Nine things financial advisory firms need to know about MiFID II

With MiFID II set to come into full effect on 3 January 2018, time for complying with the directive is fast running out. For many firms, however, the directive requires a minor tweaking of processes, rather than root and branch reform, in order to be compliant. So, what do UK financial advice firms need to be looking out for with MiFID II?

1. What is MiFID II?

The second iteration of the Markets in Financial Instruments Directive. It is fundamentally designed to offer greater transparency and protection to all investors across all asset classes. The first iteration was entered into European law on 30 April 2004 and became effective as of 1 November 2007 following an extensive grandfathering period.

There has been the small matter of a major global financial crisis since then, so the rules have needed tweaking. As a result, MiFID II has been seven years in the making, with initial consultation being opened on the subject in April 2010.

2. Will Brexit save me?

No. The UK remains part of the European Union at the time of implementation and the FCA has done a lot of work in defining the guidelines for UK firms. On top of this, firms working with EU based investors will need to comply with MiFID II, meaning large financial institutions globally will have to comply. Whilst this doesn't relate to the majority of UK based advisers, it highlights the global scope of the directive as it will, in effect, implement a higher transparency standard for investors.

3. Target markets

All products that are being sold by providers will need to have their target market defined by the provider. This is to ensure that the right products are sold to the right investors and are being appropriately packaged. This will form part of advisers' risk assessments with investors at the outset, to ensure that products are properly aligned with their interests and risk appetites. Providers should define a distribution strategy for their products which considers the best distributors (advisers in this case) for the product.

The European Securities and Markets Authority (ESMA) has defined six categories for target market identification; type of client, knowledge and experience, financial situation and ability to bear losses, risk tolerance, client objectives and client needs.

4. Aggregated costs and ongoing charges

There will need to be complete transparency for investors as regards the initial and ongoing charges that they will subjected to, as well as the impact that such charges will have on the value of the portfolio. This will require the disclosure of pre-sale costs to the investor, along with regular updates on the ongoing charges. For UK advice firms, this is broadly similar to and an extension of, the fee transparency rules which were introduced with the Financial Advice Market Review (FAMR) which aimed to simplify the way in which advisers can charge for advice.

5. 10% drop in portfolio valuations

If a client's portfolio drops by at least 10% in value, then advisers will need to notify them of the drop "no later than the end of the business day in which the threshold is exceeded." Firms will need to think carefully about how they meet this requirement. Regular valuations will need to be received and then matched to the correct customer portfolio records. This means that the data within a firm's back office system needs to be accurate, so that valuation matching can occur (see below).

The other consideration is how frequently a firm notifies its clients of the valuation of their portfolios. MiFID II requires that such reporting is conducted at least quarterly, with the notification of a 10% drop being a drop in the value of the portfolio since the last report was issued. Firms have 24 hours to notify clients in such circumstances.

6. Portfolio guidance

Related to point five, above, ESMA's Final Report: Technical Advice to the Commission on MiFID II and MiFIR (p. 170), states that:

If a firm provides its clients with access to an online system, which qualifies as a durable medium, where up-to-date valuations of the client's portfolio can be accessed, the firm does not need to provide a periodic report for the quarter where:

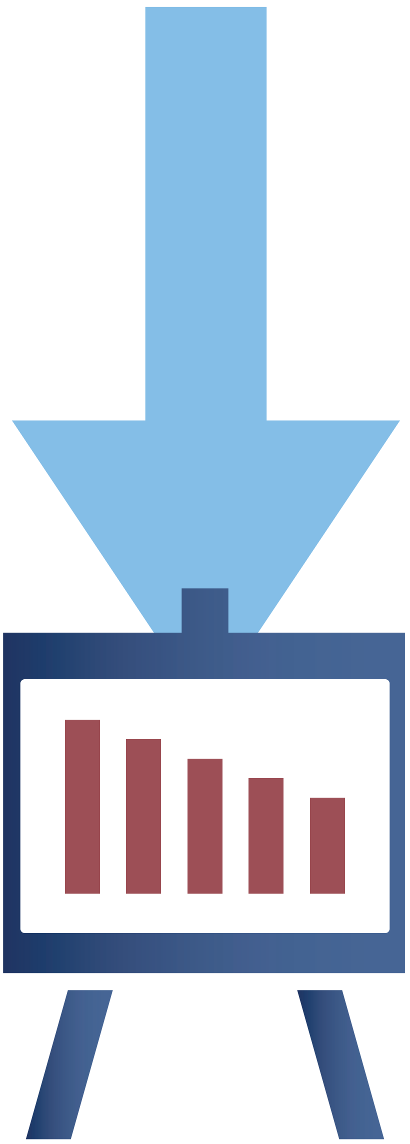
- (I) the client can easily access the information required by Article 43(2) of the current MiFID implementing directive through the same system, and:
- (II) It has evidence that the client has accessed a valuation of their portfolio at least once during the quarter.

This represents a good opportunity for firms to provide clients with paperless access to and records of, their portfolio. Through online portals, such as Intelliflo's Personal Finance Portal, firms can avoid some of the reporting requirements and set up automatic alerts for clients. So in the case that the value of a portfolio drops by 10%, for example, an automatic notification can be set up for such a scenario.

7. Data accuracy

It is imperative that valuations are accurate and pertaining to the correct client. Accurate data is becoming ever more important, if it wasn't already important enough, since inaccurate data could lead to regulatory punishment. Firms will need to ensure that they accurately leverage the valuation capabilities available to them, e.g. bulk and scheduled valuation features.

Improving data accuracy, as well as helping with MiFID II, also helps with other regulations such as the forthcoming General Data Protection Regulation (GDPR). Intelliflo operates a free Flashlight service for its clients which works with firms to enhance the way that bulk valuation files are dealt with from providers to maximise the efficiency and accuracy of data.



8. Do I really need to record all client conversations?

Yes, but not in the way initially envisaged. The FCA had proposed to transpose this aspect of MiFID II so that it would have required a full digital recording of conversations with clients. After consultation with the industry, this aspect of MiFID II has been diluted – conversations need to be recorded, but can be recorded however an adviser sees fit. This could be paper notes or a full on recording.

Embracing a digital approach to this aspect of MiFID II also has knock on effects to other areas of the business. Having a digital recording provides indisputable evidence of conversations that took place, which is useful in the event of litigation. Of course, this is an unlikely scenario, but not implausible. Firms need to carefully consider the best and most appropriate course of action since this represents an opportunity to review existing structures.

9. Legal Entity Identifiers (LEIs)

Those advisers making investments on behalf of their clients will need an LEI, whilst many advisers' clients will need one, too. The purpose of the LEI is so that regulators can have full transparency of what is going on within financial markets, with trades reported to trade repositories by trading venues and sell side operatives.

Advisers will not need to report directly, but transactions on behalf of investors without an LEI will be unable to be processed. These must be in place by 3 January 2018. There are several places from which an LEI can be obtained and there is a full list available on the Global Legal Entity Identifier Foundation website.

Overall, a lot of the new rules within MiFID II are an extension of common sense best practices, adopting them to a regulatory conclusion. As always, the changes represent an opportunity, too, since it is a chance to look into existing procedures and the solutions that are available in the market.

For more information on the solutions that Intelliflo can provide to UK financial advice firms, please visit our features page.