EFAMA

European Fund and Asset Management Association

EFAMA RESPONSE TO ESMA'S CONSULTATION PAPER ON GUIDELINES ON CERTAIN ASPECTS OF THE MIFID II APPROPRIATENESS AND EXECUTION-ONLY REQUIREMENTS

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EXECUTIVE SUMMARY

EFAMA agrees in principle with many of ESMA's suggested approaches. However, certain, essential elements still require further considerations before finalising these Guidelines.

First, ESMA introduces the concept of "gradients" of complexity for financial products in Guideline 3. This concept is in clear contradiction with the applicable Level 1 and 2 frameworks which simply distinguish between "complex" and "non-complex" products. Such an approach could seriously hinder the distribution of financial products, as some investment firms may start considering a certain financial product 'more' complex while others would see it as 'more' non-complex. To ensure uniform interpretation of the rules along the whole value chain, ESMA's final Guidelines must follow the existing "complex"/"non-complex" framework.

Second, Guidelines 2 and 8 contradict the MiFID II and MiFID II Delegated Regulation by restricting the possibility for clients to proceed with their transactions even after having received a warning. These Guidelines should be brought in line with the overarching framework.

Last but not least, ESMA suggests that a client's knowledge and experience regarding sustainability factors and risks should be a separate element to be assessed. Such an approach is systematically incorrect and overlooks that experience and knowledge of sustainability factors are a matter of personal attitudes/preferences rather than appropriateness.

ANSWER TO QUESTIONS

Guideline 1 – Information to clients about the purpose of the appropriateness assessment

Q1: Do you agree with the suggested approach on providing information about the purpose of the appropriateness assessment? Please also state the reasons for your answer.

EFAMA agrees with ESMA's approach regarding retail investors. However, we advise including in the information to such retail investors that the appropriateness test is not required for non-advised sales for non-complex products. This should be clarified in the explanation when and why an appropriateness test is applicable.

However, there may be a need to differentiate better between retail investors and professional investors. In the light of the recent MiFID 'quick fixes' (which provided some necessary alleviations for professional investors), we believe that certain parts of the Guidelines can be disapplied for professional investors to ensure proportionality, especially in relation to face-to-face interactions.

Guideline 2 – Arrangements necessary to understand or warn clients

Q2: Do you agree with the suggested approach on the arrangements necessary to understand or warn clients? Please also state the reasons for your answer.

We have several issues with ESMA's suggested approach.

First, we have some doubts whether the proposed cooling-off period and limiting the number of attempts to respond to a questionnaire, as currently written, is in line with Article 25(3) of MiFID and Article 56(2) of the MiFID II Delegated Regulation. These allow clients to proceed with transactions after failing an appropriateness test, provided – of course – they have received a warning. We ask ESMA to delete paragraph 23 in its entirety or, at least, more clearly acknowledge that clients should always be allowed to correct obvious errors.

Moreover, the phrase "*that it is particularly important that firms avoid self-assessment questions and balance these with objective criteria*" seems to suggest that appropriateness test cannot be done via means of self-assessment. This does not correspond with current practice and the nature of execution-only services where the online intake by firms in most cases relies on such online self-assessment.

Second, the final Guideline 2 should avoid mentioning "policies and procedures", implying that firms are expected to draft internal regulations rather than focus on practical implementation.

Last but not least, paragraph 27 seems to suggest that clients need to be questioned, even in cases where they are unwilling to respond to a questionnaire. This should also be rectified.

Guideline 3: Extent of information to be collected from clients (proportionality)

Q3: Do you agree with the suggested approach on the extent of information to be collected from clients? Please also state the reasons for your answer.

We do not agree that the risks associated with more complex or risky products will require more in-depth information from the client. This is particularly evident in ESMA's explanations to Guideline 3 (i.e. para. 26 on page 10), which states that complexity must be seen "as a relative term". We are vehemently opposed to this statement, as MiFID II Article 25(4) clearly defines which financial products should be considered as either complex and non-complex products. The concept of "gradients" of complexity, as currently suggested by ESMA in its draft Guidelines, is not in line with the existing regulatory framework and should, therefore, be outright deleted.

We would also draw ESMA's attention to the dangers of considering complexity as relative. It will lead to each Member State and, potentially, each manufacturer and distributor defining complexity individually, making the distribution of financial instruments almost impossible. We, therefore, ask ESMA to delete all references to "relative" complexity from the final Guidelines.

Q4: Do you agree with the suggested approach regarding the appropriateness assessment relating to a service with specific features (paragraph 34 of the Guidelines)? In particular, do you agree with the examples provided (bundled services and short selling), or would you suggest including other examples? Please also state the reasons for your answer.

Yes, as long as there is sufficient proportionality in the requirements, including the documentation. For simple and "standardised" services such as pure execution-only services, the requirements, including the documentation, should be limited. Though the proposed Guideline does not intend to provide guidance on investment advice and portfolio management, it should perhaps be considered whether there will be spill-over effects on these services as well.

