

# POSITION PAPER



## **ESBG response to ESMA Consultation Paper on Guidelines in certain aspects of the MiFID II suitability requirements**

ESBG (European Savings and Retail Banking Group)

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ESBG Transparency Register ID 8765978796-80

**October 2017**



**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.**

ESBG fully supports General Guideline 1 which requires that clients should be duly informed about the suitability assessment as, among other aspects, it will contribute to improve the investment process' transparency.

However, the extent of information to be provided to customers has reached its limits. When the information becomes too excessive, customers tend to relinquish reading to speed up towards what is in their eyes the most important aspect, more specifically, the investments advice and their investment decision. ESBG thinks this surely is the case for those customers that are early adopters of recent technological developments of the advisory market, as those customers are interested in, inter alia, the ease of use, swiftness and general efficiency of technological developments. Even more information to be provided to clients could eventually make it impossible to offer new developments. There is an urgent need to strike the right balance between providing the necessary information to clients and making sure the information is read by clients.

**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.**

The principle of proportionality is a key principle (also) under European law. However, the requirements provided by ESMA often seem to go beyond this principle for instance by requesting too much information. Some examples of necessary information are in certain circumstances of confidential nature (marital status, family situation, employment status, etc.) and potentially disproportionate to its use. As a consequence, firms providing investment services could be non-compliant with the data minimisation principle of the General Data Protection Regulation (GDPR; an organisation should only process the personal data that it actually needs to process in order to achieve its processing purposes). Furthermore, according to ESMA firms should “*appraise the client's financial literacy*” (supporting guidelines to draft general guideline 2, paragraph 29). These are questions that clients might find discriminatory. ESBG acknowledges that certain elements of information are useful to provide a suitable investment service, but this is not the case in all circumstances. It therefore would be better to mention the examples as useful, rather than necessary.

Also, in paragraph 35 ESMA states that for illiquid or risky financial instruments, ‘*necessary information*’ to be collected may include all of the following elements as necessary to ensure whether the client's financial situation allows him to invest or be invested in such instruments: extent of the client's regular income and total income, assets and regular financial commitments.

It is important to well define risky financial instruments as the ‘*necessary information*’ is very extensive and perhaps disproportionate to the products and services the firm offers.

ESBG would like to take this opportunity to make general comments on robo-advice.

When talking about new technological developments of the advisory market, the level playing field becomes more important than ever. Possibilities for gold plating by national competent authorities



should be extremely limited as they could create un-level playing field for new technological developments that are by definition not limited to Members States' boundaries.

European Banks are already using Robo-advisors so as to create added value for customers and reach a wider number of customers via these digital tools. However, a distinction should be made between the notions of "robo-adviser":

- a. "Profiling algorithms", which are used to obtain a particular profile from the client through the information obtained from knowledge and experience, investment objectives, investment horizon, etc. This process sometimes includes the suitability tests that MiFID regulates, in order to obtain the adequate information and profile clients appropriately.
- b. "Quantitative management algorithms", which are used to take decisions regarding investment in a certain type of asset or portfolio management. These algorithms take into consideration quantitative data which determines the quality of the investment made and will ultimately lead to profit differentials.

Currently, many robo-advisory solutions base their profiling decisions on a very limited set of variables, and no suitability tests are undertaken, whilst customers are not able to perceive which measures each robo-adviser takes. Therefore, in order to avoid that clients perceive the same level of risk and quality of advice by robo-advisers taking different consumer protection measures, ESBG in principles supports ESMA's approach that all types of robo-advisor will have to follow the suitability test and gather sufficient information to support the assessment of the suitability. However, digital tools designed as mere "search machines" should be excluded from the definition of robo-advisors.

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

**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 article 55 para. 3 of the MiFID II delegated regulation, "*an investment firm shall be entitled to rely on the information provided by its clients or potential clients unless it is aware or ought to be aware that the information is manifestly out of date, inaccurate or incomplete*".

However, according to ESMA firms have to take steps in order to verify information provided by their clients. For example, ESMA requests that "*firms should take reasonable steps and have appropriate tools to ensure that the information collected about their clients is reliable and consistent, without unduly relying on clients' self-assessment*" (draft general guideline 4). This does not seem to be in line with the above level 2 requirements.

