OUR APPROACH TO THE REQUIREMENTS OF MiFID II

BACKGROUND

THE MARKETS IN FINANCIAL INSTRUMENTS DIRECTIVE CAME INTO FORCE IN NOVEMBER 2007, AND WAS THE CORNERSTONE OF EU REGULATION IN FINANCIAL MARKETS. THE DIRECTIVE WAS REVIEWED AND REVISED IN RESPONSE TO THE FINANCIAL CRISIS, TO IMPROVE INVESTOR PROTECTION AND MARKET TRANSPARENCY, LEADING TO THE PUBLICATION OF A NEW DIRECTIVE AS WELL AS THE MARKETS IN FINANCIAL INSTRUMENTS REGULATION (MiFIR). THESE ARE OFTEN COLLECTIVELY REFERRED TO AS 'MiFID II', AND WE WILL REFER TO THEM THIS WAY THROUGHOUT THIS DOCUMENT. THE FINANCIAL CONDUCT AUTHORITY (FCA) HAS DECIDED TO EXTEND CERTAIN ELEMENTS OF THE MiFID II DIRECTIVE TO NON-MiFID BUSINESS.

The aims of MiFID II can be summarised as being:

- to promote the integration, competitiveness and efficiency of EU financial markets
- to improve market transparency requirements for a broader range of asset classes; including the obligation to trade derivatives on-exchange
- to strengthen protection for retail investors through:
  - limits on the use of commissions
  - conditions for the provision of independent investment advice
  - stricter organisational requirements for product design and distribution
  - greater product intervention powers
  - enhanced disclosure of costs and charges.

SCOPE

MiFID II applies to banks, investment firms and financial intermediaries carrying on MiFID investment activities, but generally excludes insurance firms (when carrying out insurance activities) and the operators of collective investment schemes. It applies to MiFID financial instruments, which includes units or shares in collective investment schemes, equities, debt securities (e.g. gilts, corporate bonds, etc.) and derivative contracts, but excludes insurance-based investment contracts (such as life bonds, endowments and pension policies).

MiFID II will come into force on 3rd January 2018.

SCOTTISH WIDOWS

IMPACT ON SCOTTISH WIDOWS

There is limited impact on Scottish Widows Group, including our life, pensions and investment businesses. However, other financial companies which Scottish Widows outsources to, or has interactions with, such as asset managers, financial advisers and platforms, will be impacted to a much greater extent.

Specifically, Scottish Widows Limited is generally exempt from MiFID II under Article 2(1)(a) of the new Directive, while Scottish Widows Unit Trust Managers (SWUTM) and HBOS Investment Fund Managers Limited (HIFML) are generally exempt under Article 2(1)(i). However, the FCA has applied some MiFID II requirements to non-MiFID businesses. This is sometimes referred to as "gold-plating", and has primarily been done where the FCA believe there are consumer and/or regulatory benefits from parity with the MiFID II requirements.

Impacted areas can be summarised as follows:

- **Best Execution:** the FCA has extended new MiFID II best execution requirements to UCITS management companies (i.e. managers or operators of collective investment schemes which satisfy the requirements of the Undertakings for Collective Investment in Transferable Securities (UCITS) Directive). SWUTM and HIFML both operate UCITS schemes, and so are impacted by these rules.

  In practice, however, as neither SWUTM or HIFML execute orders on underlying securities etc., it is the asset managers managing our investment funds who will need to deliver compliance with most of the new rules, including the creation of new reports on the top 5 trading venues or investment firms used (as per Regulatory Technical Standard 28).
- **Investment Research:** the FCA has extended the MiFID II inducement rules on the provision, receipt and payment of investment research to managers and operators of collective investment schemes. Neither SWUTM nor HIFML accepts such research, and therefore we do not expect to have to make any changes.
- **Appropriateness:** guidance from the European Securities & Markets Authority (ESMA) in relation to the MiFID appropriateness rules (for the non-advised sale of 'complex' investments) suggests we might need to carry out appropriateness tests for our non-UCITS retail schemes (NURSs). The FCA has, however, retained its view that NURS funds are neither automatically complex nor automatically non-complex. Instead, firms must determine complexity based on the nature of a fund, its investment strategy and the underlying asset types. SWUTM and HIFML have completed an assessment of their NURS fund ranges against the criteria set out in the MiFID II Delegated Regulation, with a small number of the funds subsequently being categorised as complex. However, we plan to prevent these funds from being made available to retail customers on a non-advised basis, rather than introducing an appropriateness test.
- **Disclosure requirements:** MiFID II will require more extensive disclosure of costs and charges, and in particular disclosure of transaction costs and charges for our UCITS and NURS funds. These costs and charges are not currently included in Key Investor Information Documents (KIIDs), and will instead be made available separately to the fund KIIDs.

