

FECIF's Response to ESMA Consultation on Guidelines on certain aspects of the MiFID II appropriateness and execution-only requirements.

29 April 2021

Question 1. 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.

Knowledge about the appropriateness assessment must be considered a precondition for contracting. It should be part of financial education, so that when clients are being assessed they know that it is a legal requirement, that it is standardised, and that it is in their own interests. Clear and concise educational tools on the importance of providing the information should be considered.

Question 2. Do you agree with the suggested approach on the arrangements necessary to understand or warn clients? Please also state the reasons for your answer.

The guidelines should express better practices and not presuppose bad practices on the part of firms. Emphasis must be placed on prudence and regulatory compliance.

The principles of assessment on this point should also be common to automated offerings and other types of offerings such as face-to-face or via telephone. It would be appropriate to start from online or automated offers as a typical assumption and then generalise its solutions to face-to-face or telephone offers.

The cognitive biases of customers must always be considered. To appreciate them, it is necessary that the staff offering the product and those involved in the design of the algorithms are trained in behavioural finance. ESMA guidelines on knowledge and competence should be extended in this respect.

The client assessment is not a process of discussion with the client. It should be a standardized, clear, and simple process. We propose to replace the concept "discussions with the client" with "dialogue with the client".

Question 3. 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

Freedom of trade must be preserved within the framework of product governance and the client must be guaranteed secure access to the product offerings in the target market.

The references to "complexity as a relative term" (e.g., pp. 10, 34) should be clarified. It must be assumed that complexity is a legal concept, and its determination is based on product governance.

What is relevant is the application of the principle of proportionality, which determines the content and scope of the appropriateness assessment. The level of complexity of investment products does not depend on the characteristics of clients.

Question 4. 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.

The continuous references to conflicts of interest resulting from self-placement or other types of strategies such as short positions or those where the firm receives incentives, correspond to the regulation and prevention of conflicts of interest. Therefore, including them in the guidelines is confusing. Specific guidelines for managing conflicts of interest should be developed.

The appropriateness assessment should be a clear and standardised process based on the legal concepts of complex and non-complex instruments, provision of investment advice and execution-only.

Question 5. Do you agree with the suggested approach on the reliability of client information? Please also state the reasons for your answer.

The assessment obligation is functional. It is an obligation of means with a commitment to best efforts to meet the objective and offer convenient products. In that sense, it is unfortunate to refer to the need to ensure that the assessment process produces "satisfactory results" (Guidelines 4 and 8). It is a preventive mechanism that firms must comply with but does not ensure a satisfactory result. It is not an obligation of result.

Question 6. Do you agree with the suggested approach on relying on up-to-date client information? Please also state the reasons for your answer.

The effectiveness of updating procedures depend to a large extent on the training of employees, both those who offer the products and those who design and update the algorithms. It should be recommended that firms offer educational tools alongside the assessment process. Clients who make use of such tools should be re-assessed with an update of their profile. Financial education plans should provide for the development of these tools, facilitating the work of firms. These tools should also include not only training on product risk, but also on the services provided and how they are provided. Before clients are informed on whether the relationship is advised or not, they should have the minimum training to distinguish what is an advised service from what is not. Before contracting a product online or in an automated manner, they should be aware of the risks of automation and whether they have access to a person to inform them. All these educational tools need to include training on automated services.

Question 7: Do you agree with the suggested approach on client information for legal entities or groups? Please also state the reasons for your answer.

Determining who is to be assessed is a key issue. The appropriateness assessment should be made to the client or, where appropriate, to the representative. Representation may be legal, contractual or by conclusive facts. Uncertainty on this issue creates a legal risk.

Question 8: Do you agree with the suggested approach on the arrangements necessary to understand investment products? Please also state the reasons for your answer.

Throughout the assessment process, product governance needs to be coordinated with the appropriateness assessment. With this proper coordination, many of the problems raised by the guidelines may be solved. Whether the service should be advised or not, whether the product is complex or non-complex, and the granularity of the risk analysis, are all issues relevant to the assessment that are determined by product governance. For this coordination to be effective, it is necessary that the staff who assess, as well as those who design the assessment algorithms and those who participate in updating the assessment and design processes, are adequately trained. They should be aware of the importance of product governance and the dependency between the offer of financial products, the appropriateness assessment and the result of product governance.

Question 9: 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.

Updating algorithm questionnaires and detecting errors requires adequate technical and human resources. Training of the employees involved in these tasks is essential. A lack of understanding of these proceedings might make it difficult for proper updating and effective error detection.

Question 10: Do you agree with the suggested approach on the effectiveness of warnings? Please also state the reasons for your answer.

