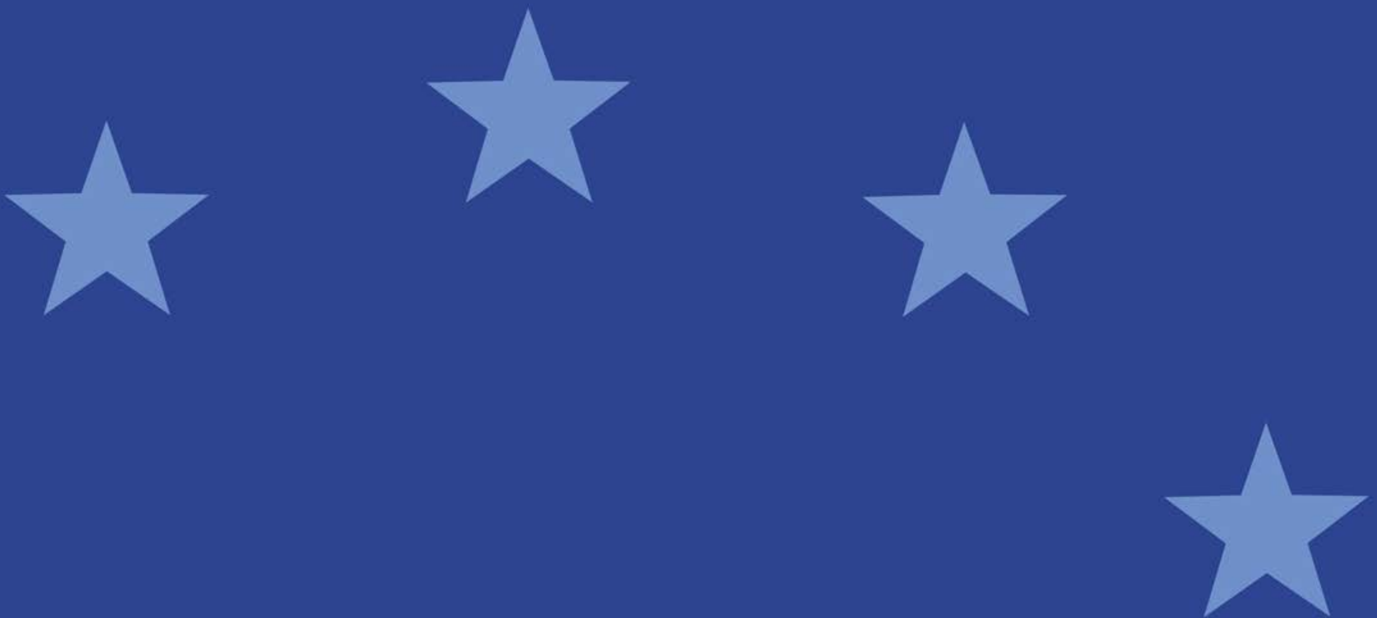
Anlage 1

Reply form for the ESMA MiFID II/MiFIR Consultation Paper



1. August 2014

European Securities and Markets Authority

Date: 1 August 2014

Responding to this paper

The European Securities and Markets Authority (ESMA) invites responses to the specific questions listed in the ESMA MiFID II/MiFIR Consultation Paper, published on the ESMA website (here).

Instructions

Please note that, in order to facilitate the analysis of the large number of responses expected, you are requested to use this file to send your response to ESMA so as to allow us to process it properly. Therefore, please follow the instructions described below:

i. use this form and send your responses in Word format;

ii. do not remove the tags of type <ESMA_QUESTION_1> - i.e. the response to one question has to be framed by the 2 tags corresponding to the question; and

iii. if you do not have a response to a question, do not delete it and leave the text "TYPE YOUR TEXT HERE" between the tags.

Responses are most helpful:

i. if they respond to the question stated;

ii. contain a clear rationale, including on any related costs and benefits; and

iii. describe any alternatives that ESMA should consider

Given the breadth of issues covered, ESMA expects and encourages respondents to specially answer those questions relevant to their business, interest and experience.

To help you navigate this document more easily, bookmarks are available in "Navigation Pane" for Word 2010 and in "Document Map" for Word 2007.

Responses must reach us by **1 August 2014**.

All contributions should be submitted online at www.esma.europa.eu under the heading 'Your input/Consultations'.

Publication of responses

All contributions received will be published following the end of the consultation period, unless otherwise requested. **Please clearly indicate by ticking the appropriate checkbox in the website submission form if you do not wish your contribution to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure.** Note also that a confidential response may be requested from us in accordance with ESMA's rules on access to documents. We may consult you

if we receive such a request. Any decision we make is reviewable by ESMA's Board of Appeal and the European Ombudsman.

Data protection

Information on data protection can be found at www.esma.europa.eu under the heading 'Disclaimer'.

1. Overview

2. Investor protection

2.1. Exemption from the applicability of MiFID for persons providing an investment service in an incidental manner

2.2. Investment advice and the use of distribution channels

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?

The German Banking Industry Committee, which represents more than 2,000 banks in Germany, does not see any need to amend/add to Article 6 of the MiFID Implementing Directive. The general, abstract compliance function requirements currently applying have stood the test in practice. There are no deficiencies (see also Article 16(2) of MiFID II, which has remained unchanged compared with Article 13(2) of MiFID).

Any "upgrading" of ESMA guidelines to delegated acts/implementing measures would also be inappropriate in the view of the German Banking Industry Committee, as it would create the false impression that amendments of their content are intended. The German Banking Industry Committee is opposed to permanent modification of regulations or interpretation guidelines without any objective necessity.

The European compliance requirements currently in force are based on the following understanding: the management of the investment firm carries overall responsibility for putting in place effective organisational arrangements to ensure that the investment firms complies with its obligations under MiFID (including for establishing an effective compliance function). The compliance function's task is monitoring and regularly assessing wether the organisational arrangements put in place by the investment firm to comply with the MiFID requirements are still effective and appropriate (second-level control). In contrast, the business areas are obliged and responsible to comply with the MiFID requirements and therefore control their own actions (first-level control). This understanding, which also underlies the MiFID Implementing Directive (see in particular Article 6 and Article 9), should be adhered to. Some of the draft technical advice (DTA) is at odds with it, however:

<u>No 3. i of the DTA</u>
The compliance function must perform monitoring regularly and, where necessary, on an ad hoc basis, but not "on a permanent basis".

<u>No. 3. iv of the DTA</u>
It is not the compliance function's task to "oversee the operations of the complaints-handling process". For the compliance function's tasks also with regard to complaints management, see Article 6(2) of the MiFID Implementing Directive.

<u>No. 4 of the DTA</u>
The monitoring programme cannot ensure that "compliance risk is comprehensively monitored". It must be "designed to" ensure that compliance risk is comprehensively monitored.

<u>No. 5. ii of the DTA</u>
The compliance officer is not responsible for "any reporting required by MiFID II", but solely for compliance reporting (as also set out in Article 6(3b) of the MiFID Implementing Directive).

The German Banking Industry Committee is also opposed to the approach of setting "special requirements" for the compliance function for some regulatory areas. There is the danger that such further specification on a case-by-case basis would be inconsistent with the general, abstract compliance function requirements. The following examples show that this danger is real:

2.4 Complaints-handling – No. 7 of the DTA
Complaints from clients are information of relevance to the compliance function for performing its general tasks under Article 6(2a) of the MiFID Implementing Directive. But it is not the compliance function's task to "analyse complaints and complaints-handling data". This is instead the task of the unit responsible for handling complaints.

2.6 Recording of telephone conversations and electronic communications – No. 7 of the DTA
We are against any requirement to monitor **all** records. It is recognised that monitoring by the compliance function should be risk-based and thus involve random sampling on the basis of a risk assessment (cf. General Guidelines 1 und 2 of the ESMA Compliance Guidelines).

2.7 Product governance - para. 3 ii
It is not the compliance function's task to put in place effective procedures to ensure compliance with the requirements. This is instead the task of the competent unit within the investment firm, which has to be monitored in its entirety (on a random sampling basis). For the compliance function's tasks also with regard to product governance, see Article 6(2) of the MiFID Implementing Directive.

The German Banking Industry Committee is therefore expressly in favour of retaining the general, abstract requirements of the MiFID Implementing Directive and of refraining from any further specification on a case-by-case basis within the framework of delegated acts.

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

No, not in the view of the German Banking Industry Committee. For the reasons, see our reply to Q3.

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?

The German Banking Industry Committee, which represents more than 2,000 banks in Germany, would like to comment as follows on the draft technical advice (DTA) concerning complaints-handling:

No. 3 of the DTA
It is correct that the compliance function may be responsible for the management of complaints. However, as the question of responsibility for complaints management falls within the scope of investment firms' organisational autonomy, reference to any possible responsibility in ESMA's technical advice should be avoided.

No. 5 of the DTA
It is not the task of investment firms to "set out the client's or potential client's options, where relevant, to refer the complaint to an Alternative Dispute Resolution (ADR) entity or for the client to take civil action". This would establish an obligation to provide legal advice. Such an

obligation would no longer be covered by the organisational requirement to have an effective and adequate complaints management function in place.

In Germany, such a requirement to provide legal advice would actually be against the law, as the provision of legal services – in the interests of clients – is reserved exclusively for certain impartial and appropriately qualified professional groups such as lawyers. The German Banking Industry Committee is therefore opposed to any requirement for investment firms to inform clients about their (individual) rights.

No. 6 of the DTA

ESMA recommends that "investment firms should provide information on complaints and complaints-handling to the relevant NCA, or ADR entity where applicable under national law". The German Banking Industry Committee considers it imperative that the question of a requirement to report complaints from clients needs to be regulated uniformly EU-wide. Different requirements in the individual Member States would be inappropriate. MiFID II also does not provide for any option for Member States in this respect (cf. Article 16(2) of MiFID II), which is the legal basis for delegated acts on complaints from clients and does not contain any corresponding empowerment).

We should first like to question whether an obligation for investment firms to proactively report/forward complaints is needed. In our view, the purpose of the provisions is also adequately satisfied by requiring investment firms to document all complaints and their handling internally. This requirement could be supplemented by a corresponding right to information for NCAs, i.e. provision of information on request.

Should ESMA, however, feel that an obligation to proactively report/forward complaints is essential, we wish to refer to the German model and the experience made with it: In Germany, investment firms have been required since November 2012 to report all complaints from clients in connection with investment advice to BaFin. In the first 15 months of its existence alone, this new requirement led to 12,000 complaints being reported, although ultimately only a few actually resulted in penalty (i.e. monetary fine) proceedings.

The reason for this high number of complaints is the existing very broad definition of "complaint" in Germany. Under this definition, any expression of dissatisfactionby a client, whether justified or not, has to be reported to BaFin. As a result, investment advisers in general are often wrongly suspected of not doing their job properly. Also, the format of a complaint (oral or written) does not matter. Finally, reporting is mandatory in Germany even if a misunderstanding on the part of the client is involved or the bank or savings bank involved promptly settled the complaint.

To keep the flood of information in check, a mandatory reporting would need to be objective and proportionate. Hence, not every expression of dissatisfaction by a client should have to be reported but only those where it emerges that after an initial face-to-face conversation/exchange of correspondence the client evidently wants the investment firm to (further) verify the transaction. This would exclude cases in which the expression of dissatisfaction is based on a misunderstanding or the investment firm and the client managed to quickly clarify, or reach an understanding on, the issue in dispute.

In addition, a requirement to report complaints should – like in Germany – be restricted to investment advice. A general reporting requirement covering all obligations arising from MiFID II/MiFIR would be disproportionate, particularly as a restriction to investment advice would adequately satisfy the actual purpose of the provisions. To keep the burden on investment firms and the flood of information at NCAs within reasonable limits, the reporting requirement for investment firms should, moreover, be restricted to only providing further information on complaints and complaints-handling to NCAs on request.

Any requirement to forward the entire complaint case to the NCA (which No. 6 of the DTA: "Investment firms should provide information on complaints and complaints-handling to the relevant NCA, …" seems to at least be hinting at) would be excessive. The consequence would be information overkill at the NCAs, which would call a reporting requirement as a whole into question.

No. 7 of the DTA
We refer in this connection to our reply to Q3 concerning chapter 2.3: "Compliance function", which we reiterate as follows:
The European compliance requirements currently in force are based on the following understanding: the management of the investment firm carries overall responsibility for putting in place effective organisational arrangements to ensure that the investment firms complies with its obligations under MiFID (including for establishing an effective compliance function). The compliance function's task is monitoring and regularly assessing wether the organisational arrangements put in place by the investment firm to comply with the MiFID requirements are still effective and appropriate (second-level control). In contrast, the business areas are obliged and responsible to comply with the MiFID requirements and therefore control their own actions (first-level control). This understanding, which also underlies the MiFID Implementing Directive (see in particular Article 6 and Article 9), should be adhered to.

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.

The German Banking Industry Committee, which represents more than 2,000 banks in Germany, wishes to stress that orderly record-keeping and the retrievability of records are in investment firms' own interests. The German Banking Industry Committee nevertheless sees no need to add to the minimum list in question.

We have fundamental reservations about the following draft technical advice (DTA):

Nos 2 and 3 of the DTA
As regards the retention requirements under the records set out in chapter 2.5 of the ESMA consultation paper, Article 51 of the MiFID Implementing Directive should continue to apply. That applies to, inter alia, the form of retention (see in this connection Article 51(2) of the MiFID Implementing Directive). Misunderstandable wording such as "in writing" (see No. 2 of the DTA) or "electronic format that facilitates the search" (see No. 3 of the DTA) should be dropped. "In writing" could be misunderstood to mean a formal civil-law requirement. Electronic retention has not been required either so far. Retention in paper form is, for example, currently allowed, along with retention of scanned documents. These recognised forms of retention should remain possible in the future as well.

No. 5 of the DTA
We do not see any legal basis that would authorise NCAs to impose additional record-keeping requirements. As, for example, Article 16(11) of MiFID II shows, national goldplating requires a specific Level 1 empowerment on"whether" and, if so, under what "conditions" goldplating is allowed. This is missing with regard to the record-keeping requirements. Article 16(6) of MiFID II, which sets out the requirements in relation to record-keeping, does not contain any such empowerment.

No. 6 of the DTA

Our comments on No. 5 of the DTA apply likewise to No. 6. ESMA is responsible for interpretation of MiFID II and MiFIR. Neither the timing of records can be specified nor additional recording requirements can be imposed by way of interpretation, however.

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

Because of the unlimited empowerment of the NCAs/ESMA in Nos. 5 and 6 of the DTA, the size of potential additional costs cannot be estimated. This means there is the danger of disproportionate record-keeping requirements and thus also of disproportionate costs for investment firms.

