Svensk Värdepappersmarknad
Swedish Securities Markets Association

Stockholm, 29 April 2021

RE. ESMA'S CONSULTATION ON GUIDELINES ON CERTAIN ASPECTS OF THE MIFID II APPROPRIATENESS AND EXECUTION-ONLY REQUIREMENTS

The Swedish Securities Market Association (SSMA) welcomes the opportunity to respond to ESMA's consultation on guidelines on appropriateness and execution-only under MiFID II.

Before responding to the specific questions, we would like to make the following general comments.

1. GENERAL COMMENTS

SSMA generally supports ESMA's initiative to issue guidelines with an aim to achieve supervisory convergence in relation to MiFID II rules on appropriateness and execution-only (Guidelines).

We note that when drafting the guidelines, ESMA has used the existing guidelines on suitability as a starting point. In some cases, this approach works well but in other cases it results in references and examples which are not well-suited for the appropriateness test or execution-only services. In our view it is particularly important to ensure that the Guidelines are technologically neutral and to avoid the creation of new administrative and complex processes for online services since this could have unintended negative consequences for clients and also go against the policy objectives of the Capital Market Union and Digital Action Plan. In its forthcoming work, ESMA should make a thorough review of the Guidelines in order to ensure that they are fit for purpose considering the type of investment services at hand. We would also like to underline that it is clear from level 1 and 2 that a client that has failed an appropriateness test and received a warning is still able to proceed with the transaction. The SSMA notes that in the Guidelines, there are several proposals which has the objective of restricting this right – in particular for complex products and self-placement services. Although one can have sympathy for the fact that regulators find it important with a high level of investor protection for complex products and to avoid conflicts of interest, we question the approach of using level 3 as an indirect way to make amendments to level 1 and 2. The co-legislators have decided on a different framework for execution services compared to advisory services and this must be respected in level 3 work.

The SSMA also proposes that references to a client as “he” should be replaced by a more gender neutral wording.

2. SPECIFIC COMMENTS

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.

No, the SSMA does not agree with the suggested approach and would like to express the following views on Guideline 1, including supporting text.

It should explicitly follow from the supporting text to Guideline 1 that investment firms are able to provide information on the appropriateness test in a standardized format, such as in the terms & conditions. There is no reason why the guidelines on appropriateness should be different than the guidelines on suitability in this respect.

Trading in financial instruments normally takes place online or over the phone. A clarification in the supporting text to Guideline 1 that “in good time” should be interpreted in a proportionate manner taking the type of investment service into account would be welcome.

As mentioned under General Comments, it is very important to take the online trading environment into account as regards the provision of information to clients regarding appropriateness test. However, we are uncertain if the use “pop-up” boxes to provide clients with information is workable in practice, considering other requirements such as the record keeping obligation in paragraph 15 of Guideline 1 and the requirements in MiFID II on durable media. ESMA’s clarifications on this point would be welcome in the final report.

According to the last bullet of paragraph 14, an investment firm shall provide clients with a summary of the differences between the requirements applicable to “advised” and “non-advice services” to avoid any confusion between “these investment services”. The SSMA notes that there is no definition in MiFID II regarding what constitutes “advised” and “non advised” services and that each of these two categories actually includes several types of investment services. We assume that ESMA’s intention is not that the client shall receive a comparison between the requirements in MiFID II applicable to the investment services per se but rather to ensure that the client understands the differences between suitability and appropriateness assessments. The SSMA proposes that the text is re-phrased so that it becomes more clear which information that the firm is expected to provide to the 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.

No, the SSMA does not agree with the suggested approach and would like to express the following views on Guideline 2, including supporting text.

