DU CHE - SCHOONJANS

Here is our answer to the **ESMA Consultation on MIFID II**

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2.15. "The legitimacy of inducements paid to/by a third person" p.118

- **Q79: Do you agree with the proposed exhaustive list of minor non-monetary benefits that are acceptable, should any other benefits be included on the list? If so, please explain.**

No, we don't agree with the proposed exhaustive list of minor non-monetary benefits and with the analysis that investment research is a non-monetary benefit.

Nothing at level 1 mentions that level 2 measures should be developed on research as an inducement. Recital (74) of MiFID II shows that restrictions on inducements are predominantly viewed from the angle of the distribution and placing of financial products to clients, i.e. the purpose is to avoid firms being improperly influenced in their investment decisions by receiving and retaining benefits from product providers and issuers.

It is our surprise to see ESMA extending the application of the inducement rules to research. In doing so, ESMA is saying that investment firms receive or retain the transaction fees (or part of) that are dedicated to research and that investment firms are influenced in their investment decisions at the detriment of the client.
Investment firms don't receive any part of the transactions fees and therefore cannot be improperly influenced in their investment decisions.

That is indeed often common practice for a portfolio manager to agree higher execution rates to allow them to also obtain higher value research from a broker.
<u>We strongly believe that the current way the research is paid is not against but, on the contrary, in the best interest of clients.</u>
Portfolio management (and execution) is extremely competitive, with performance a key axis of competition. It would be self-defeating in our view for a manager to trade more than the optimal level or at a too high rate, as this would undermine performance. On the contrary, the execution rates reflect an optimal price that enables clients to benefit from competitive transaction fees while in the same time the transaction fees enable the client to benefit from a high-quality and diversified research. In fact, research directly assists the investment manager when making its investment decision and is to the advantage of the client and not to its detriment.

<u>The qualification of any research as a prohibited non-minor benefit will have a huge impact on the current market and was not intended by the EU co-legislator.</u>
ESMA does not provide an impact assessment on the effects of qualifying tailored research as prohibited non-minor benefit. It is our understanding that the effect would lead to a massive increase of costs for active manager mandates in Europe.
If investment management companies will have to re-price the services they offer, they will face competition at least from passive management and in particular, from overseas managers.

Should research be considered as inducement, it would become a scarce commodity, available only to large investment firms. The business model of research would be radically changed and turned into a market where the cost of research would rise due to the lack of financing.

Only large investment firms would be in a position to afford it while smaller actors would need to cut down their research expenses unless they can reflect it to their clients through higher management fees.

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Similarly, providers of research on specific financial instruments (e.g. small and mid-caps, asset-backed securities...) may not find enough buyers to sustain their business; as a consequence, specialized research providers would end to disappear for the benefit of large providers or large traditional markets and SME's access to public financing would dry up.

Portfolio managers that are not in a position to finance abundant research would tend to rely on public ratings and therefore increase their dependency on ratings agencies.

Increasing cost of research would also favor passive management and index-linked products (in no need for research). As a result, States or corporates not included in indexes would be penalized for not getting access at a level-playing field to public financing.

Moreover, non-European investment firms still benefiting from an abundant research material would have a competitive advantage over European actors and their European subsidiaries would be able to benefit from it through in-house channels.
ESMA would create a distortion of competition in favor of Non-EU investment firms not subject to these rules.

We propose that research remains exclusively and rightly ruled by the "Best execution" regulation, which provides investors full transparency and protection against conflicts of interests.
In addition, some countries have gone further in tightening these rules by implementing commission sharing agreements, under which cost of research and cost of execution can be split to ensure that each provider is remunerated at the level it should be.

As an illustration of these rules, French asset managers have currently to publish a "Report on Intermediation Fees". The Report gives full transparency on the intermediation fees related to "order reception, transmission and execution services" on the one hand and intermediation fees related to "Investment decision aid and order execution services" on the other hand.

The report also gives an account of the measures implemented to prevent or deal with any potential conflicts of interest in the selection of service providers.
Such Report could be more detailed if need be in order to increase transparency and protection towards Investors in the use of transaction fees.

- **Question 80 : Do you agree with the proposed approach for the disclosure of monetary and non-monetary benefits, in relation to investment services other than portfolio management and advice on an independent basis?**

No.

<u>Preliminary</u>

Scope of investment services contemplated in the answer: non-independent investment advice.

Regarding non-monetary benefits, financial assessment is random and unreliable, disclosure of amount shouldn't be contemplated.

