5) are known as “Advised Services”. The other services, in their own right, do not involve any form of personal recommendation or discretionary activity by firms on behalf of their clients and are known as “Non-Advised Services”.

Will this apply to me?

The appropriateness assessment is conducted for customers categorised as retail clients being offered financial instruments on a Non-Advised basis. Examples of types of such complex instruments are: foreign exchange derivatives, commodity derivatives and interest rate derivatives such as interest rate swaps. Firms are permitted to assume customers categorised as professional have sufficient knowledge and experience in order to understand the risks involved, although we may still perform an appropriateness assessment for some professional clients.

Are there any costs involved?

There are no costs involved for clients or potential clients around appropriateness assessments.

What does an assessment look like?

Sales colleagues will conduct the appropriateness assessment. Examples of the type of information clients may be asked to provide include:

- The types of services, transactions and instruments they are familiar with;
- The nature, volume and frequency of transactions in financial instruments; and
- Level of education and profession or former profession.
Where clients have not had extensive experience, we will provide guidance to ensure the client has a clear understanding of the product, transaction and associated risks. Alternatively, we will not proceed with the transaction.

3. Trade Reconstruction

What is Trade Reconstruction?
Trade reconstruction is a process of reconstituting each key stage of the processing of every transaction. This will enable the regulatory bodies to carry out investigations if and where required.

Are clients able to request recordings of telephone conversations and electronic communications in regards to their transactions?
Yes

Is there a cost associated with a client request for information?
There is no associated cost

Who does a client need to contact should they wish to obtain client accessible information?
A client can either contact the MiFID II Queries Team (MiFIDIIQueries@lloydsbanking.com) or their Front Office Contact (trader, sales person or a relationship manager).

4. Transaction Reporting

Overview
MiFID II investment firms (as defined in Art 4 (1) (1) MiFID) will have to report complete and accurate details of transactions in financial instruments to the competent authorities, directly or through approved reporting mechanisms (“ARMs”) or trading venues. Trading venues will also be required to submit transaction reports on behalf of non-MiFID member firms. They may also submit transaction reports for MiFID member firms in relation to the market-side transaction reports to the competent authorities. German branches of third country investment firms and credit institutions are also required to submit transaction reports to the National Competent Authorities (“NCA”).

What is a transaction report?
A transaction report is a data set submitted to the local regulator, which contains information relating to a transaction. Our regulator in this context is the BaFin and Bundesbank (referred to as the National Competent Authorities, the NCA in EU regulation). Each transaction report includes information about the financial instrument traded, the firm undertaking the trade, the trade counterparty, the person on whose behalf the firm has dealt (where applicable) and the date/time of the trade.

The primary function for which the NCA uses transaction reports is to detect and investigate suspected market abuse. Transaction reports may also be used for conduct supervisory purposes and to support the work of other regulatory authorities.
What is the reporting requirement under MiFID II?
MiFID II requires that all transactions executed during the course of a business day have to be reported to the local regulator on a T+1 basis by both counterparties of the trade.

What are the additional products that need to be reported under MiFID II?
MiFID II has expanded the products that need to be reported to cover a wide range of instruments including:
- Certificates of Deposit;
- Money market instruments;
- Derivatives (FX, Interest rate, Credit, Equity, Commodity);
- Structured Finance products;
- Contracts for Difference;
- Structured Deposits; and
- as well as the bond and equity products covered in MiFID II.

In addition to the products and the standard particulars of the trade (i.e. timestamps, price, volume, product, etc), MiFID II expands on the information that needs to be included in the transaction reports, with greater emphasis on identifier information relating to the counterparties involved in the trade and the decision makers.

What does this mean in practice?
In order to report and execute transactions, any firm or individual must have one of the following:
- Legal Entity Identifier (LEI) – is mandatory for all our eligible clients (this includes legal entities, and those on business registers). A LEI is a code unique to a legal entity or structure. When a LEI code is allocated, the code is included in a global data system.
- National ID – this data is required for clients who are non-legal entities (i.e. Natural Persons) as they are not eligible for a LEI. The National ID is based on nationality and specific identifiers such as Passport Number, National ID, or ‘CONCAT’ which is made up of Christian Name, Surname, DOB, etc.

