

# Public consultation on the review of the MIFID II/MIFIR regulatory framework:

## CFA Society France contribution - Key messages

### Executive summary

CFA Society France focused on three topics:

1. Investor protection
2. Research unbundling rules and SME research coverage
3. The establishment of an EU Consolidated Tape

Here are the key principles CFA Society France support on each topic.

#### 1. Investor protection

*Various testimonies from CFA members have highlighted the following facts: advisory consultations are often limited to tick boxing exercises; most advisors have opted for a non-independent status which is still problematic in terms of conflicts of interest; the specific legal framework of life insurance in France makes some MiFID2 provisions inapplicable; as a result some investors are advised to invest in products not suited to their situation.*

- CFA Society France would support the development of an EU-wide database (e.g. administered by ESMA) allowing the comparison between different types of investment products accessible across the EU.
- CFA Society France does not believe that the current rules on inducements are adequately calibrated to ensure that investment firms act in the best interest of their retail clients.
- CFA Society France would see merit in setting-up a certification requirement for staff providing investment advice and other relevant information at the European level. As certified staff should also remain up to date on those topics, continuous education should be encouraged.

#### 2. Research unbundling rules and SME research coverage

- To address conflicts of interest in sponsored research, CFA Society France recommends adopting a similar regulatory framework than for credit rating agencies instead of a Charter of Good Practices, since in both cases it is the issuer that funds the production of research.
- The proposed ESMA database should identify all the existing research available for a specific security but not be used as a distribution channel. The

database should contain the contact details of the research provider to obtain the research.

- Independent research should be encouraged: independent research should be exempted on the rules on inducement; asset managers and asset owners should be able to mutualize research if needed (eg share research that they sponsored collectively).

### **3. The establishment of an EU Consolidated Tape**

- In the future Consolidated Tape, post-trade information on financial instruments should be as broad as possible.
- In the future Consolidated Tape, pre-trade information on financial instruments should include all sufficiently liquid financial instruments.
- Access and contribution to the Consolidated tape should be based on a reasonable commercial basis.

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## Investment Protection

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**Investor protection rules** should strike the right balance between different targets: not only developing the participation in European capital markets but also ensuring that the interests of investors are safeguarded at all times during the investment process. Maintaining a high level of transparency, quality in the financial advice and securing the conflicts of interests are very important elements for the CFA Institute to enhance the trust of investors into the financial market.

CFA Society France would like to express views (“**verbatim**”) from our members about specific issues regarding suitability criteria in local: 3 questions were asked, after discussions with CFA Brussels.

- How long do advisory consultations take on average?

*“The customer discovery plus the investment proposal can take from 2 to 4 hours. This time obviously includes heritage issues that are more or less complex depending on the client. The investment proposal part represents 1/3 of this time. ”*

*"In my experience, retail market consultations last on average one hour (from suitability questionnaire to implementation). Most retail consultations fall within a range of 30 minutes (transaction on an existing portfolio for a pre-qualified client) to 3 hours (setting up a portfolio for a new client)"*

*"From personal experience (retail banking network), a maximum of 1 hour is done remotely where you ask the customer for advice that you really test your knowledge and experiences. My banking network now provides a completely feasible online questionnaire without human intervention. -- Serious problem of reliability and interest of the exercise for retail." retail*

*"Looking at the minutes of the latest mystery visits of the AMF, serious problems in the banking networks: inadequate consideration of the*

*tests of suitability/appropriateness and frequent lack of information of customers on the independent or not of the board."*

- Any issues to make available certain categories of products for sophisticated clients.

*"As mentioned above, most funds and strategies in France seem relatively accessible to me. Only more closed funds can be more difficult to subscribe to in France because the minimum ticket of 100k euros (FPS, OPPCI, etc.). For these funds, the definition of professional clients within the meaning of the MIF does not prevent them from subscribing but forces the Fund management company to produce regulatory documents not necessarily necessary given the experience/the drilling of the client (KIID PRIIPS for investors - 100k - currently in the AMF doctrine)."*

*"The problem does not arise so much in mandate management (currently under the aegis of MIF 2 in France because managed in the French COMOFI) as for pure retails (via life insurance mandates in UCITS a priori not processed by MIF 2 to date while they represent a very substantial share of savings in France). Life insurance in UCITS is governed by the insurance code and is apparently excluded to this day from the protection scheme of MIF 2 it seems to me. In addition, the consideration of UCITS life insurance contracts is considered to be the insurer (professional customer), which brings the UCITS to its balance sheet, not the end customer. In short, the protection of real retail customers in France is not yet on the agenda. In addition, very few products offered to retail customers (low-performing and very busy wage savings funds, fund architecture available in very closed UCITS life insurance)."*

*"On mutual funds that are considered simple products, the sophisticated customer has access to a very wide choice. (See stat in PJ). In my opinion the real problem lies for "basic" customers. Indeed, mutual funds (excluding hedge funds and AIF) are products considered simple and yet I do not think that investors and advisors understand all*