First of all, it is clear from article 56.2 MiFID II delegated act that clients may proceed with transactions after having failed an appropriateness test, provided that they have received a

warning. In our view, level 3 guidance should therefore not require firms to implement arrangements such as “cooling off period” or “limiting the number of attempts” considering that this would in fact restrict the rights which clients have in accordance with level 1 and 2. Moreover, we are concerned with the practical consequences of this guideline and fear that it will open up for implementation of a very wide range of different approaches and arbitrary situations between investment firms; one firm implementing a cooling off period of a couple of hours vs. another firm implementing 1 day vs. a third firm implementing 2 days etc. The same goes for a limitation to the number of attempts. In addition, what should happen after the client has maxed out the number of attempts? Should firms then block clients from trading even if there is no legal requirement to do so, or simply warn the client and then let the client push through with the trade? Based on these considerations, the SSMA considers that paragraph 23 should be deleted. There are other and better ways to ensure a high level of investor protection than the use of cooling off periods or limiting the number of attempts.

Depending on the structure of a questionnaire, it is more or less relevant for a client to indicate whether he/she does not know how to answer a particular question. We therefore propose that paragraph 22 last bullet is re-phrased, for instance by including ”where relevant” (or similar)

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.

Yes, the SSMA generally agrees with the suggested approach in Guideline 3 regarding the extent of the information to be collected from clients.

However, according to article 54.3 MiFID II delegated regulation, an investment firm can assume that a professional client has the relevant knowledge and experience, it makes little sense to include in the Guideline 3 that the extent of information may vary depending on client category, i.e. since no information needs to be collected from professional clients.

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, the SSMA generally agrees with the two examples in Guideline 3 with regard to services with specific features. We do not have other examples.

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

Yes, the SSMA generally agrees with the suggested approach in Guideline 4 on the reliability of 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.

No, the SSMA does not agree with the suggested approach and would like to express the following views on Guideline 5, including supporting text.

The SSMA questions the reference to “vulnerable clients” in paragraph 41, including the example of older clients in footnote 14. MiFID II requires firms to take the client classification into retail and professional clients into account. There are no legal requirements to segment clients into “more vulnerable” and “less vulnerable”. The reference to older clients could in our view even be considered as discriminatory. Moreover, from a practical perspective, it is not possible for investment firms when executing a transaction initiated by the client following an appropriateness test to know if a client is “vulnerable” or not. Based on these considerations, SSMA considers that the sentence “particular attention should be given to the update of information for more vulnerable clients” should be deleted from Guideline 5.

Paragraphs 42 to 45 of Guideline 5 impose proactive requirements on investment firms to periodically reach out to clients in order to update information or request confirmation of previously delivered information. While such requirements make sense for advisory services provided on an ongoing basis they are not suitable for execution services where the client initiates the trading. An investment firm assesses appropriateness for a specific trading situation and not on a periodic basis and therefore cannot know in advance when to contact a client because of potential changes regarding knowledge and experience. The trigger for an update of a clients’ knowledge and experience must therefore be that a client engages the firm in order to execute a trade in which case firms should include in its process that the client has the ability to update information and/or that the firm should be in a position to update a previously made assessment of appropriateness where the clients wants to trade new financial instruments for which it has not previously been subject to a test. Guideline 5 should be amended accordingly.

In addition, and specifically regarding paragraph 45, we do not at all understand ESMA’s reasoning in regard to the risk of clients updating their knowledge and experience “too frequently”. It has to be kept in mind that firms do not dictate how often a client wants to trade different types of instruments and the firm’s responsibility is to assess the client’s knowledge and experience in relation to the instrument type which is relevant for the trade at hand. If a client has gained knowledge of certain instruments at different times during a three months period and therefore engages the bank 10 times to perform transactions, it would be necessary to “update” the knowledge and experience assessment whenever the client would engage with an instrument type for which the client has not yet passed an assessment test. To then require that two staff members should be involved in making the assessment or controlling the assessment is highly questionable. Firstly, every single staff member involved in a knowledge and experience assessment should have the sufficient knowledge and competence to make the call himself/herself. Secondly, having two staff members involved would put an unproportionate burden on the client who very well may want to execute a transaction which is time-sensitive.

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, the SSMA does not agree with the suggested approach and would like to express the following views on Guideline 6, including supporting text.

