SFPI Society of Financial Planners Ireland

The Future of Advice:

Impending Regulatory Changes & the Advisor

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Presentation Content

- Intentionally wordy for further reference
- Will cover content at a high level
- Focus on how conduct of business throughout the industry is changing
- Hopefully allow people to consider upstream and downstream changes
- We now have dates for incoming legislation
- Tried to avoid overlap with discussion on post-RDR world

Some recent conversations

We're just getting a watered down version of RDR

I charge my own fees so RDR won't affect me

The Central Bank aren't authorising one man operations

Does the Prudential Handbook now say I need a compliance officer?

Can I just outsource compliance?

Impending Regulatory Changes

- MiFID 2
  - MiFID 2 (Directive) and MiFIR (Regulation)
  - Member states have to adopt & publish by 3rd July 2016, applied by 3rd January 2017
  - MiFID 2 amends the original Insurance Mediation Directive (IMD)
    - "Insurance Based Investment Products ("IBIs")

- IMD 2
  - Compromise text proposed 20th June 2014
  - Minimum harmonisation directive
  - Expected to come into force late 2016, fully applied early 2017

- PRIPs/PRIIPs
  - Regulation on key information documents for Packaged Retail Investment Products
  - Now called the Regulation on Key Information Documents for Packaged Retail and Insurance Based Investment Products
  - Expected to come into force late 2016, fully applied early 2017

- New Prudential Handbook for Intermediaries
  - In effect from October 1st 2014

Impending Regulatory Changes

- All of the above focus on:
  - Consumer protection
  - Information provision
  - Role of distributors, product manufacturers and advisors

- Move to a uniform approach for Conduct of Business provisions across insurance and non-insurance products?

- Role (and liability) of distributor and intermediary a key focus

- Distributors of financial products (and services) require a rethink

- Today will focus on main Conduct on Business Requirements & changes
  - MiFID 2 – disclosure at point of sale/points of advice
  - PRIIPS – disclosures at product level
  - IMD 2 – heavily lobbied – however impacted by PRIIPs/MiFID reforms

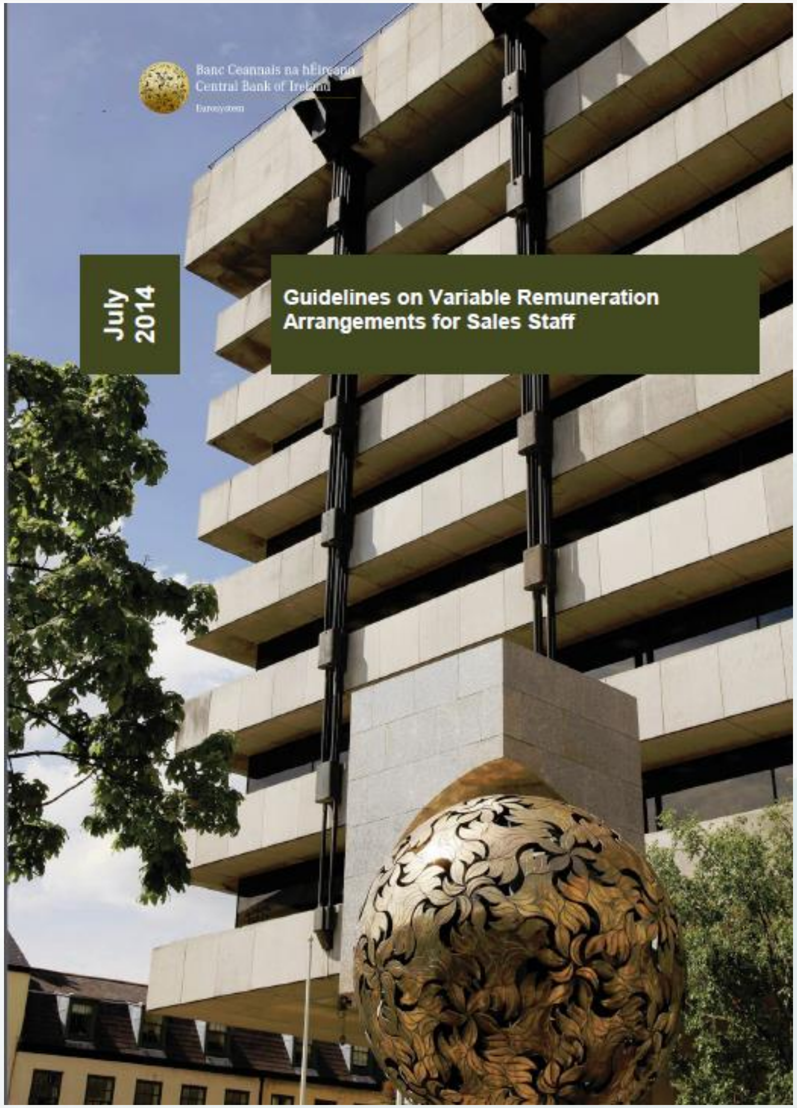
- Single Handbook like the UK?

