

Litmus test

The EU's landmark directive changes the regime applicable to French financial investment advisors

1 MINUTE READ

The new Markets in Financial Instruments Directive (Mifid II) has helped harmonise the respective regimes applicable to investment services providers and financial investment advisors (FIAs).

It adds new rules for both categories, in particular better control over conflicts of interest and reinforcement of investor information.

Work has also been carried out on rules of organisation, good behaviour and governance for these two types of actors.

Changes to the financial rules have been an opportunity for the French financial regulator to transform the role of FIA from a profession to an activity, and to overhaul access conditions.

European Commissioner Michel Barnier said in 2014: *'I welcome the agreement in principle reached today...on updated rules for markets in financial instruments. These new rules...are a key step towards establishing a safer, more open and more responsible financial system and restoring investor confidence in the wake of the financial crisis.'*

November 2007 to March 2018: nearly 11 years separate the entry into force of the first Markets in Financial Instruments Directive's (Mifid) provisions from the transposition of its second version (Mifid II) into French law.

August 2003 to March 2018: some 15 years separate the creation of the French financial investment advisor (FIA) regime from the current one analogous to Mifid II. Indeed, Mifid II helped harmonise regimes which have over the years promoted healthy competition between investment services providers and FIAs. It adds new rules for investment services providers and FIAs, in particular better control over conflicts of interest and the reinforcement of investor information within a general objective of better investor protection. Rules of organisation, good behaviour and governance surrounding these two types of actors have also been fleshed out.

The work carried out by French and European lawmakers on level 1 texts, and by the European Securities and Markets Authority (Esma) and the *Autorité des Marchés Financiers* (the French financial market authority or AMF) on level 2 texts has always struck the right balance between investor protection and maintaining a special status for FIAs under the French Mifid II regime.

The level 1 texts will be transposed into the French Monetary and Financial Code while their level 2 counterparts will be included in the AMF's General Regulation to avoid any overtransposition of European legislation. To complete the implementation of these texts, France has chosen to separate the legal status of investment firms from that of portfolio management companies.

The changes affect more than 5,044 FIAs registered since July 2017.

New conditions of access and advice for FIAs post-Mifid II

The changes to the AMF's General Regulation have been an opportunity for the regulator to transform the role of FIA from a profession to an activity, and to overhaul access conditions.

The programme of operations: a key constitutive document

Each of the four professional associations – the *Association Nationale des Conseillers Financiers-CIF*, the *Chambre Nationale des Conseils en Gestion de Patrimoine*, the *Chambre Nationale des Conseillers en Investissements Financiers* and the *Compagnie des conseils en gestion de patrimoine indépendants* – verifies that future FIA members have a programme of operations. Mifid II imposes the same obligation on FIAs as on investment firms, ie to have a programme of operations indicating future contemplated activities. These operations may include investment advice, advice relating to the provision of investment services, advice relating to the execution of transactions in miscellaneous property, the reception and transmission of orders in relation to one or more units or shares in a collective investment undertakings that a

than the funds which are remitted to pay for their services.

A major impact on advice

The new French Mifid II FIA framework maintains the obligation for FIAs to provide documents related to the provision of advice but implements new terminologies.

When establishing a relationship with a new client, the FIA will continue to give an entry into relation document which includes information such as name or company name, business address or their registered office, ORIAS registration number, name of the professional association to which they belong.

Before offering any investment advice, the FIA shall submit a letter of engagement to clients, which will be drawn up in duplicate and signed by both parties. Based on the standard model of the professional association, the engagement letter must specify whether the investment advice is provided on an independent basis or not. The investment advice is provided on an independent basis when the FIAs (i) assess a sufficient range of financial instruments available on the market which must be sufficiently diverse with regards to their type and issuers or product providers to ensure that

designed to enhance the quality of the relevant service to their clients. This quality enhancement test can be fulfilled by contacting clients at least once a year on a personalised basis to assess if the financial services or instruments are still suitable and match their clients' profile. The information in the know-your-client information questionnaires must be periodically updated in order to comply with the quality enhancement criterion.

- Secondly, despite this mode of remuneration, FIAs have to continue to respect at all times their duty to act honestly, fairly and professionally in accordance with the best interests of their clients.
- Thirdly, clients have to be informed of their existence ex ante, in good time and before providing any investment advice.

As of March 13 2018, two remuneration regimes have been in opposition: the one applicable to FIAs providing investment advice on an independent basis and the one for those providing investment advice on a non-independent basis. The letter of engagement must inform of all costs and associated charges related to the advice, the financial instruments, investment services recommended or marketed and how clients can pay for them (monies directly paid by the clients for independent FIAs and third-party payments for non-independent FIAs).

FIAs must continue to complete know-your-client information questionnaires before offering investment advice. These documents contain information regarding clients' knowledge and experience in the investment field relevant to the specific type of product or service recommended, their financial situation and their investment goals. Whether the offer of advice is physical or through connected platforms, digitalised processes or robo-advice, these questionnaires are required for FIAs. New information that should be collected under Mifid II includes the ability of a client to bear losses and acceptance of risk, to enable FIAs to recommend suitable financial instruments and appropriate financial services. FIAs might, however, determine the scope of the information collected based on the characteristics of the investment advices provided on an independent or non-independent basis.