The SSMA notes that the approach on client information for legal entities and groups has been copied from the existing ESMA guidelines on suitability. This approach does not take the specificities of execution services into account and creates unfortunate complexity to well-functioning arrangements and processes that are currently used by investment firms.

In an online trading tool, company representatives have to be coded into the client's profile so that the IT-system/platform recognizes pre-defined representatives. When dealing with a company client the starting point is then that the designated company representative is set either through a power of attorney or based on the company's articles of association. This is done when setting the client up to start using online trading services.

For front line staff dealing with clients over phone the question about the handling of representatives should of course be covered by an internal conduct of business instruction, but it makes no sense to require a dedicated policy for how to conduct an appropriateness assessment for legal representatives.

As regards a group of clients, such as a stock savings club, the investment firm should assess appropriateness in relation to the person who is acting as a representative of the group when placing the order i.e. the person with the power of attorney. In a trade situation, investment firms do not know which of the clients that would be the least knowledgeable. In order to comply with the proposed Guideline, the investment firm would need to ask all the clients in the group to do an appropriateness test and then assess who is the least knowledgeable. This is not a proportionate requirement in the context of non-advised situations.

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, the SSMA does not agree with the suggested approach and would like to express the following views on Guideline 7, including supporting text.

The SSMA questions the value of these Guidelines relating to the understanding and classification of investment products since similar requirements already exists in the product governance rules in MiFID II. To include additional requirements in these Guidelines will not add any value from an investor protection perspective but contribute to making MiFID-framework both overlapping and complex.

As regards complex products or products with special features, ESMA proposes that firms should not rely on only one data provider and should compare data by multiple sources of information (paragraph 54). We find this requirement to be unproportionate since it will lead to significant increases in costs and administrative burdens. Moreover, there will be several cases where a requirement of several data providers is not relevant such as for investment products manufactured by the investment firm itself or where there only exists one data

provider for a particular product. We therefore propose that the example in paragraph 54 is deleted or re-phrased in a more general manner.

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.

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

No, the SSMA does not agree with the suggested approach and would like to express the following views on Guideline 9, including supporting text.

The Guidelines clearly have as an ambition to make it more difficult for clients to enter into transactions after having received a warning that a product or service is not appropriate. The SSMA questions this approach since it is clear from level 1 that a client has a right to proceed with such transactions - regardless if the product is complex or if the firm is selling its own products. Changes to this principle, if any, should be decided by co-legislators on level 1 and not be introduced through the back-door on level 3. We are also concerned that there could be a lot of unintended consequences for EU capital markets if such limitations to the provision of execution services were introduced. Paragraph 71 should be deleted.

According to paragraph 67 and 68, investment firms should not "encourage" clients to proceed with transactions after having received a warning. The SSMA is concerned about the practical implications of this statement. Under MiFID II, firms have legal obligations to provide information about the appropriateness test to clients which includes information as regards warnings and consequences thereof as well as the rights which the clients have after the firm has concluded its appropriateness assessment. It would be very counterproductive if such information were to be considered as an "encouragement". For the sake of legal certainty, the SSMA proposes that ESMA confirms in the supplementing text of Guideline 9 or in the final report that this is not the intention.

The SSMA would like to stress that it is very important that clients can improve their level of knowledge of a particular product. If not, clients would never be able to enter the market. In our view financial education should be encouraged by EU regulators and it should therefore not be considered as a circumvention of the rules if firms educate their clients e.g. through webinars and afterwards allow them to re-take an appropriateness test (paragraph 69).

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

Yes.

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

No, the SSMA takes the view that record-keeping is sufficiently regulated on level 2.

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?

See response to Q12.

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.

No, the SSMA does not agree with the suggested approach and would like to express the following views on Guideline 12, including supporting text.

As mentioned under General Comments it is important that ESMA drafts technology neutral rules that takes the specificities of execution services into account. In our view, Guideline 12 should be reviewed with this in mind. In particular it should be noted that execution-only services are normally provided in an online environment such as self-service tools and platforms where the client log-on and trade without any personal contact with the firms' staff. In our view, such online trading should always be considered as provided at a clients own initiative. This should be reflected in paragraph 86.

