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## Analysing the Clash over the Knowledge and Competence Requirements in the Markets in Financial Instruments Directive (MiFID II)

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### Abstract

*This special issue aims to examine whether there is an enduring politicization in the European Union (EU) “Better Regulation” agenda despite the emphasis on neutral evidence-based policy making. Our article addresses this overarching research question by focusing on the use of stakeholder consultations in the case of financial sector governance, particularly, the amended Markets in Financial Instruments Directive (MiFID II). We show that calibrating key provisions in MiFID II, such as those concerning knowledge and expertise, is not a simple exercise in rational problem definition and policy design. The provisions examined in this article have important repercussions for financial sector firms’ business strategies and operations. Thus, investment firms, banks, training institutes and public organizations have mobilized and actively sought to assert their views on the appropriate requirements for professional knowledge and experience in MiFID II. We found that, following the stakeholder consultation, the European Securities and Markets Authority (ESMA) opted for a minimum harmonization approach at the EU level. At the same time, ESMA also supported giving the respective national competent authorities sufficient remit to issue additional requirements in accordance with national laws and regulatory practices. Our article demonstrates that while public consultations provide rich evidence for the policy making process, they also contribute to the lasting politicization of regulatory decisions.*

**Keywords:** Better Regulation, ESMA, financial regulation, expertise, MiFID II.

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## A Introduction

The European Union (EU) is often portrayed as a regulatory polity which is highly technocratic, complex and distant from citizens' daily concerns.<sup>1</sup> To counter this perception and foster a competitive regulatory environment, since the 1990s, the EU has pursued a "Better Regulation Agenda". In line with regulatory trends in the US, UK and other countries from the Organisation for Economic Co-operation and Development (OECD), the EU strives to simplify, consolidate and ensure the coherence of its regulatory framework.<sup>2</sup> One of the primary goals of "Better Regulation" was to foster economic growth by cutting administrative burden and red tape, assuring legal certainty and choosing appropriate regulatory interventions based on thorough cost-benefit assessments.<sup>3</sup> In addition to economic competitiveness and efficiency, in the beginning of the 2000s, policy makers included good governance and sustainable development as goals of the EU "Better Regulation" package.<sup>4</sup> In this context, the European Commission's "White Paper on European Governance" from 2001 emphasized a commitment to a culture of consultation and dialogue during the preparation of legislation.<sup>5</sup> A year later, as part of the first "Better Regulation" package, the Commission endorsed a set of principles and minimum standards for public consultations.<sup>6</sup>

In May 2015, the European Commission unveiled its new "Better Regulation Agenda"<sup>7</sup> which again emphasizes transparency in the preparation of laws as well as responsiveness to stakeholders and to the public. By fulfilling its duty<sup>8</sup> to consult widely before enacting legislation, the Commission seeks to ensure that its legislative initiatives are technically sound, politically viable and based on a bottom-up approach. Ideally, a transparent consultation process should lead to

- 1 K. Featherstone, 'Jean Monnet and the "Democratic Deficit" in the European Union', *Journal of Common Market Studies*, Vol. 32, 1994, pp. 149-170; A. Follesdal, 'Survey Article: The Legitimacy Deficits of the European Union', *The Journal of Political Philosophy*, Vol. 14, No. 4, 2006, pp. 441-468; A. Follesdal & S. Hix, 'Why there is a Democratic Deficit in the EU: A Response to Majone and Moravcsik', *Journal of Common Market Studies*, Vol. 44, No. 3, 2006, pp. 533-562.
- 2 R.E. Lofstedt, 'The "Plateau-ing" of the European Better Regulation Agenda: An analysis of activities carried out by the Barroso Commission', *Journal of Risk Research*, Vol. 10, No. 4, 2006, pp. 423-447; C. Radaelli & F. de Francesco, *Regulatory Quality in Europe: Concepts, Measures and Policy Processes*, Manchester, Manchester University Press, 2007.
- 3 European Commission, Action plan on 'Simplifying and improving the regulatory environment', Brussels, COM(2002) 278; G. Verheugen, 'Press Conference on Better Regulation: Less Red Tape Equals More Growth', Brussels, 16 March 2005.
- 4 R.E. Löfstedt, 'The Swing of the Regulatory Pendulum in Europe: From Precautionary Principle to (Regulatory) Impact Analysis', *Journal of Risk and Uncertainty*, Vol. 28, 2004, pp. 237-260.
- 5 European Commission, 'White Paper on European Governance', Brussels, COM(2001) 428, 2001, p. 6.
- 6 European Commission, 'Towards a Reinforced Culture of Consultation and Dialogue – General Principles and Minimum Standards for Consultation of Interested Parties by the Commission', Brussels, COM(2002) 704.
- 7 European Commission, 'Better Regulation for Better Results – An EU Agenda', Brussels, COM(2015) 215 final.
- 8 Protocol No. 7 on the application of the principles of subsidiarity and proportionality annexed to the Treaty of Amsterdam states that "the Commission should [...] consult widely before proposing legislation and, wherever appropriate, publish consultation documents".

improved regulatory outcomes, enhanced democratic participation and public support for the proposed legislation. However, can these different goals be achieved at the same time? Previous studies have found that evidence-based and efficiency-oriented policy making is not easily compatible with inclusive and participatory decision-making.<sup>9</sup> For example, on the one hand, “Better Regulation” aims to ensure greater responsiveness to citizens’ concerns, which sometimes requires more extensive rules, stricter monitoring and enforcement. On the other hand, it also aims to achieve efficiency of regulation by easing the regulatory burden on companies.<sup>10</sup> A recent Commission communication highlighted the importance of reducing “[the] unnecessary burdens and red-tape on citizens, businesses and public authorities.”<sup>11</sup> The Commission clarified that the number of proposals for regulations and directives prepared for adoption by the European Parliament and the Council under the ordinary legislative procedure declined from 159 in 2011 to 48 in 2015. Furthermore, the Annual Work Programmes of the Juncker Commission have become more streamlined: there were 100 new priority initiatives and packages in 2014 and only 23 new initiatives in both 2015 and 2016.<sup>12</sup>

The extensive stakeholder consultation process provides policy actors and analysts with an unprecedented amount of systematic insight into the positions and preferences of diverse stakeholders.<sup>13</sup> At the same time, gathering and analysing large amounts of data about stakeholders’ preferences does not automatically translate into more streamlined and coherent policy proposals. The Commission has also warned against “bias or skewed conclusions”<sup>14</sup> based on the public consultations. It also strives to “avoid regulatory capture,”<sup>15</sup> but it remains unclear how this can be ensured in practice. Consequently, as highlighted in the

9 P. Weingart, ‘Scientific Expertise and Political Accountability: Paradoxes of Science in Politics’, *Science and Public Policy*, Vol. 26, No. 3, 1999, pp. 151-161; D. Greenwood, ‘Facing Complexity: Democracy, Expertise and the Discovery Process’, *Political Studies*, Vol. 58, 2010, pp. 769-788.

