MiFID II – Conduct and PRIIPS - FAQs

For Adviser and Discretionary Investment Manager use only

This document covers certain areas where we have developed solutions to help advisers and discretionary investment managers (DIMs) to meet their regulatory obligations under PRIIPs and MiFID II as follows:

Please note our MiFID II Transaction Reporting materials can be found here.

1. Product Governance

Question 1.1: What roles do different firms play in the distribution chain?

Investment product providers (e.g. fund managers) who create, develop, issue or design investment products are considered to be manufacturers, under MiFID II. Platforms advisers and DIMs all form part of the distribution chain for investment products.

Under FCA rules (PROD 3.3.32R) most PRIIPs and MiFID II regulatory obligations fall on the last firm in the distribution chain or 'final' distributor who deals directly with the retail client. You, as the advice firm, are the final distributor in the chain when the purchase of an investment is the result of a personal recommendation, or when you are passing on instructions from the client.

Transact, as the platform, is only the final distributor when a client is providing the investment instruction directly to us. In all other in circumstances, Transact acts as an intermediate distributor with obligations to ensure relevant investment product information is passed to the final distributor in the chain and to enable the investment product provider to receive information on investment product sales from final distributors.

Question 1.2: How are target markets defined under product governance rules and who sets the distribution strategy?

Defining a target market for an investment product is a key obligation for investment product providers and final distributors (you). A target market specifies groups of clients with common characteristics or needs which the investment product is designed to meet, therefore, it differs substantially from assessing suitability, for specific individual clients. Where relevant, investment product providers should describe not only the characteristics, needs and investment objectives of the types of clients that the investment product is likely to be compatible with, but also state the characteristics, needs and investment objectives of the types of clients that the investment product will **not** be compatible with. This is referred to as the 'negative target market'.

The ESMA guidelines on MiFID II product governance set out minimum target market criteria that need to be taken into account when establishing a target market as follows:

- Client type
- Knowledge and experience
- Financial situation with a focus on the ability to bear losses
- Risk tolerance
- Clients' objectives and needs.

As well as setting a target market, investment product providers also need to establish and specify a distribution strategy which details how the investment product could be sold. Industry has adopted the European MiFID Template or EMT as a means of communicating investment product information such as target market and distribution strategy. Once defined, the target market and distribution strategy must be reviewed regularly and when there is a significant change in the risk or return profile of the investment product.

Question 1.3: How will target market and distribution strategy information be displayed?

We display the target market, distribution strategy and other relevant information on Transact Online. For collective investments such as OEICs, unit trusts, exchange traded funds (ETFs) and investment trusts, the investment product provider defines a target market and distribution strategy. This information is in the Morningstar fund factsheets which you can access by clicking on the relevant icon in our investment funds list on Transact Online. You can also download the information as a data format for multiple OEICs, unit trusts and structured products, with other asset types, such as ETFs, to be included in the first half of 2019.

Factsheets are not available for structured products and some venture capital trusts (VCTs), however, some information is available on our microsite. We have included links to the investment product providers' websites where you should find product literature, including information on target market, costs and charges, risks and key features. We have produced our own Fact Sheet - Non-Collectives Target Market (M158) to provide generic target market details for other investments by investment type which do not typically have an investment product provider to publish a target market. Examples include shares, bonds and gilts.

Further information on the investment risk associated with different investment product types can be found in the revised Transact Guide to Investment Risks (M055) on Transact Online.

Question 1.4 – How does Transact use the target market and distribution strategy provided by the investment product provider?

When dealing with clients directly, we will not adopt a target market or distribution strategy with a wider scope than that stated by the investment product provider. However, any restrictions will be based on the limited information we are expected to know as a firm operating on an execution only basis, namely client type and distribution strategy. For example, we categorise all clients as retail and, therefore, prevent clients from directly accessing any products targeted solely at professional clients, or where the investment product provider’s distribution strategy indicates the investment product is only compatible with advised distribution. Fact Sheets are available to clients, so they can assess whether an investment product is compatible with their characteristics, needs and investment objectives by reference to the target market criteria and other relevant information contained in the Fact Sheet.

You will not typically be prevented from instructing purchases on behalf of your clients on the basis of the investment product provider’s target market or distribution strategy, provided there is no other information which makes the investment product incompatible with distribution via the platform. One exception is if the investment product provider indicates a product is not compatible with distribution to retail clients, even with advice.

