ABI's remarks on the ESMA Consultation Paper regarding the Guidelines on certain aspects of MiFID II suitability requirements

11 October 2017

POSITION PAPER

Foreword

ABI welcomes the opportunity to provide its own contribution to this consultation on the Revised Guidelines regarding certain suitability requirements, in order to ensure uniform interpretation and application of the provisions in the different EU Member States and to help the industry to better fulfil the new regulatory requirements.

Generally speaking, we appreciate the way the Guidelines have been reorganised by ESMA; moreover, this rearrangement is consistent with the Guidelines drawn up by ABI and approved by Consob in 2014 in order to provide Italian banks with operational guidance in implementing the previous version of the ESMA Guidelines, taking into account the various logical phases in the relationship between the intermediary and the customer as it evolves in the course of the suitability assessment.

Our comments (already submitted to ESMA in our letter dated April 2016) are, therefore, mainly focused on those new requirements on suitability provided for by MiFID II that need further clarification through Level 3 measures.

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.

We generally agree with the suggested approach.

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.

We generally agree with the suggested approach.

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

We generally agree with the suggested approach.

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.

We generally agree with the suggested approach.

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

We generally agree with the suggested approach.

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 ESMA Guidelines under consultation on suitability assessment raise questions as to how to deal with legal entities and groups of natural persons. In particular, they leave it up to the investment firm to adopt clear and set policies (to be communicated to the client in advance) for handling the information gathering and profiling phase which will then be used for the suitability assessment in line with MIFID 2 provisions. The possibility of sharing profiling with groups of natural persons or with legal entities is also allowed for as part of a best-effort approach for the benefit of the clients.

A multitude of factors need considering here and interpreting matters will prove very tricky especially due to the various legal systems and organisational industrial structures at play to which European regulations must be applied.

At various points, the ESMA Guidelines invite the investment firms to adopt procedures and standards which internally regulate the requirements entailed by profiling and subsequently making suitability assessments of both legal entities and groups of natural persons. However, whenever it is absolutely impossible to identify an individual to be designated as a "representative" for the group of natural persons, the Guidelines provide some guidance as regards how to proceed: the investment firm must always adopt the most prudent approach (least knowledge and experience; weakest financial situation; most conservative investment objectives) or in such circumstances the firm could also decide not to provide investment adivice or portfolio management services.

It would be appreciated if the ESMA could better clarify the figure of the "representative" in order to assess his role within the group of natural persons. Indeed, in paragraph 58 mention is made of how under some legal systems the figure of a "representative" is foreseen by some national laws whilst there are other cases where no representative is foreseen.

Some legal systems of the Member states recognise different types of "representatives". For instance, in Italy, from a purely statutory point of view, there are legal representatives (a clearly defined and well established figure in legal terms) and delegated persons; in addition to these, there are also what are known as decision-makers. These last two categories require further reflection because they could belong to the group of natural persons co-holding an investment account, or be third parties designated by the group of natural persons to take given investment decisions.

So, bearing all this in mind and in view of the particular nature of the legal institute regarding the representation, it would be appropriate and desirable for ESMA to clarify whether the term "representative" can be used in its broadest sense to encompass the various different practices in place in the various Member states. Were this not to be the case, clarification should be provided as to how this particular figure should be construed, so as to avoid different approaches being taken which might be in conflict with European regulations.

To this effect, clarification as to the exact scope of the term or its precise definition would be an aid in understanding the regulations contained in § 64 relating to groups of persons who appoint a "representative" to make their investment decisions. Another essential element lies in understanding whether the "representative" must always be an individual belonging to the group of natural persons or whether he could even be a third party designated by the group.

Another issue that ESMA needs to examine carefully relates to the information required (paragraph 65 of the Guidelines) from couples. Some Italian investment firms also classify clients according to their marital status. What is more, they do not request any information about the matrimonial property regime and it would be very labour-intensive and inconvenient to have to catalogue all this information. Furthermore, it should be noted that for the Italian legal system at least, marriage and the pertinent property regime does not imply as such any joint liability as far as an investment account is concerned. Defining the regime to be applied to the investment account with the firm is at the entire discretion of the parties, who, regardless of the property regime established by statutory law (communion-of-property or separation-of-property system) can decide on joint solutions with either joint or separate powers of signature. There would be a variety of different scenarios here (for instance, property regime with communion of property and joint solutions with separate powers of signature or vice versa).