Guideline 4: Reliability of client information

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

We do not agree with ESMA's suggested approach, as paragraphs 38 and 39 of the draft Guidelines go beyond the reasonable steps mentioned in Guideline 4 (i.e. paragraph 36).

While we generally agree that the information provided by investors must be reliable and consistent, investment firms are not always in a position to control all the information they receive. This is particularly true for clients requiring only non-advised services. A very large percentage of this business happens only through digital means with no direct (i.e. personal) contact between investor and distributor.

Therefore, ESMA's final Guidelines must be brought in line with Article 55(3) of the Delegated Regulation, which states that "*an investment firm shall be entitled to rely on the information provided by its clients or potential clients unless it is aware or ought to be aware that the information is manifestly out of date, inaccurate or incomplete.*" Such necessary alignment should ensure a clearer separation between the requirements between the suitability and appropriateness assessments.

Guideline 5: Relying on up-to-date client information

Q6: Do you agree with the suggested approach on relying on up-to-date client information? Please also state the reasons for your answer.

We are concerned by the insinuation that a too-frequently updated client profile implies that the profile is updated to allow for the advice to extend to unsuitable investment products.

We also challenge ESMA's understanding in paragraphs 42 to 45 that would require investment firms proactively and periodically to reach out to clients to update the information or request confirmation of previously delivered information, even in the case of non-advised services. While this may be appropriate in some instances, such as the ongoing provision of advice, it is not suitable for execution services, which are dependent on the client engaging the firm and initiating trading services. Instead, it could be added to the explanation on the appropriateness test in Guideline 1 that is the duty of clients to provide correct, up-to-date and complete information as is necessary for the appropriateness assessment to address this issue.

Last but not least, we consider the requirement of two staff members being involved in a review too prescriptive and unproportionate. It should therefore be deleted.

Guideline 6: Client information for legal entities or groups

Q7: Do you agree with the suggested approach on client information for legal entities or groups? Please also state the reasons for your answer.

No comment.

Guideline 7: Arrangements necessary to understand investment products

Q8: Do you agree with the suggested approach on the arrangements necessary to understand investment products? Please also state the reasons for your answer.

No, we do not agree with the suggested approach and advise deleting Guideline 7.

First, whilst ESMA indicates that product governance requirements should be distinguished from the appropriateness test, this Guideline does seem to introduce product governance aspects into the test.

Second, the Guideline suggests a more granular approach concerning complex products, suggesting that, for the appropriateness test, a subset of various types of complex products may emerge. In line with our response to Q3, we believe that this goes against the Level 1 and 2 frameworks.

Last but not least, we fundamentally oppose ESMA's proposal that for more complex investment products, firms may not rely only on the information from external data providers but should check and challenge such data where possible or compare data provided by multiple sources. This would increase the burden, but also cause inconsistency in labelling products into complex and non-complex.

Guideline 8: Arrangements necessary to assess the appropriateness of an investment or else issue a meaningful warning

Q9: Do you agree with the suggested approach on the arrangements necessary to assess the appropriateness of an investment or else issue a meaningful warning? Please also state the reasons for your answer.

Yes, we generally agree with ESMA's approach. However, we note that the proposed Guideline 8 is too prescriptive and would make sense only when the appropriateness test is carried out through automated toolsets. We also have questions about what a meaningful warning should look like, particularly in an automated setting, and how this is in line with the MiFID II Article 25(3) which allows for warnings in a standardised format for the appropriateness test.

Also, paragraph 63 of the proposed Guideline 8 seems to disregard the fact that there are many "boutique" style firms, whose human and other resources are rather limited for such an overly complex approach.

In line with our response to Q2, we believe that the proposed Guideline 8 should also avoid mentioning "policies and procedures", which implies that firms are expected to draft internal regulations rather than

focus on practical implementation. The need for documentation is already adequately mentioned in paragraph 60.

Q10: Do you agree with the suggested approach on the effectiveness of warnings? Please also state the reasons for your answer.

Yes, we generally agree with ESMA's approach but have some comments.

First, ESMA suggests that supervisory experience shows that some firms provide clients (without the necessary knowledge and experience) educational tools, webinars or 'demo' trading platforms to enable them to improve their knowledge. Does ESMA suggest that such tools are not suitable for a client to improve or gain knowledge?

Second, ESMA suggests that firms should identify ex-ante whether there are any conditions and criteria under which a client would not be allowed to proceed with a transaction after having received a warning, and evaluate ex-post the overall effectiveness of warnings issued and make adjustments where necessary (in particular paras. 70 and 71 of draft Guideline 9 and para. 77, fourth bullet point of draft Guideline 11). We do not see how this would work in practice or which conditions and criteria ESMA is referring to. Also, and in line with our response to Q2, we also question how such a restriction is in line with Article 25(3) of MiFID and Article 56(2) of the MiFID II Delegated Regulation allowing clients to proceed with their transactions after having received a warning. The proposed ESMA Guideline would contradict the Level 1 and 2 frameworks.

