MIFID II

Austrian market creaks under weight of Mifid II obligations

Markus Fellner and **Johannes Kim** of **Fellner Wratzfeld & Partners** reviews Austria's implementation of Mifid II and how clients have been responding to the new information demands

In response to the global financial crisis almost a decade ago Mifid II was passed. Its aim was to strengthen investor protection and improve the integrity and transparency of financial markets. With Mifid II, European capital markets law reached its peak in terms of regulatory density. The numerous new legal requirements in this regard led to fundamental reform and gave the financial markets a kind of constitution, with the basic principle of 'greater the transparency, greater the investor protection'.

However, the many complex legal amendments were not only a challenge for the development of appropriate technical systems but also made timely implementation of the legal regulations difficult. Finally, on January 3 2018, the Austrian Securities Supervision Act 2018 (*Wertpapieraufsichtsgesetz 2018, WAG 2018*) and the Austrian Stock Exchange Act 2018 (*Börsegesetz 2018, BörseG 2018*) entered into force, implementing Mifid II in Austria and enabling the creation of the structures required for a clear and consistent framework for investment service providers in comparison to preceding frameworks. Furthermore, the implementation of Mifid II led to the revision of more than 40 acts of legislation.

Mifid II has affected Austria's entire investment services market and demanded substantial extra effort and cost. These extensive changes can be divided into four different areas: distribution and advisory, trading and execution, reporting and transparency, and risk management. Further, Mifid II tightened the transparency regulations for shares and simultaneously covered considerably more financial instruments than before. The introduction of Mifid II also meant fundamental changes for those markets where equity-like instruments, bonds, structured finance products and OTC derivatives are traded. The modifications by Mifid II had a profound impact on investment firms (including banks active in the securities business and other financial market participants) and on the entire structure of the European securities market. Investment firms needed to reassess their strategic direction, optimise existing processes, develop new ones and make extensive IT adjustments.

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The heightened investor protection obligation had a major impact on the entire financial industry. Since the benefits of third parties for financial advisors are strictly regulated and prohibited under certain circumstances, some market participants had to review and revise their entire cost calculation and product portfolio. Moreover, the new product governance regulation under Mifid II that covered the defined target market also forced distributors of financial products to make additional assessments in respect of certain customers, resulting in extra administrative effort and cost. To comply with the new record-keeping obligations, market participants had to scrutinise their business-relevant communications with customers. Certainly, staff training was necessary in the course of the implementation of the new investor protection rules. Further, some market participants had to review the set of agreements with their customers. The large Austrian banks even had to modify their general terms and conditions in order to comply with the new legal requirements pursuant to Mifid II.

Austrian Chamber of Commerce survey

At the end of 2018 the Austrian Chamber of Commerce (*Wirtschaftskammer Österreich, WKO*) conducted a survey among its members of the Financial Service Providers Association (*Fachverband Finanzdienstleister*), asking whether and what approval the extended regulations of Mifid II had so far received in practice.

The participants' first conclusion on Mifid II was not positive: 43% of all respondents had a negative opinion about the legal requirements implemented due to Mifid II.

In particular, the excess of information that Mifid II brought with it was considered too much by the majority of the participants; 76% of the respondents rated this additional information useless or even impeding.

The participants were pessimistic about the situation for consulting services for small investors: 70% of the respondents opined that consulting services for small investors had decreased as a result of Mifid II.

Regarding product range and investment volume, 36% of the respondents stated that their product range had decreased and 38% that their investment volume had decreased.

Finally, a total of 95% of the respondents believed Mifid II had increased the time spent on advising clients. In the field of documentation obligations, the time expenditure increased, with 94% of survey participants stating that they had spent more time on document obligations since Mifid II.

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The post-implementation market

In practice, several legal requirements go well beyond the legitimate objective of reasonable investor protection.