Allocating non-monetary benefits to an individual client is not possible as it is spread over a full range of investment services and clients.

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Regarding monetary benefits, along with our answers to Questions 72 and 75 on chapter "Information on costs and charges", we think that ex-ante information on monetary benefits should be disclosed on a generic basis and stick with the market practice:

- A maximum % of the amount invested as entry fees
- When relevant, an annual % of the amount invested

As for ex-post disclosure, we think that providing an exact amount (7.ii) and personalisation (7.iii) is difficult and costly ; it requires tracing all in/outflows of the client and therefore needs developing specific information systems between custodian and the distributors' client service departments ; the costs will eventually be reflected to clients for a meagre benefit.

We think there's no added value in providing a cash amount to the client as long as the client has received the method of calculating (as a % of the amount invested)

Providing the same display of information (in %) on ex-ante and on ex-post preserves the consistency of the information.

- **Question 81: Do you agree with the non-exhaustive list of circumstances and situations that NCA should consider in determining when the quality enhancement test is not met? Should any other circumstances and/or situations be included on the list? If so, please explain.**

No.
We do not agree with the negative list of circumstances and situations that NCAs should consider when determining whether a quality enhancement test is not met.

The major concern is that the spirit of MIFID II Level 1 would not be respected. The negative list of criteria for determining what is not a service enhancement ends up in an excessive narrowing of service enhancement possibilities.
As such, this negative approach disregards the EU legislator's decision and the principles set out in MIFID II Level 1 regarding payments of inducements linked to service enhancement.
The proposed negative list would leave totally unclear under what condition a payment could be allowed in future.

We believe, to the contrary, that the MiFID II regime calls for a positive list of criteria since the Commission is empowered to adopt delegated acts to ensure that investment firms comply with the principles set out in MiFID II Art. 25.
In particular, these shall include criteria to assess compliance of firms receiving inducements and not criteria for non-compliance. We therefore suggest a non-exhaustive list of positive criteria, which would be in line with the requirement of the Level 1 text and the general decision of the EU legislator that MiFID firms may still receive and pay commission, if these are designed to enhance the quality of the relevant service to the client.

More specifically, we strongly disagree with the criteria in *DTA 10.i: ESMA writes that quality enhancement test is not met when"... fee or commission is used to pay or provide goods or services that are <u>essential for the recipient firm in its ordinary course of business</u>"-*

Commissions shouldn't be submitted to criteria of volume (if that is what ESMA intends in this unclear requirement). Commissions received must be assessed through the criteria established by MIFID I and II

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level 1, i.e. being disclosed to the client, enhancing the service to the client and not impairing the client's best interest.

In France, AMF has issued clear and demanding positions on inducements and service enhancement (e.g. Position AMF 2013-10) that match the intention of the EU legislator.

DTA 11.:ESMA writes "...it should be understood that a fee, commission or non -monetary benefit could be considered acceptable if it enables the client to receive access to a wider range of suitable financial instruments or the provision of non-independent advice on an on-going basis"

We agree that service enhancement test is met when:

- Giving access to a wider range of suitable financial instruments
- Providing an on-going investment advice
- On a more general approach, providing additional service above MIFID I level

- We would like to propose more examples of service enhancement that could be offered to the client:
  - Giving a periodic suitability assessment, at least annually (in line with the position of AMF 2013-10) (see Suitability reports on 2.18 Suitability)
  - Giving an annual report on costs and charges (along with chapter 2.14 on Costs and Charges, Q/A. 73, we believe that providing an annual report on costs and charges when there is a continuous relationship is a service enhancement)
  - Giving a personalised report on costs and charges when it is technically possible (along with chapter 2.14 on Costs and Charges, Q/A. 74, we believe that providing a personalised report on costs and charges is a service enhancement)
  - Giving a personalised report aggregating all financial instruments and products held by the client
  - Alerting the client on specific thresholds (% of gain or loss) agreed with client (along with chapter 2.20 Reporting to Clients)

MIFID II requirements for investor protection induce heavy costs for investment firms; these costs can be financed either through inducements or through client fees. We believe that inducements remain the best solution and insure the fairest allocation of costs and treatment between clients.

Additionally and very importantly, no new rules should be imposed on funds distributors that would, rightly in our eyes, seem unfit for other competing investment solutions such as insurance-life, bank saving accounts or crowdfunding.

