.BVI

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BVI's response to the ESMA Consultation on Guidelines on certain aspects of the MiFID II suitability requirements (ESMA35-43-748)

Suitability assessments provide an important feature for investors. BVI[1] therefore welcomes the ESMA consultation on the suitability guidelines. With respect to many elements, we agree with the proposal. Nevertheless, we have the following general concerns:

- The guidelines only rarely distinguish between the requirements for professional investors and those for retail investors. Such distinction is very important since portfolio management as well as investment advice may in practice vary significantly. Portfolio management for instance, may be – inter alia – a standardised portfolio of investment funds for retail clients, the delegated management of a fund or a segregated account for an insurance company. While this is the same MiFID service, the specific circumstances are very different. The professional client almost always has a clear view of the strategy and investments the asset manager should carry out on his behalf. Consequently, the level of protection for professional investors should be different to that for retail investors. The distinction between retail and professional client is also enshrined in Art. 24 para. 8 MiFID II. Consequently, ESMA should apply this understanding also to the guidelines.
- The guidelines should distinguish more between investment advice or portfolio management. In practice both services might be comparable but they might also be very different. The distinction between the nature of the services is enshrined in Art. 24 para. 8 MiFID II, too. Consequently, ESMA should apply this understanding also to the guidelines.
- The level of investor protection should be the same, regardless of the means by which the service is rendered. In this regard, we do not share ESMA's approach towards robo-advice. No additional requirements should be imposed in case the advice is rendered through digital means. This reflects the approach of the European Parliament's Economic and Monetary Affairs Committee which "underlines that the same consumer protection requirements should apply to robo-advice as to face-to-face advice"[2].

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.

We generally agree with the suggested approach except for the additional set of rules for robo-advice. In this respect, we would like to caution ESMA against acting as proposed. Additional rules would significantly hinder the development of robo-advice tools to the detriment of the investors. While the market increasingly explores the potential of digital means, online questionnaires or direct banking are by no means new phenomena and have worked well in the past.

[1] BVI represents the interests of the German fund industry at national and international level. The association promotes sensible regulation of the fund business as well as fair competition vis-à-vis policy makers and regulators. Fund companies act as trustees in the sole interest of the investor and are subject to strict regulation. Funds match funding investors and the capital demands of companies and governments, thus fulfilling an important macro-economic function. BVI's over 100 members manage assets of nearly 3 trillion euros for private investors, insurance companies, pension and retirement schemes, banks, churches and foundations. BVI's ID number in the EU Transparency Register is 96816064173-47. For more information, please visit www.bvi.de/en.

[2] European Parliament resolution of 17 May 2017 on FinTech: the influence of technology on the future of the financial sector (2016/2243(INI)); para. 29

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Generally, errors can occur in both human and robo-advice. Consequently, the safeguards, requirements for suitability assessment in case of investment advice or portfolio management as well as the organisational arrangements should not differ. For instance, in a particular case:

- the information provided to the client might be insufficient both for information provided online and information provided face to face.
- a questionnaire generated online will have a risk of misunderstanding equally as the questionnaire which the advisor fills in personally.
- human advice might also involve some automation, e.g. for the selection of products through the advisor.

Consequently, we doubt that it is important for clients to be informed of the degree of human interaction. Neither in a digital nor in a face to face situation will they be in the position to clearly assess what the advice is based on. Exactly for this reason, MiFID imposes a set of responsibilities on the advisor. Furthermore, it is in the providers' own interest to provide support functions through telephone or chat. There is neither a specific need for regulatory rules nor can this be considered a part of the suitability requirements.

We believe that the development of automated advice is beneficial for clients for two different reasons. Firstly, the field of automated advice can provide investment solutions for groups of clients with lower investment volume. They gain access to individual models of asset and risk management, which otherwise were only available for clients with greater investment volume. Secondly, automated advice can be an alternative for clients who would be intimidated to consult a financial advisor because they fear the information asymmetry between the financial advisor and themselves. Offering products through digital means offers an easy way to convert cash savings into investments also for these types of consumers. In times of low interest rates, consumers who store their money in savings accounts essentially lose money. For some consumers robo-advice tools might be the way they would be willing to get experience with investing their money and to open up to further investment opportunities. These potential benefits should not be stifled by an additional set of rules for digital provision of the same investment service. The current proposal increases the complexity of client-facing questionnaires significantly which will result in confusion to clients. Hence, the supporting guidelines 20 et seq. should be deleted.