10 Communication from the European Commission, ‘Better Regulation: Delivering Better Results for a Stronger Union’, 14 September 2016, COM(2016) 615 final.

11 *Ibid.*, p. 3.

12 *Ibid.*, pp. 3-4.

13 C. Radaelli & A. Meuwese, ‘Better Regulation in Europe: Between Public Management and Regulatory Reform’, *Public Administration*, Vol. 87, No. 3, 2009, pp. 639-654; A. Meuwese, M. Scheltema & L. van der Velden, ‘The OECD Framework for Regulatory Policy Evaluation: An Initial Assessment’, *European Journal of Risk Regulation*, Vol. 6, No. 1, 2015, pp. 101-110; H. Kluver, *Lobbying in the European Union: Interest Groups, Lobbying Coalitions, and Policy Change*, Oxford, Oxford University Press, 2013; A. Bunea & R. Thomson, ‘Consultations with Interest Groups and the Empowerment of Executives: Evidence from the European Union’, *Governance: An International Journal of Policy, Administration, and Institutions*, Vol. 28, No. 4, 2015, pp. 517-531; A.W. Chalmers, ‘In Over Their Heads: Public Consultation, Administrative Capacity and Legislative Duration in the European Union’, *European Union Politics*, Vol. 15, No. 4, 2014; H. Kluver, C. Braun & J. Beyers, ‘Legislative Lobbying in Context: Towards a Conceptual Framework of Interest Group Lobbying in the European Union’, *Journal of European Public Policy*, Vol. 22, No. 4, 2015, pp. 447-461; A. Rasmussen & D. Toshkov, ‘The Effect of Stakeholder Involvement on Legislative Duration: Consultation of External Actors and Legislative Duration in the European Union’, *European Union Politics*, Vol. 14, No. 3, 2013, pp. 1-22.

14 European Commission, COM(2016) 615 final, p. 73.

15 *Ibid.*, p. 75.

introduction to the special issue, there are ongoing concerns that Better Regulation might hide “fundamental political and regulatory choices behind a language of ‘common sense’” and that “political preferences will be wrapped in the language of evidence-based policy making.”<sup>16</sup>

We examine how an EU agency, the European Securities and Markets Authority (ESMA), seeks to reconcile the tensions in the stakeholders’ diverse views and preferences to produce coherent EU-wide rules in the topical case of the Markets in Financial Instruments Directive II (MiFID II). The re-regulation of financial markets has been subject to extensive public scrutiny after the 2008 global financial crisis, and the selected directive captures well the tensions between the different goals in the “Better Regulation” agenda.

This special issue investigates whether politicization endures in “Better Regulation” law-making despite the emphasis on neutral evidence-based policy making. Our article contributes to this overarching research question by focusing on the use of public consultations. We address the topic of expertise and its role in the policy making process from a substantive and a procedural standpoint. First, from a substantive standpoint, we examine how the participants in the public consultation propose (or effectively construct) particular definitions of expertise in the context of MiFID II. The exact formulation of the definition has major distributive implications that could bring companies a competitive advantage in the market place or, alternatively, precipitate losses. Therefore, we begin by investigating how financial industry firms have mobilized during the policy-shaping stage and sought to define key legislative provisions in line with their business model and practices. Second, from a procedural standpoint, we examine the aggregating function of ESMA, which is responsible for drafting the common EU-wide guidelines. The analysis shows that calibrating key provisions in MiFID II, such as those concerning knowledge and expertise, is not a simple exercise in rational problem definition and policy design.

Overall, in this contribution to the special issue, we probe the “enduring politicization” hypothesis in the “Better Regulation” agenda based on a case study of MiFID II. We do so first by mapping out the submissions for the public stakeholder consultation and analysing the degree of variation in the articulated preferences. Second, we examine the role of ESMA in aggregating these diverse views and preferences. The article is structured as follows: Section B discusses the importance of MiFID II for EU financial sector governance and, particularly, Articles 24 and 25 which help create a more robust investor protection regime. Section C summarizes the main assumptions examined in the article, based on the literature on interest groups in financial sector governance. Subsequently, Section D presents the empirical analysis of the stakeholder positions regarding the knowledge and experience requirements. Lastly, Section E summarizes the main findings.

16 K. Wegrich, ‘Which Results? Better Regulation and Institutional Politics’, *European Journal of Risk Regulation*, Vol. 6, No. 3, 2015, pp. 369-371.

## B The Markets in Financial Instruments Directive (MiFID II)

Before the 2008 global financial crisis, EU decision-makers prioritized completing the single market in financial services, competitiveness and a smaller regulatory burden. However, the crisis underscored the need for more robust investor protection and consumer protection measures as equally important goals of regulation.<sup>17</sup> As early as 2011, the European Parliament advocated giving greater powers to the newly created ESMA in the realm of investor protection.<sup>18</sup> The importance of a strong investor protection regime at the EU level is also clear from subsequently adopted legislation, such as MiFID II, the Markets in Financial Instruments Regulation (MiFIR) and, looking ahead, a Capital Markets Union<sup>19</sup> as well as peer reviews conducted by ESMA to assess how the legislation is applied in practice by different national regulators.<sup>20</sup>

