MiFID II
what changes for me?

febelfin

MiFID: the European directive that protects investors

The European investment directive MiFID II enters into force on 3 January 2018. The new rules represent thousands of pages of regulations.

“Why all these questions? Why so much information? Are these documents necessary?” These are all common comments that a banker hears when assisting a client with their investments. The answer is often ‘MiFID’ – an abbreviation that evokes mixed feelings among quite a few people.

Some fear that MiFID, however well-intentioned, will make the relationship with the client too businesslike and rigid. But as financial institutions, we want to avoid that as much as possible.

Financial institutions fully endorse the objectives of the MiFID rules. We truly believe that MiFID II offers an opportunity to improve our investment services and benefits the client. Both you and your financial institution have an interest in understanding each other when it comes to investing. It avoids misunderstandings.

This brochure therefore explains what MiFID II means for you as a client.

01. What is MiFID II?

What is MiFID II?

The abbreviation stands for the **Markets in Financial Instruments Directive**. This European directive stipulates the ground rules that financial institutions must follow if they offer or advise you on investment products.

MiFID II succeeds the MiFID I Directive, which came into force in 2007.

To which financial products and services does MiFID II apply?

MiFID II applies to **investment products**: shares, bonds and investment funds. Different rules apply to other financial products, such as payments or loans. Separate rules also apply to the money you have in a savings account.

MiFID II further applies to all **investment services**: placing and executing stock exchange orders, advising on investment products or offering individual asset management.

To whom does MiFID II apply?

MiFID II applies to **all institutions providing professional investment services**. You always enjoy the same protection regardless of whether you use a bank, a stockbroking firm, an asset management and investment advice company, or an investment fund manager for your investment services.

How does MiFID II improve investor protection?

MiFID II has a **series of measures** that aim to strengthen existing investor protection:

- Stricter rules for the sale of complex products
- Stricter procedures to ensure that the right products reach the right target audience (product governance)
- Introduction of a new type of investment service: independent investment advice
- Restrictions on commissions that financial institutions can pay and receive when providing investment services
- Enhanced duty of care for investment service providers
- Better provision of information to the client
- More transparency about costs
- More training and education for staff
- Stricter sanctions and new powers for supervisory authorities
- Better identification of financial transaction clients for faster detection of market abuse
- Stricter rules for telephone conversations and electronic communications in relation to investment services

What gave rise to MiFID II?

MiFID is not new. You have been **protected** by the MiFID I rules **since 2008**. For example, financial institutions have been legally obliged to draw up an investor profile since MiFID I. In other words, they must check whether you have adequate knowledge and experience of investment products. And they may then only offer you products that take that knowledge and experience into account.

If your financial institution gives you investment advice, it must already have assessed your financial situation and investment objectives. The products you want must be suitable for achieving those investment objectives (the 'duty of care').

While MiFID II maintains the **principles of MiFID I**, they are **tightened** in a number of respects. The financial crisis namely showed that additional protection was needed in several areas.

Some investors invested in complex products that they did not adequately understand or they did not have a clear understanding of an investment product's cost structure. Some products also experienced significant fluctuations in value, making them unsuitable for certain investors.

As a private banking client, am I also protected?

Absolutely. MiFID II does not distinguish between private banking and other retail clients: both groups enjoy the same **protection**.

But MiFID II does distinguish between professional and nonprofessional clients. Less stringent rules apply to professional clients.
As a private individual, you can apply for professional investor status, but only under strict conditions. Your financial institution must check whether you fulfil these conditions.

And as an SME?

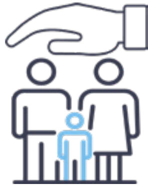
Yes, SMEs are also subject to MiFID rules, even if they have adopted the form of a company. SMEs thus enjoy the **same protection** as private clients.

Even if you were to invest a cash surplus with your company in an investment fund, for example, you would be protected under the MiFID.

From when does MiFID II apply?

MiFID II enters into force on **3 January 2018**.

Is MiFID II only about investor protection?



No, MiFID II delivers **fundamental reform**. While the rules on investor protection are being tightened, MiFID II is also about improved transparency of the stock exchanges and financial markets, and includes rules on new forms of investment such as algorithmic and automated securities trading.

Doesn't MiFID II involve a lot of red tape for clients and financial institutions?

To some extent, yes, but MiFID II provides necessary protection for both the client and the financial institution.

It can be slightly annoying as a client for the bank to ask questions about your income and future plans, for example, when you want to buy shares or participate in an investment fund. And for the financial institution, it isn't always easy to promptly help a client while applying these rules meticulously at the same time.

