



Module Dutch Laws and Regulations – Supervisory themes AFM

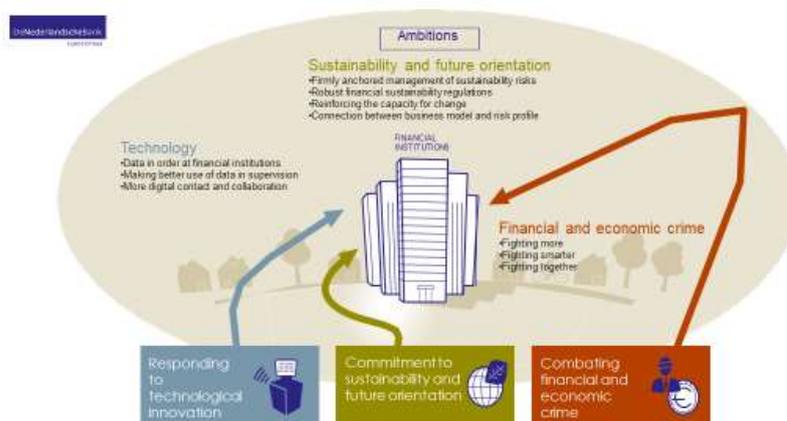
By Frank 't Hart

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Good day to you all. My name is Frank 't Hart, lawyer in Amsterdam, and I'm going to talk you through some important topics regarding MiFIDII. I have three items for you. First of all, highlighting the AFM and DNB supervisory themes. Secondly, I'm going to talk you through the MiFIDII quick fix regulation. And finally, I'm going to tell you something about duty of care and the difference between providing information to your clients and advising your clients.



DNB - Three focus areas of the Supervisory Strategy



Source: DNB Supervision Strategy 2021-2024, 17 February 2021

Note: DNB's 2021 supervisory themes were addressed in a separate presentation

Let's start with the supervisory themes. First of all, for DNB there are three items. The first one is about data driven supervision. Data driven supervision is not so much about compliance, but it





enables the DNB and also the AFM to identify risk at a very early stage. Secondly, sustainability. I will come back to that because that's also a focus area of the AFM. It's on all of our agendas. Finally, the third item is combating economic and financial crime. Since July 2018, the implementation of the fourth ALM directive, DNB and AFM investigations have been increasing rapidly. And we all have to do our duty in order to act as a gatekeeper, this applies not only to all financial institutions, but also to all lawyers like myself.



AFM priorities 2021 - selection

1. Financial services [selection]

1.1 Protection of consumers in vulnerable situations

- Apply AFM's revised vision on duty of care obligations over duration of financial product
- Review of PARP processes
- Information and advice provided on transition of the pensions sector

1.2 Organisation and culture of financial companies

- Follow-up review of structure of the compliance function

2. Capital markets [selection]

2.3 Supervision of prospectus and public offerings

- Protection of investors against misinformation: stricter action by the AFM against harmful advertising and violations of rules on public offerings and prospectuses

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[Source](#): AFM Agenda 2021



Then the AFM. First of all, the priorities. Then I'm going to focus on some themes of the AFM for 2021. And I'm talking at the end of June. First of all, financial services. The protection of consumers in vulnerable situations is one of the main topics for the AFM and they are focusing very much on the product governance and all the duty of care during the services provided to the client. So not so



much about the pre contractual phase, but more in the contractual phase of the relationship with the client. Then secondly, capital markets, the AFM is going to focus more on misinformation. Rules are not changing but the AFM is announcing that it will apply stricter action when there is a breach of information duties.

