German Banking Industry Committee

Die Deutsche Kreditwirtschaft

Comments

on the ESMA consultation paper "Guidelines on certain aspects of the MiFID II suitability requirements" (ESMA35-43-748) of 13 July 2017

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Comments on the ESMA consultation paper „Guidelines on certain aspects of the MiFID II suitability requirements" of 13 July 2017

A. General remarks

1. Term robo-advice

In various places in the draft Guidelines ESMA refers to "robo-advice".

So far, there has been scarcely any experience with robo-advice in Europe. The assets under management are by all accounts relatively low. Nor is there any compelling content or temporal connection with MiFID II. For those reasons, we regard specific provisions on robo-advice to be generally premature.

In principle, the same requirements should apply for robo-advice as for investment advice rendered by a person.

If there are to be special provisions for robo-advice none the less, we would like to point out the following:

The term "robo-advice" is yet to be uniformly defined Europe-wide. The definition used in the Guidelines does not strike us as offering any clear distinction between different kinds of services, either. It would be expedient, if there were a clear and uniform understanding in Europe as to which service offerings are covered by the term robo-advice and which are not. To ensure uniform implementation of the Guidelines in Europe, we therefore suggest that ESMA specify a corresponding definition of robo-advice.

Digital tools that are merely designed as an objective search engine do not, in our view, fall within the Guidelines' robo-advice stipulations. A corresponding clarification in the Guidelines would be desirable.

Some draft guidelines obviously apply solely to robo-advice. For some draft guidelines it is not totally clear, however, whether they only apply to robo-advice. We therefore suggest that it be made even clearer which guidelines apply for robo-advice alone.

2. Investor concept

The draft Guidelines seem to be based solely on the concept of a "vulnerable client". We regard this perspective to be too narrow, as it ignores the fact that there are also experienced and competent investors who can reliably assess the consequences of their actions and can make independent, autonomous investment decisions. These investor groups are not sufficiently considered in the draft Guidelines. We see a risk that instead of applying a responsible investor concept the investor concept underpinning the draft Guidelines will excessively patronise the

entirety of investors. To counteract this, the Guidelines should contain stipulations as to how far deviations, for example in the case of experienced investors, are possible.

3. Information Overload

The draft Guidelines lay down in numerous places new information obligations towards investors. In principle, it is correct that investors have to be well informed if they are to make sound investment decisions. So that investors are not overwhelmed with information and no longer able to distinguish between what is important and less important, however, the volume and depth of detail of the information to investors should be carefully considered. In addition, the information obligations require a legal foundation. As discussed below under B., in our view various information obligations in the draft Guidelines are not required for a good investment decision by the investor and should therefore be deleted.

4. Proportionality principle

In many parts of the draft Guidelines, ESMA fails to heed the proportionality principle. For example, as part of the obtaining of clients' information ("know your customer principle") only what is required and appropriate in a particular case for understanding the client's circumstances should be expected of investment firms.

B. Responses to the individual questions

Q1: Do you agree with the suggested approach on the information to be provided on the suitability assessment and specifically with the new supporting guidelines on robo-advice? Please also state the reasons for your answer.

Re para. 17

A duty to ascertain the client's understanding of investment risk and the relationship between risk and return on an investment by asking questions goes beyond the stipulations at level 1 and level 2. Instead, investment firms should ensure through corresponding measures that the client understands the concept of the investment risk and also the relationship between risk and return.

We would therefore argue that draft supporting guideline para. 17 be deleted and the previous supporting guideline para. 16 of 2012 be retained.

Comments on the ESMA consultation paper „Guidelines on certain aspects of the MiFID II suitability requirements" of 13 July 2017

Re para. 19

The sentence *"For example, when collecting clients' information required to conduct a suitability assessment (such as their investment horizon/holding period or information related to risk tolerance), firms should not claim that they do not assess the suitability."* contains an implicit conclusion that even asking for information which is required for the suitability assessment leads to an obligation to carry out such a suitability assessment.

We would beg to differ. Neither MiFID II nor the delegated legal acts contain any basis for this. We would also see in this a contradiction to the requirements concerning the appropriateness assessment. For as part of the appropriateness assessment, investment service providers have to (solely) ask about and assess knowledge and experience. Since knowledge and experience also have to be asked about as part of the suitability assessment, however, a query as part of the appropriateness assessment would lead to both an appropriateness assessment and, via the back door, a complete suitability assessment always being conducted. That would be a requirement that only the European legislator could impose.

