SimplyBiz Group

MiFID II – Are you miffed about MiFID?

The reality one year on

PART OF THE MiFID II SERIES

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Towards the end of 2017, we produced our **MiFID II gap analysis**, amongst a number of other compliance papers, to help you prepare for the directive. Whilst we were, and remain, confident with our interpretations, it was not an easy exercise as many aspects of the directive were 'suck it and see'. MiFID II is a complex piece of legislation which did not seem to transition seamlessly into FCA rules, nor was it apparent how a number of the areas of legislation would improve the customer experience. Compound that with the fact our regulator has provided little to no meaningful guidance, it is not a surprise there was, and continues to be, a great deal of uncertainty in the market.

This paper will reconfirm the position of our earlier guidance and provide you with additional practical clarity to dispel some of the myths you may have come across. We aim to answer some of the most common questions and concerns many firms and advisers have.

Unfortunately the complexity does not end there. Careful consideration must then be made to how all these changes integrate with the Insurance Distribution Directive (IDD) and non-MiFID and non-IDD business. We will therefore indicate within each following section these wider implications.

Suitability

There are a number of considerations to account for when applying the suitability rules. This is probably the largest collective area of uncertainty and the range of questions and concerns include:

If we make a personal recommendation do we have to review it every year?

The simple answer is **NO**. Firms need only review the suitability of a client's investment where they agree to do so under a formal agreement (your service proposition). There are many differing service propositions across the sector, and these should be aligned to firms and the needs of their clients. Typically the types of service offerings we see are:

- **Transactional** - this is not a service as such but a statement confirming no ongoing services are to be provided and that no ongoing payments will be made by the client.
- **Administrative** - this is where a firm provides only a basic on-going service which is administrative activity only (i.e. providing valuations, issuing newsletters, ongoing access to non-advisory support, etc.). The type of activity would have to be tangible in nature and meet the needs of these clients. A lower proportionate charge would be paid for this service.
- **Advisory** - this is where a review of the client's circumstances and investment(s) is undertaken, with advice given as to what action (if any) should be taken. A client would pay an ongoing advice fee for this service.

Is it correct we have to carry out suitability reviews annually?

Yes. Where you have an agreement in place to review the suitability of an investment ('advisory' as indicated above) the review must be carried out at least annually.

What about those clients who want, or are paying for, a review every other year or less frequent?

Where a client is paying for an ongoing advisory service, the review must now be carried out at least annually and, when a client holds a servicing agreement to review their investment(s) less frequently than this, it will mean a different service level will have to be agreed. This could be any one of the three options listed above, however, it does not mean you cannot review the suitability at less frequent intervals than annually. For example, if the client signs up to a 'transactional' or 'administrative' type of service, they can choose to review the suitability of their investments at any time, under a one-off payment for services. This would be a separate and standalone advice scenario and not a contract for services.

This applies to both MiFID and IDD investment and products only

MiFID II requires us to change the way we carry out suitability reviews

The directive has made **NO** changes to the way a suitability review should be carried out. Any review should be considered 'new advice', albeit the process can be simplified due to the information held on the client's records. The key areas for review, discussion and to be documented are:

- Client circumstances
- Client needs and objectives
- Attitude to risk
- Capacity for loss
- Changes in legislation
- Review of investment/funds
- Taxation
- Risks

The SimplyBiz Group has a template suitability report for reviewing investments, which can be found here.

Do we now have to issue a suitability report when carrying out a review?

Yes. In reality, this has always been mandatory when you provided advice, albeit with certain exemptions. The key implication more recently was the Treasury changing the definition of advice to include 'holding'. This means that a recommendation to make no change to a client's investment or portfolio would be full regulated financial advice and a suitability report would be required. Please see our suitability report template for reviews above.

Suitability

Do suitability reports have to be issued before conclusion of the transaction?

Yes. This applies to all investments/products and not just MiFID instruments. This will mean before monies are invested, or funds switched/rebalanced, suitability must be assessed and a suitability report must be sent to the client. This would also be the case for advice to 'hold' an existing portfolio, as that advice would be deemed conclusion of the transaction (under our interpretation of the directive) and therefore the report should not be issued retrospectively.