AFM priorities 2021

3. Asset management

3.1 Adequately functioning chain of asset management parties

- **Monitoring and improving quality at asset management parties**
- Enable structural overview of delegation (and control thereof) within the asset management chain

3.2 Ongoing activities

- Assessing licence applications, changes, fund and other notifications and registrations
- Dealing with signals, exemption and enforcement requests and other legally mandatory notifications
- Assessing assurance reports and annual reports
- Formulating policy in concert with other EU supervisors, including the formulation of a macro-prudential framework for portfolio managers and influencing new EU regulations (such as the AIFMD review)
- Preparing market parties and our own supervision for new legislation and regulations (for instance, for Cross Border Distribution, the Investment Firms Directive and Pan-European Personal Pension Products)
- Attention to a controlled and ethical business operation at asset management parties, focusing mainly on the control of business processes and risks and ethical conduct by all those concerned
- Detection of and combating violations in this sector; cooperation with DNB, FIOD and/or the Tax & Customs Administration where necessary
- Expanding the data position that feeds the dynamic dashboards (used in supervision for the localisation of risks) and enables rapid analysis

Source: AFM Agenda 2021

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So, those are the main topics. Then to asset management. The third topic I want to discuss, one of the AFM priorities, and I will pick two of the sub items. First of all, they announced that they want to help parties, market parties, asset managers to implement the cross border distribution directive, the investment firms directive and the pan European pension funds products directive. On the other hand, the AFM is also focusing on culture and the compliance function. So those are a few of the topics that the AFM has announced as priorities.

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AFM themes 2021: sustainability

1. Increasing social awareness of improving sustainability

Key activities in 2021

- 1.1 A review of the extent to which asset managers, insurers and pension funds meet the requirements of the SFDR and their progress on the integration of sustainability risks in their business operation
[Q1 2021: AFM information request on application of articles 6, 8 and 9 SFDR to managers of AIFs and UCITS]
- 1.2 A review of the application of aspects of integrated reporting, including sustainability aspects
- 1.3 A review of the potential risks of financial products that are offered and feature sustainability
- 1.4 The AFM will also contribute to the formulation of new regulations at national and international level. Internationally, the AFM is, among other things, involved in the further development of several packages of regulation, including the SFDR

[Source: AFM Agenda 2021](#)



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Then the themes, of course, sustainability has been one of the key issues for all financial companies, not only in the Netherlands but in the whole of Europe and actually worldwide. And when it comes down to asset managers, the AFM wants to ensure that they integrate risk related to sustainability into the business operation. Then the second theme is the anti-money laundering regulation.

AFM themes 2021: money laundering

2. Combating money laundering and other financial and economic criminality

Key activities in 2021

- 2.1 **Data-driven formulation of risk profiles of parties subject to supervision under the Wwft** (investment firms, collective investment schemes and their managers and intermediaries in life insurance) based on information from regular questionnaires. These risk profiles provide the AFM with an impression of the current status of the market with respect to the risks of money laundering and the financing of terrorism, as well as the extent to which these risks are controlled. We also use these risk profiles when making choices with regard to our supervisory strategy.
- 2.2 **Conducting on-site investigations, as part of the risk-based supervision of compliance with the Wwft and the Sw. The AFM takes enforcement action if necessary.**
- 2.3 Thematic and other reviews to establish that the business operations of licensees are ethical and controlled, especially in the investment segment, as defined in the Financial Supervision Act (for financial enterprises) and the Audit Firms (Supervision) Act (for audit firms). Control of integrity risks such as fraud and corruption will remain an item of special attention. The AFM takes enforcement action if necessary.
- 2.4 Assessing and reassessing the suitability and reliability of policymakers and co-policymakers at financial enterprises and audit firms.
- 2.5 Intensifying the cooperation between the national European supervisors with respect to the combating of money laundering, corruption and the financing of terrorism, including through the creation of supervisory colleges for financial enterprises operating in two or more Member States and by participation in the EBA Anti Money Laundering Standing Committee.
- 2.6 Strengthening cooperation with our other Financial Expertise Centre (FEC) partners: DNB, the national police, the Public Prosecution Service, the Fiscal Intelligence and Investigation service, the Tax & Customs Administration and FIU-Netherlands, through collective reviews and projects. With regard to the FEC, we will also explore the possibilities for a public-private partnership in the fight against money laundering and the financing of terrorism.