- Consumer Protection Code and MiFID moving closer to together

Still sound like the case?

We're just getting a watered down version of RDR

First Guidelines on Variable Remuneration



MiFID Conduct of Business Requirements

- Investment Advice
  - Distinction between independent and non-independent advice
  - Required to provide information on the costs of advice
  - Required to provide information on the basis of the advice
    - Range of products considered
    - Provided on an independent basis or not?
    - Whether a periodic assessment of the suitability of the instruments is provided? (staying suitable)
    - Explain the reasons for the advice
- Inducements
  - Restriction on inducements for:
    - Investment Advisory Services
    - Portfolio Management

Suitability

- Where an investment firm provides investment advice or portfolio management, it shall be required to obtain:
  - the necessary information regarding the client's (or potential client's) knowledge and experience in the investment field relevant to the specific type of product or service
  - financial situation including their ability to bear losses
  - investment objectives including risk tolerance so as to recommend to the client (or potential client) investment services and financial instruments that are suitable for him/her.
- It will be necessary to provide a suitability statement to retail clients
  - MiFID II Directive provides that when providing investment advice to retail clients, the investment firm shall before any transaction is entered into on foot of that investment advice, provide the client with a statement specifying the advice given and how that advice meets the preferences, objective and other characteristics of the retail client;

Appropriateness

- Currently the obligation to conduct an appropriateness test does not apply where
  - (i) the service is an execution only service (e.g. it consists of execution and/or the reception and transmission of client orders) and relates to non-complex financial instruments or
  - (ii) where an investment firm is providing a service to a professional client, on the basis of a presumption that professional clients have the necessary level of experience and knowledge in order to understand a particular product or a transaction
- MiFID 2 changes the above
  - First exemption will only apply where the service relates to certain non-complex financial instruments. Where the instrument contains an embedded derivative or contains a structure which makes it difficult for the client to understand the risk involved, the instrument will likely be regarded as a complex financial instrument
  - exemption will no longer apply where the UCITS is a structured UCITS
  - exemption will no longer apply to professional clients

Non-complex instruments redefined

- Appropriateness requirements apply to non-advised services. The categories of ‘non-complex’ products will be narrowed, so that the ‘appropriateness’ test will apply:

  – to shares unless they are traded on a regulated market (or third country equivalent) or MTF and to shares in a non-UCITS collective investment undertaking or that embed a derivative;

  – to bonds and other forms of securitised debt unless they are traded on a regulated market (or third country equivalent) or MTF;

  – to all debt instruments that embed a derivative or ‘incorporate a structure which makes it difficult for the client to understand the risk involved’;

  – to structured UCITS; and

  – to structured deposits that ‘incorporate a structure which makes it difficult for the client to understand the risk of return or the cost of exiting the product before term’

Specifics on Independent Advice

- Those providing financial advice on an independent basis should:
  - not accept and retain fees;
  - commissions; or
  - any monetary or non-monetary benefits paid or provided, by any third party or any person acting on behalf of a third party in relation to the provision of the service to a client.
  - “Quality Enhancement Condition”
- Greater transparency will be required in relation to bundled services.
- There are new provisions for the recording of telephone and electronic communications.