Question 1.5: What happens if there is no target market information available from an investment product provider?

Clients and advisers will not typically be able to instruct the purchase of a collective investment where there is no target market (and costs and charges information) information provided by the investment product provider.

Question 1.6: What are you doing to help advisers meet their information sharing obligation to provide investment product providers with information on sales of their products?

Product Governance requirements under MiFID II require distributors (like you) to send aggregated sales information to investment product providers (e.g. fund managers), to enable them to review their target market and distribution strategy. We send sales information to investment product providers for all purchases made through the platform with a view to helping you meet your obligation to provide such information to them. This is currently when requested by the investment product provider, although it may be pushed to providers automatically in future. The sales information identifies you as the final distributor, along with other information such as whether the client is retail or professional. In most instances, this information should be sufficient, although the investment product provider may follow up with you as the final distributor, either through Transact or directly, where there is an indication of unexpected or unusual sales, for example, sales into an investment product’s negative target market.

Please notify us if you have categorised any of your clients as Professionals, so we can include this in the Sales MI when you are providing the instruction. This information will only be used to enrich the sales information we send to investment product providers.

For sales information, we make the assumption that any advised sale of an investment product to a client outside the target market will be for diversification or hedging reasons and that you have assessed the portfolio, as a whole, to be suitable for the client. You should inform us and the investment product provider where this is not the case, particularly where the client corresponds with the negative target market criteria. Please use secure e-mail via Transact Online with a title of 'target market'.

You should continue to pass on client complaints about the performance of an investment product to the investment product provider, although please alert us where this includes suspicions of fraudulent activity.

2. Costs and Charges Disclosure

Question 2.1: How will the cost breakdown be produced and how often will it be made available to advisers?

MiFID II creates an obligation for firms recommending or marketing products and investments which are subject to MiFID II, to disclose costs and charges related to those investment products and associated investment services to clients on both a pre-sale (ex ante) and post-sale (ex post) basis. The costs and charges to be disclosed include those charged by firms and third parties, where linked to the investment service, or where the client has been directed to them. It also specifies that advisers or firms acting as the final distributor in the chain need to provide the pre-sale costs and charges disclosure in good time before the purchase of an investment product.

To help you meet your pre-sale costs and charges disclosure obligations we have made changes to our Transact Personalised Illustrations so that costs and charges are aggregated and expressed both as a cash amount and a percentage. The Transact Personalised Illustration is an online tool available 24/7 for all wrappers, covers a wide range of transactions and allows you to include any investments or investment products currently held.

The post-sale disclosure, which must be personalised to each client and reflect the actual costs and charges incurred by the client, will be disclosed as part of our client Annual Statements. We will include statements covering two periods. The 12 months from January to December 2018, as required by the regulation and then the 3 month period 1 January 2019 to 5 April 2019.

Question 2.2: Which charges will be included in illustrations used for pre-sale disclosure?

The Transact Personalised Illustrations tool separates service charges and investment charges. These charges include (where applicable): adviser charges, platform charges, investment manager charges, brokerage, stamp and investment charges.

The charges are grouped as follows:

Service Charges

Adviser Charges	Initial/Portfolio Establishment Fee Annual payment Additional payment (one-off)
Transact Charges	Buy charges i.e. Buy commission Annual payment i.e. Annual commission Administration Wrapper Charge
Investment Manager Charges	Annual payment Additional payment (one-off)
3rd Party Charges	Stamp Duty Brokerage

Note: the percentage amounts displayed in the service charges section will now be effective rates specific to the client.

Investment Charges

This section displays percentage amounts for: initial charges, ongoing charges, transactional costs, incidental costs and exit costs. These percentages are used to calculate a total percentage and monetary amount per investment or investment product.

Note: Exit costs are disclosed but are not included in projection calculations. Where information is not provided by the investment product provider we have provided reasonable estimates.

Listed securities, investment trusts and exchange traded funds have Transact dealing charges applied.

Total wrapper costs and charges for years one and two are disclosed both as a percentage and as a monetary amount.

Our illustration system uses negative as well as positive values. The oddity of a negative transaction cost can sometimes occur because MiFID II requires delays in trading the underlying investments within a fund to be treated as a cost It also allows investment product providers to offset costs with the effect of swing pricing, which occurs when fund provider adjusts the net asset value (NAV) of a fund in order to pass on the costs of trading to those that are buying and selling within their accounts. Overall transaction cost estimates for the fund will be negative if the gains resulting from these trading delays and swing pricing are greater than all the other transaction costs incurred. Personal illustrations affected therefore include the following words by way of our best attempt at a concise explanation: 'Your illustration includes a negative transactional cost for one or more of your chosen investments. This has arisen because of the calculation methodology specified by regulators.'

