

Enhanced protection for retail investors: MiFID II and MiFIR

Changes are being made to a key piece of European law whose purpose is to protect you when you buy or invest in financial products. The Markets in Financial Instruments Directive (MiFID) is being updated and strengthened in some important areas and will be known as MiFID II.

MiFID is central to the regulation of financial markets in the European Union. It regulates the provision of investment services in financial instruments (such as shares, bonds, derivatives and various structured products) by banks and investment firms, and the operation of traditional stock exchanges and alternative trading venues. One of its core objectives is to ensure a high degree of **harmonised protection for investors in financial instruments**.

We highlight below some of the more important changes taking place to MiFID which we think are most relevant to you as a retail investor.



investment firms that sell investment funds to you). In

Changes to the payments that firms receive when they are providing you with an investment service: third party payments and benefits (inducements)

These changes will come into effect over the next few years, so you should read these carefully and understand what it means for you. MiFID II limits the receipt of commissions (inducements). It does this by strengthening the current MiFID protections around the types of payments a firm can receive or pay when they provide investment services to you. In some circumstances, MiFID II will introduce a complete ban on some firms receiving a payment or some other form of non-monetary benefit from third parties (such as payments that managers of investment funds make to

the future, any portfolio manager or firm which says they provide you with independent financial advice will no longer be able to accept or retain payments (fees, commissions or any other monetary benefit) or non-monetary benefits that they receive from a third party for a service they carry out on your behalf. Where they receive any payments from third parties in relation to the provision of investment advice or portfolio management to you, they have to pass it on to you.

Under certain conditions, minor non-monetary benefits that enhance the quality of the service provided to you will be allowed as **long as they are clearly disclosed to you.**

If firms are providing investment services to you other than portfolio management or independent advice, these types of payments and non-monetary benefits can continue as long as they:

- are designed to enhance the quality of the relevant service provided to you;
- do not impair the firm's duty to act honestly, fairly and professionally towards you in accordance with your best interests; and
- are disclosed to you.

What does this change to payments that firms receive or pay mean for you?

This important change should give you more confidence that whoever is providing investment services to you acts with your best interests in mind, and are not selling or recommending a product to you just because they are paid commission or any other benefit to do so.

Investment advice

Under the existing MiFID legislation, firms providing investment advice are not required to explain to you the exact nature of their advice services: that is, they are currently not required to tell you whether the advice and products they recommend to you is provided on a broad and independent basis or on a more restricted analysis of what's available on the market. They can also receive a number of monetary and non-monetary payments from other firms.



In the future, the changes to MiFID will mean that firms will have to be very clear to you about:

- whether or not the advice they offer to you is done on independent basis; and
- whether the advice they provide to you is based on a broad or on a more restricted analysis of what financial products are available on the market (this is important because it affects whether and how your investment objectives are met).

The adviser will continue to be obliged to match your personal profile with the characteristics of the product recommended to you (suitability assessment). In addition, in the future your adviser will need to specify how the advice given to you meets your personal characteristics and needs. Your adviser must also tell you whether they will provide you with a periodic assessment of the suitability of the products they recommend to you.

What does the introduction of ‘independent advice’ mean for you?

When a firm says it is providing investment advice on an independent basis, then it will mean that they:

- have assessed a sufficiently diverse range of financial products available on the market - this means that your investment adviser should consider a broad number and type of financial products from a broad number of issuers or suppliers to ensure that your investment objectives can be suitably met, and
- do not accept or retain payments or non-monetary benefits paid from a third party (or a person or firm acting on behalf of a third party) in relation to the provision of the service that is being provided to you (note, however, as mentioned above, that under certain conditions minor non-monetary benefits may be accepted).

Primarily, these changes are designed to ensure that, irrespective of the type of advice that you receive, the products recommended to you should be suitable and meet your needs.

The introduction of independent advice will enable you to decide which type of advice you prefer, and how you want to pay for it. This important change will mean that, when you decide to receive advice on an independent basis, you will pay your adviser for

it directly, and you can be confident that your adviser has considered and assessed a wide range of products from across a range of product suppliers (not just ones with links to the firm providing you with advice).

Stricter controls on the products that reach you: product governance

MIFID II will require firms to have stricter internal or organisational requirements to ensure that firms have explicit arrangements around their product design and distribution. In other words, in the future, firms must have better ‘product governance’.

Product governance arrangements will apply to firms that manufacture products as well as firms that sell financial products. The requirements are designed to ensure that firms understand the nature and risks of the products they are manufacturing and/or selling to you.

Therefore firms will be required to identify the target market for each product and ensure that all relevant risks are assessed and understood before a product is distributed to you. They must also ensure that the product is only distributed to those investors for whom it was actually designed.

What does product governance mean for you?

Product governance is a key improvement in MiFID II for investors and their protection. It will mean that when a firm designs a new product or makes changes to an existing one, they must consider the investor for whom it is meant and that any risks connected with the product are adequate for those types of investor.

These changes should mean that in the future, poor quality products that are primarily aimed at benefiting the firm, rather than you, are less likely to be found in the market place or distributed to you. It should also mean that you will be able to select from a range of financial products which work in your interests and meet your investment requirements.

