

## Minutes

Meeting:	MiFID II Implementation – Conduct Forum	
Date of Meeting:	18 April 2016	
Venue:	25 The North Colonnade, Canary Wharf, London, E14 5HS	
Present:	Stephen Hanks - FCA	
	Alexander Smith - FCA	Jennifer Watson - FCA
	Susan Cooper - FCA	Jason Pope - FCA
	Sarah Raisin - FCA	Isla Cully - FCA

### 1 MiFID II Conduct Forum

- 1.1 As part of the series of MiFID II implementation trade association roundtables, the FCA held a bespoke session - on certain MiFID II conduct of business matters - for trade associations and their nominated member firms. In response to feedback from recent roundtables, as well as from the October 2015 MiFID conference, this session covered product governance and the disclosure of costs and charges.
- 1.2 The FCA requested pre-submitted questions on these two topics, and provided a further opportunity to raise questions during the session itself. The questions and answers are summarised in these minutes. The slides from the session have also been published.

### 2 Introduction

- 2.1 The FCA noted that (i) the MiFID delay legislation, having been voted on by the European Parliament, was currently in discussion in the Council<sup>1</sup>; (ii) it expected the remaining implementing legislation to be published in the next few weeks; (iii) following the markets-related consultation paper (CP) in December 2015, it was planning to publish two further MiFID II implementation CPs in July and in September 2016 – with the aim of completing its MiFID II transposition by April next year, in order to give firms sufficient time for implementation.
- 2.2 The FCA caveated that while the product governance content was set out in the published Implementing Directive, the costs and charges disclosure material would be covered in the forthcoming Implementing Regulation, and therefore, comments on costs and charges disclosure would be made in the context of the European Securities and Markets Authority's (ESMA) Technical Advice, although there are likely to be limited differences between ESMA's advice and the final Level 2 text.

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<sup>1</sup> Council of the European Union.

### 3 Product governance

- 3.1 Product governance refers to the systems and controls firms have in place to design, approve, market and manage products throughout their lifecycle to ensure they meet legal and regulatory requirements. Good product governance should result in products that (i) meet the needs of one or more identifiable target markets, (ii) are sold to clients in the target markets by appropriate distribution channels, and (iii) deliver improved consumer outcomes.
- 3.2 Our existing expectations are set out in the Responsibilities of Product Providers and Distributors for the Fair Treatment of Customers (RPPD) guidance, which includes provisions for both providers and distributors to consider the impact of their actions on their clients in the various stages of the product life-cycle.

#### *Questions and answers*

- 3.3 The following is a summary of questions and answers given during the session:

**Q1:** Does the FCA propose to implement the provisions as rules outside MiFID scope?

**A1:** We are still considering our approach for non-MiFID business. The RPPD sets out current expectations for all firms and while this is guidance rather than rules, it is broadly reflected in the new MiFID provisions. It is worth noting that the IDD also includes product governance provisions.

**Q2:** How do the provisions apply where a MiFID distributor firm wishes to sell a MiFID product manufactured by a non-EEA firm?

**A2:** In this scenario, the firm will need to take reasonable steps to obtain information so the product can be distributed in accordance with the characteristics, objectives and needs of the target market. They must perform the necessary due diligence to provide adequate consumer protection standards.

**Q3:** How do the provisions apply where a MiFID manufacturer firm develops a product for sale outside the EEA?

**A3:** The firm would still need to follow the MiFID provisions to the extent that a MiFID service is provided to the distributor firm.

**Q4:** How are the terms 'distributor' and 'manufacturer' defined?

**A4:** The delegated directive defines manufacturers as "firms that create, develop, issue and/or design products". Distributors are defined as firms that make a decision over "the range of products (issued by themselves/other investment firms/non-MiFID entities) and services they intend to offer to clients ...".

**Q5:** How do the provisions apply where firms work together to manufacture a product?

**A5:** Where firms work together to develop a product, or to distribute a product, firms should agree how to share responsibilities.