Furthermore, it must be ensured that record-keeping costs do not increase (significantly) due to the fact that currently recognised forms of retention such as paper or scanned documents are no longer to be allowed in future although there appears to be no good reason for this (for more details, see our reply to Q6).

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?

The German Banking Industry Committee, which represents more than 2,000 banks in Germany, rejects the idea of implementing **additional** measures to ensure compliance with the rules on recording telephone conversations and electronic communications.

As far as the **scope of the recording requirement** is concerned, it may be inferred from Article 16(7), subparagraph 1 of MiFID II that only the concrete order needs to be recorded. The German Banking Industry Committee believes no requirement to record additional material can be read into Article 16(7) of MiFID II. The first argument in favour of this view is that, during the legislative process surrounding MiFID II, only the recording of order and transaction data was discussed and made subject to a rule. There was no discussion of broader recording obligations. Second, the phrase "…shall also include those that **are intended to result in transactions concluded** [This and if so subsequent emphasises in citations were untertaken by the author.] …" in Article 16(7), subparagraph 2 of MiFID II should not be misinterpreted as meaning that something other than the concrete order itself needs to be recorded. The wording "…to result in transactions **concluded**…" makes it clear that it is the order itself which has to be recorded, not a preceding conversation with the investment adviser, for instance. We understand the clause "…even if those conversations or communications do not result in the conclusion of such transactions or in the provision of client order services" at the end of subparagraph 2 as a requirement also to record the placing of conditional orders, such as limit orders. If the condition attached to the order is not met, the placing of the order will not result in the conclusion of the transaction. Orders of this kind are, however, "…intended to result in transactions concluded".

As to records of **face-to-face conversations**, we understand the requirement under Article 16(7), subparagraph 7 of MiFID II to minute or make notes of the conversation as an obligation to draw up a written confirmation of the order listing the salient points of the transaction. If the conversation takes the form of investment advice, the requirement can be met by an advisory or suitability report, for example.

The German Banking Industry Committee rejects the idea of a requirement to **record internal calls** relating to transactions (para. 7, No. 3i of the draft technical advice (DTA)). The

correspondence between a transaction executed and the terms of the order placed by the client can easily be checked without recording internal conversations. It would suffice to compare the confirmation of the order with the confirmation of execution, for example. It is therefore not clear why CESR's advice of 29 July 2010 (CESR/10-859, No. 33) should now be overturned and the recording requirements extended. The same applies to the objective of preventing market abuse, which was also considered in CESR's advice of 29 July 2010. We are not aware of any instances of abuse which would make it necessary to extend the scope of the recording requirement to "some internal calls". Furthermore, the expression "relates to" is imprecise and does not make it clear exactly which internal conversations would need to be recorded.

Recording telephone conversations and electronic communications under Article 16(7) of MiFID II is **not compatible with data protection rules**. This goes both for client data and for the data of the staff at investment firms. We would like to draw your attention to the recent **judgment of the European Court of Justice on data retention** (C-293/12 and C-594/12: Digital Rights Ireland and Seitlinger and others), the **E-Privacy Directive (2002/58/EC)** and the **Data Protection Directive (95/46/EC)** – especially Articles 2(h) and 7(a) – and the national data protection rules drawn up on the basis of the above two directives. ESMA's conclusions about privacy matters in para. 15 are not correct. Owing to the existing uncertainty, it is in fact impossible for firms to comply with both the recording requirement and national and European data protection rules. In an opinion delivered on 10 February 2012, the European Data Protection Supervisor also expressed serious concerns about compliance with data protection legislation. There is a pressing need to clarify these issues since, without legislation legalising the recording of telephone conversations, investment firms risk rendering themselves liable to prosecution.

As regards **labour law**, it should be borne in mind that workers' councils in Germany have a right of codetermination on the introduction and use of any technical equipment which serves to monitor the behaviour or performance of staff. This is another potential source of difficulties when it comes to implementing the telephone recording requirement.

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

The German Banking Industry Committee categorically rejects the introduction of a requirement to periodically monitor "records of **all** transactions and orders subject to these requirements including relevant conversations".

The introduction of periodic monitoring of **all** transactions and orders of this kind would lead to an excessive expansion of internal monitoring processes. In practice, it would simply be unworkable. MiFID I and ESMA's existing guidelines already give supervisors and internal monitoring systems sufficient authority to scrutinise records if there is **due cause to do so**. The compliance function, for instance, is empowered under MiFID I and the Market Abuse Directive to obtain access to all information when carrying out **spot checks** or if there are **reasonable grounds for suspicion**. The directive does not prescribe any further requirements. These would need to be agreed by European lawmakers.

Nor is there any practical need for periodic monitoring **without a cause**. This proposal should be dropped in the interests of proportionality and to avoid excessive bureaucracy.

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?

No further items of information are necessary, in the Germany Banking Industry Committees's view.

The German Banking Industry Committee would also suggest dropping information about the **location** of the meeting as a minimum requirement (No. 9 ii of the DTA). It is not clear what added value to investor protection or the prevention of market abuse this information would deliver.

Nor do we understand what precisely is meant by "other relevant information about the transaction" (No. 9 v of the DTA). In the interests of **legal certainty** for market participants, this item needs to be spelled out in more detail.

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

The above-mentioned confirmation of the order does **not need to be signed** by the client because this would constitute unequal treatment of orders placed in face-to-face and telephone conversations. On top of that, clients will have no interest in signing the document. After the execution of the order, the client already receives a confirmation of execution with details of the transaction; these details can be compared with those on the confirmation of the order.

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

Once again, the German Banking Industry Committee would like to draw ESMA's attention to the judgment of the European Court of Justice on data retention (C-293/12 and C-594/12: Digital Rights Ireland and Seitlinger and others). A **retention period of five to seven years seems disproportionately long** given the purpose of making the recordings. Clear powers and rules with respect to storing, retaining and using of personal data are needed in both European and national law.

In its judgement, the European Court of Justice points out that the Data Retention Directive requires data to be retained for a period of at least six months without making any distinction between categories of data on the basis of the persons affected or on the basis of the data's possible usefulness in achieving the objective pursued. Nor is there any guarantee that the retained data will not be misused. The court also criticises the lack of a requirement for the data to be stored within the European Union. **The determination of the period of retention must be based on objective criteria in order to ensure that it is limited to what is strictly necessary** (ECJ Judgment (see above), para. 64). These points need to be considered when regulating the storage and retention of telephone recordings and electronic communication under MiFID II.

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?

The cost to the German banking industry of putting the technical prerequisites in place for meeting these requirements would be enormous. A study conducted in 2008 found that the **acquisition costs alone would be around 632 million euros**. To this would be added the **operating costs**, which the study put **at around 323 million euros annually**.

Given this huge financial burden, there is a **real risk that investment services will no longer be able to be provided over the phone at all branches**. From the investor's perspective, the establishment of centralised call centres for the provision of investment advice would not be an adequate alternative. Investors in Germany prefer to obtain advice from someone who is familiar to them and set store by being able to place their orders with this person directly.

Faced with these costs, financial institutions may no longer find it commercially viable to offer investment advice by telephone in all branches and to all clients, particularly in rural areas. There is a danger that professional investment advice will cease to be available to all categories of client and throughout the country. This would represent a serious cutback in the range of services offered both in Germany and in the European internal market.

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.

The German Banking Industry Committee which represents more than 2000 banks in Germany would like to begin by pointing out that the term "investment product" is not defined. The German Banking Industry Committee would suggest confining the scope of the proposed product governance requirements to financial instruments. As far as the German Banking Industry Committee is aware, EBA, and not ESMA, is the authority responsible for structured deposits.

The German Banking Industry Committee takes the view that the distributor requirements should apply to the primary market only. The secondary market is extremely important to both investors and companies. The hurdles to be cleared by those wishing to trade and participate in this market should not be set too high.

Extending product governance obligations to distribution in the secondary market would translate into higher costs and greater legal risk. On the German secondary capital market, no active distribution relationship exists at present between most manufacturers and intermediaries. And given the hundreds of thousands of products involved, it would not be feasible to establish the kind of network envisaged. Should product governance obligations nevertheless be introduced in this area, distributors would significantly cut back their range of products in order to limit the impact on their business. The consequences for investors would be, first, that a number of financial instruments would no longer be available for purchase from their bank. As a result, their portfolios would be less diversified than at present, thus frustrating the objective of creating an "open architecture". Second, individual risks could no longer be adequately hedged. Third, earnings opportunities could not be exploited. And fourth, investors would have a more limited ability to sell instruments on.

In addition, some of the obligations, such as identifying a target market, cannot be met if securities are listed on a stock exchange. A prerequisite of listing is the ability for the securities to be traded freely. There cannot be a target market because it is in the nature of free trading that anyone can acquire these securities. On top of that, secondary market trading on stock exchanges is highly important to companies. It enables companies to place equity and debt issues with investors without tying them permanently to their investment. Without the ability to sell the investment on via the stock exchange, the vast majority of investors would not be prepared, or would not be able for regulatory reasons, to subscribe to new issues in the primary market. The hurdles to be cleared by all those wishing to trade and participate in these markets should not be set too high.

The German Banking Industry Committee takes the view that the product governance requirements refer **exclusively to financial instruments actively promoted by**

distributors. The German Banking Industry Committee infers this from, among other things, the phrase "for sale to clients" in Article 24(2) of MiFID II.

If Level 1 lawmakers had intended the product governance requirements to be applied wherever there is an opportunity to acquire financial instruments, this phrase would have been superfluous. The German Banking Industry Committee naturally assumes that lawmakers included it in the Level 1 text for a reason. The phrase "offers or recommends" in Article 16(3), subparagraph 6 of MiFID II also clearly indicates, in our view, that not every type of opportunity to acquire a financial instrument from an intermediary is meant to be covered by the product governance requirements. It does not constitute an offer or recommendation, as the German Banking Industry Committee sees it, if an intermediary selects a finite number of products from the infinite number available worldwide and puts the technical and organisational systems in place to enable clients to take up these products via online trading, by telephone or in a face-to-face conversation. The German Banking Industry Committee believes that, based on the wording of Article 24(2) and Article 16(3), subparagraph 6 of MiFID II, the scope of the product governance requirements covers only cases in which a financial instrument is actively promoted, i.e. the distributing investment firm takes concrete steps to highlight a financial instrument and encourage clients to purchase it.

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?

No. There should be no requirement for a written agreement between the distributor and a non-MiFID manufacturer. The German Banking Industry Committee sees no need for such agreements at all, irrespective of where the manufacturer comes from or whether or not it is a MiFID firm. A requirement of this kind would encourage distributors to work together with fewer manufacturers, thus frustrating the objective of an "open architecture". This would restrict the range of financial instruments available to investors, with the result that investors would not always be able to purchase the most suitable financial instrument for their needs.

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?

No. An obligation for distributors to provide periodic information to manufacturers would run counter to the concept of an "open architecture". The distributor would need to invest significant technical resources in establishing permanent communication channels with all manufacturers whose products were part of its range. To keep the associated costs to a minimum, the distributor would work with as few manufacturers as possible. This would significantly reduce the choice of financial instruments available to the investor. For further consequences, please see our reply to Q14.

There would be no additional benefit to the client to offset these drawbacks. Manufacturers are already required to continuously monitor their financial instruments. They are in a much better position than the distributors to monitor and evaluate the development of their products over time. This is because of the manufacturer's expertise and, in particular, the fact that the manufacturer has the most extensive information about the price components and the factors influencing them over the entire life of the product as well as precise knowledge of the total amount of capital invested over the life of the product. Ultimately, the distributor could merely advise the amount of its sales of certain financial instruments. But the manufacturer already has these figures too.

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 manufacturer should not, and cannot, be required to take any specific action if its products are acquired by investors who do not belong to the envisaged target market. The fact that a product has been acquired by an investor outside the target market says nothing about whether or not the product matches the client's needs. Nor can it be assumed that the manufacturer has not complied with its responsibilities.

In practice, the manufacturer has no means of ascertaining with certainty whether products are reaching only the identified target market. The manufacturer does not normally know who the end investors are and cannot therefore map the distribution pattern.

Depending on the circumstances, moreover, there may be very good reasons for **advising** an investor to purchase a financial instrument even if he/she is outside the target market. These reasons may include, for instance, the existing composition of that investor's portfolio or the specific need to hedge a particular risk. The manufacturer has no knowledge of these arguments in favour of the investor purchasing the product and so cannot judge whether the product is suitable for the investor or not. For this reason, the manufacturer cannot, and should not, be obliged to take action if an investor who does not belong to the envisaged target market buys the manufacturer's product.

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)?

For the following reasons, distributors should not have any additional obligations to take action if they become aware of circumstances which could affect the potential risk to the target market.

When offering **investment advice**, distributors are already obliged to recommend only products which are suitable for the particular client. This includes considering any risk associated with the product. If the distributor concludes that, owing to this associated risk, a product is not suitable to an investor, the distributor is not allowed to recommend it, or must recommend that it be sold. There is no need to prescribe further action or impose further obligations on distributors.

Where **investment services** are provided **without advice**, the distributor will not know the investor's readiness or capacity to take on risk, nor is it up to the distributor to ascertain this information. Clients making use of these investment services inform themselves about potential risks and rewards and make their own autonomous decisions without involving the investment firm. The distributor neither knows nor is in a position to assess the investor's reasons for making this decision. With this in mind, distributors providing investment services without advice should also not be required to take specific action.

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.

- **Target markets should be identified only on the basis of abstract, product-related factors**

It is essential to clarify that, when describing the target market, manufacturers are not obliged to use terms which also serve as criteria for assessing the suitability of the product for a specific investor. The German Banking Industry Committee believes it would be problematic, for example, to require manufacturers to specify criteria for assessing the investor's willingness to take on risk (suitability test). In other words, they should not, when describing their product, have to say it is suitable for "conservative" or "growth-oriented" investors, or for investors with "low" or "medium" willingness to take on risk. This is because the distributor will have its own, possibly differing understanding of such criteria since it alone knows the particular investor. The requirements should take account of the practical circumstances and the basic division of responsibilities between manufacturers and distributors.

The German Banking Industry Committee welcomes ESMA's acknowledgement that manufacturers can only be required to identify a "potential" target market and ascertain the needs and characteristics of clients with whom the product is compatible "on a theoretical basis" (cf. No. 7 of the draft technical advice (DTA) and footnote 34 respectively). An abstract, product-related perspective of this kind is essential because the manufacturer, as mentioned above, has no direct relationship with the client.

There is consequently a need to clarify that, when describing the target market, manufacturers may confine themselves to using abstract, product-related terms.