Warnings of non-appropriateness or non-assessment due to the lack of providing information should have a standardised content to be clear and not misleading. ESMA should consider drafting a standard notice that could be used by institutions without further explanation. Such warnings should be accompanied by information on the educational tools available. After receiving these warnings, clients can take the initiative to contract the product and firms can provide the service in compliance with the relevant rules of conduct.

Question 11: Do you agree with the suggested approach on the qualifications of firm staff? Please also state the reasons for your answer.

ESMA should complete its guidelines on knowledge and competence with the importance of certified training on the necessary coordination between product governance and the assessment process, on the design of questionnaires and algorithms and on the risks of automated services.

Question 12: Do you agree with the suggested approach on record-keeping? Please also state the reasons for your answer.

Effective record-keeping requires an adequate training of employees on the relevant information that must be recorded and on the diversity of recording systems according to the form of selling (online, telephone, face-to-face).

The COVID-19 experience shows that simplified controls and recording of telephone and automated transactions are possible.

MiFID II requires firms to keep records of transactions.

MiFID II creates high demands on record-keeping, both on the breadth of content to be recorded and its accessibility for inquiry by clients and regulators.

In general MiFID II record-keeping obligations can be categorised into three data types: orders and transactions, telephone and electronic communications, general records on the client.

This obligation involves several issues in its execution, apart from ensuring the training of the personnel responsible for the execution of this obligation, the firms must ensure the archiving systems security. In fact, records must be stored in a durable medium and must not be altered. Records must be kept for a minimum of 5 years, and MiFID II demands strict oversight over the management and operations of record-keeping.

It also demands the periodic monitoring of the record-keeping programme and its content, which can further complicate matters. The content must be recorded so all steps in a transaction can be reconstructed. Lastly, it requires content to be readily accessible. The primary goal of management and operations teams in MiFID II record keeping planning is to ensure compliance with the above topics, and eliminate all negative effects.

Thus, the management should have effective oversight and control over policies and procedures. One of the negative effects is the inability to effectively define roles and responsibilities which may compromise oversight, the assignment of management responsibility and the distribution of responsibilities, as the firm evolves.

The record must be monitored periodically, firms need to set up procedures to ensure compliance with the GDPR, increased procedures to track data lineage and content types of reconstitution of a financial transaction for research and monitoring.

Question 13: Do you see any specific difficulties attached to the requirement to keep records of any warnings issued and any corresponding transactions made by clients?

The determination of the appropriateness assessment or the possibility of execution-only are assumptions determined in MiFID regulation. To be effective, staff must be familiar with these concepts. Training programs should include the analysis of these precepts and their practical application, particularly in the operations carried by the firm.

Technical difficulties exist and show a lack of adequate resources for the record keepers. Hence, it is necessary to remember that MiFID regulation should not underestimate the difficulty of keeping track of new technologies designed for financial transactions. Crypto-assets operations have given proper illustration of difficulties linked to digitalisation. The national authorities are still studying the pros and cons of interfering in these types of markets. They are facing both the need for supervision and the goal of facilitating the clients' interests in growth in such market. However, their focus on both goals is unbalanced. Practically, it is a bit too early to consider the feasibility to fulfil that requirement of keeping records. Technical difficulties may occur within several phases of the operation: Firstly, it may occur during the storage of crypto-assets. Secondly, some technical issues are related to exchanges' organisations and trading platforms maintenance. While it is clear that participants don't have equal duties when it comes to GDPR, in some cases platforms tend to keep control of the transaction from the start to the end in order

to be more efficient in the risk management and to cover the costs of large volumes of operations. The requirement of keeping records may introduce some interferences within firms and platforms' risk management systems that could shift the fluidity of the operations away.

Also, firms carrying these types of investments will face difficulties due to the rising number of intermediaries. Record duties of that kind will probably create the need to allow external platforms to undertake the role of recording. Creating more responsibilities for disparate intermediaries might blur the sight of keeping track of the transactions in a fluent way.

Moreover, requirements of keeping records will introduce further reliability and safety requirements. The risks of hacks and digitalisation issues creates another burden that will be added to those in charge of keeping records. It will surely reveal lack of resources for such responsibility.

Platform operators will also have to consider technical difficulties that might occur in matching the trading rules to the records requirements.

Question 14: Do you agree with the suggested approach on determining situations where the appropriateness assessment is needed? Please also state the reasons for your answer.

See answer to question 13.

Question 15: Do you agree with the suggested approach on controls? Please also state the reasons for your answer.

The control of automated systems with artificial intelligence is determined by the design of the algorithm. Therefore, for an effective control of these systems it is necessary to review the initial design and for staff to be aware of its implications.

Question 16: 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.

A Guideline 14 should be included regarding the need to assess clients' knowledge and experience on sustainable products in relation to their risks. This is a key issue, relevant to avoid greenwashing, to ensure the appropriateness of green products according to the client's profile, and to the effectiveness of sustainable finance schemes.