

## AFME Equity Capital Markets (ECM)

### Application of the MiFID II Allocation and Product Governance requirements to global ECM deals

#### GENERAL PRINCIPLE FOR APPLICATION OF MIFID II

- On global capital markets deals, extra-territorial considerations may arise because of the location of:
  - (i) the issuer/seller client (EU or non-EU);
  - (ii) the buy-side investors (EU and non-EU); and
  - (iii) the legal entity to which the deal is booked or out of which the deal is led, i.e. the service provider.
- The key variable to determining whether MiFID II applies is (iii), i.e. the location of the service provider:
  - An entity located in the EU which is conducting MiFID II regulated activities in respect of MiFID II regulated products will be subject to MiFID II (the “**EU firm**”) and will owe duties to its clients irrespective of their location; and
  - Non-EU affiliates without authorisation under MiFID II (the “**non-EU affiliate**”) would not be subject directly to MiFID II. This note does not consider the application of local licensing requirements to the non-EU affiliates.

#### THE ECM CROSS BORDER SCENARIOS

- Global capital markets deals are often structured with a cross border element such that different EU and non-EU affiliates may step in at different stages, or for different activities, on any particular deal. For example:
  - A deal may be booked to the EU firm which is therefore the contractual underwriter/placing agent for the issuer/seller client; however, the principal activities related to such deal (e.g. origination, design, bookbuilding, allocation, pricing, and syndicate desk location) are undertaken by the non-EU affiliate (“**remote booking scenario**”). The remote booking scenario could also have variants with incrementally more involvement by the EU firm. For example, the EU firm may:
    - a) act as an intermediary in collecting orders from EU investors and passing them on to the non-EU syndicate;
    - b) have been involved in the origination of the deal and continue to then be involved throughout the deal through client relationship management – e.g. where the issuer/seller is EU-based and the EU firm therefore has the client relationship; or
    - c) participate more actively in the design or allocations process.
  - A deal may be booked to a non-EU affiliate which is therefore the contractual underwriter/placing agent for the issuer/seller client. The syndicate desk is also located in the non-EU affiliate which generally runs the transaction and exercises the key discretions in respect of this (e.g. per above - origination, design, bookbuilding, allocation, pricing, and syndicate desk location are all undertaken by the non-EU affiliate). However, because there are EU buy-side investors or an EU issuer/seller, the EU firm is also involved in some way in the transaction, e.g. per (a), (b) and (c) above.
- The question therefore is whether the EU firm on any such cross-border deal will be deemed to be undertaking the relevant MiFID II activities which may trigger the allocation and/or product governance requirements, or whether it could be argued that it is in fact the non-EU affiliate that undertakes such activities and therefore the deal should not be regarded to be in scope of the relevant MiFID II requirements.

## THE TRIGGERS FOR ALLOCATION AND PRODUCT GOVERNANCE REQUIREMENTS

- The product governance and allocation requirements are triggered where the EU firm undertakes the following activities:
  - **allocation** requirements (Art 40 MiFID II Delegated Regulation) – triggered where there is “placing”. This is a service provided to the issuer/seller and consists of finding investors for securities on behalf of an issuer/seller, i.e. running the book and exercising discretion as to how it is allocated and priced;
  - **manufacturer** requirements under the product governance regime (Art 9 MiFID II Delegated Directive) – triggered where the EU firm is involved in the “creation, development, issuance and/or design of financial instruments” (Art 9 MiFID II Delegated Directive), “including when advising corporate issuers on the launch of new financial instruments” (Recital 15 MiFID II Delegated Directive); and
  - **distributor** requirements under the product governance regime (Art 10 MiFID II Delegated Directive) – triggered where the EU firm is “offering or selling” (Recital 15 MiFID II Delegated Directive) or “offering or recommending” (Art 10 MiFID II Delegated Directive) the financial instrument.