**Q6:** Will the FCA consider providing a standardised approach to the form this agreement should take?

**A6:** We invite firms to give us feedback on this point in terms of their preferred approach.

**Q7:** In how much detail should the product target market be assessed?

**A7:** In line with the proportionality principle, the target market for more mainstream, plain vanilla investments would likely be identified with less detailed information and these investments would be likely be suitable for a wider target market. More complicated products would require more granular detail to identify the target market. Ultimately, this is a decision for firms to ensure that that target market is identified sufficiently to ensure that products are made and sold to people with the relevant knowledge and experience to use them.

**Q8:** How does the FCA expect the distributor provisions to apply for execution-only business?

**A8:** Again in line with the proportionality principle, we would expect distributors to obtain more detailed, granular information for more complex products while more vanilla products would likely be distributed with more generic, less detailed information. Where an execution-only service is offered without client appropriateness tests, the distributor role may be more about communicating the target market to the investor than imposing any additional point-of-sale requirements.

**Q9:** The provisions require distributors to share information with manufacturers to allow product reviews to take place. How does the FCA envisage this working?

**A9:** The review should assess whether the product remains consistent with the needs of the identified target market and whether the distribution strategy remains appropriate for the product and target market. The starting point may be where the manufacturer considers whether it has appropriate and sufficiently detailed information from the distributor to undertake a regular product review. Relevant information could include, for example, information about the proportion of sales made outside the target market, summary information of the types of client using the product, a summary of any complaints received or client feedback based on questions raised by the manufacturer. Firms must determine the type and amount of information needed to support product reviews.

**Q10:** Can distributors provide information to manufacturers in a way that does not challenge client confidentiality?

**A10:** We would expect that the detail submitted by distributors to manufacturers would not relate to individual clients but would relate to product performance and client use more broadly. This may include, for example, aggregate data or anonymised feedback. Where specific client information is requested, firms would need to consider how to provide this in a way that is compatible with data protection and confidentiality rules.

**Q11:** The new provisions may substantially increase the regulatory burden, particularly on smaller firms that both manufacture and distribute products and on firms in the wealth management sector, for example in relation to information sharing between distributors and manufacturers. Are these costs being taken into account?

**A11:** We recognise that there may be additional procedures for firms as a result of the new MiFID II provisions which aim to establish a proportionate framework that benefits consumers. We will continue to support the development of ESMA Level 3 guidance to consider how industry concerns about costs can be addressed.

**Q12:** Will the product governance provisions be compatible with the recommendations of the Financial Advice Market Review (<https://www.fca.org.uk/static/fca/documents/famr-final-report.pdf>)?

**A12:** We expect the two to be well aligned. For example, products designed for a clearly-articulated target market may be more compatible with streamlined advice distribution channels, which is one of the FAMR recommendations.

**Q13:** Are distributors able to sell investments outside the manufacturer's target market?

**A13:** Distributors will need to develop their own target market for investments. It may be that there are reasonable grounds for difference in the distributor's target market. In addition, as sub-paragraph 7 of MiFID II Level 1, article 16(3) makes clear, distributor product governance provisions are without prejudice to other MiFID requirements, such as suitability. If it would be suitable to recommend an investment to an individual investor who lies outside the target market, the product governance provisions do not prevent the firm from giving advice.

**Q14:** What are the main changes expected under MiFID II, compared with the current regulatory framework?

**A14:** As noted above, the RPPD and other materials set out the FCA's current expectations for firms to deliver product governance protections. Firms need to satisfy the Principles now and can do this by showing they have adopted the approach outlined in current guidance or how they are taking another approach which also satisfies the Principles. Under MiFID II, there will be more detailed and binding rules, limiting some of the current flexibility allowed under the current approach.

#### **4 Costs and charges**

- 4.1 The FCA noted that under MiFID II, as with most of MiFID II's conduct requirements, the requirements for the disclosure of costs and charges information are being strengthened.
- 4.2 In particular, MiFID II will require firms to disclose information on all costs, and associated charges, relating to both investment and ancillary services, and the financial instrument. This excludes those costs caused by "*the occurrence of underlying market risk*" (which ESMA's Technical Advice suggests should be interpreted narrowly). Firms will also be obligated to aggregate all costs - so that clients are clear, not only about the total cost of the investment, but also about the cumulative effect on the return on their investment. The FCA noted the expectation that the Level 2 will require this aggregation to be disclosed both as a cash (or monetary) amount, and as a percentage. The FCA noted that it is likely that firms will be required to disclose some costs that have not typically been disclosed to date, including, for example, transaction costs.
- 4.3 Firms will be required to provide clients with this information both on a pre-contractual and on a post-sale basis; and, under certain circumstances, on a regular basis (but at least annually). The expectation is that the pre-contractual disclosure could be generic in nature, based on an assumed investment amount and reasonable assumptions; whereas the on-going disclosure should be personalised and based on the actual investment amount – although this is yet to be confirmed in the delegated legislation.
- 4.4 Firms will be required to disclose this cost information to all clients - not only to retail clients, but now also to professional clients and to eligible counterparties.