The suitability report replaces the former written report to formalise FIA advice. Beyond the change in terminology, it outlines in writing how the recommendation provided is suitable for clients. It must explain how it

Minor non-monetary benefits remain authorised if they enhance the quality of service provided to clients

client to whom they have provided an advisory service intends to subscribe for or sell, other asset-management-related consultancy activities and the provision of legal advice or drafting of private deeds for others under the appropriate legal competence. The programme of operations defines organisational structure as well as direct and indirect shareholders. It also includes previous conditions of access such as age and reputation, professional civil liability insurance and organisational rules. The FIAs have to enter in the sole register of insurance, banking and finance intermediaries, the *Registre Unique des Intermédiaires en Assurance, Banque et Finance* (ORIAS), and are prohibited from receiving financial instruments from their clients or funds other

the investment objectives of their clients can be suitably met; and (ii) don't accept or retain fees, commissions or any monetary or non-monetary benefits other monies received from their clients. The FIA are obliged to specify why their advice is provided on an independent basis. Minor non-monetary benefits remain authorised if they enhance the quality of service provided to clients, and are of a scale and nature such that they could not be judged to impair compliance with the FIA's duty to act in the client's best interests.

When providing investment advice, non-independent FIAs are not precluded from accepting and retaining fees, commissions or monetary or non-monetary benefits (so-called inducements) if three conditions are met:

- Firstly, the payment or benefit has to be

meets their investment objectives, knowledge and experience in the investment field, financial situation and personal circumstances, especially their ability to bear losses. When providing an annual suitability assessment of their initial recommendations in order to enhance the service provided, the FIA may specify only subsequent changes, or increase the frequency of this assessment depending on the risk profile of their clients and the type of financial instruments recommended.

New organisational and good conduct rules post-Mifid II

FIA's need to have adequate resources and procedures in place to run their business efficiently. Mifid II also imposes a number of new requirements.

Strengthened conflicts of interest policy

Mifid II strengthens processes around the prevention, detection and treatment of conflicts of interest. Conflicts are now defined as those between the FIA's or their employees and their clients, or between two clients, arising in the course of providing one or a combination of activities or their mode of remuneration.

The FIA's have to take all appropriate steps to identify, prevent and manage conflicts. They must take into account minimum criteria such as (i) a financial gain realisation or the avoidance of a financial loss at the expense of their clients; (ii) an interest in the result of a service provided or a transaction carried out for their clients different from the interest of their clients; or (iii) an inducement which may favour their own interests over those of their clients. They shall maintain and operate effective organisational and administrative arrangements with a view to taking all reasonable steps designed to prevent conflicts of interest from adversely affecting the interest of their clients. Where

organisational or administrative arrangements made by the FIA's to prevent conflicts of interest from adversely affecting the interest of their clients are not sufficient to ensure that

the products they intend to recommend or sell in order to ensure that the distribution strategy is consistent with the needs, characteristics, and objectives of an identified

A special register must be kept to record and update benefits for which conflicts of interest have occurred or are likely to occur

risks of damage to client interests will be prevented, the FIA's shall clearly disclose to their clients the general nature and/or sources of conflicts of interest and the steps taken to mitigate those risks before undertaking business on their behalf. A special register must be kept to record and regularly update the types of benefits for which conflicts of interest have occurred or are likely to occur. The FIA shall ensure that it does not remunerate or assess staff performance in a way that conflicts with their duty to act in the best interests of clients when providing financial services. In particular, they shall not make any arrangement by way of remuneration, sales targets or otherwise that could provide an incentive to their staff to recommend a particular financial instrument to their clients.

The new financial instruments governance policy

FIA's must possess the necessary expertise to understand the characteristics and risks of the financial instruments recommended or offered and evaluate their compatibility with the needs, characteristics and objectives of an identified target market and that the intended distribution strategy is consistent with the identified target market. FIA's should offer or recommend financial instruments only when they are in their clients' interest.

As distributors, the FIA's obtain from manufacturers information to gain the necessary understanding and knowledge of

target market. Furthermore, FIA's identify and evaluate the needs of their clients they intend to target. In return, they provide the product producers with information on sales and, where appropriate, information on the reviews they had to do.

Mifid II aims to provide a clearer definition of the respective responsibilities of producers and distributors by establishing a link between the two main constituents of the distribution chain. To implement this provision, FIA's will have to monitor the following three parameters:

- the characteristics of the financial instrument for which advice has been provided (level of risk, investment duration and placement horizon etc);
- the target markets (the clients/relevant category of clients whom the financial instruments are intended for); and
- the appropriate distribution strategy for the target market.

Further monitoring and adjustment must be expected. This is because the AMF allows FIA's to each apply financial instruments governance policy in a suitable and proportionate manner taking into account the nature of the financial instruments, the investment services and the target market for the product.



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