Source: AFM Agenda 2021



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On the one hand, the AFM is also announcing that like the DNB it will make more use of data driven information, so they want to identify, in an early stage, what is the risk profile of an asset manager, and based on that risk profile, they may select an asset manager and conduct an on-site investigation with respect to that asset manager.

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The duty of care which is the second item I would like to discuss with you. Information requirements, investment advice requirements and difference and pitfalls are what I want to go through. First of all, let's start with MiFID Know Your Client. Know Your Client, as a result of the first MiFID directive in 2007, is part of the daily business, part of the duty of care, one of the main obligations when it comes down to the duty of care. And we all know that we have to get our information about the financial position, the investment objectives of the client, the risk appetite or risk profile as you may call it. And finally, knowledge and experience. But new to that is the non-financial information you have to get from your client, about the client, and that is the sustainability preferences of the clients.



And that makes it of course a little bit difficult because, especially when it comes down to retail clients, they may not determine or have determined yet for themselves what their preferences are. So I predict that perhaps less professional parties and retail clients may want to be helped, identifying what their preferences are.

So, it's not about the question: "Do you want to invest in sustainability goals?". Your clients need help to identify what exact sustainability goals that may be, and the United Nations goals, those 17 goals may help you further with that. So that has to be considered. This applies to all types of clients. So that is really something new, which will become more important nowadays. Also when you provide investment advice it is necessary to make clear what the sustainability factors are that you have taken into consideration when selecting the financial instruments. So most investment firms have a range of financial instruments, funds, shares, bonds or whatever to invest in, and they focus on the selected type of financial instruments. But you have to make sure that you know about each instrument that you are going to distribute, what the sustainability factors are, in order to – and that's also part of product governance - make sure that the sustainability factors match with the sustainability preferences of your clients.

Is there a difference between information and providing advice. Yes, there is and for two reasons, this is important. Asset managers are qualified under SFDR as a financial markets party. So that means that they are subject to strict information requirements. On the other hand, if you provide only information, you are subject to less severe information requirements. And finally, when you're not advising, execution only, from a strict legal point of view that falls out of the scope of SFDR.

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Information requirements

Article 52: Information about investment advice

Paragraph 3 : Investment firms shall provide a description of:

- (a) the types of financial instruments considered;
- (b) the range of financial instruments and providers, analysed per each type of instrument according to the scope of the service;
- (c) where relevant, the sustainability factors taken into consideration in the selection process of financial instruments;
- (d) when providing independent advice, how the service provided satisfies the conditions for the provision of investment advice on an independent basis, and the factors taken into consideration in the selection process used by the investment firm to recommend financial instruments, including risks, costs and complexity of the financial instruments.;

Source: Proposed amendments art. 52 (3) MiFID II Delegated Regulation (EU) 2017/565 (COM (2021)2618 final)

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So, in practice, it is important to know exactly what the difference is between providing information to clients and providing advice to clients. And to keep it fairly short, I will go through the criteria. When you provide information, you have to ensure that you provide factual information, so don't qualify facts, but stick to the facts and simply tell the facts. Advice is being regarded as a personal recommendation, with respect to a concrete financial instrument. So, to keep it very short: it has to be a personal recommendation, and it has to apply to a concrete financial instrument. If you advise on an asset allocation, that would qualify as advice under civil law, but under MiFIDII, under the Wft, that would not qualify as advice, because it doesn't relate to concrete financial instruments.

On the other hand, if you say you have to invest in this fund, or I would recommend you to buy this share or that bond, that would typically qualify as an advice under MiFIDII. Nowadays ESMA has formulated five criteria which you see here on the slide.

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Criteria information > advice

- 1 Does the service being offered constitute a recommendation?
- 2 Is the recommendation presented as suitable and is the recommendation based on a consideration of the person's circumstances?
- 3 Is the recommendation in relation to one or more transactions in financial instruments?
- 4 Is the recommendation issued otherwise than exclusively through distribution channels or to the public?
- 5 Is the recommendation made to a person in his capacity as an investor or potential investor and is the recommendation made to a person in his capacity as an agent for an investor or potential investor?

