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European Securities and Markets Authority
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ESMA Consultation Paper – Draft Guidelines on certain aspects of the MiFID II suitability requirements (the "Consultation Paper")

Dear Sir/Madam,

BlackRock, Inc. (BlackRock)[1] is pleased to have the opportunity to respond to the Consultation Paper on the draft Guidelines on certain aspects of the MiFID II suitability requirements issued by the European Securities and Markets Authority ("ESMA") on 13 July 2017.

About BlackRock

BlackRock supports a regulatory regime that increases transparency, protects investors, and facilitates responsible growth of capital markets while preserving consumer choice and assessing benefits versus implementation costs.

We welcome the opportunity to comment on the issues raised by this Consultation Paper and will continue to contribute to the thinking of ESMA on any issues that may assist in improving the final outcome.

Our response to this Consultation Paper is drawn on our experience in providing discretionary portfolio management and investment advice services to professional clients rather than to retail clients.

Executive summary

BlackRock supports the provision of Guidelines on certain aspects of the MiFID II suitability assessment. While the proposed approach seems reasonable in many areas, where we believe it would be beneficial to adopt a more proportionate approach reflecting the needs of different client types. We summarise these below:

- The draft Guidelines are mainly focused on the needs of retail clients and there is a lack of clarity as to the applicability of certain requirements to the provision of services to professional clients. We believe it should be possible to apply the Guidelines in a proportional manner, recognising differences between the nature of services provided to different types of client. It would be beneficial for the final Guidelines to be clearer as to what applies only to retail clients and what applies to all clients.

[1] BlackRock is one of the world's leading asset management firms. We manage assets on behalf of institutional and individual clients worldwide, across equity, fixed income, liquidity, real estate, alternatives, and multi-asset strategies. Our client base includes pension plans, endowments, foundations, charities, official institutions, insurers and other financial institutions, as well as individuals around the world.

- We believe Guideline 10 fails to distinguish adequately between legitimate concerns about suitability in the context of the retail market and the realities of the institutional market.

  We believe that the nature of the asset management agreement in the institutional space, with documented investment and risk parameters set out in pre-agreed investment guidelines and detailed ex post reporting to clients obviates the need for an additional rigidly defined cost-benefit process. Portfolio management is a continuous process of adjustment and the whole idea of 'switching', which may be relevant to retail portfolios with 'one-off' or several 'investment decisions linked by a same intent', does not make sense in an institutional process with due diligence and monitoring conducted at the level of the overall portfolio.

  Furthermore, the cost-benefit analysis as described in the draft Guidelines would bring trading under quantitative investment strategies (which trade in very high volumes) to a standstill or at best would delay trading, adding frictional cost and challenging established concepts of best execution. Qualitative strategies would fair little better.

  We encourage ESMA to follow a more purposive approach in the case of institutional portfolio management where there are fewer conflicts of interest arising from commissions on switching and instead focus on additional ex-post controls in the form of portfolio turnover and performance monitoring as well as enhanced reporting of transaction costs to clients.

- One approach might be to distinguish between recommending an advisory portfolio management client to trade and deciding to trade on behalf of a discretionary portfolio management client. Given that Article 54(11) specifically refers to 'recommended new investments' it could be argued that this sub-article refers to advisory portfolio management looking at individual stocks and not to discretionary portfolio management focussing on the portfolio as a whole.

- The disapplication of the requirement to perform a cost-benefit analysis for passive strategies replicating an index as envisaged in para. 84 of the Consultation Paper should be reflected in the final Guidelines (Guideline 10).

- The draft general Guideline 6 introduces a disclosure requirement for investment firms not envisaged in Article 54(6) of the MiFID II Delegated Regulation.

- It is important that robo-advisors are subject to the same framework of regulation and supervision as traditional advisors. While we welcome the updates made to the Guidelines to take into account robo-advice, additional guidance or rules introduced for robo-advisors do not always feel justified (e.g. para. 20, 22 or 30). The same requirements and standard should apply to all advice media

We have provided more details on the above points in our detailed response to ESMA's Consultation Paper.

We welcome further discussion on any of the points that we have raised.

Yours faithfully,

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Responses to Consultation Paper questions

Guideline 1 - Information to clients about the purpose of suitability assessment

1) 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.

