FECIF's response to the Consultation on Guidelines on certain aspects of the MiFID II suitability requirements

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.

Yes, we do. Specifically, we agree with the information on robo-advice to be provided to clients (i.e. concerning the use of an algorithm, the degree of human involvement and the description of how the information gathered will be used). With regard to the "degree of human involvement", we believe that a distinction is needed between:

- *Robo-for-advisors* - these are semi-automated tools to be used in the first stage of the advisory process to collect information about the clients and enable them to understand their need for investment advice, i.e. human interaction with an advisor. The core service is thus provided by a human advisor;
- *Robo-advice tout court* - automated tools where no form of human interaction takes place.

In light of the critical role of advisory services, we believe that automated tools may foster efficiency in the first stage of the advisory process, but in later stages they shall be complemented with a personalised service and the interaction with human advisors (*robo-for-advisors*). Indeed, in the long run, excessive automation may hinder the opportunity to access human financial advice at all, thereby sacrificing human sensitivity. To avoid an Orwellian world, automated tools shall rather be conceived as a complement to human advice.

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.

Yes, we do. Commenting on the supporting guidelines, we agree with:

- The need to give attention to "exhaustiveness and comprehensibility of the questionnaire" (par. 25). This statement appears to be fully consistent with Regulation EU 1286/2014 on KID (Article 6, the KID shall be "clearly expressed and written in language and a style that communicate in a way that facilitates the understanding of the information, in particular, in language that is clear, succinct and comprehensible”). In general, all the information provided to investors about services and products should respond to this principle of clarity and comprehensibility;

- The idea of avoiding the reply “no answer” in questionnaires (par. 25). Rather, we believe that such a reply should be avoided entirely;
- Par. 29, i.e. it is important that firms appraise the client’s financial literacy. In this sense, we point out that (human) interaction with financial advisors is of key importance to promote financial education;
- Par. 30, point iii), i.e. the need to consider whether “some human interaction (including remote interaction via emails or mobile phones) is available to clients when responding to the online questionnaire”. Such a clarification is of primary importance, as it marks the border between robo-advice *tout court* and other forms of semi-automated systems for the provision of investment advice or portfolio management (cf. our answer to Question 1);
- Par. 30, point iv), i.e. the importance of steps to address inconsistent client responses when responding to an online questionnaire, especially alerts or flags when responses appear inconsistent.

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 particularly agree with these guidelines:

- «Self-assessment should be counterbalanced by objective criteria » (par. 44 and 45). In general, we believe that the mechanisms adopted by the firms to avoid self-assessment are particularly important for the assessment of client’s knowledge, experience, financial situation and risk tolerance. For instance, to assess risk tolerance through a questionnaire it is possible to ask the client what he/she would do in the face of negative market trends, choosing between these possible answers:
    - Disinvest immediately, because I am not willing to bear higher losses;
    - Hold the investment and wait to recoup its value before selling it;
    - Hold the investment to achieve a positive return in the long-term;
    - Hold the investment and further invest in it to profit when the market goes down;
- Appropriate systems and controls are needed to ensure that the tools used *by clients* as part of the suitability process are fit for purpose and produce satisfactory results. In particular, we agree with par. 46: risk-profiling software

should include controls of coherence of the replies provided by clients in order to highlight contradictions between different pieces of information collected;

- Adequate mechanisms are required to avoid that clients may tend to overestimate their knowledge and experience. We completely agree with par. 49 when it recognizes that such measures are particularly important in the case of robo-advice, where the risk of overestimation by clients may be higher.

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

We agree with par. 51, i.e. firms should implement procedures to encourage clients to update the information originally provided where significant changes occur. This guideline should be read in conjunction with par. 26, i.e. when one of the listed elements (e.g. marital status, employment situation ...) is subject to change, client information should be updated.