- **Target market requirements under MiFID should be considered met if manufacturers have already satisfied the corresponding requirements under the PRIIPs Regulation**

The European Parliament legislative resolution of 15 April 2014 on the proposal for a regulation of the European Parliament and of the Council on key information documents for packaged retail and insurance-based investment products (PRIIPs) (COM(2012)0352 – C7-0179/2012 – 2012/0169(COD)) also contains requirements for describing a target market (description of the consumer type, Article 8(3)(b)(iii) ("a description of the consumer type to whom the PRIIP is intended to be marketed, in particular in terms of the ability to bear investment loss and the investment horizon") and of a summary risk indicator, Article 8(3)(c)(i) ("a summary risk indicator, supplemented by a narrative explanation of the indicator, its main limitations and a narrative explanation of the risks which are materially relevant to the PRIIP and which are not adequatedly captured by the synthetic risk indicator"). The German Banking Industry Committee believes it is essential to take a harmonised approach to these information requirements for manufacturers. As the German Banking Industry Committee sees it, the regulatory objective of both sets of requirements is identical. It would therefore make no sense to prescribe different requirements at Level 2.

In the interests of consistency, it could be specified at Level 2 that the requirements concerning target market information under MiFID II will be deemed to have been met if the manufacturerissuer has already satisfied the above requirements for PRIIPs.

- **No negative identification of the target market**

By describing the potential target market using positive indicators, the manufacturer will already have given the distributor an indication of what type of investor the product has been designed for. **It would be superfluous and without benefit to investors or distributors if it were also necessary to describe the kind of investor for whom the product would not be suitable**. A requirement of this kind would, in addition, fly in the face of the objective of investment advice, namely to recommend to the investor a product that is suitable for him or her. When using **investment services with or without advice**, clients should continue to be able to obtain products which match their individual needs. When providing investment advice, moreover, it should be possible to make recommendations which may be outside the

manufacturer's target market but are nevertheless suited to clients with their individual portfolio composition and overall risk situation in mind. It may make good sense in certain circumstances to recommend adding a product to the portfolio mix which the manufacturer would assume was not, in principle, suitable for the potential target market to which the investor belongs.

- **Compliance function's task**

The German Banking Industry Committee refers in this connection to its reply to Q3 concerning chapter 2.3: "Compliance function", which is reinterated as follows:

"2.7 Product governance - para. 3 ii
It is not the compliance function's task to put in place effective procedures to ensure compliance with the requirements. This is instead the task of the competent unit within the investment firm, which has to be monitored in its entirety (on a random sampling basis). For the compliance function's tasks also with regard to product governance, see Article 6 (2) of the MiFID Implementing Directive."

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.

The German Banking Industry Committee sees a need not for further product governance requirements, but for a few exemptions and clarifications.

First, it should be clarified that the identification of a target market for a product has no influence on a client's ability to purchase this product if the distributor is providing the client with investment services without advice. Only the product's appropriateness will be examined in such cases.

Second, there is a need for exemptions from the proposed general product governance requirements for certain types of product. The obligations set out in the consultation paper have evidently been developed with a particular image of products and distribution in mind – an image based on investment products with an underlying investment strategy driven by a distribution model in which manufacturers and distributors work in close cooperation.

This image is not true of a significant proportion of products for retail investors on the German market. A large number of the products on offer in Germany, particularly structured notes and warrants, are designed for investors who make their own autonomous decisions. These clients make their investment decisions without advice from the distributor, as is expressly permitted by MiFID. The products are purchased via the investment firm (bank/broker) where the client's portfolio is maintained.

There is no interaction between manufacturers and distributors on products like these. Yet to meet the proposed product governance requirements, manufacturers and distributors need to coordinate with one another. This would be totally unfeasible given what would be involved, namely coordination between the manufacturer and hundreds of potential banks or brokers – i.e. every bank or broker maintaining portfolios for German clients. These products are not even covered by the relevant MiFID II provisions. They have not been manufactured "for **sale to clients**" but, to be precise, for **acquisition by** clients.

With this in mind, there should be an exemption from the product governance requirements for products "manufactured for acquisition by clients through investment firms which do not recommend such products."

On top of that, many products – on the German market at least – do not match the "image" of products described above because they are manufactured in a number of varieties for different market expectations on the part of investors, for instance.

A solution needs to be found to enable the appropriate treatment of products which do not carry the risks that the product governance requirements are designed to mitigate. The German Banking Industry Committee believes explicit exemptions should limit the scope of the requirements as follows. If there is no cooperation between the manufacturer and distributors on the distribution of a product, this product should be totally exempt from the requirements. Products which are not based on a specific investment strategy and whose structure rules out any misconceptions about the product's functioning should at least be exempted from the obligations under Nos 6, 9, and 11 to 15 of the DTA and from the obligations for distributors under Nos 21 and 25 to 27 of the DTA. Alternatively, manufacturers and distributors could be given the option of deciding for themselves, on the basis of policies resting on risk analyses, whether or not the requirements apply to a specific product.

2.8. Safeguarding of client assets

Q22: Do you agree with the proposal for investment firms to establish and maintain a client assets oversight function?

Establishing and maintaining a dedicated function to oversee the orderly safekeeping of client assets not only makes good sense for large financial institutions, but is probably already normal practice. The German Banking Industry Committee, which represents more than 2,000 banks in Germany, would nevertheless ask ESMA to clarify that it is not necessary for a "single officer" to assume this role. Every departmental or division manager is responsible for ensuring that the tasks entrusted to their business unit are carried out in a correct and orderly manner. And if custody services are outsourced to a specialist firm, it will be responsible for ensuring all obligations are met. This is sufficient to ensure that business is conducted in a correct and orderly way and thus that client assets are adequately protected.

To overcome the difficulties outlined in para. 8 – namely that supervisors have no single contact person – and in para. 10 – that responsibilities for safeguarding client assets are divided among several persons – firms could be required to nominate a person responsible for the safeguarding of client assets. Depending on the size and internal organisation of the firm, this person may be a division or departmental manager, a member of the management board or, in exceptional cases, an officer charged with this function. But we reject the idea of making it mandatory to appoint an additional dedicated officer.

Q23: What would be the cost implications of establishing and maintaining a function with specific responsibility for matters relating to the firm's compliance with its obligations regarding the safeguarding of client instruments and funds?

Even in a small bank, where the tasks of this new "single officer" would be assumed by one person only, the average overall cost of establishing and maintaining a separate compliance function for the safeguarding of client assets would be between 100,000 and 150,000 euros per year. Given that the treatment of client assets is normally scrutinised during the audit of a firm's annual accounts, we do not consider it necessary to have a separate compliance function or staff unit together, possibly, with support staff and infrastructure. For smaller financial institutions, in particular, a separate function along these lines would be disproportionately costly and resource-intensive.

Q24: Do you think that the examples in this chapter constitute an inappropriate use of TTCA? If not, why not? Are there any other examples of inappropriate use of or features of inappropriate use of TTCA?

We agree that the examples ESMA provides in its draft technical advice (DTA) constitute an inappropriate use of TTCAs and would like to point out that such practices do not occur in Germany because they would be in breach of civil law.

We would, however, welcome clarification that appropriateness only needs to be considered and demonstrated in the context of loan collateralisation and that the DTA will not apply to the use of standard master agreements (such as the Global Master Repurchase Agreement, European Master Agreements or German master agreements) because the protection of clients is already adequately ensured in these cases. The example described in No. 3 iii of the DTA, in particular, can only occur in cases referring to the client's entire business relationship with the investment firm.

We would also like to point out that TTCAs are mainly used in transactions which are not typical loan agreements. In Germany, TTCAs have no importance outside their use in repos and credit support annexes for derivatives. In the Financial Collateral Directive (FCD), the term "title transfer collateral arrangement" is defined as explicitly including repos (Article 2(1)(b) of the FCD). In the money market, repos are concluded with the express purpose of avoiding high-risk, uncollateralised business and in the interests of financial stability. There is always a strong connection in transactions of this kind between the value of the instrument serving as financial collateral and the purchasing price paid for it (No. 3 i of the DTA). There is also a close connection between the value of the claims of the client and of the investment firm (No. 3 ii of the DTA). The situation with securities collateral under a securities lending transaction is comparable.

Given regulatory developments in the areas of clearing obligations and haircuts on financial collateral, the possibility cannot be ruled out that the application of the DTA may cause problems in the future. Future regulatory requirements could, for instance, impose haircuts on financial collateral, which would make it difficult to apply No. 3 ii of the DTA. Any resulting legal uncertainty would have disastrous consequences for liquidity management and the collateralisation of derivatives. For this reason too, the DTA should not apply to TTCAs concluded in the context of repos or standardised credit support annexes for securities lending or derivatives transactions. This applies all the more since professional clients are invariably aware that, when transferring an asset, they receive a contractual claim to the delivery of an asset of the same type and quality and that this claim can be netted against other claims in the event of the counterparty's default (close-out netting). The transfer of title to the financial collateral is consciously intended to enable the counterparty to reuse the collateral (e.g. for funding purposes).

The concern underlying Article 16(10) of MiFID II, namely that the use of a TTCA can place clients at a disadvantage and wrongly leave their assets unprotected, does not apply to repos or to fulfilling margin requirements [cf. also Recital 52 of MiFID II: "The requirements concerning the protection of client assets are a crucial tool for the protection of clients in the provision of services and activities. Those requirements can be excluded when full ownership of funds and financial instrument is transferred to an investment firm to cover any present or future, actual or contingent or prospective obligations. That broad possibility may create uncertainty and jeopardise the effectiveness of the requirements concerning the safeguard of client assets."].

The final point we wish to make is that, contrary to what is stated in para. 14, TTCAs are not used in the course of re-hypothecation in prime brokerage. Instead, a security financial collateral arrangement as defined in Article 2(1)(c) of the FCD will normally be concluded in such cases. By

contrast, both EMIR and the clearing terms and conditions of central counterparties (CCPs) make it mandatory to use TTCAs when carrying out repos and posting collateral.

Q25: Do you agree with the proposal to clarify that the use of TTCA is not a freely available option for avoiding the protections required under MiFID? Do you agree with the proposal to place high-level requirements on firms to consider the appropriateness of TTCA? Should risk disclosures be required in this area? Please explain your answer. If not, why not?

The idea behind the ban in Article 16(10) of MiFID II is that retail investors should not bear the risk of the counterparty's insolvency that they would assume under a TTCA because ownership of the assets would pass to the counterparty in exchange for a contractual claim to the return of the assets. This claim would not be insolvency-resistant, especially if it were not matched by sufficient obligations on the part of the investor so that a netting of mutual claims would not be possible, or not possible on an adequate scale.

Should such a situation arise with professional clients, ESMA's proposal would certainly be worth considering. But we would like to point out that cases of this kind, if they occur at all, will result from the use of a security financial collateral arrangement in connection with the granting of a right of use. TTCAs will not be involved.

It should also be borne in mind that the situation with profession clients is normally as follows, at least in Germany. A TTCA, i.e. the transfer of financial collateral, is normally agreed in the course of a repo or when collateralising a derivatives or securities lending contract – that is to say in the direct context of collateralising a specific liability. It is essential that TTCAs remain a freely available option in such cases and on no account should uncertainty be generated about whether the provision of collateral will be legally effective. This same needs to apply if the parties to an agreement consciously choose a TTCA as the most appropriate mechanism for their particular purposes. Otherwise, an incalculable risk to financial stability will arise. The consideration of appropriateness in the form envisaged by ESMA is not necessary for the TTCAs normally used in Germany.

Furthermore, TTCAs are not always agreed only between a client and a custodian; they may be agreed with any counterparty. If the counterparty does not happen to be the custodian of the financial collateral, the custodian will merely receive an instruction to transfer the assets in question to another party. The custodian will not normally know that this instruction was triggered by a TTCA agreed between its client and a third party. In consequence, the custodian will not be in a position to consider the appropriateness of the underlying TTCA and ESMA's technical advice should not require it to do so. In addition, we consider it superfluous to highlight the risks involved since (professional) clients who consciously agree to a transfer of title are well aware that they will lose ownership of the assets and obtain a contractual claim to their return in exchange. A requirement to explain the risks involved would be an unnecessary formality; it would not deliver any additional benefit but only sow uncertainty as to the possible legal consequences of a violation.

Q26: Do you agree with the proposal to require a reasonable link between the client's obligation and the financial instruments or funds subject to TTCA?

In Germany, TTCAs are usually used in connection with repos and credit support annexes for derivatives or securities lending contracts. In such cases, there is invariably a reasonable link between the client's obligation and the financial instruments or funds subject to the TTCA. If a TTCA is used as collateral for a loan, civil law requires there to be a reasonable link between the collateral and the collateralised loan. We do not consider it necessary to introduce additional prudential restrictions.

Q27: Do you already make any assessment of the suitability of TTCAs? If not, would you need to change any processes to meet such a requirement, and if so, what would be the cost implications of doing so?

The TTCAs used in the course of repos and derivatives or securities lending transactions may always – in Germany at least – be considered suitable for the client. This is because contractual provisions in the relevant standard master agreements are designed to protect the interests of all the contractual parties. German investment firms go further, and also assess the suitability of the product, i.e. the repo or derivative, for the individual client.

As to the use of TTCAs as general collateral for "present or future, actual or contingent or prospective obligations" [cf. Recital 52 of MiFID II], strict civil law restrictions already exist in Germany, so an assessment of suitability would automatically be made when the TTCA was put in place.

We would also like to point out that the use of TTCAs may also become necessary or be prescribed by the Eurosystem in the context of the **TARGET2-Securities** project.

Q28: Are any further measures needed to ensure that the transactions envisaged under Article 19 of the MiFID Implementing Directive remain possible in light of the ban on concluding TTCAs with retail clients in Article 16(10) of MiFID II?

Article 19 of the MiFID I Implementing Directive regulates the use of a client's financial instruments for the investment firm's own account or the account of another client of the firm. This may, but need not necessarily, affect TTCAs.

We would therefore welcome clarification that securities financing transactions (SFTs) will **not** be affected by the ban in Article 16(10) of MiFID II if the transfer of the securities is the primary obligation under the agreement between the client and investment firm. This is the case with securities lending arrangements, in particular.

Contrary to what is stated in paras 22 and 23 of chapter 2.8, the execution of a securities lending arrangement in the EU **always** requires the transfer of title to the securities – not just "in certain jurisdictions". The purpose is to enable the borrower to use the securities, which it does not itself hold and has therefore borrowed, as if it were the owner – i.e. to exercise the associated rights or use the securities to meet its own delivery obligations.

