

MiFID II

ESMA's Guidelines on cross-selling

December 2015

Key Points

- The European Securities and Markets Authority ("**ESMA**") issued the final MiFID II guidelines on cross-selling on 22 December 2015. The guidelines apply to the sale of two or more products or services bundled or tied together in a "package".
- The guidelines require firms to:
 - disclose the total price for the package and for each component product;
 - disclose key information on the non-price features of the package and related risks;
 - inform clients whether each component product can be purchased separately;
 - train sales staff properly and ensure that their pay does not incentivise mis-selling; and
 - ensure that clients can cancel component products within the package, where applicable.
- National competent authorities ("**NCA**s"), 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.

Background

On 22 December 2015, the European Securities and Markets Authority ("**ESMA**") issued its final report (the "**Final Report**") on guidelines on cross-selling practices (the "**Guidelines**") for the purposes of the revised Markets in Financial Instruments Directive ("**MiFID II**").¹

The MiFID II Directive requires ESMA, in cooperation with the European Banking

Authority ("**EBA**") and the European Insurance and Occupational Pensions Authority ("**EIOPA**") (together, the European Supervisory Authorities ("**ESAs**")), to develop guidelines on the assessment and supervision of cross-selling practices.²

The Joint Committee of the ESAs published a consultation paper containing draft guidelines on 22 December 2014.³ However, following concerns over the legal basis of the guidelines in relation to banking and insurance, the final report contains cross-selling guidelines issued by ESMA for the purposes of MiFID II only.⁴

Aims

According to the Final Report, the Guidelines are intended to:

- improve the content of disclosure on price, costs and other non-price features when different products are cross-sold with one another;
- require that all relevant information is communicated in a timely and prominent manner;
- improve client understanding of whether the purchase of the individual products is possible;
- address training and remuneration aspects; and
- clarify the application of any post-sale cancellation rights attached to the purchase of one of the products.⁵

Scope

The Guidelines apply to cross-selling practices as defined in the MiFID II Directive, that is, the offering of an investment service together with another service or product as part of a package or as a condition for the same agreement or package.⁶

¹ ESMA, *Final Report: Guidelines on Cross-Selling Practices* (22 December 2015) (ESMA/2015/1861), which is available at <https://www.esma.europa.eu/press-news/esma-news/esma-publishes-mifid-ii-guidelines-cross-selling-practices>. The Guidelines are contained in Annex 5 of the Final Report.

² Article 24(11), MiFID II Directive.

³ Joint Committee of the European Supervisory Authorities, *Joint Committee Consultation Paper on Guidelines for Cross-Selling Practices* (22 December 2014) (JC/CP/2014/05), available at [https://www.eba.europa.eu/documents/10180/936747/JC+CP+2014+05+\(Consultation+Paper+on+Cross+selling\).pdf](https://www.eba.europa.eu/documents/10180/936747/JC+CP+2014+05+(Consultation+Paper+on+Cross+selling).pdf).

⁴ Final Report, p. 3.

⁵ Final Report, p. 4.

⁶ Article 4(1)(42), MiFID II Directive.

The Guidelines will apply to the marketing and sale of products to retail and professional clients. ESMA has confirmed that references in the Guidelines to "clients" should be understood as referring to both retail and professional clients.⁷

The Guidelines distinguish between "bundled" packages and "tied" package. Bundled packages involve products or services that are available separately and where a client may choose to purchase each component product separately. Tied packages on the other hand contain at least one product or service that is not available separately to the client.

The Guidelines are not intended to override any other conduct of business standards that may apply to the services or product. They apply to tied and bundled packages, except to the extent any legislation prohibits them from applying to the relevant services or product.

The Guidelines are addressed to national competent authorities ("NCAs") with responsibility for supervising firms that are subject to MiFID II, the Undertakings for Collective Investments in Transferable Securities ("UCITS") Directive or the Alternative Investment Fund Managers Directive ("AIFMD"). NCAs are required to notify ESMA whether they comply or intend to comply with the Guidelines within two months of the date of publication of the translated versions of the Guidelines.⁸

Application

The Guidelines apply irrespective of the sales channel used, meaning that companies using social media or other online methods to promote and sell their products and services need to be just as aware of the rules as those using more traditional methods, such as telephone sales or over-the-counter transactions in a branch.