For the purposes of being transparent and ensuring that clients provide correct, up-to-date and complete information, we agree that investment firms should inform their clients about the suitability assessment and its purpose.

Although investment firms can decide on the form of communication and the medium to be used, the requirement for posteriori controls implies that information needs to be disclosed in a formal manner.

Investment firms take a cautious approach when disclosing information to clients and a prescriptive approach can lead to a focus on protection against litigation and legalistic drafting. This can distract from the main intent to ensure that individuals have access to financial advice that can meet their needs and provide clients with quality advice. This often results in clients being provided with long and unengaging documents that are neither useful nor user friendly for them.

In the robo-advice space, where there is limited face-to-face interactions, there is a higher dependency on the information provided by clients. The disclosure requirements for robo-advisers as noted in the Guidelines seems reasonable and in line with the stance taken by other regulators. It is expected that most investment firms would make use of a disclaimer/prompt (requiring client acknowledgement) to disclose all required information to clients. While this might be the best way for an investment firm to address the regulatory requirement, the amount of information required to be disclosed could easily distract the investor from the intent. Ease of access and greater alignment to clients' needs are the primary drivers of the shift towards digital advice for many individuals. Lengthy disclosure would complicate the process and could discourage certain investors from using online advice tools.

We are supportive of robo-advisors being subject to the same framework of regulation and supervision as traditional advisors, especially on the topic of suitability. Back in September 2016, we published a ViewPoint on Digital Investment Advice[*] touching on suitability and other key observations such as disclosure, algorithm design and oversight. While we welcome the updates made to the Guidelines to take into account robo-advice, additional guidance or rules introduced for robo-advisors do not always feel justified. The additional guidance under para. 20 and 22 for example would introduce additional operational burdensomeness (without offering a higher level of protection to the clients). It is also likely to render the digital service less attractive to users which would defeat the purpose of robo-advisors to make advice more accessible to individuals.

Overall, we believe that investment firms should determine the best way to disclose information to clients and that the approach should not be overly formalistic. Emphasis should be given to the substance over the form. We believe that a more proportionate approach would be for firms to put in place procedures to ascertain whether clients have understood and are able to act on the disclosures which have been provided to them.

Guideline 2 - Arrangements necessary to understand clients

2) Do you agree with the suggested approach on the arrangements necessary to understand clients and specifically with how the guideline has been updated to consider

[*] https://www.blackrock.com/corporate/en-at/literature/whitepaper/viewpoint-digital-investment-advice-september-2016.pdf

behavioural finance and the development of robo-advice models? Please also state the reasons for your answer.

These Guidelines focus on the needs of retail clients. There would be merit in distinguishing between retail and professional clients in these Guidelines. Suitability represents a key risk for retail clients but for professional clients, the risk is deemed as lower on the basis that such clients are likely (depending on the client categorisation) to have the necessary level of experience and knowledge and the ability to bear losses. We note that the draft Guidelines do not currently reflect the caveat for certain professional clients and certain investment services under Article 54(3) of the MiFID II Delegated Regulation.

In addition, professional clients are likely to have bespoke mandates set out in a bespoke investment management or, where applicable, investment advisory agreement and this should be taken into consideration in these Guidelines.

In our view, the suitability assessment must be tailored to clients' goals and to the services being offered. In many cases, goal-based investing, where there is a single and specific investment objective, does not require a significant number of inputs to assess suitability, whereas more information might be needed for more comprehensive wealth management solutions addressing different investment objectives over an individual's life of course. As such, investment firms need to retain some flexibility in determining the necessary arrangements to understand clients as long as this is done in a consistent manner. We believe this is in line with the requirement under Article 54(2) of the MiFID II Delegated Regulation: 'Investment firms shall determine the extent of the information to be collected from clients in light of all the features of the investment advice or portfolio management services to be provided to those clients'.

Where permitted and where conditions are met, investment firms can also rely on other investment firms regarding suitability (as covered under the Financial Conduct Authority's COBS 2.4.4) in regard to suitability. In such instance, it is imperative that arrangements in place accurately reflect the relationships with the client and the other investment firm

In relation to the update of the Guidelines to consider behavioural finance, we think this would be a helpful tool to uncover the true risk tolerance and the ability to bear losses of a client in the retail space, provided this avoids processes which become over-engineered and burdensome to operate. From a client perspective, there is a need to keep the outputs simple to ensure the client experience remains positive.