The "alternative legal mechanism" referred to in para. 23 is strongly reminiscent of the US civil law system of securities entitlements, under which investors do not have ownership of their securities, but only a contractual claim vis-à-vis the investment firm. A transfer to title may naturally be dispensed with in a system of this kind. But under continental European law, the legal position of the client is stronger at the outset because clients can acquire ownership of a security and not just a contractual claim against the custodian. Prudential requirements based on the US legal system – even if limited to the handling of securities lending arrangements – would not be workable under continental European law. We do not agree with ESMA's conclusions in paras 22 and 23 and consider them totally unrealistic.

It should also continue to be possible to conclude securities lending arrangements with retail clients, especially when their purpose is not to collateralise a retail loan. In this case, they do not even constitute a TTCA. Securities lending arrangements are often concluded with existing shareholders in connection with underwriting and placement and these shareholders may sometimes by retail investors. More commonly known as greenshoe options, these arrangements are an indispensable element of the stabilisation strategies investment firms need to implement and are expressly endorsed by Regulation (EU) No. 596/2014 on market abuse (MAR) and Commission Regulation (EC) No 2273/2003 implementing Directive 2003/6/EC (Market Abuse Implementing Regulation), [Recital 11: "Stabilisation transactions mainly have the effect of providing support for the price of an offering of relevant securities during a limited time period if they come under selling pressure, thus alleviating sales pressure generated by short term investors and maintaining an orderly market in the relevant securities. This is in the interest of those investors having subscribed or purchased those relevant securities in the context of a significant distribution, and of issuers. In this way, stabilisation can contribute to greater confidence of investors and issuers in the financial markets."].

Q29: Do you agree with the proposal to require firms to adopt specific arrangements to take appropriate collateral, monitor and maintain its appropriateness in respect of securities financing transactions?

This question refers to No. 7 of the DTA. We believe its scope needs to be more clearly formulated since investment firms will not always be in a position to fulfil the proposed requirements. If it is acting as a party to a securities financing transaction or as an agent arranging a securities financing transaction for a client, an investment firm can naturally require the provision of collateral.

But if the investment firm is neither a party nor an agent, but is merely processing a transaction agreed between the client and a third party, the firm will have no influence on the details of the transaction. It will not normally even be aware that such a transaction has been agreed, but will only receive an instruction to transfer the securities.

It is therefore essential to clarify that No. 7 of the DTA only applies if the investment firm is itself a party to, or is acting as an agent in, a securities financing transaction.

Q30: Is it suitable to place collateral, monitoring and maintaining measures on firms in respect of retail clients only, or should these be extended to all classes of client?

Master agreements for securities financing transactions generally require collateral to be provided or a cash adjustment to be made. Exceptions to this rule should nevertheless remain possible in legitimate circumstances, e.g. if alternative measures have been taken or if the client expressly desires otherwise. The important point is that the protection of the client is ensured.

Q31: Do you already take collateral against securities financing transactions and monitor its appropriateness on an on-going basis? If not, what would be the cost of developing and maintaining such arrangements?

Please see our reply to Q 30.

Q32: Do you agree that investment firms should evidence the express prior consent of non-retail clients to the use of their financial instruments as they are currently required to do so for retail clients clearly, in writing or in a legally equivalent alternative means, and affirmatively executed by the client? Are there any cost implications?

We agree that the express prior consent of nonretail clients should be evidenced. We fear, however, that the expression "affirmatively executed by the client" will be alien to a number of European legal regimes. Under German law at least, it will not be possible to fulfil this requirement. Most other continental European legal systems will probably also be unfamiliar with the concept, which is rooted in the Anglo-Saxon legal tradition. In our view, member states could at most be given an option to require a declaration of consent in a form over and above "express prior consent … recorded in writing or in a legally equivalent alternative means."

Member states should also be enabled to resolve difficulties of demarcation between this prudential requirement for consent in written form and similar civil law requirements (e.g. Section 16 of the German Safe Custody Act – Depotgesetz).

Q34: Do you think that it is proportionate to require investment firms to consider diversification of client funds as part of the due diligence requirements when depositing client funds? If not, why? What other measures could achieve a similar objective?

We agree in principle that firms not licensed as credit institutions should be required to consider diversification when placing client funds. It must, however, be ensured that this obligation does not override the importance of ensuring availability. Funds should not be placed at greater risk simply to achieve diversification. No specific percentage for central bank deposits, credit institution deposits and money market funds should be introduced. If a client makes a specific request – which may come at a cost to the client – the investment firm should deposit the funds as the client advises (e.g. with a third party rather than intra-group).

As we understand it, the term "funds" refers only to cash, not to securities. This distinction is also reflected in Articles 17 and 18 of the MiFID Implementing Directive, which differentiates between "depositing client financial instruments" (Article 17) and "depositing client funds" (Article 18).

Q35: Are there any cost implications to investment firms when considering diversification as part of due diligence requirements?

Increasing requirements for diversification would generate significantly higher operational complexity and cost in terms of more requests for proposal (RfPs), additional due diligence, legal opinions, documentation, pledge waivers requested by clients, additional opening and management of cash accounts and potentially less funds available for cash clearing and lending. On top of that, new funding and defunding processes would need to be implemented.

Q36: Where an investment firm deposits client funds at a third party that is within its own group, should an intra-group deposit limit be imposed? If yes, would imposing an intra-group deposit limit of 20% in respect of client funds be proportionate? If not, what other percentage could be proportionate? What other measures could achieve similar objectives? What is the rationale for this percentage?

We agree that an intra-group deposit limit should be imposed on investment firms that are not licensed credit institutions to avoid exposure to concentration and contagion risk. However, we recommend carefully analysing where to place the cap on the proportion of client funds. Any cap imposed should not unnecessarily decrease the overall liquidity of the group credit institution and increase costs for clients.

Q37: Are there any situations that would justify exempting an investment firm from such a rule restricting intra-group deposits in respect of client funds, for example, when other safeguards are in place?

To avoid disproportionate costs for smaller investment firms, we would recommend setting a specific minimum threshold (i.e. an amount) of client funds above which the restrictions would apply. There would be little benefit to the client if a small amount of funds had to be diversified across multiple banks.

Q38: Do you place any client funds in a credit institution within your group? If so, what proportion of the total?

Yes.

Q39: What would be the cost implications for investment firms of diversifying holdings away from a group credit institution?

The diversification requirement would generate significant costs owing to the need to determine the daily available cash and move it to a non-group credit institution. There would also be increased operational risk.

Several factors need to be considered. To calculate the available liquidity, the cash liquidity required to prefund the overnight settlement cycle needs to be taken into account. Excess balances are usually small as additional collateral is not usually required for equity and custody DMA products. Often clients also have overdrafts in other currencies that would need to be considered, so the additional benefit to the client would be small compared to the cost the client would pay for diversifying the funds. Each deposit of an investment firm's clients funds with a third party would reduce the benefit to the credit institution and hence the benefit to its clients (the bid/ask spread remains with the credit institution in the case of deposits of intra-group client funds)

Q40: What would be the impact of restricting investment firms in respect of the proportion of funds they could deposit at affiliated credit institutions? Could there be any unintended consequences?

Firms could face a large increase in costs and a reduction in efficiency that could have a direct impact on the service to clients. It may also result in funds being placed with lower-quality counterparties as the need for diversification would require more institutions to be utilised than is the case today.

Q41: What would be the cost implications to credit institutions if investment firms were limited in respect of depositing client funds at credit institutions in the same group?

Depending on the agreed ratio and the ability to gain additional client funds from external investment firms, there might be a significant opportunity cost in terms of lost revenues for the credit institution and significant operational cost implications for the implementation and maintenance of the required monitoring process for the investment firm. Each deposit of an investment firm's clients funds with a third party would reduce the benefit to the credit institution and hence the benefit to its clients (the bid/ask spread remains with the credit institution in the case of deposits of intra-group client funds).

Q42: Do you agree with the proposal to prevent firms from agreeing to liens that allow a third party to recover costs from client assets that do not relate to those clients, except where this is required in a particular jurisdiction?

The scope of the proposed requirement is not totally clear. Where it applies to custodianship, we consider this requirement appropriate and essential to protecting client assets. German investment firms which offer custody services achieve this protection by obtaining a so-called Three-Point Declaration. By signing the declaration, custodians outside Germany confirm that liens, rights of retention and similar rights with respect to assets held in custody will be asserted only to satisfy claims that arise from the purchase or administration of those particular assets.

This should not be confused with cases in which the client consents to grant third parties a lien or other right in respect of the assets although the third party has no claim on the client (the assets' owner). In other words, the lien is granted on the basis of an agreement outside the confines of custodianship. It would therefore be helpful to clarify that Nos 13 to 15 of the DTA refer to the agreements with intermediate custodians on which custodian services are based.

Q43: Do you agree with the proposal to specify specific risk warnings where firms are obliged to agree to wide-ranging liens exposing their clients to the risk?

Underlying custodianship is the common interest which the investment firm and client have in ensuring that the client's assets are protected. In Germany, this is achieved with the help of the Three-Point Declaration.

If other investment firms do not follow this practice, we agree that the firm should be required to inform its clients that their assets can only be held in custody if the investment firm grants third parties liens over the assets even in relation to claims not directed at the client.

Q45: Should firms be obliged to record the presence of security interests or other encumbrances over client assets in their own books and records? Are there any reasons why firms might not be able to meet such a requirement? Are there any cost implications of recording these?

We believe orderly record-keeping demands that a record be kept of any liens, security interests or other encumbrances in respect of assets held in custody. This only applies to liens and security interests granted to third parties, however. A bank's own liens – especially liens under German banks' General Business Conditions – are not recorded in its books. These liens in favour of the investment firm normally exist for all the firm's claims against the client arising from the banking business relationship. In consequence, their composition and value are in a state of flux. It would not be practicable to always note the exact value of the bank's lien in the custody account.

Q46: Should the option of 'other equivalent measures' for segregation of client financial instruments only be available in third country jurisdictions where market practice or legal requirements make this necessary?

No. It would not be appropriate to place restrictions on the "other equivalent measures" option envisaged under Article 16(1)(d) of the MiFID Implementing Directive. Nor would it be appropriate to restrict the application of the option to third countries outside the EU internal market.

Article 16(1)(d) of the MiFID Implementing Directive requires investment firms to "take the necessary steps to ensure that any client financial instruments deposited with a third party [...] are identifiable separately from the financial instruments belonging to the investment firm and from financial instruments belonging to that third party [...]". There is no requirement for mandatory segregation of accounts. Segregation is mentioned only as an example of how to ensure instruments can be identified as belonging to a particular client.

The objective is to protect the instruments in the event of the custodian's insolvency and ensure that they can be returned. If this can be guaranteed through "other equivalent measures", there is no need for segregation. One example of a measure equivalent to segregation might be to allow client assets and the custodian's own assets to be held in the same account, but to instruct the custodian to treat that account as if all the assets held in it were client assets. Whether such a measure may be deemed "equivalent" naturally also depends on the individual circumstances involved and on the legal regime applicable in the place of custody.

The obligation to segregate accounts proposed by ESMA would be incompatible with the future UCITS V Directive and Article 38 of the future CSD Regulation, which expressly allow assets to be held in custody in omnibus accounts. In the case of the CSD Regulation, this applies not only at the level of the CSD itself, but also at the level of its participants and their clients. Further segregation is not prescribed. To avoid a conflict in European law, there should be no restrictions on the options permissible under Article 16(1)(d) of the MiFID Implementing Directive.

Nor is it necessary to specifically inform clients that "other equivalent measures" are in place because these measures have to "achieve the same level of protection" as that offered by segregated accounts.

Q47: Should firms be required to develop additional systems to mitigate the risks of 'other equivalent measures' and require specific risk disclosures to clients where a firm must rely on such 'other equivalent measures', where not already covered by the Article 32(4) of the MiFID Implementing Directive?

We do not consider it necessary for firms to have additional systems in place. Article 16(1)(d) of the MiFID Implementing Directive requires measures used as an alternative to segregating accounts to be "equivalent" and "achieve the same level of protection". If these conditions are met, there is no need for the investment firm to take further action. If these conditions are not met, client assets should on no account be placed in custody with this custodian. So "additional systems" will always be superfluous.

Q49: Should investment firms be required to maintain systems and controls to prevent shortfalls in client accounts and to prevent the use of one client's financial instruments to settle the transactions of another client, including:

As we understand it, ESMA is concerned that an investment firm might use securities belonging to one client to fulfil another client's delivery obligations vis-à-vis a third party by booking

securities out of an omnibus account although the client with the delivery obligations does not have a sufficient number of securities available at the time.

The measures listed in No. 18 of the DTA will be able to eliminate this concern, in our view.

We would nevertheless suggest putting these measures in reverse order. Investment firms should, first, monitor whether delivery obligations are met (iii), then actively request any securities that do not look as if they will be delivered on time (ii), and finally conclude agreements with clients on measures to be taken if timely settlement cannot be ensured (i).

Q50: Do you already have measures in place that address the proposals in this chapter? What would be the one-off and on-going cost implications of developing systems and controls to address these proposals?

German banks already have internal procedures and technical systems in place which monitor whether a sufficient number of instruments are available both on the client's and on the omnibus account and also conduct reconciliations between omnibus and client accounts. Should not enough securities be available to settle a transaction, measures are in place either to ensure that the assets of one client are not used to settle the transaction of another client or to ensure that the shortfall is made up in time or that a cash adjustment is made. We therefore assume there would be no additional cost implications over and above the cost of these existing procedures and systems.

We would nevertheless like to point out that these procedures and systems are designed very differently, first for technical reasons, and second, due to the different specifics involved (trading, custody business, intermediate custodianship, outsourcing, etc.). Should these procedures and systems have to be changed, the cost implications would depend on the sometimes highly complex technical details.

Q51: Do you agree that requiring firms to hold necessary information in an easily accessible way would reduce uncertainty regarding ownership and delays in returning client financial instruments and funds in the event of an insolvency?

We believe that the existing recording and record-keeping requirements are sufficient and that additional requirements, such as those listed in Nos 19 and 20 of the DTA, would merely generate legal uncertainty about what additional obligations they might entail. These existing recording and record-keeping requirements fulfil their purpose of ensuring that the staff responsible for safeguarding client assets always have an adequate overview and that all obligations towards clients are satisfied. By virtue of their office, insolvency administrators, national competent authorities and resolution authorities already have full access to all the books and systems of an investment firm as well as the authority to issue binding instructions to the firm's staff. If the investment firm has met its existing recording and record-keeping obligations, insolvency administrators and the relevant authorities will therefore also be in a position to obtain an overview of the situation and satisfy the clients' claims. There is no need for any additional requirements in this area.