## THE GENERAL PRINCIPLES FOR APPLICATION OF ALLOCATION AND PRODUCT GOVERNANCE REQUIREMENTS TO ECM CROSS-BORDER SCENARIOS

- Given the triggers for each of the requirements above, the following high level principles (the “**General Principles**”) can be adopted (subject to the comments below) for the application of the MiFID II allocation and product governance requirements to global ECM deal scenarios:
  - **allocation** requirements – these will only apply where the discretion in respect of the bookbuild and allocation resides with the EU firm. This could generally be determined by the location of the syndicate desk. Where the non-EU affiliate exercises such discretion, the MiFID II allocation requirements should not apply;
  - **manufacturer** requirements under the product governance regime – these will only apply where the EU firm is involved in the creation, development, issuance and/or design of financial instruments. In the context of ECM transactions, this broadly covers designing the deal and advising on strategy and structure, rather than merely the booking of underwriting liability; and
  - **distributor** requirements under the product governance regime – these will only apply where the EU firm is involved in the distribution process, including where it acts as an intermediary in passing orders from EU investors to the non-EU syndicate desk.
- Please see the Appendix for an illustration of the application of the General Principles to global ECM deal scenarios.
- Where an EU firm has incrementally more involvement and discretion on a global ECM deal, there is likely to be an incremental increase in the risk of regulatory scrutiny. For example, where a deal involves both EU investors and an EU issuer/seller client, if the deal is booked to an EU firm, there may be a greater onus to show that the EU firm did not in fact engage in any of the relevant conduct that would trigger the application of the rules.

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## Appendix

### Illustration of the application of the General Principles to global ECM deal scenarios

Note that ECM deals booked to an EU firm, and where the principal syndicate activity is undertaken by the EU firm, are subject to the allocation and product governance requirements.

Remote Booking Scenario - Non-EU led deal booked to an EU firm (i.e. the EU firm is the contractual underwriter/placing agent, and all syndicate activity is undertaken by a non-EU affiliate).	<b>Scenario 1:</b> remote booking to EU firm and no other involvement by the EU firm.	<b>Scenario 2:</b> EU firm involved in contacting buy-side investors and passing orders to syndicate (but no discretion on allocation or on the creation, development, issuance and/or design).		
	PG MANUFACTURING - NO	PG MANUFACTURING - NO		
	PG DISTRIBUTING - NO	PG DISTRIBUTING - YES		
	ALLOCATION - NO	ALLOCATION - NO		
Non-EU booked deal with involvement from EU firm.	<b>Scenario 3:</b> Syndicate activity undertaken by non-EU affiliate; EU firm involved in contacting buy-side investors and passing orders to syndicate (but no discretion on allocation or on the creation, development, issuance and/or design).	<b>Scenario 4:</b> Syndicate activity undertaken by non-EU affiliate; EU firm involved in pre-mandate client relationship and introduction to non-EU affiliate but no other involvement in the deal once this is handed over to non-EU affiliate <sup>1</sup> .	<b>Scenario 5:</b> Some syndicate activity or other involvement in the creation, development or design, undertaken by EU firm and some undertaken by non-EU affiliate; there is a co-manufacturer agreement between EU firm and non-EU affiliate delegating manufacturing responsibility to non-EU affiliate which in turn complies with local rules.	<b>Scenario 6:</b> all syndicate activity undertaken by EU firm.
	PG MANUFACTURING - NO	PG MANUFACTURING – NO	PG MANUFACTURING – NO, WHERE PROPORTIONATE <sup>2</sup>	PG MANUFACTURING - YES
	PG DISTRIBUTING - YES	PG DISTRIBUTING - NO	PG DISTRIBUTING - YES	PG DISTRIBUTING - YES
	ALLOCATION - NO	ALLOCATION – NO	ALLOCATION - YES	ALLOCATION - YES

<sup>1</sup> To the extent that the EU firm's sales force is involved in the distribution (e.g. by contacting buy-side investors and passing orders to syndicate, but with no discretion on allocation or on the creation, development, issuance and/or design) then the position is as per Scenario 3, where the EU firm will be a PG distributor but will not be a manufacturer or subject to the allocation requirements.

<sup>2</sup> Proportionality is an intrinsic part of the product governance regime under MiFID II. Where it is proportionate to rely (through the co-manufacturer agreement) on the non-EU affiliate taking responsibility for manufacturing, and it does so in compliance with local law applicable to it in the context, including any product governance-type requirements, then the EU firm need not duplicate that responsibility.