Moreover, ESMA should be aware that the more information the advisor is required to give the client, the less the client will be willing to take it on board and able to process. Already the information requirements according to MiFID II have increased substantively. We do not believe in the concept of the more, the better but would rather recommend ESMA to thoroughly analyse whether any additional information requirement is really for the benefit of the investor or will not be noticed in the amount of information to be provided.

Lastly, there should be a common understanding of what comprises advice in this respect. We agree that the process of gathering personal client information can subsequently lead to a personal recommendation and has some potential to convey the impression that the firm will provide a personal recommendation. The gathering of one or more personal facts itself, however, cannot constitute a personal recommendation. Therefore, sentence 2 of the supporting guideline 19 should be adjusted in a way that firms should avoid giving the impression that they will assess suitability if they in fact do not, e.g. by gathering personal information. Besides, the definition of advice as a personal recommendation according to MiFID II Level 1 provides for regulatory leeway, which could lead to an unlevel playing field throughout Europe. The gathering of one or more personal facts per se should not trigger the requirement to assess the suitability.

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.

We generally agree with the suggested approach taking into account behavioural finance for retail investors. Questions should be clear and not misleading and with as little technical language as possible. Furthermore, we agree that questions should only gather information on one item at a time. In order to be able to set up consistent processes, it is, however, necessary to provide a choice of answers. It is our understanding that it is not required to pose questions to which the client can answer in the form of free text. However, the guidelines do not reflect the situations where a firm gathers information from a professional client. In particular where the professional investor negotiates a mandate with the client with a clear vision of an investment strategy and the assets to be included, a different set of guidelines should also apply to the gathering of information.

We do not agree with the specific set of rules regarding robo-advice models (cf. answer to question 1). The supporting guideline 30 again shows that the additional value of such set of rules is very limited. For instance, it goes without saying that the firm has to analyse whether the information collected allows the conclusion that the product recommended is suitable for the client – regardless of whether the client accesses the questionnaire online or through a human advisor. The same applies for the requirement that the questions have to be sufficiently clear and that steps need to be taken in case of inconsistent replies. Furthermore, with respect to human interaction, it is in the firm’s own interest to provide tools where the clients can pose any questions. Therefore, we suggest deleting supporting guideline 30.

Moreover, we generally agree with the proposal that firms should base their assessment on information available to them (i.e. as a firm). However, we would like to point out that even within a firm sharing of information might be prohibited (e.g. due to data protection rules). Within these legal boundaries, such information sharing will generally be feasible within the same legal entity. Besides this, we see the following practical limitations on the assessment which in our view could be dealt with by applying the principle of proportionality:

- Often different legal entities are involved in the process. For instance, the firm safekeeping the financial instruments of the client might be different to the firm providing investment advice and this in turn might be different to the firm giving out a credit to the investor although all three entities may belong to the same group. Therefore, the information to be taken into account depends on the type of product the firm offers (e.g. only UCITS), the amount to be invested and the available means for the firm to gather information (e.g. retrieving these from the client and / or affiliates).
- In case of a smaller first time investment, consumers are generally reluctant to disclose the allocation of all of their assets. Therefore, the principle of proportionality should apply to these cases with the consequence that the consumer should be able to make certain smaller or more mainstream investments without disclosing every detail of his financial situation.
- Common robo-advice models often consist of a limited amount of (mostly ETF based) model portfolios in different risk classes. For these cases, we believe, the information gathering process can be less detailed than in cases where the firm renders advice on the clients’ portfolio as a whole.

Consequently, depending on the product and the amount to be invested, gathering information with respect to the client’s portfolio as a whole should not be necessary (e.g. for smaller investments in mass retail products).

Lastly, we appreciate the guidance given in supporting guideline 22, however, we doubt that these guidance should be part of a regulatory requirement. While with respect to content the suggestions are not generally incorrect, we believe ESMA should be more cautious in transforming user demands into regulatory principles.

Q3: Do you believe that further guidance is needed to clarify how firms should assess clients' ability to bear losses?

No further guidance is needed since the rules in Art. 54 of the delegated regulation, in the product governance guidelines as well as in the draft suitability guidelines provide sufficient clarity on how firms have to assess clients' ability to bear losses. However, situations where the client is professional should be reflected.