Product Governance and Target markets

- Firms which manufacture financial instruments for sale to clients will be required to maintain a product approval process.

  - Must identify the target market for each product
  - Must ensure that all relevant risks to that target market are assessed and that the intended distribution strategy is consistent with the identified target market.
  - The target market and performance of products should be subject to periodic review.

- Firms which offer or recommend financial instruments which they do not manufacture must ensure that they understand the features of those products, including the identified target market.

- Product manufacturers must ensure products meet the needs of their identified target market and must take reasonable steps to ensure that the products are being distributed to that target market.

- Upstream risks from point of sale will now be much more onerous
  - Obvious implications in post retirement markets and with retail & vulnerable consumers

PRIIPS

- Complementary to MiFID 2 reforms, and IMD 2 objectives
- Key objective is to improve the quality of information to consumers when considering investments
- A "packaged retail investment product" is an investment "where the amount repayable to the investor is subject to fluctuations because of exposure to reference values or to the performance of one or more assets which are not directly purchased by the investor".
- Packaged Retail Investment Products (“**PRIPs**”) can be divided into 4 product families:
  - Investment Funds (including UCTIS)
  - Retail structured securities
  - Structured Term Deposits
  - Insurance-based investment products
    - “an insurance product which offers a maturity or surrender value which is wholly or partly exposed, directly or indirectly, to market fluctuations”

Exemptions from PRIIPS

- Exemptions from PRIIPS
  - General insurance and protection based life insurance policies (having no surrender value);
  - Deposits exposed only to an interest rate and other products which carry no investment risk;
  - Shares and bonds held directly; and
  - Pension products

- UCITS funds have a 5 year transitional period

- There will be a new disclosure document – Key investor information document ("**KIID**")

Content of KIDs

- KIDs must set out information in a manner that is "fair, clear and not misleading";
- the KID must be a stand-alone document, separate from marketing materials,
  - unless the range of investment options means that all information cannot be provided in a single concise document, in which case it must clearly signpost where the additional information can be found;
- No more than three sides of A4 paper, and no small-print;
- Information must be restricted to what investors need and must be written in plain language
- the KID must promote comparability of different PRIIPs
- Question arises as to how much clients will rely on KIDs vs. other advisory documents

Content of KIDs

- an explanation of the purpose of the KID;
- the identity of the manufacturer and its regulator;
- a comprehension alert for complex products, including includes derivatives and structured products under the current MiFID regime;
- information describing the PRIIP headed 'What is this product?' including type, objectives, target consumer, details of any insurance benefits and term;
- a section headed 'What are the risks and what could I get in return?' setting out the risk-reward profile using prescribed information;
- details of guarantee schemes or other cover under the heading 'What happens if the PRIIP manufacturer is unable to pay out?';
- a section called 'What are the costs?';
- details on recommended holding periods and early encashment consequences headed 'How long should I hold it and can I take money out early?';
- complaint redress information; and
- a section for detailing other information documents required from the investor entitled 'Other relevant information'.

PRIIPs - Liability and Enforcement

- Civil liability now a very real issue
- If a PRIIP manufacturer does not abide by the Regulation's rules on the content of KIDs then it will be liable for damages if investors lose money
- Other than those content requirements and in the case of misleading or inaccurate statements, PRIIP manufacturers will not incur civil liability in respect of the KID.
- Product intervention (Enforcement) now across product types
- EIOPA has the power to temporarily intervene in the promotion or sale of insurance-based investment products in the EU. This is consistent with the powers granted to other ESAs under MiFID II in relation to specific non-insurance investments.
- In a further measure aimed at achieving consistent powers in respect of PRIIPs and MiFID products, the Regulation gives national regulators the power to prohibit or restrict the promotion, distribution or sale of insurance-based investment products.