Source: CESR 10-293 and ECLI:NL:CBB:2015:121 (9 April 2015)

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This gives you some guidance, when a recommendation or information qualifies as an advice. You need to fulfil all five in order to qualify the information you provide, as an investment advice under MiFIDII. If there's no hit on one of those five, then, it does not qualify as advice. That's it, but in practice I always say: is it a personal recommendation? So, one on one, so not on the website, not when it's made public, then it is an investment advice. And it has to relate to a concrete financial instrument. CESR published some further guidance, pointing out some pitfalls.

For instance, if you discuss with an execution only client about the investment he or she intends to do, that may be interpreted by the client as advice. For instance, if the client asks about the investment for what do other clients of yours intend to do. So, those are typically questions which you should respond in a way that you have to say I cannot answer that because I don't provide you with advice, because that may be considered as investment advice under MiFIDII.

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Examples of information pitfalls

Situations where providing a client with the information could involve giving a personal recommendation:

- a person may offer to tell a client when certain shares reach a certain value on the basis of a prior recommendation to purchase or to sell at that price; or
- a person may offer to provide information on directors' dealings on the basis that, in his opinion, were directors to buy or sell investors would do well to follow suit

Source: CESR 10-293 (Q&A, 19 April 2010)



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Examples information pitfalls

Examples of objective information that might be given to a client, without amounting to a personal recommendation:

- listings of share and unit prices;
- company news or announcements;
- an explanation of the terms and conditions of an investment;
- a comparison of the benefits and risks of one investment as compared to another;
- league tables showing the performance of investments of a particular kind against set published criteria;
- alerts about the happening of certain events (for example, certain shares reaching a certain price);
- details of directors' dealings in the shares of their own companies

Source: CESR 10-293 (Q&A, 19 April 2010)

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So pitfalls in short

- Client interprets general or pre-contractual information as advice
- Discussion with execution only client who interprets information as advice
- Information requirements for independent investment advice
- Portfolio management: liaise with client on transactions

So stay away from those pitfalls and make sure that if you don't intend to provide investment advice, you stick to factual information, factual information such as, what is the price of the share, what is the price of the bond, what are the characteristics of the fund. Those items, this kind of information qualifies as factual information, and not as investment advice. Here are some more examples: company news, announcements, explanation of terms and condition of an investment, all examples of factual information.



The AFM as you might have seen has published an interpretation with respect to investment advice or portfolio management, which has more or less the same meaning. In essence, the AFM is of the opinion that, to put it shortly, if you consult your client before making a decision, before making a transaction I have to say, when you consult a client, then it may qualify as advice, and you are no longer conducting portfolio management. That would mean that you have to apply for license if you are a portfolio manager in order to conduct investment advice.



Advice vs portfolio management

Points of attention for difference between portfolio management and advice

- Too broad interpretation of scope of individual portfolio management
- AFM: for individual portfolio management the investment decision is always with the investment firm
- AFM: transactions for which the investment decision is with the client are in general [the result of] investment advice, reception and transmission of orders (and/or execution of orders), or a combination thereof.

Source: AFM Sectorbrief over verschil tussen individueel vermogensbeheer en advies (3 February 2021) (available in Dutch only)

Source:
<https://www.hartadvocaten.nl/media/d/HartAdvocatenvrijehandvanvermogensbeheerder.pdf> (in Dutch only)

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I'm not fully in agreement with the AFM, I do not fully agree with the interpretation of the AFM. I always find it difficult when a local supervisory authority, publishes this kind of guidance, because you need to take into account the European level playing field, of course. So it's really up to ESMA to say something about the interpretation of the definition of portfolio management or asset management.