Therefore, we feel that couples should be put on a par with groups of natural persons.

Moreover, we believe that the approach outlined under paragraph 63, letter b) and expounded under paragraph 67, which envisages collecting information and assessing the suitability of each single client, may be one of the possible options but not the only one, especially in the case whereby the group of natural persons does not designate a "representative". We do not think that the investment firm should be obliged to perform a suitability assessment for each single client (for instance, in the event of joint ownership either with joint or separate powers of signature), but should be able to maintain operational margin of discretion, albeit on a formalised footing, as regards the client. In the event of joint ownership with separate powers of signature, there should be the option of carrying out a suitability assessment on the individual who comes to carry out the transaction, just as, in the case of joint ownership with joint powers of signature, there should be the option of choosing which profile to assess.

As regards the feasibility of the options envisaged by ESMA and the difficulty of implementing each one of them, we would like to point out that the overarching principles and illustrative case studies set forth in the Guidelines will serve as drivers for the National Authorities as they put supervisory activities in place; investment firms will need to adapt from a regulatory and operational point of view and will be forced to take into consideration the principles and provisions laid down by the national statutory system and administrative procedures in use. We hope that the Guidelines will take this aspect into account. To this end, so as to provide clarification on the adaptation of ESMA's general principles to the national system and for the purpose of providing a complete picture, we hereby include an extract from ABI's Guidelines on suitability assessments adopted in implementation of ESMA's Guidelines of 25 June 2012, officially validated by Consob in 2014 and directly related to the topic at hand.

Excerpt from the ABI suitability assessment Guidelines adopted in implementation of the ESMA Guidelines of 25 June 2012 – chapter on Profiling groups of natural persons, natural persons represented by other individuals and entities

"If the client is a legal entity or a group of two or more natural persons or if a natural person is represented by another natural person, in order to identify who should undergo the suitability assessment, the firm should first of all base itself on the applicable legal framework. Therefore, based on the Italian legal framework as regards regulations governing the various legal instruments which may apply from time to time:

- joint ownerships, differentiated in turn according to whether they are characterised by separate or joint powers of signature;

- voluntary, judicial and legal representation for natural persons (whether they have sole ownership or joint ownership);
- the legal representative in the case of legal persons/entities.

The indications provided by this legal framework allow the investment firm to establish the powers as well as any limits to the operative powers of the client; on this basis, it can then establish procedures for discussing with the interested parties (the persons belonging to the group or the natural persons represented or the representative of the legal persons/entity) and reaching an agreement as to who should undergo the suitability assessment and the methods to be used in practical terms - this includes the individual from whom details shall be collected as regards knowledge, experience, financial situation and investment objectives. This agreement is part of the investment advice or portfolio management agreement.

In this context, the investment firms (acting according to the aforementioned procedures) shall establish how to profile groups of natural persons, representatives of natural persons or legal persons/entities (whether these be established under private or public law), evaluating whether to use a sole questionnaire or one customised according to the type of clientèle, and adapting the details to be collected on the basis of the criteria indicated below.

JOINT OWNERSHIP

In the case of accounts made out to several natural persons, the investment firm shall propose an agreement to those interested on the basis of its own set procedures. This agreement must cater for the features of these persons' particular legal circumstances so the investment firm can then collect and appraise the "components" of knowledge, experience, financial situation and investment objectives and ensure that agreement takes into account the interests of all those involved and their protection requirements.

