.BVI

1 August 2014
Frankfurt am Main

ESMA Consultation Paper on MiFID II/MiFIR (ESMA/2014/549) – Investor Protection Issues

BVI[1] gladly takes the opportunity to comment on the Investor Protection Issues raised in the ESMA Consultation Paper concerning possible implementing measures to the MiFID II/MiFIR regime.

In general terms, we would like to express our gratitude to ESMA for involving the industry and other shareholders in the rule-making process by way of this public consultation. In this respect, we very much hope that the comments submitted to ESMA will be taken into true consideration in the revision of ESMA's proposals in order to arrive at reasonable and balanced regulatory solutions in line with the legislator's intentions. In particular, we urge ESMA to focus its recommendations on issues which have been discussed during the Level 1 legislation process and for which the MiFID reform has been designed as an appropriate regulatory response. The delegated acts due under MiFID II should not be (mis)used in order to deal with points of high relevance such as the treatment of research services without proper involvement of and a clear mission statement from the EU legislator.

Executive Summary

BVI's response to the ESMA's consultation is focused on the following five issues which are of key relevance to the German fund industry:

- **Legitimacy of inducements in the context of non-independent advice**: The proposed text seems to disregard the EU legislators' decision to further allow payments of inducements (in compliance with MiFID II Level 1 criteria). ESMA's approach of a negative list of situations to determine when the quality enhancement test is not met would likely lead to an effective ban on nearly all established distribution models based on commissions. It remains totally unclear under what condition a payment could be deemed to be allowed in future. Such result runs counter to elementary decisions of the EU legislator and hence would, if it were to become part of the final delegated acts, go beyond the empowerment provided by the MiFID II provisions. The MiFID II regime, however, implies positive criteria: The Commission is empowered to adopt delegated acts including criteria to assess compliance of firms receiving inducements and not criteria for non-compliance. Further, a (factual) ban of inducements as well as a stricter approach for inducement payments for advice under MiFID would fundamentally favour insurance and other non-MiFID products such as building savings contracts. We therefore suggest a list of positive (alternative) criteria which would be in line with both the requirement of the Level 1 text and the general decision of the EU legislator that MiFID firms may still receive and pay commissions if these are designed to enhance the quality of the relevant service to the client.

[1] BVI represents the interests of the German investment fund and asset management industry. Its 82 members currently handle assets of EUR 2.2 trillion in both investment funds and mandates. BVI enforces improvements for fund-investors and promotes equal treatment for all investors in the financial markets. BVI`s investor education programmes support students and citizens to improve their financial knowledge. BVI`s members directly and indirectly manage the capital of 50 million private clients in 21 million households. BVI's ID number in the EU register of interest representatives is 96816064173-47. For more information, please visit www.bvi.de.

- **Treatment of research services in relation to portfolio management**: ESMA's understanding relating to minor non-monetary benefits will have a significant impact on the market. We urge ESMA to reconsider its approach in particular with respect to the qualification of research as non-monetary benefit. ESMA should allow for a genuine discussion on this subject before deciding on an approach which will lead to radical changes to the European Financial Market causing competitive disadvantages also to the detriment of the investors ESMA intends to protect. In particular, we have great concerns as regards the practical impact on the market of research providers, on research coverage of smaller and medium sized entities and on the pricing of financial instruments. ESMA's view regarding the qualification of some types of research as prohibited benefits contradicts the Level 1 text and is not suitable to enhance investor protection. Given the complexity of this issue, we stand ready to support ESMA in finding solutions to the treatment of investment research which enhance investor protection while avoiding the corresponding detriments.

- **Classification of AIFs as complex instruments**: ESMA's assumption regarding complexity of shares (or units) in AIFs on the one hand and its concept of dealing with complex products within the suitability test on the other hand would lead to an inappropriate treatment of AIFs. MiFID II Level 1 does neither signal that AIFs generally should be considered as complex nor does it indicate that complex instruments are generally less suitable to clients.

  AIFs cover a broad range of products. Due to the fact that the original intention of the AIFMD was "to extend appropriate regulation and oversight to all actors and activities that embed significant risks", AIFs are often wrongly considered only as risky products such as single hedge funds. The AIFMD defines AIFs as all non-UCITS funds, the definition therefore includes a very broad range of products. AIFs also include retail funds that are strictly supervised and have to be approved on a product level as well as for marketing to retail investors. In some cases, these AIF might even be less complex than some UCITS. Many AIFs today meet the qualitative criteria of instruments being non-complex and according to our understanding will also comply with the two new criteria suggested by ESMA. They should therefore still qualify as non-complex under the MiFID II regime.

  Less complex products are not generally better suitable. Suitability depends on the client's knowledge and experience regarding the field relevant to the specific type of product (or service). ESMA seems to suggest that even for clients for whom complex products are suitable, non-complex products are preferable. In particular with respect to units or shares in AIFs (which ESMA wrongly per se qualifies as complex instruments) this would lead to a major disadvantage. An advisor might be inclined to always recommend a direct investment in a listed share where the investor does not have the advantage of a risk diversification as it is the case in an investment fund.

- **Transparency of product costs and charges:** ESMA should reconsider the proposed approach to the presentation of product costs taking into regard that it is virtually impossible to stipulate ex-ante the level of costs incurring in the management of a product. In particular, highly volatile cost elements such as transaction costs or performance fees should not be included in the on-going charges figure in order to avoid confusion and misinterpretations by investors. In this respect, ESMA should recognise that transaction costs are to a high degree caused by the underlying market risk of the instruments traded, e.g. as regards bonds traded with bid and ask spreads, or in some cases form an intrinsic part of the overall instrument price. In these terms, it is important that UCITS distributors remain able to rely on the UCITS KIID as a sufficient and appropriate source of information on product costs and charges in accordance with recital 78 of the Level 1 text. The

same should apply for retail AIF distributors, provided the AIFs feature KIIDs in line with the UCITS standards according to national law.

Moreover, given the plenitude of underlying assumptions, we believe that it is highly inappropriate to disclose the on-going charges at the product level in monetary terms as such disclosure will never produce correct results. In fact, provision of knowingly false figures to clients could easily qualify as misleading and thus violate the general principle on client information in Article 24(3) of the Level 1 text. Since the MiFID regime does not provide for a limitation of liability similar to that applicable to the UCITS KID, disclosure of cash amounts on the basis of assumptions bears also significant liability risks for investment firms under the applicable civil law.

- **Product governance in relation to investment funds:** It should be clear that the product governance standards laid down in Articles 16(3) and 24(2) of MiFID Level 1 cannot apply to the manufacturing of investment funds, be it UCITS or AIFs. Investment funds are governed by separate pieces of EU legislation imposing specific requirements on the fund management process in relation to the fund manager and in case of UCITS to the individual product and are therefore explicitly exempted from the MiFID regime in Article 2(1)(i) of MiFID Level 1. Moreover, ESMA should recognise that product information available under the UCITS Directive and AIFMD is sufficient to meet the distributors' information needs under para. 26 of the draft technical advice meaning that distributors should not be additionally required to agree on the provision of such information on a contractual basis. In this context, it is important to recognise that product manufacturers should not be held responsible for any actions taken by distributors in their course of business. Investment firms distributing investment products act in their own capacity by performing investment services under MiFID. They are subject to separate regulatory requirements and to the supervision by competent authorities.

BVI's response to ESMA's specific questions

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2.2 Investment advice and the use of distribution channels

Q2: *Do you agree that it is appropriate to clarify that the use of distribution channels does not exclude the possibility that investment advice is provided to investors?*

We generally agree with the understanding that the communication channel used does not influence the qualification of communication as personal or non-personal communication and hence agree that the words "through distribution channels" could be removed. In addition, the preceeding word "exclusively" should be removed as well. If a communication is provided to the public, it cannot be personal since it is communicated to a broad range of people. For a communication being considered as personal it has to contain elements specific to the client. Otherwise, every published market analysis handed to the client without any qualifying statement would be considered a personal recommendation. If, however, the advisor states that based on the analysis, he recommends this financial instrument, the communication would have to be considered as personal recommendation.

2.3 Compliance function

Q3: *Do you agree that the existing compliance requirements included in Article 6 of the MiFID Implementing Directive should be expanded?*

We think that ESMA's suggestions for enhancement of the current compliance requirements are appropriate and have no further suggestions in this regard.

Q4: *Are there any other areas of the Level 2 requirements concerning the compliance function that you consider should be updated, improved or revised?*

We see no need for further action in this respect.

2.4 Complaints-handling

Q5: *Do you already have in place arrangements that comply with the requirements set out in the draft technical advice set out above?*

BVI members already ensure adequate treatment of investor complaints on the basis of relevant provisions in the UCITS Directive[2] and at national level. Hence, we also agree with ESMA's draft technical advice concerning establishment of a complaints management function under MiFID. In particular, it appears reasonable that information on complaints and complaints-handling by investment firms shall be provided alternatively to the NCA or the ADR entity if such entity is regarded as competent under national law.

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[2] Cf. Article 6 of Directive 2010/43/EU (UCITS Implementing Directive).

2.5 Record-keeping (other than recording of telephone conversations or other electronic communications)

Q6: *Do you consider that additional records should be mentioned in the minimum list proposed in the table in the draft technical advice above? Please list any additional records that could be added to the minimum list for the purposes of MiFID II, MiFIR, MAD or MAR.*

We do not think additional records should be mentioned in the list. The list is a comprehensive enumeration of records to be kept by investment firms which should enable the NCAs to assess investment firm's compliance with the markets regulation in MiFID, MiFIR and MAD/MAR.

Q7: *What, if any, additional costs and/or benefits do you envisage arising from the proposed approach? Please quantify and provide details.*

We do not see any specific benefits in enhancing the list CESR has already provided for. We have no information regarding the additional cost which will incur due to enhancement of the requirements.

2.6 Recording of telephone conversations and electronic communications

Q8: *What additional measure(s) could firms implement to reduce the risk of non-compliance with the rules in relation to telephone recording and electronic communications?*

We do not see any further measures that investment firms should or could implement to reduce an alleged risk of non-compliance. We understand that the record keeping requirements and the storage of such records will be very costly. We appreciate the general objective of such records to allow NCAs to fulfil supervisory tasks and perform enforcement actions under MiFID/MiFIR as well as MAD/MAR. Nevertheless, we believe that ESMA should not implement every requirement imaginable but should remain proportionate in its suggestions and allow for the general arrangements to be tested in practice whether they fulfil these objectives.

In addition, ESMA should clarify that investment firms are allowed to forbid that orders are received or transmitted through telephone in order to avoid costly storage of telephone recordings. In such case, the investment firm should be exempt from the recording requirements relating to telephone conversations. In any case, the requirement does not apply to management companies even in case they provide investment advice as a MiFID service. The relevant action for the recording requirements has to be related to reception, transmission or execution of an order. Hence, prior advice might be covered by this requirement but only if it is provided by a MiFID firm able to execute the transaction.

Q9: *Do you agree that firms should periodically monitor records to ensure compliance with the recording requirement and wider regulatory requirements?*

As pointed out, the record keeping requirements should be implemented based on proportionality. Hence, it is vital that any monitoring is proportionate. This means in practice that the monitoring should be based on risk-based samples of transaction records. We therefore think that the expression "periodically monitor" as suggested in para. 7 p. 37 is unclear. Hence, we would welcome a clarification in this regard.

Q10: *Should any additional items of information be included as a minimum in meeting minutes or notes where relevant face-to-face conversations take place with clients?*

ESMA should clarify its suggestion in No. 9 v. It is unclear what other relevant information about the transaction should be included. This wording is in our view to broad and could cover a range of information which might not serve the purpose of such records. ESMA should therefore replace the wording with the wording "**details of the order from the client including amount and type of financial instrument.**[3]" This would meet the purpose behind the recording requirement.