Even so, we mustn't lose sight of the fact that the MiFID rules are there to help investors and to manage their savings in the best and safest way possible. The financial institutions thus support the principles of MIFID II: first and foremost, **better protection for investors** followed by **more transparency and better market conditions**.

02. Why is MiFID II a good thing for investors?

What does MiFID II change in relation to complex products?

MiFID II classifies more investment products as complex. **Stricter rules** apply to these products: a financial institution may offer them to you only if it has checked that you have the necessary knowledge and experience to invest in such a product. You will thus not be able to simply instruct your financial institution to purchase a complex product for you.

Wasn't there already a moratorium on complex products in Belgium?

That's correct. In 2011, almost all financial institutions in Belgium signed the 'Moratorium on the marketing of especially complex financial products'. The Financial Services and Markets Authority (FSMA) called on the financial sector with this moratorium not to sell especially complex products to private investors.

MiFID II does not replace that Moratorium. It continues to apply to especially complex products. Less complex products that do not fall under the Moratorium, but which are still not available to every investor, will be subject to stricter rules under MiFID II.

As a client, what do I gain from enhanced product governance?

Financial institutions will have to establish stricter procedures to ensure that the right products reach the right target audience. Although most financial institutions in Belgium already did this of their own accord, MiFID II now obliges them to:

- **Define** a clear **target group** for all products they offer (e.g. private investors with a three-year investment horizon). They may only offer products whose characteristics suit the target group;

- Ensure that all products continue throughout their life cycle to **correspond** with the needs, characteristics and objectives of the **target group**. If a financial institution discovers that a product no longer corresponds with the target group, it must take measures to ensure that the target group is adjusted and that the products are no longer sold to the original target group.

MiFID II introduces a new type of investment service: independent investment advice. What is that?

MiFID II distinguishes between independent investment advice and non-independent investment advice.

From now on, your financial institution must clarify which type of investment advice it offers. Both services are equivalent. An institution can even offer independent and non-independent investment advice simultaneously. But an independent investment adviser must adopt several additional measures to ensure for its clients that it does not limit its advice to proprietary products and that it has no financial incentives to recommend proprietary products over third-party products.

Independent advice

If your bank or investment firm claims to give you independent investment advice, it must research a wide range of investment products on the market before it recommends one or more of them to you, and several additional rules apply to ensure that the advice is actually fully independent.

Non-independent advice

A financial institution may also choose to give non-independent advice. There is nothing untoward about that. It simply means that your financial institution will not necessarily consider products from other financial institutions when giving investment advice, but could limit itself to products that it has developed. Your financial institution must inform you about this. But even in this case, it still has to check whether the product is suitable for you.

New rules apply to commissions that financial institutions may pay or receive when providing investment services. What do these rules entail?

If a financial institution sells a financial product, it will often receive payment from the manufacturer of the product, usually in the form of a commission. Under MiFID II, financial institutions will be able to receive or pay commission only under strict conditions.

Why? Because there is a risk of a **conflict of interests**. After all, a financial institution might be tempted to offer products that earn it more commission but are less suitable for the client. Although MiFID I already regulated these commissions, also known as 'inducements', these rules are now being tightened considerably.

Commissions or other monetary/non-monetary incentives must **be passed on to the client** for asset management services or independent investment advice.

But a financial institution may continue to receive commissions or other monetary/non-monetary incentives and need not pass them on to the client for services other than asset management or independent investment advice. This is on condition that the financial institution can demonstrate that this commission benefits the quality of the service to the client, for example by providing the client with digital tools to better monitor their investment portfolio.

What is the duty of care?

If financial institutions offer investment services, they must always act in a **loyal, honest and professional** manner towards their clients. This standard is also known as the duty of care.

The same obligation existed under MiFID I and will be extended under MiFID II from 2018. Although the general principle remains unchanged, financial institutions will have to act in the **client's interest** even more than before. Specifically, this means:

- They give you more comprehensive information on the costs of the services and products they offer;
- They must give you a written report on the investment advice they have provided;
- When they develop new products, the target group must be defined.

Financial institutions are also obliged to exercise adequate **prudence**. They must enquire about the financial situation and wishes of their clients and then inform them accordingly. They must also check the information that the client gives them. Based on this, they can decide not to provide the requested services, where necessary.

How does MiFID II improve the provision of information?

Financial institutions must better **inform you about the nature of their services**. They must let you know in advance whether they are giving independent investment advice, namely whether they are making a broad analysis of different types of financial instruments.

If financial institutions recommend a certain product to you, they must **justify in writing** why that product precisely meets your investment objectives (in a 'suitability report').