The amended MiFID II<sup>21</sup> is a cornerstone piece of legislation in the governance architecture of EU financial services. It was adopted in 2014 as part of a larger regulatory package, which also includes MiFIR. MiFID II extends the scope of MiFID I, in force since 2007, to cover previously exempted firms, an expanded class of assets and structural market reform. Originally proposed in 2011, MiFID II was finally adopted in 2014 after a lengthy process of stakeholder consultation, impact assessment and legislative negotiations amongst the EU member states in the Council as well as between the Council and the European Parliament. Figure 1 at the end of this section shows the timeline for adopting MiFID II and the specific provisions examined in this article. MiFID II is expected to alter firms' over-the-counter trading practices, pricing and bring about further structural changes to the exchange-traded equity market in the EU.<sup>22</sup> Thus, the directive has important business model repercussions for investment banks, private banks, asset managers, retail banks, insurance firms, market infrastructure providers and even non-financial firms, such as energy providers.<sup>23</sup> Moreover, the impact of MiFID II will be felt beyond the EU borders, as many large investment firms oper-

17 N. Moloney, *How to Protect Investors. Lessons from the EU and the UK*, Cambridge, Cambridge University Press, 2010; N. Moloney, 'The European Securities and Markets Authority and Institutional Design for the EU Financial Market – A Tale of Two Competences: Part 1: Rule-Making', *European Business Organization Law Review*, Vol. 12, No. 1, 2011, pp. 41-86.

18 Moloney, 2011, p. 11.

19 V. Ross, 'Regulatory and Supervisory Developments, the Challenges Ahead – A European Perspective', ESMA/2016/1497, Speech of ESMA's Executive Director at Finanstilsynet 30th Anniversary International Conference, Oslo, Norway, 20 October 2016.

20 See, e.g., ESMA, 'MiFID Suitability Requirements Peer Review Report', ESMA/2016/584, available at: <[https://www.esma.europa.eu/sites/default/files/library/2016-584\\_suitability\\_peer\\_review\\_-\\_final\\_report.pdf](https://www.esma.europa.eu/sites/default/files/library/2016-584_suitability_peer_review_-_final_report.pdf)>.

21 Directive No. 2014/65/EU on markets in financial instruments OJ: L 173/349-496, 12 June 2014 (MiFID); Regulation No 600/2014 on markets in financial instruments OJ L 173/84-148, 12.6.2014 (MiFIR).

22 Deloitte, 'MIFID II What will be its Impact on the Investment Fund Distribution Landscape?', Retrieved 28 July 2016, p. 5, available at: <<http://www2.deloitte.com/lu/en/pages/mifid/articles/markets-financial-instruments-directive-mifidII.html>>.

23 J. Ehrenfeld, 'Global Securities Reporting: Industry Trends, Challenges and Future Perspectives', *Journal of Securities Operations & Custody*, Vol. 8, No. 2, 2016, p. 152.

ating in the EU single market are based in other jurisdictions, such as the US, Japan, China, Australia and Canada. Similarly, EU-based investment firms have substantial international operations.

In this article, we focus particularly on MiFID II Articles 24 and 25 regarding the provision of investment advice. The articles were selected for the analysis because in the framework of MiFID II, employees informing clients about investment decisions play a crucial role in ensuring that clients receive sufficient insight into both the risks and benefits related to their investment decisions. Prior to 2008, it was fairly common for investment advisors to share only limited, or sometimes even misleading, information in order to secure more business for the bank or investment company.<sup>24</sup> This pitfall was exacerbated by existing remuneration practices, which awarded employees bonuses based on the amount and value of the products they sold.<sup>25</sup> To provide incentives for a more complete information disclosure and analysis prior to selling a product, MiFID II stipulates more stringent requirements for intermediaries and financial advisers regarding information provision to the potential clients as well as the financial knowledge and proficiency of staff members providing investment advice.

MiFID II and MiFIR give ESMA the mandate to develop appropriate draft Regulatory Trading Standards (RTS) and draft Implementing Technical Standards (ITS).<sup>26</sup> Over the course of 2015, ESMA published three sets of technical standards, including its final report on the guidelines for the assessment of knowledge and competence in December 2015.<sup>27</sup> The latter set of guidelines is part of ESMA's investor protection work stream within the general MiFID II framework and specifies a set of criteria for the assessment of knowledge and competence of employees providing advice or information about financial instruments, investment services or ancillary services to clients. The main criteria governing information provision, independent advice and cross-selling are set out in MiFID II *Article 24* regarding "General principles and information to clients" and those about knowledge and competence – in *Article 25* regarding "Assessment of suitability and appropriateness and reporting to clients."<sup>28</sup>

*Article 24* regulates prohibited payments and retention of inducements. Out of the entire MiFID II package, this article has been particularly controversial and generated vocal opposition by the financial industry. The article stipulates that whenever investment advice is provided, firms have to inform the client in

24 E. Avgouleas, 'The Global Financial Crisis, Behavioural Finance and Financial Regulation: In Search of a New Orthodoxy', *Journal of Corporate Law Studies*, Vol. 9, No. 1, 2009, pp. 23-59; R. Ball, 'The Global Financial Crisis and the Efficient Market Hypothesis: What Have We Learned?', *Journal of Applied Corporate Finance*, Vol. 21, No. 4, 2009, pp. 8-16.

25 *Ibid.*

26 European Commission, 'Technical Standards Under Directive 2004/39/EC (MiFID I), Directive 2014/65/EU (MiFID II) and Regulation (EU) No 600/2014 (MiFIR)', 1 February 2017, available at: <[http://ec.europa.eu/finance/securities/docs/isd/mifid/its-rts-overview-table\\_en.pdf](http://ec.europa.eu/finance/securities/docs/isd/mifid/its-rts-overview-table_en.pdf)>.

27 ESMA, 'MiFID II and MiFIR', available at: <<https://www.esma.europa.eu/policy-rules/mifid-ii-and-mifir>>.

28 Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU, OJ L 173/349.

advance whether or not this advice is provided on an independent basis, whether it is based on a broad or more restricted analysis of types of instruments and whether the client will receive a periodic suitability assessment regarding the product. Furthermore, firms have to provide clients with information on all costs and associated charges, such as the cost of the investment advice and the cost of the financial instrument recommended or marketed, including any third-party payments. The article also specifies that this information should be provided to the client on a regular basis, at least annually, for the entire duration of the investment and in a comprehensible form.