In addition, the requirements should be feasible in practice. For this, the relation between minutes and the suitability report should be clarified. In Germany, advisors are required to keep records in form of advice minutes. These minutes comprise both the relevant elements of the conversation as well as the reasons for the advice given. Hence, in case of investment advice, notes and suitability report should be put together in one document.

Q11: *Should clients be required to sign these minutes or notes?*

The clients should be required to sign the minutes or notes in order to ensure that the investment firm and the client have the same understanding.

Q12: *Do you agree with the proposals for storage and retention set out in the above draft technical advice?*

We have no specific concerns regarding ESMA's proposal.

Q13: *More generally, what additional costs, impacts and/or benefits do you envisage as a result of the requirements set out in the entire draft technical advice above?*

As stated before, we understand that the record keeping and storage is quite costly, therefore, we suggest ESMA should request an impact analysis regarding the costs for recording and storage of phone conversations. Further the principle of proportionality should be closely regarded.

2.7 Product governance

Q14: *Should the proposed distributor requirements apply in the case of distribution of products (e.g. shares and bonds as well as over-the-counter (OTC) products) available on the primary market or should they also apply to distribution of products on the secondary market (e.g. freely tradable shares and bonds)? Please state the reason for your answer.*

Secondary trading of financial instruments should not be perceived as a distribution channel. The distribution services under the MiFID comprise of investment advice, reception and transmission of orders and dealing on own account. Secondary market trading can only be seen as means of executing client orders once the investment decision has been reached. Hence, secondary markets are only

[3] See MiFID II Recital 57: "[...] such records should ensure that there is evidence to prove the terms of any orders given by clients and its correspondence with transactions executed by the investment firms, as well as to detect any behaviour that may have relevance in terms of market abuse".

possible trading venues within the meaning of Art. 4 (1) point (24) of MiFID Level 1 for executing orders resulting from distribution services under MiFID, not a distribution service on its own.

Seen from that angle, the product governance requirements at the distributor's level should be triggered by the provision of a relevant distribution service under MiFID regardless of whether the consecutive client order is being executed on the primary or secondary market. Nonetheless, and for the avoidance of doubt, the final technical advice should clarify which investment services qualify as distribution for the purpose of product governance arrangements.

Q15: *When products are manufactured by non-MiFID firms or third country firms and public information is not available, should there be a requirement for a written agreement under which the manufacturer must provide all relevant product information to the distributor?*

First of all, we would like to make clear that the manufacturing of UCITS and AIFs is not subject to the product governance standards under MiFID due to the general exemption of these products under Article 2(1)(i) of MiFID Level 1 (for further details, cf. our answer to Q19 below).

In this light and taking into account that it is the primary distributor's duty to provide the client with information concerning the product and the service at the point of sale, we agree with ESMA that distributors should be able to obtain from manufacturers, including non-MiFID firms, all information necessary to ensure distribution to the relevant target market. Furthermore, we support the notion that an agreement between the parties concerned should be only necessary if the relevant information is not publicly or otherwise available. In this regard, we would like to point out that UCITS manufacturers are under the obligation to stipulate the characteristics of the target group of investors the fund prospectus and possibly also in the UCITS KIID[4]. These requirements have been extended to certain AIF types allowed for public distribution under national law[5]. In addition, the fund prospectus under the UCITS Directive or the disclosure requirements under AIFMD feature comprehensive information about the fund's investment objectives and risk profile and thus deliver adequate basis for the assessment of the target market by distributors[6]. **Hence, we believe that publicly available information concerning investment funds, UCITS and AIFs alike, should be considered sufficient to meet distributors' information needs under para. 26 of the draft technical advice.**

The text of para. 26 should facilitate reliance on fund information documents by acknowledging that such documents constitute an acceptable source of information. To this effect, the third sentence of para. 26 should be amended as follows:

> "Publicly available information may only be accepted if it is clear, reliable and produced to meet directive requirements, such as the requirements in the Prospectus Directive**,** ~~**or in**~~ the Transparency Directive**, the UCITS Directive or in the AIFM Directive**.".

Moreover, we are of the view that distributors should not be bound by the identification of the target market made by the product manufacturer, but should have the discretion to make their own determinations based on the circumstances and needs of their clients. The information provided by manufacturers should be considered a mere indication in this regard. This pertains in particular to

[4] Cf. Article 69(2), Annex I section 5.2 of the UCITS Directive (UCITS prospectus must inform about the profile of the typical investor), Article 7(2)(f) of the Commission's Regulation (EU) 583/2010 (UCITS KIID must inform about the recommended minimum holding period).

[5] In Germany, the UCITS rules on fund prospectus have been extended to all open-ended retail AIFs, cf. §§ 164 and 165 of the German Capital Investment Code (Kapitalanlagegesetzbuch – KAGB).

[6] Cf. Article 69(1) of the UCITS Directive, Article 23(1)(a) of the AIFMD.

advice-based distribution where the investment firm bears the ultimate responsibility for recommending a suitable investment to the client.

Q16: *Do you think it would be useful to require distributors to periodically inform the manufacturer about their experience with the product? If yes, in what circumstances and what specific information could be provided by the distributor?*

We believe that the responsibilities of product manufacturers and distributors should be clearly separated. ESMA should bear in mind that distributors are not delegates or agents of the manufacturer, but provide investment services to their own clients under their own responsibility and on the basis of a separate licence. Their relations to the product manufacturers are based upon distribution agreements which set out the duties and obligations of both parties in order to ensure compliance with their respective legal framework (e.g. for UCITS managers, compliance with the duty to equip intermediaries with KIID for their products). Thus, distribution of investment products such as funds by third parties cannot be automatically treated as an outsourcing activity giving rights to control and access to data. The distributor has the freedom to sell a particular product; its decision to market it is driven not by the manufacturer, but by the distributor's assessment of the suitability for their end client's needs. There are normally no minimum sales targets, performance-based incentives or detailed service-level standards (which might be indicative of a delegation) imposed by the manufacturer. On the contrary, there are usually further requests from distributors concerning e.g. product price delivery or detailed information on a product. These types of contractual provisions imply an arrangement at arm's length rather than delegation.

Thus, product manufacturers should take the information provided by distributors into account when determining and reviewing the target client group in accordance with the relevant internal process, but must not be bound by any assessment or evaluation of this information stemming from external sources. This is particularly important if distributing partners are free to undertake their own assessments of the target market in line with our suggestions made above.

We also believe that the requirement for distributors to regularly review the financial instruments they offer or market is sufficient to warrant regular information exchange between manufacturers and distributors. We do not see any further need to regulate on specific responsibilities of the distributor (or manufacturer). Especially, the timing and content of such information exchange should depend on the type of product and the target market and thus should be subject to the decision by the parties concerned.

Moreover, ESMA should bear in mind that investment products may be distributed by investment firms not having any contractual links to product manufacturers. It is quite common for distributors to purchase investment products, including investment funds, on secondary markets in accordance with their clients' orders or specific investment needs. This "open architecture" distribution model should not be put into question by a general requirement for distributors to submit periodical information to product manufacturers. Therefore, any potential provisions on information exchange between distributors and product manufacturers should be conditional upon the existence of a distribution agreement between those parties.

***Q17:** What appropriate action do you think manufacturers can take if they become aware that products are not sold as envisaged (e.g. if the product is being widely sold to clients outside of the product's target market)?*

The question arises to what extent manufacturers shall be in the position to intervene in the determination of the target client group at the distributor level, given that distributors are required to set up their own product governance arrangements and to identify target client groups for each distributed product.

From an asset managers' viewpoint we have to reiterate that UCITS (and to a certain extent AIF) manufacturers are already under the legal obligation to define the characteristics of the target group of investors in the fund prospectus and possibly also in the KIID by providing comprehensive information about the fund's investment objectives and risk profile and thus deliver an adequate basis for the assessment of the target market by distributors (please see our answer to Q15 for more detailed comments).

From a wider market perspective, it is preferable to require the product manufacturer to identify, only in general terms, the target market of each product. Investment firms distributing products to the end-clients should take this determination into consideration, while remaining allowed to adapt the target market to the characteristics and needs of their client base. In particular, distributors should be able to sell the product outside the suggested target market where it is in line with the distributor's suitability or appropriateness assessment of its client (e.g. in case certain more complex/risky products may not be appropriate as core holdings, but could still be added to a client portfolio to achieve appropriate diversification of investments). In such cases, however, distributors should be aware that different and potentially inconsistent conclusions in terms of the target market for the same product which might create confusion in the market, especially in case of relevant information presented in the product documents, and therefore should explain their assessment towards their clients in an appropriate manner.

In this context, we would like to point out that there are no uniform criteria for classifying clients which go beyond the general client categorisation as retail or professional according to Annex II of MiFID Level 1. Therefore, the duty to determine the target market for a product should not imply a categorisation below that level in order to avoid inconsistent standards to be applied by different distribution channels. Furthermore, we do not see added value in the requirement to specify groups of investors for whom a product is not compatible as it is the distributors' ultimate responsibility to ensure suitability/appropriateness of a product.

In any event, it is of utmost importance that product manufacturers are not considered responsible for any actions taken by distributors in their course of business. Investment firms distributing investment products act in their own capacity by performing investment services under MiFID. They are subject to separate regulatory requirements and to supervision by competent authorities. Hence, product manufacturers becoming aware of deficiencies at the distributor level should be expected to take corrective actions as appropriate, but must not incur responsibility or be held liable for the distributor's shortcomings.

***Q18:** What appropriate action do you think distributors can take, if they become aware of any event that could materially affect the potential risk to the identified target market (e.g. if the distributor has mis-judged the target market for a specific product)?*

If distributors become aware of circumstances which may materially affect the identification of the potential target market at the product level, they should also be expected to pass the relevant information to the product manufacturer with whom they have concluded a distribution agreement.

***Q19:** Do you consider that there is sufficient clarity regarding the requirements of investment firms when acting as manufacturers, distributors or both? If not, please provide details of how such requirements should interact with each other.*

We do not think that the draft technical advice provides sufficient clarity as regards the requirements for product manufacturers. In particular, we do not agree with the implications for UCITS and potentially for AIFs as suggested in ESMA's analysis[7]. Moreover, we challenge the suggested application of product governance standards to the range of services offered at the distributor's level[8].

Implications for manufacturing of UCITS and AIFs

UCITS and AIFs are governed by separate pieces of EU legislation imposing specific requirements on the fund management process in relation to the fund manager and in case of UCITS, to the individual product. Therefore, collective investment undertakings – UCITS and AIFs alike – are explicitly exempted from the MiFID regime in Article 2(1)(i) of MiFID Level 1. Only fund managers providing ancillary investment services in addition to the management of UCITS or AIFs are bound by MiFID provisions on internal organisation and conduct of business in relation to those ancillary services[9]. This pertains to the provision of portfolio management, investment advice and/or custody services in relation to fund units as relevant on the basis of the fund manager's licence under the UCITS Directive or AIFMD.

Thus, it should be clear that the product governance standards laid down in Articles 16(3) and 24(2) of MiFID Level 1 cannot apply to the manufacturing of UCITS and AIFs which is explicitly exempted from the MiFID scope and subject to specific regulation under EU law. The statement in ESMA's analysis according to which "the proposals [on product governance] do not override responsibilities in other directives, such as (…) UCITS" is prone to misunderstanding in this regard and should therefore be deleted.

Any other outcome would be not only in breach with the general systematics of the EU financial services legislation, but also arbitrary in terms of results. This goes down to the fact that manufacturing of UCITS or AIFs could only be affected by the MiFID standards if the relevant fund manager has been licensed to provide ancillary services in addition to its core activity of collective portfolio management. Consequently, we would face a situation where a fraction of UCITS and AIFs were submitted to the product governance provisions under MiFID whereas UCITS and AIFs managed by pure fund managers were not affected by these rules, leading to a split in standards for the same products. Clearly, this cannot be the desired goal of a sensible regulatory approach.

