

Response

ESMA Consultation Paper „Guidelines on certain aspects of the MiFID II suitability requirements“ (ESMA35-43-2998)

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Q1. Do you agree with the suggested approach on the information to clients about the purpose of the suitability assessment and its scope? Please also state the reasons for your answer.

From our point of view, it is self-evident that the investment firm will also explain the aspect of sustainability and the differences between the various products according to Article 2(7) lit. a), b) and c) MiFID II Delegated Regulation to the client.

In this respect, it is good that ESMA includes this aspect in the guidelines. It is also positive that the statement is general and that the investment firms have discretion as to how they implement this in practice. This leeway should also be left to them in the final guidelines.

Q2. Do you agree with the new supporting guideline in relation to the information to clients on the concept of sustainability preference or do you believe that the information requirement should be expanded further? Please also state the reasons for your answer.

In our view, the presentation in paragraph 16 is sufficiently clear and at the same time leaves the investment firms sufficient room for maneuver in implementation. The requirements should not be further specified.

Q3. 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 of the clients' sustainability preferences? Please also state the reasons for your answer. Are there other alternative approaches, beyond the one suggested in guideline 2, that you consider compliant with the MiFID II requirements and that ESMA should consider? Please provide examples and details.

The presentation in paragraph 25 is very helpful in our view, as ESMA clarifies the statutory scope of the sustainability preferences query.

With regard to the fourth bullet point, however, the wording is broader than the statutory requirement in Article 2(7) lit. c) MiFID II Delegated Regulation: There, the wording refers to qualitative or quantitative criteria, whereas the guidelines refer to qualitative and quantitative criteria. Here, the final guidelines should be adapted to the legal wording.

In general, it should be noted that the legal requirements are already very extensive and require a very thorough exploration of the client. Sustainability will play a very important role in the advisory discussions and the difficult topic will pose great challenges for clients and advisors. For this reason, it is important that the specifications in the guidelines are not extended further. In this respect, we take a critical view of the exemplary approach outlined in

paragraph 26. It is positive that the procedure is described as a possible approach and therefore optional. Nonetheless, the exploration presented goes well beyond the legal requirements and will hardly be feasible in practice. Therefore, the presentation should be reduced and reference should be made to certain points on the legally required contents in paragraph 25, e.g. by stating that ranks can also be queried for the minimum proportion or, that the criteria for financial instruments falling under aspect c) can be based on the individual indicators as well as on the superordinate categories of the SFDR RTS. These notes are very helpful in practice, as they deal with aspects that the legislator has still left open.

We consider the presentation in paragraph 27 to be correct with regard to portfolio management. In the case of portfolio advice (investment advice with regard to the portfolio), the investment firms do not have to relate the question to the entire portfolio, but can also ask the client - in contrast to portfolio management - about his sustainability preferences in every investment advice session. In view of the low range of sustainable products on offer at the outset, the regular query would have the advantage from the client's point of view that he/she can be offered more products in subsequent advices.

Furthermore, advisors can be more flexible which is important as investment advice with a portfolio approach concerns several products (with different risk profiles): When providing advice with regard to shares, there will probably be only PAI products (Article 2(7) lit. c)) but when providing advice with regard to bonds, advisors can stick to Green Bonds that constitute as taxonomy aligned products (Article 2(7) lit. a)), if a client is interested in these products. These examples show that it will be beneficial for clients if investment firms were allowed to also explore sustainability preferences in each advice session.

Therefore, we ask ESMA introduce a more flexible approach that also allows a recurring exploration when providing portfolio advice.

Q4. Do you believe that further guidance is needed to clarify how firms should assess clients' sustainability preferences?

No, in our view this is not necessary. Rather, the presentation in paragraph 26 should be shortened and more closely aligned with the legal requirements (see already above regarding Q3.).

Q5. Where clients have expressed preference for more than one of the three categories of products referred to in letters a), b) or c) of the definition of Article 2(7) of the MiFID II Delegated Regulation, do you think that the Guidelines should provide additional guidance about what is precisely expected from advisors when investigating and prioritizing these simultaneous / overlapping preferences?