We request that ESMA expressly clarify this point in the Guidelines.

Re para. 20 and 21

It is an understandable requirement that the client be sufficiently informed about the service offering and the functioning of the pertinent platform. The information to the client should, however, take the services and the complexity of the products into account. Many platforms have the goal of making the investment "simple and understandable" for the client, so that the degree of information should match the relevant client target group and not exceed a reasonable volume. It should be avoided that robo-advice platforms provide in particular an inappropriate amount of information so as not to "overwhelm" the client with complex topics. Likewise, the particular aspects of the medium in which the offer is being provided should be taken into consideration. For example, on the internet there should also be possibilities to provide information via links so as to avoid long scroll texts.

Re para. 21

We assume that para. 21 applies for robo-advice only.

The last bullet point ("An explanation of how and when the client‛s status will be updated.") is – also in context - not understandable. It is unclear which status of the client is being referred to and in which cases an update of that status should be considered. We would therefore suggest that the last bullet point be deleted.

Comments on the ESMA consultation paper „Guidelines on certain aspects of the MiFID II suitability requirements" of 13 July 2017

Re para. 22

We assume that para. 22 applies for robo-advice only.

We do not regard it as appropriate for the Guidelines to make technical stipulations on how investment firms actually inform their clients. The technical design of the information should be left up to those investment firms.

We therefore suggest para. 22 be deleted.

Q2: Do you agree with the suggested approach on the arrangements necessary to understand clients and specifically with how the guideline has been updated to take into account behavioural finance and the development of robo-advice models? Please also state the reasons for your answer.

In principle, we agree with the described requirements for robo advisors to obtain relevant information from their clients and to check its consistency – this also constitutes a key precondition for obtaining meaningful and suitable recommendations as part of the digital offering. Nevertheless, it must always be borne in mind which information is supposed to be actually relevant for the client in a particular case so that suitability can be checked. Here, investment firms should have sufficient decision-making scope so as not to ask the client for unnecessary details which then ultimately leads to a refusal to provide information and hence the client not receiving any investment advice. We also agree that automated review of consistencies in the clients' information must be assured due to the (mostly) lacking possibilities of a "human"/manual review of responses. The client should be confronted with any inconsistencies and given an opportunity to correct them.

Re para. 25

The requirement in the last bullet point strikes us as problematical. The investor must in general be able not to answer a question. A requirement under which it must be defined how the client can answer already at the questionnaire level does not strike us as meaningful and would unnecessarily patronise the investor.

We therefore suggest that the last bullet point in para. 25 be deleted.

The Guidelines could instead require that investment firms have to adopt measures for handling clients who respond with "no answer" too frequently (e.g. policies, procedures.)

Comments on the ESMA consultation paper „Guidelines on certain aspects of the MiFID II suitability requirements" of 13 July 2017

Re para. 26

Questions about marital status and age are regarded by some clients as discriminatory. Investment firms should therefore not be required ask clients about this.

It is correct that abusive practices in which investors are recommended **pension plan** products, for example, even though they will probably never live to see disbursement are to be prevented. Such practices are already illegal, however, and would lead to prosecution. Such individual cases should not result in investors being discriminated against due to their age.

Investors of every age can have a justified interest in buying every type of financial instrument. Even for older investors it can, for example, be meaningful to buy a share or a long-term bond (e.g. to bequeath them). In this context, we would like also point out the legislative's viewpoint that simple products, such as shares and bonds, can be bought in execution-only transactions without an appropriateness assessment being carried out. This principle should also be taken into account appropriately by the Guidelines. It would seem contradictory, if an investor can buy shares in a major industrial company but the same shares cannot be recommended due to his or her age.

The Guidelines should also take into account that an older investor can also have gained an above-average wealth of experience in financial instruments.

The holding period of a financial instrument should therefore per se not speak for or against the suitability of the financial instrument. The purchase of speculative products can also be meaningful for older investors, e.g. for hedging purposes.

Important and correct is that the investor should specify the investment objective and the firm judge the suitability based on that investment objective.