*the strategies put in place especially in "absolute return" funds. In the spirit of regulation, it is necessary for the advisor and the client to understand the investment made, which I do not think is the case. And yet, these strategies can have a diversification benefit in a portfolio."*

*"I don't believe in the client signing a waiver. My opinion is that customers are offered too much of complex products (including Structured) and not too enough of simple products (ETF)"*

*"Age is too often used as a proxy for investment horizon, barring older client from investing in products that would be suitable in their situation. The investment horizon is more relevant than the client's age for suitability. Older clients tend to be over-protected regardless of their financial situation / long-term objectives. Some clients whose goal is capital appreciation for transmission (i.e. their pension income is more than sufficient for their projected needs) should be allowed to invest a larger part of their portfolio in equity having an investment horizon that goes beyond their life expectancy"*

- **Whether there is 'tick boxing exercise' in the assessment of suitability of products for clients**

*"It is an exercise that is disliked by clients and thus painful for advisors. Most advisors do it appropriately. Breaches usually occur when the advisor has already designed an allocation before any suitability test has been conducted. In these cases, advisors are more likely to try to adjust client answers during the questionnaire to ensure suitability is obtained.*

*"In retail networks, tick boxing is really the norm. "*

*"In my opinion, clients answer a standard questionnaire (archiving) and interview with advisors and push product and marketing more or less disguised as education "I'll explain". In the end, investors fall into a limited number of risk profiles."*

Regarding inducements, financial advisers continue to be in some jurisdictions incentivized to sell products for which they receive commissions instead of recommending the most suitable products for their

clients.

- Several of our members inform us that they have noticed that financial advisors ask if it is possible to exclude ETFs from UCITS life insurance contracts since they do not receive rebates on these products. These are probably marginal cases, but they exist and therefore it does not benefit the end customer.
- Others point out that wage savings products in France subsidize account-keeping through management commissions, so there will be no incentive to use ETFs.
- In practice, in France, for investment advisory, the strong constraints (large range of funds to be analyzed - limitation of inducements) has led most Financial advisers to choose the status of non-independent advisor. In fact, therefore, the aspect of limiting inducements is relatively limited.
- Finally, in the banking and insurance networks, despite the establishment of the open architecture, the sale of home products remains predominant. Only private banks or private banking departments of the major networks offer a sufficiently wide choice in terms of products not developed in-house. We think it is necessary to recalibrate.

Bearing in mind these different testimonies of its members CFA Society France is in favor of strengthening transparency, independence, and the proper management of conflicts of interest.

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## Research unbundling rules and SME research coverage

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- The implementation of MIF2 addressed a major conflict of interest problem and a situation where research production was sometimes tangled and uninteresting.
- .That being said, like the services of the European Commission, CFA Society France **considers the coverage of companies listed by independent research as a necessary element for the proper formation** of prices in the market and the liquidity of the latter, and that the implementation of MIF2 (by imposing a separate billing from the research service) seems to have accentuated the slightest coverage by analysts **of small and medium capitalizations**.
- Indeed, according to a widely shared diagnosis in the financial center of Paris, the drop in the prices of the research billed, coupled with a rationalization of investor budgets, has consequences on the number of analysts and the coverage of companies.
- CFA Society France and CFA Institute have been mobilizing early on the subject of research funding and have been talking to market regulators since 2016.
- This mobilization has resulted in:
  - . CFA Society France's response\_ to the October 2016 AMF [consultation](#) on new funding arrangements for research by investment firms under the MiFID II Directive;
  - . CFA Institute's publication of two surveys of CFA members in Europe:
  - . In 2017: '[MIFID II, a new Paradigm for Investment Research](#)' - Investor Perspectives on research costs and procurement
  - . In 2019, [MIFID II: One year on](#) - Accessing the Market



- .The two CFA Institute [surveys](#) provided quantitative data in [Europe](#) on many aspects:
  - . the decrease in overall research budgets, by geographic area on the one hand, and by size of assets under management on the other
  - . changes in asset class hedging (including lower hedging on small and medium caps)
  - . the distribution by type of research providers (with the finding of a decline in buy-side research with the sell-side, and a greater use of internal research, the methods of funding research (with the finding of a predominance of funding by management companies via P and L, in opposition to the financing of research by clients via RPAs) buy-side

Faced with this very worrying finding, which is drying up the production of research on SMEs, we believe that we need to act in several ways simultaneously and in particular by accepting the development of sponsored research:

- Sponsored research must be considered "acceptable non-monetary benefit" in order to make sponsored research available free of charge to any investor. If this were not the case, management companies would only be able to access this research by including it in their contract with the design offices to gain access to it. In this case, the risk of attrition from the dissemination of the research may be similar to the situation observed before the development of the sponsored search.
- We are in favor of including sponsored research in the concept of investment research. We support the establishment of a high level of transparency between issuers, design firms and investors through a Charter of Good Practices to be established both at European and Member States if necessary. Quality and independence must be at the heart of this charter. or better, we



would promote the alignment of the sponsored research on existing rules for ratings agencies.

