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AVOCATS

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Transparency for Investors

Me Christophe Wilhelm attended in Brussels on October 20, 2015 the MiFID II workshop organized by Markus Ferber of the ECON Committee of the European Parliament. This workshop is intended to give an in-depth insight into the regulatory goals of MiFID II and the implementation of those goals into practice. On October 20, 2015, the Workshop was organized to address the issues of **Transparency for Investors**.

This topic is about what are the information that have to be provided by the financial institutions to their clients.

In a nutshell, according to Mr Ferber, the actual asymmetry between a very knowledgeable financial institution, on one hand, and the not so well informed clients, on the other hand, has to be broken.

1) Information to Clients:

What are the general principles guiding investment firms when it comes to providing information to clients? As a principle, the information must be (1) "fair", (2) "clear" and (3) "not misleading".

But what does it mean? "Fair" means "true". The information must be real. "Clear" means "correct", i.e. solely related to facts. "Not misleading" means that the information must not be too much influenced by a human intervention.

The information must be clear on "all relevant risk". By "relevant risk", it means that the information provided must be adequate to address the potential risk. Therefore the information must not be oriented to "self-protect" the financial institution. A self-protected information does not break the above mentioned asymmetry of information. It does not help. "Clear" means also that the information needs to be easily understandable by the client. It also means that the information must be up to date and complete.

This means that the effects of cost and charges have to be clearly explained.

It has to be well kept in mind that this level of information is going both in the direction of protecting the interests of the clients but also in the direction of the protection of the financial institution as well.

2) Inducements and the Question of Independent Advice:

The notion of independence relates on (1) avoiding a conflict of interest and on (2) properly disclosing inducements.

One element to measure the level of independency is to oblige clients to pay fees for investment advices even though it does not result in an investment. Mr Ferber tends to say that non-independent advices are often free.

However, it does not mean that non-independent advices cannot be provided anymore under the regulation of MiFID II but such advices have to be presented as non-independent because, for example, induced by a third party. Banning inducement is therefore not mandatory and is not the outcome of the new MiFID II regulations. MiFID II is therefore preserving the options between independent or non-independent advices.

However inducements are allowed only if they are brought to enhance the quality of the investment advices provided. Of course, the client has to be informed in advance. The same financial institutions can therefore provide independent and non-independent advices but it should be disclosed to the client in advance. For example, during the same meeting the advisor cannot appear as independent and induced.

The clear cut must be announced and disclosed to the client.

The Quality enhancement test. This is needed to allow non-independent advices. In the early draft of the MiFID II, this test is not defined. Actually, this issue is still relatively unclear, reports Mr Ferber. Examples are provided, such as (i) the large number of financial instruments presented to the client, (ii) providing new electronic or digital financial tools giving access to a large number of financial investments.

MiFID II does not make a distinction between the frequency of the inducement, for example between frequent and regular inducements and rarer inducements.

Negative example are also provided in the draft of MiFID II. According to Mr Ferber the Quality Enhancement Test has to be made more clear by the ESMA (the European Securities and Markets Authority) of the European Commission.

This is also the case of “minor non-monetary benefits”. According to Mr Ferber these “minor non-monetary benefits” should be covered by the same rules on inducements and should not form a special category.

Coming back to the notion of independent advice, Mr Ferber is outlining that the MiFID II regulations won’t provide clear and precise test on what basis is an advice supposed to be independent. MiFID II regulations won’t provide how many financial instruments a particular financial institution should grant access to its clients.

As a matter of fact, financial institutions should enact and implement a proper policy on inducements and independent advices. This policy should address the criteria of the information reported to the client on inducements.

Inducements in relation on Equity Research is another big issue. Mr Ferber confirms that there is no ban on such inducement under MiFID II. However, a rule should address this issue as Equity Research is more and more often used as a form of inducement. Research is needed, but the cost of it must be valuable, i.e. useful for the client to be charged to him. According to Mr. Ferber, Equity Resarch will be considered as an inducement unless it is provided by an independent entity and charged to the financial institution and reported as a cost to the client.

3) Information on Costs and Charges:

Under MiFID II, such information should be provided to the client if he so requested. It could be reported on an aggregated way but upon the client’s first request, it should be disclosed in the format of an itemized breakdown in order to allow the client to understand how these costs and charges are structured and organized.

Such an information should be provided on a regular basis during the life of the investment. It should be clear and understandable by a non-professional client.

This kind of information have to be provided regarding (i) investment services and (ii) regarding financial instruments. By investment services, it is meant any services related to the services provided to the client by the financial institution. Of course, as far as cost and charges related to the financial instrument are concerned such information only relates to the cost and charges that the financial institution is aware of, i.e. for example cost and charges reported by the developer of the considered financial product.

Here again a clear and well-defined internal policy should be enacted by the considered financial institution on the level of information about cost and charges to be provided.

A very important issue for MiFID II regulations is to remain in coherence with UCITS and PRiPS regulations. If not, it would create an inextricable situation for the financial institutions. Mr Ferber is outlining in this respect that MiFID II regulations are in advance to PRiPS and should remain as a cornerstone for UCiTS and PRiPS regulations.

As a general conclusion for this session, Mr Ferber outlines that MiFID II regulations do not provide for a ready-made template on how and in what terms the appropriate information should be disclosed but provide guidelines setting forth the key principles regarding this information: fair, clear and not misleading.

The next and last block of the MiFID II workshop organized by Mr Ferber of the WCON Committee of the EU Parliament will take place on November 17 and 18, 2015 and will address the issues of how to determine the “Right Product for the Investor”.
Christophe Wilhelm – October 27th, 2015

Source : https://www.wg-avocats.ch/en/news/company-law/transparency-for-investors/