Question 2.3 What do the investment charge terms relate to?

Initial charges. These are entry costs charged by the investment product provider for investing in the product expressed as a % of net asset value (NAV).

All of the following are provided as an annualised % of NAV and are mutually exclusive (i.e. there is no overlap for any given product).

Ongoing charges. These are the actual ongoing charges and include the annual management charge. These should align closely to the OCF in product literature and the ongoing charges calculated for the UCITs KIID.

Transactional costs. These are costs associated with carrying out transactions and are deducted from NAV by the fund manager. These are typically based on the average of those incurred over the last 3-5 years, although some adjustments can be made where the investments held are large illiquid assets such as commercial property. In the past, these were not typically included in the investment product provider's product literature, nor included in the OCF.

There are two types:

Explicit costs. These are charged to and paid for the product and should be easily identifiable. These include broker commissions, transaction taxes and fees.

Implicit costs. These are not costs charged to the product, but are an estimate of the difference between the mid-market price of an asset before an order is placed and the price obtained. This is quite contentious because it specifies market risk as a cost and can be negative as well as positive. It is dependent on factors such as the liquidity of the assets and the investment strategy deployed by the investment product provider. Implicit transactional costs can cover:

1. Costs embedded in the bid-offer spread.
2. Market impact of executing a large order in one go, which can move the market and lead to a lower price to be obtained than expected.
3. Opportunity cost if a trade is partially executed, it could lead to missing an opportunity to participate in favourable market opportunities.
4. Price difference from the initiation of an order to the point the order is executed on the market.
5. Effect of any swing pricing which can be used to offset other transactional costs.

The calculations are often based on historical data which is not captured for the purpose of calculating implicit transactional costs. In certain scenarios the investment product providers are allowed, for a limited period, to deviate from the 'arrival price methodology' specified by the regulation. All of which can put question marks around the accuracy, consistency and usefulness of the some of the estimates provided, although it is hoped there will be improvements over time.

Incidental costs. These are typically performance fees and carried interests, dependent on the future performance of the product. Of course this is unknown, therefore, product investment product providers provide an estimate to use in ex ante disclosures, expressed as a % of NAV and based on past performance, average performance fees levied over the last 3-5 years and anticipated growth.

Question 2.4 Will the pre-sale and post-sale costs and charges disclosures differ?

The client Annual Statements provided post sale will aggregate and disclose the actual costs and charges incurred by the client, whereas the pre-sale disclosure through the Transact Personalised Illustrations is, of necessity, an estimate. We anticipate that the client Annual Statement will include incidental and exit costs.

3. Best Execution

Question 3.1: How will Transact demonstrate Best Execution?

The requirements set out a series of factors that we must take into account to demonstrate that sufficient steps have been taken to obtain best execution for clients.

Under MiFID II we provide details regarding execution venues and quality via an annual Best Execution report. Our first report was hosted on our website on 30 April 2018 and will be updated annually thereafter. The report covers the top five execution venues in terms of trading volumes where we executed client orders in the preceding year and provide information on the quality of execution obtained.

To ensure we can provide all the information we need to, we have redesigned the contract notes we send to clients.

4. Periodic Reporting

Question 4.1: What is Transact doing to satisfy its obligation to send quarterly client statements including valuation information?

New quarterly client statements are produced showing Portfolio Valuations as at the end of June, September and December and provided to clients in addition to the client Annual Statement. We make these available in the normal way on Transact Online and on paper for those clients who have chosen to receive communications by post.

Question 4.2: Will Transact help DIM firms carrying out portfolio management with their periodic reporting obligations?

To assist DIMs with their quarterly reporting obligations to clients with managed portfolios, we now provide quarterly management statements showing the portfolio performance and management activities undertaken for each client Portfolio for the three month periods up to the end of March, June, September and December. When using the term DIM in this section, we are referring to both third party discretionary investment managers and to advisers with permission to manage investments.

Question 4.3: What is Transact doing to satisfy the requirement for DIM firms carrying out portfolio management to inform a client within 24 hours where they experience a depreciation of 10%?