Article 24(11) authorizes ESMA, in cooperation with the European Banking Authority (EBA) and the European Insurance and Occupational Pensions Authority (EIOPA), to develop and periodically update appropriate guidelines supplementing the provisions in MiFID. Furthermore, Article 24(12) authorizes the member states to impose additional requirements on investment firms, but those should be “justified and proportionate so as to address specific risks to investor protection or to market integrity which are of particular importance in the circumstances of the market structure of that Member State.”<sup>29</sup> Thus, the article prohibits the previously widespread practice of providing inducements for discretionary asset management and investment advice.<sup>30</sup>

All in all, as Franke and Mosk have pointed out, Article 24 has generated substantial compliance costs, compared to MiFID I.<sup>31</sup> Article 25 stipulates that firms have to ensure, and be able to demonstrate to the relevant national competent authorities, that employees giving investment advice or information possess the necessary knowledge and competence. The precise calibration of the requirements is shaped by the complex multi-level governance framework of EU securities markets. In addition to the general MiFID II provisions, ESMA is authorized to draw up general guidelines on the assessment of knowledge and competence applicable in the entire EU, and the member states are authorized to prepare and publish additional requirements valid for their own country.

Under MiFID II, financial firms are obliged to carry out a so-called suitability assessment, which means that they have to assess the client’s knowledge and experience in the investment field relevant to the specific type of a product or a service offered, her or his financial situation including her or his ability to bear losses, and her or his investment objectives including risk tolerance. After carrying out this initial assessment, the investment advisor has to provide a formal statement on suitability, specifying the advice given and how that advice meets the preferences and objectives of the retail client. Even if, in the end, no formal investment advice is given, the suitability test is still required. Especially in case the investment advisor considers a financial product to be inappropriate, she or he has an obligation to warn the client about this.

29 *Ibid.*

30 Deloitte, ‘Navigating MiFID II: Strategic Decisions for Investment Managers’, 2015, available at: <<http://www2.deloitte.com/content/dam/Deloitte/lu/Documents/financial-services/IM/mifidii-changes.pdf>>.

31 G. Franke, T. Mosk & E. Schnebel, ‘Fair Retail Banking: How to Prevent Mis-selling by Banks’, *Sustainable Architecture for Finance in Europe*, White Paper Series, No. 39, 2016, pp. 1-29.

Furthermore, the provisions of MiFID II need to be considered together with the accompanying guidelines developed by ESMA and enforced by the financial conduct authorities of the EU member states. The intention of the guidelines is to ensure that investment firm employees providing investment advice possess the necessary knowledge and competence to meet legal, regulatory and business ethics standards. In particular, Article 25(9) of MiFID II authorizes ESMA to adopt guidelines specifying a more concrete set of criteria for the assessment of knowledge and competence required under Article 25(1).

To fine-tune the exact conditions specified in the guidelines, ESMA launched a public consultation,<sup>32</sup> open for submissions April to July 2015, focusing on six questions to which any interested stakeholders were invited to submit their answers and reasoning. ESMA aimed to develop a set of clear guidelines that reflect the practice of financial sector firms, but are not overly prescriptive and burdensome. The stakeholder consultation process was in line with the established best practices in the “Better Regulation” package. Additionally, ESMA also considered the view of its Securities and Markets Stakeholder Group (SMSG), which provides technical advice on policy development and ensures that stakeholders’ views are taken into consideration well in advance during policy formulation.<sup>33</sup>

The open public consultation would help ESMA to gauge the full range of existing practices and differences amongst the member states, regarding the structure, size, maturity and sophistication of national financial markets as well as the accompanying training systems put in place for the employees of investment firms.<sup>34</sup> Lastly, EU-wide guidelines would facilitate the exchange of best practices and mutual recognition of training standards across the member states, thus supporting the mobility of employees across investment firms and national borders.<sup>35</sup>

When it comes to the state of compliance with MiFID II at the time of drafting the guidelines, ESMA identified significant discrepancies amongst the EU member states. On the one hand, the proposed minimum harmonization standards under MiFID II were already in place in some member states, such as Belgium, Denmark, Finland and the UK. On the other hand, in other member states, such as Italy, the existing national requirements were below the thresholds specified in the draft requirements.<sup>36</sup>

32 See ESMA Stakeholder Consultation, ‘Draft Guidelines for the Assessment of Knowledge and Competence’, available at: <<https://www.esma.europa.eu/press-news/consultations/draft-guidelines-assessment-knowledge-and-competence>>.

33 ESMA, ‘Securities and Markets Stakeholder Group’, available at: <<https://www.esma.europa.eu/about-esma/governance/smsg>>.

34 ESMA, ‘Draft guidelines for the assessment of knowledge and competence’, ESMA/2015/753, available at: <[2015-753\\_cp\\_mifid\\_guidelines\\_on\\_knowledge\\_and\\_competence.pdf](#)>.

35 ESMA, Draft Guidelines, ESMA/2015/753, p. 5.

36 *Ibid.*, p. 4.



On 17 December 2015, following the stakeholder consultation period, ESMA issued its final report on the guidelines<sup>37</sup> specifying the criteria for the assessment of knowledge and competence of individuals providing investment advice or information about financial instruments, investment services or ancillary services to clients as per Article 25(1) of MiFID II. Subsequently, on 25 April 2016, the Commission formally adopted these guidelines in a delegated regulation<sup>38</sup> supplementing MiFID II, which contains a broader set of rules about the organizational requirements for investment firms, data reporting services providers and conduct of business obligations in the provision of investment services.

As illustrated in Figure 1, the formal adoption of MiFID II, MiFIR, accompanying RTS, ITS and supplementary measures has been a rather complex and lengthy process. In recognition of the implementation challenges for regulators and the financial industry, the Commission extended the general deadline for implementing MiFID II by 12 months to 3 January 2018.<sup>39</sup> Moreover, ESMA conducted a peer review to ensure that the consistent application of the suitability requirements in MiFID II when firms provide investment advice to retail clients across the member states. The findings, released in April 2016, showed that

while most national regulators have a good understanding of the investment advice market in their jurisdictions and regularly review the distribution methods and business models of investment firms, there is scope to adopt more proactive supervisory approaches and strengthen enforcement activities.<sup>40</sup>

Therefore, ESMA underscored that it would actively pursue better supervisory convergence and enforcement of MiFID II in the coming years.