IMD 2

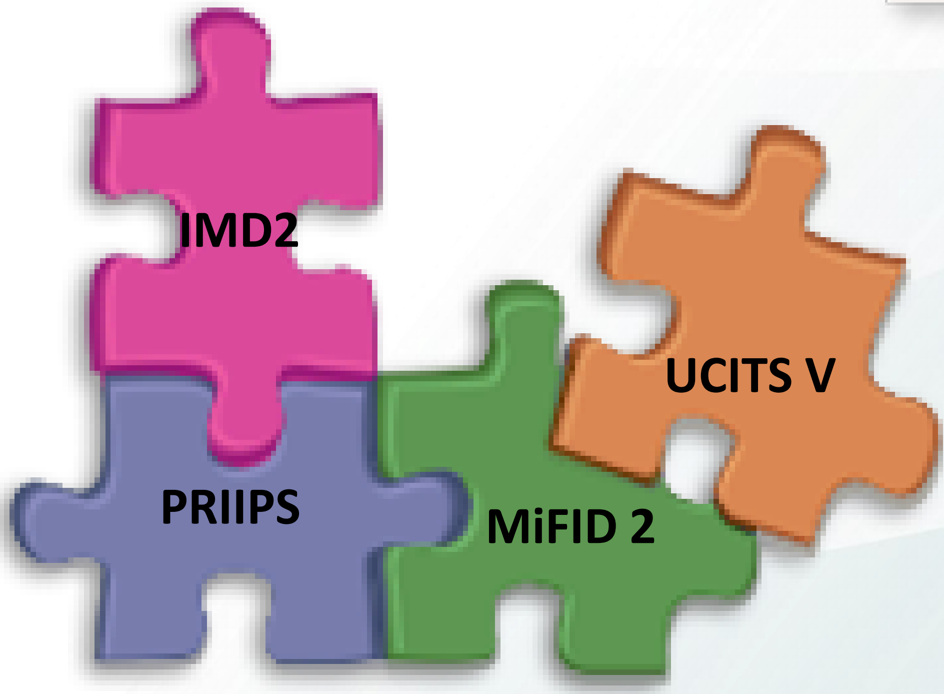
- Original IMD was less onerous than MiFID and did not cover direct selling.
- Reform of the IMD was intended to
  - "Ensure alignment" between MiFID and IMD
  - Improve consumer protection in the insurance sector through increased information provision and advice
  - Create common standards for insurance sales across European market
  - Ensure the provision of honest, professional advice
  - Ensure the provision, in advance of sales, of clear information about the status of the person selling the product and the remuneration they receive
- IMD2 contains a number of provisions to address perceived or potential shortcomings in the interaction between intermediaries and insureds.
- Minimum harmonisation directive

