

## **MiFID II brings important developments for improved investor protection**

MiFID II is an EU legal framework that has been transposed into Austrian law by the Securities Supervision Act 2018 (WAG 2018; Wertpapieraufsichtsgesetz 2018) that entered into force on 3 January 2018. The new rules are intended to significantly improve investor protection. Investor protection is now enshrined in the product development process, with new obligations for product manufacturers and subsequently for the undertakings that distribute these products having been introduced. Furthermore, the new Securities Supervision Act 2018 is intended to make investment advice more transparent and thereby to improve the quality of the investment advice.

The new rules are intended for credit institutions and other undertakings (e.g. investment firms), that provide services in relation with securities and funds and other financial instruments. The following contribution provides an overview about the more important developments.

### **Greater transparency in product selection as a result of the target market assessment being conducted during product development (Product Governance)**

MiFID II creates product governance obligations for undertakings that manufacturer financial products and for undertakings that distribute such financial products. A product approval process is to be established, to which every financial instrument is to be subjected, prior to be marketed or distributed. The definition of a target market is a material component of the product approval process. Undertakings are already required to define a target market for end customers when producing a product. (Article 30 para. 10 WAG 2018)

During the target market assessment, the product manufacturer must determine whether a financial product is tailored towards private clients, professional clients or eligible counterparties, and what range of knowledge and experience and what level of ability to absorb losses the targeted group of investors should have. The risk/performance profile of the product as well as its recommended holding period must also be defined. It must also be determined whether the product is tailored in such a way to fulfil special client requirements, such as for clients wishing to invest in sustainable investments. Product manufacturers must also already make statements about the suitable distribution strategy for the financial instrument during this process. It should be geared to the requirements of the target market. (Article 30 para. 10 et seq. WAG 2018 in conjunction with the ESMA Guideline on MiFID II product governance requirements)

The distributors of the financial product must further define the target market determined in advance by the manufacturer with require to their individual business model and their client base. In the event that the manufacturer of a financial instrument is not subject to MiFID II, for example because the manufacturer is located in a third country, the distributor shall determine the target market and the distribution strategy by itself. (Article 31 para. 1 et seq. WAG 2018)

The Product Governance Rules in MiFID II also contain the obligation to continuously review products that have already been placed on the market. Information about events that are relevant for the definition of the target market of the manufacturer must be reported back by the distributor to the manufacturer (Article 30 para. 17 WAG 2018; Article 31 para. 9 WAG 2018).

## **Communications with clients are recorded (recording obligations)**

Credit institutions and investment firms are subject to enhanced recording obligations as a result of MiFID II. In the future, for example, telephone calls and electronic communications for services that are related to the receiving, transmission and execution of client orders, shall be recorded from start to finish. The undertaking must inform the client prior to providing the investment service or at least once a year, that communications are being recorded, otherwise the investment service shall not be allowed to be conducted. (Article 33 WAG 2018) All relevant information related to relevant face-to-face conversations with clients must also be recorded (Article 76 (9) of Delegated Regulation (EU) 565/2017, hereinafter referred to simply as the "Delegated Regulation").

Telephone calls, electronic communications and information about personal meetings must be recorded on a durable medium. They must be able to be played back again or to be copied. The company must retain the records for at least 5 years. These records must be easily accessible and available at the client's request, and must be made available to the client free of charge upon request. (Article 33 para. 9 WAG 2018 in conjunction with Article 76 (10) of the Delegated Regulation)

The recording of telephone calls and electronic communications should improve market monitoring by the supervisory authorities, and increase the legal clarity in the interest of investment firms and their clients. The obligation to keep records also serves the purpose of investor protection. The records should ensure that the conditions of the orders issued by the customers match up with those of the executed transactions. Market abuse should also become easier to detect in this way. (Recital 57 MiFID II)

## **The investor must receive this information - suitability statement and charges report**

### *Suitability statement*

If a client makes use of investment advice, then the client advisor must send a so-called suitability statement to the client prior to the execution of a client order. This must be done using a durable medium (Article 60 para. 2 WAG 2018). This means that the client must be able to consult the information for an appropriate period of time and be able to reproduce it without changes. (Article 1 no. 64 WAG 2018)

This statement contains an overview about the recommendation that has been given. It also indicates to what extent this recommendation has been matched with the preferences, requirements and other characteristics of the client. Reasons are given why the recommendations of the adviser are suitable for the client. (Article 60 para. 3 WAG 2018 in conjunction with Article 54 (12) of the Delegated Regulation)