- We consider that the production of research by investment analysts not associated with an investment service provider should not be subject to the regime defined in Article 13 of the delegated directive on research-related inducements nor the resulting guidance when their offering does not present a conflict of interests with other activities. Consequently, research consumers subject to MIFID II should be free to receive the analyses produced by third-party players without having to implement the mechanism provided for in the above-mentioned article.
- We consider that the MIFID II review is a good opportunity to introduce a form of proportionality into the regime defined in Article 13 of the delegated directive. This should be done based on a cost-benefit analysis in order to determine the level of proportionality that is most likely to boost coverage of small and mid-caps, especially in the context of development of the Capital Market Union.

Therefore, we approve some proposals expressed by the European Commission in order to increase the production of SME research:

- Introduction a specific definition of research in MIFID II level 1.
- Exclude independent research providers' research from Article 13 of delegated Directive 2017/593 (see below).
- prevent underpricing in research.
- amend rules on free trial period in research.
- promote and develop sponsored research, but by defining adequate rules of governance in order to manage conflicts of interest.

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- Carefully explore some alternative ways of financing SMEs research (program set up by a market operator, a partially public funding program).
  - explore the creation of a public EU-wide SME research database.

## The establishment of an EU Consolidated Tape

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- The discussion on the willingness and need of establishing a Consolidated Tape (CT) in the EU has been ongoing for many years. MiFID II aimed at achieving the establishment of a CT by a commercial entity. However, until now no commercial Consolidated Tape Provider (CTP) has emerged and it appears unlikely that within the current legal framework a CTP will emerge in the future.
- We agree with ESMA<sup>1</sup> that a CT for equity instruments could deliver significant benefits:
  - *“would contribute to remedying the fragmentation of markets and allowing market participants to have a reliable view of liquidity across the Union”<sup>2</sup>;*
  - *“would contribute to establishing a Capital Market Union (CMU) and add to the creation of a real single market for equity trading in the Union”<sup>3</sup>;*
  - *“would limit to some extent the market power of trading venues when selling real-time post-trade data”<sup>4</sup>; and*
  - *“could be used for supplementing best execution policies, in particular for retail investors”<sup>5</sup>.*

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<sup>1</sup> On 5 December 2019, [ESMA submitted to the Commission a report on the development in prices for pre- and post-trade data and on the consolidated tape for equity instruments](#).

<sup>2</sup> ESMA, “MIFID II/MIFIR Review Report N°.1”, 5 december 2019, point 169, page 47.

<sup>3</sup> Idem

<sup>4</sup> Idem

<sup>5</sup> Idem

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- We accept that, at the same time, that there are arguments against the establishment of a CT. In particular:
    - *“the current level of OTC data quality is insufficient to allow for the establishment of a CT.*
    - *a CT may result in higher prices for market data not covered by the CT in case trading venues and APAs try to recover lost revenues.*
    - *potentially high costs for establishing a CT.”*<sup>6</sup>
  - Nevertheless, Like ESMA we consider that the advantages of establishing a CT outweigh the arguments against such establishment.
    - First, ESMA should issue further guidance on the provision of market data, and in particular on the concept of providing market data on a Reasonable Commercial Basis (RCB). This should address concerns that establishing a CT may result in higher prices for market data not covered by the CT.
    - Second, ESMA should work towards improving data quality. In addition, we consider that a CT could also be an important driver towards establishing more consistent reporting standards.
    - Finally, we consider that it should be possible to address the arguments against establishing a CT when developing the governance model of the CT.
  - We therefore recommend to the Commission to appoint a CT for equity instruments in the EU taking into account the experiences made with CTs in Canada and the US (as explained in ESMA’s report), in order to reduce the cost of access to market data for investors. We agree that post-trade (Price and Volume of executed trades on each venue) information for shares, bonds and ETFs, interest-rate swaps and credit default swaps should be essential for market players. Pre-trade information for shares, ETFs and liquid bonds should also be included.
  - We agree that:

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<sup>6</sup> ESMA, “ MIFID II/MIFIR Review Report N°.1”, 5 december 2019, point 170, page 48.

- a European CT could indeed also be one major step towards “democratizing” access to “market data” so that all investors can see what the best price is to buy or sell a particular share at a given point in time and to analyze ex post the effectiveness of the trading procedure. Different levels of service could be imagined regarding immediateness of data provided that after some reasonable time the data becomes publicly available. We nonetheless recommend health warnings on the dissemination of stale data to ensure that market participants understand the data may not reflect current market conditions anymore.
  
- Finally, we agree with ESMA that given the complexity of this project and the need to amend the legal framework, the time for establishing a CT should not be underestimated. We consider that the period between the decision of establishing a CT until the go-live of such a tape should be as short as possible.