UNI Europa Finance response to the Consultation Paper on Guidelines on certain aspects of the MiFID II suitability requirements

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.

UNI Europa Finance (UEF) welcomes ESMA's efforts to further harmonize the implementation of MIFID II which will hopefully result in a more level playing field. UEF also welcomes the guidelines' focus on proportional and indiscriminate advice. UEF is happy to note ESMA's awareness to the fact that robo-advice is not free from biases that may cause both risks as to costs and trust. There are however a few comments to be made in concern to the availability of human advice, biases in robo-advice, client info, employee empowerment and the development of robo-advice and new technologies.

We believe that clients have the right to be informed whether they will be communicating solely with a robot or whether a degree of human interaction will be possible (and if so how). We support ESMA's view (art 21, page. 40) that clients should be informed about this. However, we believe it is important that clients are informed <u>from the beginning</u> about this, in order to avoid that they spend time answering a questionnaire, only to discover later on that they do not have the possibility of human interaction, if they would need so. For this reason, we suggest adding a sentence to article 21, (see italic):

"An explanation of the degree of human involvement in the oversight and management of investment services (e.g. whether the client can ask for human interaction -and if so explain how- when providing information to the firm on his status, objectives, needs knowledge and experience). *This information should be given before the client spends time providing information, hence at the beginning of the process."*

Both in the context of face-to-face advice as in the context of robo-advice, it is important that investors are also informed about the reason why they should provide information. Sometimes, questions regarding their personal situation or regarding their financial situation are misunderstood as an intrusion upon their privacy or as an inquiry with hidden commercial motives. It should be clear that answering the questions is ultimately in their own interest and required for legal reasons.

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.

Today, both the insurance and bank sector employs a high percentage of women while the IT sector suffers from a huge gender gap, with women being underrepresented. This means that the finance sector in general need to take special concern to possible gender biases or other biases that may exist when developing both robo-advice and human advice in order to provide all investors and customers with equal access to financial services. In order to take behavioral finance into account in the development of robo-advice it is therefore important that the individuals or groups directly or indirectly involved in developing new robo tools are diverse and aware of possible pre-existing biases as they for example develop questionnaires. Therefore, UEF recommends that following will be added as a second bullet point in article 25 on page 42:

- *Attention should be given to the diverse composition of the individual or group behind the tools that enable suitability assessments, avoiding discriminating biases in technical development or phrasing of questions.*

Since automated advice tools may be marketed as the financial institutions budget alternative, there is a risk that the human advisors will be available only to those who can afford/are prepared to pay extra for it. UEF believes that a development like this would be highly disturbing. This is what has happened in the UK, where automated financial advice tools have increased after a ban on kick-backs for financial advisors in 2013. The affordable automated financial advice tools, such as robot advisors, are mainly used by the average or low-income consumer. The qualified human advisors have mostly been reserved for the wealthier consumer, who can afford to pay an extra charge for the service of tailored advice. The consequence may be that many brits will receive a low pension due to the lack of qualified and tailored advice. Therefore, UEF recommends that following will be added in the third bullet point of article 30 on page 44 (in italic):

- Whether some human interaction (including remote interaction via emails or mobile phones) is available to clients when responding to the online questionnaire *and at what cost*;

It is our concern that the suitability assessment is not done exclusively from the perspective of above average wealthy investors that want to have access to a broad range of investment products (and for whom consequently more extensive knowledge questions are required). Questionnaires that are needlessly lengthy increase the risk that investors do not pay the necessary attention to properly answering the questions. For this reason, we support articles 32 (and further) on p 45 (and further), which allow for a degree of proportionality in the suitability assessment, to be particularly useful.

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

UEF finds that the ESMA has identified and described the challenges connected to assessment of clients' ability to bear loses accurately. There is however an overwhelming focus over all in the guidelines on restricting the clients' possibility to provide information that enhance their chances to be matched with certain investment products. In improving assessments tools customer satisfaction

and trust in technological tools cannot be overlooked. There must be allowance as well as time and resources for staff to assist clients in providing accurate information that better give a complete picture of a client's ability to bear losses.
Therefore, UEF recommends an addition to article 24 on page 42 (in italic):

- 24. Firms' policies and procedures shall enable them to collect and assess all information necessary to conduct a suitability assessment for each client, *including the possibility for human interaction*. For example, firms could use questionnaires (also in a digital format) completed by their clients or information collected during discussions *between them and staff*. Firms should ensure that the questions they address to their clients are likely to be understood correctly and that any other method used to collect information is designed in a way to get the information required for a suitability assessment.