[7] Cf. recital 17 on page 46 of the Consultation Paper.
[8] cf. para. 16 to 18 of the draft technical advice on page 48-49 of the Consultation Paper.
[9] Cf. Article 6(3) and (4) of the UCITS Directive, Article 6(4) and (6) of the AIFMD.

On this basis, we urge ESMA to confirm in its final technical advice to the Commission that UCITS and AIFs are not subject to the product governance obligations at manufacturer's level due to them being exempted from the scope of application under Article 2(1)(i) of MiFID Level 1. At the very least, ESMA should abstain from any statements which might imply a different interpretation of the Level 1 text.

Application to distribution services

It is unclear what ESMA has in mind when suggesting that the product governance obligations for distributors should apply "when deciding the range of products and services they intend to offer to clients". Given that the specific requirements in para. 16 et seqq. of the draft technical advice pertain in the first place to investment products and partially mirror the provisions for product manufacturers, it is difficult to conceive the relevance in terms of investment services. In any case, it appears that the MiFID investment services are generally compatible with any group of clients; it is rather the range of investment products encompassed by those services which makes the difference. For instance, it is hard to conceive situations in which the service of portfolio management or investment advice per se should be considered incompatible with any clients, but portfolio management or investment advice focusing on complex or risky products such as securitised instruments or derivatives used for speculative purposes is certainly not generally appropriate in the context of retail services.

On balance, we believe that it is unnecessary and confusing to extend the product governance obligations for distributors to the range of services offered to clients. Product governance at the distributor level should focus at ensuring that the products offered by investment firms match with the characteristics, objectives and needs of their target client groups. Consequently, the reference to "services" in para. 16 et seqq. of the draft technical advice should be deleted.

Q20: *Are there any other product governance requirements not mentioned in this paper that you consider important and should be considered? If yes, please set out these additional requirements.*

We have no further suggestions in this regard.

Q21: *For investment firms responding to this consultation, what costs would you incur in order to meet these requirements, either as distributors or manufacturers?*

Given that the manufacturing of UCITS and AIFs is not subject to the new product governance obligations due to the general exemption from scope under Article 2(1)(i) of MiFID Level 1, we expect no direct costs for fund providers. Moreover, there should be no additional costs resulting from the information needs of distributors as all information relating to the investment funds' risk profile and characteristics of the target investors is already available in line with the UCITS Directive and AIFMD (cf. our reply to Q15 above).

2.9 Conflicts of interest

Q54: *Should investment firms be required to assess and periodically review - at least annually - the conflicts of interest policy established, taking all appropriate measures to address any deficiencies? Please also state the reason for your answer.*

We agree with ESMA that investment firms should be required to periodically review the internal conflicts of interest policy and to address any deficiencies which may emerge in the context of such a review. Moreover, we support further clarifications of the conflicts of interest provisions as suggested by ESMA in its draft technical advice.

2.11 Remuneration

Q63: *Do you agree with the definition of the scope of the requirements as proposed? If not, why not?*

In general, we agree with the proposed scope of the remuneration requirements. However, we would like to seize the opportunity to emphasize once again that remuneration requirements under different EU Directives must allow investment firms and other financial entities to make sound and reasonable remuneration arrangements for their employees. In particular, investment managers rendering management services under the UCITS Directive, AIFMD and MiFID must be able to remunerate their staff in a consistent manner and in accordance with one internal remuneration policy.

As regards the details of the draft technical advice, ESMA's approach to governance is not fully compatible with the CRD IV and AIFMD rules insofar as it requires the management body to consult the compliance function before approving the firm's remuneration policy. Under CRD IV and AIFMD the responsibility for design and approval of the remuneration policy rests with the management body after taking advice from the remuneration committee if such committee has been established by the firm. Hence, in order to align the internal processes, ESMA should at least accept advice from the remuneration committee set up under other EU Directives as equivalent to the involvement of the compliance function under MiFID.

Consequently, the wording of para. 4 of the draft technical advice could be modified as follows:

> "The design of the firm's remuneration policy should be approved by the management body of the firm after taking advice from the compliance function **or, where relevant, from the remuneration committee**."

2.12 Fair, clear and not misleading information

***Q65:** Do you agree that the information to retail clients should be up-to-date, consistently presented in the same language, and in the same font size in order to be fair, clear and not misleading?*

The proposed requirement for retail client information to be consistently presented in the same language does not take into account the information regime under the UCITS Directive. UCITS management companies are only required to translate the UCITS KID into the official language of the relevant distribution market. All other information materials required by law may be presented in the language customary in the sphere of international finance; this pertains in particular to the UCITS prospectus and annual/semi-annual report[10]. These product-related information standards are the outcome of a carefully calibrated approach to investor protection in the context of the Single Market. They should be regarded as prevailing in terms of UCITS information also at the point of sale and must not be put into question by contradicting Level 2 provisions under MiFID.

Hence, we would welcome a clarifying statement by ESMA that the requirement for consistent use of the same language does not apply insofar as the use of different languages is explicitly allowed under the UCITS Directive and possibly other EU Directives governing product-related information.

***Q66:** Do you agree that the information about future performance should be provided under different performance scenarios in order to illustrate the potential functioning of financial instruments?*

We agree with ESMA's suggestion and would like to point out that "structured UCITS" are already under the obligation to display in their KIDs performance scenarios illustrating possible future performance in line with the relevant CESR Guidelines[11]. The presentation standards stipulated therein should be regarded as adequate for the purpose of client information under MiFID II.

***Q67:** Do you agree that the information to professional clients should comply with the proposed conditions in order to be fair, clear and not misleading? Do you consider that the information to professional clients should meet any of the other conditions proposed for retail clients?*

We support the proposed general principles for information to professional clients, but see definitely no need to impose further requirements in this respect. Especially, it appears inappropriate to subject professional clients to information standards designed to protect the retail public.

2.13 Information to clients about investment advice and financial instruments

***Q68:** Do you agree with the objective of the above proposals to clarify the distinction between independent and non-independent advice for investors?*

<u>Information provided about whether investment advice is independent or not</u>

[10] Cf. 94(1) of Directive 2009/65/EG (UCITS Directive).
[11] Cf. CESR Guidelines on selection and presentation of performance scenarios in the Key Investor Information document (KII) for structured UCITS dd. 20 December 2010 (CESR/10-1318).

No, we do not agree with the proposals. There is a clear distinction in Level 1 between qualification of independent advice and the legal consequences of such qualification. Level 1 states that the legal consequences apply, once the investment firm informs the client that it provides the advice on an independent basis (Art. 24 para. 7 MiFID). Only in such case the MiFID firm has to comply with the requirements regarding the product scope and the inducements ban. In ESMA's proposal this distinction is not clear. ESMA states that investment firms should explain whether and why the investment advice could qualify as independent or not (p. 97, para. 1). This mixes legal consequences with the preconditions. The wording "whether and why investment advice could qualify as independent or not" should hence be removed. Moreover, we believe the client should only be informed about the relevant consequences that apply to the investment firm if it holds itself out as independent: Firstly, that it is not allowed to accept and retain third party payments and hence is paid by the client. Secondly, that it has to advise on a sufficient range of financial instruments which is sufficiently diversified and that it cannot limit its advice to instruments issued by firms having a close link, legal or economic relationship. There should not be any additional information requirements.

Information about the broad or restricted analysis of different types of financial instruments

Regarding the requirement to distinguish for each type of financial instrument the proportion issued by entities not having a close link with the investment firm, **we strongly oppose the notion that these financial instruments generally better meet the client's profile or need**. This understanding is not based on any empirical argument or further reasoning why this should be the case but seems to be a general assumption ESMA gives. In this light, we doubt that disclosure of the proportion of instruments issued by entities not having a close link with the investment firm gives the client any valuable information. In any case, the requirement should only apply once the client and the investment firm start discussing specific financial instruments. Only then the information is relevant to the client.

Moreover, regarding the information requirements, ESMA should clearly distinct between information to be provided in case of independent advice and in case of non-independent advice. In paragraph 4, p. 97, for example, this does not seem to be the case. We suggest revising the wording by including a reference to the non-independent advice relating to the paragraph as a whole.

ESMA should be cautious not to ask for too many information requirements but to focus on the information in fact relevant to the client. If, for example, the client is interested only in shares, the investment firm should not be required to state for all financial instruments it assesses the proportion of the instruments issued by entities without close links. We would welcome such clarification.

Information about the periodic assessment of suitability

Generally, ESMA's advice at this point should only contain requirements regarding the information about the periodic assessment of suitability and not any requirements regarding review or frequency of the assessment. Formally, this should be part of the section regarding the suitability report (2.17). Moreover, the expression "extent of the periodic suitability assessment" is unclear and should therefore be removed (see p. 97, para. 6 (i)). The client has or will receive advice and should therefore understand what the suitability test means. Hence, it is sufficient if he is informed of the frequency, the firm will assess suitability and what the triggers are.

***Q69:** Do you agree with the proposal to further specify information provided to clients about financial instruments and their risks?*

We do not agree with the general application of the additional requirement in para. 8 of the draft technical advice to investment funds. Performance simulations in different market conditions make definitely no sense in case of actively managed funds as the fund manager takes discretionary investment decisions due to which the fund performance may significantly differ from the market development and more important, is not predictable ex-ante. Hence, actively managed funds are not able to present information on future performance which would provide added value to investors.

For this reason and as a matter of principle, product information for UCITS or retail AIFs presented in the KIID in accordance with the UCITS Directive should be considered appropriate as regards the description of risks, including performance risks, in line with recital 78 of the Level 1 text. The same pertains to the future key information document under the PRIIPs Regulation. Moreover, ESMA should bear in mind that a comprehensive depiction of the fund's risk profile is provided in the UCITS prospectus[12] and forms part of the investor information under the AIFMD[13]. It appears not appropriate to require further specifications or supplements of this already extensive product information at the point of sale.

Thus, we would welcome a clarification in ESMA's analysis that investment firms may rely on the product information provided in accordance with the UCITS Directive and the AIFMD, especially in line with the UCITS KIID, for the purpose of informing their clients about the functioning and performance of investment funds.

***Q70:** Do you consider that, in addition to the information requirements suggested in this CP (including information on investment advice, financial instruments, costs and charges and safeguarding of client assets), further improvements to the information requirements in other areas should be proposed? If yes, please specify, by making reference to existing requirements in the MiFID Implementing directive.*

We have no indications of further deficiencies in terms of client information which would require regulatory intervention under MiFID II.

2.14 Information to clients on costs and charges

***Q71:** Do you agree with the proposal to fully apply requirements on information to clients on costs and charges to professional clients and eligible counterparties and to allow these clients to opt-out from the application of these requirements in certain circumstances?*

According to our experience, information to professional clients should be tailored to the specific needs of the relevant client category. As a rule, professional clients will have no interest in receiving illustrations of cumulative effects of costs on the return or in disclosure of assumed monetary figures which bear no relevance for the actual level of costs.

[12] Cf. Article 69(1) second subparagraph of the UCITS Directive.
[13] Article 23(1)(a) of the AIFMD.

Furthermore, opting-out mechanisms are a proven and tested instrument for enhancing consumer protection in areas where consumers are likely to forgo their protective rights out of disinterest or ignorance. These factors are clearly not relevant in a business environment of professional investors.

Therefore, we believe that the detailed information meant for retail clients should be made available to professional clients and eligible counterparties upon explicit request only. As a minimum, professional clients and eligible counterparties should be generally allowed to dispense with the retail cost disclosure in order to agree with the investment firm on the level of information which suits their particular needs. The limitations proposed by ESMA in para. 2 of the draft technical advice are not appropriate in the business relationships with professional clients.

