MiFID II

ESMA's Guidelines for the assessment of staff knowledge and competence

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Key Points

- On 17 December 2015, The European Securities and Markets Authority ("**ESMA**") issued the final MiFID II guidelines on the assessment of knowledge and competence of staff.
- The guidelines require firms to assess the knowledge and competence of staff (i) giving investment advice or (ii) providing information on financial instruments, structured deposits, investment services or activities, or ancillary services.
- National competent authorities ("**NCAs**"), including the FCA, must make every effort to comply with the guidelines. Once the guidelines have been translated into the other EU languages, NCAs will have two months to confirm whether they comply or intend to comply.
- Firms should consider whether they need to extend their training and assessment programmes to new categories of staff (i.e. those giving "information" as opposed to "advice", and how they will ensure a clear demarcation between advisors and staff giving information only.

Background

On 17 December 2015, the European Securities and Markets Authority ("**ESMA**") issued its final report (the "**Final Report**") on the MiFID II guidelines for the assessment of knowledge and competence of staff providing investment advice or information (the "**Guidelines**").[1]

The revised Markets in Financial Instruments Directive ("**MIFID II**") states that member states must require firms to ensure that individuals:

- giving investment advice; or
- providing information about financial instruments, investment services or ancillary service,

possess the necessary "knowledge and competence".[2]

The MiFID II Directive requires ESMA to develop guidelines on the assessment of "knowledge and competence" in investment firms' personnel.[3] Following a consultation paper containing draft guidelines published on 23 April 2015, ESMA has now issued its final guidelines.[4]

Aims

The purpose of the Guidelines is to specify the criteria for the assessment of knowledge and competence in staff providing investment advice or information about financial instruments, structured deposits, investment services or ancillary services as required by MiFID II.[5]

Scope

The Guidelines set out a series of criteria to assess the knowledge and competence of staff providing advice, or information, on investments. The distinction between "advice" and "information" is critical in the Guidelines:

- The nature of investment advice is defined in the MiFID II Directive as the "*provision of personal recommendations to a client, either upon its request or at the initiative of the investment firm, in respect of one or more transactions relating to financial instruments*".[6]
- According to the Final Report, "giving information" means "*directly providing information to clients about financial instruments, structured deposits, investment services or ancillary services, either upon the request of the client or at the initiative of the client"* when providing investment services or

1 ESMA, *Final Report: Guidelines for the Assessment of Knowledge and Competence* (17 December 2015) (ESMA/2015/1886), which is available at https://www.esma.europa.eu/sites/default/files/library/2015-1886_-_final_report_on_guidelines_for_the_assessment_of_knowledge_and_competence.pdf.

2 Article 25(1), MiFID II Directive.

3 Article 25(9), MIFID II Directive.

4 ESMA, *Consultation Paper: Draft Guidelines for the Assessment of Knowledge and Competence* (23 April 2015) (ESMA/2015/753), available at https://www.esma.europa.eu/sites/default/files/library/2015/11/2015-753_cp_mifid_guidelines_on_knowledge_and_competence.pdf.

5 Final Report, p. 34.

6 Article 4(4), MiFID II Directive. The definition is identical to that provided in the MiFID I Directive.

activities or ancillary services for the purposes of MiFID II.[7]

ESMA also states that firms should take into consideration the Q&A issued by its predecessor, the Committee of European Securities Regulators ("**CESR**") when assessing the boundary between "advice" and "information".[8]

The Final Report further clarifies that a staff member would be entirely outside the scope of the Guidelines if he or she:

- only points out where clients can find information;
- distributes brochures and leaflets to clients without giving additional information with regard to its content or providing any follow-up investment services to those clients;
- only hands over information such as key investor information documents at the client's request without giving any additional information with regard to its content or providing any follow-up investment services to those clients; or
- is an employee who performs back-office functions and does not have direct contact with the clients.[9]

Application

The Guidelines are stated to apply to the following firms:

- investment firms;
- credit institutions when providing investment services;
- investment firms and credit institutions when selling or advising clients in relation to structured deposits; and
- UCITS management companies and external AIFMs when providing the investment services of individual portfolio management or non-core services.[10]

National competent authorities ("**NCAs**"), including the FCA, and firms within scope of the Guidelines must make every effort to comply with the Guidelines. NCAs should comply by incorporating the Guidelines into their supervisory practices.[11]

The Guidelines

The Guidelines are divided into five parts:

- general guidelines;
- criteria applicable to staff giving information;
- criteria applicable to staff giving advice;
- organisational requirements; and
- publication of information by NCAs.

General guidelines

The Guidelines state that:

- staff giving investment advice are expected to have greater knowledge and competence than those who only give information;
- staff should possess the knowledge and competence to meet regulatory and legal requirements and business ethics standards;
- staff should understand and comply with the firm's policies and procedures designed to comply with MiFID II; and
- the compliance function should assess compliance with the Guidelines.

The Final Report provides examples of how a firm would comply with these general guidelines, including:

7 Final Report, p. 34.

8 Final Report, Annex VII; see CESR, *Questions & Answers: Understanding the definition of advice under MiFID* (19 April 2010) (CESR10-293), which is available at: https://www.esma.europa.eu/sites/default/files/library/2015/11/10_293.pdf.

9 Final Report, Annex VII.

10 Final Report, p. 33. ESMA has expressly stated that the sale and giving of advice on structured deposits by investment firms and credit institutions is within the scope of the Guidelines. This clears up any possible doubt as to whether structured deposits are caught, given that they are not within the definition of "financial instruments" for the purposes of MIFID II.

