MiFID II

New investment protection regime: investment advice

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MiFID II planning and implementation is a top priority for asset managers affected by European regulations and brings with it both challenges and opportunities.

The changes brought about by MiFID II in relation to investment advice will affect the way in which managers distribute their products, as the legislation is expanded and introduces the concept of the provision of investment advice on an independent basis plus a number of additional restrictions.

The new investor protection regime could affect whether you are able to accept payment/ benefit from third product providers for advised sales, instead charging clients directly. It could also lead to a reduction in the type of financial products and the firms providing those products in the market where firms are unable to easily prove they are providing independent advice.

The Council of the European Union on 13 May 2014 formally endorsed a new regulatory regime that will replace the current Markets in Financial Instruments Directive (MiFID), which has been in force since 2007. The new legislation, in the form of a recast Directive (MiFID II) and Regulation (MiFIR), is scheduled to go in effect on 3 January 2018.

Investment advice: what's new under MiFID II?

Although the definition of investment advice under MiFID has not changed, i.e. offering or recommending investment products or services to clients on a personalized basis, MiFID II introduces a further concept of the provision of investment advice on an independent basis and this will impact the way in which managers distribute their products going forwards.

The MiFID obligation on firms to provide clients with appropriate information on financial instruments and investment strategies is expanded in a number of respects under MiFID II. A firm providing an advisory service must tell its clients:

- The nature and type of advice it will provide.
- Whether or not its advice will be "independent".
- How broad or restricted the range of that advice will be.
- Whether the service will include a periodic assessment and if so details of how this will be conducted.

To what type of investors does this apply?

The requirements apply to both retail and professional clients.

What is "independent advice?"

For a firm to provide independent advice, it must define and implement a selection process to assess and compare a sufficient range of financial instruments available on

2007	2011	2014-2015	2016	3 July 2017	3 January 2018
MiFID in force	Proposal for MiFID II	ESMA consults on implementation	MiFID II application delay confirmed	Deadline for incorporation of MiFID II into EU Member State national law	**MiFID II and MiFIR apply**

the market. The selection process should include the following elements:

- The number and variety of financial instruments considered must be proportionate to the scope of investment advice services offered by the independent adviser.
- The number and variety of financial instruments considered must be adequately representative of financial instruments available on the market.
- The quantity of financial instruments issued by the firm itself or by entities closely linked to the firm itself must be proportionate to the total amount of financial instruments considered.
- The criteria for selecting the various financial instruments should include all relevant aspects such as risks, costs and complexity as well as the characteristics of the investment firm's clients, and should ensure that the selection of the instruments that may be recommended is not biased.

Where such a comparison is not possible due to the business model or the specific scope of the service provided, the firm providing investment advice should not present itself as independent.

For firms providing independent advice, but which focus on certain categories or a specified range of financial instruments, must comply with additional restrictions including: (i) marketing in a way that is intended only to attract clients with a preference for those categories or range of financial instruments; (ii) requiring clients to indicate that they are only interested in investing in the specified category or range of financial instruments; and (iii) prior to the provision of the service, ensuring that the service is appropriate for each new client on the basis that its business model matches the client's needs and objectives, and that the range of financial instruments that are suitable for the client. Where this is not the case the firm should not provide a service to that client.

What are the implications of providing independent or non-independent advice?

An independent adviser will not be allowed to accept any payment or benefit from third party product providers for advised sales (unless it passes these on directly to the client) and must charge its fees to the client directly.

In contrast, third party inducements may still be paid where products are distributed by a tied sales force or where the range of products advised on is insufficient to qualify as independent.

What if both independent and non-independent advice is provided?

Where advice is offered or provided to the same client on both an independent and non-independent basis, investment firms should explain the scope of both services to allow investors to understand the differences between them and not present itself as an independent adviser for the overall activity. Firms should not give undue prominence to their independent investment advice services over non-independent investment services in their communications with clients.

Impact on distribution

ESMA has confirmed in its technical advice that the provision of a recommendation through a distribution channel to a wide group does not necessarily indicate that the recommendation is not a personal recommendation. Therefore, a firm may need to review its use of distribution channels, e.g. restricted access websites, as these may be seen as providing a personal recommendation. ESMA has noted that it may develop further guidelines as part of its work on Level 3.

If a firm cannot easily prove that it is providing independent advice, it may decide that it is easier to provide non-independent advice. This could lead to a reduction in the types of financial products and the firms providing those products in the market.

The ability for investors to self-advise and subscribe for products on an execution only basis will be limited to non-complex products. To invest in complex products (which include products containing embedded derivatives and structured UCITS products which by virtue of being a UCITS are targeted towards retail investors) retail clients must seek investment advice and pay the associated costs in doing so.

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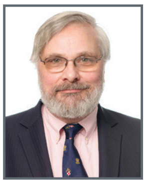

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