As we saw in this section, MiFID II has introduced significant changes in European financial sector governance and has become a focal point of attention and mobilization for the financial industry. The stakeholder consultation conducted by ESMA on Articles 24 and 25 and the submissions of market participants shed light on the different business models and preferences of the actors. These positions also help us understand the contested nature of knowledge and expertise in regulatory affairs, as reflected in the debates about the exact definitions and conditions stipulated in Articles 24 and 25, examined below.

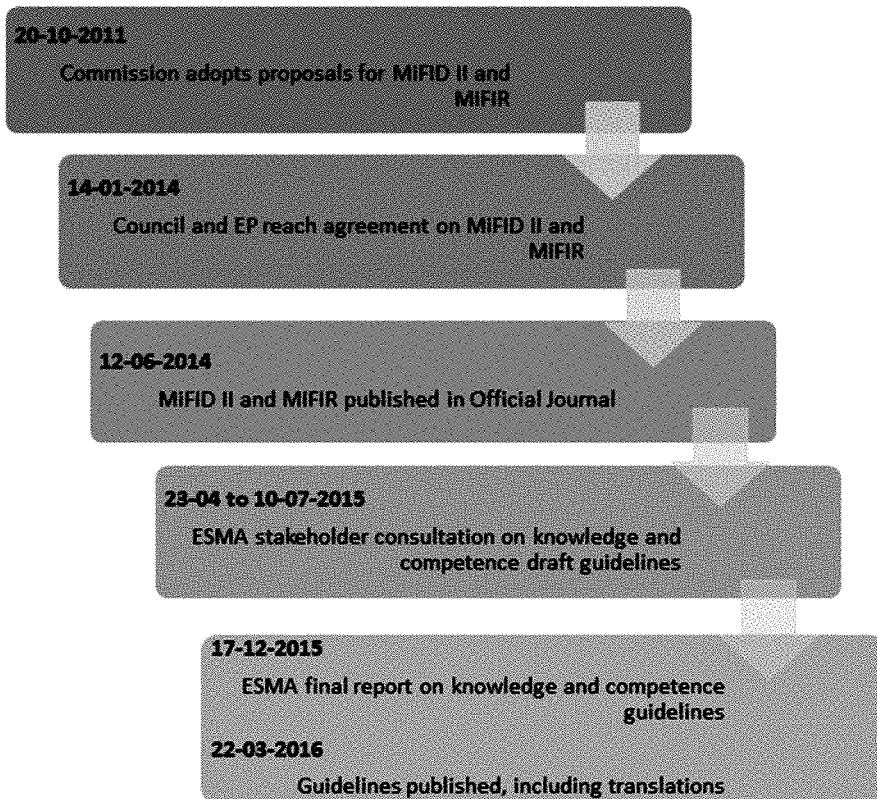
37 ESMA, 'Final Report on Guidelines for the Assessment of Knowledge and Competence', available at: <2015-1886\_-\_final\_report\_on\_guidelines\_for\_the\_assessment\_of\_knowledge\_and\_competence.pdf>.

38 Commission delegated regulation of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive, available at: <[http://ec.europa.eu/finance/securities/docs/isd/mifid/160425-delegated-regulation\\_en.pdf](http://ec.europa.eu/finance/securities/docs/isd/mifid/160425-delegated-regulation_en.pdf)>.

39 Proposal for a directive of the European Parliament and of the Council amending Directive 2014/65/EU on markets in financial instruments as regards certain dates, 11 April 2016, COM(2016) 0056.

40 ESMA, 'ESMA Finds Room for Improvement in National Supervision of Investment Advice to Retail Clients', ESMA/2016/582, Press Release, 7 April 2016, p. 1.

**Figure 1** *Timeline of MiFID II and the ESMA guidelines on knowledge and competence*



### C Assumptions Regarding Appropriate Knowledge Experience

Turning to the methodology of the analysis and central assumptions, this article examines the position papers of all 73 respondents to ESMA stakeholder consultation, conducted between April and July 2015, regarding the draft guidelines for the assessment of knowledge and competence for investment firms in order to fulfil their obligations under MiFID II. We analyse the positions of different stakeholders and compare the final version of the guidelines to the initial proposal. The empirical investigation is focused on two key issues, captured by questions 1 and 2 in ESMA stakeholder consultation:<sup>41</sup>

41 ESMA, 'Draft Guidelines for the Assessment of Knowledge and Competence', available at: <[https://www.esma.europa.eu/sites/default/files/library/2015/11/2015-753\\_cp\\_mifid\\_guidelines\\_on\\_knowledge\\_and\\_competence.pdf](https://www.esma.europa.eu/sites/default/files/library/2015/11/2015-753_cp_mifid_guidelines_on_knowledge_and_competence.pdf)>.

- (1) The length of the appropriate experience of the person providing advice or information to the clients;
- (2) The level and intensity of the knowledge and competence requirements of the employee.

Based on the literature on interest groups in financial sector governance,<sup>42</sup> we expect the majority of respondents from banks and investment firms to prefer a shorter period of ‘appropriate experience’ stipulated in ESMA guidelines. Furthermore, we expect that firms will have different preferences about the required relevant experience, depending on the company’s size and business model. The main fault line is likely to be between big investment companies and smaller firms. Structurally, the business model of large companies allows them to have more narrowly specialized employee profiles, whereas smaller companies often expect the same employee to be able to fulfil different tasks. Thus, when it comes to the definitions of “giving information” and “giving advice,” bigger companies have more resources to afford specialization and differentiation between staff giving information and advice, whereas smaller companies have more limited resources and less room for narrow staff specialization. In the following section, we investigate whether the evidence from the stakeholder positions confirms or contradicts these expectations.