In this agreement the investment firm will be able to arrange for the suitability assessment to be carried out with reference:

- to a profile associated with a jointly owned account for which:
  - the component of knowledge and experience must refer to the individual who orders the transaction. In particular: (i) in the event of accounts with separate powers of signature, the component of knowledge and experience must, therefore, refer to the single joint owner for whom the service is provided on each separate occasion; (ii) in the event of accounts with "joint signatures" by law, the component of knowledge and experience must be assessed on the basis of the joint owner within the group who has the least knowledge and experience; (iii) in the event of accounts with

voluntary “joint signatures” (viz. those for which the joint usage is a free choice of the customer), this assessment can also take place by referring to the “investment decision-maker” who shall be the individual identified within the joint ownership and officially authorised by all the joint owners to make investment decisions (for instance, so as to be able to benefit from the expertise of the joint owner with most proficiency in the investment field), it being understood, however, that the transactions must be authorised jointly;

- the financial-situation and investment-objective components must refer to one of the joint owners or to information which is common to all of them, regardless of whether the account has separate or joint powers of signature;

- to the profile of the most prudent joint owner (or of the joint owners).

On the other hand, whenever it is not possible to reach an agreement with the joint owners, the investment firm – which can exercise its right to offer such a service or not – should take into consideration the profile of the joint owner(s) with the most prudent investment outlook.

NATURAL PERSON REPRESENTED BY ANOTHER NATURAL PERSON

As per the provisions in annex II of the MiFID for small-sized entities (professional clients) who authorise another person to act on their behalf, should one or more natural persons be represented by another natural person, in assessing the knowledge and experience “component”, the firm should bear in mind the extent of knowledge and experience of the representative ordering the transaction and refer to the investment objectives and financial situation of the represented client.

OTHER ASPECTS RELATING TO NATURAL PERSONS

In the event of judicial representation (that is to say, representation ensuing from the law as in the case of incompetent/incapacitated persons represented by a trustee/guardian) or in the event of legal representation based on parental responsibility, the suitability assessment should take into consideration the experience and knowledge of the representative, whilst abiding by the objectives and respecting the financial situation of the represented party (for example, as provided for in the authorisation).

In the event of delegated accounts which must be formalised with the delegator, the suitability assessment should comply with the aforementioned criteria whilst taking into account the experience and knowledge of the delegate.

In the event of fiduciary accounts, the suitability assessment should take into account the profile of the settlor, who could be identified via a set code to be associated with information conveyed by the trust company.

Should the firm be providing investment advice to a group of two or more natural persons, and the investment advice agreement be made out jointly to these persons, without, however, them being joint holders of the financial accounts underlying said investment service, for the purposes of profiling, the firm shall apply the rules on joint ownership (that it has established as outlined above) and carry out the suitability assessment on the assets indicated by the individuals in the group and entailed in the consultancy service. In its internal regulations, the investment firm shall establish and formalise suitable measures aimed at managing the risk of intermingling the assets of the individuals belonging to the group."

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.

We generally agree with the suggested approach.

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.

We generally agree with the suggested approach.

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.

As regards the proposal for a new Guideline on the concept of equivalent products:

- **we fully agree about how this assessment should be carried out on a central, higher up level (see paragraph 90).**
  Indeed, each firm providing investment advice should first establish the product investment advice assortment on a central level (via

specific advisory units and/or committees). These activities must under no circumstances be left up to the sales staff and the suitability assessments. This task must, therefore, be completed before the investment advice is given to the single client. It must take place on a prior central level.

Basically, it makes logical sense that this “equivalence” assessment be part of the product-governance process and its relative policy, in line with what else has already been stated in another part of the document (see paragraphs 28-33) where it is rightly pointed out that “the more effective the product governance arrangements, the lower the risk of ‘failure’ of investor protection rules that apply at the point of sale, included suitability”and that there is a “close relationship between product governance and suitability”;

- **however, we do not entirely agree with limiting this approach only to common strategies or model investment propositions (see paragraph 90).**
  This approach could lead to operational uncertainty and we suggest it be removed or replaced with more far-reaching activities for the definition of investment advice product assortment or product offer carried out by the firms. This is the most crucial indispensable phase which any investment firm dealing in investment advice and portfolio management services must provide no matter what.