Also, while ESBG agrees with the general Guidelines 4 on reliability of client information, ESBG does not support paragraph 45 of the supporting guidelines which introduces an obligation on investment firms to take into account client's risk perception.

Investment firm through the suitability test are able, among other things, to assess the risk tolerance of the client and update his risk profile taking into account a series of variables such as age, income, investment horizon etc. The client's risk perception is much more subjective and volatile than the



client's risk tolerance and ESG doubts that it is possible to measure it and use it for the suitability assessment process. Therefore, ESG suggests deleting the requirement to take into account the client's risk perception.

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

According to ESMA firms should “*adopt measures to mitigate the risk of inducing the client to update his own profile so as to make appear as suitable a certain investment product that would otherwise be unsuitable for him*” (general guideline 5, supporting guidelines, paragraph 54).

This requirement contradicts MiFID II Delegated Regulation Article 55(3) according to which firms can in principle rely on the information provided by their clients. Moreover, implementation of such measures would involve a disproportionate effort for firms in practice.

**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.**

The suggested approach to conduct the suitability assessment for a group of clients is not conclusive. The right to represent groups of clients is subject to the applicable national law. If the applicable national law provides rules for the representation of groups of clients, there is no need for regulations in the firm's policy. Therefore, the approach in the 2012 guidelines should be maintained: additional rules are only necessary in the event that national law did not provide for a representative.

Furthermore, the content of general guideline 6 (paragraph 56) seems to not be in line with the level 2 requirements. Although Article 54(6) of the MiFID II Delegated Regulation does foresee that the investment firm shall establish and implement policy as to who should be subject to the suitability assessment and how this assessment will be done in practice, the Delegated Regulation does not provide that the firm should inform its clients *ex-ante* about its policy. Therefore, ESG suggests to delete the *ex-ante* information requirement.

**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.**

According to ESMA firms “*should also assess appropriately, through robust and objective procedures, the level of 'complexity' of products*” (general guideline 7, supporting guidelines paragraph 71).

The distinction between complex and non-complex is not a viable criterion in the context of the suitability assessment. Such distinction, *inter alia*, refers to the ESMA guidelines on complex debt instruments and structured deposits. However, these guidelines were provided for the purpose of the appropriateness test, and not for the suitability assessment. Furthermore, ESMA's guidelines on complex debt instruments and structured deposits have a very broad approach: some parts could be interpreted in such a way that even simple bank bonds being eligible to bail-in are complex products.

Furthermore, ESMA itself recognised that the complexity of a product is not a suitable criterion in order to assess the target market of a product. Therefore, the complexity of product is not applied in the final product governance guidelines for the assessment of the target market.

ESBG is therefore opposed to the extension of ESMA's guidelines on complex debt instruments and structured deposits to other areas of law such as the suitability assessment.

**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.**

In some Member States (Belgium in particular) the suitability assessment has to be done on an investment per investment basis, which means that should checked the suitability of an investment with the risk profile of the client, irrespectively of his existing portfolio. Clarification would be useful, as ESBG thinks customers are benefitting more from a suitable portfolio than suitable investments.

Paragraph 75 states that all available information about the client necessary to assess whether an investment is suitable, including the client's current portfolio of investments (and asset allocation within that portfolio), must be taken into account. It is confirmed in paragraph 80: "*where a firm manages a portfolio or advises a client with regard to his portfolio, it should adopt a methodology that would allow it to conduct a suitability assessment based on the consideration of the client's portfolio as a whole.*"

In paragraph 82 and 83 concentration and credit risk within a portfolio is discussed. An example is given for a client's portfolio concentrated in products issued by one single entity (or entities of the same group). ESBG wants to raise attention to the fact that not all banks are operating in open architecture, moreover ESBG consider concentration and credit risk as more important on the level of underlying assets.

Therefore, ESBG does not agree with ESMA's proposal, as presented in paragraph 83, that an exposure of the client's portfolio to one single issuer or to issuers part of the same group should be considered as an additional risk. Such an "additional risk-classification" would increase the administrative burden without any added value for the client. Firms would have to provide another layer of information to the client despite the fact that the client has, in any case, to be informed about whether the advice regarding the available product range is provided on an independent or non-independent basis and, beyond that, about bail-in related issues.

