



## Regulatory Newsflash

FSMA Communication on the preparation for the entry into force of MiFID II (conduct of business rules)

### Introduction

On July 18, the Financial Services and Markets Authority (FSMA) published a communication ([Dutch](#) / [French](#)) on the preparation for the entry into force of the MiFID II conduct rules.

In this communication the FSMA:

- Lists the relevant legislative texts relating to the MiFID II conduct of business rules and their entry into force;
- Summarises the most important changes made by MiFID II to the conduct of business rules; and
- Points out to firms the importance of creating an action plan to identify the measures to be taken in order to ensure MiFID II compliance.

The FSMA will consider whether more specific communications on the rules of conduct are required in the future.

## Relevant legislative texts and their entry into force

In the first chapter of its communication, the FSMA provides an overview of all relevant legislative texts and guidance and their entry into force (i.e. 3 January 2018). The FSMA informs that the Belgian legislative texts transposing MiFID II requirements into Belgian law will be submitted to Parliament soon.

## Most important changes due to MiFID II

In this chapter, the FSMA indicates the changes under MiFID II to which in its opinion firms need to pay specific attention. For each of those important changes, the FSMA has included the relevant articles from the MiFID II texts (the articles of the Belgian legislation will be included once final) and has clarified the key provisions, as summarized below.

### **The extension of the scope of certain requirements to the commercialisation of structured deposits or the provision of investment advice relating to such deposits.**

Firms will in these cases need to apply certain conduct of business rules (e.g. conduct of business rules regarding suitability, inducements, product governance, etc.) and comply with organisational requirements (such as the general governance requirements and the product governance requirements).

### **Product governance.**

MiFID II introduces product governance rules for financial instruments and structured deposits (together 'products') containing requirements for both manufacturers and distributors in order to guarantee that the interests of clients are respected throughout the lifecycle of the products.

Manufacturers must establish a product approval process for the products they originated and specify a target market of end clients for these products, together with a distribution strategy compatible with that target market. Manufacturers must provide distributors all relevant information, and periodically monitor that the product remains compatible with the needs, characteristics and objectives of that target market and with the distribution strategy.

Similar product governance rules also apply to distributors, who need to take measures to retrieve the necessary information from manufacturers, determine the target market within their client base, monitor the products they distributed and exchange information with manufacturers.

The product governance rules, however, do not replace the suitability and appropriateness requirements or any other conduct of business rules set forth by MiFID II.

## **Provisions, commissions or other monetary and non-monetary benefits (inducements) (including the requirements concerning research).**

Within the framework of portfolio management or independent investment advice, MiFID II introduces a ban on inducements. Only minor non-monetary benefits that enhance the quality of the services provided to clients, do not cause any detriment to the interests of the client and of which the client has been informed, are still allowed.

For other investment services, the conditions as set forth in MiFID I become more strict, more specifically regarding the criterion of enhancing the quality of the services provided to the client (MiFID II contains a list of examples in this regard) and the provision of information to the client.

Besides the above, MiFID II provides for specific arrangements for the reception of research, which will be regarded as an inducement unless:

- The firm pays for the research itself; or
- The firm makes the payments from a research payment account. This account needs to be funded by amounts charged to the clients and is subject to several organisational requirements.

## **Remunerations.**

MiFID II explains what is expected from firms regarding the policies and practices they need to develop for the remuneration of their staff.

## **Investment advice, including the concept of independent advice.**

The scope of the definition of 'investment advice' will be refined by removing the criterion that a recommendation is not regarded as personalized when it is made only through distribution channels.

MiFID II also requires firms to provide ex ante information to their clients about the nature (independent or not) and the scope (range of products, periodic assessment (incl. modalities) or not) of the investment advice they provide.

Each investment advice needs to be documented in a suitability statement that needs to be provided to the client before a transaction is executed following that advice.

Firms have the possibility to provide clients with a periodic assessment of the suitability of the financial instruments recommended to them. To enhance the quality of the service provided to the client, the periodic assessment needs to take place at least once a year, whereby the frequency increases in function of the client's risk profile and the type of financial instruments recommended.