Re para. 25 and 26

An online questionnaire is a meaningful tool especially for robo advisors to obtain clients' information in a targeted manner. When formulating the requirements for such an online questionnaire, it should always be taken into consideration, however, that an online application has the goal of describing information clearly and easily understandable for the client and – depending on the business model – simplifying the financial investment. Many robo advisors especially have the goal of using minimum technical jargon when addressing the client target group. Therefore, the degree of complexity should also be considered particularly in standardised products. In the case of highly complex products/services a questionnaire will probably differ significantly compared with a more simple and non-complex product/service. Concerning the use of online questions, the quantity of questions should always be taken into

consideration too, so that only the actually relevant number of questions are put. Robo advisors are here faced with the challenge of providing or obtaining the right information (to the right degree) so as not to overwhelm or even "lose" the client during the answering phase. To that end, robo advisors should be able to bundle questions.

Re para. 29

We regard appraising the investor's "financial literacy" and taking this into account in the suitability assessment as very problematical. It is not even clear how this could be done in practice. It should not be the duty of investment firms to conduct education tests with the investor.

We see here a general risk of discrimination as well, e.g. if it were decided largely based on academic qualifications whether an investor can be recommended a certain financial instrument or not.

The aforementioned requirement goes beyond level 1 and level 2, so that we suggest it be deleted.

Q3: Do you believe that further guidance is needed to clarify how firms should assess clients' ability to bear losses?

No.

Q4: Do you agree with how the guideline on the topic of 'reliability of client information' has been updated to take into account behavioural finance and the development of robo-advice models? Please also state the reasons for your answer.

Re para. 41

The requirement "Firms should also encourage clients to disclose their financial investments they hold with other firms in detail, if possible also on an instrument-by-instrument basis." is very problematical in a number of ways.

For example, there are investors who intentionally decide to hold several security accounts with different banks. One reason may be that the investment firms in question are not to have a full picture of the financial instruments held.

In practice, it is common that the investor holds his or her various security accounts for various independent purposes. In that case, the advising investment firm could not draw any meaningful conclusions from information about security accounts at other investment firms.

Another problem is that the composition of the various security accounts will frequently change particularly with active investors. It appears remote from actual practice that clients will bring current account statements with them to every appointment. This is particularly the case if the client has intentionally decided to have his or her financial instruments managed by various investment firms. The consequence at any rate would be that the information held by the advising investment firm would generally not be timely.

Sufficient in our opinion is that the advising investment firm judge based on the information given by the client whether the planned recommendation is financially viable for the client.

Re para. 42

General comment on general guideline 4 and supporting guidelines:

Under Art. 55 (3) Delegated Regulation 2017/565 an investment firm may rely on the information provided by its clients or potential clients being correct. The investment firm may only not rely on the client's information if it is or ought to be aware "that the information is manifestly out of date, inaccurate or incomplete."

Accordingly, the information that the client gives an investment firm can in principle be treated as accurate. There is no fundamental duty on the part of an investment firm to verify the information provided by its clients. Only in cases in which the client information has "manifest" deficiencies do investment firms have to verify client information.

General guideline 4 and its supporting guidelines could create the impression that investment firms were in principle obliged to verify information provided by clients. This would, however, go beyond the level 2 stipulations in MiFID II. It must remain sufficient that investment firms carry out correct questioning of their clients.

We would argue for retaining the previous supporting guideline para. 42 of 2012 ("For example, firms should consider whether there are any obvious inaccuracies in the information provided by their clients.").

Re para. 43

Investment firms in Germany do of course tell their clients how important it is that clients pass on new information to investment firms. Clients in Germany are also regularly asked as part of the investment advice process whether the information they have provided is still accurate. Above and beyond this, responsibility for actuality and correctness of the client information must, however, remain with the client.

Therefore, we regard the phrase "and cannot limit their responsibility by means of a specific clause in the contract with the client, in the general terms and conditions, or otherwise." in the third sentence of para. 43 as not appropriate.

Incidentally, the possibility for drafting contracts is laid down by the pertinent national civil law of each member state. The phrase quoted above could create the impression that the draft Guidelines were aiming at shaping the civil law in the member states. We assume that this was not intended.

