MiFID II implementation and experiences from a supervisory authority

Dear Ladies and Gentlemen,

It's my great pleasure to be here. I wish to thank afme as an important organization in the financial industry for inviting me to this conference and for having the opportunity of speaking to you about our experience with the implementation of MiFID II.

Only nine months after the implementation of one of the most challenging legal frameworks for all financial institutions trading or selling financial instruments, I would like to try to draw a first conclusion of the developments and challenges we have observed so far.

My highly respected and experienced colleague Robert Ophele will elaborate on the experiences we have faced in the field of the new MiFID II-framework for the markets and trading venues, whereas I would like to concentrate on the implementation of MiFID 2 in the field of investor protection.

When preparing this key note I asked myself: Is it the right moment in time to draw some first conclusions or is it still too early to judge how MiFID II has changed the world in the field of investor protection?

Two years ago we all breathed a sigh of relief when the European legislators decided to postpone the commencement of MiFID II from January 2017 to January 2018. I think this was not only true for the financial market participants but also for us as regulators and supervisors.

One year ago you, and also we, were very much under pressure to implement the last steps of this important piece of legislation.

In January 2018, we all held our collective breath and waited to see what would happen when business started on the 3rd of January.

And: Many of us were relieved to acknowledge that the world moved on and securities markets worked generally well – in the area of retail and whole sale markets.

Nine months after the implementation we see in more detail where and how MiFID II has impacted the trading of financial instruments in the whole sale and retail market.

But to be honest: It is still too early to draw a final conclusion. As always: markets, market participants – including retail investors – need a certain amount of time to adapt to a fundamentally new legal framework.

As a first point, I would like to thank you as representatives of market participants for the huge efforts you have made to implement MiFID II, especially because I know that this was not the only piece of legislation which had to be implemented at the beginning of this year.

For many of you who produce or distribute financial instruments, the implementation of the PRIIPs regulation was also important and challenging.

For the colleagues in the legal and compliance departments, I guess it was a huge workload to answer questions from the business teams about how the two legislative frameworks should be implemented.

I mentioned that MIFID II was a fundamentally new framework. This was in my view also true with respect to investor protection.

One could ask: Is this really the case that it is a fundamentally change under MiFID II when taking into account that MiFID I also dealt with investor protection issues? Investor protection is really not a new invention.

But in my view, MiFID II introduced some fundamental new ideas of investor protection which were not covered under MiFID I.

These are the following new requirements which I will mention here as a non-exhaustive list:

- Firstly: The responsibility of the manufacturer to consider the client's interests at the time of deciding which product should be part of his product-line. The distributor of the product has similar obligations: He has to consider that financial products are distributed in such a way that they meet client's needs.

  Both manufacturer and distributor have to interact with each other to ensure that these aims are met. These requirements are part of the new product governance regime.

- Secondly: The new requirements in the field of transparency especially with regard to costs and charges.

- Thirdly: The requirement to record telephone conversations – the so-called taping.

- And finally, the obligation to record why the advised financial instrument is suitable for the client – the suitability report.

All new requirements create the need to collect, exchange and record data and make them accessible when needed.

For example, data exchange between the manufacturer and the distributor of the product, recording and storing tapes of many telephone conversations or involving many data of instruments in the process of advising or selling financial instruments.

In Germany, more than 1500 different financial institutions have to handle the aforementioned challenges and we, as their supervisor, were of course interested in how these requirements were being implemented and how they work in this sensitive relationship between the financial institution and the client at the point of sale.

Very early this year – in February - just a month after the start of MiFID II, we conducted a market investigation into the area of cost and charges, suitability reports and telephone taping – based on the experiences in January.

Another investigation is currently being conducted with regard to product governance. We asked manufactures and distributors about their experience with the definition of target markets and the interaction between them. We will have the results in a few weeks and will inform the market about them.

But let me come back to our first market investigation: We surveyed 40 financial institutions representing all sectors of the German market. We asked a cross section with regard to the size and the business model – from small to big from local advice to online-business, including institutions with cross-border operations.

Although the market investigation was not mandatory, every, which was asked, answered our questions.

We know that answering our questions, providing us with a sample of telephone recordings was a further burden for some of you or your colleagues in the legal and compliance department.

But as a remark besides my main topic today: When asking compliance and legal officers difficult and sensitive questions, we always hope that this emphazises how important you and your responsibility are in our eyes and that you should be involved in all issues of implementing new legal frameworks.

But going back to our investigation: what are the conclusions? I will focus on five take aways:

Our first observation: The implementation of the necessary technique went well. We saw only a few problems in this area, for example when the recording of the conversation technically didn’t work.

Furthermore, we saw during the first days, that some financial instruments were not accessible because information on cost and charges or the so called PRIIPS-information document – the KIID - was missing.

Our impression is that these problems were solved quickly and the complaints we received from retail investors in the first weeks soon decreased.