The contract for the recommended transaction shall only allowed to be concluded, if the suitability statement has been sent to the client. If the contract is concluded by means of distance communication, for example by telephone, it is permissible that the suitability statement shall be submitted immediately following conclusion of the contract. A prerequisite for doing so is, however, that the client has consented to this and the advisor has offered to delay the transaction. (Article 60 para. 3 WAG 2018) Where the client has been promised a regular assessment of suitability, then an update must be enclosed with the suitability statement. This shall also apply, if portfolio management services are provided. (Article 60 para. 4 WAG 2018)

### *Charges report*

The undertaking may make understandable information available to the client about all charges relating to the recommended product, the service, any ancillary services (incl. charges for advice) and information regarding the payment modalities. The information about the charges are to be clearly summarised, so that the client understands the total charges and the effect of the costs on the returns of the investment. (Article 48 para. 1 no. 3 WAG 2018)

The information about the charges is to be handed out prior to the conclusion of the contract in a standardised form on the basis of an indicative invested amount (e.g. € 10 000). If the contract is concluded by means of distance communication, for example by telephone, it is permissible that they are submitted immediately following conclusion of the contract. A prerequisite for doing so is, however, that the client has consented to this and the advisor has offered to delay the transaction. (Article 48 para. 3 WAG 2018) Furthermore the undertaking must make information available on at least an annual basis about the actually incurred costs, in relation to the actual amount of the investment. (Article 60 para. 1 WAG 2018 in conjunction with Article 50 (9) of the Delegated Regulation)

### **A legal framework is created for fee-based advice (independent investment advice)**

MiFID II also creates a legal framework for independent investment advice. This means, among other things, that the independent advisor, in performing advisory activities:

- must evaluate an adequately broad range of products on offer with regard to their nature and issuers. this means that the offer shall not be allowed to be restricted to the proprietary financial instruments of the company, a closely associated company or a company to which there is a close legal or economical relationship (Article 50 WAG 2018).
- shall not be allowed to accept any commissions or incentives from third parties, or if doing so must immediately pass them on to the client.

The client must be regularly informed about the benefits that are transferred to them. The advisor shall be allowed to keep minor non-monetary benefits under certain conditions, provided that they do not exceed the de minimis threshold. (Article 53 WAG 2018)

The second and hitherto common form of advice in Austria is "non-independent" (commission-based) investment advice. The advice in such a case may be restricted to proprietary products. The acceptance of inducements (e.g. sales commissions) is only permissible in this case, provided that by doing so:

- leads to an improvement in the quality of the service provided for the respective client,
- the obligation to act in the best interest of the client is not adversely affected, and
- the type and amount of the inducement is disclosed in full to the client prior to the service being provided.

The company must inform customers promptly by means of a durable medium prior to advice being given, whether advice is being provided on an independent basis or not. An advisor shall only be allowed to provide exclusively independent advice or exclusively non-independent advice. (Article 52 (3) of the Delegated Regulation).

## Increasing Quality of Investment Advice

The requirements in terms of knowledge and experience of all persons involved in investment advice are being increased. The quality of advisory services should be visibly increased as a result of specific minimum requirements and training requirements, that are set out in the ESMA Guidelines (ESMA/2015/1886) and the FMA Circular ("The Criteria for the Assessment of Knowledge and Competence of Investment Advisors and Persons providing Information about Investment Products (Article 55 WAG 2018)").

The highest requirements are placed on investment advisors. In particular, they shall be required to prove their knowledge and competences in relation with the suitability assessment, as well as an understanding about

- material features, risks and functions of the available investment products,
- general tax effects,
- charges and fees,
- features of investment services,
- how the financial markets work, and
- the influence of economic figures and relevant events upon the markets and the value of the value of investment products.

However persons that provide information about investment products and investment services or ancillary services, must also possess the necessary knowledge and competence.

The knowledge and competences of such persons are to be ensured by means of attending training courses and passing examinations, and are to be proven to the supervisor upon request.

## Conclusion

Both MiFID II as well as the new Securities Supervision Act improve investor protection as a whole. A target market is required to already be defined during the product manufacturing process and it is to be ensured that all risks are assessed for this target market and the distribution strategy corresponds to the target market. The requirements to keep records should ensure that the conditions of the orders issued by the customers match up with those of the executed transactions. The transparency of advice is increased as a result of the suitability statement and the charges report. A legal framework has been created for independent advice and the quality requirements in terms of knowledge and experience increased for all persons involved in investment advice. These new features mean a strengthening of collective consumer protection within a harmonised European legal framework.