- **Q82: Do you anticipate any additional costs in order to comply with the requirements proposed in this chapter? If yes, please provide details**

Considering the huge economic impact of these requirements, it is more adequate to anticipate that:

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- Some investment firms and research providers would face hard time to maintain their business as the balance of their business model will be disrupted (more costs, less revenues)
- Clients will eventually pay higher fees for research and investment advice
- Some public and private entities not covered by research nor included in market indexes would see their source of public financing drying up

2.16. "Investment advice on Independent basis" p.126

- **Question 83: Do you agree with the approach proposed in the technical advice above in order to ensure investment firm's compliance with the obligation to assess a sufficient range of financial instruments available on the market? If not, please explain your reasons and provide for alternative or additional criteria.**

No.
MIFID II Level 1 has already provided a definition of independence by banning the reception of inducements for independent advisors. This should speak for itself and no further criteria should be added.
Further, providing long lists of descriptions of financial universes and financial instruments would not be effective.

Indeed, this requirement would lead to long lists sorted out by type of financial instruments and by type of investment advice (one-off advice or on-going advice, global or specific).

Besides the types and numbers of financial instruments varies periodically along with new products, new manufacturers and new clients. Each list would need to be updated on a permanent basis.

Lastly, the width of a universe is not a sufficient criterion for delivering a suitable advice.

Our proposal would be to go for simplicity and transparency;

- The investment firm specifies (if any) (a) its "close-links" or its "control relationships" with other entities and (b) the % of financial instruments and/or products under review issued and/or manufactured by these entities.

- The investment firm informs the client on whether the specific product it recommends is issued or manufactured by a "close" or "related" entity.

- The investment firm informs the client on whether it receives commissions on the product recommended.

- The investment firm informs the client on the selection process of the product it recommends.

We think that this act of transparency would provide investor the trust and the protection he's expecting.

- **Question 84: What type of organisational requirements should firms have in place (e.g. degree of separation, procedures, controls) when they provide both independent and non-independent advice ?**

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The contemplated requirement that a relevant person might not provide independent and non-independent advice would put small investment firms in a very difficult position. Such a requirement would clearly not be in line with the proportionality principle.

In line with the philosophy of the level I Directive, clients should have the choice, on a case by case basis, and in full transparency to have advice on an "independent basis" or not.

- **Question 85: Do you anticipate any additional costs in order to comply with the requirements proposed in this chapter? If yes, please provide details**

Yes.

Compiling ling lists of financial instruments would induce marketing costs, but most of all, having two separate teams of investment advisors –independent and non-independent- would certainly lead to heavy additional costs that some investment firms will not able to support.

2.17. "Suitability" p.131

- **Q. 86 Do you agree that the existing suitability requirements included in Article 35 of the MiFID Implementing Directive should be expanded to cover points discussed in the draft technical advice of this chapter?**

No.
We do not fully agree with extending the requirements on Suitability.

ESMA writes in DTA, 1.iii: Investment firms in direct relationship with clients must have procedures and be able to demonstrate that they do fully understand the product they recommend and that they **assess whether alternative financial instruments, less complex or with lower costs,** could meet their client profile.

We do not agree with this additional requirement; ESMA is interfering in the investment advice process and induces the belief that "simplicity" and "cheapness" are relevant criteria for choosing a financial product, which they are not.
Indeed, it would (1) induce that passive management is preferable and make the way for ETF over active management which not always in the client's best interest and could increase systemic risk (2) link "complexity" with risk which is not right (innovative management techniques are often risk mitigant) except when complexity means absence of possibility to explain the risk/reward profile of the product.

ESMA writes in DTA.1(v): When providing advice or portfolio management that involves switching investment, the firm should collect the "necessary information on the client's existing investments to undertake an analysis of the costs and benefits of the switch", so they are able to demonstrate the benefit of the switch.

We do not agree with this additional requirement.

Where portfolio management service is provided, the client has given in writing the portfolio manager full mandate to operate transactions and switches any time the portfolio manager finds it appropriate without taking into account other assets the client might hold outside the mandate.

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ESMA's requirement creates an obligation which does not stand with the intention of the investor expressed in the portfolio management mandate. The mandate can always be adapted when the client feels like it.

ESMA writes in DTA, 1. (viii.b.c): Investment firms should have robust process to asses both the client's ability to bear losses and the client's risk tolerance.

We agree as long it is well understood that ability to bear losses and risk tolerance is associated with an investment horizon.