The Guidelines only apply to cross-selling within the meaning of MiFID II. Consequently, they apply only to the following firms:

- investment firms;
- credit institutions when providing investment services;

- UCITS management companies when providing investment services; and
- external AIFMs when providing investment services.⁹

The Guidelines

The Guidelines contain 10 high-level guidelines illustrated by practical examples. The Guidelines are intended to indicate to national competent authorities ("NCAs") how to ensure firms' compliance with general conduct of business standards expected of firms in the context of cross-selling practices.

Disclosure of price information

The first four guidelines relate to the disclosure of pricing information by firms to their clients.

Guideline 1 states that clients should be provided with information on the price of the package and of its component products.

The Guideline states that the information should comprise a clear breakdown and aggregation of "all relevant known costs". This includes administration fees, transaction costs and exit or pre-payment penalty charges.

Example of Guideline 1: The Guidelines provide the following example:

- When cross-selling an interest rate swap with a variable rate loan to allow a client to hedge interest rate risk, the firm provides information on all aspects of the swap that materially affect the cost incurred by the client, such as: (a) the client's potential payment liability when interest rates change; and (b) the exit charges from the swap contract.

Guidelines 2 and 3 state that such price and cost information should:

- be made available in good time before the agreement becomes binding, in order to allow clients to make an informed decision;
- be communicated in a prominent, accurate manner;

⁷ Final Report, p. 7.

⁸ Final Report, p. 35.

⁹ Final Report, p. 4.

- be communicated in simple language, with any technical terminology explained; and
- ensure that equal prominence is given to the price and cost information of component products, so that clients can assess the cost impact of buying these products.

Examples of Guideline 3: By way of example, the Guideline states:

- In marketing communications, the font used to communicate the relevant price and cost information for each component product should be the same; the price of one product should not be in bolder or bigger type than that of another.
- Where the sale takes place on the internet or through another channel without a salesperson, the price and cost information should appear early on; it cannot be "hidden" further down in the online sales form.

Guideline 4 states that price and cost information in tied and bundled packages must be presented in a way that:

- is not misleading;
- does not distort or obscure the real cost to the client; and
- does not prevent meaningful comparison with alternative products.

Disclosure of non-price information

Guideline 5 requires clients to be provided with key information relating to the non-price features and risks of each of the component products and the package. In particular, firms should disclose how risks are modified as a result of purchasing the tied or bundled package rather than each of the components separately.

Example of Guideline 5: The Guideline provides the example of a savings account that offers a preferential rate only when purchased with a structured bond. In this case, the level of risk of purchasing the package is higher than that of buying the savings account alone. The different risk profile of the package compared

with the savings product should be disclosed to the client.

Guideline 6 states that key non-price factors and the relevant risks should be promoted to clients with the same prominence and weight as information on the price and cost. They should be:

- made clear to clients in simple language, with any technical terminology explained;
- in good time before the client is bound;
- presented to clients in a way that is not misleading; and
- presented in a way that does not distort the impact of these factors for the client.

Examples of Guideline 6:

- The Guideline provides an example of how a firm should:
 - draw the client's attention to limitations and risks of the package; and
 - guide the client through the information setting out the key benefits, limitations and risks.

In this example, the sales person explains carefully and in due time how the non-price factors materially change according to: (i) whether the component product is purchased; and (ii) which component is selected.

- The Guideline also gives an example of a firm not relying exclusively on a general reference to its terms and conditions in order to disclose non-price information to its clients. Instead, the firm explains the risks (if relevant) and non-price information to the client in plain language.

Whether components can be purchased separately

Guideline 7 states that clients should be properly informed whether it is possible to purchase the component products separately. Clients should be able to choose a product actively, and make a conscious decision whether to buy the component product or the package.