The nature of the reviews and issuing of a suitability report apply to all types of investment business. The timing for the issue of the suitability report for all other types of business (non-MiFID) is before conclusion of the contract (The SimplyBiz Group consider this to be before both parties agree terms of the contract)

This will mean firms having to change the way they carry out suitability reviews and will make one review meeting become at least two!

That should not be the case. Firms will need to consider, and possibly adapt, their approach to client review meetings but it should not result in having to carry out two meetings. We envisage a review could be carried out in one of the two approaches opposite:

1. The client is sent material to review and update prior to the meeting. On receipt of this, the adviser considers the information and conducts the review remotely. The recommended actions are then written in a suitability report which is provided to the client during the review meeting. Should the client decide to take a different approach (i.e. not to switch a particular fund) the adviser could confirm this back to the client after conclusion of the transaction as it would not result in a change of the adviser's initial recommendation.
2. A meeting is arranged with the client to carry out a review of the client's circumstances, etc. If the adviser is in a position to make a recommendation at the same meeting (i.e. a fund switch or to rebalance the portfolio), the suitability report should be sent to the client before the switch/rebalancing is carried out (remembering about timely execution). Where the adviser is going to recommend the client 'hold' or make no changes to their portfolio, the client can be informed that the recommendation will be sent to them shortly following the meeting, setting out the actions, if any, and following a more in-depth analysis.

Action Points

- Review your service propositions
- Ensure you have a robust investment review process
- Always issue a suitability report following an invesment review

Disclosure

MiFID II brought with it a number of new regimes for disclosure of charges and certain events. Again, like the suitability rules, it is sometimes difficult to see the logic and benefit to some of these, but the key fundamental difference between 'disclosure' and 'suitability' is that, whilst the disclosure rules are clearly set out, it is difficult to know how their application will be achieved. This includes:

What is ex-ante disclosure?

This is the (likely) cost of purchasing the investment. It includes the cost of manufacturing and purchasing the investment and the cost of the advice. This must be shown as an aggregated cost, which must also include any other ancillary service (e.g. platform costs). It must be given 'up front' before any investment is made, and be shown as a monetary amount and percentage. The simplest way to show this is through issue of the KIID/KFI illustration or other supplementary information provided by the platform/provider.

What then is ex-post?

This only applies where the firm has an ongoing relationship with the client, typically under a contract for services. Ex-post information is the **actual cost** to the client of holding that investment and must be disclosed at least annually. This information will contain the same level of information as per ex-ante and be personalised to the client.

How do firms produce ex-post information?

In short, **we do not believe firms would ever be in a position to produce this level of information**. We expect platform/product providers to do this. The reality is that many of the platforms/providers have not yet been able to produce the required disclosure and is proof that this is such a complicated exercise to carry out. It is the responsibility of firms to ensure that, when this information has been made available, it has also been delivered to the client, but if not, it must then be issued to the client by the firm itself.

It is over 12 months into MiFID II and we have not sent ex-post disclosure. Does this mean we will be in breach?

Firstly, MiFID II legislation is not applied retrospectively. This annual disclosure applies from the date the investment was implemented. Therefore, if you recommended an ISA on the 1st March 2018 and you provide an ongoing service the ex-post disclosure would not be required until 1st March 2019. That is not to say the platform/provider will be in a position to provide full ex-post disclosure come that later date.

As an interim measure, and due to the known complexities, we would recommend firms deal with their responsibilities by ensuring the client has a known breakdown of the costs e.g. fund/product charges, any platform charges (both usually provided by the platform/provider themselves) and your servicing charges. This way you are showing willingness to deal with your responsibilities and we expect the regulator to be understanding of this.

Do I disclose the aggregated costs for the investment wrapper as a whole or for each fund separately?

This will depend on how the investment is held. If the investment is within a packaged product e.g. investment bond, the aggregated charge will apply to the product itself. Where it is within an investment wrapper (e.g. general investment account/ISA) it is likely to be disclosed in the following ways:

Where it is held on a platform – platform providers are likely to provide this on a collective basis for all funds held within each investment wrapper. Whilst some platforms may itemise individual fund costs, we do not believe firms would then need to disclose aggregated charges at that level as disclosure would be sufficient based on the wrapper collectively.