Safeguarding of client assets

Investment firms must, when holding your assets, have proper controls to safeguard your ownership rights, especially in the event that the firm gets into financial difficulty and/or goes out of business.

The changes that MiFID II introduce will also mean that firms must consider whether your client funds are spread across different banks- so that if one firm in a financial group gets into financial difficulty, the risk to your assets is contained.

What do these new rules on client assets mean for you?

These changes will mean that firms will be prevented from using your product/assets for its own gain or for its own interests and that you will have greater confidence that in the event of a firm failing your assets will be safeguarded.

New powers for regulators to ban products: product intervention

MiFID II provides some important powers to financial regulators in your member state to ban certain products permanently, if they consider these products are not in the interests of investors and provided that a number of legal conditions are fulfilled. Regulators will also be able to limit the marketing of these products to certain investor types only.

Regulators will monitor the kinds of products firms market to certain investors and, where appropriate, will also ban (but on a temporary basis) the marketing and distribution of products that give us cause for concern. These proposals seek to enhance investor protection and to also improve market stability.

What do these new powers to ban products mean for you?

By preventing the supply of certain products or restricting their marketing or distribution to certain investor types, this will help to ensure that products that have the potential to cause significant investor protection detriment are not marketed to you. This should limit the risk that you will be mis-sold a product that does not meet your needs or expectations.

Changes to the type of information firms must supply to you before you invest in a financial instrument or receive investment advice

MiFID II strengthens requirements for investment firms to provide, in good time, appropriate information to you.

- For financial instruments, firms must provide you with appropriate and clear guidance and warnings of the risks associated with these financial instruments and whether the financial instrument is intended for the everyday retail market or for more sophisticated ‘professional’ clients.
- In the future, when firms provide you with investment advice they must inform you whether such advice is based on a wide or narrow range of financial instruments and must let you know whether the range of instruments highlighted to you is issued or provided by other firms with links to the firm offering you this investment advice.

What do these new rules on information provision mean for you?

These changes will mean that you will be better able to assess the investment risks associated with a particular financial product and that firms providing you with investment advice ensure that

they are advising you on products which are more consistent with your investment capabilities and experience.

You should also be more confident that whoever is advising you to invest in financial instruments will have to be clear about whether they are doing so in an independent way or instead are affiliated with a supplier of financial products.



Information on costs and charges

Already, under the existing MiFID, firms must disclose important cost information to you when they provide investment services. MiFID II will introduce some additional disclosures about a firm's costs, mainly:

- All costs and related charges must now include information relating to both investment and other or 'ancillary' services, including the cost of advice and the cost of the financial instrument you invest in. The firm should make clear how you are to pay for these services/products.
- The total figure (aggregated) of all costs and charges must be provided to you. This will enable you to understand the impact of costs and charges on the return on your investment.
- An itemised breakdown of costs should be provided by your investment firm if you request one.

What do these new information disclosures mean for you?

The purpose is to provide you with more comprehensive and detailed information on the costs that firms charge you when they provide investment services, as well as the costs and charges of the financial instruments. This increased transparency should help you to better understand the level, nature and rationale behind both a firm's and a product's

charges. This type of enhanced cost disclosure will also help you to determine how much a firm charges relative to your investment returns.

Greater price transparency

The requirements to ensure prices are clear before and after trading on an exchange or other type of trading platform, will now apply to a wider set of financial instruments than just shares. For instance, firms will have to be clear about prices offered to buy or sell bonds, depositary receipts, exchange traded funds, structured finance products and derivatives and must also be clear at what price these products were actually bought and sold.

What does greater market transparency mean for you?

These new requirements will allow you to see more clearly the actual prices of various financial instruments, enabling you to compare prices and find the most competitive offer available.

More products will be regulated - structured deposits

MiFID II will increase the protections provided to you when firms sell financial instruments to you. It will do this by limiting the types of non-complex instruments that can be sold to you without the firm needing to ask about, or assess, your knowledge and experience.



In addition, MiFID II will cover structured deposits - a category of financial products which was previously unregulated at EU level, but which satisfies similar investor needs and raises comparable investor protection challenges to the types of financial instrument already within scope of MiFID.

In the future, the sale of structured deposits will have to comply with several MiFID requirements - in particular, with the conduct of business and conflicts of interest rules which govern how financial firms should behave towards you, including when they are designing, advising or distributing MiFID instruments.

What does this extension of MiFID's scope mean for you?

If you have bought, or intend to buy in the future, a structured deposit, then this change should reassure you that firms selling you these types of products must adhere to stricter MiFID regulatory standards. As a result, you will receive important protections like those described above.

MiFID II will also make clear that complex products (including complex structured deposits) cannot be sold to you on an execution-only basis and will broaden the category of complex products. This will mean that firms must ensure that you receive all the relevant information before investing in this type of instrument.

What else do I need to know about the changes

The changes will take effect over the next few years, and will apply across all European Member States.

Visit our [website](#) and our Investor Corner for more information, or, your member state's financial regulator.