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

Additional guidance as to how these Guidelines should be applied when providing services to professional clients would be welcomed.

In some instances, an investment firm would only advise on or manage a portion of the assets of a client. This is often the case when the client is a large institutional client such as a pension scheme, an insurance company or a sovereign wealth manager. In such instance, an investment firm can only truly assess the ability of the client to bear losses at the 'mandate-level' rather than at the 'client-level'. The Guidelines currently imply an assessment at the 'client-level' and it would be beneficial to incorporate some flexibility based on such limitation and an acknowledgement that, in some instances, the assessment can only be performed at 'mandate-level'.

In relation to portfolio management services for per se professional clients, one practical solution to assessing a client's ability to bear losses might be to record details of the client's tolerance for maximum drawdown/loss for the particular mandate.

As noted in our response to question 2, the Guidelines are heavily focused on retail clients and do not reflect the caveat under Article 54(3) of the MiFID II Delegated Regulation that allows an investment firm to assume that a per se professional client has the ability to financially bear any related investment risks consistent with his investment objectives if the service provided is investment advice.

Guideline 4 - Reliability of client information

4) 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.

The reliability of client information is heavily dependent on the client providing correct, up-to-date and complete information. The provision of information to clients on the suitability assessment and its purpose by investment firms (guideline 1) should encourage clients to do so.

Again, the Guidelines are very focused on retail clients and this is reinforced by the updates made to consider behavioural finance. In the case of professional clients, it is expected that clients would be more experienced and investment firms could place more reliance on the accuracy and consistency of the information provided.

There are limitations to the reliability of client information with robo-advice models. Such limitations include but are not limited to:

- Lower quality of information resulting from the subjectivity of responses and the reliance placed on the user reading information and selecting a response or an option as intended; or
- Reliance on the client responding to a request to confirm and/or update its information rather than the client proactively updating its information (as opposed to investment firms facing periodically their clients).

Investment firms would clearly have to take these limitations into account when offering online tools to their clients to ensure reliability and consistency of information. As such additional guidance on the subject for robo-advisors feels redundant. Requirements should apply to all advice media and standards should not differ.

Guideline 5 - Updating client information

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

The approach suggested in the Guidelines seems sensible. We would note, however, that investment firms would need to take into consideration differences related to client categorisation when determining the extent of these procedures.

Guideline 6 - Client information for legal entities or groups

6) 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.

We agree in principle with the suggested approach and the need for investment firms to have clear Guidelines on how to conduct suitability assessment in situations where there is no sole client and the applicable legal framework does not provide sufficient indications in this regard. This is particularly important where clients are retail clients as the level of knowledge and competency, the financial situation and investment objectives might differ between individuals.

For professional clients, the need for regulatory guidance on the topic is less needed as the relationship would be governed by contractual arrangement in the investment management, or where applicable, investment advisory agreement.

We also note that these Guidelines introduce a requirement for an investment firm to inform its clients ex-ante about its policy. Upon reviewing Article 54(6) of the MiFID II Delegated Regulation, we note that 'an investment firm shall establish and implement a policy and record this policy' but there is no requirement to disclose such policy to clients. Although we agree with the principle of providing relevant information to clients, the Guidelines should not introduce a disclosure requirement not specified in the Directive. As such, para. 56 of the draft Guidelines should be amended accordingly.

Guideline 7 - Arrangements necessary to understand investment products

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

Knowledge of investment products is imperative to ensure that investment firms recommend suitable investments, or invest into suitable products on behalf of their clients. We agree that investment firms should have policies and procedures in place to understand the characteristics, nature and features of investment products and are of the view that the suggested approach is reasonable.

Guideline 8 - Arrangements necessary to ensure the suitability of an investment

8) 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.

Consideration of all available information

The scope of the information to consider is quite broad and it would be beneficial to limit the scope to 'all available information about the client acquired in the course of the suitability assessment and during other current/past mandates'. This would provide investment firms with clearer parameters to define their policy and procedures and would align with the requirement under Article 54(2) of the MiFID II Delegated Regulation for investment firms to 'determine the extent of the information to be collected from clients in light of all the features of the investment advice or portfolio management services to be provided to those clients'.

