

Group Briefing

March 2017

MiFID II Series: Investment Advice

Under MiFID, “*investment advice*” is the provision by an investment firm of a “*personal recommendation*” to a client, either at the client’s request or at the firm’s initiative, in respect of one or more transactions relating to financial instruments.

Under MiFID II, the definition of “*investment advice*” itself is not changing. However, the concept of “*personal recommendations*” is being widened.

MiFID II also draws a new, crucial distinction between the provision of investment advice on an independent basis, and the provision of investment advice on a non-independent basis. Additional client-facing and internal obligations will be imposed on firms who provide investment advice on an independent basis from 3 January 2018, and those firms should be putting processes in place now to ensure that they are well-prepared for the new rules.

IMPACT SUMMARY

Under MiFID II, firms will be required to tell clients if investment advice is being provided on an independent or non-independent basis.

Firms that provide investment advice on an independent basis will be required to assess a sufficient range of financial instruments available on the market, and will generally not be allowed to accept inducements from third parties in relation to the provision of the service. Those firms will also be required to put specific internal processes in place.

Extra requirements are also being imposed on firms that provide investment advice on both an independent and non-independent basis.

PERSONAL RECOMMENDATIONS: WHAT'S CHANGING?

Position under MiFID

Under MiFID, a recommendation made to a person in his capacity as an investor or potential investor (or to his agent), is not treated as a personal recommendation if it is issued to the public, or exclusively through distribution channels (i.e. channels through which information is, or is likely to become, publicly available).

Reasons for change

Concerns arose that recommendations using distribution channels (such as social media platforms, and email distribution lists used for the dissemination of newsletters/brochures) that reached a large number of investors/potential investors were not deemed to be “*personal recommendations*” (and were therefore not subject to MiFID rules on investment advice). This was viewed as less than ideal from an investor protection perspective.

Position under MiFID II

In light of the above, the exemption for recommendations via distribution channels is being removed, meaning that a recommendation will only be treated as outside the scope of MiFID II’s rules on investment advice if it is made exclusively to the public at large.

Unless it is made exclusively to the public at large, a recommendation by a firm will be in-scope for the MiFID II rules on investment advice if it is either presented as suitable for the client, or based on a consideration of the client’s circumstances, and recommends that one of the following steps be taken:

- » the purchase, sale, subscription, exchange, redemption, holding or underwriting of a particular financial instrument; or
- » the exercise or non-exercise of any right conferred by a particular financial instrument to purchase, sell, subscribe for, exchange, or redeem a financial instrument.

ESMA has published, and is maintaining, [Questions and Answers on MiFID II and investor protection topics](#) - it is possible that further guidance on personal recommendations and investment advice will be included in that document from time to time and that the practical impact of the change will become clearer.

WHAT IS “INDEPENDENT” INVESTMENT ADVICE?

To provide investment advice on an “independent” basis:

» **Range:** the firm must consider:

- » a sufficiently wide range of financial instruments available on the market; and
- » a sufficiently diverse range of financial instruments (i.e. diverse types, diverse issuers/product providers),

to ensure that the client’s investment objectives can be met in a suitable way;

» **Providers:** the financial instruments considered by the firm should not be limited to those provided by:

- » the firm itself; or
- » other entities that have close links with the firm, or other entities with close legal or economic relationships with the firm, in a way that could impair the independent nature of the advice;

» **No inducements:** the firm cannot receive and keep benefits from third

parties in relation to the provision of the service to the client (save where the benefits are minor non-monetary benefits, and where the receipt of those benefits will not impair the firm’s ability to act in the best interests of the client).