***Q72:** Do you agree with the scope of the point of sale information requirements?*

We do not deem the proposed treatment of portfolio management appropriate. It appears that ESMA considers the services of portfolio management as encompassing the elements of recommending or marketing financial instruments. However, this understanding is neither reflected in the definition of portfolio management in Article 4(1)(8) of MiFID Level 1 nor does it correspond with the reality of the portfolio management services. The portfolio manager takes its own discretionary decisions about the suitable investments for a client in accordance with its appointment as a fiduciary agent and on the basis of a mandate stipulated in the relevant contractual agreement. Hence, the purchase of financial instruments in the course of the portfolio management activities is not the result of recommendations or marketing, but of the investment decisions taken by the appointed manager.

Therefore, it is not in line with the MiFID Level 1 text to apply the cost disclosure requirements in relation to financial instruments to the portfolio management services. ESMA should also bear in mind that there are different types of mandates with different degrees of discretion in the market ranging from standardised fund-based management services to fully discretionary management of portfolios with certain performance objectives. In the most instances, however, it will be simply impossible to specify at the time of concluding the management contract what investments shall be made in which instruments for the account of the client which will render the envisaged disclosure a quite fruitless exercise.

Furthermore, in relation to paragraph 3(ii), we do not conceive situations where investment firms not recommending or marketing financial instruments shall be under an obligation to provide a KID/KIID to clients. In any event, investment firms are only bound to ensure adequate disclosure of product costs if they provide an investment service in relation to the relevant product.

***Q73:** Do you agree that post-sale information should be provided where the investment firm has established a continuing relationship with the client?*

We agree with the envisaged scope of the periodic post-sale disclosure requirements, but it should be made sure that it pertains solely to situations involving a continuing relationship with a client.

In this context, we object to the statement in para. 34 of ESMA's analysis implying that investment firms providing one-off services should be obliged to inform their clients ex-post about the exact amount of the inducements received if they were not able to provide such information at the point of sale. Such requirement of additional ex-post information is not covered by Article 24(9) of MiFID Level 1 which acknowledges the disclosure of the relevant calculation method in terms of inducements as fully adequate. Moreover, the added value of such additional disclosure is very limited given the fact that the

investment decision has already been taken by the client and there is no continuing relationship with the investment firm.

In consequence, we ask ESMA to delete the second sentence in para. 34 on page 106 as well as para. 7 (ii) of the draft technical advice on page 123 which is meant to endorse the ex-post disclosure requirement (cf. also our reply to Q80 below).

Q74: *Do you agree with the proposed costs and charges to be disclosed to clients, as listed in the Annex to this chapter? If not please state your reasons, including describing any other cost or charges that should be included.*

We believe that ESMA should thoroughly reconsider the proposed approach to costs and charges related to financial instruments which shall form part of the aggregated cost disclosure.

On-going charges at the product level

Especially with regard to the disclosure of on-going charges, we would like once again to point out that it is purely impossible to stipulate ex-ante the level of costs which incur in the management of a product. Speaking for investment funds, only straightforward charges calculated in relation to the NAV of the fund such as the management fee and the depositary fee can be determined in advance in percentage terms. All other cost items are entirely dependent on specific management activities during a year which are influenced by the market developments. This pertains in particular to costs and charges related to portfolio transactions, including securities lending costs and costs associated with derivative contracts. In case of performance fee which is triggered by a specific outperformance of the fund and often subject to further conditions like a high-water mark, it is even uncertain whether any costs will be charged to the fund at all.

In our view, this situation prompts two necessary conclusions:

- First, it is not reasonable to include highly volatile cost elements in the on-going charges figure in order to avoid confusion and misinterpretations by investors. This applies to all elements of transaction costs mentioned above and, above all, to performance fees. It is simply not responsible to disclose an on-going charges figure featuring the performance fee if its occurance in the next year is entirely unclear and vice versa (in fact, suggesting an overall cost disclosure based on a year without performance fee might provoke false expectations in terms of the product costs and eventually mislead investors). The on-going charges figure under the UCITS KIID does not reflect these volatile cost elements as a result of regulatory omission, but based on the deliberate decision by then CESR after intense work with the industry and several rounds of consumer testing.

- Second, it is highly irresponsible to present investors with on-going charges figures in monetary terms. Given that at the point of sale only the investment sum, but not the investment outcome at the end of the charging period can be specified, investors cannot even be told in reliable manner the amount of the management fee to be paid to the product provider, let alone the amount of other fees and charges depending not only on the fund's NAV. It should be clear that disclosing specific numbers in the circumstances exhibits only a spurious accuracy, but will never produce correct results. In fact, such disclosure could easily qualify as misleading and thus violate the general principle on client information enshrined in Article 24(3) of the Level 1 text. Moreover, as the MiFID

regime does not provide for a limitation of liability similar to that applicable to the UCITS KID[14], disclosure of knowingly false figures on the basis of assumptions bears significant liability risks for investment firms under the applicable civil law.

Consequently, we urge ESMA not to reinvent the on-going charges in relation to investment funds under the MiFID regime, but to adhere to the understanding developed under the UCITS Directive. This proven and tested interpretation of on-going charges should be regarded as sufficient and appropriate in accordance with recital 78 of MiFID Level 1. In particular, there should be no obligation to disclose cash amounts in terms of on-going charges at the product level due to the many imponderables and assumptions which have the potential to mislead investors.

Transaction costs

We do not agree with ESMA's analysis according to which transaction costs have to be made transparent as part of the overall product costs. Generally speaking, transaction costs are to a high degree caused by the underlying market risk of the instruments traded. In case of e.g. bonds traded with bid and ask spreads, it is not possible to determine which part of the spread is attributable to the broker and which goes down to a market momentum at the time of trading. Moreover, it should be borne in mind that in some transactions such as OTC derivative contracts transaction costs are simply not knowable as they are intrinsically embedded in the instrument price. **Therefore, transaction costs should not be included in the required compilation of costs and charges in accordance with Article 24(4) second subparagraph of MiFID Level 1.**

Treatment of UCITS and AIFs which feature a KIID according to UCITS standards

Specifically in relation to the cost transparency by UCITS, ESMA should bear in mind that the EU legislators has decided upon a temporary relief from the PRIIPs information requirements for the next five years. This temporary exemption applies to UCITS and in addition, to all retail AIFs which feature a KIID in line with the UCITS standards according to national law[15]. We believe that ESMA should not attempt to effectively circumvent this exemption by requesting the Commission to consider aligning the UCITS disclosure standards with the future requirements of the PRIIPs Regulation. Such measures appear incompatible with the declared will of the EU legislators and would not be in line with the Commission's request to ensure coherence within the wider regulatory framework of the EU[16].

Consistency in the calculation of the ongoing product charges under the MiFID and the UCITS framework is also essential in order to ensure effective investor protection and to avoid confusion at the point of sale. ESMA should be aware that direct distribution by fund managers does not fall under MiFID, but is part of the collective management activity under the UCITS Directive or AIFMD. Therefore, fund managers will in any case be able to rely on the cost disclosure in the UCITS KIID or AIF KIID required under national law when selling their units directly to end-investors. It appears then unreasonable and counterproductive in respect of investors' confidence to require presentation of different figures in terms of product costs by MiFID intermediaries.

[14] Cf. Article 79(2) of the UCITS Directive.
[15] Cf. Article 24 of the Regulation (EU) on key information documents for packaged retail and insurance based investment products (PRIIPs).
[16] Cf. 1.2 of the Commission's request to ESMA for technical advice dated April 23, 2014, p. 7.

For these reasons, UCITS distributors should remain able to rely on the UCITS KIID as a sufficient and appropriate source of information on product costs and charges in accordance with recital 78 of the Level 1 text. The same should apply for retail AIF distributors, provided the AIFs feature KIIDs in line with the UCITS standards according to national law.

Q75: *Do you agree that the point of sale information on costs and charges could be provided on a generic basis? If not, please explain your response.*

We agree that information about the costs related to the financial instrument could be provided on a generic basis at the point of sale. However, we believe that the limitation in para. 56 of ESMA's analysis according to which generic disclosure should be allowed only if "the investment firm ensures that the costs and charges provided in the generic disclosure are representative of the costs that the client would actually incur" is not appropriate in the broader context of the draft technical advice. As explained in our reply to Q74, disclosure encompassing volatile cost elements such as transaction costs and/or performance fees and requiring specification of cash amounts on the basis of several assumptions will not produce even roughly accurate results. Thus, ESMA should reconsider the proposed approach to product cost disclosure in light of our suggestions made above.

Q76: *Do you have any other comments on the methodology for calculating the point of sale figures?*

Even though we principally agree that the actually incurred costs should be taken as a proxy for the disclosure of the ex-ante product costs, we would like once again to stress that such approach is appropriate only in relation to steadily recurring costs such as the management fee and constant expenses included in the calculation of the on-going charges figure for UCITS. Volatile cost elements such as transaction costs and/or performance fees should not be taken into account in the calculation of ex-ante figures as they will prompt significant fluctuations of the overall costs which have the potential of confusing and misleading investors.

Moreover, ESMA should bear in mind that the MiFID regime does not provide for a limitation of liability in terms of the cost disclosure similar to that applicable under the UCITS Directive or to be applicable under the PRIIPs Regulation. Therefore, the required assumptions and estimations bear a significant liability risk for the distributors of financial instruments under the relevant civil law. The final recommendations by ESMA should thus be carefully calibrated in order not to discourage investment firms from distributing products with variable on-going costs. Otherwise, distribution of investment funds involving active portfolio management could be put at a disadvantage compared e.g. to banking products based on pre-defined formulas and hence displaying rather stable cost profiles.

Q77: *Do you have any comments on the requirements around illustrating the cumulative effect of costs and charges?*

We understand that ESMA considers requiring investment firms to provide clients with an illustration of the cumulative effect of costs and charges on the return of a product at the point of sale. The corresponding explanatory text in para. 59 of ESMA's analysis is, however, very confusing as it states that the obligation to illustrate the cumulative cost effect should apply both ex-ante and ex-post and refers specifically to the services of portfolio management and investment advice.

In our opinion, it should be clear that the respective illustration requirement is meant to assist clients with their understanding of the overall costs before the investment decision has been taken and therefore, applies only at the point of sale and not after the provision of the investment service.

Consequently, there should be no obligation of portfolio managers or firms providing investment advice to present their clients with any retrospective illustrations of costs and charges.

Q78: What costs would you incur in order to meet these requirements?

We have no information in this regard.

2.15 The legitimacy of inducements to be paid to/by a third person

Q79. *Do you agree with the proposed exhaustive list of minor non-monetary benefits that are acceptable? Should any other benefits be included on the list? If so, please explain.*

ESMA's understanding relating to minor non-monetary benefits will have a significant impact on the market. We urge ESMA to reconsider its approach in particular with respect to the qualification of research as non-monetary benefit. In particular, we have great concerns of the practical impact due to ESMA's view regarding the qualification of some type of research as prohibited benefits (2.). Moreover, we do not agree with the proposed exhaustive list of minor non-monetary benefits. An exhaustive list with specified types of benefits would inappropriately limit the inducements rules under MiFID II Level 1. We think only a positive non-exhaustive list of benefits would be in line with the Level 1 text. In addition, a complete definition of minor non-monetary benefits would be helpful (1.). ESMA should adjust the definition of minor non-monetary benefits and consider the proposed list as a non-exhaustive list of specified types of benefits which may fulfil such criteria (3.).

1. Exhaustive list of minor non-monetary benefits narrows the Level 1 text inappropriately

The EU legislator aimed to restrict benefits that may impair clients' interests. An exhaustive list of specified types of benefits would not only restrict benefits that may impair clients' interests but also exclude benefits which would not impair clients' interests. Non-monetary benefits which appear legitimate under the Level 1 text would in practice be excluded from the exhaustive list.