## D Empirical Analysis of Stakeholders’ Positions

### I Issue 1: Length of the Appropriate Experience of the Person Providing Advice or Information to the Clients

The majority of respondents participating in the stakeholder consultation (52 out of 73) agreed with ESMA’s general approach to define knowledge and competence in terms of a certain number of required years of experience. After further examining the opinions of the 52 stakeholders which considered the definition of “appropriate experience” within the scope of Articles 24 and 25 of MiFID II, two categories stand out. A larger subset of respondents considered the 5-year requirement excessively long and called for a shorter period. A smaller subset of respondents was in favour of five or more consecutive years of experience.

42 C. Woll, *The Power of Inaction: Bank Bailouts in Comparison*, Ithaca, Cornell University Press, 2014; K.L. Young, ‘Financial Industry Groups’ Adaptation to the Post-Crisis Regulatory Environment: Changing Approaches to the Policy Cycle’, *Regulation and Governance*, Vol. 7, No. 4, 2013, pp. 460-480; K.L. Young, ‘Transnational Regulatory Capture? An Empirical Examination of the Transnational Lobbying of the Basel Committee on Banking Supervision’, *Review of International Political Economy*, Vol. 19, No. 4, 2012, pp. 663-88; K.L. Young & S. Pagliari, ‘Capital United? Business Unity in Regulatory Politics and the Special Place of Finance’, *Regulation and Governance*, 2015; E. Tsingou, ‘Club Governance and the Making of Global Financial Rules’, *Review of International Political Economy*, Vol. 22, No. 2, 2015, pp. 225-256; A.W. Chalmers, ‘Financial industry mobilization and securities markets regulation in Europe’, *European Journal of Political Research*, Vol. 54, No. 3, 2015, pp. 482-501.

To be precise, 39 out of 73 respondents considered the requirement of five consecutive years of experience to be too strict, which is in line with the assumptions presented in the preceding section. Many firms and associations stressed that the experience requirement should be proportional to the nature of services performed. For example, they pointed out that a high threshold should not apply to an employee who only provides investment information.<sup>43</sup> Moreover, the majority of respondents did not agree with the requirement to have consecutive years of experience and argued that this requirement could come across as discriminatory when used in practice, since it would affect employees who are on maternal, paternal or sick leave. For instance, InsureSec AB, representing the Swedish Insurance Intermediaries' Association, argued that this can be "problematic and unfair to employees that have been on parental leave."<sup>44</sup> The organization expressed a preference for calculating appropriate experience based on the total number of years of experience, without an expectation that those should be strictly consecutive.

Likewise, the majority of respondents pointed out that it was not essential to acquire the relevant experience in the same company. In practice, staff members often move between financial sector firms, and changing jobs does not have a substantial influence on the experience gained. The majority of banking and asset management companies supported an approach that would allow firms to assess the competence and knowledge of staff members individually.<sup>45</sup> Moreover, acquiring experience in different firms might even help employees develop a better understanding of different products and investment approaches used in the industry.<sup>46</sup>

A different line of reasoning in the stakeholder consultation positions draws on the existence of strong national training systems. For example, in France, the training system Association Française des Sociétés Financières (AMF) certification is used to ascertain a level of knowledge about the financial system and regulatory environment.<sup>47</sup> According to the regulatory guidelines in France, all candidates for a position at a financial services firm operating in France must either possess or acquire AMF certification within 6 months of starting their employment. From the perspective of countries such as France, which have a strong national training and certification system, the period of five consecutive years of

43 InsureSec AB, 'Response to ESMA's Consultation Paper on Draft Guidelines for the Assessment of Knowledge and Competence', 2015, p. 2.

44 *Ibid.*

45 BVI, 'Response to ESMA's Consultation Paper on Draft Guidelines for the Assessment of Knowledge and Competence', 2015, p. 2; Amundi, 'Response to ESMA's Consultation Paper on Draft Guidelines for the Assessment of Knowledge and Competence', 2015, p. 3; EFAMA, 'Response to ESMA's Consultation Paper on Draft Guidelines for the Assessment of Knowledge and Competence', 2015, p. 2; BlackRock, 'Response to ESMA's Consultation Paper on Draft Guidelines for the Assessment of Knowledge and Competence', 2015, p. 1.

46 BVI, 2015, p. 2.

47 Association Française des Sociétés Financières, 'Response to ESMA's Consultation Paper on Draft Guidelines for the Assessment of Knowledge and Competence', 2015, p. 1.

appropriate experience seems rather long. This stance is clearly visible in the responses of all French asset management companies.<sup>48</sup>

In addition to the 39 respondents who considered the proposed requirement of five consecutive years too strict, we observe that a minority of stakeholders, 13 out of 52, were in favour of a longer period of required experience. These are public sector organizations or professional training institutes. Moreover, of those 13 respondents, 4 supported the idea of an additional assessment that would take the form of a recognized certification carried out by an independent third party, also authorized by ESMA.<sup>49</sup>

In summary, ESMA did take into account the opinion of financial sector firms regarding the length of appropriate experience and lowered the initially proposed requirement of *five consecutive years* in its draft guidelines to the final specification of *6 months*. In its final report, ESMA also noted the opinion of the SMSG in favour of a shorter period.<sup>50</sup> It pointed out that, in order to ensure a minimum degree of harmonization, all relevant employees should possess a minimum period of previous experience of *6 months*.<sup>51</sup> However, ESMA also granted to the competent national authorities the possibility to add further specifications, possibly going beyond the minimum requirement. ESMA also removed from the definition of appropriate experience the reference to continuous experience and experience within the same company, thus addressing stakeholders' concerns about any potential discriminatory effect on employees making use of a leave period.<sup>52</sup>

## *II Issue 2: Level and Intensity of the Knowledge and Competence Requirements*

A large majority of respondents (57 out of 73) agreed with ESMA proposal to differentiate between the level and intensity of the knowledge and competence between employees providing only information versus those providing investment advice. The gist of the proposal is that staff members providing investment advice should comply with a higher standard of knowledge and competence. Still, many respondents supporting the distinction argued that the difference between staff giving information to the clients and those providing investment advice is not completely clear. Several stakeholders asked for a clearer definition and fur-

48 See, e.g., Amundi, 2015, p. 2.

49 See Dutch Securities Institute, 'Response to ESMA's Consultation Paper on Draft Guidelines for the Assessment of Knowledge and Competence', 2015, p. 2; Chartered Institute for Securities & Investment (CISI), 'Response to ESMA's Consultation Paper on Draft Guidelines for the assessment of knowledge and competence', 2015, p. 1; Verband unabhängiger Vermögensverwalter Deutschland e.V., 'Response to ESMA's Consultation Paper on Draft Guidelines for the Assessment of Knowledge and Competence', 2015, p. 2; Investment & Life Assurance Group Ltd, 'Response to ESMA's Consultation Paper on Draft Guidelines for the Assessment of Knowledge and Competence', 2015, p. 2.