We also support par. 54: firms should adopt measures to mitigate the risk of inducing the client to update his/her profile so as to make appear as suitable an unsuitable investment product. To this end, firms might use alerts to detect situations whereby the updated client's profile significantly deviates from the previous one, especially when the update results in a higher risk profile. From this point of view, also par. 55 is of particular importance: i.e., firms should inform the client when the additional information provided results in a change of his/her profile.

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 general, we believe that reliability of the algorithms is a key issue: overconfidence in the use of artificial intelligence (and its underpinning algorithmic infrastructure) may lead to an inflated standardisation of client profiling and, consequently, to herding and pro-cyclical investment behaviour. Indeed, it is unlikely that an algorithm based on a given number of variables may really meet the needs of all European citizens.

Accordingly, we espouse the solution envisaged in par. 85: to ensure the consistency of the suitability assessment conducted through automated tools (both robo-for-advisors and robo-advice *tout court*) firms should regularly monitor and test the algorithms that underpin the suitability assessment. To this end, all the suggested procedures and mechanisms are of utmost importance: an appropriate system-design documentation, a documented test strategy, security arrangements, timely review and update of the algorithms, policies and procedures enabling to detect errors within the algorithm.

In this sense, we believe that par. 85 gets the point: the underlying algorithms require fully-fledged controls and reviews to avoid them becoming "black boxes" with no form of supervision. In particular, it is necessary to avoid a situation where algorithms may be devised to favour the distribution of products which create more revenue for distribution platforms, at the expense of customer protection.

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.
We believe that par. 91 needs some clarification: costs and complexity are not the only elements to be considered when equivalent products are evaluated. Further criteria whose importance shall not be underestimated encompass portfolio diversification, liquidity, risk level and, more broadly, the aim of achieving suitable and efficient investment solutions.

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.
We agree with par. 94: an ex-ante clear explanation of the reasons why the benefits of the recommended switch are greater than its costs is required. This requirement should not be regarded as a mere burden; rather, it represents an important step in the advisory process, whereby financial advisors can interact with investors and convey specific forms of financial education, aimed at assessing the evolution of the client's profile.

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 espouse the reasoning outlined in par. 102: staff not directly facing clients must still possess the necessary skills, knowledge and expertise required depending on their particular role in the suitability process. To this end, periodic meetings with client-facing staff may be useful so as to enable "back office staff" to properly understand markets and clients.

Q12: Do you have any further comment or input on the draft guidelines?
In general, we believe that a core principle of technological neutrality shall apply: the same activity shall be subject to the same regulation irrespective of the way the service is delivered (i.e. automated systems where no human interaction takes place, robo-for-advisors, traditional interaction models with clients), thereby conveying the same result from the point of view of investor protection.
Although there are no specific questions with regard to General Guideline 3, we would like to comment on par. 41 («Firms should also encourage clients to disclose the financial

investments they hold with other firms in detail, if possible also on an instrument-by-instrument basis.»). On the one hand, a comparison can be drawn between doctors and financial advisors: a whole understanding of the patient's condition is needed to provide suitable medical advice; in the same way, financial advisors need to possess complete information about the client's financial investments to provide suitable recommendations (especially in the case of investment advice with a portfolio view). On the other hand, we agree with par. 41 when it specifies that «Firms should also encourage clients to disclose their financial investments they hold with <u>other firms</u> in detail, <u>if possible also on an instrument-by-instrument basis</u>.» (i.e., obtaining information on instrument-by-instrument basis held with other firms is desirable, but not always possible).

About FECIF

The **European Federation of Financial Advisers and Financial Intermediaries** (FECIF) was chartered in June 1999 for the defence and promotion of the role of financial advisers and intermediaries in Europe.

FECIF is an independent and non-profit-making organisation exclusively at the service of its financial adviser and intermediary members, who are from the 28 European Union member states, plus Switzerland; it is the only European body representing European financial advisers and intermediaries. FECIF is based in Brussels, at the heart of Europe.

The European financial adviser and intermediary community is made up of approximately 500,000 private individuals exercising this profession as a main occupation (representing approximately 26,000 legal entities including 45 networks), about 280,000 are members of national professional associations (51 at today's count).