

CP (2016-04)

Consultation Paper of the Cyprus Securities and Exchange Commission regarding a proposed circular on the obligations of Cyprus Investment Firms ('the CIFs') when providing information to clients in relation to services and instruments offered

In the context of establishing effective arrangements and procedures for consultation with market participants regarding proposed changes in the regulatory framework, the Cyprus Securities and Exchange Commission ('the CySEC') is circulating this Paper for consultation in relation to the organisational requirements, qualifications and professional conduct of persons employed by a CIF when providing information to clients about the services and financial instruments offered by the CIF.

The proposed circular is attached as Appendix 1.

The CySEC invites you to submit your comments/suggestions, in word format, by Friday 15 July 2016, to the electronic address supervision@cysec.gov.cy only.

TO : Cyprus Investment Firms

FROM : Cyprus Securities and Exchange Commission

DATE :

CIRCULAR NO. :

SUBJECT : Obligations of CIFs when providing information to clients on the services and instruments offered

The Cyprus Securities and Exchange Commission ('the CySEC') wishes to remind the Cyprus Investment Firms ('the CIFs') of their obligations in relation to the organisational requirements, qualifications and professional conduct of persons employed by a CIF when providing information to clients on the investment and ancillary services, as well as on the financial instruments offered by the CIF¹. Particularly:

A. Legislative framework

1. When providing information to clients, CIFs must comply with both the requirements of article 18(2) of the Investment Services and Activities and Regulated Markets Law of 2007 as in force ('the Law'), and of paragraph 4 of Directive DI144-2007-01 of 2012 of the CySEC ('the Directive') in relation to the organisational requirements, and the rules governing the conduct of business, as laid down in article 36(1) of the Law and Part III of Directive DI144-2007-02 of 2012.

Moreover, CIFs must follow the provisions of paper ESMA/2015/1886- Guidelines for the assessment of knowledge and competence (['the Guidelines'](#)).

B. Organisational requirements

2. CIFs maintain a special unit / department, which is responsible for communicating with clients and providing information on the investment and ancillary services as well as the financial instruments provided by the CIF. This special unit / department usually carries the name client support unit /department, sales department, marketing department or other similar term (hereinafter referred to as 'clients support unit').
3. CIFs must clearly define the roles and responsibilities of persons employed in the clients support unit, which are included in the internal operations manual of the CIF.
4. Persons of the clients support unit may:

¹ It is clarified that this circular does not cover the content of the information that is provided to clients.

- i. Provide information and/or resolve client inquiries/questions in relation to the CIF and its services, financial instruments and proposed investment strategies, including appropriate guidance and warnings on the risks associated with these investments or in respect of particular investment strategies, execution venues and costs and associated charges.
 - ii. Provide assistance to clients on technical questions regarding the CIFs' platforms and websites.
 - iii. Provide assistance to clients on the opening and operation of an account.
5. It is noted that the persons of the clients support unit **cannot** provide investment advice in relation to financial instruments.

CIFs must ensure that (if they are licensed to provide investment advice) the roles of the clients support unit and the investment advice unit are clear and known to the relevant staff.

For the purpose of ensuring the above, CIFs establish, *inter alia*, a sales script which they distribute to the clients support unit staff in order to inform it of the framework in which it may operate.

6. CIFs must ensure that practices such as frequent and repeated telephone calls to clients and/or the use of aggressive language, and/or the exercising of pressure, urging/advising the client e.g. to invest and/or to deposit funds, **are not applied and cannot be applied** by the clients support unit as these are not consistent with the provisions of Article 36(1) of the Law.
7. CIFs must ensure that the staff of the clients support unit receives regular and specific training.
8. CIFs must ensure that the remuneration of the clients support unit staff is in line with Circular C138 on the remuneration policies and practices.
9. CIFs must ensure that the staff of the clients support unit uses its **real name** when communicating with clients and not an alias.
10. CIFs must establish, implement and maintain appropriate procedures for the assessment of the performance of the clients support unit staff and for taking measures in instances where the assessment is poor or negative, and/or upon determining that the actions of a particular staff member towards clients are contrary to the provisions of the Law and the present circular (e.g. adopting recommendation/warning process, imposition of sanctions and/or dismissal of the staff member who have acted in such manner). It is provided that the staff is informed of the aforementioned processes.

For example, in the event that a staff member of the clients support unit exerted intense and constant pressure to a retail client to deposit money and invest in complex instruments or provided investment advice to a retail client, the CIF must take action against that staff member in order to ensure that such behavior is not repeated.

C. Knowledge and competence of the clients support unit staff

- 11.** The CIF must ensure that the staff of the clients support unit possesses the necessary skills, knowledge and expertise in order to be able to implement the legislation requirements and the business ethics standards. The CIF must specify the academic qualifications and experience needed to meet the above mentioned requirements.

Furthermore, considering the Guidelines, CIFs are expected to request from the staff of the clients support unit to be certified (success in basic exams and registration in the Public Register), in accordance with the Directive of the CySEC regarding the Certification of Persons and the Certified Registers ([R.A.D.174/2015](#)).