In particular, pre-ticked boxes (whether online or in any other sales document) should not be used when cross-selling one product or service with another.

Examples of Guideline 7:

- The Guideline gives examples of a firm setting out the client's options clearly:
 - the firm makes it clear that the client has the option to purchase the firm's execution-only service with no additional products such as market data and financial analysis; or
 - it is clear whether the client's choice is restricted to particular bundles of component products, or if he or she has a free choice as to which ones they can combine together.
- The purchase option for a bundled package of execution-only service and markets research on the firm's sales internet pages is left blank. The client has to opt in by clicking "yes" in order to buy the add-on product.

Need for adequate staff training

Guideline 8 states that the staff offering products that are cross-sold should have adequate training. They should be familiar with the risks (where relevant) of the component products and the bundled or tied package and be able to communicate these to the client in plain (non-technical) language.

Remuneration of sales staff

According to **Guideline 9**, firms should ensure that suitable remuneration models and sales incentives are in place, and motivated by senior management, that encourage:

- responsible business conduct;
- fair treatment of clients; and
- the avoidance of conflicts of interest for staff.

Examples of Guideline 9:

- Remuneration structures should not encourage sales staff to "push" sales and encourage unnecessary or unsuitable sales. For example, if sales staff are incentivised to cross-sell a loan with a brokerage account, this could incentivise potential mis-selling.
- A firm avoids remuneration policies that reduce sales staff's basic salary substantially if a specific sales target in relation to a bundled or tied package is not met.
- A firm does not reduce bonus or incentive payments because a sales target or threshold for the bundled package has not been met.

Post-sale cancellation rights

According to **Guideline 10**, firms should ensure that where "cooling-off" periods or post-sale cancellation rights apply to one or more component products, these rights should continue to apply to those components within the package.

Firms should ensure that clients are subsequently allowed to split the products grouped in a cross-selling offer without disproportionate penalties unless there are justified reasons why this is not possible.

Detrimental cross-selling practices

The Final Report provides examples of detrimental cross-selling practices in Annex 6. The examples include:

- offering two products together where the price of the package is higher than the total price of the components if they had been offered separately;
- inducing a client to buy a product by promoting the fact that the overall cost is lower than buying each component separately, even though in reality the costs over time will be a higher amount;
- not returning the proportion of fees relating to a pre-paid insurance premium where the insurance product is no longer in force following termination of an investment service;
- imposing disproportionate early termination charges for an ancillary

insurance product if a customer wants to move to an alternative provider, or threatening the termination of the contract with respect to another product included in the package; or

- offering a product bundled with another product that has not been requested by the client when the firm is aware, or should be aware, that the product unnecessarily duplicates another product that the client already has and cannot benefit from (including because the client is not eligible).

Commentary

Recent initiatives by the FCA contain similar provisions to the Guidelines, which may provide the basis for implementing the Guidelines in the UK. The FCA recently provided new rules regulating the sales of "add-on" general insurance products. In particular, the rules, which will take effect from April 2016, will ban opt-out selling, i.e. putting the obligation on the client to choose to opt out of buying a product.¹⁰ This is similar to the concept of banning a "pre-ticked box" in Guideline 7, which is intended to expand comparable requirements to the cross-selling of investment services and products generally.

Likewise, the FSA previously warned firms in its guidance on the risk of financial incentives encouraging staff to engage in mis-selling.¹¹ This existing guidance is similar to Guideline 9, in that it requires firms to consider the need to manage financial incentive schemes, and how such schemes may impact on the marketing and sale of their services and products.

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.

¹⁰ FCA, *General Insurance Add-Ons Market Study: Remedies: banning opt-out selling across financial services and supporting informed decision-making for add-on buyers* (September 2015) (PS15/22), available at <https://www.fca.org.uk/news/ps15-22-general-insurance-add-ons-market-study-remedies>.

¹¹ FSA, *Final guidance: Risks to customers from financial incentives* (January 2013) (FG13/1), available at: <http://www.fca.org.uk/your-fca/documents/finalised-guidance/fsa-fg131>.

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