For these two reasons, we regard deletion of that passage as legally appropriate.

Re para. 44

Verifying the client's self-assessment with practical exercises, as envisaged in lit (a). we regard as problematical. On the one hand, there is in our opinion no legal foundation for this. Secondly, clients would reject such a "knowledge quiz" as discriminatory.

We therefore suggest that lit. (a) be deleted.

Re para. 48

Here, it is pointed out that the reliability of a client's self-assessment is always to be assumed. This also applies for the rendering of robo advice. Whilst robo advisors can and should point out inconsistencies, it is however ultimately the client's responsibility to provide information truthfully and (after further querying) check for consistency themselves and to make any changes. Assistance to the extent necessary is a good idea, but should not lead to the client being confused or influenced too much in his or her self-assessment. Whilst there is hardly any down-stream manual review of the furnished information at robo advisors, as this would otherwise contradict a fully automated process workflow and its advantages – this does not mean that there should not be meaningful plausibility checks in the appropriate places. This should be regarded as sufficient.

Re para. 49

Under Art. 55 (3) Delegated Regulation 2017/565 investment firms can rely on the information which the client gives an investment firm as being accurate. There is no fundamental duty on the part of an investment firm to verify the information provided by its clients. Only in cases in which the client information has "manifest" deficiencies do investment firms have to verify client information.

The duty envisaged in para. 49 that investment firms should actively address the risk of a possible over-estimation by the clients would contradict this legislative position.

We also regard this as being practically impossible to implement because it would presume that investment firms would have to verify information given by the client, e.g. with practical exercises. This would be regarded by clients as discriminatory.

We therefore suggest para. 49 be deleted.

Q5: Do you agree with the suggested approach on the topic of 'updating client information'? Please also state the reasons for your answer.

Re para. 54

ESMA calls upon investment firms to use suitable measures to reduce the risk that clients – without an actual change in their situation – update their information with a view to "making suitable" certain otherwise unsuitable products.

This requirement conflicts with Art. 55 (3) Delegated Regulation 2017/565, under which an investment firm may rely on the information provided by its clients or potential clients being correct. Incidentally, such a requirement could be implemented in practice, if at all, only with unreasonably great effort.

We would therefore argue for para. 54 being deleted.

Q6: Do you agree with the suggested approach to conduct the suitability assessment for a group of clients, especially where no legal representative is foreseen under applicable national laws? Please also state the reasons for your answer.

Re para. 56

Sentence 3 of para. 56 contains the requirement that investment firms have to inform their clients about how they will carry out the suitability assessment if the client is a group of natural persons or a legal person.

We regard such a provision as unnecessary. The right to represent natural and legal persons is defined at the level of the member states. For example, in Germany there are very specific statutory stipulations on this. Therefore, additional corresponding information to the client is not required.

We would therefore argue that para. 56 sentence 3 be deleted.

Re para. 58, 60 and 61:

It is not clear why the bank's internal policy must contain detailed provisions for the suitability assessment in cases in which national law envisages a legal representative for legal persons or groups of persons. We therefore suggest retaining the provision in the 2012 Guidelines. This envisaged additional provisions merely for the case that national law does not require a representative or no representative was appointed.

Re para. 65

Sentence 2 of para. 65 contains a duty to take the matrimonial regime for couples into account in the investment firm's policy ("take into account the matrimonial regime applicable to that couple").

The matrimonial regime defines the asset relationships between spouses, i.e. the couple's internal relationship. This is to be distinguished from the external relationship between the investment firm and the clients, which is not bound by the matrimonial regime. Moreover, consideration of the matrimonial regime across jurisdictions would not be feasible for the investment firms in practice.

We would therefore argue that para. 65, sentence 2 be deleted.

Q7: Do you agree with the suggested approach on to the arrangements necessary to understand investment products for the purposes of suitability assessment? Please also state the reasons for your answer.

Re para. 71

In para. 71, the draft guidelines require investment firms to assess the complexity of financial instruments.

A reference is also made to the distinction complex/non-complex under Art. 25 (4) MiFID II and also the pertinent ESMA Guidelines. We regard this reference as extremely problematical, as the Guidelines at that time were consulted with the condition that they help to distinguish whether a product can be sold without an appropriateness assessment.