- 12.** According to the Guidelines, CIFs must ensure that the members of the staff providing information about investment services and financial instruments to clients have the necessary knowledge and competence to:

- i. Understand the key characteristics, risk and features of those investment products available through the firm, including any general tax implications and costs to be incurred by the client in the context of transactions. Particular care should be taken when giving information with respect to products characterised by higher levels of complexity.
- ii. Understand the total amount of costs and charges to be incurred by the client in the context of transactions in an investment product, or investment services or ancillary services.
- iii. Understand the characteristics and scope of investment services or ancillary services.
- iv. Understand how financial markets function and how they affect the value and pricing of investment products on which they provide information to clients.
- v. Understand the impact of economic figures, national/regional/global events on markets and on the value of investment products on which they provide information.
- vi. Understand the difference between past performance and future performance scenarios as well as the limits of predictive forecasting.
- vii. Understand issues relating to market abuse and anti-money laundering.
- viii. Assess data relevant to the investment products on which they provide information to clients such as Key Investor Information Documents, prospectuses, financial statements, or financial data.
- ix. Understand specific market structures for the investment products on which they provide information to clients and, where relevant, their trading venues or the existence of any secondary markets.

- x. Have a basic knowledge of valuation principles for the type of investment products in relation to which the information is provided.

D. Outsourcing of the client support function to third parties/service providers

- 13. The client support function is a critical or important operational function of the CIF (paragraph 3 of Directive 144-2007-01 of 2012 ‘the Directive’) and it is therefore advisable to be provided for internally, either from the head office of the CIF or from its branch situated in the Republic or in another Member State.
- 14. In case of outsourcing the client service function to external bodies/service providers, the CIF must ensure that the following conditions are satisfied:

i. 1st option

The service provider is situated in a Member State of the European Union and:

- either it is authorised pursuant to European Directive 2004/39/EC on markets in financial instruments, or
- if acting under the full and unconditional responsibility of the CIF, it is registered in accordance with Article 40 of the Law (tied agents).

It is noted that the outsourcing of the clients support function to service providers situated outside the European Union is not allowed.

2nd option

The service provider is situated in a Member State of the European Union and:

- either it is authorised pursuant to European Directive 2004/39/EC on markets in financial instruments, or
- if acting under the full and unconditional responsibility of the CIF, it is registered in accordance with Article 40 of the Law (tied agents).

The CIF may outsource the client support function to a service provider situated in a third country provided that the CIF maintains, on an ongoing basis, in addition to Pillar 1 [Article 67(1) of Law 144(I)/2007], own funds to cover the risk of non-compliance that it may undertake due to the fact that the service provider is not situated in the European Union (article 68 of the Law). It is noted that the amount of additional own funds depends on the nature and the level of risk of non-compliance that a CIF may undertake, which may in no case be less than one million euro (€1.000.000). The final amount of the additional own funds to cover the specific non-compliance risk (conduct risk) will be assessed by CySEC in accordance with article 70 of Law 144(I)/2007.

- ii. The provisions of article 18(2)(d) of the Law and Part V of the Directive on outsourcing as well as the relevant circulars issued from time to time by the CySEC (eg C138), fully apply.

iii. Sections A – C and E of this circular fully apply to the service provider as well as to the staff of the service provider.

15. The CIF's obligation to supervise and effectively oversee the client support function that has been outsourced and its obligation to take appropriate measures when it determines that the service provider is not performing the said functions effectively and in accordance with the applicable legislation is emphasized.

For this purpose, the CIF must ensure that it has effective, direct and constant access to data related to the outsourced activities, as well as to the business premises of the service provider.

E. Monitoring of the client service department– compliance function

16. CIFs must ensure that the compliance function has sufficient resources and direct access to all relevant information in order to be able to monitor and regularly evaluate the operation of the clients support unit, including the activities of the staff members of that unit and to ensure the adequacy and effectiveness of the procedures adopted.

This paragraph also applies when the client support function is outsourced to a service provider.

17. It is noted that the provisions of [Circular C030](#) of the CySEC on certain aspects of the compliance function also apply in this case.
18. For an effective assessment of the operations of the clients support unit, the compliance officer must, *inter alia*, include in his monitoring the assessment, on a regular basis, of the telephone conversations between the staff and the clients of the CIF.
19. The tasks carried out by the compliance function are recorded in a manner that allows the CySEC to check the compliance of the CIF with its relevant obligations.

F. Actions required by CIFs

20. CIFs must maintain all necessary records in a way that enables the CySEC to monitor compliance with the requirements under this Circular.
21. CIFs are requested to:
- i. Review their policies and procedures and ensure they fully comply with the provisions of this Circular.
 - ii. Immediately take, without delays, corrective measures, where necessary.
 - iii. Provide to the CySEC confirmation signed by the members of the board as to their compliance with this circular and, where applicable, provide reference to any corrective measures adopted for their compliance.

The above confirmation must be sent to the electronic address supervision@cysec.gov.cy only as soon as possible and not later than xxx (3 μήνες).