50 SMSG Advice on Assessment of Knowledge and Competence in the Context of MiFID II 2015/SMSG/20, 24 July 2015, available at: <[www.2015-smmsg-020-advice\\_on\\_knowledge\\_and\\_competence\\_requirements.pdf](http://www.2015-smmsg-020-advice_on_knowledge_and_competence_requirements.pdf)>.

51 ESMA, 2015, p. 24.

52 *Ibid.*

ther guidance on the interpretation of the two types of financial advice.<sup>53</sup> A clearer distinction would, consequently, guarantee better consumer protection and explicit differentiation of employee tasks according to the nature of the service provided.

On the one hand, staff members providing information about existing products and services usually have a different job description than employees providing investment advice. A client will mostly act and purchase a financial product after receiving guidance from an investment advisor.<sup>54</sup> On the other hand, several stakeholders raised the point that the distinction between an employee giving information and one providing investment advice is often blurred in smaller firms, which recruit staff for more versatile positions.<sup>55</sup> This finding is in line with the assumptions presented earlier about the influence of a firm's size and business model.

Large training organizations in the sector, such as the Chartered Financial Analyst (CFA) Institute, also have a stake in the debate, as stricter more widely applied requirements are likely to generate more demand for their services. The CFA argued that:

for staff whose role it is to provide information, but who are not involved in the management and origination of investments, it is important to obtain a level of knowledge and professional competence sufficient to meet a suitability standard.<sup>56</sup>

Nevertheless, even in the case of small firms, if an employee is providing both information and, subsequently, advice to the client, the CFA argued that the higher level of knowledge and experience standards should apply. The European Federation of Financial Advisers and Financial Intermediaries (FECIF) also emphasized the frequently blurred lines between providing information on financial instruments and giving investment advice.<sup>57</sup> The organization acknowledged that it is reasonable to require more knowledge and competence when staff members provide advice about complex investment products rather than simple ones.

A minority of the respondents, 12 out of 73, explicitly disagreed with the distinction between different level of experience for different task descriptions and demanded the application of the highest standard to all employees, regardless of

53 Unicredit, 'Response to ESMA's Consultation Paper on Draft Guidelines for the Assessment of Knowledge and Competence', 2015, p. 2; Dutch Banking Association, 'Response to ESMA's Consultation Paper on Draft Guidelines for the Assessment of Knowledge and Competence', 2015, p. 2.

54 European Association of Co-operative Banks, 'Response to ESMA's Consultation Paper on Draft Guidelines for the Assessment of Knowledge and Competence', 2015, p. 3.

55 Chartered Financial Analyst (CFA) Institute, 'Response to ESMA's Consultation Paper on Draft Guidelines for the Assessment of Knowledge and Competence', 2015; European Federation of Financial Advisers and Financial Intermediaries (FECIF), 'Response to ESMA's Consultation Paper on Draft Guidelines for the Assessment of Knowledge and Competence', 2015.

56 CFA Institute, 2015, p. 9.

57 FECIF, 2015, p. 3.

whether they provide investment information or advice.<sup>58</sup> In France, the AMF professional certification does not make any difference between information and advice. Consequently, the AMF and French organizations argued in favour of uniform knowledge and experience standards for all financial sector employees, based on the professional certification issued by the AMF.<sup>59</sup>

Furthermore, many respondents sought clarification about the differentiation of task descriptions and profiles of staff members giving information about financial instruments, structured deposits, investment services or ancillary services to clients. The SMSG, for example, highlighted that it would not be fair to expect “people at the reception desk who merely distribute brochures” to meet the higher knowledge and competence criteria.<sup>60</sup> In response to this concern, ESMA outlined in its final guidelines that the definition of employees “giving information” should be read in a broad sense, including all situations when employees are put in direct contact with clients while engaging in a discussion about, for example, portfolio management.<sup>61</sup> Therefore, employees who do not engage with a client directly during the provision of investment advice, for example back office staff, fall outside the scope of Article 25(1) of MiFID II and the ESMA guidelines.

While ESMA took on board this concern and acknowledged the existence of important differences between the member states regarding knowledge and competence requirements, it also emphasized that member states’ national competent authorities should decide which exams should be passed to ensure that the necessary knowledge and competence requirements are met.<sup>62</sup>

At the same time, giving the national competent authorities a broader remit to issue additional requirements has implications for the level playing field in the single market in financial services, as it could lead to potential discrepancies amongst different national competent authorities. Nevertheless, some respondents recommended that ESMA should not impose too strict requirements but rather delegate more responsibilities to the member states.<sup>63</sup> The need for more flexibility at the domestic level stems from the lack of a common qualification and training system in financial services across the EU. Given the absence of such a common framework, ESMA opted to support the national competent authorities in their bid to specify the qualifications required for their respective national system. Similarly, the national competent authorities can determine whether the assessment of the staff members’ qualifications should be carried out internally

58 Centre de formation de la profession bancaire (CFPB) – AFG Formation, ‘Response to ESMA’s Consultation Paper on Draft Guidelines for the Assessment of Knowledge and Competence’, 2015; Amundi, 2015; The Luxembourg Bankers’ Association – The ABBL, ‘Response to ESMA’s Consultation Paper on Draft Guidelines for the Assessment of Knowledge and Competence’, 2015, p. 5.

59 Centre de formation de la profession bancaire (CFPB), 2015, p. 2.

60 SMSG, 2015, p. 4.

61 ESMA, 2015, p. 25.

62 *Ibid.*, p. 27.

