Comments

Guidelines on certain aspects of the MiFID II appropriateness and execution-only requirements

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German Banking Industrie Committee
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A. General remarks

- The system of non-advised services and investment advice business is crucial for clients in the German market. Because of the existing regulatory restrictions, there are already client complaints today (e.g. about PRIPPs because clients cannot buy the product (e.g. corporate bonds) because there is no KID) and they are switching to less heavily regulated markets.
- Non-advised services should not be made more complicated.
- The appropriateness assessment relates to the "**self-directed business**", in which the client wishes to purchase an instrument of their own accord, unconnected to any advice or recommendation from the advisor.
- For this reason, in particular all approaches, apart from the legally stipulated experience and knowledge parameters, that amount to the filtering/a filtering effect of the financial instruments and products within the context of the appropriateness assessment must be rejected.
- Appropriateness requirements should not be mixed with product governance requirements. These stipulate filtering by various clusters and categories by the manufacturer and distributor. Under the existing regime, distributors must already adjust the manufacturer's target market if necessary and may not take it over without checking. There is therefore no need for any more extensive filtering in the context of the appropriateness assessment.
- We consider control requirements to be disproportionate in light of the existing suitability and appropriateness requirements.
- Sustainability factors and risks should not be taken into account in the assessment of knowledge and experience in the context of non-advised business.

B. Responses to the individual questions

Guideline 1 – Information to clients about the purpose of the appropriateness assessment

Q1: Do you agree with the suggested approach on providing information about the purpose of the appropriateness assessment? Please also state the reasons for your answer.

Paragraph 14

The obligation to inform clients before the non-advised service about the situations in which no appropriateness assessment will be conducted and the related consequences (paragraph 14, second indent) is unnecessary in light of the clear requirement set out in subparagraphs 2 and 3 of Article 25(3) of MiFID II.

Guideline 2 – Arrangements necessary to understand or warn clients

Q2: Do you agree with the suggested approach on the arrangements necessary to understand or warn clients? Please also state the reasons for your answer.

Paragraph 23

It must be possible for clients to correct their responses (themselves). In cases where clients make mistakes when entering responses, these mistakes must be reversible. Clients will not understand if they are not allowed to correct an incorrect entry.

Limiting the number of corrections is not necessary if the pool of financial instruments is not limited by the client questions. Any limitation in the context of non-advised business on the basis of client knowledge and experience is not expedient. The clients are already sufficiently protected by warnings because they are made aware of any lack of knowledge and experience and can take this into account when making their well-informed decision. Only if the range of available investments is made dependent on the responses to a questionnaire being correct is incentive created for the client to want to inappropriately change their responses, if necessary several times.

Paragraphs 24 and 25

In our view, the recommendation that clients should not assess their own knowledge of certain products is misguided. As a general rule, a certain level of knowledge is conveyed to clients when they open a securities account. In addition, however, investment firms usually have to rely on a self-assessment by their clients, since only the clients themselves are in a position to assess how well they know the products in question. It should be noted in this context that, in addition to knowledge, experience is also relevant. Experience can be objectified (at least over time) on the basis of the clients' activities at the institution concerned, so that there is objectified knowledge about the clients' experience in addition to the subjective self-assessment by the clients about their knowledge.

Investment firms cannot be expected to conduct a fundamental assessment/review of the plausibility of client disclosures about knowledge and experience [paragraph 25 – second indent]. On the one hand, Article 55(3) of the MiFID II Delegated Regulation sets out that investment firms are entitled to rely on the information provided by their clients or potential clients unless they are aware or ought to be aware that the information is manifestly out of date, inaccurate or incomplete. On the other, clients invest little time and resources in non-advised services, with the result that the assessments of knowledge would generate additional effort that which would lead to great dissatisfaction on the client side. Ultimately, there are no robust criteria for determining whether the client really has a sufficiently in-depth understanding of the operating principle.

Paragraph 28

There is no legal reference point for a requirement that clients should be given an opportunity to review the assessment of their knowledge and experience based on their transaction history, so that, for this reason alone, such a requirement should be abandoned.

Guideline 3: Extent of information to be collected from clients (proportionality)

Q3: Do you agree with the suggested approach on the extent of information to be collected from clients? Please also state the reasons for your answer.

Paragraph 29 (at end) and paragraph 32 et seq.