Our reply to Q51 is therefore "yes, we agree", but we reject the DTA since we consider it superfluous.

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.

This requirement already exists. Article 6(2)(a) of the MiFID Implementing Directive requires the compliance function to monitor and regularly assess the (continuing) adequacy and effectiveness of the measures and procedures put in place to comply with MiFID. This includes monitoring and regularly assessing the conflicts of interest policy. With this in mind, the German Banking Industry Committee, which represents more than 2,000 banks in Germany, sees no need for any further requirements.

Q55: Do you consider that additional situations to those identified in Article 21 of the MiFID Implementing Directive should be mentioned in the measures implementing MiFID II? Please explain your rationale for any additional suggestions.

No, we see no need to add to the situations already mentioned in Article 21 of the MiFID Implementing Directive.

This is because Article 22(2) of the MiFID Implementing Directive makes it incumbent on investment firms to identify all circumstances which constitute or may give rise to a conflict of interest. The situations described in Article 21 of the MiFID Implementing Directive illustrate the type of circumstance in which a conflict may be potentially detrimental to a client. Providing additional examples may lead investment firms to rely too heavily on the situations described instead of considering what further circumstances might give rise to a conflict of interest.

Q56: Do you consider that the distinction between investment research and marketing communications drawn in Article 24 of the MiFID Implementing Directive is sufficient and sufficiently clear? If not, please suggest any improvements to the existing framework and the rationale for your proposals.

Investment firms have now learnt to work with this distinction, even though there were initially significant difficulties of interpretation when the MiFID Implementing Directive was transposed in 2007. To avoid the risk of changes to the existing requirements generating further legal uncertainty for investment firms, the German Banking Industry Committee is in favour of retaining Article 24 of the MiFID Implementing Directive in its present form.

Q57: Do you consider that the additional organisational requirements listed in Article 25 of the MiFID Implementing Directive and addressed to firms producing and disseminating investment research are sufficient to properly regulate the specificities of these activities and to protect the objectivity and independence of financial analysts and of the investment research they produce? If not, please suggest any improvements to the existing framework and the rationale for your proposals.

The German Banking Industry Committee considers the existing requirements of Article 25 of the MiFID Implementing Directive to be sufficient and effective. There are no deficiencies in this area, in our view. Article 25 of the MiFID Implementing Directive should therefore be retained in its present form.

2.10. Underwriting and placing – conflicts of interest and provision of information to clients

The German Banking Industry Committee, which represents more than 2,000 banks in Germany, would like to point out that this chapter 2.10 of the consultation paper does not seem to make a distinction between equity underwriting and placing on the one hand and bonds/debt underwriting and placing on the other, although there are significant differences between them which should be taken into account as regards the requirements under the draft technical advice (DTA).

Q58: Are there additional details or requirements you believe should be included?

No additional requirements need to be included.

Regarding details, however, clarification should be made with respect to Nos. 3, 5, 14, 16 and 19 of the DTA:

1. No. 3 of the DTA

The "explanation" required according to No. 3 i of the DTA can only cover the financing alternatives **available at the respective investment firm**. Otherwise, this would impose an extensive obligation to provide advice which is not required with respect to relevant conflicts of interest. What is more, the exhaustive advice on all financing alternatives may also require external advice from, for example, a legal or tax perspective, which clients usually obtain separately and which investment firms would be prohibited from providing. We therefore suggest amending No. 3 i of the DTA accordingly.

Regarding the fees, it would be more useful for the client to receive an overall indication of these. However, market abuse provisions (i.e. non-disclosure of information, Chinese walls) need to be taken into consideration in this context. Furthermore, any indication of fees can involve complex and elaborate evaluation that investment firms would need to charge for. We would therefore suggest deletion of the second half of No. 3 i of the DTA.

The DTA deals with conflicts of interest in cases of underwriting and placing and with the measures to be taken by investment firms to manage any conflicts arising, including disclosures. The circumstances described in No. 3 vi of the DTA will thus also have to be included in such management. Therefore, we would like to suggest the deletion of No. 3 vi, especially as it may be cause for concern in terms of competition law and data protection law when disclosure takes place before a contract is entered into.

2. No. 5 of the DTA

The expression "determines the price" may lead to the wrong assumption that it is the investment firm and not the market that arranges the offering price. We would like to suggest a more differentiated wording.

We would also like to point out that the approach taken by Regulation (EU) No 596/2014 (Market Abuse Regulation – MAR) and Commission Regulation (EC) No. 2273/2003 implementing Directive 2003/6/EC in respect of stabilisation of financial instruments should be considered accordingly in No. 5 of the DTA. Please see details in Q59.

3. No. 14 of the DTA

Our suggestion is to use a more neutral wording than "it would be appropriate to refrain from acting as arranger for the securities offering" in No. 14 of the DTA, such as to consider if potential conflicts of interest exist and to reconsider the steps to be taken in case of affirmation. Otherwise, it may be understood that ESMA automatically assumes a conflict of interests

whenever a loan is repaid with the proceeds of an issue. We do not think this is the case in many circumstances. In particular, it may be even more favourable for the issuer client to refinance itself through an equity or bond issue rather than continuing with an existing loan for a variety of reasons (for example: achieving better economic conditions, reducing dependence on lenders, obtaining relief from restrictions in debt documentation such as covenants, freeing up assets from being used as collateral, increasing further "debt capacity" (i.e. availability of further debt financing), enhancing credit rating, and so on).

A restriction could also result in higher costs for issuer clients as cross calculations between lending and underwriting/placement could not take place any longer. Moreover, the requirements in Nr. 14 of the DTA seem to favour pure investment banks over universal or wholesale banks, which provide both loan financing and underwriting services.

We would also like to clarify that refraining from acting as arranger for the securities offering is not the only, and also not always the best, solution. As also outlined in our comments on N0. 19 of the DTA below, clarification is needed (like in No. 12 of the DTA) that non-engagement should always be a last- resort option. Additionally, a client may want to continue a tried and tested customer relationship and mandate an investment firm despite being aware of a potential conflict of interests. Furthermore, we would like to draw ESMA´s attention to the provisions of Prospectus Directive 2003/71/EC and Prospectus Regulation (EC) No. 809/2004, both as amended, on the completeness and accuracy of information for investment clients. We cannot, therefore, relate to the considerations in para. 36 of the consultation paper.

4. <u>No. 16 of the DTA</u>

No. 16 of the DTA does not seem to take into consideration the legal framework for lending business. It is market practice to agree on the non-disclosure of the information received in the course of the lending mandate and to use it only for the purpose it has been provided for (i.e. granting a loan), making it impossible to simply share sensitive information about a client with other business units or group entities. First and foremost, sharing sensitive information may constitute a breach of market abuse provisions.

5. <u>No. 19 of the DTA</u>

No. 19 of the DTA states that "the only way to manage the conflict would be for the investment firm not to engage in the operation". We would like clarification that the non-engagement in an operation is to be understood as a last resort, only to be considered if all other measures are insufficient to manage the conflict appropriately, as is considered in No. 12 of the DTA.

This is particularly the case for situations described in para. 39 of the consultation paper (clients being competitors). Here, a case-by-case analysis is inevitable. In this context, we would like to point to the general principles set out in Article 23 MiFID II and manifold measures when managing potential conflicts of interest, including the non-exhaustive list in Article 22(3) of Commission Directive 2006/73/EC implementing Directive 2004/39/EC (MiFID Implementing Directive):

- procedures to prevent or control the exchange of information
- separate supervision of relevant persons
- removal of any direct link between the remuneration of relevant persons principally engaged in one activity and the remuneration of, or revenues generated by, different relevant persons principally engaged in another activity,
- prevention or limitation of persons from exercising inappropriate influence
- prevention or control of the simultaneous or sequential involvement of a relevant person in separate investment or ancillary services or activities.

Additionally, disclosure of the conflict and risk- mitigating steps is foreseen in Article 23(2) of MiFID II where the arrangements are not sufficient to ensure that risks of damage to client

interests will be prevented. This enables the client to take an informed decision with respect to the service in the context of which the conflict of interests arises.

As regards acting for competitors, it is also worth noting that clients have an interest in working with experienced financial institutions that have the relevant industry expertise. Such expertise could hardly be gained (or maintained) if the institution were only allowed to work for one competitor at the same time.

Q59: Do you consider that investment firms should be required to discuss with the issuer client any hedging strategies they plan to undertake with respect to the offering, including how these strategies may impact the issuer client's interest? If not, please provide your views on possible alternative arrangements. In addition to stabilisation, what other trading strategies might the firm take in connection with the offering that would impact the issuer?

Investment firms do, and should, discuss general strategies with regard to underwriting and placement with their issuer client. We would, however, like to clarify that the hedging of underwriting risks and stabilisation measures regarding the (client's) securities are two different operations and that it is of importance that they are not commingled.

Hedging takes part, if at all, in respect of the investment firm's underwriting risk. Please note that the majority of bond issues take place on a best effort basis without the need for hedging. Stabilisation measures with regard to the client's securities are taken after the actual execution of a placement, i.e. if the underwriting risk has been dealt with and no longer exists. Moreover, stabilisation, over-allotment and greenshoe options are not only expressly allowed but also desired under Regulation (EU) No. 596/2014 on market abuse (MAR) and Commission Regulation (EC) No 2273/2003 implementing Directive 2003/6/EC (Market Abuse Implementing Regulation; Recital 11 Market Abuse Implementing Regulation: "Stabilisation transactions mainly have the effect of providing support for the price of an offering of relevant securities during a limited time period if they come under selling pressure, thus alleviating sales pressure generated by short term investors and maintaining an orderly market in the relevant securities. This is in the interest of those investors having subscribed or purchased those relevant securities in the context of a significant distribution, and of issuers. In this way, stabilisation can contribute to greater confidence of investors and issuers in the financial markets."). Given the aforementioned course of action, stabilisation, over-allotment and greenshoe options are unrelated to the hedging of underwriting risks.

We would, therefore, welcome clarification that the legal approach taken under MAR and the respective implementing regulations are consistent with the approach under MiFID II. Stabilisation measures (including over-allotment and greenshoe options) should thus not be regarded as cause for concern from a conflicts of interest perspective. Furthermore, it should be taken into consideration that all details with regard to stabilisation measures are disclosed to the public and the competent authorities (Article 9 Market Abuse Implementing Regulation).

With respect to hedging, we believe that short-selling the client's securities is not necessarily a suitable way to effectively hedge underwriting risks as described in para. 21 of the consultation paper. Not only would it affect the market price of the underwritten securities and thus increase the market and execution risk for the contemplated transaction, it could also only be effected to a limited extent, particularly with regard to the availability of the required share lending to ensure delivery under short sales. Hedging with the aforementioned side-effect on the market price would also have a negative impact on the investment firm's reputation, especially in terms of execution capacity. Hence, we do not believe that investment firms have any interest of their own in executing hedging transactions in the form described in the consultation paper.

In addition, such short-selling can only take place after the underwritten transaction has been publicly announced. Otherwise, this could constitute prohibited insider dealing.

Therefore, investment firms may seek other strategies (like index-related transactions) not linked directly to the issuer client's securities to hedge their underwriting risk in order to reduce their market risk exposure. These strategies consequently do not affect the client's interests. Any discussion with the client on the investment firm's hedging strategies regarding its underwriting risk should thus be conducted on a general basis. The details of the hedging strategy could constitute inside information as defined under MAR and their disclosure to the client would be unlawful according to Article 10 MAR.

Q60: Have you already put in place organisational arrangements that comply with these requirements?

Our members have implemented conflicts of interest policies and further organisational arrangements to identify and manage conflicts of interest as required under MiFID I and the related delegated acts and implementing measures. These also cover potential conflicts of interest that may result from underwriting and placing. In view of the forthcoming requirements under MiFID II and the final delegated acts to be adopted thereunder as well as national implementing measures, our members will review these policies and arrangements and make the necessary adjustments. On a preliminary basis, we would not expect these adjustments to be of a fundamental nature, given that, as set out in para. 12 of the consultation paper, ESMA does not propose to redefine the MiFID I conflicts of interest regime and does not regard MiFID II as mandating a fundamental review of such regime.

Q61: How would you need to change your processes to meet the requirements?

As set forth in our response to Q60, we do not expect major changes to meet the future requirements under MiFID II.

However, we would like to mention that it is common practice for major financial institutions to provide services to competitors[1]. This should not create an unmanageable conflict of interests per se. Whether conflicts arise in these cases and what measures have to be taken need to be assessed on a case-by-case basis. A systematic prohibition on acting for competitors would for several reasons not be in the interests of issuer clients either and is therefore currently not envisaged in our members' conflicts of interest policies. Room should remain also in future for appropriate measures to resolve any conflict of interest arising. Otherwise, if firms were restricted to acting only for one competitor in a certain industry, this would significantly limit the availability of banking services to the detriment of corporate clients and effectively eliminate competition. What is more, there is a risk that no firm will be willing to provide investment services to seemingly less attractive players, especially SMEs. We believe this is clearly not in the interests of the respective clients, nor is it necessary to manage conflicts of interest appropriately.

2.11. Remuneration

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

[1] Cf. para. 39 of the consultation paper (brackets)

For various reasons, the German Banking Industry Committee, which represents more than 2,000 banks in Germany, does not agree with the objective of the proposed requirements.

- ESMA's Guidelines on Remuneration Policies and Practices (ESMA Guidelines) were issued as recently as 11 June 2013. With this in mind, we would like to begin by commenting on the relationship between these guidelines and possible implementing measures for MiFID II. It may be inferred from para. 6 of chapter 2.11 and No. 1 of the draft technical advice (DTA) that ESMA intends to propose further implementing measures on the basis of its guidelines. It would not be appropriate, in the German Banking Industry Committee's view, to "upgrade" the ESMA Guidelines to implementing measures. This could create the wrong impression that changes in content were involved. The German Banking Industry Committee rejects the idea of continually adjusting requirements and interpretation guidelines without good reason.

- As to the objective set out in No. 2 of the DTA, we would like to point out that "relevant person" as defined in Article 2(3) of Directive 2006/73/EC – the MiFID Implementing Directive – is a term of general relevance to various requirements governing investment firms (e.g. staff transactions, management of conflicts of interest). Given the legal certainty and legal clarity for market participants associated with this established term, we reject the idea of defining "relevant person" in the context of one specific area, as seems to be the intention of No. 2 of the DTA. The term as used in No. 2 of the DTA contains a number of imprecise legal concepts, such as "material impact", "directly and indirectly", "that the remuneration of such persons and related incentives may create a conflict of interest" and "to act against the interests of the clients". On top of that, it mixes together a personal and material scope and is therefore unsuitable as a definition.