From a legal point of view, I would say, what really matters is two things. First of all, in the contract between the portfolio manager and the client, it has to be stipulated that the client may not instruct the portfolio manager to conduct certain transactions at the request of the client. That's the first condition. The second condition is that consulting with your client does not qualify you as an investment advisor, but, what really is relevant, at the end of the day, you as an investment firm, make the decision whether or not you have consulted your client. And if the latter is the case, then this still qualifies as portfolio management, but the AFM seems to have a slightly different interpretation, which in practice means that you can qualify as an investment advisor, although you think to act as a portfolio manager.

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The MiFIDII quick fix, which more or less is some amendments to the MiFIDII regulation. What are the most important amendments? First of all, sustainability, of course, which is the main issue perhaps for this year. And one of the major changes relates to product governance. Product governance, regulation of product governance is not new, we all have, I assume that in place, but you have to include in your product governance process that you take into account the sustainability preferences of your target market, that is, of course, important, but it is also quite severe. It will not broaden the target market, because if you have to take into account those preferences, it will make the target markets smaller, because clients that have the same financial preferences, the same risk profile from a financial point of view or from an investment point of view, may have very different preferences if it comes down to sustainability. You need to include that in your product governance, and perhaps you may want to change or amend the products you are distributing to your clients. That relates not only to manufacturers but also to distributors.

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PARP - MIFID II (sustainability)

Proposed amendments Delegated Directive 2017/593

Article 9: Product governance obligations for investment firms manufacturing financial instruments

Paragraph 9: Member States shall require investment firms to identify at a sufficiently granular level the potential target market for each financial instrument and specify the type(s) of client for whose needs, characteristics and objectives, **including any sustainability preferences**, the financial instrument is compatible. As part of this process, the firm shall identify any group(s) of clients for whose needs, characteristics and objectives the financial instrument is not compatible, **except where financial instruments consider sustainability factors**. Where investment firms collaborate to manufacture a financial instrument, only one target market needs to be identified.

Paragraph 11 sub (b) (new): the financial instrument's **sustainability factors, where relevant, are consistent with the target market**.

Paragraph 14: Member States shall require investment firms to review the financial instruments they manufacture on a regular basis, taking into account any event that could materially affect the potential risk to the identified target market. Investment firms shall consider whether the financial instrument remains consistent with the needs, characteristics and objectives, **including any sustainability preferences**, of the target market and if it is distributed to the target market, or is reaches clients for whose needs, characteristics and objectives the financial instrument is not compatible.

Source: C(2021)2612 final (21 April 2021)



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PARP - MIFID II (sustainability)

Article 10: Product governance obligations for distributors

Paragraph 2: Member States shall require investment firms to have in place adequate product governance arrangements to ensure that products and services they intend to offer or recommend are compatible with the needs, characteristics, and objectives, **including any sustainability related objectives**, of an identified target market and that the intended distribution strategy is consistent with the identified target market.

Investment firms shall **appropriately identify and assess the circumstances and needs of the clients they intend to focus on**, so as to ensure that clients' interests are not compromised as a result of commercial or funding pressures. As part of this process, investment firms shall identify any groups group of clients for whose needs, characteristics and objectives the product or service is not compatible except where financial instruments consider sustainability factors.

Paragraph 5: Member States shall require investment firms to **review the investment products they offer or recommend and the services they provide on a regular basis**, taking into account any event that could materially affect the potential risk to the identified target market. Firms shall assess at least whether the product or service remains consistent with the needs, characteristics and objectives, **including any sustainability related objectives**, of the identified target market and whether the intended distribution strategy remains appropriate.

Firms shall **reconsider the target market and/or update the product governance arrangements** if they become aware that they have wrongly identified the target market for a specific product or service or that the product or service no longer meets the circumstances of the identified target market, such as where the product becomes illiquid or very volatile due to market changes.





So whether or not you are the issuer of the financial instruments or an asset manager, in both cases you need to comply with these new rules under the MiFIDII quick fix.