As regards paragraphs 82, 83 and 86, the SSMA would like to underline the following: In situations where a non-advised transaction is made through a direct personalized communication with an employee of the firm (so called hand-held situations) firms should have internal instructions for employees to be able to distinguish between transactions falling within the execution-only exemption and other non-advised transactions. However, it is a completely different case for self-service tools and platforms where clients log on themselves to initiate orders and execute transactions. That a client logs on to a self-service channel to execute a transaction could be based on either one of the three situations happening prior to that the client initiates the order:

1. The client has made its own assessment of equity A and logs on to the firm's self-service channel and initiates a trade;
2. The client has had a chat with an equity broker at the firm where they talked about the equity market in general and equities A, B and C specifically. The client some time thereafter logs on to the firm's self-service channel to initiate a trade in equity A;
3. The client has received a personalized communication through an e-mail subscription whereby the firm communicates its house views on a certain equity model portfolio. The client some time thereafter logs on to the firm's self-service channel and initiates a trade in equity A which is covered by the communication.

The examples above could be further complicated by adding the scenario that the client logs on to the firm's self-service channel and initiates a trade in equity A as well as a trade in equity D, which is not covered by the communication in points 2 or 3 above.

It should almost be needless to say, but there are no possible connections between the type of communication in points 2 and 3 on the one hand and a firm's self-service channel on the other hand. How should the underlying logic of a self-service channel know whether a client that logs on to it has been in contact with e.g. a broker and/or has received a communication in written form via e-mail?

If ESMA's suggested paragraph 86 were to become the norm, it would in practice mean that firms can no longer make use of the execution-only regime in pure self-service channels. It would create a situation where firms would need to design and apply a general appropriateness test for all non-professional clients just in order for them to get access to and use a pure self-service channel. Given that the instruments in scope here are non-complex, this type of end result of the proposed Guidelines would go against the intention of the execution-only regime as stated in the MiFID II Directive. Furthermore, it would act contrary to providing clients with efficient access to financial instruments which have been deemed to not pose material risks from a client protection perspective.

As for hand-held situations the firm's internal instructions should define the boundaries of what can be handled as execution-only and what cannot. The employee having the conversation with the client will in the vast majority of cases be completely unaware of whether a client has received a previous communication. From this starting point the employee should be able to assume that the order is made on the client's initiative, unless the client informs the employee of the previous communication or the employee otherwise has knowledge about the previous communication.

A question that would also need to be addressed is for how long the firm should consider that previous communications would prevent the use of the execution-only regime and the impact it would have on the need for traceability. At what point in time can firms consider that the communication is no longer valid from the perspective of defining a transaction as in scope or out of scope from the execution-only regime?

Considering all these aspects, requiring firms to trace whether the order is made in response to a personalized communication would be unproportionate. It should be sufficient that quality assurance testing is made based on for example a review of how well employees adhere to the firm's internal instructions (with components like documentation of appropriateness assessments and taped calls). Furthermore, we would advocate for the following:

i. transactions initiated by clients through the use of pure self-service channels should always be seen to be made on the initiative of the clients;
ii. for client transactions that are made in hand-held situations firms should have internal instructions to define the boundaries between

situations that fall within the execution-only regime and situations that cannot be handled within the execution-only regime.

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

Yes.

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 n the appropriateness assessment? Please also state the reasons for your answer.

The SSMA notes that the inclusion of a specific product's characteristics into the appropriateness assessment is already required by Art. 25(3) in MiFID II and therefore in part d be covered by the proposed Guideline 7 and Guideline 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. If sustainability is singled out as a separate characteristic it would risk diminishing other factors and risks from the appropriateness assessment.

Moreover, although from a general perspective the SSMA supports several of the recent EU initiatives in the area of sustainability, we note that the time-table for many of the proposals is still uncertain and that there is lack of available data. The SSMA therefore supports a cautious approach and propose that ESMA refrains from proposing any rules in the Guidelines at this point in time.

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