Further, an exhaustive list is also not in line with the empowerment to the Commission in relation to Article 24 MiFID II: The Commission may adopt delegated acts which include criteria to assess compliance of firms receiving inducements with the obligation to act honestly, fairly and professionally in accordance with the best interest of the client (Art. 24 (13) sentence 1 (d) MiFID II). In this regard, the Commission only asked for a definition and conditions for acceptable minor non-monetary benefits (Commission's Request, p. 26). Nevertheless, we believe that a list of specified types of benefits would in practice allow to clearly identify benefits which meet the Level 1 requirements and would give legal certainty for such payments. We therefore think that a list of specified types of benefits that is not exhaustive would be helpful in applying the MiFID II criteria. Benefits not listed would still have to fulfil the general criteria of Level 1 or the proposed definition at Level 2 in order to be allowed.

We believe that ESMA's proposed definition of minor non-monetary benefits should be completed since ESMA is defining the term "minor" (No. 4 second sentence, p. 123 CP) but not the term "benefit".

- Generally, benefits require a person to receive services or goods that give an advantage.

- ESMA describes benefits as being of a minor nature if they are reasonable and proportionate and of such a scale that they are unlikely to influence the behaviour in any way that is to the detriment of the interests of the relevant client. We think the definition is somewhat repetitive with respect to the terms "reasonable" and "proportionate". According to Level 1, the benefits allowed should only be of such a scale and nature that they could not be judged to impair compliance with the firm's duty to act in the client's best interest. It is unclear what notion ESMA wants to add with the additional preconditions "reasonable" and "proportionate". In our view, it is hard to think of proportionate or reasonable benefits which are likely to influence the behavior of the relevant client. In addition, it is unclear to which reference the benefit should be proportionate. We therefore think that at least the term "proportionate" should be deleted. Further, we do not see that the term "reasonable" has a specific meaning and suggest deleting this as well. Generally, we understand that any benefit that is unlikely to influence the investment firm's behaviour should be regarded as reasonable.

2. Treatment of research

We strongly disagree with ESMA's proposal to deal with research as a minor non-monetary benefit in the course of portfolio management or independent investment advisors. This approach contradicts the Level 1 text and is not suitable to enhance investor protection. On the contrary, it will have significant impact to the market in practice, which will also be to the detriment of investors. Given the complexity of this issue, however, we stand ready to support ESMA in finding solutions to the treatment of investment research which enhance investor protection while avoiding the corresponding detriments. In sum, we urge ESMA to reconsider the approach to allow for a genuine discussion on this subject before deciding on an approach which will lead to radical changes the European Financial Market causing competitive disadvantages also to the detriment of the investor ESMA intends to protect.

The qualification of any tailored research as prohibited non-minor benefit would have a huge impact on the market of research providers, on research coverage of smaller and medium sized entities and on the pricing of financial instruments. If active portfolio managers and investment management companies under the UCITS Directive or the AIFMD would have to pay for tailored research, this would (i) decrease competition between research providers and asset managers, (ii) reduce the access for smaller and medium sized companies ("SMEs") to research and (iii) influence fair pricing of financial instruments. In addition, the effect on the costs for the end investor is hard to predict. The effects on the markets in particular but without limitation include:

- The proposed ban would require asset managers to reduce the amount of research they take into account, in order to stay competitive. Consequently, this would reduce competition between research providers thereby favouring the larger market participants. Furthermore, while larger asset managers may be in the position to build up their own research departments, smaller asset managers will not be in such position and will have less access to research which will likely deteriorate their market position.

- Large research providers will be less interested in providing research for all SMEs with the consequence that such companies would have less or no research coverage. Since the access to research might be the pre-condition for an IPO or other financing, this contradicts the European approach to remove obstacles for SMEs to acquire long-term financing (see e.g. proposal for the Regulation on European Long-term Investment Funds).

- The decrease of available research is also designed to affect fair pricing of products. Research generally distributes information into the market and hence allows for information asymmetries to be mitigated. This generally increases fair pricing of shares.

- It is in the genuine interest of the client that the asset manager has wide access to research. Limited access to research might have an effect on the quality of investment decisions.

- If active managers and investment management companies under the UCITS Directive or the AIFMD would have to re-price the services they offer, they will face competition in particular from overseas managers. Investors might simply flee Europe and look for cheaper investment possibilities overseas. There, the manager is not supervised by a European authority and the national supervisors will have less influence regarding the practice of such manager. Funds may generally be managed outside Europe and distributed within Europe under certain preconditions. The unbundling of research and broker fees is not a precondition for the distribution of funds by third country firms under EU legislation. To prevent a shift from the European to the US and Asian market, ESMA should seek an approach which does not facilitate an unlevel playing field between EU and non-EU firms.

The qualification of any tailored research as prohibited non-minor benefit is not intended by the EU legislator, contradicts the Level 1 text and has not yet been discussed properly. The EU legislator did not intend such change of the current market situation. Since the effect to the European Market regarding commission sharing agreements or similar practices would be significant, MiFID II Level 1 should have made a reference that the current situation should be revised. Within the legislative process no such proper discussion has taken place. Furthermore, no recital does indicate any such intention of the legislator. Moreover, ESMA does not provide for an impact analysis regarding the effect the qualification of tailored research as a prohibited non-minor benefit will have. We are aware that the FCA recently has published its discussion paper regarding the use of dealing commission regime (FCA DP14/3). In this paper, the FCA provides a first idea of what the impact will be with a limited focus on the UK market. Even though, according to the FCA, the UK market accounted for around 36 percent of the assets under management in Europe (see FCA DP 14/3, p. 44), this is only one third of the market in Europe. In addition, the other markets are not structured like the UK market. Hence, it is decisive that ESMA conducts specific impact analyses with respect to at least all the other markets.

Tailored research does not qualify as benefit. Instead, it has to be seen in the context of potential conflicts of interest and should be addressed accordingly. Traditionally, supervisory authorities have taken the approach to qualify research as an inducement or benefit. We think, however, ESMA should revisit this position. Research is not for the benefit of the portfolio manager but only informs the manager to bring him in a position to make well-informed investment decisions for his client. ESMA's argument that tailored research may influence the recipient's behaviour, i.e. portfolio managers might be inclined to "churn" their clients ´ portfolios, does not lead to another conclusion. The mere possibility that the portfolio manager's behaviour is influenced does not qualify the research as benefit. Conduct may be influenced in several ways and not every action which may influence conduct is considered as benefit but only action that is for the benefit of the recipient. Influence on behaviour is rather a potential source of conflict of interests and hence should be dealt with as such. The mere possibility that portfolio manager might churn their client's portfolio, i.e. could execute transactions for another purpose than increasing the client's return or reducing any losses, however, does not justify excessive regulation. ESMA suggests that portfolio managers are under a general suspicion to disregard the already existing obligation to act in their client's best interest. In this context, ESMA falls short of giving any empirical justification that churning in fact takes place, but only states that a firm may

be influenced to churn. Moreover, though tailored research may influence investment firms' behaviour, such behaviour is not necessarily to the detriment of the client. In fact, research directly assists the investment manager when making his investment decision and is therefore to the advantage of the client and not to his detriment. Conflicts of interest problems can arise in case the research received in connection with execution of the trade for a specific portfolio may generally not be used for this specific portfolio. In such case the interest of one client can conflict with the interest of another client. Furthermore, the portfolio manager is bound to best execution requirements which might also require him to decide differently in the specific situation. Consequently, the problem should be dealt with not in form of a ban of research as non-minor non-monetary benefit but as a potential conflict of interest situation and a matter of best execution. ESMA, however, has not evaluated any existing mechanisms, e.g. disclosure requirements, to deal with such situations. Not only the impact but also the current market practices to deal with the situation have to be evaluated before any regulatory decision is made.

We strongly support the development of solutions following a proper discussion. Any discussion, however, has to bear in mind that the portfolio manager cannot know in advance whether he can use the research or not and whether he can use it for the specific portfolio. We believe that the provision of research and payment for such research cannot be evaluated with respect to specific transactions but rather as an ongoing service which corresponds with the ongoing service the portfolio manager provides. Unbundling might be achieved in several ways, in particular by way of disclosure or by way of prohibition. MiFID II itself provides for the former. The bundling of services per se is allowed as long as the client is informed of the packaging and the costs and charge of each component (Art. 24 (11) first sub-paragraph). Disclosure would be the less strict measure. This is required by the Level 1 text and will achieve the necessary transparency without significantly changing the market and increasing prices to the detriment of the client. Nevertheless, we understand that the issue raises concerns with the regulator and that at least some NCAs feel that disclosure would not be a sufficient way to deal with the situation. Therefore, we are happy to support ESMA and BaFin in developing a system which enhances investor protection without affecting the investor's interests and the market following proper discussion of the current situation and the effects any approach will have. We generally believe that more arguments should be discussed before any significant decision is made. Given the fact that ESMA is dealing with answers to 245 questions for the Consultation Paper alone, one of several aspects relating only to one question is definitely not a sufficient way to deal with a problem that will cause major market disruptions. Hence, the best way forward would be if ESMA advises the Commission to (i) have an impact analysis conducted, (ii) consult possible solutions with the market participants and (iii) in the meantime deal with the issue as a matter of conflicts of interest which may be managed and disclosed as a last resort.

3. Definition of minor non-monetary benefit and non-exhaustive list

Based on this, we suggest the following definition and non-exhaustive list for minor non-monetary benefits.

> **A minor non-monetary benefit is a service or good which gives the recipient an advantage of such scale that it is unlikely to influence the recipient's behaviour in any way that is detrimental to the interests of the relevant client.**
>
> **By example, the following benefits can be considered as minor non-monetary benefits**:

i. information or documentation relating to a financial instrument **~~(including financial research)~~** or an investment service. This information could be generic in nature or personalised to reflect the circumstances of an individual client;
ii. participation in conferences, seminars and other training events on the benefits and features of a specific financial instrument or an investment service; and
iii. hospitality of a reasonable value, this could for example include **~~food and drink~~ hospitality** during a business meeting or a conference, seminar or other training events mentioned under ii.
iv. IT development or maintenance allowing complete or partial access to data and/or electronic systems of third parties in order to receive specific market or product information mentioned under (i).

Q80. *Do you agree with the proposed approach for the disclosure of monetary and non-monetary benefits, in relation to investment services other than portfolio management and advice on an independent basis?*

We object to the proposal in para. 7(ii) of ESMA's analysis implying that investment firms providing one-off services should be obliged to inform their clients ex-post about the exact amount of the inducements received if they were not able to provide such information at the point of sale. Such requirement of additional ex-post information is not covered by Article 24 (9) of MiFID Level 1 which acknowledges the disclosure of the relevant calculation method in terms of inducements as fully adequate. Moreover, the added value of such additional disclosure is very limited given the fact that the investment decision has already been taken by the client and there is no continuing relationship with the investment firm.

In consequence, we ask ESMA to delete the second sentence in para. 34 on page 106 as well as para. 7 (ii) of the draft technical advice on page 123 which is meant to endorse the ex-post disclosure requirement (cf. also our reply to Q73 above).

Q81. *Do you agree with the non-exhaustive list of circumstances and situations that NCAs should consider in determining when the quality enhancement test is not met? If not, please explain and provide examples of circumstances and situations where you believe the enhancement test is met. Should any other circumstances and/or situations be included in the list? If so, please explain.*

We do not agree at all with the overall approach of a negative list of situations, i.e. situations where NCAs should consider in determining when the quality enhancement test is not met. It would probably lead to an effective ban on nearly all established distribution models based on commissions even though the legislative foundation remains materially unchanged. This result runs counter to elementary decisions of the EU legislator and hence would, if it were to become part of the final delegated acts, go beyond the empowerment provided by the MiFID II provisions.

- The EU legislator has deliberately decided to further allow payments of inducements (in compliance with MiFID II Level 1 criteria) and has not reinforced the preconditions in the area of non-independent advice. The proposed negative list, however, seems to disregard this approach because the established distribution models would have to be considered as forbidden (1.).