Along the same lines, paragraph 71 states that an ex-post evaluation should be made. We do not agree with this approach, because we consider that firms should not have this responsibility in non-advised services. If the warning given by the entity is clear enough, the entity's liability should not go beyond that. We consider that firms should not be required to adapt their policies and procedures to an ex-post analysis. We, therefore, would suggest these conditions be deleted outright.

Last but not least, we urge ESMA to also check the requirements under Art. 22 of GDPR, which restrict the recourse to automated decision-making.

Guideline 10: Qualifications of firm staff

Q11: Do you agree with the suggested approach on the qualifications of firm staff? Please also state the reasons for your answer.

No comments.

Guideline 11: Record-keeping

Q12: Do you agree with the suggested approach on record-keeping? Please also state the reasons for your answer.

Yes, we generally agree with ESMA's approach, provided there is a limited duration of such record-keeping. We would consider three years as sufficient unless stipulated otherwise in national law.

Q13: Do you see any specific difficulties attached to the requirement to keep records of any warnings issued and any corresponding transactions made by clients?

Yes, we generally agree with ESMA's approach.

Guideline 12: Determining situations where the appropriateness assessment is required

Q14: Do you agree with the suggested approach on determining situations where the appropriateness assessment is needed? Please also state the reasons for your answer.

While we generally agree with ESMA's approach, we foresee substantial challenges in implementing the requirement regarding the order traceability as being made on the back of a personalised communication when a client registers an order through an online self-service tool (paragraph 86 of the proposed Guidelines). There is a need for technology-neutral rules that work for self-service tools and platforms. In our view, such online trading should always be considered as provided at a client's own initiative, since there are no possible connections between the self-service tool and what may have happened before the client logs on to use the tool. This should be reflected in paragraph 86.

That being said, we would like to use this opportunity to stress that EFAMA does not agree with ESMA's Q&As that only non-structured UCITS can be considered non-complex. Several EU Member States have (in many cases, for a long time) permitted certain types of retail AIFs, which are subject to management and product rules akin to UCITS rules, to be marketed to retail investors in that state. These types of funds should also have access to the test in Article 57 of the MiFID II Delegated Regulation, thus allowing these funds to be sold through execution-only channels. To prevent such products from being able to be considered against the Article 57 test not only misunderstands the breadth of the AIF universe but also effectively nullifies a provision in Regulation. We would question the legal basis for this.

Guideline 13: Controls

Q15: Do you agree with the suggested approach on controls? Please also state the reasons for your answer.

Yes, we generally agree with ESMA's approach.

ESMA highlights that firms should evaluate the overall effectiveness of the warnings issued to clients and should take account of this analysis and all other relevant information when conducting a regular review of the target market and distribution strategy of the relevant investment products. We ask ESMA to provide a concrete example of how this could be taken into account.

With this in mind, paragraph 90 of the proposed Guideline 13 seems to imply that firms should produce minutes from face-to-face meetings, which is not supported by the Level 1 and 2 frameworks. The final Guidelines should be adopted accordingly.

Sustainable finance

Q16: When providing non-advised services, should a firm also assess the client's knowledge and experience with respect to the envisaged investment product's sustainability factors and risks? If so, how should such sustainability factors and risks be taken into account in the appropriateness assessment? Please also state the reasons for your answer.

Knowledge and experience regarding sustainability factors and risks should not be a separate element or requirement for firms to assess. It seems methodically incorrect to consider experience and knowledge of sustainability factors as it is a matter of attitude/preferences (and appropriate disclosures) rather than appropriateness.

The inclusion of a specific product's characteristics into the appropriateness assessment is already required by MiFID II Art. 25(3) and would be covered by the proposed Guidelines 7 and 8. If a product's characteristics include specific sustainability factors and risks, these should be covered by the aforementioned rule and proposed guidelines, just as any other specific features and risks related to a specific product (e.g. liquidity, volatility, specific exposures, exit possibilities etc.). Sustainability factors and risks are just two additional components to already existing factors and risks that a financial instrument can have. It is important to clearly state that sustainability risks are not separate type of risks. If sustainability is singled out as a separate characteristic, it would risk diminishing other factors and risks from the appropriateness assessment.

Last but not least, sustainable finance concepts are in the process of being further developed within the various pieces of legislation of the EU Sustainable Finance Plan, thus further underlining that sustainability factors should not be included in the appropriateness assessment until this process is finalised.

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About EFAMA

EFAMA, the voice of the European investment management industry, represents 28 Member Associations, 58 Corporate Members and 24 Associate Members. At end Q3 2020, total net assets of European investment funds reached EUR 17.6 trillion. These assets were managed by more than 34,200 UCITS (Undertakings for Collective Investments in Transferable Securities) and almost 29,400 AIFs (Alternative Investment Funds). At the end of Q2 2020, assets managed by European asset managers as investment funds and discretionary mandates amounted to an estimated EUR 24.9 trillion.

More information is available at www.efama.org.

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