IMD 2 Changes

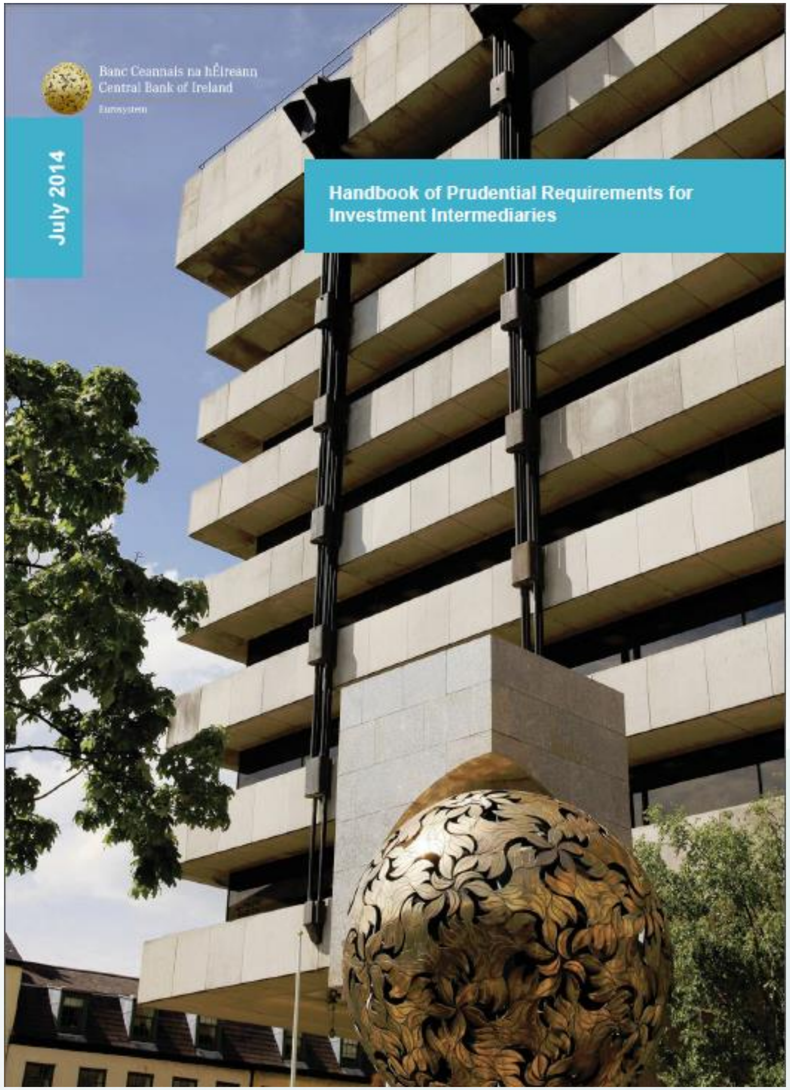
- Expand the scope to all sellers of insurance products including direct writers. Currently, only agents and brokers are covered by the IMD
- Stricter requirements for the sale of life insurance products with investment elements
- Mandatory disclosure at the pre-contractual stage by insurance intermediaries of the nature, basis and amount of remuneration received, as well as any variable remuneration received by individual employees
- Additional information requirements for bundled products - ability to purchase each part of an insurance product separately
- Mutual recognition of professional knowledge and ability
- Improved requirements for life assurance products with investment elements , covering sales standards, conflicts of interest, and a ban on commission for independent advice
- Effective sanctions in respect of breaches

Conclusion

We're just getting a watered down version of RDR?



New Handbook of Prudential Requirements



New Handbook of Prudential Requirements

- Takes effect on 1st October 2014
- Requirements for robust governance and improved standards for organisation and management of businesses.
- The requirement to provide an annual on line return is also reflected in the new requirements.
- Minimum capital for AAs (€10k) and MAIs now removed.
  - €50k minimum capital requirement still in place for product producers
- Positive net asset position must be maintained
- Goodwill and intangibles not eligible for inclusion in regulatory capital
  - Transitional period of 5 years
- Awaiting negotiation results on reclassification of AAs and MAIs – IBA, PIBA, CBoI

New Handbook of Prudential Requirements

- Part 2: General Supervisory Requirements
  - Notification requirements – e.g. material issues
- Part 3: Financial Position and Reporting Requirements
- Part 4: Professional Indemnity Insurance
  - €1.25m per claim
  - €1.85m in aggregate
- Part 5.2: Governance
  - a clear organisational structure with well defined, transparent and consistent lines of responsibility;
  - effective processes to identify, manage, monitor and report the risks it is or might be exposed to;
  - adequate internal control mechanisms to mitigate risk; and
  - sound administrative and accounting procedures.

New Handbook of Prudential Requirements

- Part 5.3: Adequate levels of staff and expertise
  - An investment intermediary shall have adequate levels of staff and expertise to carry out its activities in the interests of its customers and the proper and orderly regulation of the investment intermediary.