- The MiFID II regime implies positive criteria since the Commission is empowered to adopt delegated acts to ensure that investment firms comply with the principles set out in Art. 25. In particular, these shall include criteria to assess compliance of firms receiving inducements and not criteria for non-compliance. Under the approach taken by ESMA, it remains totally unclear under what condition a payment could be deemed to be allowed in future (2.).

- A (factual) ban of inducements as well as a stricter approach for inducement payments for advice under MiFID would fundamentally favour insurance and other non-MiFID products such as building savings contracts (3.).

- We therefore suggest a list of positive (alternative) criteria which would be in line with both the requirement of the Level 1 text and the general decision of the EU legislator that MiFID firms may still receive and pay commissions if these are designed to enhance the quality of the relevant service to the client (4.).

1. Approach taken by ESMA is not in line with the EU legislator's decision regarding payment of inducements

ESMA should be aware that the "quality enhancement" test, as proposed in para. 10 of its draft technical advice on inducements, puts most – if not all – commission based advisory models into question. **We are decidedly of the opinion that this approach disregards the EU legislator's decision regarding payment of inducements in the area of non-independent advice.**

The EU legislator has decided to allow both commission-based and fee-based advice, the former as long as the payments are designed to enhance the quality of the service and do not impair with the firm's duty to act in accordance with the best interest of its clients. The MiFID II Level 1 text clearly states that investment firms should have the choice between independent and non-independent advice (see recital 73).

One reason for this decision is that a prohibition of such payments would significantly decrease the private clients' access to investment advice including advice for pension provision solutions. We understand that due to the Retail Distribution Review in the UK an advice gap has emerged which limits the access to advice for less wealthy clients. Studies show that only the minority of the society is prepared to pay for advice. For example, according to a recent German study only 19 percent of the respondents would be prepared to pay at all for independent advice regarding pension provision solutions; the average amount respondents would be inclined to pay is EUR 35.[17] Such amount, however, would not be sufficient to cover all costs which a MiFID firm has to provide for advice, in particular personnel costs and costs for regulatory compliance. Hence, MiFID firms would not be able to offer advice for such amounts. As a result, in particular less wealthy investors would no longer have access to advice. The EU legislator wanted to avoid such possible outcome.

In this context, we are deeply worried by the fact that ESMA is obviously acting under the misperception that the rules on inducements for non-independent advice have been reinforced from MiFID I to MiFID II. This became obvious from statements given by ESMA representatives during the public hearing on the draft advice on July 8 in Paris when justifying ESMA's decision to challenge established models of commission-based advice.

[17] Steinbeis Research for financial services, Altersvorsorgereport: Deutschland 2014, p. 8, see: www.sparda-bank-hamburg.de/pdf/news/Altersvorsorgereport_2014_Final.pdf.

It is essential to bear in mind that the preconditions for inducements in the area of non-independent advice, especially the requirement that they shall be designed to enhance the quality of the relevant service, remain materially unchanged since MiFID I. MiFID I constituted the general principle that investment firms have to "act honestly, fairly and professionally in accordance with the best interests of its clients" (Art. 19 (1)). It was then left to the Commission to adopt implementing measures in order to substantiate this principle (Art. 19 (10)). In doing so, the Commission adopted the MiFID I Implementing Directive, Article 26 of which lays down the preconditions for inducements. The legislator of MiFID II recognised the Commission's interpretation of the general requirement to act in the best interests of the client as regards inducements by incorporating it in the Level 1 text in the context of non-independent advice. He did not change it in terms of content. Hence, already today any commissions earned by MiFID firms for non-independent advice either must be in line with these requirements or would have to be considered in breach of EU legislation.

There is no indication whatsoever that the EU legislator felt that the criterion "designed to enhance the quality" should be tightened or in general payment of inducements should be prohibited in case of non-independent advice. The shift from Level 2 to Level 1 was only made because MiFID II restricts the payment of benefits in case the MiFID firm provides investment advice promoted as independent. Hence, it was the logical step to include the rules on payment of inducements for non-independent advice also into the Level 1 text. No other conclusion can be drawn from the Commission's request for advice: The Commission requests measures further detailing the criterion of enhancing quality in order to achieve greater convergence in its application across Europe (Commission's Request, p. 25). This was the very same motivation of MiFID I when calling for implementing measures and does not give an indication that the preconditions for inducements payments have to be tightened.

This being said, it remains totally unclear why the rationale of recital 39 of the MiFID I Implementing Directive and the relevant Recommendations issued by CESR on "Inducements under MiFID" (CESR/07-228b) should no longer be valid in the area of commissions on non-independent advice. Recital 39 stated the general principle that the receipt of commissions in connection of advice should be considered as designed to enhance the quality of the advice as long as is not biased as the result of the commission. Given that the material regulatory basis for these deliberations remains unaltered under MiFID II, they still should give guidance on the interpretation.

2. Negative list not appropriate to assess compliance but only non-compliance

Under ESMA's proposal it is very unclear how any payment of distribution commissions may be regarded as being designed to enhance the quality of the service. First, it is not clear which payments would fulfil the negative criterion that they are used to pay or provide goods or services essential for the recipients firm in its ordinary course of business (No. 10 (i), p. 124). ESMA does not give any reasoning why the use of payments for goods or services essential in the ordinary course of business cannot be considered as designed to enhance the quality. It is in the client's best interest that the firm has a sound infrastructure and well educated staff – regardless of whether this is paid through commissions or else. If, however, commission payments could no longer be used to pay for goods and services essential for the business, investment firms might have to lower their standards (as far as possible), e.g. hire less qualified staff, which could be to the client's detriment. Further, we believe that there are situations where e.g. a service would not be provided at all to clients without the commission payment. It might simply be too expensive for an investment firm to provide for investment advice if commission payments are prohibited, in particular in less populated regions. In addition, the objective of the

inducements provision is to enhance investor protection. The prohibition in this case would, however, lead to a complete different effect since investors would not be advised at all and therefore less protected. Hence, the criterion "designed to enhance the quality of the service" should not be defined in a way that payments cannot be used to provide for the provision of the service or the payment for goods, because this might be in the client's very interest. It is worth mentioning that then CESR saw the requirement of being designed to enhance the quality of the service fulfilled in a very similar example laid down in its Recommendations on Inducements under MiFID if "in the absence of payment ... these investment services, most likely, would not be provided"[18].

Secondly, the negative criterion of a firm not providing a higher quality above the regulatory requirements disregards the fact that in many terms, the Level 1 text or ESMA in its proposals provide for the highest possible standard already. Due to this, it might in practice not be possible to generally increase such high standards. For example, according to ESMA's proposed technical advice, investment firms have to be able to demonstrate that they assess whether alternative financial instruments, less complex or with lower costs could meet their client's profile. According to ESMA, it is hence not sufficient to provide for a suitable product but it seems as if the firm has to rule out that no other product available in the market is more suitable. The quality for such standard might not possibly be enhanced above the regulatory requirements. In fact, in such case it would in practice not be possible to pay or receive inducements since there would be no room for it to be designed to enhance the quality. Consequently, the applicability of the second negative criterion would in such case lead to a prohibition of inducements, which was not intended by the EU legislator. We therefore believe that in some cases the compliance with regulatory requirements should be sufficient to generally enhance the quality of the service.

Thirdly, it is unclear how the criteria ESMA enumerates are related to each other. First it is unclear whether all negative criteria have to be applied at the same time, i.e. whether the MiFID firm has to ensure that none of the negative criteria is fulfilled. Should this be ESMA's intention, a payment of inducement would in practice be impossible. Furthermore, it is uncertain how the positive criteria of enabling the client to receive access to a wider range of suitable financial instruments or the provision of non-independent advice on an ongoing basis (para. 11, p. 124) relate to the negative criteria (para. 10, p. 124). In our view, payments fulfilling any of the positive criteria have to be considered as being designed to enhance the quality regardless of whether in addition any of negative criteria is fulfilled. This means that granting a client access to a wider range of financial instruments should be per se considered as designed to enhance the quality even if the payments to get such access are used to pay for goods or services that are essential for the recipients firm. It also shows that the list of positive alternative criteria would not provide for questions regarding the relation between several positive or negative criteria but would allow for a clear distinction what fulfils the requirement to be designed to enhance the quality of the service.

Fourthly, with respect to the positive criterion "enabling the client to receive access to a wider range of *suitable* instruments", this is not feasible in practice. Suitability has to be tested on a specific client basis, i.e. the test whether an instrument is suitable varies from client to client and may change over time. ESMA indicated at the hearing that an institution which will generally provide clients with a broader range of products that it would have without the payment of inducements, would likely fulfil the positive criterion. We further understand that ESMA's intention for this positive criterion is to induce MiFID firms to provide a broader range of products than those issued within their group. While we understand such intention, we do not believe that this should then be a question of suitability which the

[18] CESR/07-228b, para. 21.

firm may only determine on a case by case basis. Hence, the term "suitable" should in any case be deleted.

MiFID II Level 1 empowers the Commission to adopt delegated acts which include the criteria to assess compliance of firms receiving inducements with the obligation to act honestly, fairly and professionally in accordance with the best interest of the client (Art. 24 (13) sentence 1 d). This means that the Commission is being invited to define criteria according to which firms may know that inducements received or paid may be regarded as enhancing the quality. The Commission, however, requests ESMA to provide for conditions under which inducements are not deemed to meet the requirement of enhancing the quality of the relevant service (Commission's Request, p. 25). ESMA follows this request and proposes a list of negative criteria where the requirement of enhancing the quality of the relevant service is not met. In addition, ESMA stated in the hearing that it has not been able to find positive criteria.

A list of negative criteria does not allow firms to assess whether the way they act is in compliance with the condition that the receipt or payment of inducements is designed to enhance the quality. It only shows when it is not designed to enhance the quality. Hence, it further narrows the Level 1 text. Further restricting requirements on payment or receipt of inducements is allowed for Member States when implementing MiFID II (see recital 76); however, the Level 1 text does not indicate that the Commission or ESMA are allowed to further narrow such requirements in the Level 2 Delegated Acts. It is unclear how ESMA expects MiFID firms to find situations where they would be able to receive or pay inducements in compliance with these requirements if ESMA itself states it has been difficulties developing positive criteria. Besides, we believe that ESMA can advise the Commission that the request is not in line with the Level 1 text and that negative criteria would be difficult to apply in practice.

3. Stricter rules would favour non-MiFID products

We note that the UK and the Netherlands have already implemented a ban of inducements. We understand that in both countries the ban also applies to a wide range of products which at least include life insurance products. Imposing stricter rules on payment of inducements under MiFID II would however only cover the MiFID products and not any other investment products like insurance contracts. Nevertheless, in practice, life insurance products compete with other financial instruments, such as investment fund units as a vehicle for pure saving purposes. Stricter rules which would only apply to MiFID products would hence have severe adverse effects on investor protection in regard to insurance distribution channels and heavily distort the competition among packaged investments. In order to provide substance to the key objectives of the overall PRIIPs initiative – namely, bringing about similar rules on selling practices for all PRIIPs including insurance products –, the regulatory approach to inducements under both IMD and MiFID should not deviate in such way that it leads to competitive disadvantages for MiFID products. Hence, a level playing field for competing products is crucial. This includes that any stricter rules would have to come into force at the same time in order to avoid shifts in the market which may not easily switched back once the rules are into place for all products.

4. Positive list of criteria would be in line with Level 1 and able to achieve greater convergence across Europe

Notwithstanding the fact that the negative list not in line with MiFID II for formal and material reasons, we believe that a positive list is at least as appropriate to achieve convergence like a negative list. Unlike a negative list, a positive list will give the market participants legal certainty and will allow them to comply with the criteria instead of trying to avoid the negative criteria and still being not sure whether

the payment would be considered as designed to enhance the quality. By this it will achieve greater convergence since the market participants can rely on these criteria.