#### *Questions and answers*

- 4.5 The FCA noted that the pre-submitted questions fell broadly into three categories:
  - Interaction between PRIIPs, UCITS and MiFID II requirements.
  - The presentation of costs and charges under MiFID II.

- Obligation to provide pre-contractual information and on-going disclosures.

#### Interaction between PRIIPs, UCITS and MiFID II requirements

- 4.6 The FCA noted that with the probable delay to the date of MiFID II application to 3 January 2018, there would be a year-long gap from 31 December 2016, when the Packaged Retail and Insurance-based Investments Regulation (PRIIPs) takes effect, where the PRIIPs and MiFID II reporting requirements would not be harmonised. It noted that there would be a further 3-year harmonisation gap, until 31 December 2019, where UCITS will be exempt from the obligations under the PRIIPs KID; and that the Insurance Distribution Directive (IDD) also includes costs and charges disclosure requirements for insurance-based investments.
- 4.7 Asked about a possible delay to the application date for PRIIPs, the FCA said that only the European Commission can table proposals for any delays to the application dates for European legislation.
- 4.8 The FCA noted that the interaction of the MiFID II disclosure requirements with the information to be included in the PRIIPs Key Information Document (KID) is important, because it is crucial that consumer information is accessible. The FCA noted that the ESA's Joint Committee had recently published the Regulatory Technical Standards underpinning the PRIIPs disclosure requirements; and that Recital 78 of MiFID II sets an expectation that, for pre-contractual disclosure, firms may be able to rely on the information included in the PRIIPs KID, or the prospectus and UCITS KIID, when disclosing the product costs under MiFID II for investment products.

#### The presentation of costs and charges under MiFID II

- 4.9 The FCA noted that, unlike the PRIIPs KID, there is no prescription in the MiFID II Level 1 text for the design or shape of the costs and charges disclosure. The FCA noted its view that the MiFID II requirements are therefore flexible, giving firms the scope to determine and develop the most appropriate layout or format for this disclosure.
- 4.10 The FCA recalled its MiFID II Discussion Paper in March 2015 where it sought views on whether it should look to standardise the MiFID disclosure for retail consumers. It noted that a number of stakeholders were in favour of this standardisation approach – saying that this would help consumers to compare across products and services, and that any meaningful comparison is not possible without standardisation; while also giving firms the confidence that they are getting this disclosure right.
- 4.11 The FCA also noted that there were those who opposed standardisation, the main reasons for this being twofold. Firstly, the MiFID II costs disclosure forms part of a wider package of information that consumers receive. So, in not standardising, there are benefits of providing firms with flexibility to ensure that the disclosure is consistent with the broader information pieces being provided to clients – such as through the PRIIPs KID. Secondly, a standardised 'one-size-fits-all' format may not work for all consumers across all firms, given both (i) the many different types of products available, and (ii) the variety of business models which operate and exist. So, trying to develop a single, easily understandable standard across all products, and for all business models, could possibly become fairly unwieldy, and therefore may not in the end deliver the desired transparency and ease of comparison.
- 4.12 The FCA, through its Smarter Consumer Communications initiative, is encouraging firms to design disclosures around the information needs of their clients or their target markets, so that that communication with their clients is effective. It noted it had encouraged firms to consider using electronic interfaces, rather than paper documents, for example, to deliver the various disclosure obligations. So any standardisation of disclosure, therefore, could restrict future innovation in this regard (the choice and use of various media) and prevent

firms from disclosing the cost of their product or service in the most meaningful way for their target market.