- Part 5.4: Compliance Arrangements
  - Shall ensure that it has:
  - compliance and audit staff with the necessary authority, resources, expertise and access to all relevant information, with regard to the investment intermediary's compliance, operational and financial risks;
  - Responsibility for compliance and audit activities are clearly assigned;
  - The duties and responsibilities of those with responsibility for compliance and audit activities are clearly defined and documented; and
  - The proposed reporting lines/functional relationships between employees with compliance and audit responsibilities and the investment intermediary's senior management and where relevant, board of directors, are clearly defined.

New Handbook of Prudential Requirements

- Part 5.5: Procedures and Risk Monitoring
  - An investment intermediary shall do the following:
  - establish accounting policies and procedures which enable it, at the request of the Central Bank, to deliver in a timely manner to the Central Bank, financial reports which reflect a true and fair view of its financial position and which comply with all applicable accounting standards and rules;
  - have sufficient resources to effectively conduct its business within the applicable legislative requirements and regulatory requirements;
  - on an on-going basis, be aware of and monitor all risks to its business and maintain adequate technical, organisational and procedural safeguards; and
  - establish, implement and maintain systems and procedures that are adequate to safeguard the confidentiality, integrity and availability of information.

- Part 5.6: BCP/DR
  - An investment intermediary must establish, document and maintain effective business continuity and disaster recovery procedures

- Part 5.7: Evidence!
  - An investment intermediary must maintain records evidencing its compliance with the requirements in the Handbook and such records are required to be retained for six years.

Conclusion

- The detailed language in the Prudential Requirements are important
- Evidence of compliance is key
- Need to think about more than just Conduct of Business Requirements/CPC
- Responsibility for compliance clearly assigned, defined and documented
- Board minutes, management minutes, contemporaneous notes
- Risk monitoring now to be considered
- Proactive P&L and balance sheet management
- Concept of Industry Best Practice embedded in Requirements

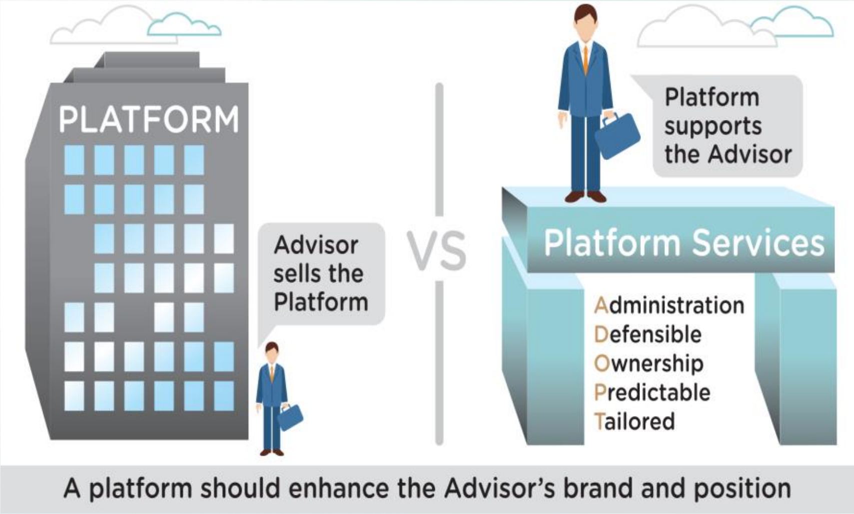
Effective Change Management Strategies

- Early adopters will benefit given number of regulatory changes coming at once
- Don’t rely on product producers to run your business for you
- Pause for inward reflection – build out your own proposition carefully and slowly
- Carefully plan cashflow considerations
- Perform a client segmentation exercise
- Make compliance inline and procedural
- Prudential Requirements **plus** Conduct of Business Requirements
- Document and evidence internal organisational matters
- Make some mistakes

Effective Change Management Strategies

- Is it the “golden age of the advisor”?
- In other markets - advisors are certainly empowered.
- In a rising tide, all boats will rise, but some will significantly outperform
- Fundamental shift in client relationship and Product Producer to Advisor
- Adopt a methodology:

  (A) Administration
  (D) Defensible
  (O) Ownership
  (P) Predictable
  (T) Tailored



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