Once they have provided investment advice and you have purchased a product, financial institutions must also state whether they will continue to monitor that product and check whether it complements your investor profile. You also need to know how often they will do this and how it will be done.

More transparency about costs. What does that mean?

MiFID II aims to ensure that clients have a better understanding than before about what costs they are paying when they buy a product or service. All costs relating to the provision of investment services and to investment instruments must therefore be consolidated. In this way, the client can see the **impact** these costs have on the **return** on their investment.

The financial institution must express that consolidated whole as **one amount** (either in cash or as a percentage). This will be clearly shown in an illustration (such as a graph) with accompanying explanations.

More training and education for staff. Is that necessary?

The staff of Belgian financial institutions already have to meet **extensive training requirements**. They have to attend training on investment products and services and are tested on these through training programmes approved by the FSMA (Financial Services and Markets Authority). MiFID II does not change much for the Belgian market in this respect. Employees who have client contact will now have to know, understand and explain the essential characteristics of the products offered to the client even better (for example, does the product offer capital protection, how are the proceeds taxed, what happens if interest rates fluctuate, what is the appropriate investment period, and so on).

Enhanced supervision, why?

European and national financial supervisory authorities will receive new powers through the MiFID II regulations, allowing them to tighten their supervisory policies.

As from 3 January, supervisory authorities will be able to **prohibit** financial institutions from offering certain investment products on the market. Obviously, this cannot be done arbitrarily; the supervisory authorities must have a **valid reason** to do so: for example, if a product is too complex for a certain type of investor, there is a risk they might be **inadequately protected**. However, a national supervisory authority must coordinate such a restriction with the European supervisory authorities first.

Will there be stricter sanctions?

Yes, the supervisory authorities will have more options to impose sanctions on financial institutions that do not respect the new rules. For example, they can impose **higher fines** (up to €5 million). The supervisory authorities will also be able to announce more quickly that they have imposed a sanction. This should **act as a deterrent** for financial institutions that do not comply with the rules, as they could suffer significant reputational damage.

Is it true that a legal entity will need a registration number for certain financial transactions?

Yes, MiFID II provides that banks and investment firms performing transactions in financial instruments must report these transactions to the competent authority (in Belgium this is the FSMA, the Financial Services and Markets Authority) no later than the end of the next business day. This is to enable supervisory authorities to more quickly identify institutions involved in fraudulent transactions, such as insider trading or price rigging.

One of the elements that a financial institution must report is the identity of the transaction client. For a natural person, the national register number suffices as identification, but a legal entity now requires an **LEI or Legal Entity Identifier**: a 20-character alphanumeric code that clearly and uniquely identifies each legal entity operating in the financial markets.

Without an LEI, legal entities will no longer be able to perform transactions in financial instruments.

Legal entities can obtain an LEI from an LEI provider: an organisation that the Global LEI Foundation (GLEIF) authorises for this purpose.

These LEI providers are currently located in Belgium:

- GS1 Belgium & Luxembourg (www.mylei.be)
- Acerta (https://acerta.be/lei)
- Xerius (www.xerius.be/lei)

Belgian legal entities can also choose to apply for an LEI from a foreign provider. A list of all LEI providers is available on the GLEIF website: www.gleif.org/en/about-lei/how-to-get-an-lei-find-lei-issuing-organizations.

Why does MiFID II contain rules for telephone conversations and electronic communications?

Under MiFID II, financial institutions are required to record and keep telephone conversations and electronic communications (such as video calls) that relate to receiving, transmitting or executing client orders.

This must help supervisory authorities to better monitor whether financial institutions are **complying with their obligations** when providing investment services.

03. Why does a financial institution want to draw up an investor profile and what is the purpose of the questionnaires I must complete when I buy an investment product?

Why is an investor profile drawn up for me?

Your financial institution will draw up your investor profile based on a questionnaire. This is not a test or an exam, but a **way to get to know you better** and gain insight into your knowledge, experience, investment objectives (including sustainability preferences - see next question), financial situation and risk appetite. This helps them ensure that you get the investment product or advice best suited to you.

The questionnaires are not standardised. Each financial institution can use its own questionnaire and tailor it to its product range. This avoids asking you irrelevant questions.

In general, clients match one of these investor profiles (name, number and type may differ from bank to bank):

- Defensive/conservative
- Neutral/balanced
- Speculative/dynamic

Does the bank also take into account my sustainability preferences?

From 2 August 2022 onwards, your financial institution will also have to assess your possible sustainability preferences, i.e. they will have to ask you whether you wish to base your investments solely on financial considerations or whether you also wish to invest according to 'extra-financial' criteria, in socially responsible investments (ESG), based on three criteria: environmental, social and governance criteria.