While Mifid II imposes an excessive number of obligations on clients over information disclosure, there is no option to waive these obligations under any circumstances. In practice, we have seen that not only have some clients (at least in part) not asked for the exhaustive piles of information, but they have even refused to receive such information. They are worried about being inundated with information, for example quarterly deposit reports, *ex-ante* cost information and declarations of suitability for multiple transactions of a similar nature executed within a short period. After appropriate clarification, there should be the opportunity for clients to waive the need for such excessive amounts of information.

Furthermore, the extensive information obligations regarding *ex-ante* costs has led to considerable problems, with few financial services providers sales staff and clients willing to accept the information.

Ex-ante cost information only has to be given once for a product group with an almost identical cost structure, after which recital 69

Consultants working at Austrian banks are afraid of violating the complex Mifid II processes

Delegated Regulation (EU) 2017/565 can be used as a legal basis. Recital 69 states that: "where an investment firm is required to provide information to a client before the provision of a service, each transaction in respect of the same type of financial instrument should not be considered as the provision of a new or different service". This means that a client who has received the relevant information once does not have any additional benefit by retrieving the same information again.

The information obligations under Mifid II apply not only to private clients, but also to professional clients and suitable counterparties. For the most part, transactions with professional clients and suitable counterparties are concluded by telephone or in conversations under high time pressure, which makes the transmission of *ex-ante* cost information more difficult. In addition, it is problematic that the price inevitably changes while *ex-ante* cost information is being provided. This price change can be negative for the client, meaning that the provision of *ex-ante* cost disclosure can lead to a financial disadvantage. Furthermore, if a bank were to withdraw its offer in the event of such price differences and would make a new offer, new *ex-ante* cost information would also have to be provided.

Further, as a result of the obligation to record telephone conversations, a strong decline in telephone consultations with Austrian banks was noted within the first months of Mifid II implementation into Austrian law. Consultants working at Austrian banks are afraid of violating the complex Mifid II processes and information obligations and are being held liable under service law, data protection law and civil law. In the absence of concrete customer requests for the disclosure of telephone records, the question of the usefulness of the telephone recording obligation arises from the client's point of view. Against the background of investor protection, alternatives to telephone recording must be considered.

According to Article 63 para 1 Delegated Regulation (EU) 2017/565 investment firms must provide their clients with a list of the financial instruments held on a durable medium at least once a quarter. However, clients can view their report online or request an extract from their consultant at any time. Therefore, a transmission regarding longer intervals instead of every quarter is sufficient. This existing obligation means a considerable cost burden with questionable added value for the client.

As for the efforts that have been made by the regulators, the Austrian financial sector has already endeavoured to obtain legally binding statements from the Austrian Financial Market Authority (*Finanzmarktaufsicht, FMA*) after the draft laws on the WAG 2018 and BörseG 2018 became available. The FMA has shown itself to be quite cooperative on implementation issues, although in some cases a stricter standard than expected has also been applied by the FMA.

Furthermore, the Austrian Chamber of Commerce has collected questions from the Austrian financial sector regarding the implementation of Mifid II and in respect of research issues. Those questions were answered in consultation with the FMA. The FMA also provides assistance in questions of interpretation regarding the various legal requirements.

Looking ahead

The legal requirements regarding research pursuant to Mifid II should prevent dependencies for business partners and make costs more transparent. However, critics warn against cost increases and fear disadvantages for small companies that cannot afford to pay extra for research.

Instead of introducing more transparency and protection, the outcome could be the exact opposite, if established financial services providers decide to exit certain markets for strategic reasons in order to avoid the extensive costs and efforts of application of the excessive Mifid II regulations.

Large financial services providers could increasingly gain market dominance, while smaller firms would have to specialise in order to remain active in the market, otherwise they may not be able to withstand the high cost pressure of all legal regulations of Mifid II.

Since the legal requirements regarding Mifid II have been in force for only two short years, the impacts still cannot yet be predicted reliably. In our view, the strict regulations regarding investor protections will lead to fewer investor litigation cases.

Nevertheless, there are still numerous questions of implementation in various areas of application, which can presumably – as was the case with the implementation of Mifid I – only be clarified in Supreme Court decisions.