Second observation: We recognized that for clients and advisers, the recording of the conversation on the phone was and is unfamiliar and sometimes the clients were annoyed and refused to be recorded with the result that they couldn’t get investment advice on the phone.

It is not a secret that during the discussion of the new legal framework, Germany was not in favor of this recording requirements and that we strongly believed there should be the chance to replace recording of the conversation with a written report. But now we have to adapt to the new requirements.

Now we try to help the institutions to show clients the advantages of such a recording especially in cases of misunderstandings or disagreements. And we published further guidance and explanations.

Additionally we also urge the institutions to take this requirement seriously. We have heard some conversations which start with the wording: “now we will record for the files what we have already discussed before” – this is obviously not in line with the legal requirement.

Third observation: One of the major problems is the requirement to provide the client with the cost information, in the format of a durable medium, in good time prior to the provision of investment service especially if the client is advised on the phone.

If the client is not willing to open a second channel like an email-connection or an electronic letter box, the investment firm is not able to provide the client with the information in the requested form.

Some firms decided to read out the information about the costs. But to be honest: this does not fulfill the requirement that the information has to be provided on a durable medium in advance.

As supervisors we understand the complaints from the industry that for more experienced clients, or in cases of fast markets when the client is only interested in selling his or her financial instruments as soon as possible – whatever it costs – this obligation is really burdensome. But the legal framework is clear on this point.

Our fourth observation tackles the suitability reporting.

This reporting is, from our point of view, extremely important because it should explain to the client why the specific instrument was advised.

In some cases we recognized very simple explanations like “the product is suitable because it is suitable” or “because it is in line with the risk tolerance of the client”.

We also see very standardized explanations with no real relation to the individual situation. At this point, I would like to emphasize again how important this new requirement is to really explain to the client why a special product meets his or her needs and objectives.

The final observation relates to the equally important new requirement to disclose cost and charges ex-ante.

We really believe that this requirement is a crucial step in the field of better investor protection. It gives the client the possibility to compare costs with the possible performance of the instrument on the one hand and with the costs of other products on the other hand.

Clients should be enabled to decide on an informed basis whether or not they should place an order. It is also possible that a client will refrain from placing an order after considering the specific costs.

We see some room for improvement here. In BaFin's view, information on costs has to be based on the specific financial instrument. A comparison of financial instrument costs is only possible if such information is provided for each financial instrument and not in a generic way or better said for asset classes.

Further: the market investigation disclosed that no market standard currently exists for the calculation of the percentage as part of the information on costs.

This topic needs to be discussed and solved because otherwise this information is sometimes meaningless or at least not comparable. It would be preferable here to have a consistent reference value that enables clients to compare costs.

Let me summarize here and reflect a little bit on the way forward:

Against all odds: the implementation of MiFID II in the area of investor protection has generally gone well. This is the result of a combined effort of many of you: Compliance, legal, business and the IT-Teams in your institutions – and huge investments of money, personnel and intellectual commitment in the development of the necessary frameworks.

On the other hand, we see some practical challenges especially in the area of the advice given on the phone or just the placement of orders in financial instruments on the phone. Market participants and supervisors are still discussing possible solutions.

Let us have a glimpse at the reactions of the clients: Yes, we have received complaints from clients that they find MiFID II requirements are sometimes burdensome, more time is needed, a lot of documents and papers are required which , in the eyes of some clients, are documents with unnecessary information.

But the problem here is that the clients usually do not inform us when they are happy with a new requirement.

Based on direct discussions with retail clients, we have received the feedback that, especially the new requirements on the transparency of costs and charges, are valued by the clients – also by experienced clients.

The same is the case for the documentation why a special product is suitable in the view of the advisor. I must however, confess: All this is just anecdotal evidence and more elaborate investigations are needed here to see which requirements are really valued by the clients.

Coming back to my first question: is it too early to draw conclusions? I have to say: Yes, in this regard we need more time to evaluate how the clients are receiving the new framework.

When we look forward, for us as supervisory authorities, the focus of our work is now on the supervisory convergence. It is our main goal that the requirements are implemented in a convergent way cross Europe.

We are working extremely hard on the many questions we have received from the industry and we strongly believe that only a convergent implementation can enhance

cross-border distribution of financial instruments to create a real European Capital Markets Union.

We know that many very pragmatic questions have arisen during the implementation and also afterwards.

We have also received comments that, in the different jurisdictions, the implementation is different – and usually the complaining institutions point out that it is easier or better in the other jurisdiction.

We take this serious and will discuss all these remarks for further guidance in our working groups and committees at the level of the European Securities and Markets Authority.

I can assure you that it is one of our main interests as supervisors, to have a common understanding and convergent implementation of MiFID II across Europe.

With that I would once again like to thank afme for the invitation and I wish you as representatives of the financial insitutions, the investors across Europe and also us – the supervisors - an ongoing successful application of MiFID II.

Thank you very much.