Investment firms providing services to professional clients could also be restricted in considering all available information. For example, investment firms might have some internal restrictions (such as information barriers, confidentiality or data privacy rules) that would prevent access to all information for a particular client within the firm. In addition, and as previously noted, investment firms might in some instances only advise on or manage a portion of the assets of a client and would only be able to consider 'mandate-specific' information.

Knowledge and experience regarding each investment product

The Guidelines introduce a requirement to assess the knowledge and experience of a client regarding each investment product and risks involved in the related transaction (para. 81 of the draft Guidelines). In the context of a discretionary portfolio management service, performing such assessment at the transaction level rather than at the portfolio level is not appropriate and is in contradiction with para. 36(b) of the draft Guidelines.

We encourage ESMA to amend the Guidelines to differentiate between investment advice and portfolio management services. Having to assess each transaction at the level of the transaction instead of at the level of the portfolio as a whole undermines and contradicts the benefits of discretionary portfolio management while depriving investors of the benefits of diversification. The approach suggested by ESMA does not reflect the best interests of investors seeking a diversified portfolio of investments

Guideline 9 - Costs and complexity of equivalent products

9) 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 answer.

Although we understand the intent of the Guidelines, there are instances where this requirement does not seem relevant and would not be beneficial to the client and could potentially be disadvantageous for the client.

Where a discretionary portfolio management service is provided, the investment firm exercises its discretion within the limits of the client's agreed objective and investment guidelines. It is unclear what benefit such exercise would have for the client. In addition, it can also be expected that the client would not be interested in alternative solutions. This is particularly the case in relation to professional clients.

Guideline 10 - Costs and benefits of switching investments

10) 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.

We believe Guideline 10 fails to distinguish adequately between legitimate concerns about suitability in the context of the retail market and the realities of the institutional market.

We believe that the nature of the asset management agreement in the institutional space, with documented investment and risk parameters set out in pre-agreed investment guidelines and detailed ex post reporting to clients obviates the need for an additional rigidly defined cost-benefit process. Portfolio management is a continuous process of adjustment and the whole idea of 'switching', which may be relevant to retail portfolios with 'one-off' or several 'investment decisions linked by a same intent', does not make sense in an institutional process with due diligence and monitoring conducted at the level of the overall portfolio.

Furthermore, the cost-benefit analysis as described in the draft Guidelines would bring trading under quantitative investment strategies (which trade in very high volumes) to a standstill or at best would delay trading, adding frictional cost and challenging established concepts of best execution. Qualitative strategies would fair little better.

We encourage ESMA to follow a more purposive approach in the case of institutional portfolio management where there are fewer conflicts of interest arising from commissions on switching and instead **focus on additional ex-post controls in the form of portfolio turnover and performance monitoring as well as enhanced reporting of transaction costs to clients**.

One approach might be to distinguish between recommending an advisory portfolio management client to trade and deciding to trade on behalf of a discretionary portfolio management client. Given that Article 54(11) specifically refers to 'recommended new investments' it could be argued that this sub-article refers to advisory portfolio management looking at individual stocks and not to discretionary portfolio management focussing on the portfolio as a whole.

We would suggest that an extra paragraph be inserted into the Guidelines along the lines of:

> *Switching involves two, or more, investment recommendations which are linked by a same intent, such that the sale is recommended so that the purchase can be made. This would not, generally, include: a general intent, such as*
>
> - *to decisions to deal for the client on a discretionary basis, or*
> - *rebalancing of the portfolio under management;*
> - *or passive strategies to replicate an index.*

Furthermore, the Guidelines could also seek to define switching as recommending the selling of one packaged retail investment product in order to buy another as this would then correctly focus the requirements on the retail sector where there may historically have been a greater link between the churning of portfolios and commission payments.

The drafting of para. 97 of the Guidelines do not currently reflect well established arrangements with professional clients, especially where investment firms run bespoke mandates and strategies.