For such list, it seems appropriate to use ESMA's ideas regarding the criteria "designed to enhance the quality of the service" by transferring the negative approach into a positive one. We therefore suggest the following list:

A payment can generally be regarded as fulfilling the criteria "designed to enhance the quality of the service" if e.g. one of the circumstances and situations of the following indicative list is met, in particular, if

- it provides for an additional or higher quality service above the regulatory requirements provided to the end user client;
- it provides a tangible benefit or value to the recipient's end user client;
- it enables the client to receive access to a wider range of financial instruments;
- it enables an efficient and high-quality infrastructure for services with regard to financial instruments including the qualification of the investment firm's employees; it enables the client to receive access to the provision of non-independent advice on an on-going basis; or
- in particular in relation to an on-going inducement, it is related to the provision of an on-going service to an end user client;

It should be understood that a fee, commission or non-monetary benefit could only be considered acceptable as long as any such service is provided without bias or distortion as a result of the fee, commission or non-monetary benefit being received.

Q82. *Do you anticipate any additional costs in order to comply with the requirements proposed in this chapter? If yes, please provide details.*

We strongly believe that if ESMA does not reconsider its approach regarding inducements, additional costs would arise for clients and investment firms. As stated in our answer to Q79, we believe that the approach regarding tailored research as non-minor monetary benefit will significantly increase the costs for active portfolio management and investment advice. We therefore urge ESMA to reconsider this approach. Further, as stated in our answer to Q81, the significant inhibitions for commission payments in relation to non-independent advice have the potential of changing the market of investment service provision in Europe except for the markets where commission based advice is already banned. As explained above, we believe that this will also have a significant impact on costs for clients and investment firms.

In general it has always been our belief that society should have a strong interest in maintaining the choice of distribution channels for investors and that a ban on inducements will actually lead to a reduction in competition among distribution channels, and/or a reduction in the number of products offered by distributors. Several studies show that a large majority of retail clients are unwilling to pay for advice, and under a fee-based model the current subsidization of advice to small retail clients will no longer be possible. More than ever, EU citizens need access to sound advice for long-term investment, as both social security systems and companies are forced to cut back on pension provision, and pension fund returns suffer from the financial crisis. Further reducing access to advice neither is in the

interest of retail investors, nor encourages savings accumulation and therefore a healthy growth of EU capital markets in the long term.

2.16 Investment advice on independent basis

Q83: *Do you agree with the approach proposed in the technical advice above in order to ensure investment firm's compliance with the obligation to assess a sufficient range of financial instruments available on the market? If not, please explain your reasons and provide for alternative or additional criteria.*

We disagree with ESMA's indication in paragraph 1 p. 128 et seq. that the total number of financial instruments and providers analysed per each type of instruments according to the scope of the service is a relevant benchmark. A higher number of products does not necessarily lead to better investment advice. **We also strongly oppose the notion that less complex financial instruments or financial instruments issued by an entity not having close links to the investment firm generally better meet the client's profile or needs.**

Further, we have concerns regarding the unclear expressions "class" and "type" of financial instrument and "various financial instruments". In particular in connection with ESMA's statement that if the investment firm could not compare "various financial instruments", it would not be allowed to claim itself "independent", e.g. p. 129 para. 1 (v) and 2. It is our understanding that an investment firm could specialize in certain types of financial instruments such as units or shares in investment funds and could still be independent, provided it meets the requirements ESMA states in para. 3, p. 129. We would appreciate a clarification in this respect, in particular what is meant by type, class or various instruments.

We also have concerns regarding the requirements for investment firms focusing on certain classes of instruments. It is understandable why clients should be able to easily identify a preference for the class or range of financial instruments as suggested by ESMA in para. 3 (ii), p. 129. The requirement, however, that the client shall be able to self-select with a high degree of accuracy should be deleted. In case a client would be able to self-select, it is unlikely that he would need advice at all. Such requirement contradicts the general intention of advice, i.e. to provide the client with a recommendation which he cannot draw himself. Furthermore, it is unclear how an advisor in practice should be able to test and proof in case of dispute such requirement. With respect to the requirement to refer the client to another firm in case the firm cannot easily confirm that its service is appropriate for the new client, we strongly suggest to delete this as well (para. 3 (iv), p. 129). First of all, it seems to be an inappropriate burden to be required to refer a client to a competitor. Secondly, there is no requirement within MiFID for firms to know the quality of their competitors. If, however, such requirement would be imposed upon firms, they would have to analyse the market of their competitors to provide a recommendation which is of any use to the client.

Q84: *What type of organisational requirements should firms have in place (e.g. degree of separation, procedures, controls) when they provide both independent and non-independent advice?*

The higher ESMA sets the requirements, the less likely it becomes that investment firms will set up independent advice as an alternative to non-independent advice. Higher requirements usually lead to increased costs which might not pay off if investment firms will not be able to build up a client base with

clients prepared to pay for advice themselves. Setting up a separate department with separate personnel in order to provide both independent and non-independent advice might simply be too expensive for most of the existing investment firms. We generally appreciate ESMA's ideas to clearly distinct between independent and non-independent advice but e.g. the requirement to clearly separate both types of advice increases the costs for personnel and hence decreases the likelihood of firms offering independent advice. ESMA should consider a transition period for firms to enable them to build up a client base for independent advice. In any case, it should be clear that an investment firm could be paid by the client without following the rules for independent advice (e.g. advising on a smaller range of financial instruments), if it does not present itself as independent. This is based on the fact that the advisor has to follow the rules for independent advice once it informs the client of its independence.

From a drafting point of view, ESMA should align the technical advice for sections 2.13 and 2.16 since some of the requirements seem to be repetitive.

Q85: *Do you anticipate any additional costs in order to comply with the requirements proposed in this chapter? If yes, please provide details.*

As indicated, setting up a separate department with separated personnel might be too expensive for some investment firms which will then refrain from doing so.

2.17 Suitability

Q86. *Do you agree that the existing suitability requirements included in Article 35 of the MiFID Implementing Directive should be expanded to cover points discussed in the draft technical advice of this chapter?*

We do not agree with ESMA's proposal expanding the suitability requirements. We would strongly suggest to re-evaluate the current draft technical advice proposing that investment firms have to reassess their intended assessment in the light of alternative financial instruments that are less complex or that have a lower cost that "would meet the client's profile better" (para. 1(iii); last part of the paragraph and para. 1 (ix); p. 133f). We believe that these requirements are simply contradicting the suitability assessment, which is meant to provide investors with suitable advice. ESMA's technical advice insinuates that investment firms would generally be in breach of their duties when assessing suitability if they are required to assess whether alternative financial instruments could better meet the client's profile. Such requirement to assess whether another product is more suitable for the client bears a huge risk of civil liability for the investment firm. If such requirement would come into force, we believe it will have a significant impact on the market of investment firms providing investment advice due to the legal risks caused by the requirements ESMA suggests.

In particular, we do not agree with ESMA's assumption that less complex products are generally better suited. Suitability depends on the client's knowledge and experience regarding the field relevant to the specific type of product (or service). ESMA seems to suggest that even for clients for whom complex products are suitable, non-complex products are preferable. We do not see any support for this approach within MiFID Level 1. In particular with respect to units or shares in AIFs (which ESMA wrongly per se qualifies as complex instruments) this would lead to a major disadvantage. An advisor might be inclined to always recommend a direct investment in a share where the investor does not have the advantage of a risk diversification as it is the case in an investment fund. Also, the requirement to

assess whether an instrument with lower costs would be suitable would also place too big an emphasis on the cost element of suitable financial instruments. Cheaper financial instruments are not necessarily better suited for the client. This, however, is the notion ESMA brings forward. From an advice perspective it has to be considered that there are more facets for suitable products than costs or complexity. In addition, in our view the requirement contradicts ESMA's proposal regarding the second criterion of inducements not designed to enhance the quality of the service: If one is required by law to provide for the best suited product, it is simply not possible to enhance the quality compared to the legal requirements.

In any case, it is completely unclear how the requirement regarding products with lower costs and less complex products would interact. Would in any case the product with lower costs be preferable for the client even if it is more complex than the product which the advisor had first selected? Or would that decision heavily depend on how much more complex the product would be and how much lower the costs are? Hence, we do not believe that such a test would in practice be feasible.
Finally, this would mean that retail products such as retail AIFs (including ELTIFs which would qualify as AIFs) could not be sold by way of execution only and would in addition hardly be sold in form of advised distribution. However, depriving potential investors in retail AIFs of the possibility to receive proper advice does not seem to be an appropriate outcome. Thus, we urge ESMA to delete this requirement.

Q87. *Are there any other areas where MiFID Implementing Directive requirements covering the suitability assessment should be updated, improved or revised based on your experiences under MiFID since it was originally implemented?*

None.

Q88. *What is your view on the proposals for the content of suitability reports? Are there additional details or requirements you believe should be included, especially to ensure suitability reports are sufficiently 'personalised' to have added value for the client, drawing on any initiatives in national markets?*

With respect to the first question, we ask for deletion of para. 2 (iii), p. 133 of ESMA's draft technical advice. An explanation of the disadvantage of the recommended course of action seems inappropriate. Any risk is not inherent in the financial advice as such but within the recommended financial instrument. Advisors are generally required to disclose to the client the risk of financial instruments. Further, risks related to the financial instruments are disclosed in the legal marketing material such as a KID and prospectus for investment funds.

Regarding the latter question, we do not think that there are any additional details or requirements that should be included, especially to ensure suitability reports are sufficiently personalised to have added value for the client, drawing on any initiatives in national markets.

Q89. *Do you agree that periodic suitability reports would only need to cover any changes in the instruments and/or circumstances of the client rather than repeating information which is unchanged from the first suitability report?*

Yes, we agree.

2.18 Appropriateness

Q90. *Do you agree the existing criteria included in Article 38 of the Implementing Directive should be expanded to incorporate the above points, and that an instrument not included explicitly in Article 25(4)(a) of MiFID II would need to meet to be considered non-complex?*

Although we agree with the existing criteria to be expanded to incorporate the aspects suggested by ESMA, **we strongly disagree with ESMA's conclusion regarding shares in AIFs** (see para. 7, p. 137). **MiFID II Level 1 does not signal that shares in AIFs should not be considered as non-complex (1.)**. The general treatment of AIFs as complex products would be inappropriate (2.). We believe that open-ended non-UCITS (i.e. alternative investment funds – AIF) launched under German law can generally fulfil the new criteria and could therefore still meet the definition of a non-complex financial instrument on a case-by-case basis. ESMA should revise its assumption regarding units or shares in AIF and should make clear that they may meet the requirements of instruments being considered as non-complex.

1. No indication by the Level 1 text regarding complexity of AIFs

MiFID II Level 1 only enumerates instruments which can be considered as non-complex without any prejudice to other instruments of the same legal type. Generally, all instruments not included explicitly in Art. 25 para. 4 (a) MiFID II have to meet the test in order to be considered non-complex. ESMA, however, draws the general conclusion by way of reversion that instruments of the same legal type mentioned in the list in MiFID II Level 1 should be considered per se as complex.

While we generally doubt this conclusion by way of reversion is correct**, it definitely is not correct for the example of shares in non-UCITS, i.e. AIF**. Explicitly non-complex instruments include shares admitted to trading on a regulated market, excluding *shares* in AIFs (Art. 25 (4) (a) (i) MiFID II). This wording does not allow for a general conclusion regarding shares *or units* in AIFs. First, the exclusion just prohibits that shares in AIFs are automatically being considered as non-complex just because they are listed. The legislator´s intention here was to avoid that a management company would list shares in AIF in order to allow these to be considered non-complex. This is also shown by the wording of the exclusion in Art. 25 (4) (a) (i) MiFID II: It only comprises "shares" in non-UCITS and not "shares or units" in non-UCITS. The latter is the usual wording if any general reference is made to interests in funds because of the different legal forms that funds may take (corporate, contractual or trust structure). A fund's legal form, however, does not prejudice whether its interests should be considered as complex or non-complex. Hence, it cannot be derived from the wording that the EU legislator signals that AIF in general have to be considered as not non-complex.