No, we do not consider this to be necessary. If it is not possible to offer the client a product that meets all the desired categories, this must be documented and justified.

Q6. Do you agree with the proposed approach with regard to the assessment of ESG preferences in the case of portfolio approach? Are there alternative approaches that ESMA should consider? Please provide possible examples.

We consider the presentation in paragraph 27 to be correct with regard to portfolio management. In the case of portfolio advice (investment advice with regard to the portfolio), the investment firms do not have to relate the question to the entire portfolio, but can also ask the client - in contrast to portfolio management - about his sustainability preferences in every investment advice session. In view of the low range of sustainable products on offer at the outset, the regular query would have the advantage from the clients' point of view that he or she could be offered more products in subsequent advices, provided that a broader range of products is available. When providing advice with regard to shares, there will probably be only PAI products (Article 2(7) lit. c) but when providing advice with regard to bonds, advisors can stick to Green Bonds that constitute as taxonomy aligned products (Article 2(7) lit. a)), if a client is interested in these products. These examples show that it will be beneficial for clients if investment firms were allowed to also explore sustainability preferences in each advice session.

Recurrent exploration should also be enabled by making the guidelines more open with a view to portfolio advice.

Q7. Do you agree with the suggested approach on the topic of 'updating client information'? Please also state the reasons for your answer.

The proposed approach in paragraph 55 makes sense. Again, it is good that ESMA leaves investment firms some leeway as to how they implement the requirement to update sustainability preferences in practice.

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

It is self-evident that investment firms know and understand the sustainability factors of the products they sell in their advisory services. It is positive that ESMA has once again stated this in the guidelines. A cross-reference to the statements in guideline 7 should be included in the guidelines on product governance that are yet to be prepared in order to emphasize the close connection to the product governance requirements there as well.

We find both the general statement in paragraph 70 and the optional exemplary procedure presented in paragraph 71 good and helpful. We do not consider further specifications to be necessary in order to leave investment firms sufficient flexibility as to how they implement the requirement within the framework of existing processes.

Q9. Do you believe that further guidance is needed to clarify how firms should take into consideration the investment products' sustainability factors as part of their policies and procedures? Please also state the reason for your answer.

We find both the general statement in paragraph 70 and the optional exemplary procedure presented in paragraph 71 good and helpful. We do not consider further specifications to be necessary in order to leave the investment firms sufficient flexibility as to how they implement the requirement within the framework of existing processes.

Q10. Do you agree with the additional guidance provided regarding the arrangements necessary to ensure the suitability of an investment concerning the client's sustainability preferences? Please also state the reasons for your answer.

In the additions to Guideline 8, we are critical of some points that should be adjusted in the final guidelines:

a) No mandatory two-step process

In paragraph 79, the requirement is established to first query the conventional criteria of the suitability test and then to make a product preselection in order to then address the sustainability preferences. This is certainly a feasible approach in practice, but it should not be prescribed as mandatory. Investment firms should also be free to explore clients in detail (including their sustainability preferences) and then use this as a basis for product selection. This approach also does not contradict Recital 5 MiFID II Delegated Regulation. Both approaches will lead to the same result: Either the product fits all the criteria queried or it does not. The order of the query (first the general criteria and then the sustainability preferences or all together) is irrelevant.

The subordinate nature of the sustainability preferences can also be taken into account by allowing deviations from the sustainability preferences - as provided for in Article 54(10) MiFID II Delegated Regulation - (which must of course be documented and justified in the suitability report), while excluding this for other criteria (so that a conservative client cannot be recommended a high-risk product outside of portfolio advice). This approach also ensures that the aspect of sustainability is given a lower priority than the other criteria in the suitability test. The final guidelines should therefore be worded in such a way that they also allow for other approaches.