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.

According to an OECD pilot study from 2013 financial illiteracy is at worryingly high levels (http://www.oecd-ilibrary.org/finance-and-investment/measuring-financialliteracy_5k9csfs90fr4-en). There is therefore a risk that consumers that don't have the full understanding of their financial situation and/or the outcome of their actions will suffer. UEF is glad to see that ESMA is taking special consideration to this fact.
UEF do however disagree in the wording of article 47 on page 49. We wish to highlight to ESMA that the use of automated financial advice tools could increase risk of miss-selling. An algorithm for an automated financial advice could easily be programmed to be biased towards specific products and services if those products or services comes with provision for the financial institutions selling them. ESMA should also be aware that as robo-advice becomes more common many customers will continue to request human interaction. A recent Swedish study (http://www.kvalitetsindex.se/wp-content/uploads/2015/10/Bank- 20151.pdf)shows that even young people who are eager to engage in digital financial services – such as automated financial advice tools can be characterized as – want to consult an advisor face to face while making big financial decisions (either via video or in person). This is also the result from a recent Danish study, that shows that 63% of the respondents in the ages 18-29 years old states that they find it important to have a physical branch nearby (http://politiken.dk/oekonomi/privatoekonomi/ECE2260705/unge-overrasker-de-vil-havebankfilialer-taet-paa/). The role of the customer-facing staff must therefore not be underestimated.
Customer-facing staff are key in enhancing customer satisfaction in terms of both service and experience. Technology that collect client data are excellent tools to optimize services provided and give room for the human advisors to focus on customer relations and advice. Customer-facing staff are also key in discovering possible technical errors or understanding the unique situation of the individual customer, essential to building trust and customer satisfaction. Even if automated financial advice tools may provide more consistent advice to consumers, it will not be able to see to the needs of specific consumers as a human advisor could, as all advice cannot be programmed. Robo-advice can consequently have a negative impact on the quality of the advice and information provided. All robo-advice should therefore be seen as important employee empowering tools. And employees in the financial sectors that use digital devices or automated tools for their work must never be liable for

any shortcomings in such devices and tools that have caused, or may potentially cause, damage to consumers.
UEF therefore recommends making an addition to article 46, on page 44 as follows (in italic):

- 46. Where firms rely on tools to be used by clients as part of the suitability process (such as on-line questionnaires or risk-profiling software), they should ensure that they have appropriate systems and controls to ensure that the tools are fit for purpose and produce satisfactory results, *and they should ensure that clients have access to human advice that can provide support if needed.* For example, risk-profiling software could include some controls of coherence of the replies provided by clients in order to highlight contradictions between different pieces of information collected.

UEF therefore recommends striking parts of article 47 and to make an addition, on page 44 as follows (in italic):

- Firms should also take reasonable steps to mitigate potential risks associated with the use of such tools. For example, potential risks may arise if clients were encouraged ~~*by customer-facing staff*~~ to provide certain answers in order to get access to financial instruments that may not be suitable for them (without correctly reflecting the clients' real circumstances and needs). *Or for example, potential risks may arise if clients do not provide sufficient answers to get access to financial instruments that are suitable for them, if any.*

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

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.

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.

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.

Both in the context of face-to-face advice as in the context of robo-advice, it is important that investors are informed about the reason why they should provide information. Sometimes, questions regarding their personal situation or regarding their financial situation are misunderstood as an intrusion into the privacy or as an inquiry with hidden commercial motives. It should be clear that answering the questions is ultimately in their own best interest, and resources should be engaged in unequivocally explaining this.

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.

The requirement to compare equivalent products and assess on cost/complexity has, especially for integrated financial institutions and their employees, far-reaching implications as compared to the present way of working, where advice is usually based on a limited range of products, that are sometimes brought in the picture by HQ through supporting material to sales and advice staff. This requirement further reduces the scope for product-pushed advice, already initiated by the ban on product-based sales targets. However, this new requirement also increases the risk that the sales and advice staff is sandwiched between the new regulatory requirements on the one hand and existing 'corporate culture' on the other. For this reason, we suggest adding a sentence on article 87 (see italic):