Another meaning cannot be derived from MiFID II recital 80. The wording suggests only which types of instruments should be part of a complexity test. As already pointed out, the Level 1 text presumes only which instruments may per se be considered as non-complex. All other instruments are not excluded by MiFID II to pass the complexity test, rather MiFID II recital 80 references to all instruments for which in particular the complexity test will be required.

In addition, ESMA stated at the hearing AIFs should also be considered as complex since they embed a derivative. This general assumption is not correct. AIFs may or may not acquire and sell derivatives, as the case may be, however this is not the understanding of an embedded derivative. A derivative is embedded if it is a component of the financial instrument itself, i.e. it cannot be transferred separately

from the financial instruments. If an AIF only invests in derivatives, the derivate can be transferred separately from the AIF and is hence not embedded.

2. General treatment of AIFs as complex would be inappropriate

A general treatment of AIFs as complex would be inappropriate. AIFs cover a broad range of products. Due to the fact that the original intention of the AIFMD was "to extend appropriate regulation and oversight to all actors and activities that embed significant risks", AIFs are often wrongly considered only as risky products such as single hedge funds. The AIFMD, however, introduced a broad definition of AIF, i.e. all non-UCITS funds, which therefore includes a very broad range of products. AIFs also include highly regulated (i) retail funds that only differ from UCITS insofar as they may invest in precious metals, (ii) open-ended real estate investment funds or even (iii) funds for professional investors that are more conservative than UCITS due to the supervisory regime those investors have to follow (e.g. social insurance agencies). Those funds might be structured in a way that they are less complex even than UCITS. Furthermore, in Germany retail AIFs are strictly supervised and have to be approved on a product level as well as for marketing to retail investors. These instruments today often meet the requirements of instruments being non-complex and according to our understanding will also comply with the two new criteria suggested by ESMA. They should therefore still qualify as non-complex under the MiFID II regime.

Therefore, we urge ESMA to redraft in its final advice to the Commission that there is no presumption that AIFs are not to be considered non-complex. At least ESMA should delete the presumption in para. 7 of the analysis (p. 137) regarding shares in AIFs.

Q91: *Are there any other areas where the MiFID Implementing Directive requirements covering the appropriateness assessment and conditions for an instrument to be considered non-complex should be updated, improved or revised based on your experiences under MiFID I?*

We see currently neither any further regulatory need to revise the requirement for an instrument to be considered non-complex nor the requirements for the appropriateness assessment.

2.19 Client agreement

Q92: *Do you agree that investment firms should be required to enter into a written (or equivalent) agreement with their professional clients, at least for certain services? If yes, in which circumstances? If no, please state your reason.*

We do not see any reason to impose regulatory requirements relating to the conclusion of service contracts with professional clients. The status of a professional client implies per se higher flexibility in the business relationship with the service provider which should correspond with a measurably lower level of regulatory investor protection. Professional clients are either financial institutions and large undertakings or other entities/individuals who meet the relevant criteria relating to their financial means and experience and in respect of whom the investment firm is satisfied on the basis of an individual assessment that the client is capable of making investment decisions and understanding the risks involved[19]. Hence, it should be borne in mind that the assignment of the professional client status on

[19] Cf. Annex II Section II.1. third subsection of MiFID II Level 1.

request already involves high hurdles in order to exclude waiving the investor protection standards for the insufficiently experienced or adept clients.

Therefore, it is not appropriate to require professional clients to enter into written agreements with investment firms, let alone to prescribe the formal conditions of such agreements (in paper/other durable medium). Similarly, the content of service agreements with professional clients should be subject to contractual negotiations between the parties and not be bound by protective measures designed for retail clients. In particular, the suggestion to "state the types of financial instruments that may be purchased and sold and the types of transactions that may be undertaken" goes too far in the context of professional portfolio management. The same applies to the underlying reasoning depicted in recital 19 of ESMA's analysis: professional clients do not need regulatory measures enabling them to better understand the nature of the services provided and where appropriate, to seek judicial recourse.

As a consequence, paragraph 2 of the ESMA's draft technical advice should be deleted.

Q93: *Do you agree that investment firms should be required to enter into a written (or equivalent) agreement for the provision of investment advice to any client, at least where the investment firm and the client have a continuing business relationship? If not, why not?*

A written agreement in terms of investment advice appears appropriate if the parties have the intention to establish a continuing relationship in their business contact. In this regard, we would like to remind ESMA that in the current market practice investment advice is generally provided as a one-off service and does not imply periodic assessments of suitability or other recurring services. Therefore, situations in which the client seeks investment advice from a firm in a repeated or even regular manner, or is contacted by the advisor at certain intervals should not be automatically treated as establishing a continuing business relationship between the investment firm and the client.

Q94: *Do you agree that investment firms should be required to enter into a written (or equivalent) agreement for the provision of custody services (safekeeping of financial instruments) to any client? If not, why not?*

We agree with ESMA's suggestions in this respect.

Q95: *Do you agree that investment firms should be required to describe in the client agreement any advice services, portfolio management services and custody services to be provided? If not, why not?*

As explained in our response to Q92 above, the content of service agreements with professional clients should be subject to contractual negotiations between the parties and not be bound by protective measures designed for retail clients. In particular, the suggestion to "state the types of financial instruments that may be purchased and sold and the types of transactions that may be undertaken" goes too far in the context of professional portfolio management. The same applies to the underlying reasoning depicted in recital 19 of ESMA's analysis: professional clients have adequate knowledge, experience and expertise[20] and thus do not need regulatory measures enabling them to better understand the nature of the services provided or to seek judicial recourse.

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[20] Cr. Annex II Section II.1 third subparagraph of MiFID II Level 1.

2.20 Reporting to clients

Q96: *Do you agree that the content of reports for professional clients, both for portfolio management and execution of orders, should be aligned to the content applicable for retail clients?*

As regards portfolio management, we deem it not at all appropriate to align the content of reports for professional clients with the standards applicable to retail clients.

ESMA fails to provide a justification for this suggestion. In our view, however, the reporting needs of professional clients are fundamentally different from the standards applicable in relation to retail clients. Very frequently, professional clients request tailored reporting on the basis of specific formats and with the focus on certain elements based on the regulatory reporting standards applicable at the client level. For instance, insurance undertakings and credit institutions need very granular reporting on their holdings in investment fund assets under the Solvency II and CRD IV regimes which also encompass fund investments made by the appointed portfolio manager. Hence, it is part of the service provided by the portfolio manager to ensure that the client reporting to such institutions is compatible with their own reporting obligations and can be utilized for such purpose. Moreover, portfolio reports are often designed in a way enabling professional clients to meet their accounting duties which means that the structure of reporting as well as the reported details vary depending on the particulars of the relevant accounting standards. By way of example, undertakings accounting in accordance with the IFRS standards request specific IFRS reporting packages from portfolio managers.

Consequently, the suggested alignment of portfolio reporting for professional clients with the standards applicable in the retail business does not at all correspond with the needs of professional clients and should be foregone. Para. 2 of the draft technical advice should be amended accordingly.

In more general terms, we would like once again to point out that we see no need for regulatory intervention in the conduct of business with professional clients. The status of a professional client implies per se higher flexibility in the business relationship with the service provider which should correspond with a measurably lower level of regulatory investor protection (cf. our reply to Q92 above).

Q97: *Should investment firms providing portfolio management or operating a retail client account that includes leveraged financial instruments or other contingent liability transactions be required to agree on a threshold with retail clients that should at least be equal to 10% (and relevant multiples) of the initial investments (or the value of the investment at the beginning of each year)?*

We are reluctant towards accepting a minimum 10% threshold as appropriate for all portfolio management arrangements with retail clients. Clearly, extraordinary reporting duties should be only triggered by losses which are exceptional in the context of the specific portfolio composition. Hence, a 10% trigger appears inappropriate as regards e.g. a client portfolio focusing on equity investments in selected markets, as clients favouring such investments should be prepared to bear high performance volatilities. Moreover, it is uncertain how to deal with situations in which the client makes investments in addition to the existing portfolio or disinvests parts of its holdings during the years.

Therefore, specification of the loss threshold should be subject to the contractual agreement with the retail client in order to allow the parties to pay consideration to the individual circumstances.

Q100: *What other changes to the MiFID Implementing Directive in relation to reporting to clients should ESMA consider advising the Commission on?*

We see no need for further regulatory changes in relation to client reporting under MiFID II.

2.21 Best execution

Q101: *Do you have any additional suggestions to provide clarity of the best execution obligations in MiFID II captured in this section or to further ESMA's objective of facilitating clear disclosures to clients?*

We generally welcome ESMA's understanding that Level 1 does not require major changes to the best execution regime. With respect to ESMA's suggestions regarding the execution policy though, we do not think that a relative importance of the different factors taken into account for the execution is an approach which should be taken within the policy. We believe that the importance of those factors very much depends on the specific transaction, i.e. type of instruments, size of order, etc.

ESMA also seems to require a very detailed report to the clients regarding order execution. We believe that such requirement might become very burdensome and costly and might therefore not be in the interest of the client. In any case, ESMA should consider allowing specific agreements between professional investors and MiFID firms to refrain from such reporting.

Q102: *Do your policies and your review procedures already the details proposed in this chapter? If they do not, what would be the implementation and recurring cost of modifying them and distributing the revised policies to your existing clients? Where possible please provide examples of the costs involved.*

No answer submitted.

2.24 Product intervention

Q107: *Do you agree with the criteria proposed?*

Principally, we agree with the criteria proposed in the draft technical advice. In more specific terms, however, we would like to point out that product intervention rules have been developed in order to give competent authorities the power to intervene into the manufacturing and/or distribution process in case of substantial concerns relating to investor protection or market integrity/stability. In relation to UCITS and AIFs regulated at national level, such intervention powers form an inherent part of the long-established product regulation. Especially, UCITS are subject to a product approval process which encompasses supervisory investigation into the details of the product design. Moreover, UCITS supervisors are in the position to monitor the product functioning on a continuous basis since material changes to the fund rules require anew approval by the NCA. The same applies to many AIFs admitted to retail distribution by national law such as the German open-ended real estate funds. In all these cases, NCAs have long been able to intervene into the products both at the time of launching and during their lifetime. These powers have been broadly used by the authorities e.g. by requesting modifications in the investment strategy or other product features, or sometimes by refusing

authorisation under the applicable law. As regards AIFs in general, national authorities receive notifications of the fund rules and other relevant information before AIF units are marketed to investors and are able to impose bans or other restrictions in case of established breaches of applicable law.

Against this background, we believe that the relevance of product intervention rules under MiFID to UCITS or AIFs authorised under national law should be very limited. Further, we would like to suggest that the existence of a product approval or a substantive notification process should be accepted as a criterion for the assessment of a potential "threat" under para. 4 of the draft technical advice (cf. our answer to the question below).

Q108: *Are there any additional criteria that you would suggest adding?*

As explained above, we would like to suggest that the existence of a supervisory product approval process encompassing substantive examination of the product rules should be accepted as a criterion for the assessment of a potential "threat" under para. 4 of the draft technical advice. The same applies to product notification requirements involving direct intervention powers of NCAs. Specifically, para. 4 could be supplemented by the following new subparagraph:

"(xii) Alternative means of supervisory intervention. Under this factor, more detailed elements to be considered could include, for example:

a. Application of a product approval process prior to the commencement of distribution,
b. Requirement of product notification prior to the commencement of distribution,
c. Requirement of prior approval or notification in terms of material changes to the product."