Article 54(11) of the MiFID II Directive implies an underlying assumption for the required cost-benefit analysis to be proportional and justified. There are several situations where the application of this requirement in the portfolio management space for professional clients would not be proportional and justified and would not be the result of an active decision or proposal from an investment firm. To illustrate our point, we would like to provide certain examples:

- As part of a portfolio management service, investment firms often receive instructions from clients to execute buy/sell trades in relation to the managed portfolio. This is a fairly common occurrence, especially in relation to professional clients, who might instruct a switch, for example, to express an investment preference at a particular time which they want to be considered by the firm or for other reasons (such as compliance with its investment policies).

- In relation to portfolio management mandates, switching investments may also be the result from the need to address compliance with the client's investment guidelines applicable to the mandate. Rather than a result of a cost-benefit analysis, the switch would be done to ensure the mandate remains managed in accordance with the client's investment objective and parameters.

- In some instances, the investment firm might only manage a portion of the assets of a client and as such would not have visibility over the client's other existing investments and could not possible be able to perform a cost-benefit analysis of a switching decision considering all the client's existing assets.

- During the life of a portfolio management mandate a professional client may decide to change its investment guidelines or investment objective. This could require a switch of investments by the portfolio manager to implement such changes.

We believe professional clients would benefit from amendments to the Guidelines to clearly distinguish between investment advice and portfolio management services. Clients receiving a portfolio management service are expecting the investment firm to exercise its discretion in regard to their investments, in accordance with agreed the objective and investment guidelines.

If the switch of investments results in the mandate remaining compliant with those objective and investment guidelines, it should not result in a requirement to assess the suitability of the switch. In some instances, the proposed Guidelines may undermine the requirement for best execution applying to investment firms.

Investment firms would have controls in place to monitor portfolios turnover which could be leveraged to ensure a client is not switched unnecessarily.

We also would like to raise the following points on the draft Guidelines:

Conflicts of interest

The focus of the Guidelines should be on situations where a switch would trigger a conflict of interest. For example, where the portfolio manager switches from an investment product issued or managed externally to one issued or managed internally, the documentation of the investment rationale and suitability of the decision is very important in ensuring the management of the perceived conflict of interest arising from the switch.

Index tracking

The disapplication of the requirement to perform a cost-benefit analysis for passive strategies replicating an index as envisaged in para. 84 of the Consultation Paper should be reflected in the final Guidelines.

Definition of 'switching'

Greater clarity on what would be regarded as a switch is required. Per Article 54(11) of the MiFID II Delegated Regulation, a switch can be effected by 'selling an instrument and buying another or by exercising a right to make a change in regard to an existing instrument'. The MiFID II Delegated Regulation and the Level One Directive do not provide a definition of the terminology. The scope of the switch should be limited to packaged products which have traditionally carried high fees structure, where there is a conflict of interest. This would differentiate from the continuous adjustment process taking place when providing a discretionary portfolio management service.

Delay in trading and missed investment opportunities

We are also concerned about the costs associated with the requirement to perform a cost-benefit analysis when switching investments in a portfolio managed on behalf of a client. This concern is not only about the cost for investment firms but also the cost for clients resulting from missed investment opportunities or delay in trading. While we appreciate this might be limited for retail investors due to trading taking place less frequently, this can have a large impact on mandates managed on behalf of large professional clients.

Guideline 11 - Qualifications of firm staff

11) 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.

We do not think that further guidance is 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.

Guideline 12 - Record-keeping

12) Do you have any further comment or input on the draft Guidelines?

We have no further comments.

Guideline 13

13) What level of resources (financial and other) would be required to implement and comply with the Guidelines (market researches, organizational, 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 organization and the nature, scale and complexity of the activities of your institution, where relevant.

It is difficult to quantify the impact of upscaling our suitability process due to the lack of clarity around the applicability of certain requirements to the provision of services to professional clients. The Guidelines need to be as specific as possible so investment firms can ensure they have efficient and effective suitability processes in place.

We are also concerned about the costs associated with the requirement to perform a cost-benefit analysis when switching investments in a portfolio managed on behalf of a client. This concern is not only about the cost for investment firms but also the cost for clients resulting from missed investment opportunities or delay in trading.

Conclusion

We appreciate the opportunity to address and comment on the issues raised by the Consultation Paper and will continue to work with ESMA on any specific issues which may assist in the implementation of these Guidelines on certain aspects of the MiFID II suitability requirements.