ESMA writes in DTA, 3: The "Suitability report" must outlined, when appropriate, the need for **regular assessment** with the client (i.e. when there is a probability that the portfolio deviates from its targeted allocation).

When it comes to portfolio management, we do not agree with the wording of this requirement.
Portfolio management service already includes a regular reporting and encounter with the client. But rebalancing portfolio toward its targeted allocation is under the responsibility of the portfolio manager and doesn't need a specific review with the client. Once again, the client can ask for a modification of the mandate when he feels it is needed.

When it comes to investment advice, when the client and the investment firm agree on a periodic review, it should be considered as a service enhancement taking place in an on-going relationship. This position is in line with the AMF Position 2013-10 (§3.2.1) and with our proposal in Question 81, chapter "2.15. "The legitimacy of inducements paid to/by a third person".

- **Q87. Are there any other areas where MiFID Implementing Directive requirements covering the suitability assessment should be updated, improved or revised based on your experiences under MiFID since it was originally implemented?**
  No.
  We think that investment firms should be given space to personalize and improve their suitability assessment adapting it to their type of services and clients.

- **Q88. What is your view on the proposals for the content of suitability reports? Are there additional details or requirements you believe should be included, especially to ensure suitability reports are sufficiently 'personalised' to have added value for the client, drawing on any initiatives in national markets?**
  No.
  We think that investment firms should be given enough space to personalize and improve their suitability report adapting it their type of services and clients.

- **Q89. Do you agree that periodic suitability reports would only need to cover any changes in the instruments and/or circumstances of the client rather than repeating information which is unchanged from the first suitability report**
  No.
  We think that investment firms should be given enough space to adapt their suitability report adapting it their type of services and clients.

2.18 "Appropriateness" (p.136)

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Q90: Do you agree the existing criteria included in Article 38 of the Implementing Directive should be expanded to incorporate the above points, and that an instrument not included explicitly in Article 25(4)(a) of MiFID II would need to meet these criteria to be considered non-complex?

ESMA writes in DTA.1 (ii): the instrument is not complex if *"it does not include any explicit or implicit exit charges that have the effect of making the investment illiquid even though technically frequent opportunities to dispose or redeem it would be possible.*
It appears to be broad and confusing to be implemented on a satisfactory manner by the industry.

Notably, the terms *"any explicit or implicit exit charges"* could refer to various situations, such as certain funds beneficiating from specific tax advantages linked to the engagement not to redeem shares/units before a certain period of time.

Based on a literal interpretation of this provision, one could consider that the loss of the tax benefit would constitute an "implicit exist charges". If so, all French life insurance would be deemed complex and we know it is not.

Further, this proposal would require portfolio management companies to process with a "case by case" approach by determining for each product whether it is complex or not, with a significant degree of risk that a same product would be "complex" for a portfolio management company and "not complex" for another one.

This could be avoided by issuing a technical schedule listing all products that must be qualified as "complex".

In addition, ESMA will further increase and worsen the confusion between illiquid products and complex products which was already latent in the level 1 text. One can agree with the idea that illiquid products should not be placed through so-called 'execution only' to retail clients. But the qualification of 'complex' has a very detrimental marketing effect.

If this new criteria is introduced, it will be necessary to change the qualification and to speak either of complex products or of illiquid products.
Structured products as defined in article 36, § 1 of N° 583/2010 EU Regulation should also be qualified as such in order to avoid employing the term complex. In fact, these products are often much safer than other UCITS as well as very simple to understand with respect to their risk/return profile.

So we propose that products which should not be sold through 'execution only' would be called either:
- complex products (with the meaning of having a risk/return profile difficult to assess at first glance)
- illiquid products
- structured products

...depending on the reason of their exclusion from 'execution only'.

Lastly, we do not agree with the fact that all non-UCITs funds should be considered as 'complex'. In fact many funds which are UCITS-like (so-called *'fonds à vocation générale'* in French) have been qualified as AIF after the enforcement of AIFMD and are neither complex, nor illiquid, nor structured.

In this respect, each national regulator should benefit of some latitude to classify funds which are only sold in its own country.

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Q 91 Are there any other areas where the MiFID Implementing Directive requirements covering the appropriateness assessment and conditions for an instrument to be considered non-complex should be updated, improved or revised based on your experiences under MiFID I?
Yes. It is included in our answer to Q.90

2.19 Client agreement p.139

Q92. Do you agree that investment firms should be required to enter into a written (or equivalent) agreement with their professional clients, at least for certain services? If yes, in which circumstances? If no, please state your reason.