The very broadly drafted Guidelines – individual passages could be construed such that every simple bank bond which qualifies as "bail in" is to be deemed a complex instrument – are now increasingly being extended to other areas. Under the PRIIPs Regulation, a distinction is made as to whether there should be a warning in the key information document. This will lead to

practically all key information documents containing a warning. This shows that the distinction is not suitable for being extended to other areas. In addition, the transfer is also questionable from the rule-of-law perspective, as the consulted Guidelines are now being made relevant in regulatory fields which were not the subject matter of the consultation. Accordingly, we do not regard the distinction complex/non-complex and especially the reference to the Guidelines as a robust distinction for the obligations in the suitability assessment.

The complexity of financial instruments was also exhaustively discussed at the European level with respect to the ESMA Guidelines on MiFID II product governance requirements (2 June 2017, ESMA35-43-620, below "product governance Guidelines"). ESMA rightly came to the conclusion that the complexity of financial instruments is not a suitable criterion for determining the target market for financial instruments. It is even disputed whether complexity has any relevance whatsoever for the client. Nor is there in Europe - above and beyond the aforementioned distinction between complex and non-complex - any uniform understanding of how the degree of complexity of financial instruments would be determined. Accordingly, complexity was not taken up in the final product governance Guidelines for determining the target market.

In the spirit of consequent supervisory practice, we regard it to be consistent and necessary that the present draft Guidelines do not envisage that complexity be given a particular role to play in the suitability assessment, either.

We therefore recommend that para. 71 be deleted.

Re para. 73

We see para. 73 as further precision of the requirements for determining the target market and should therefore be defined in the product governance Guidelines. We recommend that para. 73 be removed from the draft Guidelines.

Q8: Do you agree with the additional guidance provided with regard to the arrangements necessary to ensure the suitability of an investment? Please also state the reasons for your answer.

Re para. 76

ESMA sees not only a recommendation to buy, sell and hold a financial instrument but also a recommendation not to buy or sell a financial instrument ("or not to do so") as a personal recommendation and therefore requires that a suitability assessment be carried out (draft guideline 8, para. 76).

This in our opinion clearly contradicts the intention of the European legislative at level 2. Pursuant to Art. 9 Delegated Regulation 2017/565 there is a personal recommendation only if this is aimed at buying, selling, subscribing for, exchanging, redeeming, holding or underwriting a particular financial instrument; recommending not to carry out such a transaction is not covered, however. Art. 9 Delegated Regulation 2017/565 is exhaustive and leaves no leeway for extending the scope of application.

Re para. 86

Bullet points 2 to 4 ("The prevention and detection of, and response to, cybersecurity threats, "The protection of client accounts; The use of social and other forms of electronic media in connection with the marketing of the robo-advice services provided (e.g., websites; Twitter; remuneration of bloggers to publicise services; "refer-a-friend" programs)" have no objective relevance for the suitability assessment and should therefore not be included in the Guidelines.

Q9: Do you agree with the suggested approach for ensuring that firms assess, while taking into account costs and complexity, whether equivalent products can meet their clients' profile? Please also state the reasons for your answers.

Re para. 87

As part of its work on the product governance Guidelines, ESMA decided that the complexity of financial instruments is not a suitable criterion for determining the target market for financial instruments. For on the one hand the relevance of complexity for the client is contested and on the other hand, there is in Europe no uniform understanding for determining the degree of the complexity.

In the spirit of consequent supervisory practice, we regard it to be consistent that the present draft Guidelines do not envisage that the degree of complexity be given a particular role to play in the suitability assessment, either.

To underscore that Art. 54 (9) Delegated Regulation 2017/565 is definitive and exhaustive concerning consideration of the criteria costs and complexity, we would at any rate favour that the word "thorough" be deleted.

In para. 87 it should be clarified that costs and complexity are to be taken into account not in general, but only for equivalent products. This could be achieved with the wording "taking into account product's cost and complexity of equivalent products".

Comments on the ESMA consultation paper „Guidelines on certain aspects of the MiFID II suitability requirements" of 13 July 2017

Re para. 88

The description of "equivalent product" in para. 88 indicates that ESMA is adopting a very broad understanding of "equivalent". However, we regard a focus on "similar target market" or "similar risk-return profile" as selection criterion as clearly too broad. The investment firm or adviser would in all probability have to take a very large product horizon into account for the selection. There would probably be thousands of financial instruments that satisfy the aforementioned equivalence stipulations, although those financial instruments cannot be regarded as equivalent due to their differing design or functioning.