The bank will therefore ask you about your willingness to integrate ESG investments into your investment strategy, in what proportion and in what form you wish to include them in your investment portfolio.

In concrete terms, if you tell your bank that you want to invest in socially responsible investments (ESG), the bank will then ask you more detailed questions divided into three categories, that have been set by the European legislator.

a) Would you like the bank to ensure that a minimum proportion of your portfolio is made up of environmentally sustainable investments (also known as '**taxonomy investments**')? These are investments in sectors where activities meet a standard of environmental sustainability, contributing to at least one of the following six environmental objectives: climate change mitigation, climate change adaptation, sustainable use and protection of water and marine resources, transition to a circular economy, pollution prevention and reduction, protection and restoration of biodiversity and ecosystems.

b) Would you like your bank to ensure that a minimum proportion of your portfolio consists of "sustainable investments" as defined in the **SFDR Regulation**, i.e. :

- an investment in an economic activity that contributes to an environmental objective (e.g. resource efficiency with regard to the use of energy, renewable energy, proper management of waste production or limitation of greenhouse gas emissions)

- or an investment in an economic activity that contributes to a social objective (e.g. the fight against inequality or social inclusion)

- provided that the companies in which the investments are made apply good governance practices (e.g. remuneration of competent personnel and compliance with tax obligations).

c) Would you like the bank to take into account the possible negative environmental, social and governance impacts of your investment ("**Principal Adverse sustainability Impacts**" or "PAI"1) when building your portfolio? The aim is to propose an investment that takes into account several indicators such as greenhouse gas emissions, gender pay inequality, exposure to controversial weapons, and expectations regarding biodiversity.

[1] Since March 2021, financial market participants are required to make a statement on how they intend to integrate their PAI into their investment processn.

Your bank will then suggest, from the range of products available, the financial products that match both your risk profile and your sustainability criteria.

Is there a single standardised questionnaire that all banks use?

Why not?

Institutions do not all use the same questionnaires. Although the questions can vary, each financial institution will test your knowledge and experience just as thoroughly. The differences between the questionnaires mainly relate to the financial institution's product range. Not all financial institutions offer the same products. They therefore limit the questions to those that are relevant **to their product range**.

A financial institution offering options and leveraged structured products will thus need to ask different questions than a financial institution offering only simple investment funds.

How do I know that my financial institution has correctly drawn up and complies with my investor profile?

The Belgian supervisory authority FSMA (Financial Services and Markets Authority) **supervises** this process. Through inspections of the
financial institutions, it can assess questionnaires for completeness, coherence and reliability.

And through **mystery shopping**, the FSMA can also check whether financial institutions actually draw up client profiles correctly and comply with them when providing investment services.

Can I be refused as a client based on the questionnaire?

No, you will not be refused. The questionnaire serves only to draw up your investor profile.

If your financial institution determines on the basis of your investor profile that a certain type of product is not suitable for you, it **cannot recommend** that particular product to you. It can recommend a product only once it has verified that you have sufficient knowledge and experience in the specific type of product, and that the product corresponds with your investment objectives and financial capacity. If this is not the case for a particular product, the bank will look with you and on the basis of your profile for other products that are suitable for you, and which it can therefore recommend to you.

Can a financial institution help me answer the questions?

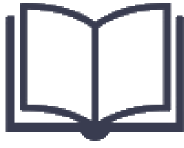
A financial institution may help you to understand a financial product if it finds that you have misinterpreted how it works. For example, it can give you an information leaflet to explain how certain products work.

But the financial institution may not answer the questionnaire on your behalf, or suggest answers.

A MiFID questionnaire is both an **opportunity for the bank to get to know you better**, and **an opportunity for you to clarify your wishes**. It is therefore in your interest and that of your financial institution to complete the questionnaire honestly and correctly.

If a financial institution were to help clients complete the questionnaires, it would moreover be exposing itself to considerable sanctions. The FSMA (Financial Services and Markets Authority) can also detect such practices through mystery shopping.

What does this questionnaire have to do with financial literacy?



The use of the questionnaire is merely a statutory obligation for the financial institutions to check whether you understand the characteristics of a particular investment product that you wish to purchase or that the financial institution wishes to offer you.

Financial literacy is a much broader concept: it refers to the extent to which a person is familiar with savings products, loans, online banking, and so on.

Financial literacy is essential in ensuring that users of financial services and products are informed individuals. It is therefore a collective responsibility of the general public, schools, supervisory authorities and financial institutions.

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