We do not see any reason to impose regulatory requirements relating to the conclusion of service contracts with professional clients. The status of a professional client implies per se higher flexibility in the business relationship with the service provider which should correspond with a measurably lower level of regulatory investor protection.
Professional clients are either financial institutions and large undertakings or other entities/individuals who meet the relevant criteria relating to their financial means and experience and in respect of whom the investment firm is satisfied on the basis of an individual assessment that the client is capable of making investment decisions and understanding the risks involved1. Hence, it should be borne in mind that the assignment of the professional client status on request already involves high hurdles in order to exclude waiving the investor protection standards for the insufficiently experienced or adept clients.

Therefore, it is not appropriate to require professional clients to enter into written agreements with investment firms, let alone to prescribe the formal conditions of such agreements (in paper/other durable medium). Similarly, the content of service agreements with professional clients should be subject to contractual negotiations between the parties and not be bound by protective measures designed for retail clients. In particular, the suggestion to "state the types of financial instruments that may be purchased and sold and the types of transactions that may be undertaken" goes too far in the context of professional portfolio management. The same applies to the underlying reasoning depicted in recital 19 of ESMA's analysis: professional clients do not need regulatory measures enabling them to better understand the nature of the services provided and where appropriate, to seek judicial recourse. **As a consequence, paragraph 2 of the ESMA's draft technical advice should be deleted.**

Q93. Do you agree that investment firms should be required to enter into a written (or equivalent) agreement for the provision of investment advice to any client, at least where the investment firm and the client have a continuing business relationship? If not, why not?

No. If an investment firm is providing investment advice to clients, it shall be liable if the advice is not conducted properly. Not having in place an agreement, as now proposed by ESMA, could be used as an argument against the client, as the investment firm could deny having provided advice (and therefore not being liable for inaccurate advice). We are of the opinion that the current MiFID II Level 1 text explicitly did not mention such written agreements for this very reason.

Q94. Do you agree that investment firms should be required to enter into a written (or

[1] Cf. Annex II Section II(1); third subsection of MiFID II Level 1

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equivalent) agreement for the provision of custody services (safekeeping of financial instruments) to any client? If not, why not?

Yes

Q95. Do you agree that investment firms should be required to describe in the client agreement any advice services, portfolio management services and custody services to be provided? If not, why not?

Yes

2.20 Reporting to Clients p.143

Q96. Do you agree that the content of reports for professional clients, both for portfolio management and execution of orders, should be aligned to the content applicable for retail clients?

No we do not agree.
We find inappropriate to align the content of report for professional clients (both for portfolio management and execution of orders) with those applicable to non-professional clients.
In many cases the format of the reports presented to professional clients are tailored in order to meet their specific requirements. ESMA fails to provide a justification for this suggestion.
In our view, the reporting needs of professional clients are fundamentally different from the standards applicable in relation to retail clients.

Q97. Should investment firms providing portfolio management or operating a retail client account that includes leveraged financial instruments or other contingent liability transactions be required to agree on a threshold with retail clients that should at least be equal to 10% (and relevant multiples) of the initial investments (or the value of the investment at the beginning of each year)?

Not on a systematic basis. Such agreement terms on threshold alerts should be left to the parties, based on the objectives of investment of the client or the periodic reporting on his managed portfolio.

Q98. Do you agree that Article 43 of the MiFID Implementing Directive should be updated to specify that the content of statements is to include the market or estimated value of the financial instruments included in the statement with a clear indication of the fact that the absence of a market price is likely to be indicative of a lack of liquidity?

We do agree.
However, it is not always the case that an indicative price means a lack of liquidity (i.e. a share may be suspended for a short time on a regulated market due to a corporate action or market value based on the last available redemption price).

Q99. Do you consider that it would be beneficial to clients to not only provide details of those financial instruments that are subject to TTCA at the point in time of the statement, but also details of those financial instruments that have been subject to

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TTCA during the reporting period?

(Applicable to TCC only or also applicable to AM ? if so, no reason to say no… , to be completed)

Q100. What other changes to the MiFID Implementing Directive in relation to reporting to clients should ESMA consider advising the Commission on?

2.21 Best execution

2.22 Client order-handling

Q103. Are you aware of any issues that have emerged with regard to the application of Articles 47, 48 and 49 of the MiFID Implementing Directive? If yes, please specify.

We are not aware that any changes to the Implementing Directive are required.

2.23 Transactions executed with eligible counterparties
2.24 Product Intervention