We take a critical view of the proposal to conduct a more in-depth appropriateness assessment for more complex or riskier products than for "simpler" products. From the standpoint of the distributors, a **uniform** appropriateness assessment for self-directed investors should be possible. This would allow standardised IT processes, which are necessary especially in the brokerage business, to be used. This level of standardisation is also in the client's interest, as it ensures that orders can be executed without delay.

It should be considered in this context that there are already increments in the legal requirements that take account of the differences in the products:

- The appropriateness assessment is unnecessary for non-complex products.
- The appropriateness assessment is sufficient for all other products (e.g. non-PRIIP bank bonds). In the wake of MiFID, additional product governance measures were also established to further protect clients (e.g. classification as level 3 knowledge and experience in the context of target market). These are sufficient, and no further safeguards are required. Certain products with a high degree of complexity are sufficiently filtered through the target market requirements with the result that they cannot be bought on a non-advised basis or by retail clients. Any more far-reaching filter effect offers no added value.
- When purchasing packaged investment products, in addition to the appropriateness assessment, investors receive a product-related information sheet in which the manufacturer explains the product to them (key investor information or KID – depending on the product).

Any more extensive differentiation in the appropriateness assessment process is not necessary or reasonable from the client's perspective.

Q4: Do you agree with the suggested approach regarding the appropriateness assessment relating to a service with specific features (paragraph 34 of the Guidelines)? In particular, do you agree with the examples provided (bundled services and short selling), or would you suggest including other examples? Please also state the reasons for your answer.

Paragraph 34

Among other things, ESMA addresses the scenario here where a client purchases two separate services in a bundle of services. ESMA plans to impose specific requirements on the appropriateness assessment here.

In our view, a reference to the requirements governing cross-selling within the meaning of Article 24(11) of MiFID II, which also include the specific requirements governing the appropriateness assessment under the second sentence of Article 25(3) of MiFID II, is sufficient in this context. These state that an institution must examine the appropriateness of all components in the case of non-advised **cross-selling**.

An unambiguous reference to the above-mentioned requirements, for which ESMA has already issued guidelines, would avoid conflicting interpretations. The current wording could give rise to the impression that it not only refers to cross-selling within the meaning of Article 24(11) of MiFID II, but also covers other scenarios. This would run counter to the statutory requirements.

Guideline 4: Reliability of client information

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

Paragraphs 36 and 38

Under Art. 55 (3) Delegated Regulation 2017/565 an investment firm may rely on the information provided by its clients or potential clients being correct. The investment firm may only not rely on the client's information if it is or ought to be aware "*that the information is manifestly out of date, inaccurate or incomplete.*" Accordingly, the information that the client gives an investment firm can in principle be

treated as accurate. There is no fundamental duty on the part of an investment firm to verify the information provided by its clients. Only in cases in which the client information has "*manifest*" deficiencies do investment firms have to verify client information.

General guideline 4 and its supporting guidelines (Rt. 38) could create the impression that investment firms were in principle obliged to verify information provided by clients. This would, however, go beyond the level 2 stipulations in MiFID II. It must remain sufficient that investment firms carry out correct questioning of their clients.

Guideline 5: Relying on up-to-date client information

Q6: Do you agree with the suggested approach on relying on up-to-date client information? Please also state the reasons for your answer.

Paragraph 41

To the extent that ESMA emphasises that the frequency for updating client information in the context of the appropriateness assessment can be lower than in the context of the suitability assessment, this is understandable and correct. However, we take a very critical view of the proposal that particular attention should be paid to the update of information for more vulnerable clients. We see a risk of discrimination – especially from the client's point of view – in the illustrative reference to the fact that older clients in particular (see footnote) may be particularly vulnerable. Older investors are not per se vulnerable. On the contrary, experience and knowledge is likely to increase, rather than decrease, with increasing experience of life and corresponding trading activities.

Paragraph 44

According to ESMA, "*in order to avoid relying on client information that is incomplete, inaccurate or out of date, firms should have arrangements in place to ensure that they ask the client to update the information on his knowledge and/or experience upon becoming aware of a relevant change that could affect his level of knowledge and/or experience. An example would be updating the information of the client's knowledge and/or experience where* ***unusual transactions*** *are registered on the client's account.*"

The term *"… where unusual transactions are registered on the client's account*" is too vague. It would be impossible to implement such monitoring in practice.