- Another problem is that the scope of the draft technical advice appears to diverge from the ESMA Guidelines on the issue of tied agents.

  As far as we are aware, tied agents in most jurisdictions do not form part of the organisation of the investment firm. In Germany, for example, tied agents operate as commercial agents under Section 84 of the German Commercial Code (Handelsgesetzbuch – HGB). By law, commercial agents have to be self-employed; otherwise, they are classified as employees. One aspect of their self-employed status is that they bear the entrepreneurial risk of their activities. This is normally the case if the commercial agent receives commission payments only for his/her services, not a fixed remuneration.

  To take account of the legal specificities of tied agents in Germany and other jurisdictions, the ESMA Guidelines rightly state the following in Annex I, para. 18: "When determining the remuneration for tied agents, firms may take the tied agents special status (usually as self-employed commercial agents) and the respective national specificities into consideration." The Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin) used this leeway when implementing the ESMA Guidelines in Germany.

The draft technical advice, by contrast, contains no such reference to the status of tied agents. This could give the impression that it is no longer possible to take account of a tied agent's special status. We would therefore suggest incorporating the above wording from Annex I, para. 18 of the ESMA Guidelines into the technical advice.

Q64: Do you agree with the proposal with respect to variable remuneration and similar incentives? If not, why not?

The German banking industry does not agree with the proposal on variable remuneration and similar incentives for two reasons.

- First, No. 6 of the DTA is at odds with the ESMA Guidelines, although the latter were issued comparatively recently.

  According to No. 6 of the DTA, "Remuneration and similar incentives may be partly based on commercial criteria, but should be principally based on criteria reflecting compliance with the applicable regulations, the fair treatment of clients and the quality of services provided to clients [...]." The term "principally" could be understood to mean that commercial criteria must determine less than 50% of the amount of variable remuneration. This would not take adequate account of the commercial necessity of performance-related remuneration. Profitability considerations demand that it be possible to structure staff remuneration flexibly, since wages and salaries have to be paid for out of the profits earned by the firm.

  The ESMA Guidelines, by contrast, do not lay down a specific ratio of quantitative to qualitative criteria. The guidance simply says that "firms should not only take sales volumes into account" (Annex I, para. 18) and that "firms should consider qualitative criteria that encourages the relevant persons to act in the best interests of the client" (Annex I, para. 19). The Federal Financial Supervisory Authority took this into account when implementing the ESMA Guidelines in Germany.

  To resolve this contradiction and promote a consistent regime, we would suggest wording No. 6 of the DTA in a way that avoids implying that there should be a specific ratio of quantitative to qualitative criteria.

Second, the final clause in No. 6 of the DTA lacks logic ("...provided that in any event the remuneration structure does not favour the interests of the firm or its staff against the interests of any clients"). The remuneration structure may reflect a potential conflict of interest but is not itself a suitable instrument for taking client interests into account. This is one of the tasks of the remuneration policy. As the ESMA Guideline in Annex I, para. 7 puts it: "On the one hand, remuneration policies and practices should ensure compliance with the conflicts of interest requirements set out in Articles 13(3) and 18 of MiFID; and on the other hand they should also ensure compliance with the conduct of business rules set out in Article 19 of MiFID." With this in mind, we suggest deleting the final clause of No. 6 of the DTA.

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 German Banking Industry Committee, which represents more than 2,000 banks in Germany, does not believe it would be appropriate if heavily formalised and detailed requirements are set at Level 2 concerning for, for example, consistent presentation of information to retail clients in the same language and use of a specific font size when indicating the relevant risks. As rules on interpretation of Article 24(3) of MiFID II cover all information, information of any kind irrespective of its context is affected. Level 2 should only deal with general interpretation issues of substantial importance. Implementation in detail should be allowed to reflect the specificities of each individual case.

In connection with para. 10 of this chapter and No. 2. iv of the Draft Technical Advice (DTA), we agree that, when it comes to the "up-to-date" requirement, different standards apply to printed media and online information. But a distinction also has to be made with regard to online information: whereas information that is provided via online databases must generally be up-to-date, lower standards should be set for information material available for downloading (e.g. pdf documents) in order to allow for the updating required. Otherwise, bearing in mind the ongoing

maintenance needed, the provision of online information to clients would likely have to be reduced significantly in future. Even lower standards should apply to printed media to take due account of the time lag between going to print and availability. Indicating an "as at" date can show investors how up-to-date such information is.

In general, a situation in which a requirement to provide new, detailed information means that the client's essential information needs are no longer taken into account must at any rate be rejected. Such an approach would not be in the interests of clients.

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?

No. 3 of the DTA cannot be implemented in all cases and should be deleted. It should at least be restricted to cases involving structured products. There are, after all, products which are designed to be held until maturity and whose value and yield at maturity are independent of future market conditions, e.g. certain fixed-rate bonds. In their case, only a single scenario is sensible, namely presentation of the fixed redemption amount and the total amount up to the product's maturity date. As this income is independent of market conditions in the meantime, any requirement to indicate different scenarios for different market conditions makes no sense for such products.

If performance scenarios are considered, it should be made clear that these are merely aimed at showing how the product works. Presentation of model scenarios in a simple and easy-to-understand format is best suited to satisfying investors' information needs and should be allowed to reflect the specificities of each product. Formalised requirements regulating the method of presentation are therefore unsuitable.

In this case as well, superfluous, formalised standard information is contrary to the individual interests of clients.

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 are opposed to the envisaged systematic expansion of the requirements originally developed for retail clients to cover professional clients/eligible counterparties. These requirements are unsuitable for professional clients/eligible counterparties. Instead, investment firms should be allowed to base the content, format and frequency of information for professional clients/eligible counterparties on the circumstances of an individual case in order to satisfy the requirements for fair, clear and not misleading information.

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?

The German Banking Industry Committee, which represents more than 2,000 banks in Germany, rejects No. 1 of the draft technical advice (DTA). The requirement to explain "whether and why investment advice could qualify as independent or not and the type and nature of the restrictions that apply" is excessive. If investment firms provide commission-based advice, they

are already required to inform clients of the “existence, nature and amount of the payment or benefit (...), or, where the amount cannot be ascertained, the method of calculating that amount”. The German Banking Industry Committee does not believe that firms offering only one form of investment advice need to supply information over and above that under the latter requirement and the general information about the type of investment advice they have to provide under Article 24(4)(a)(i) of MiFID II. We do not consider it the task of investment firms to explain to the client the differences between the legally prescribed basic principles of all kinds of services before providing each and every service. That ESMA basically shares this view is evidenced by No. 2 of the DTA, which suggests that, “where both types of advice are intended to be proposed or provided to the same client, investment firms should (i) explain the scope of both services to allow investors to understand the differences between them.” Only in cases such as these, where the investment firm offers both types of investment advice, does it make sense to inform the client about the basic principles of the investment advice being offered.

The German Banking Industry Committee also firmly rejects the requirements to describe the “types of financial instruments considered”, the “total number of financial instruments and providers analysed per each type of instrument according the scope of the service” (No. 4 of the DTA) and to distinguish, if the mentioned conditions are met, “for each type of financial instrument, the proportion of the financial instruments issued or provided by entities not having any links with the investment firm” (No. 5 of the DTA). These go beyond that which is required under Level 1. No information about the quality of the supplier or the investment advice can be derived from such details. They would be more likely to confuse clients than to deliver added value.

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

No. If the proposals were implemented, it would no longer be possible to make information available in the form of an overall description of the relevant type of financial instrument. The new requirements could only be met by drawing up product fact sheets. Distributing investment firms and banks find it extremely costly and time-consuming to obtain sufficiently reliable information about every single product and present it in an appropriate way to clients. Sometimes, this is even impossible, especially in a world of global trading. Except when offering investment advice, firms and banks would have to radically reduce their existing product range for cost reasons, which would in turn significantly limit the variety of investment opportunities for clients. For this reason, the scope of the new information requirements should on no account be extended to the provision of investment services where no advice is involved. Nor should additional information requirements be introduced if the client is already supplied with legal documents to comply with other statutory obligations, e.g. UCITS KIID, AIF KIID or under the future PRIIPS Regulation.

No. 8 of the DTA would require investment firms to inform clients about the functioning and performance of financial instruments in different market conditions. This requirement would be particularly difficult, if not impossible, to fulfil and it should at least be restricted to structured products. It should not apply to products such as fixed-rate bonds, which are designed to be held until maturity and the value of and return on which at maturity do not depend on future market developments. In cases such as these, it only makes sense to describe the specified amount payable on redemption and the total return over the period until the product matures. These elements are not dependent on market developments in the interim, so it makes little sense to have to describe how the instrument would function and perform in different market conditions.

It should, in addition, be clarified that the purpose of describing performance scenarios is merely to explain how the product functions. The best way of meeting the investor's need for information in a simple and understandable way is to provide illustrative examples of performance based on certain assumptions. One-size-fits-all rules in this area would not be suitable. It should remain possible to satisfy information requirements in a way which takes into account the specific features of the instrument involved.

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.

No. The German banking industry takes the view that the existing requirements under MiFID I are totally sufficient to ensure that clients are adequately informed. It should also be borne in mind that clients are protected not just by prudential requirements, but by civil law as well.

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?

No. In the view of the German Banking Industry Committee, which represents more than 2,000 banks in Germany, the scope of the requirements should only be extended to professional clients and eligible counterparties on an opt-in basis.

Substantial resources would be needed to comply with these new requirements, yet professional clients and eligible counterparties need far less protection than do retail clients. The general extension of information requirements to professional clients and eligible counterparties in the form proposed would go too far and exceed the mandate of the Commission (cf. extract from the Commission's mandate: "**appropriate** modalities to provide such information to professional clients and eligible counterparties"). The result would be to blur the difference in the level of protection afforded to the different categories of client.

The opt-out solution currently envisaged would be excessively onerous. In our view, an opt-in would be the best means of ensuring in an appropriate and proportionate way that any professional client or eligible counterparty with a real interest in the information in question would be able to obtain it. In any event, the option should be exercisable irrespective of whether or not the financial instrument embeds a derivative since a derivative is embedded in most financial instruments relevant to these categories of client.

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

No. It would not always be feasible to satisfy these requirements, which, according to our understanding, exceed the Level 1 provisions. Article 24(4) of MiFID II merely requires "appropriate information" to be provided. We believe the scope of the requirements needs to be more precise. At present, it is virtually infinite.

Article 24(4)(c), subparagraph 1 of MiFID II contains an obligation to provide information about financial instruments "recommended or marketed to the client". ESMA's view that the scope of

the requirements should also cover a “general recommendation” and firms “promoting” certain financial instruments (para. 18) could, if interpreted broadly, result in hardly any conceivable circumstances not being included. Yet the wording of Article 24(4)(c), subparagraph 1 of MiFID II shows that the additional requirements for the provision of information about the costs of financial instruments are not intended to be applied in all, but only in certain cases. Given that Level 1 has used the phrase “recommended or marketed” as a limiting parameter, the proposed Level 2 requirements exceed the provisions of Level 1 by applying an effectively limitless interpretation. The German Banking Industry Committee considers it essential to interpret the terms used in Level 1 more precisely.

It is clear from the context of Article 24(4)(c), subparagraph 1 of MiFID II that the term “recommended” is to be understood solely as a “personal recommendation” in the context of investment advice within the meaning of Article 4(1)(4) of MiFID II. The expression “general recommendation” as used in para. 18 of chapter 2.14 is not a suitable term for setting out the scope of these requirements. It should be used only as in its original context, namely Annex I, Section B (5). Otherwise, the erroneous impression could arise that a new category of investment service was being created somewhere in the area between investment advice (“personal recommendation”) and services provided without advice. No such category corresponds to any form of distribution familiar in practice, however.

The interpretation of the Level 1 term “marketed” should also be interpreted more narrowly. This cannot, as the German Banking Industry Committee sees it, be understood to mean any form of making a financial instrument available for purchase by an intermediary. It cannot be considered marketing if an intermediary selects a finite number of products from the infinite number available worldwide and puts the technical and organisational systems in place to enable clients to take up these products via online trading, by telephone or in a face-to-face conversation. The German Banking Industry Committee believes the term only covers cases in which a financial instrument is actively promoted, i.e. the distributing investment firm takes concrete steps to highlight a financial instrument and encourage clients to purchase it. All other cases are examples of the situation described in para. 20, in which an investment firm “passively provides execution of orders services”. The limiting parameter “marketed” used in Article 24(4)(c), subparagraph 1 of MiFID II would otherwise be meaningless, since the current effectively limitless interpretation would in practice leave nothing outside its scope.

From the client’s perspective, too, it is important to place reasonable limits on the scope of the new requirements. As things stand, users of investment services without advice can select financial instruments of all kinds from all over the world. It would be very costly and time-consuming, however, in this world of global trading, to obtain the required information and process it into the format envisaged by ESMA. Sometimes, it would even be impossible since the information required by the European legislator about issuers, trading partners, trading venues, etc. are either not available from parties outside the EU or are supplied in different formats. It is therefore probable that the range of products available to users of investment services without advice would be significantly reduced. The possibility cannot be excluded that no more products would be available to such users than those offered under the investment advice model. This would limit the investment opportunities for investors and/or make them more costly. Ultimately, therefore, the proposed scope of the information requirements would be detrimental to investors.

No. 3 ii of the DTA (cf. also para. 19) should be deleted because it would extend the scope of the requirements to cases where the distributing investment firm has not provided a service and no financial instrument has been “recommended” or “marketed” to a client. This goes beyond the Level 1 text and consequently has no legal basis.

According to para. 22, the cost of services provided by other involved firms should be disclosed if the distributing investment firm “has directed the client to these firms”. In practice, determining whether or not a client has been “directed” to a third party is likely to be a very grey area. What is

more, No. 5 of the DTA contains no comparable criterion for deciding when third-party costs should be included. Some sort of limitation is essential, however, since the required information cannot always be obtained early enough and may not always be totally reliable in cases where more than one firm is involved. The term "directed" should be dropped because its meaning is not clear-cut. Investment firms are in a position to provide information about the cost of their own services. By contrast, the cost of services provided by third parties, such as exchanges or CSDs, and costs associated with the financial instruments of other issuers can only be provided by intermediaries if there is a corresponding legal basis or if the third parties involved inform the investment firm of these costs. Only then is it possible to tell the client exactly what costs will be charged by other involved firms. An information requirement going beyond this would severely hamper the supply of financial instruments in the European market and lead to a cutback in the range of services offered to clients.