  On the other hand, all other operational aspects are left to the discretion of the investment firms such as the use of model portfolios, the automatic or manual selection of financial instruments to be inserted in the investment advice proposal to the client, the use of set and massive investment advice strategies, etc...;

- **we believe it is necessary to broaden the scope of drivers to be used to check the “equivalence” requirement (see paragraph 88).**
  In addition to the drivers already mentioned (same target market and similar risk-return profile), in the definition of the investment advice product assortment, other drivers could also be promoted. Today investment firms already refer to these other drivers when creating and selecting investment advice products, drawing inspiration from investment advice models typically based on creating model portfolios characterised by asset class and asset type. For instance, belonging to the same asset type (e.g. emergent euro bonds or plain vanilla bonds having similar duration and coupon “structure”: fixed/variable rate,

etc.) are other drivers which could be useful markers for clustering "equivalent" products;

- **we do not agree that it should be compulsory to tell the single client in the suitability report about more complex and expensive products (see paragraph 91).**
  In the MiFID II, in keeping with MiFID I and as reaffirmed in ESMA's Technical Advice, there is no obligation to recommend the most suitable product to the client.

  Moreover, as already stated, the verification and clusterisation activities for equivalent products in terms of cost and complexity carried out beforehand when defining product assortment and product governance will bring about itself a process of revisiting and removing any products which cannot be considered equivalent for the given equivalence cluster, because they are, for example, too expensive and out the range of maximum eligibility that the firm has set for itself.
  Therefore, when recommendations are made to the single customers, the investment advice product assortment in use will have already been verified *ab initio.* Therefore, not only would giving this information to the client be pointless, it would actually be misleading.

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.

Generally speaking, we agree with the proposed approach. However, we would like to make the following observations.

We believe that, basing itself on a specific and prior assessment, each investment firm can set forth in its own policy and internal procedures the benefits via the pre-set "drivers", which, notwithstanding the costs and additional burdens, can reasonably show that there are more advantages than disadvantages (the benefits exceed the costs).

These "drivers" would, therefore, be considered suitable if the costs/additional burdens (if any) borne by the client are sustainable by virtue of one or more benefits deriving from one or more "drivers" after a comparison of set features.

In this regard, we suggest inserting (in addition to the proposed examples with which we agree):

- a provision which states that a recommendation for investment and divestment aimed at turning an inadequate portfolio into an adequate one (in line with the firm's undertaking to provide a periodic suitability assessment) is per se a driver which gives the client the greatest possible benefit;
- a provision which states that, for a recommendation containing investment and divestment transactions which lower the costs (negative cost difference), it is not necessary to ascertain whether there are any benefits because the cost reduction is in itself a benefit.

We believe that only the recommendation for the sale of a financial instrument and the simultaneous purchase of another financial instrument (this also includes the multiple recommendation in which several purchases and several sales are involved at the same time) must be verified in terms of "costs-benefits" (scope).

Therefore, we believe that as part of the suitability assessment carried out before a switch recommendation and the suitability statement, prior procedural checks (as automated as possible) could be implemented using set rules so as to identify the extent of any benefits justifying the additional costs borne.

With a view to monitoring any risk of the "costs/benefits" assessment obligation being sidestepped, in addition to prohibitions being included in the investment firm's internal procedures, non-automatic checks could be implemented to randomly monitor and check afterwards the operations which took place in the course of the day, seeing as it is not possible to put automatic checks in place which establish whether there is an initial link between sale and purchase transactions taking place at different moments in time.

With reference to the above, we do not feel it to be necessary (in the portfolio reallocation stage carried out by the management portfolio provider on each single mandate) to envisage any cost-benefit checks but rather envisage a series of internal procedures for the investment firm whose purpose it is to establish:

- at a higher level, functions which approve (with rationale) the allocation choices, any portfolio reorganisation and pertinent investment/divestment decisions, in keeping with the provisions in paragraph 96 of the Guidelines;

- rules and criteria for the provider in the selection of financial instruments on which to invest/disinvest and arranging for periodic monitoring on the portfolio turnovers of the single management mandates.

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.

We generally agree with the suggested approach.

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

No further comments.

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.

Should our proposals on the assessment of equivalent products according to cost and complexity not be approved and therefore, should the costs be included in the suitability assessment procedures, the operational impact (from an IT point of view as well) both for product classification and algorithm logics for calculating the suitability would be very great due to the high effort involved in achieving the objective and the high costs incurred.