Instead, is it in our opinion appropriate and necessary to read the term "equivalent" as "almost identical".

Re para. 90 and 91

An innovation compared with the 2012 Guidelines is that there must be a thorough assessment of possible investment alternatives, taking into account the costs and complexity, as part of investment advice and asset management (see draft guideline 9).

Positive in our opinion is the clarification that this assessment of possible investment alternatives needs not necessarily take place at the adviser level but can also be done at "a higher level" (para. 90).

In this context, we would propose a clarification in para. 91: This reads that where a more costly or complex product is recommended the reasons for this are to be included in the suitability report. If the decision about possible investment alternatives is taken at a higher level (e.g. the product committee), however, documentation in the suitability report (by the adviser) makes no sense. For it is not the adviser who takes the decision in that case, but the higher-level committee. In addition, the obligation laid down in the draft Guidelines to document the reasons for the selection in the suitability report goes beyond Art. 25 (6) MiFID II and Art. 54 (9) Delegated Regulation 2017/565, which merely require that adequate policies and procedures must be "in place and demonstrated", in other words organisational arrangements are required. We would therefore argue for para. 91 sentence 2 being deleted.

Q10: Do you agree with the suggested approach for conducting a cost-benefit analysis of switching investments in the context of portfolio management or investment advice? Please also state the reasons for your answer.

Comments on the ESMA consultation paper „Guidelines on certain aspects of the MiFID II suitability requirements" of 13 July 2017

Re para. 93

According to ESMA, all the advantages and disadvantages of the switch should be considered. With respect to costs, both monetary and also non-monetary factors are to be taken into consideration. We are not aware of any reason or legal foundation that requires non-monetary factors also having to be taken into consideration concerning the costs. We would therefore argue that this requirement be removed.

Re para. 94 and para. 96

Under para. 94, the clients would have to be told in the suitability report why the advantages of a recommended switch are greater than the costs. This is a clear contradiction to para. 96, under which the cost-benefit analysis can also be carried out "on a higher level". If a higher-level committee takes the decision about the costs and benefits of a switch, however, documentation in the suitability report (by the adviser) makes no sense. For it is not the adviser who carries out the cost-benefit analysis in that case, but the higher-level committee. In addition, this requirement also goes beyond the level 2 text, which merely requires that investment firms can "demonstrate" that the benefits of the switch are greater than the costs (see Art. 54 Abs. 11 Delegated Regulation 2017/565).

Re para. 95

In para. 95 a very broad definition of "switch" is considered, under which in principle all sell and buy orders with a temporal connection would be deemed as a "switch". This is not appropriate.

At least those transactions for which a sell recommendation is given because a product is no longer suitable (e.g. change of risk class) should not be deemed as a switch. Re-investment of released funds is not to be deemed a sale and thus not as a "switch" either.

In view of the special character of individual financial portfolio management, in which the investor – unlike with investment advice – reaches an agreement up front with the investment firm on a certain investment strategy that the investment firm is then responsible for implementing, it is appropriate to waive a particular cost-benefit analysis for transactions that serve to implement the investment strategy. This should be clarified.

Q11: Do you believe that further guidance would be needed with regard to the skills, knowledge and expertise that should be possessed by staff not directly facing clients, but still involved in other aspects of the suitability assessment? Please also state the reasons for your answer.

Q12: Do you have any further comment or input on the draft guidelines?

Re para. 107 and 109

Concerning para. 107 and 109 there is no practical link to the suitability assessment. In order to avoid fragmentation of the legal sources, the stated passages should not be included in the Guidelines.

Q13: What level of resources (financial and other) would be required to implement and comply with the Guidelines (market researches, organisational, IT costs, training costs, staff costs, etc., differentiated between one off and ongoing costs)? When answering this question, please also provide information about the size, internal organisation and the nature, scale and complexity of the activities of your institution, where relevant.

As a federation of associations, we cannot specify the level of resources that would be required to implement and comply with the Guidelines in each investment firm.