The German Banking Industry Committee would also like to stress that third-party payments are not costs. The Level 1 text evidently also takes the view that these are two separate issues because it makes a distinction between information about costs (Article 24(4)(c) of MiFID II) and information about inducements (Article 24(9) of MiFID II). Combining the two categories would be incompatible with the text of MiFID II, in our view. Irrespective of this, we would like to make the following point. Should "third-party payments received by investment firms" pursuant to Article 24(9) of MiFID II in future be considered part of the cost of the service (paras 24-27 and 51, No. 6 of the DTA), we have strong reservations about the view that "the investment firm should also provide an explanation about the nature of this amount in a comprehensive, accurate and understandable manner" (cf. para. 51). This wording could lead to excessive requirements concerning this explanation and should therefore be dropped. On no account should the impression wrongly arise that the distributing investment firm might be obliged to provide separate "cost guidance" on top of the actual investment service. It should be stressed instead that it is sufficient if the amount is recognisable as a third-party payment.

Nor – contrary to the view taken in para. 52 – can non-monetary inducements be regarded as costs and on no account should they have to be included in the information about the cost of a financial instrument. This should apply whether or not they are of significant value. Non-monetary inducements should be dealt with only in terms of potential conflicts of interest. By contrast, they have no relevance for the client in terms of overall costs.

No. 13 of the DTA requires the information about costs to be supplied "in good time before the provision of the investment and/or ancillary service." It is essential to clarify that, in cases where investment advice is provided, the information has to be made available before the order is placed and not, as currently envisaged in the draft technical advice, before the provision of the service itself. It would be impossible provide information about the costs associated with the recommended financial instrument since a suitable financial instrument is selected and recommended only in the course of the conversation with the client.

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

No. The term "continuing relationship" is used in such a way that it covers virtually everything and would make "one-off" services more or less non-existent in practice. The German Banking Industry Committee believes the extensive requirements proposed in the event of a "continuing relationship" would, at most, be appropriate if a special contractual agreement were made with the client for the provision of services on a permanent basis. This agreement would also have to spell out an explicit obligation to provide post-sale information. Only these circumstances should fall under the scope of "where applicable" within the meaning of Article 24(4)(c), subparagraph 2 of MiFID II. In particular, the German Banking Industry Committee does not see how a continuing advisory relationship can be deemed to exist simply because the client has a portfolio and an account at the bank providing the advice since these are prerequisites for executing an

order. If one takes the opposing view, any form of advice, with the exception of advice given to prospective clients, would satisfy the criterion of a continuing relationship and the scope of the requirements would be extended ad infinitum. Nor is the mere opening of an actively used trading account a suitable indication of a continuing relationship. Opening a trading account is a purely technical step which may be necessary for settling transactions if one-off services are provided at intervals. Otherwise, there is a danger of one-off advice provided to the client at intervals being retroactively redefined as a "continuing relationship".

The expression "continuing relationship" is imprecise and likely to give rise to considerable legal uncertainty and inconsistent implementation across the EU. This applies especially in connection with the language used in para. 33iii concerning investment advice. To assume a continuing relationship existed on the basis of a client request or because the relationship is "otherwise established" would lead to limitless interpretation of the term.

From the client's perspective, too, it is important to place reasonable limits on the scope of this requirement. Otherwise, investment firms are likely to significantly reduce the range of products they offer. This would limit the investment opportunities for investors, and/or make them more costly, and ultimately be detrimental to investors.

Para. 34 proposes that ongoing payments from third parties should automatically trigger a requirement for firms to provide information to clients about the amount received on an individual basis and at least once a year. This goes too far. There is no basis for this requirement, as we see it, in either the Level 1 text or the mandate for ESMA. The requirement to provide post-sale information in the event that ex-ante disclosure is impossible, as proposed in the same paragraph, also goes too far, in our view.

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 would suggest regulating the disclosure of product costs in detail in the Regulation on key information documents for packaged retail and insurance-based investment products (PRIIPs) instead of at Level 2 of MiFID II. This is because the requirements for issuers are dealt with in this regulation and, for practical and technical reasons, MiFID and PRIIPs requirements should not diverge from one another.

Under the PRIIPs Regulation, product costs have to be shown on the relevant documents in accordance with the PRIIPs definitions. The result is a clean, logical and easily understandable division of costs – those associated with the product on the one hand and with the transaction on the other.

Investment firms are in a position to provide information about the cost of their own services. By contrast, the cost of services provided by third parties, such as exchanges or CSDs, and costs associated with the financial instruments of other issuers can only be provided by intermediaries if there is a corresponding legal basis or if the third parties involved advise the investment firm of these costs.

Only then is it possible to tell the client exactly what costs will be charged by other involved firms. An information requirement going beyond this would severely hamper the supply of financial instruments in the European market, limit the range of products available to investors, and/or make them more costly. The consequences for investors would ultimately be detrimental.

When providing financial broking services, third-party fees charged by foreign stock exchanges, for example, cannot always be specified on an ex-ante basis.

Individual (client-specific and country-specific) tax deductions cannot be specified on an ex-ante basis.

To avoid legal uncertainty, there is also a need to clarify that bid/offer spreads are not to be understood as costs.

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.

Yes. The German Banking Industry Committee warmly welcomes the interpretation that information may be provided on a generic basis.

The ability to provide information on a generic basis is key to enabling the Level 1 text to be implemented in a reasonable and appropriate manner. Article 24(4) of MiFID II requires the provision of "appropriate information". The German Banking Industry Committee therefore agrees with ESMA that the decisive point in ensuring that the purpose of the requirement is met is that clients should be able to clearly identify what costs they will actually incur. This principle should also apply to information about the costs associated with the service, however (cf. para. 56). The German Banking Industry Committee does not understand the rationale for the blanket exclusion of service costs from the option to provide generic information or the highly singular example which is cited. The important point here, too, is surely that clients can identify in good time before the service is provided what costs will be relevant in their particular case. The option of providing generic information is essential to enabling reasonable and appropriate implementation of the rules whatever form the distribution of financial instruments may take. In the interests of proportionality, and given the very substantial resources needed for implementation, the option of presenting the information in different ways should be allowed in this area, too. The wording of para. 56 should be amended or partially deleted accordingly.

The German Banking Industry Committee welcomes, in this context, the fact that ESMA has applied the principle of proportionality and refrained from specifying whether the disclosure of costs should be provided "at a '**service**' level or at an '**individual'** level" (cf. para. 23).

The ability to provide information on a generic basis should not, however, be called into question by ESMA's further analysis of the requirement under Article 24(4)(c), subparagraph 2 of MiFID II for the aggregation of information about costs ("shall be aggregated"). ESMA's consideration of proportionality in para. 23 should apply in equal measure in this context too. There should be no requirement to indicate the actual costs as an overall amount both in euros and as a percentage in the form of a single figure comprising the costs associated with the financial instrument and the costs associated with the service (para. 39 and No. 12 of the DTA). We believe it should be sufficient if the overall cost to the client is clearly indicated at the point of sale. Please also see our reply to Q76.

An appropriate interpretation of the new requirement allowing information to be provided on a generic basis is important from the client's perspective, too. Otherwise, investment firms are likely to significantly reduce the range of products they offer. This would limit the investment opportunities for investors, and/or make them more costly, and ultimately be detrimental to investors.

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

First, the German Banking Industry Committee would like to stress our express agreement in our reply to Q75 with the idea of providing information on a generic basis. The ability to present information in this form should not be undermined by creating an obligation to aggregate the

costs associated with the financial instrument and with the service in a single figure (para. 39, No. 11 of the DTA).

There is no need to add the two elements together. The German Banking Industry Committee also strongly opposes the proposed requirement to express this figure in euros and as a percentage (para. 39, No. 12 of the DTA). This would be totally unfeasible in practice if the calculation had to be based not just on an illustrative example but on actual, concrete costs.

If, for instance, the fee charged for executing a client's order to buy shares is a percentage of the purchasing price, the amount in euros can only be calculated after the order has been executed because the share price may move in the period between the order's placement and execution. Another example: if the charge for maintaining a client's portfolio is calculated as a percentage of the account balance at the end of the year, the amount in euros will depend on the value of the account when the year ends. A counterexample: if the client pays a flat fee of x euros for a one-off service, what is the reference value or basis for converting the amount into a percentage? In other words, x = y% of what? It would be far more practicable to allow the figure to be expressed either as an amount in euros or as a percentage.

An aggregation of the two cost elements and the calculation of both a euro amount and a percentage would in many cases only be feasible (if at all) in the form of an illustrative calculation based on estimates and assumptions about client behaviour and (possibly) the composition of the portfolio. One way of implementing the new requirements for providing "appropriate information" within the meaning of Article 24(4) of MiFID II, in the view of the German Banking Industry Committee, might be to provide illustrative examples of calculations for the relevant category of financial instruments.

It is highly important from the client's perspective, too, to interpret the new requirements in an appropriate way which will allow euro and percentage amounts to be provided in the form of illustrative calculations for a category of financial instruments. Otherwise, we are likely to see a significant reduction in the current broad range of products and services available in the European market, which will ultimately restrict the investment opportunities available to the individual investor. Investment opportunities available when services are provided without advice would be especially at risk. In the final analysis, the proposed requirements for aggregated information on costs and charges could not be satisfied by the banking industry and would ultimately have adverse consequences for investors. For this reason, we believe it would be appropriate to permit implementation using illustrative examples and generic information rather than on the basis of individual transactions. Standardised presentation should be explicitly permitted, not least because it increases the comparability of information and makes it easier to understand.

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

It is highly important, in the view of the German Banking Industry Committee, that it should be permissible to work with illustrative calculations based on assumptions about investor behaviour and portfolio composition. Otherwise, implementation of the requirements will necessitate substantial technical resources and further standardisation of business processes. Moreover, provision of the information in the form of illustrative calculations is sufficient to achieve the objectives of MiFID II. Standardised presentation should also be explicitly permitted because it will increase the comparability of the information and make it easier to understand. The return on the investment cannot be specified ex ante since it depends on future developments which cannot be known in advance. Costs may also depend on future developments. For this reason, it is only possible to describe in abstract terms what cumulative effect costs may have on the return.

The requirement to show "anticipated spikes or fluctuations" should be dropped since this would increase the complexity of calculations and tie up even more technical resources.

It is not clear to the German Banking Industry Committee how and why an ex-post illustration of cost scenarios should be made (cf. para. 59). The Level 1 provisions focus quite clearly on ex-ante information at the point of sale and envisage ex-post information only in exceptional situations (cf. "where applicable" within the meaning of Article 24(4)(c), subparagraph 2 of MiFID II).

From the client's perspective, too, it is important to interpret the new requirements in an appropriate way. Otherwise, investment firms are likely to significantly reduce the range of products they offer. This would limit the investment opportunities for investors, and/or make them more costly, and ultimately be detrimental to investors.

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

It is not possible as things stand to make a robust estimate since the final form of many implementation requirements is not yet clear. Costs will depend on the scope of application and the degree of detail of the future requirements. Overall, the amount is likely to be extremely substantial.

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.

The German Banking Industry Committee, which represents more than 2,000 banks in Germany, **opposes the proposal to introduce an exhaustive list** of minor non-monetary benefits for all investment and ancillary services.

The introduction of an **exhaustive list leads to a further, uncalled-for restriction of the already existing comprehensive requirements** for the acceptance of non-monetary benefits. Stringent requirements already apply at present under MiFID I and Directive 2006/73/EC (MiFID Implementing Directive): under these, inducements must be designed to enhance the quality of the services provided to clients. They are, in addition, not allowed to contradict the principle of acting in the best interests of clients. No reasons for a further restriction of these criteria by way of an **exhaustive list** (and by vague criteria such as the level of distribution of financial analysis provided or requirements for agreements with third parties) are evident in MiFID II.

Besides that, German Banking Industry Committee opposes the idea that research could not be considered a non-minor monetary benefit or could be considered an inducement. Such an approach will **create an unlevel playing field with UCITS and AIFMD** in the short term and create competitiveness impacts on the EU on the long term, which will fall disproportionately on small companies looking to access capital markets and small asset managers looking to benefit from research services.

Research services primarily benefit the end customer. Investment decisions based on research are required to refresh, maintain and change the investor´s portfolio. Research services are essential to help the investor to make an informed execution/investment decision and generate wealth. By accepting that execution is a core service for the end customer it also has to be accepted that a material value for the end customer can only be achieved by using research.

Instead of an exhaustive list, we are therefore in favour of a **list of abstract criteria** to define non-monetary benefits or a list of standard examples.

In addition, the German Banking Industrie Committee **rejects any extension of this list to cover all investment and ancillary services**. Neither MiFID II nor the European Commission's mandate contain enabling provisions for such an approach. Article 24(7)(b) and Article 24(8) of MiFID II each stipulate that minor non-monetary benefits are exempted under certain conditions from the general ban on inducements applying to independent investment advice and portfolio management. Article 24(9) of MiFID II contains no such exemption, as MiFID II does not impose any general ban on inducements for investment service. The legal starting situation for independent advice and portfolio management on the one hand and inducement-based investment advice on the other therefore already differs. For this reason as well, two individual provisions must not be considered as the basis for establishing a general rule for all types of investment and ancillary services. Any extension of a list of admissible minor non-monetary benefits would lead to the **assumption** that **benefits not included in this list are inadmissible**. This would, however, mean a restriction for all other types of investment and ancillary services, although MiFID II only provides for such a restriction concerning independent advice and portfolio management.

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?

The German Banking Industry Committee **agrees** with this approach **in part**.

The requirement for an investment firm to **inform the client on an ex-post basis of the exact amount of any payment or benefit** where it was unable to ascertain the amount ex ante (No. 7. ii of the Draft Technical Advice (DTA)) is **inappropriate** in our view. Under Article 26 of the MiFID Implementing Directive, "the existence, nature and amount of the fee, commission or benefit, or, where the amount cannot be ascertained, the method of calculating the amount must be clearly disclosed to the client, in a manner that is comprehensive, accurate and comprehensible, prior to the provision of the relevant investment or ancillary service." This enables the client to make an informed decision taking into account potential conflicts of interest. Furthermore, the wording of Article 24(9) of MiFID II does not provide any legal grounds for setting an ex-post disclosure requirement ("[...] must be clearly disclosed to the client [...] prior to the provision of the relevant investment or ancillary service.")

We are **opposed to** No. 7. iii of the DTA, which states that investment firms should **inform their clients at least once a year about the actual amount of payments or non-monetary benefits received on an ongoing basis**. We do **not see any added value** in this for the client, as the calculation basis was already disclosed to him prior to the transaction. As practice shows, clients are not interested in such information. The additional workload instead imposes a burden on all intermediaries. Such a high level of detail for each product or service could, at the end of the day, lead to a restriction on the range of products or services offered and to higher transaction costs that the client would ultimately have to bear. This would not be in the interests of sound investor protection. Should some clients expressly wish this information, it would be sufficient if the investment firm were required, in line with No. 7. ii of the DTA, to indicate the exact amount **ex post on request**.