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.

First, the guidelines do not reflect the situation where the client is a professional investor. We believe that for these situations, the guidelines should allow the firm to generally rely on investors' information.

Second, while we appreciate that an advisor or portfolio manager should understand the clients' knowledge and comprehension of risks and natures of financial instruments, we doubt that the test ESMA indicates in the new supporting guideline 44 a) will be the appropriate measure. First, due to different market situations it is not feasible to provide scenarios which are correct or real. Second, a client who is seeking investment advice does not intend to pass a test but intends to benefit from the advisor's competence. Practical examples could be useful to show a client typical performance situations which ESMA already indicates in guideline 45. We therefore suggest deleting guideline 44.

Third, we again doubt that there is an increased risk of overestimation by clients in case of robo-advice. Clients can overestimate their knowledge and experience or risk tolerance in all situations. Therefore, we suggest deleting the second sentence of guideline 49.

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

We generally agree with the proposal. However, we again would like to caution ESMA against imposing too many formalised information requirements such as the new requirement to inform the client about an updated profile. If the client informs the firm about changes in his personal circumstances relevant for his profile, it is obvious that the firm will have to change the clients' profile accordingly.

Q6: Do you agree with the suggested approach to conduct the suitability assessment for a group of clients, especially where no legal representative is foreseen under applicable national laws? Please also state the reasons for your answer.

We generally agree with the guidelines 57 to 66. However, ESMA seems to introduce a requirement for an investment firm to inform clients ex ante about its policy according to guideline 56. Article 54(6) of the MiFID II Delegated Regulation requires an investment firm to establish and implement a policy and to record this policy, but there is no requirement to disclose such policy to clients. We agree with the

principle of providing relevant information, but the guidelines should not introduce an additional disclosure requirement not specified in the Delegated Regulation.

Furthermore, the wording in guideline 67 is unclear. We would agree with the approach if the advice will be given to a group of clients. Though, the wording implicates that the client is not a group of but rather individuals. In such situation, the suitability test should refer to the specific client.

Q7: Do you agree with the suggested approach on to the arrangements necessary to understand investment products for the purposes of suitability assessment? Please also state the reasons for your answer.

We generally agree with the proposal.

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.

The proposed guidelines in number 81 seem to contradict the portfolio approach according to the product governance guidelines. In particular with respect to portfolio management, the firm should not have to assess each investment product and risks involved against the knowledge and experience of the client. It is decisive that in case of portfolio management, the focus is on the manager's responsibility to ensure the suitability of the portfolio as a whole for the client. Furthermore, it is also in contradiction with para. 36(b) of the draft guidelines which – correctly – state that in case of portfolio management "the level of knowledge and experience needed by the client with regard to all the financial instruments that can potentially make up the portfolio may be less detailed than the level that the client should have when an investment advice service is to be provided." **Consequently, an approach requiring each and every product to be assessed against the client's knowledge and experience contradicts the idea of portfolio management and deprives investors of the benefits of diversification to the detriment of investors.** For the service of portfolio management, an investor delegates the decision on the purchase of the individual instrument to a professional. This is to entrust building up of a diversified portfolio to a professional with the intention to reduce unsystematic risk in a way the investor would not be able to do it himself. An approach as suggested by ESMA would not reflect the best interests of investors seeking a diversified portfolio of investments. In particular given the fact that for investment advice each and every instrument has to be suitable, portfolio management allows investors an access to diversified portfolio build up by a professional. A portfolio manager should be able to build a portfolio without being limited to offering investors only a limited range of low-risk investment options such as government bonds.

Furthermore, this is not the understanding which has been enshrined in the product governance guidelines 52 et seq. The final guidelines only require a reporting on the product level in case the client falls within the negative target market of a product (see product governance guideline 55). For all other cases, no reporting is required even in case the product does not match the knowledge and experience requirements of the client. The portfolio approach for the suitability test should be the same and reflect the understanding that the knowledge and experience and the risks involved should not be assessed on a product level but at the level of the portfolio against which the portfolio manager will assess each transaction.

Again, we oppose discrimination of the use of digital tools. While firms are required to ensure that their staff is properly trained and competent, clearly tools should be fit for purpose and produce appropriate

results. However, tools should not be required to provide for a higher level of suitability assessment as it is indicated in guideline 78. This should be deleted.