Then, in addition a few exemptions are being introduced which is good news for the wholesale segments. Investment firms are exempt from certain requirements. For instance, when the investment services relate to bonds with no other embedded derivatives than a make-whole clause, or when the financial instruments are marketed or distributed exclusively to eligible counterparties. So be aware of those two exemptions. You may, in practice, decide to continue to still apply product governance rules, even if you can make use of the exemptions, because you find it simply useful for yourself.

MiFID II product governance

Article 16a

Exemptions from product governance

An investment firm shall be exempted from the requirements set out in the second to fifth subparagraphs of Article 16(3) and in Article 24(2),

where the investment service it provides relates to bonds with no other embedded derivative than a make-whole clause

or

where the financial instruments are marketed or distributed exclusively to eligible counterparties.

[Source: article 16a MiFID II \(new\)](#)



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MiFID II electronic communication

Article 24:

Paragraph 5a: Investment firms shall provide all information required to be provided by this Directive to clients or potential clients in electronic format, except where the client or potential client is a retail client or potential retail client who has requested receiving the information on paper, in which case that information shall be provided on paper, free of charge.

Investment firms shall inform retail clients or potential retail clients that they have the option of receiving the information on paper.

Investment firms shall inform existing retail clients that receive the information required to be provided by this Directive on paper of the fact that they will receive that information in electronic format at least eight weeks before sending that information in electronic format. Investment firms shall inform those existing retail clients that they have the choice either to continue receiving information on paper or to switch to information in electronic format. Investment firms shall also inform existing retail clients that an automatic switch to the electronic format will occur if they do not request the continuation of the provision of the information on paper within that eight week period. Existing retail clients who already receive the information required to be provided by this Directive in electronic format do not need to be informed.

Source: Article 24 (5a) MiFID II (new)

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Then another change under this MiFIDII quick fix is electronic communication. Electronic communication is important nowadays. When I started as a lawyer, it was totally the other way around. Those days the client had to give permission for electronic communication, now it's totally turned around. So, you may make use of electronic communication, but you have to offer your client, the possibility to get it on paper. So basically, the information we have to provide to your clients should say that, Listen, dear client, we are going to communicate electronically. But if you want to have it on paper, please let us know - so it's more an opt in for the client. Then, finally, another important change is the research, the inducement regime, with respect to which research is quite severe. So, for many smaller companies, there is an exemption and that exemption indeed, in essence, enables you to ask a joint payment for the provision of research and provision of execution only services. So, if you combine those two, you may ask for a joint payment. That is new, and the purpose is that it is important for mid and small cap companies to get easier access to the capital markets, and that is the reason why this exemption has been introduced.

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MiFID II research for small and mid-caps

(8) (...) Research on small and middle-capitalisation issuers is essential to help issuers to connect with investors. (...) Investment firms should be allowed to pay jointly for the provision of research and for the provision of execution services provided certain conditions are met.

One of the conditions should be that the research is provided on issuers whose market capitalisation did not exceed EUR 1 billion, as expressed by the end-year quotes, for the 36 months preceding the provision of the research. That requirement relating to market capitalisation should be construed as covering both listed companies and non-listed companies, on the understanding that, for the latter, the balance sheet item on own capital did not exceed the EUR 1 billion threshold.

It should also be noted that newly listed companies and non-listed companies established for less than 36 months are included within the scope as long as they can demonstrate that their market capitalisation did not exceed the EUR 1 billion threshold, as expressed by end-year quotes since their listing, or expressed by the own-capital for the financial years when they are or were not listed.

To ensure that newly established companies that exist for less than 12 months can equally benefit from the exemption, it is sufficient that they did not exceed the EUR 1 billion threshold since the date of their establishment.

Source: Article 24 (9a) MiFID II (new) and recital 8 Directive (EU)2021/338

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This was my quick overview of some major changes, some major topics when it comes down to MiFIDII. I thank you for watching, and I always say, see you in court. Thank you very much.

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