11 Final Report, p. 35.

- providing regular mandatory training to staff on conduct of business and organisational requirements;
- adopting a code of ethics;
- regular mandatory product training for staff;
- ensuring staff are familiar with the rules on conflicts of interest; and
- ensuring staff are familiar with the requirements regulating inducements.[12]

Giving information on products and services

Staff giving information on investment products, investment services and ancillary services should have the necessary knowledge and competence to:

- understand key characteristics, risks and features of the investment products, including general tax implications;
- understand the costs to be incurred by the client;
- understand the characteristics and scope of investment services or ancillary services;
- understand how financial markets function and how they affect the value and pricing of products;
- understand the impact of economic figures and national, regional and global events on the markets and on the value of products;
- understand the difference between past and future performance and the limits of predictive forecasting;
- understand issues relating to market abuse and anti-money laundering;
- assess data relevant to the products, such as key investor information documents, prospectuses, financial statements, or financial data;
- understand specific market structures for the products and, where relevant, trading venues and secondary markets; and
- have a basic knowledge of the valuation principles for the products.

Giving investment advice

Staff giving investment advice should have the necessary knowledge and competence to:

- understand key characteristics, risks and features of the investment products, including general tax implications
- understand the costs to be incurred by the client;
- fulfil obligations in relation to the MiFID II suitability requirements;
- understand how the product may not be suitable for the client;
- understand how financial markets function and how they affect the value and pricing of products;
- understand the impact of economic figures and national, regional and global events on the markets and on the value of products;
- understand the difference between past and future performance and the limits of predictive forecasting;
- understand issues relating to market abuse and anti-money laundering;
- assess data relevant to the products, such as key investor information documents, prospectuses, financial statements, or financial data;
- understand specific market structures for the products and, where relevant, trading venues and secondary markets;
- have a basic knowledge of the valuation principles for the products; and
- understand the fundamentals of managing a portfolio, including being able to understand the implications of

[12] Final Report, Annex VII.

diversification regarding individual investment alternatives.

The Final Report gives examples of how a firm would comply with the Guidelines on assessing staff who give investment advice. This would involve a firm regularly monitoring:

- the suitability assessments provided by staff;
- the ability of staff to ask appropriate questions to the client to understand his or her investment objectives, financial situation and knowledge and experience;
- the ability of staff to explain risks and rewards of a particular product or strategy; and
- the ability of staff to compare selected products with regard to terms and risks.

Organisational requirements

The Guidelines state that firms should set out the responsibilities of staff and ensure that, where relevant, there is a clear distinction between the roles of giving information and giving advice. Specifically, firms should:

- ensure that staff are assessed through gaining qualifications and appropriate experience;
- review, at least annually, staff members' development and experience needs; and
- assess regulatory developments and take action where necessary to comply.

The Guidelines also set out special requirements for the supervision of staff who do not yet have the necessary knowledge and competence. A staff member may not be supervised for a period of more than four years.

The Final Report gives examples of how a firm could comply with the Guidelines:

- documenting staff roles and responsibilities and evaluates their performance against key set criteria; and
- communicating publicly their criteria for demonstrating how staff comply with these Guidelines.[13]

Continuous professional development is required for staff to hold the appropriate qualification. This ongoing assessment:

- may involve training in the form of courses, seminars, independent studies or learning; and
- include verification questions demonstrating that staff have the necessary knowledge and competence.

Publication of information by NCAs

NCAs are required to publish information to enable compliance with the Guidelines. If an NCA does not publish a list of appropriate qualifications that would meet the criteria in these Guidelines, then it must publish the criteria in the Guidelines as well as the characteristics that an appropriate qualification would need in order to comply with the Guidelines.

NCAs should also publish on their websites:

- information on the period of time required to gain appropriate experience;
- the maximum period of time under which a staff member lacking appropriate qualification or appropriate experience is allowed to work under supervision; and
- whether the review of the staff member's appropriate qualification should be carried out by the firm or an external body.

Commentary

The UK already requires staff providing investment "advice" to adhere to the standards set out in the Training and Competence sourcebook ("**TC**") in the FCA Handbook. These contain provisions that are broadly similar to those required by the Guidelines, such as the need for appropriate qualifications and experience, and for staff to be supervised until they achieve the necessary level of expertise.

[13] Final Report, Annex VII.

However, the Guidelines also require firms to assess staff who provide "information" on products and services. This requirement is not currently contained in TC. Moreover, in practice, it may be difficult to distinguish between the giving of advice and the giving of information.

Once the FCA has clarified its approach to the Guidelines and how this requirement will be added to the Handbook, firms will have to consider carefully whether their training and assessment programmes should be extended to cover other staff, and whether they need to set up or reinforce controls to mark clearly the boundary between "advice" and "information".

Next steps

The Guidelines, which are contained in Annex 5 of the Final Report, are due to be published on ESMA's website (https://www.esma.europa.eu/).

National competent authorities ("**NCAs**"), including the FCA, must make every effort to comply with the guidelines. Once the guidelines have been translated into the other EU languages, NCAs will have two months to confirm whether they comply or intend to comply.

At present, the Guidelines are intended to apply from 3 January 2017. This is in line with the text of the MiFID II Directive which currently states that it will take effect from 3 January 2017. However, due to legislative delays, it is expected that the implementation of MiFID II will be delayed until January 2018. The impact of this expected delay on the Guidelines has not yet been confirmed, but it seems likely that the implementation of the Guidelines will be delayed accordingly.

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