With the aim of promoting market integrity, investment firms will be required to keep records of the transactions they carry out for at least seven (7) years. This is so that regulators can have access to them, to ensure compliance with MiFID II and wider obligations (such as those relating to money laundering and market abuse). Investment firms also have to report to the regulators the transactions they conduct in MiFID II instruments which are:
- traded on or admitted for trading on trading venue, or
- the underlying traded on or admitted for trading on trading venue, or
- the underlying is a basket or index composed of financial instruments traded on venue.

How will Lloyds Bank Corporate Markets Wertpapierhandelsbank GmbH (‘LBCMW’) execute Transaction Reporting?
We will report via an Approved Reporting Mechanism (“ARM”) to the BaFin. This will help them to: detect and investigate potential cases of market abuse, to monitor the fair and orderly functioning of markets, as well as the activities of investment firms.
What are the things to look out for?
Professional clients and eligible counterparties will be required to provide a LEI code (a code unique to a legal entity or structure) or a National ID (depending on the entity status and eligibility), in order to enable us to trade certain products with them.

Further information on how to obtain a LEI code can be found on the following Global Legal Entity Identifier Foundation (GLEIF) site: https://www.gleif.org/en/about-lei/how-to-get-an-lei-find-lei-issuing-organizations

5. Post Trade Transparency

Overview
Investment firms which, either on own account or on behalf of clients, conclude transactions in non-equity products (as well as equity products) e.g. bonds, structured finance products, emission allowances and derivatives traded on a trading venue, shall make public the volume and price of those transactions and the time at which they were concluded. This information shall be made public through an Approved Publication Arrangement (APA).

What is the required time of publication?
Post-trade information shall be made available as close to real time as is possible and in any case:
- Within 15 minutes after the execution of the relevant transaction from 3 January 2018 until 1 January 2020;
- Within 5 minutes after the execution of the relevant transaction after 1 January 2020.

Are there any exemptions from Post Trade Transparency?
The NCA can grant a temporary suspension of the post trade transparency obligation for transactions concluded in the financial instruments for which there is not a liquid market, or where the different volume thresholds for liquid/illiquid instruments are not met.

Deferred Publication
The BaFin can grant publication deferrals based on the following:
- The financial instrument is classified as illiquid (as determined by the regulation’s liquidity calibration criteria);
- The trade size meets the large in scale (LIS) waiver criteria;
- The trade size meets the size specific to instrument (SSTI) waiver criteria;
- For package transactions, if one or more of the components of a package transaction meets any of the three criteria above (liquidity, SST or LIS).

What are the Trade Publication Responsibilities?
Post trade transparency reporting is single sided reporting.

The reporting party logic is based on a hierarchy of MIFID II entity type followed by seller reports.

The summary of trade publication responsibilities is set out below.
### Trade Between

<table>
<thead>
<tr>
<th>Who is responsible for publishing the trade?</th>
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<tr>
<td>MiFID II Investment Firm &lt;-&gt; Trading Venue</td>
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<tr>
<td>MiFID II Systematic Internaliser (SI) Investment Firm &lt;-&gt; MiFID II SI Investment Firm</td>
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<td>MiFID II Investment Firm &lt;-&gt; MiFID II SI Investment Firm</td>
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<td>MiFID II Investment Firm &lt;-&gt; MiFID II Investment Firm</td>
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<tr>
<td>MiFID II Investment Firm &lt;-&gt; Non MiFID II Investment Firm</td>
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### What happens if a trade is cancelled or amended?

**Cancellation** – Where a previously published trade is cancelled, investment firms trading outside a trading venue shall make public a new trade report which contains all the details of the original trade report and the cancellation flag.

**Amendment** – Where a previously published trade is amended, trading investment firms shall make the following information public:

- A new trade report that contains all the details of the original trade report and the cancellation case
- A new trade report that contains all the details of the original trade report with all necessary details corrected and the amendment flag.

### What will it mean in practice?

MiFID II investment firms will have to report in accordance with RTS 2 (the Regulatory Technical Standard) on bonds, structured finance products, derivatives and emission allowances within 15 minutes after the execution of a transaction. Investment firms will publish their trade reports via an APA (approved publication arrangement). The APA will then make the trade economics of the trade report public. Note that post trade transparency is anonymous and the counterparty data will be removed by the APA when publishing to the public domain.

### What are the things to look out for?

Each firm will need to establish whether they are a MiFID II investment firm and assess whether they trade in-scope products (e.g. bonds, structured finance products, derivatives and emission allowances).
6. Systematic Internaliser

What is a Systematic Internaliser?
Systematic Internaliser (SI) means an investment firm which, on an organised, frequent, systematic and substantial basis, deals on own account when executing client orders outside a trading venue.