Finally, MiFID II introduces the concept of "independent advice", which implies that a firm has an adequate variety of products available on the market in its product offering that are sufficiently diverse as to type and

issuers or product distributors and are not issued or offered by the firm itself or by firms with whom it has close links.

### **Duty to care.**

MiFID II enhances the duty to care by elaborating and clarifying multiple elements regarding the suitability assessment, and appropriateness assessment and execution only requirements.

- Regarding the suitability assessment, those elements include the responsibility for the suitability assessment, the use of automated or semi-automated systems, the capacity to bear losses and risk tolerance, reliability of information gathered from clients and periodic suitability.
- Regarding the appropriateness assessment and execution only requirements, those elements include record keeping of appropriateness assessment and the concept of non-complex financial instruments.

Further, firms need to have in place policies and procedures allowing them to determine whether other investment services or financial instruments, similar to the services or instruments selected for the client, might correspond with the profile of their client considering the price and complexity of these services or instruments.

Firms must also obtain the necessary information about a client's existing and new investments that are recommended in case their portfolio management or advisory services lead to a switch in investment products. They must analyse the costs and benefits linked to the switch in order to demonstrate that the benefits outweigh the costs.

### **Best execution and best selection.**

MiFID II provides for more stringent information requirements to enable clients to better assess the firm's best execution/selection policy and arrangements. This includes the annual publication of an overview of the top five execution venues/ brokers used by the firm.

Further, the FSMA clarifies that whilst firms remain subject to the same overarching obligation to obtain the best possible results on a consistent basis when executing client orders, the requirement for "sufficient" steps introduced by MiFID II sets a higher bar for compliance than "reasonable" steps under MiFID I.

### **Provision of information to clients (incl. reporting).**

MiFID II tightens or completes the existing MiFID I information requirements, especially with respect to the following topics:

- The description of the service of investment advice (see above);
- The financial instruments and proposed investment strategies (e.g. clarify whether they are intended for professional or non-professional clients, include restrictions in the risk description on the possibility to sell financial instruments, describe the nature and extent of capital protection/guarantee);

- Costs and charges (including ex ante and ex post disclosure of cumulative effect of costs and charges on return);
- The threshold of depreciation of a managed portfolio (i.e. 10% loss);
- The research payment account (inform clients about budget before providing investment services and provide annual information to clients on actual costs made for research).

## **Taping of telephone conversations and electronic communication.**

MiFID II requires firms to tape telephone conversation or electronic communications relating to or aiming at:

- Dealing on own account;
- Reception, transmission and execution of client orders.

As such, it is not required to tape telephone conversations regarding the provision of investment advice. However, ESMA clarified that if investment advice is possibly provided during a telephone conversation that must be taped; the investment advice will have to be taped as well. This will be the case, for example, if the investment advice provided results/is intended to result in the reception, transmission and/or execution of a client order.

Firms must inform their clients that telephone conversations and electronic communications will be taped.

Orders placed through other channels must be documented on a durable medium, or in case of face-to-face conversations through meeting minutes.

Records must be kept during 5 years, or 7 years at request of the competent authority.

## **Knowledge and competence of staff.**

Staff providing either investment advice, information on financial instruments, or investment and ancillary services to clients must possess the necessary knowledge and competence to do so.

ESMA issued guidelines in that respect, incl. the requirement to have at least 6 months of experience. The Belgian Royal Decree of 1 July 2006 will be aligned with these ESMA guidelines.

## **The value of an action plan**

Considering the entry into force of MiFID II on January 3, 2018, the FSMA expects firms to draft an action plan as soon as possible to ensure timely compliance with MiFID II requirements.

Such action plan must follow a gap analysis pursuant to which all necessary measures can be identified in order to ensure timely compliance. In this respect, both the way in which the firm provides its investment services to clients, including its business model, as well as its organization and internal control model must be investigated.

All departments involved should play a role in the drafting and implementation of such action plan.

The FSMA expects the measures taken following such action plan to result in an elaboration of different policy lines, a revision of the documents used in client contacts, obtaining client approval whenever required, a revision of the firm's procedures, and a consideration of the impact of these measures on compliance, risk management and internal audit.

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## Contact

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