63 Société Française des Analystes Financiers, ‘Response to ESMA’s Consultation Paper on Draft Guidelines for the Assessment of Knowledge and Competence’, 2015, p. 2.

within the company or by an external body.<sup>64</sup> ESMA main objective is to ensure that regardless of the location or size of the investment firm, only fully trained employees, who meet the stricter knowledge and experience requirements, are allowed to provide investment advice and additional services to clients.<sup>65</sup>

In summary, the majority of respondents agreed with ESMA's approach proposed in the draft guidelines to differentiate the knowledge and competence requirements according to the nature of the service provided. Thus, staff members providing investment advice are subject to higher standards than those providing only information to clients. Nevertheless, many stakeholders argued that the draft guidelines did not provide sufficiently clear information on how to implement the distinction between types of employees in practice. Consequently, ESMA proposed to delegate power to the national competent authorities of the member states to further tailor the definitions of required level of knowledge and competence for the main relevant staff profiles and determine whether a particular certificate of qualifications is necessary. Lastly, ESMA expressed a commitment to drawing up more detailed practical guidelines to assist the national competent authorities.

Moreover, although beyond the central focus of this article, the stakeholder consultation responses to questions 4 and 5<sup>66</sup> also shed light on the feasibility of the "Better Regulation" ambition to optimize policy making relying on evidence-based analysis. The majority of stakeholders, 54 out of 73, emphasized that a complete and accurate analysis of costs for firms and stakeholders cannot be drawn during the consultation period.<sup>67</sup> The positions show that the majority of respondents were unable to estimate the approximate costs that would be incurred due to the vague nature of the draft guidelines. Market participants pointed out that the expenses would also depend on the criteria specified by the national competent authorities of the member states. The costs would include direct compliance expenses as well as expenses for trainings, e-learning and meeting any additional organizational requirements.<sup>68</sup>

## E Conclusion

The MiFID II directive examined in this article has important repercussions for investment firms, banks and other financial market participants with regards to

64 ESMA, 2015, p. 28.

65 *Ibid.*, p. 26.

66 ESMA, 'Draft guidelines for the Assessment of Knowledge and Competence', available at: <[https://www.esma.europa.eu/sites/default/files/library/2015/11/2015-753\\_cp\\_mifid\\_guidelines\\_on\\_knowledge\\_and\\_competence.pdf](https://www.esma.europa.eu/sites/default/files/library/2015/11/2015-753_cp_mifid_guidelines_on_knowledge_and_competence.pdf)>.

67 *See, e.g.*, Banca Patrimoni Sella & C., 'Response to ESMA's Consultation Paper on Draft Guidelines for the Assessment of Knowledge and Competence', 2015, p. 3.

68 The Luxembourg Bankers' Association – The ABBL, 'Response to ESMA's Consultation Paper on Draft Guidelines for the Assessment of Knowledge and Competence', 2015; Federation of Finnish Financial Services, 'Response to ESMA's Consultation Paper on Draft Guidelines for the Assessment of Knowledge and Competence', 2015, p. 5; Société Française des Analystes Financiers, 2015, p. 3.



their business strategies and operations. Our analysis showed that market actors mobilized and advocated their preferred definitions of required professional knowledge and experience for employees providing investment advice. We found that, following an extensive stakeholder consultation, ESMA opted for a minimum harmonization approach at the EU level. At the same time, ESMA also supported giving the respective national competent authorities sufficient remit to issue additional, possibly more extensive, requirements in accordance with national laws and regulatory practices.

Still, the complexity of MiFID II, the multi-level governance structure of EU securities markets and a high degree of contestation by the industry have given rise to implementation problems. In fact, ESMA reported that it would have to collect data from about 300 trading venues on about 15 million financial instruments to fine-tune the technical standards it develops and oversees under MiFID II.<sup>69</sup> Neither the national competent authorities nor market participants would have the necessary systems ready by the initial deadline of 3 January 2017. Thus, as explained by the Commission, “[i]n light of these exceptional circumstances and in order to avoid legal uncertainty and potential market disruption, an extension was deemed necessary.”<sup>70</sup> The recently announced 1 year delay of the transition deadline to 3 January 2018<sup>71</sup> will give banks and other financial companies more time to upgrade their IT systems and develop appropriate compliance and professional trainings to meet the important investment information, knowledge and expertise provisions in MiFID II.

Our findings suggest an enduring politicization of the EU regulatory process. On the one hand, the very definition of expertise in the context of MiFID II was highly contested. Our study corroborates the insights of Science and Technology Studies (STS) scholars that the “technical is political”<sup>72</sup> when we examine the role of expertise in policy making. The consulted stakeholders presented different interpretations of expertise in the submitted position papers and different views about the appropriate regulation. Moreover, the aggregation of these varying preferences by ESMA to produce sound EU-wide rules was also embedded in a political process. All in all, using expertise systematically in governance processes involves a significant degree of contestation, interpretation and negotiation rather than a straightforward provision of objective information to be used by decision-makers in a streamlined policy process.<sup>73</sup>

69 European Commission, ‘Commission Extends by One Year the Application Date for the MiFID II Package’, IP/16/265, Brussels, 10 February 2016, available at: <[http://europa.eu/rapid/press-release\\_IP-16-265\\_en.htm?locale=en](http://europa.eu/rapid/press-release_IP-16-265_en.htm?locale=en)>.

70 *Ibid.*

71 *Ibid.*

72 For an overview see S. Rayner, ‘Democracy in the Age of Assessment: Reflections on the Roles of Expertise and Democracy in Public-Sector Decision-Making’, *Science and Public Policy*, Vol. 30, No. 3, 2003, pp. 163-170 and A. Moore, ‘Beyond Participation: Opening up Political Theory in STS’, *Social Studies of Science*, Vol. 40, No. 5, 2010, pp. 793-799.

73 W. Bijker, R. Hendriks & R. Bal, *The Paradox of Scientific Authority*, Boston, MIT Press, 2009, pp. 1-46.

Returning to the overarching good governance objectives of the “Better Regulation” agenda, our analysis indicates greater responsiveness to the concerns of financial industry actors about the economic costs of ‘red tape’ and very extensive knowledge and experience requirements in the provision of investment advice. We observed minimum harmonization dynamics at the EU level. Still, the final version of ESMA’s guidelines is more demanding in terms of years of experience and the extent of training than was the case prior to 2008.