Is LBCMW going to be a Systematic Internaliser (SI) and for which Financial Instruments?
We have opted in to be a SI for the following products, based on MiFID II product classifications, that are traded on a trading venue (“TOTV”):

- Bonds
- Structured Finance Products

Our SI status will be monitored and reviewed regularly.

What is the LBCMW Market Identifier Codes (MIC)?
The SI market identifier code for LBCMW is: LBCW

We will not offer firm quotes over-the-counter when dealing below the size specific to instrument when acting in the SI capacity and the instrument is considered both liquid and TOTV. For such circumstances we ask that you meet us on a trading venue.

How does this affect the trade reporting obligation?
Where a trade between us is on a TOTV instrument, LBCMW will support you by having the responsibility to post trade report all trades where we are acting in a SI capacity through our Approved Publication Arrangement (APA) TRADEcho.

Do you offer assisted reporting?
Where we transact with you in a non-SI capacity you may have the obligation to report if you are the seller. We offer assisted reporting through our APA to help you comply with post trade reporting obligations, please contact us for further information.

Which APAs will your firm sign up to for trade reporting, and for which instrument class?
APA: TRADEcho provided by the London Stock Exchange (LSE)
Instrument Class: All classes

Will Clients be able to see the trades LBCMW report on clients’ behalf through the APA?
Clients who use TRADEcho as their APA will be able to view their trade reports via the client web portal provided by TRADEcho.

Will investment managers be required to enter into an Assisted Post Trade Reporting Agreement with LBCMW for post-trade reporting services?
Yes, the contracts will require signing ahead of any assisted reporting activity.
Trading outside the rules of a trading venue
In this respect it is essential to clarify which investment firm is to make public a transaction in order to ensure the publication of transactions without duplication - this is in cases where both parties to the transaction are investment firms established in the European Union. The responsibility to make a transaction public should always fall on the selling investment firm unless only one of the counterparties is a systematic internaliser and it is the buying firm.

What about transactions where one counterparty is a SI?
Where only one of the counterparties is a SI in a given financial instrument and it is also the buying firm for that instrument, it should be responsible for making the transaction public. Its clients would expect it to do so and it is also better placed to fill in the reporting field mentioning its status of SI. To ensure that a transaction is only published once, the SI should inform the other party that it is making the transaction public.

How will duplication be avoided?
Investment firms should take all reasonable steps to ensure that the transaction is made public as a single transaction. For that purpose, two matching trades entered at the same time and for the same price with a single party interposed shall be considered to be a single transaction.

7. Legal Entity Identifier (LEI)

What is a client Legal Entity Identifier (LEI)?
Financial Instrument transactions must be reported within one business day to the relevant local regulator. MiFID II requires that all clients must be uniquely identified for every transaction in this report. They will be identified either with a Legal Entity Identifier (LEI) for relevant entities, or a National Identifier for other natural persons and other non-entities.

A LEI is a code unique to a legal entity or structure. When a LEI code is allocated, the code is included in a global data system. This enables every legal entity or structure (that is a party to a relevant financial transaction) to be identified in any jurisdiction. A LEI is mandatory for all legal entities trading financial instruments. Clients that are incorporated, i.e. listed with Companies House or a registered partnership, trust or charity, need to apply for a LEI if they have not done so already.

Where can I get a LEI?
LEI codes can be bought from a LEI issuing organisation. A list of these can be found on the Global Legal Entity Identifier Foundation (GLEIF) website: https://www.gleif.org/en/about-lei/how-to-get-an-lei-find-lei-issuing-organizations

There is a fee charged by all LEI issuing organisations, and these do vary. The average time for the request to be processed is 1-3 working days (valid as at July 2017) and there is also an annual renewal cost charged by the issuing organisation.

What are the Legal Entity Identifier (LEI) codes of Lloyds Banking Group?
Lloyds Bank PLC: H7FNTJ4851HG0EXQ1Z70
Bank of Scotland PLC: OQ3T05P7YR8P5YJEVI93
Lloyds Bank Corporate Markets PLC: 213800MBWEIJDM5CU638
Lloyds Securities Inc.: 213800ZJO44UP14YDH76
LBCMW: 21380089NOMBRMROI73
My question is not answered in this document. Who should I contact for further information?
Please e-mail us at MiFIDIIQueries@Lloydsbanking.com.

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