

THE FLAG OF INDEPENDENCE

For many financial advisers, the prospect of MiFID II and its impact on their firm is probably towards the back of their minds particularly as many were originally not affected by the original MiFID I back in 2007. They were either fully exempted from its provisions or only subjected to a limited element of the full directive. However, MiFID II the sequel will have an impact.

The concept of independence is being widened to include a broader range of products and certainly within the UK this clearly means that some products outside of the retail investment product definition will have independence requirements on implementation of MiFID II. This imposes new requirements on those firms dealing with such instruments and indeed those execution only services which may also be affected, particularly if they wish to hold themselves out as remaining independent.

The new directive also makes it very clear that firms who advise on the product will also be expected to have an appropriate organisational arrangements that specifically address the issue of product governance. Whilst there has always been a requirement to understand the products under advice, this is now required to be more organised and formal and increasing expectations on existing systems and controls.

In order to maintain independence, the new regulation requires those firms offering independent advice to assess a sufficient range of different product

providers prior to making a personal recommendation.

It seems clear from the guidance given by ESMA that independent advisers should consider a range of financial instruments proportionate to the scope of advice and adequately representative of the products available on the market. It is this definition that may give financial advisers in the UK their best idea as to whether it is practicable to consider all types of products that may be suitable for their client's needs. The key issue here is the practicality of these advisory firms being able to research the wide range of products available, which will be very challenging from a research and capacity perspective.

In addition is the conundrum of what constitutes a complex product. Whilst the final definitions have yet to be announced it would appear that a large number of the current products advised on a UK financial services firms will fall into the complex category. The definition of this European independent standard for advice includes shares, bonds and derivatives products that currently sit outside of the FCA's definition. Irrespective of whether every product is analysed, the advice is to consider a very wide spectrum of products which could lead into uncharted waters of product technical knowledge and the need for further research tools not usually utilised. One question is how will MiFID II better protect investors? MiFID includes a number of measures aimed at protecting



investors in the context of the provision of investment services. Those rules take into account the type of services (for instance, investment advice or execution of orders) and the classification of clients, with higher protection granted to retail clients. The rules include both conduct of business requirements (for instance, collecting sufficient information to ensure that the products provided are suitable or appropriate for the client) and organisational requirements (for instance, requirements to identify and manage any conflicts of interest). However, modifications and improvements are introduced to strengthen the framework for the provision of services.

Firstly, the scope of the Directive is broadened in order to cover financial products outside the scope of MiFID I but which satisfy similar investor needs and raise comparable investor protection challenges. In the future, the sale of structured deposits will have to comply with several MiFID II requirements, and in particular with conduct of business and conflicts of interest rules. MiFID II will also extend some of the information to clients and conflict of interest requirements to insurance-based investment products by amending the Insurance Mediation Directive 2002/92/EC.

Secondly, conduct of business requirements are modified in order to grant additional protection to investors. The rules for investment advice are improved both when advice is provided on an independent basis and in the long term. Advisers declaring themselves as independent will need to match the client's profile and interests against a broad array of products available in the market and say whether they will provide

the client with a periodic assessment of the suitability of advised products. Independent investment advisers and portfolio managers will be required to transfer all fees, commissions or any monetary benefits paid or provided by a third party to the client who should be accurately informed about all such commissions. The conditions for services where investors receive less protection from firms are more limited. In particular, the Directive clarifies the conditions and situations in which investors are able to transact freely in certain non-complex instruments with minimal protection afforded by investment firms.

Finally, organisational requirements for the provision of services to investors are strengthened. For instance, the involvement of senior management in the design of the firm's policies as to how products and services may be sold or provided to their clients and the adoption of adequate internal controls is consolidated. In addition, MiFID II introduces harmonised powers and conditions for national competent authorities, the European Securities and Markets Authority (ESMA) and the European Banking Authority (EBA) to prohibit or restrict the marketing and distribution of certain financial instruments and structured deposits, financial activities or practices in case of threats to investor protection, financial stability or the orderly functioning of markets.

The real point of interest will be in seeing the eventual benefit to the retail consumer.

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