As investment firms have to introduce the measures to implement the new requirements into the existing advisory processes, we ask ESMA to introduce a more flexible approach in the final guidelines that allows firms to efficiently adapt the new requirements into the existing processes.

b) No mandatory modification of sustainability preferences

We are also critical of the approach in paragraph 80, according to which a deviation from the sustainability preferences should only be possible if the client has first modified them. In our view, this requirement goes beyond the requirements of Article 54(10) MiFID II Delegated Regulation:

- Article 54(10) subpara. 1 contains today's general rule, according to which a recommendation of an unsuitable product is inadmissible:

„When providing the investment service of investment advice or portfolio management, an investment firm shall not recommend or decide to trade where none of the services or instruments are suitable for the client.“

- Article 54(10) subpara. 2 and 3 contain new special rules for sustainability preferences: Subparagraph 2 allows investment firms to recommend a product that does not meet sustainability preferences if they disclose the deviation.

„An investment firm shall not recommend financial instruments or decide to trade such instruments as meeting a client's or potential client's sustainability preferences when those financial instruments do not do meet those preferences. The investment firm shall explain to the client or potential clients the reasons for not doing so and keep records of those reasons.“

The above wording is somewhat complicated, although the legislator has made it very clear in the first sentence of Recital (8) that the recommendation of a product that does not meet the sustainability preferences of the client is possible with a corresponding indication:

Recital 8 s. 1:

„It is necessary to clarify that financial instruments that are not eligible for individual sustainability preferences can still be recommended by investment firms, but not as meeting individual sustainability preferences.“

- Article 54(10) subpara. 3 provides for the further possibility that the advisor offers the client to change his sustainability preferences if he does not have a suitable product.

However, this possibility is on an equal footing with the above-mentioned provision in subparagraph 2:

„Where no financial instrument meets the sustainability preferences of the client or potential client, and the client decides to adapt his or her sustainability preferences, the investment firm shall keep records of the decision of the client, including the reasons for that decision.’;

- Recital 8 also states that the client must have the opportunity to change his sustainability preferences. That this change of preferences should be a prerequisite for the recommendation cannot be inferred from the legal requirements.

In our view, it is more honest if the case, which probably occurs frequently in practice, that certain sustainable product categories (especially taxonomy products according to lit. a)) are hardly available, is openly communicated to the client in the advisory process and documented in the suitability report. This allows the client an informed decision whether to purchase the product even if it does not meet his/her sustainability preferences. The procedure whereby the deviation from the sustainability preferences is clearly communicated and documented should also be explicitly enabled in the guidelines (as is also done in paragraph 84, which in our view contradicts the strict requirements in paragraph 80).

Against this background, we ask ESMA to align the final guidelines with the legal requirements and allow the possibility foreseen in Article 54(10) subpara. 2 MiFID II Delegated Regulation.

c) Notes in paragraphs 82, 83 and 84

We consider the guidance in paragraphs 82 on portfolio management, 83 on dealing with clients who do not have sustainability preferences, and 84 on deviations from sustainability preferences to be useful and helpful clarifications.

Q11. Do you agree with the approach outlined with regards to the situation where the firm can recommend a product that does not meet the client's preferences once the client has adapted such preferences? Do you believe that the guideline should be more detailed? Please also state the reasons for your answer.

As already noted above in the answer to Q10, we are very critical of the procedure in paragraph 80, according to which a deviation from the sustainability preferences should only be possible if the client has first modified them. In our view, this requirement goes beyond the requirements of Level I (see in detail in the previous question). In practice, the requirement

can lead to the client being forced into a certain product type, which does not correspond to his preferences.

From our point of view, it is more honest if the case that certain sustainable product categories (especially taxonomy products according to lit. a)) are hardly available, which probably occurs frequently in practice, is openly communicated to the client in the advisory process and documented in the suitability report. This procedure, in which the deviation from the sustainability preferences is clearly communicated and documented, should also be explicitly enabled in the guidelines.

Q12. Do you agree with the approach outlined with regards to the situation where the client makes use of the possibility to adapt the sustainability preferences? Please also state the reasons for your answer.

The additional information in paragraph 81 on how to proceed if a client changes his sustainability preferences seems understandable to us (despite the criticism of the requirement that a deviation from the sustainability preferences is only possible if the client changes them beforehand, see our response to the previous questions).