GIVING INFORMATION TO CLIENTS ABOUT ADVICE

Information for clients (whether advice is provided on an independent basis or not):

Before providing investment advice to clients/potential clients, the firm must tell the client the following (as part of the general information that it is required to provide):

- » If the advice is being provided on an independent basis.
- » If the advice is based on a broad or more restricted analysis of different types of financial instruments.
- » The range of financial instruments that it has assessed.
- » Whether the range of financial instruments assessed is limited to financial instruments issued or provided by entities that either have close links with the firm or have any other close legal or economic relationships with the firm, whereby the independent nature of the advice could be put at risk.
- » If the firm will give the client a periodic assessment of the suitability of the recommended financial instruments, when and why that is likely to happen, the extent to which information will be subject to reassessment and how the client will receive any updated recommendation(s).

Additional information for clients (when investment advice is provided on an independent basis):

The firm must explain the following to the client:

- » How it has met the conditions for providing the advice on an independent basis.
- » What it took into account when selecting financial instruments to recommend (such as risks, costs and complexity).
- » If it is recommending its own financial instruments, or those of an entity with which it has close links or a close legal or economic relationship, and if it is also recommending financial instruments from entities that are not linked to it, the firm must distinguish between the range of financial instruments in both categories.
- » That it cannot receive and retain inducements (subject to the exception below).
- » Whether it is receiving minor non-monetary benefits in connection with the provision of the service (this is allowable if it will not affect the firm’s ability to act in the client’s best interests).

Additional information for clients (if advice being provided on both an independent and non-independent basis):

In that case, the firm must explain the following to the client:

- » That it is giving advice on both an independent and non-independent basis.

WHAT INTERNAL PROCESSES MUST FIRMS PUT IN PLACE WHEN PROVIDING INVESTMENT ADVICE ON AN INDEPENDENT BASIS?

<p>General:</p>	<p>Firms must implement selection processes for assessing and comparing a sufficient range of financial instruments available on the market, so that:</p> <ul style="list-style-type: none"> » the number and variety of financial instruments considered must: <ul style="list-style-type: none"> » be proportionate to the scope of investment advice services offered by the firm; and » adequately represent the financial instruments available on the market; » the quantity of financial instruments issued by the firm itself or by entities with which it has close links must be proportionate to the total amount of financial instruments considered; and » the criteria for selecting financial instruments must: <ul style="list-style-type: none"> » include all relevant aspects i.e. risks, costs and complexity and the characteristics of the firm's clients; and » ensure that the selection is not biased. <p>If a comparison is not possible, the firm cannot hold itself out as providing advice on an independent basis.</p>
<p>If the independent advice will relate to specified categories/ranges of instruments (i.e. 'green' investments):</p>	<ul style="list-style-type: none"> » The firm's marketing strategy must be designed to attract only those clients with a preference for those categories/that range. » The firm must require its clients to confirm that they are only interested in investing in one of those categories/in that range. » The firm must ensure, before providing the service, that it is appropriate for the new client, and that the range is suitable for that client. If the service/range is not appropriate/suitable, the firm cannot provide the service.
<p>If the firm will provide advice on both an independent and non-independent basis:</p>	<p>The firm must have adequate organisational requirements and controls in place to ensure that:</p> <ul style="list-style-type: none"> » it cannot hold itself out as being an independent investment advisor in respect of all of the activities it is carrying on for that client; » both types of advice are kept separate (i.e. the same individuals cannot provide advice on both an independent and non-independent basis, and the individuals who provide each type of advice must be clearly separated); » clients are not likely to be confused about which type of advice they are receiving; » communications to clients cannot give undue prominence to advice provided on an independent basis over advice provided on a non-independent basis; and » clients are given advice that is appropriate for them.

CONCLUSION

The new investment advice rules in MiFID II will force firms to consider whether they wish to provide advice on an independent basis, a non-independent basis, or both. Firms that choose to provide advice on an independent basis will need to ensure that they can meet the conduct of

business rules and, in particular, that their business models allow them to comply with the new inducements restriction.

If you require any assistance with your MiFID II implementation project or advice on the impact of MiFID II on

your business, please do not hesitate to contact Rob Cain, Dara Harrington or Aiden Small.

KEY CONTACTS

For further information please speak to your usual Arthur Cox contact or:



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