



MIFID II AND CORPORATE GOVERNANCE



Introduction

Corporate Governance is at the center of MiFID II. Among other measures like ensuring transparency in transactions and reporting trades to regulators, MiFID II also requires the aspect of corporate governance to be a matter of continuous surveillance by regulators and firms internally.

This is mainly due to the fact that corporate governance-related issues were one of the main reasons behind the financial crisis in the latter part of the last decade. Also at the international level, there is a consensus that corporate governance in firms need to be scrutinized at the highest level to prevent any crisis. Broadly, detailed

attention is needed around the ability and the knowledge of management bodies of firms (irrespective of size) to ensure that they understand the business, bring in adequate experience around it and manage the business in such a way that investor confidence is maintained.

MiFID II and corporate governance

MiFID II mainly targets the following areas within corporate governance:

- Improve / expand the role of the compliance function within the firm
- Improve integrity and competitiveness of senior management
- Eliminate conflict of interest within firms
- Streamline and regulate how products are manufactured and sold



Regulatory challenges – implications for firms

1. Revamping the role of the compliance function (Article 16 (1))

- **Strengthen compliance:**
MiFID II requires the compliance function to expand and get more involved in a firm's business. Also, firms engaged in complex, sensitive businesses, need to be more organized, wide, and alert. Also, the compliance officer must be competent to carry out the assigned role, be independent of any interest in the business of the firm, and be compensated reasonably / proportionately to the role performed
- **Remuneration policies:**
Under MiFID II, the compliance department needs to monitor, or get involved in, the remuneration policies of the firm.
- **Regulators require that the compliance department regularly reviews remuneration-related policies (mainly key executives) and advise company management.**
- **Monitoring / Reporting the firm's risk and businesses:**
The compliance function must be able to report on a sustainable basis any risks arising to the business and publish, at least annually, a status report on the health of the control procedures within the firm. In addition, the compliance department must carry out continuous risk-monitoring activities of the firm.
- **Customer Complaints Unit (CCU):**
The customer complaints unit must be closely supervised by the compliance department. It must look into the nature of the customer complaints department and establish procedures to independently manage this function. It is also required that the compliance function must use the complaints coming in as one of the key measures to address possible systems and process issues within the firm. This is applicable for both existing and potential clients.

2. Role of management body

- **Experience and Knowledge:**

- MiFID II requires the management body of a firm to have adequate experience and knowledge of the business, which they are required to oversee in their specific role. They must have a clean image and should be able to devote adequate time to perform their assigned roles and responsibilities in the firm.

- The management body must also ensure that all personnel engaged in the services are acting responsibly while conducting the business, always keeping client's interest (suitability) in mind, and staying away from any conflict of interest. MiFID II specially looks at preventing and managing conflict of interest at all levels.

- **Organizational Requirements:**

- MiFID II requires the management body to set out the corporate

governance framework for the firm. A frequent scrutiny of the corporate governance practices also needs to be done.

- To successfully monitor the corporate governance practices, firms must make available all necessary documents needed to do so to the management body on a real-time basis.

- **Policies and Procedures:**

- The management body of the firm, must approve the policies and procedures of the firm across all functions.

- In addition to approving and operationalizing them, the management body must also conduct stress-testing of these to ensure that the products or service levels are working in the interest of the clients and as laid out in the policies and procedures which must be regulatory-compliant.

3. Product governance rules

MiFID II has specific obligations around product governance. This applies to both manufacturers and retailers of the products. The specifics around product control are as below:

- All personnel engaged in manufacturing and retailing of the product must be adequately trained in the product they are handling
- During the product design stage, firms must do necessary due diligence (on an ongoing basis) to define the suitability of the product with regard to a target segment

- The management body of the firm must be fully aware of all the firm's products, and their suitability to customers
- Any conflict of interest must be avoided, for example, between the product manufacturer and the retailer
- Retailers must perform due diligence to choose and display products that suit customers
- Clear policies and procedures must be there for products which need to be regularly reviewed and stress-tested





Technology impact of regulations on firms

Since MiFID II would require significant amounts of data to be made available to senior management and compliance on-the-go, firms have to invest significantly in building robust management information systems. Many vendors worldwide have already launched dashboards that enable management to be on top of MiFID II activities and compliance.



- These dashboards, among others, must enable senior management to navigate through the directives, assign tasks, and monitor them on an ongoing basis to track effective implementation and compliance.
- These advanced business intelligence (BI) tools will have to be connected real time and seamlessly to relevant systems (business and operations) that can feed data and present a management view of the state of affairs.
- On a product level, these data-driven dashboards must allow firms to impact-assess MiFID II on product P&L, analyze sales processes, prioritize product portfolio impacts, and assess what improvements are needed across products to ensure systems and processes are in place to be compliant.
- Since MiFID II impacts all business and support functions, each department should maintain their own dashboard, which must consolidate into an organizational compliance objective.
- From a compliance perspective, the dashboards must enable centralized compliance and present a single view of how processes and systems are aligned to the requirements of MiFID II. They should also enable compliance to effectively look at results of the risk assessment on a periodic basis.
- To build a compliance culture and to reduce risk of noncompliance, firms must build MiFID II-compliant policies and procedures across all business and support functions. Care must be taken to ensure that these policies and procedures are connected, updated, and approved by the compliance function, on a quarterly basis. These policies and procedures must be automated, and available online with dynamic change management options available. These must be closely connected to the departmental KPIs that track compliance.
- An effective e-learning mechanism must also be put in place (aligned to policies and procedures) to ensure that employees are up-to-date on tasks and are aware of the impact of MiFID II on their function. Optimum focus must be on sales, product management, operations, and risk management.

Conclusion

As we near MiFID II timelines, regulators will need the management body and compliance department to understand regulations, get it to percolate to the bottom of the organization, and own their implementation at all levels.

Regulators will closely look at corporate governance requirements and would look up to the senior management and compliance to implement them in full spirit and maintain them on an ongoing basis.

Some of these requirements are already in place as per rules from ESMA and MiFID I. But MiFID II will expand these and demand a holistic firm-wide adherence of these.

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