Q13. Could you share views on operational approaches a firm could use when it does not have any financial instruments included in its product range that would meet the client's sustainability preferences (i.e. for the adaptation of client's preferences with respect to the suitability assessment in question/to the particular transaction and to inform the client of such situation in the suitability report)?

In this constellation, which in practice will occur primarily when advising on OTC derivatives, which can hardly be sustainable, the investment firm should ask the client whether he is interested in sustainable products. If the client answers in the affirmative, further detailed exploration of the product types or even the desired minimum proportions should be omitted. Further inquiry would be pure bureaucracy and should not be necessary.

The exploration requirement should thus only exist to the extent that the answer to the question has relevance for the product selection. It would therefore be a sensible compromise that investment firms must ask clients up to the point where it is clear that no suitable product of the desired specification is available (example: question about the product type if at least one of the three product types is available; but no question about the minimum proportions if no products according to Article 2(7) lit. a) or lit. b) MiFID II Delegated Regulation are available).

This would be in line with the Level 2 requirements since Article 54(5) foresees that the information on the preferences of client only need to be asked for if they are relevant. This allows not to ask for certain information that is not relevant in the current advice session.

Article 54(5) reads as follows:

'5. The information about the investment objectives of the client or potential client shall include, where relevant, information about the length of time for which the client wishes to hold the investment, his or her preferences regarding risk taking, his or her risk tolerance, the purpose of the investment and in addition his or her sustainability preferences.'

In addition, investment firms should be obliged to inform the client about the absence of sustainable products and to document the deviation from the sustainability preferences also in the suitability report. On this transparent basis, the client can decide whether he wants to purchase the recommended product despite the deviation from his sustainability preferences.

This procedure should at least be allowed for investment firms who ask their clients regularly on their ESG preferences (which is the case when providing regular investment advice or should be allowed when providing investment advice with a portfolio approach, please see our answer to Q3). If more or different sustainable products become available, the firm needs to address further questions in the next advice session that relate to the new products.

Q14. Do you agree with the proposed approach for firms to be adopted in the case where a client does not express sustainability preferences, or do you believe that the supporting guideline should be more prescriptive? Please also state the reasons for your answer.

We consider the presentation in paragraph 83 to be accurate and appropriate. The clarification is helpful in practice. In particular, it complies with the legal requirements that clients are only to be asked whether they have positive sustainability preferences and not whether they reject sustainable products.

Q15. Do you agree with the proposed approach with regard to the possibility for clients to adapt their sustainability preferences in the case of portfolio approach? Do you envisage any other feasible alternative approaches? Please provide some possible examples.

With regard to portfolio management, we also view it critically if the client is to be urged to change his sustainability preferences in order to be able to offer him a suitable investment strategy.

In our view, it should also be possible in the presentation of asset management in paragraph 82 for the deviation from the sustainability preferences to be communicated and documented accordingly, so that the client can make a conscious decision on this basis. This possibility is also provided for at Level I (Article 54(10) subpara. 2 and Recital 8, see in detail in our answer to Q10.).

Q16. What measures do you believe that firms should implement to monitor situations where there is a significant occurrence of clients adapting their sustainability preferences? What type of initiatives do you envisage could be undertaken to address any issues detected as a result of this monitoring activity?

In our view, investment firms should in particular not be required to pressure clients to change their sustainability preferences by also making it possible to make the deviation from the sustainability preferences transparent and to document it (see our answer to Q10. for more details).

If an investment firm makes use of this option, no further precautions are likely to be required, as it is the client who decides how to deal with the deviation from his ESG preferences.

Q17. Do you agree with the proposed amendment to supporting guideline 10? Please also state the reasons for your answer.

In our view, the new wording in paragraph 97 is appropriate. However, it should be added that the suitability report can also be provided retrospectively within the framework of the legal requirements.

Q18. Do you agree with the additional guidance regarding to the qualification of firms' staff or do you believe that further guidance on this aspect should be needed? Please also state the reasons for your answer.

The references to staff qualification in paragraph 104, which in future must of course also include the aspect of sustainability, appear appropriate.