We send an alert to DIMs where the value of a client's Portfolio falls below 10% (or multiples of 10%) of its starting value as at the beginning of the relevant quarter. In the case of DIMs, an alert is also be sent to the linked adviser providing the opportunity to liaise with the DIM and the affected client.

More information is available in the guide MiFID II – 10% Reporting Obligation (M162).

5. Packaged Retail Investment and Insurance-Based Products (PRIIPs)

Question 5.1: What are the PRIIPS requirements?

The PRIIPs regulation now makes it a requirement for advisers advising on, or selling, investment products which are PRIIPs to provide a Key Information Document (KID) to retail clients prior to purchase of a PRIIP. The KID is fundamental to the EU's consumer protection agenda, intended to improve the ability of retail clients to understand and compare investment products across sectors.

> A PRIIP is defined as: an investment where, regardless of its legal form, the amount repayable to the retail investor is subject to fluctuations because of exposure to reference values or to the performance of one or more assets that are not directly purchased by the retail investor; or an insurance-based investment product which offers a maturity or surrender value that is wholly or partially exposed, directly or indirectly, to market fluctuations.
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> Hence the term 'PRIIP' covers a range of products including investment funds, life insurance policies with an investment element, structured products and structured deposits.

The PRIIPs regulation dictates the form and content of the KID with the aim of making such documents easily comparable across products. KIDs are no longer than three sides of A4-sized paper and include information such as the risk-reward profile and the total aggregate costs. It also specifies that advisers need to provide the KID in good time before the purchase of a PRIIP

UCITS funds are also PRIIPs. However there is a transitional period allowing UCITS managers to continue to use the UCITS Key Investor Information Document (KIID) in place of the PRIIPs KID until 2019. The FCA is extending this for Non-UCITs Retail Schemes by allowing NURS Key Investor Information Document (KIID). It is anticipated that at that point UCITS and NURS managers will switch over from KIID documents to PRIIPs KIDs. However, there is a possibility that the transitional period could be extended or that UCITS KIIDs may be deemed to be equivalent to PRIIPs KIDs.

Question 5.2: What is Transact doing to satisfy the PRIIPs requirements?

To comply with the PRIIPs regulation, we are publishing a generic high level KID for each of our Onshore and Offshore Bonds which will fall under the definition of a PRIIP.

PRIIPs investment product providers have been required to publish up to date KIDs/KIIDs on their websites since the beginning of January 2018; however availability of some KIDs/KIIDs was sporadic and many of those available earlier in the year have already been updated. As a result the number of KIDs/KIIDs and revised KIDs/KIIDs available via the buy pages on TOL has increased considerably since then.

Our current data feed with Morningstar makes PRIIPs KIDs and KIIDs available, where required, for other third party investment products available on Transact Online. Some PRIIP product providers have not provided a PRIIPS Key Information Document (KID) or UCITS or NURS Key Investor Information Document (KIID).

Following recent additional guidance from the FCA that PRIIPs (including UCITS and NURS funds) purchases should not be permitted, unless the wrapper provider can make a KID/KIID available even in the case of advised sales. We have concluded that it is prudent to block, with immediate effect, purchases (including regular or phased purchases) of PRIIPs for which there is no realistic prospect of sourcing a KID/KIID.

Question 5.3 How have the total costs and reductions in yield been calculated?

The total cost and reduction in yield figures have been calculated based on the projection method set by the European Insurance and Occupational Pensions Authority and uses the historical returns of assets which were available to purchase on the platform on 31 August 2018. As projections are based on historical data there is a large range of costs.

The total costs are based only on the projected growth of the underlying assets. Assets with the highest projected growth produce the higher total costs due to the increase in value of the investment holdings. The highest and lowest costs do not relate to the most common assets held in the Onshore and Offshore Bonds.

The reduction in yield is calculated using the internal rate of return which takes into account the timing of cash flows. In the first year, entry costs are a larger proportion of the investment holding which causes a higher reduction in yield.

The highest and lowest reductions in yields may be for different assets that produce the highest and lowest total costs. Therefore, the assets with the highest costs may not have the highest reductions in yield.

The regulations specify that the calculations should be based on an investment amount of £10,000, to make comparisons easier, and allow fixed fees (such as the quarterly wrapper fee) to be scaled back. For example, with our Offshore Bond, we use a platform quarterly wrapper fee of £30, rather than £60, as the minimum investment we allow is £20,000.

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