Where it is invested directly with the investment house – the investment house will disclose the charges for the cost of their fund(s). This would be sufficient disclosure to the client, ensuring it includes your service/advice charge, but you would not be required to aggregate this with any other separately held funds with different investment houses.

The investment house is unable to provide personalised costs and charges or have said the fund is not MiFID regulated!

It may be that where you are liaising directly with an investment house (off-platform holdings), the fund may have been established pre-MiFID II and no changes have been made to the investment since. **Remember** MiFID II is not retrospective legislation and therefore aggregated ex-post disclosure would not be required. Should the investment house say the fund is not MiFID regulated, this may be because it benefits from an exemption. It is not possible to list all the funds this applies to and we suggest where you receive such confirmation you hold this on file. In this instance, we recommend you disclose your ongoing advice charges (where applicable) to the client separately, and again on an annual basis.

Disclosure

We charge our advice and servicing costs directly to the client. How do we factor this into the aggregated costs?

The simplest way to do this is by including the costs into a table of charges. An example of this is within the appendixes of our suitability reports. See below:

Investment services and/or ancillary services – cost of advice, platform costs, discretionary fund management cost, etc. Should you chose you can itemise these amounts	£X,XXX	X.XX %
Financial instrument/The product – the investment/scheme	£X,XXX	X.XX %
Total costs and charges.	£X,XXX	X.XX %

As the charge for the ongoing service is not deducted from the investment, there would be **no requirement to show a revised illustrative effect on the return**.

What do I do if a client's investment portfolio reduces by 10% or more?

Where a client's investment is managed on a discretionary basis, that client must be notified where the value of their portfolio reduces by 10% or more. Where there is **no** discretionary management e.g. you provide advice to your client on every fund switch or act on their instructions, this 10% reporting rule **does not apply**.

MiFID II brought in a requirement for discretionary managers to provide quarterly reporting to investors. At the start of these quarterly periods, the overall portfolio valuation must be recorded and if its value drops by 10% (and each 10% thereafter) at any time before the start of the next reporting period, the client must be notified **by close of business the same day**.

> The 10% reporting rule applies to MiFID business only and you should review any agreements you hold with DFMs or MPSs to know responsibilities

My clients are invested into a Discretionary Fund Manager (DFM)/Model Portfolio Service (MPS) proposition but we are not the discretionary manager. Does this mean there is nothing for us to do?

Sadly not. Whilst the rules do not apply to you directly, you will need to check your agreement with the DFM/MPS. If you are acting as **'agent as client'** this may bring with it some regulatory responsibilities. The 'agent as client' agreement is to ensure the DFM/MPS can meet the suitability requirements of managing the portfolio by relying on the advice firm's assessment of suitability for each client invested. Since MiFID II, some DFMs/MPSs have extended this 'agent as client' duty to include the reporting of the 10% deductions. You should check the agreement you hold with any DFM/MPS provider to determine your responsibilities, to then carry out an internal assessment on how you can meet any additional regulatory reporting requirements.

There is no prescribed template within the directive that should be used for providing this communication. We would suggest, given the sensitivity of the information, you should tailor this to each client (or client category), taking account of their capacity for loss.

Within our research and due-diligence guide, you will find a range of questions that you should be asking of any DFM/MPS provider. Where the responsibility for the 10% reduction reporting has been allocated to your advice firm, it should be a trigger to determine if that type of responsibility is appropriate for you.

> We understand some platforms/providers may notify firms where a client's portfolio has dropped by 10% or more. Where this relates to a client that is NOT under a DFM/MPS service, there is no prescribed regulatory action required

> IMPORTANT - Should the 'agent as client' agreement require you to notify the client, you must document how, on receiving the notification to the 10% reduction from the DFM/MPS, you will notify the client by close of business the same day to ensure you avoid any regulatory penalty

Action Points

- Understand the approach your platforms and providers have for disclosure of aggregated charges
- Think how you will include any direct payments for your servicing charges in the aggregated costs
- Remember the 10% rule; Non-discretionary portfolio management – no reporting required
- Discretionary portfolio management – reporting required – CHECK YOUR AGREEMENT WITH THE DISCRETIONARY MANAGER