- 87. Suitability policies and procedures should ensure that, before a firm makes a decision on the investment product(s) that will be recommended, or invested in the portfolio managed on behalf of the client, a thorough assessment of the possible investment alternatives is undertaken, taking into account products' cost and complexity. *These procedures should include a clear delineation of responsibilities to avoid undue incitements towards sales and advice staff to consider only a narrowed range in the assessment.*

MIFID I. Recital 51. For the same reason, staff of investment firms must possess an appropriate level of knowledge and competence in relation to the products offered. This is particularly important given the increased complexity and the continuous innovation in the design of investment products. Buying an investment product implies a certain risk and investors must be able to rely on the information and quality of assessments provided. It is furthermore necessary that staff is given adequate time and resources to be able to provide all relevant information to clients.
In this context, we would also like to point at the need for training. However, for this we refer to our reply on the question 13.

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.

As the HLEG on sustainable finance and Juncker's speech to the union conclude that the financial sector need to better promote sustainable finance and contribute to environmental, social and governance goals (ESG). So, should the guidelines on MIFID II and investment advice reflect this, and not limit the narrative of costs and benefit. Robo-advice as well as human advice should be able to

advice investors for example on climate impacts of certain investments or the respect of human rights by certain investments.
Therefore, UEF recommends an addition to article 92 on page 63 (in italic):

- 92. Firms should have adequate policies and procedures in place to ensure that an analysis of the costs and benefits, *financial and others*, of a switch is undertaken such that firms are reasonably able to demonstrate that the expected benefits of switching are greater than the costs. Firms should also establish appropriate and proportionate controls to avoid any circumvention of the relevant MiFID II requirements.

Therefore, UEF recommends an addition to the last bullet point in article 93 on page 63 (in italic):

- Benefits to the client's portfolio stemming from the switch, such as (i) an increase in the portfolio diversification (by geographical area, type of instrument, type of issuer, etc.); (ii) an increased alignment of the portfolio's risk profile with the client's risk objectives; (iii) an increase in the portfolio's liquidity; (iv) a decrease of the overall credit risk of the portfolio; *(v) a decrease of carbon footprint; (vi) a presence of collective agreements and fair living wages; or (vii) a respect for human rights (by the issuer).*

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.

Before answering the question with regard to non-client facing staff, we agree with the approach to remind firms that, for client-facing staff, they should refer to the mentioned detailed Guidelines on knowledge and competence"). This reference to the existing guidelines is useful, as we need to avoid, as ESMA correctly indicates, two sets of overlapping guidelines.
UEF also welcomes article 86-88 on page 27 and article 103 on page 65 which highlight the responsibility of firms to provide training for its staff. However, we would suggest including in the guidelines a reference to the need to provide training on the new suitability assessment. This can be done, for example, by adding a sentence of a footnote to art 101.

- *"In terms of ESMA Guidelines for the assessment of knowledge and competence, V.IV.20b, the firm should provide training, where appropriate on the new elements regarding suitability assessment, introduced by these guidelines."*

As far as non-client facing staff is concerned, the ESMA guidelines gives some quite relevant examples (compliance, staff involved in setting up the questionnaires, defining the algorithms for the suitability assessment) of categories of staff that should have sufficient knowledge of the regulatory requirements regarding suitability assessment. However, it could be difficult to delineate in all detail what should be known by whom. For this reason, we tend to believe that a principle-based approach, as is done in the draft guidelines, is sufficient. (must possess the necessary skills, knowledge and expertise required depending on their particular role in the suitability process).
UEF is open to arguments in favor of more guidance, should these arise, but would then want prior consultation with stakeholders, including employee representatives and trade unions.

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

Our focus as employee representatives focuses on the impact for employees. Here, we would like to point at the following elements:

- To the extent that guidelines require changes in the existing questionnaires, doing over interviews with a large client base will require time. This may not be so much a concern for advisors that have a small number of well-above-average wealthy clients, but for sales and advice staff in typical retail banks, who serve a high number of clients, this could be more cumbersome.
- The requirement to assess whether equivalent products that are less costly/less complex also suit the needs of the clients, undoubtedly requires training.
- Key staff in certain departments that are engaged in the implementation of regulation (ranging from compliance to ICT…) are currently overburdened with the pace of regulation that is coming towards them: Priips; MiFID II product governance; and upcoming… this new suitability assessment. Too much is to be done in too little time…

For all these reasons, we believe that a phased implementation is inevitable. A period of 60 calendar days (see point 4) is not sufficient.