Obligation to provide pre-contractual information and on-going disclosures

4.13 The FCA acknowledged the complexities of having to deal with various cost calculations - in particular, with aggregating costs on an annual basis. But it noted that for pre-contractual disclosure, ESMA's Technical Advice stated that this could be generic using actual costs as a proxy for expected costs, and based on an assumed investment amount (and that where actual costs are not available, firms may make reasonable assumptions about these costs).

4.14 The FCA noted that on-going and annual disclosure, on the other hand, should be personalised, and reflect the actual costs incurred. This would also apply in relation to illustrating the cumulative effect of charges. The FCA also noted that ESMA's Technical Advice set out when investment firms should provide annual disclosure: firms are obliged to disclose annual post-sale information about all costs if a firm (i) has recommended or marketed the financial instrument(s); or (ii) has provided the client with the KID/KIID in relation to the financial instrument(s); and (iii) has/or has had an ongoing client relationship during the year.

4.15 The following is a summary of questions and answers noted during the session:

**Q1:** A key issue for firms is what 'actual costs' means, given that the level of precision could be quite onerous, especially in the context of platforms and of portfolios of products.

**A1:** ESMA and the MiFID II Level 1 text is clear that costs refer to 'all costs' (except those caused by underlying market risk), and that there is no materiality. Consumers should be provided with full transparency so that they receive an accurate picture. There might be ESMA Level 3 work on this issue.

**Q2:** With regard to Recital 78 in the MiFID II Level 1 text, and the ability to rely on the PRIIPs KID (or UCITS KIID) for information, if certain information is missing, can it be assumed it is not relevant? And which figures should be used if the numbers for the same costs differ between the PRIIPs KID and the UCITS KIID?

**A2:** Firms must take a judgement on what is fair, clear and not misleading; and should be making qualitative judgements as to what necessary information may be missing, but needs to be disclosed in addition.

**Q3:** The PRIIPS Regulation is viewed as requiring pre-sale disclosure for retail clients, whereas in the wholesale/ECP context MiFID also looks at onward transmission. It is less clear where the boundary is in the wholesale context. How will this work in the wholesale context?

**A3:** The FCA noted that it might be appropriate for ESMA to consider this in future Level 3 work.

**Q4:** What is the definition of 'ongoing relationship'? Does this only apply in the suitability context?

**A4:** Application of this is more straightforward in the UK, particularly in an advice relationship. ESMA sought to clarify this in its Technical Advice, and it may form part of its Level 3 work.

**Q5:** In primary markets, banks advise issuers and charge fees, for example. Bonds have ongoing interest costs which may be underwritten, but the underwriters step out post-issuance.

**A5:** If it is purely a transactional relationship, there is no ongoing relationship with the issuer, and therefore no continuing obligation from a costs and charges perspective, given the upfront disclosure.

**Q6:** In terms of system builds, firms do not have as much flexibility as it appears is necessary to deal with the different methods to apportion costs - because there are only a finite number of systems. How are firms to deal with this, also in terms of delivering consistency? Is there going to be a common approach?

**A6:** Firms should make judgements as to what is sensible. Although further steers may be available over time, once the implementing measures bed in, it is unlikely that any granular detail for each situation will be possible.

**Q7:** With regard to Organised Trading Facilities (OTFs), do they have an 'ongoing relationship' that requires costs and charges disclosure to be provided on a regular basis?

**A7:** The FCA said it had not previously considered this question, and would need to think about it further. One of the points it would need to take into account is that there is a separate provision in MiFID II regulating the fee structures of OTFs.

**Q8:** Can the PRIIPs KID replace the prospectus given there is some cross-over in terms of content? How does the PRIIPs KID fit with the official disclosure contained in the prospectus?

**A8:** The PRIIPs KID does not replace the scheme prospectus or an approved prospectus required under the Prospectus Directive. These are separate documents with different and distinct purposes. The PRIIPs KID is intended to be high level and is aimed at the retail end-client, not at the distributor. However, the PRIIPs KID can refer to the fact that a prospectus has been prepared for the PRIIP, and indicate where it may be found.

## **5 AOB**

- 5.1 The FCA noted that it will be organising a range of events over the coming months to assist firms with MiFID II implementation.