Q19. Do you agree on the guidance provided on record keeping? Please also state the reasons for your answer.

The presentation in paragraph 109 on the recording requirements also seems understandable to us. In our view, however, the requirement that deviations from the client's sustainability preferences need also be documented should be added (as an alternative to the change in sustainability preferences mentioned in the third bullet point).

Q20. Do you agree on the alignment of the two sets of guidelines (where common provisions exist for the assessment of suitability and appropriateness)? Please also state the reasons for your answer.

We take a very critical view of this approach, as the three services of investment advice and portfolio management on the one hand and the advice-free self-decision-making business on the other are very different. On the one hand, the investment firm makes the investment decision for the client or recommends one to him, which requires a precise determination of the client's investment goals and a deep understanding of the products. In contrast, the self-decision maker acts on his own initiative and asks the investment firm to execute the desired order. For the execution of the order, which from the client's point of view should be fast and unbureaucratic, the investment firm does not necessarily have to know the desired financial instrument, as it does not carry out its own evaluation of the transaction. ESMA also recently pointed out the difference between the services in question in its letter of April 13, 2022 „Ref: Consultation on options to enhance the suitability and appropriateness assessments“ to the European Commission.

In our view, further harmonization of the two guidelines would blur the differences between the various services, which would not be appropriate. In this respect, the two guidelines should not be harmonized too much, even if they have intersections and thus partly address the same aspects.

Q21. Do you have any further comment or input on the draft guidelines?

On the one hand, we would like to point out once again that the legislator has already set out very far-reaching requirements with its three-stage query of sustainability preferences and the three product types, which will present clients and advisors with major challenges in practice. It is to be feared that many clients will already be overwhelmed by the query. Against this background, the statutory requirements should be specified by ESMA, but not extended. This approach is taken into account in many places in the guidelines, but adjustments should be made in some points (see the notes on the individual questions).

In addition, there is a large number of regulatory requirements relating to sustainability (ESG) that are being continuously developed. This requires that the investment firm be given sufficient leeway to be able to respond to this further developments. For this reason, mandatory requirements in the guidelines that go beyond the legal requirements should be avoided. This is also largely observed in the Consultation paper, but adjustments should be made at some points in the guidelines (see our notes on the individual questions).

For banks and savings banks, it is also very difficult that the guidelines will probably not be available before the legal requirements are applicable. This will lead to expensive adjustments for investment firms, which will have to be implemented downstream. In future, the legislator should ensure that the implementation period also takes into account the publication of guidelines and is correspondingly longer so that the IT systems only have to be adapted once. However, this is a demand that is primarily directed at the legislator. Nevertheless, we would welcome ESMA's support for this aspect.

Q22. Do you have any comment on the list of good and poor practices annexed to the guidelines?

From our point of view, some of the examples are very granular, so it seems doubtful to us that they can be implemented on a large scale. The following are some examples:

- Switching: In most cases, it will hardly be possible to specify the expected return on investment, since this cannot be predicted. A concrete figure would raise false expectations among clients. In this regard, we refer to the major problems with the PRIIPs KIDs, where it has not been possible to date to develop meaningful forward-looking performance scenarios, which is why a warning had to be included in the KIDs.
- Control functions /Monitoring: Since funds are generally diversified to offset the risks of individual investments, we do not consider the reference to diversification of risks in funds to be meaningful.

Since the examples given are results of CSAs practiced by individual market participants (but not by all, who have made other arrangements to implement the regulatory requirements), the examples should not be binding in any way. The non-binding nature of the examples should also be mentioned in the financial guidelines.

Q23. What level of resources (financial and other) would be required to implement and comply with the guidelines (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

As an association, we have no information on the costs of implementation. However, it is clear that the investment firms will have to make expensive IT adjustments to meet the new requirements.

The costs will also be increased by the fact that the investment firms will first have to implement the statutory requirements by August 2, 2022, and then any subsequent implementations resulting from the guidelines. In future legislation, care should be taken to ensure that the guidelines are in place prior to applicability (which requires longer implementation periods foreseen at Level 1 or 2) to avoid these additional costs.