Additionally, it should also be considered here that the client's experience is objectified over time by the client's order behaviour at the institution concerned.

Paragraph 45

According to ESMA, "*firms should adopt measures to mitigate the risk of inducing the client to update his level of knowledge or experience so as to make a certain investment product appear appropriate that would otherwise be inappropriate for him, without there being a real modification in the client's level of knowledge and experience*."

This requirement conflicts with Articl. 55(3) of Delegated Regulation 2017/565, under which an investment firm may rely on the information provided by its clients or potential clients being correct. In other respects, such a requirement could only be implemented in practice, if at all, with unreasonable effort.

Guideline 6: Client information for legal entities or groups

Q7: Do you agree with the suggested approach on client information for legal entities or groups? Please also state the reasons for your answer.

Paragraph 46

Paragraph 46 contains the requirement that investment firms have to inform their clients about how they will carry out the appropriateness assessment if the client is a group of natural persons or a legal person. We regard such a provision as unnecessary. The right to represent natural and legal persons is defined at the level of the Member States. In Germany, for example, there are very specific statutory stipulations on this. There is therefore no requirement to providecorresponding additional information to the client.

Paragraph 48

Moreover, it is not clear why the bank's internal policy must contain detailed provisions for the appropriateness assessment in cases in which national law envisages a legal representative for legal persons or groups of persons.

Paragraph 49

The second subparagraph of Article 54(6) of the MiFID II Delegated Regulation clearly states that the assessment of knowledge and experience must be based on the person who is acting. This may be the securities account holder or authorised representative. The institution is then obliged to assess whether the person wishing to place the order (i) has the right of disposal (either as the securities account holder or the authorised representative) and (ii) has the necessary knowledge and experience. If this is the case, the institution must base the appropriateness assessment on that person. This statutory requirement is also appropriate, because it is irrelevant what knowledge/experience any third party who does not place the order has. This unambiguous statutory requirement should not be called into question in the guidelines, which is the case in paragraph 49, for example.

Guideline 7: Arrangements necessary to understand investment products

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

With regard to Guideline 7, it should generally be noted that the appropriateness assessment relates primarily to the "**self-directed business**", in which the client wishes to purchase an instrument of their own accord, unconnected to any advice or recommendation from the advisor.

In the German market, investors can buy a very wide range of financial instruments. The approach being proposed by ESMA would effectively amount to an assessment in the non-advised business whose depth would be similar to the assessment required for investment advice. The product governance requirements expressly do not provide for such an assessment. This is a key difference to the advised business, in which the advisor must, of course, be familiar with the advisory products.

If this were to be treated differently, this could result in institutions having to significantly reduce their offering of products that self-directed investors can buy in the non-advised business. Investors would suffer from this because they might no longer be able to buy certain products that they can currently purchase. It also increases the risk that dissatisfied clients will switch to dubious offerings and providers.

Our view is that ESMA should await the results of the product governance assessment. Any room for improvement in the context of the product governance process should be implemented by means of changes to that process, and not as part of the appropriateness assessment.

Guideline 8: Arrangements necessary to assess the appropriateness of an investment or else issue a meaningful warning

Q9: Do you agree with the suggested approach on the arrangements necessary to assess the appropriateness of an investment or else issue a meaningful warning? Please also state the reasons for your answer.

Paragraph 59

ESMA takes the position that the tools should not classify clients and investment products too broadly. It must be ensured in this context that the information obtained and assessed at the level of the questionnaire is not too granular.

Guideline 9: Effectiveness of warnings

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

Paragraph 64

We already warn our clients if they do not have sufficient experience and knowledge. We therefore do not oppose clear and unambiguous warnings if the client does not have sufficient knowledge and experience, or if the information provided by the client insufficient to make a reliable assessment.

Paragraph 71

In non-advised services, it should be noted that clients wish to order the products as self-directed investors. To ensure the greatest service quality, the institutions want to offer their customers as broad a range of products as possible. From the client's perspective, it is a key sign of quality if the distributor can order the product that clients want for them and does not have to tell them that it is, unfortunately, not allowed to execute the desired order.