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

Yes, we generally agree with the approach for retail clients. In particular it is important that the equivalence test may also relate to financial instruments of a specific asset class if there is a valid reason to focus the investment on a specific asset class. We understand that this approach would be feasible due to the reference to the target market. Furthermore, we think it is important that for the benefit of the client other criteria can be considered besides cost and complexity.

However, ESMA should bear in mind that its understanding of complex products is not consistent. ESMA – as we understand for practicability reasons – considers all AIFs per se complex although individually they might have stricter fund rules than some UCITS and are for instance AIFs just because they are domiciled outside the EEA. The "complexity" of such products can be taken into account in a personal recommendation.

We doubt, however, that such approach would be of additional value to mandates or delegated fund management where a professional client has a clear understanding of an investment strategy and is very cost sensitive. ESMA should consider less strict requirements for professional investors.

Lastly, we struggle with the term "broadly equivalent" in guideline 88. It should be clear that the investment advisor should not be required to analyse each and every product the firm offers. Hence, we suggest deleting the term "broadly".

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 understand ESMA's approach with respect to individual portfolio management provided for typical retail clients. It is in particular important that safeguards prohibit switching of investments for the sake of generating revenue. We also appreciate the level of analysis which is required for common strategies according to guideline 96.

However, with respect to professional clients or other institutional clients such as pension schemes, it is important that the guidelines recognise the very common situation where the investor decides which strategy he wants the asset manager to apply. This is in particular the case for delegation of fund management and also for the majority of mandates. Often investors determine the asset classes, the investment limits and the overall strategy, which then are stipulated in the investment guidelines. The investor also gives instructions for specific investments. In such portfolio trades occur regularly and the documentation foreseen in guideline 93 and 94 would not only be very cumbersome but also of no benefit to the investor whose interest is the fulfilment of the investment strategy. **Asset managers should be able to agree with the professional and institutional client on an abstract cost-benefit analysis in advance.** In particular guideline 97 should not apply to these cases but should be limited to non-institutional investors. We urge ESMA to sufficiently distinct this situation from the provision of portfolio management services to a natural person being a retail client.

Generally, a proportionate approach regarding the term “switch” should be in the interest of the client. Two separate investment or advice decisions should not be regarded as a switch. The same applies for situations such as rebalancing to index weights. This would also be in line with the objective of this rule, i.e. to avoid a portfolio turnover for the sake of generating revenue while at the same time not depriving investors of the benefits of an application of the investment strategy.

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 do not think that further guidance is needed. ESMA’s guidelines on knowledge and competence already provided thorough guidance for personnel providing advice. Furthermore, we believe that the guidelines regarding competence of staff for automated tools are superfluous because of the general requirement to ensure compliance with the obligations under MiFID according to Art. 16 para. 2 MiFID.

Q12: Do you have any further comment or input on the draft guidelines?

It is very important that ESMA finds a balanced approach for portfolio management and also investment advice towards professional clients both for the practical case of delegated fund management as well as individual mandates or the cases in which the firm advises on funds’ investments (Advisory). Professional clients often have a very specific understanding of the investment strategy the asset manager should apply.

Regarding guidelines 37, 38 and 40, ESMA should bear in mind that automated advice tools have limited options to gather information in a tailored way. Furthermore, even in case of human advice, there are limits to individualise the process of information gathering because the firm must ensure that it provides advice in a consistent manner. Consequently, for mass retail products it should be clear that the information gathering process can be appropriately less detailed and less tailored.

Q13: What level of resources (financial and other) would be required to implement and comply with the Guidelines (market researches, 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.

While we do not have specific information on the level of resources required to implement adjust to the updated guidelines, with respect to the additional requirements which would be imposed on robo-advice models, we see the following cost-intense measures:

- For the implementation of the additional requirements suggested by ESMA, an extensive remodelling of existing websites and client onboarding process would be required. This involves design, user testing and refinement, legal interpretation and sign-off, development, construction of new interfaces.
- One BVI member suggested a sum of around 3,5 million Euro, provided a transition period of one year is granted.

Generally, ESMA should give sufficient time for implementation of new requirements since automatic processes have to be adapted. Such adaptations usually require around nine to twelve months.