Paragraph 76 supporting the general guideline 8 states that: "*Firms are reminded that the suitability assessment is not limited to recommendations to buy a financial instrument. Every recommendation must be suitable, whether it is, for example, a recommendation to buy, hold or sell an instrument, or not to do so*".

ESBG disagrees with this statement as Article 9 of the MiFID II Delegated Regulation provides a definition of "*investment advice*" being a personal recommendation "*(...) to take one of the following sets of steps: (a) to buy, sell, subscribe for, exchange, redeem, hold or underwrite a particular financial instrument; (...)*". ESBG sees that as an exhaustive list leaving no room for an extension of the scope of application of Article 9.

In our view, this conclusion is not put into question by the recital 87 of the same MiFID II Delegated Regulation which, inter alia, refers to "*recommendations ... not to buy, hold or sell an investment*" in the

context of the suitability assessment. Article 9 is the relevant (level 2) text in this regard and must therefore prevail over the recital, which is not legally binding.

**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.**

According to ESMA, “...before a firm makes a decision on the investment product(s) that will be recommended, ... a thorough assessment of the possible investment alternatives is undertaken, taking into account products' cost and complexity” (draft guideline 9, paragraph 87). In ESMA's opinion, such “alternative products” must be “broadly 'equivalent' to each other ... such as financial instruments with similar target markets and similar risk-return profile”.

First, ESG highly appreciate that ESMA admits that the assessment of cost and complexity for 'equivalent' products can be done centrally “on a higher level” (for example within an investment committee). This is a very important factor in practice because advisors would be overburdened if they had to make that assessment individually for every client.

However, ESG does not agree with the requirement that “a clear explanation of the reasons for recommending a more costly or complex product should be included in the suitability report”. At this point, ESMA goes beyond the level 2 requirements according to which it is enough if investment firms can “demonstrate adequate policies and procedures” in order to assess whether equivalent instruments can meet their client's profile (Article 54(9) of the MiFID II delegated regulation). Furthermore, the evaluation of equivalent products is very hard to implement in automated suitability reports that financial institutions are developing at this moment.

**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.**

ESMA requests that “firms should have adequate policies and procedures in place to ensure that an analysis of the costs and benefits of a switch is undertaken such that firms are reasonably able to demonstrate that the expected benefits of switching are greater than the costs” (draft guideline 10, paragraph 92).

For the above-mentioned reasons, ESG highly appreciates that ESMA allows that the costs/benefits analysis of a switch could be done “on a higher level than at the level of each individual client”.

However, ESG does not agree with the requirement that “when providing investment advice, a clear explanation of the reasons why the benefits of the recommended switch are greater than its costs should be included in the suitability report”. This request is not in line with the level 2 requirements according to which firms must (only) “be able to demonstrate that the benefits of switching are greater than the costs” (cf. article 54 paragraph 11 of the MiFID II delegated regulation). Moreover, if the decision to switch investments is taken at a higher level – and not on a case-by-case basis by the advisor – it makes no sense that the advisor should “explain” such decision in the suitability report.



**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?**

- Comments on 'complexity':

ESMA in several paragraphs of the guidelines (paragraphs 34 and 55) mentions the need to offer products with different levels of complexity. For instance, in paragraph 71, it expressly states: *“The more complex a product, the more detailed the information firms will have to collect with regard to the knowledge, experience, financial situation and investment objectives of the client”*.

ESBG does not support ESMA’s approach towards complex products. MiFID II categorises products into two categories: (i) complex and (ii) non-complex. The different levels and nuances between the complexities of products is something that has not been standardised at EU level. Moreover, despite the fact that some entities may have internal policies on this matter, it is something that should not be included in the suitability guidelines as it will only make it even more difficult to implement across EU member states.

**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.**



## About ESBG (European Savings and Retail Banking Group)

### ESBG – The Voice of Savings and Retail Banking in Europe

ESBG brings together nearly 1000 savings and retail banks in 20 European countries that believe in a common identity for European policies. ESBG members represent one of the largest European retail banking networks, comprising one-third of the retail banking market in Europe, with 190 million customers, more than 60,000 outlets, total assets of €7.1 trillion, non-bank deposits of €3.5 trillion, and non-bank loans of €3.7 trillion. ESBG members come together to agree on and promote common positions on relevant regulatory or supervisory matters.



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Published by ESBG. October 2017.