In order to meet this quality standard, institutions should not be required to limit the range of products they make available to self-directed investors beyond the regulatory requirements (such as product governance, a product intervention or the lack of a PRIIPs KID). The requirements relating to the appropriateness assessment and execution-only transactions are conclusively governed by MiFID II and Delegated Regulation (EU) 2017/565. There are no provisions here for including parameters other than knowledge and experience. This sort of additional "filtering effect" would also lead to high client dissatisfaction and create inappropriate incentives (see our response to Guideline 7). Clients are already dissatisfied if they are barred from certain financial instruments because of PRIIPs requirements, target market assessments and product bans. Yet another exclusion criterion will lead to a regime that is impenetrable and incapable of being explained to the client. In addition, we are already seeing clients switching to unregulated or less regulated products and markets. It would not be wise to accelerate this trend by means of further regulatory restrictions.

Apart from this, we do not understand what could be meant by "any conditions and criteria under which a client would not be allowed to proceed with a transaction after having received a warning". The MiFID II

requirements explicitly do not provide for an order being rejected because of the appropriateness assessment; on the contrary, the client must be warned and allowed to decide to proceed with execution despite this warning. Rejecting the order as a result of the appropriateness assessment would also establish significant risks under civil law. These passages should be deleted without replacement for the reasons set out above.

Ultimately, ESMA should make it clear in the guidelines that a sale will continue to be possible with a corresponding warning if the appropriateness assessment fails.

Guideline 10: Qualifications of firm staff

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

Paragraph 72

We have no concerns where ESMA states in paragraph 72 that investment firms must ensure that their staff involved in the appropriateness assessment have the necessary knowledge and experience. However, we believe that the obligation formulated in this context to provide these employees with regular further training or continuing development goes too far and should therefore be deleted. There is no legal basis for this sort of obligation. Nor does paragraph 20b of the *Guidelines for the assessment of knowledge and competence* (ESMA71-1154262120-153 (rev)) contain such an obligation, but rather requires an internal or external review, on at least an annual basis, of their staff members' development and experience needs. This is designed to ensure that staff always possess an appropriate qualification for their work.

As an alternative to deleting the last sentence in paragraph 72 ("To that end, firms should regularly train their staff."), a reference to paragraph 20b of the *Guidelines for the assessment of knowledge and competence* could also be considered. This would avoid potential misunderstandings that a different interpretation now has to be made.

Guideline 11: Record-keeping

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

Q13: Do you see any specific difficulties attached to the requirement to keep records of any warnings issued and any corresponding transactions made by clients?

Guideline 12: Determining situations where the appropriateness assessment is required

Q14: Do you agree with the suggested approach on determining situations where the appropriateness assessment is needed? Please also state the reasons for your answer.

Paragraph 84

Financial instruments should not qualify for execution-only transactions if there are any doubts. The uncertainty of the institutions about whether they may execute a transaction in a financial instrument as an execution-only transaction is further increased, especially since ESMA writes elsewhere that a combina-

tion with another offer, e.g. a securities loan, may also rule out the execution-only execution of a transaction in a financial instrument that is otherwise eligible. These passages should be deleted without replacement for the reasons set out above.

Guideline 13: Controls

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

Paragraph 91

In our view, the requirement should be deleted in order to avoid unnecessary redundancies in the processes: under product governance, for example, firms must include target market deviations in distribution in their review of product governance. This also includes deviations from the target market criterion of knowledge and experience.

In this respect, a potential situation where many clients do not have the necessary knowledge and experience for a particular product is already reflected in the review without having to refer to the appropriateness assessment. As this produces identical results in most cases, the additional reference to the appropriateness assessment would have no added value. Nevertheless, many distributors would have to establish a separate process if they were required to capture not only target market deviations (which, as mentioned, also capture knowledge and experience deviations), but also negative appropriateness assessments, in order to include them for their internal processes. In light of the established processes relating to target market deviations, such an additional requirement would be disproportionate.

Sustainable finance

Q16: When providing non-advised services, should a firm also assess the client's knowledge and experience with respect to the envisaged investment product's sustainability factors and risks? If so, how should such sustainability factors and risks be taken into account in the appropriateness assessment? Please also state the reasons for your answer.

Sustainability is an investment preference that is taken into account in advised services. As with other preferences, it is irrelevant in the case of non-advised services, otherwise the distinction between investment advice and non-advised services would be removed.