FREQUENTLY ASKED QUESTIONS

Q What Scottish Widows products and funds are impacted?

A Units or shares in the SWUTM and HIFML-operated collective investment schemes are MiFID financial instruments, and so certain activities undertaken in respect of these units or shares are impacted by the new rules. This includes advising on and/or arranging transactions in the units or shares. Operating the collective investment schemes is not in itself a MiFID investment activity.

Contracts of insurance are not MiFID financial instruments, and carrying on insurance business is not a MiFID investment activity. As such, our insurance business is generally exempt from MiFID II. This includes our Retirement Account, Group and Individual Personal Pensions, Investment Bonds and Endowment products, as well as our pure protection and general insurance business.

It is worth noting that, as a personal pension with a broad set of investment options, Retirement Account competes with other self-invested personal pension (SIPP) products which can involve carrying on MiFID investment activities. If you have any queries around this, you can contact us using the information at the end of this document.

Q What is an LEI, and do we need to provide it?

A A Legal Entity Identifier (LEI) is a unique identifier for legal persons, including companies, charities and trusts. New MiFID II rules will prevent firms from executing trades for legal entities which do not have an LEI.

In respect of the trading activity that takes place under Scottish Widows Insurance business, Scottish Widows do not require customer or scheme LEI details. It is Scottish Widows, not the customer, who is ultimately buying, selling or holding assets, and so trades should be reported under the Scottish Widows Limited LEI.

Please note that you may require an LEI for other purposes and when dealing with other companies, please consult the FCA website for further guidance.

If you need to know the LEI for any of our companies, please use:
www.gleif.org/en/lei/search/

Q Will Scottish Widows provide target market data, as defined in the European MiFID Template (EMT)?

A Yes, EMT templates will be made available, including information which is already available on the existing KIIDs.

When a new fund is launched, the relevant EMT data will be captured prior to launch.

Q How will Scottish Widows help intermediaries and other third parties comply with the new costs and charges disclosure requirements?

A Alongside the KIIDs we currently produce for our collective investment schemes, we will make available a cost and charges sheet. This will include transaction costs data not currently disclosed to customers. The costs will be calculated by our external Fund Managers and our Fund Accountant, and will be updated at least annually.

Q What are the obligations for Portfolio Management?

A Scottish Widows does not carry out portfolio management ('managing investments') for our customers. However, Retirement Account customers can access discretionary management services via their policy, while portfolio managers can use certain Scottish Widows products.

In particular, MiFID II introduces a new requirement for portfolio managers to immediately inform customers if the value of the customer's portfolio falls by 10% or more. While Scottish Widows will not be required to make such a disclosure, we will provide relevant information to help support portfolio managers to identify significant falls in investment values.

Q What MI is required from Intermediaries and Platforms to fulfil product governance obligations?

A Scottish Widows will expect to receive sales data, at share class level, for each of our collective investment schemes.

Q What are the similarities (and the differences) between MiFID II & PRIIPs?

A MiFID II is far wider ranging than the Packaged Retail and Insurance-Based Investment Products (PRIIPs) regulation, which focusses particularly on pre-sale disclosure and introduces a new document: the Key Information Document (KID).

The PRIIPs KID will include transaction costs. Until 31st December 2019, UCITS and NURS schemes will be outside the scope of the PRIIPs regulation, and instead customers will continue to receive a UCITS Key Investor Information Documents (KIID) for these products. UCITS KIIDs do NOT include transaction costs.

As MiFID II requires transaction costs to be disclosed, these will be made available separately for UCITS and NURS customers, and their advisers. These costs will be calculated using the same methodology agreed for PRIIPs, although for MiFID II ex ante disclosure, the PRIIPs 'simplified' methodology can be used.

Q Will contractual changes be required to our existing Fund Partner Agreements and / or Service Level Agreements (SLAs)?

A All such agreements are currently being reviewed by our Legal department. It is broadly expected that all existing agreements will cover the regulatory changes.

If you have any questions on this document or MiFID II please send them to:
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