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.

The German Banking Industry Committee is **strongly opposed to** the envisaged introduction of this **negative list**. **The rigid requirements** that ESMA sets for this list under No. 10. i-iv of the DTA **mean a de facto ban on inducement and thus the end of inducement-based investment advice**.

The European legislator deliberately decided to retain the possibility for clients to choose between inducement-based investment advice and investment advice on an independent basis. Proposals for the introduction of a ban on inducement failed to win acceptance in the legislative process. The European legislator opted for a ban on inducements solely for portfolio management and investment advice on an independent basis. Neither ESMA nor the European Commission (within the framework of the Request to ESMA on Technical Advice of 23 April 2014) are authorised to undermine the decision of the democratically legitimised legislator at Level 1 by making proposals for measures at Level 2. In addition, because of the **largely unchanged wording** of the "quality enhancement" criterion compared with MiFID, the European legislator provided no enabling provisions for any tightening of requirements.

Consequences of a de facto ban on inducement-based investment advice:

- Such a substantial tightening of the existing legal framework would mean, for the German market at any rate, the **end of the widespread provision of investment advice**. Large sections of the population in Germany, particularly retail investors, would have no access in future to qualified investment advice. Yet, in the German market, inducement-based investment advice **ensures advice for all sections of the population**.
- Retail investors in particular are unable or unwilling to pay the high fixed costs associated with fee-based advice. This is shown by the **still very low demand for independent (fee-based) investment advice** not only in Germany but also in countries regarded as pioneers in this area (e.g. the US or UK). Ultimately, there is the danger that investment advice may no longer be available as a service to many investors.
- Any such restriction of the provision of services would be fatal for the German market in our view, as securities are a **key element in balanced wealth-building**. Inducement-based investment advice provided to all sections of the population can – as has been recognised in academic studies – **lay claim to convincing weaker social groups as well of the need to save and provide for old age**. This aspect is also of fundamental economic importance.
- In addition, inducement-based investment advice allows the **provision of qualified investment advice across the country, i.e. in both urban and rural areas**. Given the high commercial break-even threshold for fee-based investment advice (for the German market, an hourly fee of at least € 150 for investment advice is assumed), exactly this nationwide investment business would dry up. The consequence would be **less local presence** by investment firms and fewer services available to large sections of the population. This is another reason why it is of fundamental economic importance, particularly at a time of demographic change, to maintain the provision of qualified advice to all groups of investors.
- Clients who cannot afford independent (fee-based) investment advice would turn to **non-advised services, despite the risks involved**.
- Such a substantial tightening of the existing legal framework means that a **restriction of the range of product offerings** to a few standardised products or reversion to deposit-taking business only is likely.

- Such a substantial tightening of the requirements for inducement-based investment advice would ultimately also have **competitive implications**. This is because investment advice on an independent basis is subject to neither a requirement for fees to be designed to enhance the quality of advice provided to clients nor to special disclosure requirements.
- Any tightening of the existing legal framework would ultimately mean that **the provision of services in the single European financial market would be seriously restricted**. The **figures and forecasts** cited by the European Commission in its Impact Assessment of 20 October 2011 have proved to be **wrong**:
    - The European Commission, referring to the Retail Distribution Review (RDR) in the UK, stated that "it is anticipated that, 23 per cent of UK advisory firms might exit the market (...), with a much higher ratio amongst the smallest advisors. **Overall, advisor numbers would fall about 11 per cent**." – Impact Assessment of 20 October 2011, p. 258. It thus underestimated the impact. According to a survey by the UK Financial Conduct Authority, the number of retail investment advisers (RIAs) dropped **overall by around 30%** between summer 2012 and 2013. Some press reports put the decline in the number of financial advisers at **as much as 40%**. A de facto ban on inducements means that a **similar sharp drop in adviser numbers** is likely not only in the German market but also in the entire single European financial market.
    - The **widespread provision of investment advice in the German market** would be hit hardest. Here, too, the **assumptions** made by the **Commission** have **turned out to be wrong**: it anticipates that around 50,000 to 70,000 advisers will be affected (Impact Assessment, employees requiring recording, table 36, p. 199). In contrast, in the register of advisers at the German Federal Financial Supervisory Authority (BaFin) a much higher number, namely **around 160,000, are affected**. The serious restrictions on the provision of services in the German financial market and the single European financial market that are thus expected cannot be in the interests of sound investor protection.

Given the serious impact that a de facto ban on inducements would have in general not only for the German financial market but also for the single European financial market, we suggest that this issue should be closely examined by an **ESMA impact assessment**.

Positive list instead of a negative list

The quality enhancement criterion is not in fact suitable for a further restriction. The content of the quality enhancement criterion has, for good reason, not been put up for discussion in the EU legislative process. Instead, experience so far shows that the **quality enhancement criterion in its present form is a suitable instrument** for ensuring investor protection. The inducements received under the inducement-based model ultimately benefit investors, as they are designed to maintain and improve high-quality investment advice on the basis of existing provisions.

We are therefore in favour of a non-exhaustive **positive list** of examples where the quality enhancement criterion is fulfilled.

We wish to refer in this respect to the further specification under supervisory law by way of AT 8.2 of the Minimum Requirements for the Compliance Function and Additional Requirements governing Rules of Conduct, Organisation and Transparency pursuant to Sections 31 et seq. of the Securities Trading Act, issued by the German Federal Financial Supervisory Authority (BaFin). AT 8.2 provides that investment firms record circumstances indicating that an inducement is designed to enhance or assure the quality of the services provided to clients. For this purpose, investment firms have been required since financial year 2013 to prepare a list of all monetary and non-monetary inducements ("list of inducements") at the end of each financial year and to prepare a separate list indicating for what quality enhancement/assurance measures they used the monetary inducements received during the financial year ("list of inducement

applications"). In the list of inducement applications, investment firms indicate that they use the inducements to improve quality, e.g. for efficient and high-quality infrastructure, human resources, employee qualifications and information, client information, as well as quality assurance and enhancement processes. Not only all inducements received, but also their use, are thus documented. **There is neither any need nor any room for the introduction of a "negative list" alongside such a "positive list"**.

This "positive list" model also shows that there is no material justification for restricting the quality enhancement criterion too heavily, as proposed in the negative list. This is because the requirement that inducements should be designed to enhance the quality of the services provided to clients does not increase the conflict of interests inherent in inducement-based investment advice, but reduces it. The quality enhancement criterion creates a sort of tie-in to a specific purpose, i.e. investing inducements in improving the quality of the services provided to clients, so that investment firms are not free to use the inducements as they wish. Since a profit-oriented firm inevitably has little interest in income of this kind, the conflict of interests will ultimately be reduced by the quality enhancement criterion.

Comments on Nos. 10 and 11 of the DTA in detail:

Should ESMA intend to stick to the proposed provision despite the arguments outlined above, the following modifications are required in the German Banking Industry Committee's view:

- **Deletion of No. 10. ii of the DTA**

An argument in favour of deletion of No. 10. ii of the DTA is that the MiFID I provision has remained largely unchanged and the European legislator has thus **not provided any legal grounds** for tightening it. No. 10 of the DTA ultimately means that the admissibility of acceptance of inducements is further restricted. This is at odds with the assessment of the European legislator, since the legislator expressly adheres to the possibility for the client to choose between commission-based investment advice and independent (fee-based) investment advice. No. 10. ii of the DTA is also **contradictory**: it would, for example, mean that minor non-monetary benefits which ESMA sees under No. 5 of the DTA as including particularly client information media would, on the one hand, be admissible by way of exception under certain circumstances, but would not, on the other hand – where they are prescribed by law – fulfil the quality enhancement criterion.

- **Further specification of No. 10. iii of the DTA – "tangible"**
- The term "tangible" is unclear. As we understand it, the condition is fulfilled if the sum total of the inducements received is lower than the total cost of providing the investment service. It should be made clear that the new provision is not intended to alter existing practice. It should in principle also be remembered in this context that not every payment by a third party must be regarded as an inducement. For instance, underwriting fees that an investment firm receives for placing securities could be mentioned. If the investment firm then sells the securities to clients, the payment made by the issuer in return for placement of the securities must not be deemed to be an inducement. Another example is so-called distribution fees.

- **Deletion of No. 10. iv of the DTA**
- The requirement proposed in No. 10. iv of the DTA, which sets new and additional conditions for fees based on ongoing payments, is inappropriate. Firstly, it should be borne in mind that inducements based on ongoing payments may currently only be accepted if they have been disclosed and are unlikely to jeopardise acting in the client's best interests. Secondly, it should be remembered that, for clients, it does not matter whether inducements are paid in the form of fees based on ongoing payments or underwriting fees. In this context, we wish to point out once again that inducements based on ongoing payments are by no means counter to the interests of clients – quite the contrary:
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- A fee structure that is to a significant extent **based on ongoing payments may in particular be beneficial for investors who have limited funds to invest**. Since this group of investors, especially in markets where such fee schemes are well established, will generally be unable and/or unwilling to pay a high direct up-front fee for investment advice, fees based on ongoing payments, that are in effect paid out of revenue generated by the investment itself, will provide them with the possibility to receive quality investment advice and make suitable investments. This position is clearly supported by the fact that in market segments of investment products that are directly targeted at small investors, like for example the German tax-incentivised private pension scheme ("Riester Rente"), approximately 90% of the eligible investors have actually invested in the respective products. This level of market penetration certainly is at least to some degree attributable to a fee structure that does not burden the investor with high up-front investment advisory fees.
- Also, the total amount of fees based on ongoing payments that is charged to an investor during the term of his investment is **not necessarily higher** than one-off fees, since its calculation is based on the average (and recommended) term of an investment in the respective product.
- Finally, an investment firm that receives part of its fees based on ongoing payments has **no incentive to churn** the portfolio of the investor in order to receive additional up-front fees but is instead incentivised to build a long term, loyal relationship with its client, since a significant portion of its fees will only be received over time and based on the performance of the portfolio and hence investor satisfaction. Therefore, such a fee system in general has a stabilising effect on the markets.

For the above reasons, we are strongly in favour of **rewording No. 10 of the DTA**. When doing so, it should in particular be remembered that the **cost of the "infrastructure"** to allow the provision of investment advice and other services to the client should be regarded as **quality-enhancing**.

We welcome the clarification provided by ESMA in the hearing that No. 11 is to be applicable alongside No. 10. This should be made clear in the text. As the conditions set out in No. 11 ("access to a wider range of suitable financial instruments" and "provision of non-independent advice on an on-going basis") are worded too narrowly, we believe that modification of the wording of No. 11 of the DTA is also essential.

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

Any estimate of additional costs depends on the measures that are to be specifically introduced. No reliable estimate is therefore possible at present.

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.

The German Banking Industry Committee, which represents more than 2,000 banks in Germany, considers it right and logical that independent investment advice should not be offered on the basis of a narrow range of only a few products. However, the proposed criteria give the impression that it is the quantity rather than the quality of the financial instruments considered which is important. The requirement proposed in No. 1 iii of the draft technical advice (DTA), for instance ("the number and variety of financial instruments considered comprises a substantial part of financial instruments and available on the market"), goes too far. Given the huge range

and sheer number of financial instruments on the market, it would not be feasible to consider "a substantial part" of them. The upshot of such a requirement would be that potential suppliers of independent investment advice would be put off by the associated legal risk. Nor would it be particularly beneficial from the client's perspective to have to choose from a seemingly unending range of products. In our view, ESMA´s advice should confine itself to setting out suitable criteria for ensuring that an adequate range of products is considered. At the very least, the selection process should be limited to "…a**n** ~~substantial~~ adequate part of financial instruments…".

We welcome the intention to permit firms to offer independent investment advice aimed at a specific target group of clients. The wording of the requirement in No. 3 i of the DTA ("is able to market itself in a way that **only** attracts clients with a preference for certain classes or a range of financial instruments") is too narrow, however. Investment firms cannot guarantee that their services will appeal exclusively to one specific type of client ("**only** attracts clients with…"). They can merely endeavour to **gear** their marketing strategies towards a specific target group of clients. It is up to the clients themselves – whether within or outside the actual target group – to decide if they are interested in a service/product or not. This should be reflected in the wording of No. 3 i of the DTA.

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?

We welcome the objective of permitting investment firms to offer both inducement-based investment advice and independent investment advice. We nevertheless have reservations about No. 4 iii of the DTA, which proposes that both services and advisers should be strictly separated from one another. The obligation "not [to] allow a relevant person to provide both independent and non-independent advice" would mean in practice that small and medium-sized firms, which are unlikely to have the resources to satisfy this requirement, would be forced into an "either/or" decision. We see a need for a de minimis rule which would permit advisers (natural persons) at small and medium-sized investment firms to offer both types of investment advice. This could be made conditional on having arrangements in place to ensure that all parties are clear from the outset of every advice what type of investment advice is being provided (independent or non-independent) and that all the regulatory requirements relating to this type of advice would be complied with. The same de minimis rule should apply to small branches of investment firms. This is the only way to enable independent investment advice to be offered although in particularly rural areas and to all social classes. Otherwise, nothing about the present situation will change and independent investment advice will continue to remain the preserve of the wealthy. A de minimis rule would in no way undermine the purpose or objective of the proposed requirements since it would always have to be made absolutely clear to the client what type of investment advice he/she was being offered.

No. 4 i of the DTA requires clients to be provided with information "in a durable medium". This goes too far, in our view. The purpose and objective of this information requirement could be achieved, for instance, by verbally advising clients in advance of the type of investment advice provided and documenting this fact in the minutes which are later made available to them.

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

A robust cost estimate is not possible at present. But if the requirement is retained to strictly separate fee-based and commission-based advisers and services, this would impose a significant financial burden on investment firms – assuming, of course, that they were willing to assume the financial and commercial risk associated with offering both types of investment advice.

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?

Recommending to the client the **most suitable** financial instrument for him from an investment portfolio (or from among all available financial instruments) – the approach evidently pursued in No. 1. iii of the Draft Technical Advice (DTA) through the requirement "… and that they assess whether alternative financial instruments, less complex or with lower costs, could meet their client´s profile;" and in No. 1.ix of the DTA through the requirement that "…investment firms should assess whether an alternative instrument, less complex and with lower costs, would better meet the client's profile" – goes much further than the requirements at Level 1, which stipulate that the client should not be recommended the most suitable product, but a **suitable** product (Article 25(2) of MiFID II). The German Banking Industry Committee, which represents more than 2,000 banks in Germany, is therefore firmly opposed to such an approach.

With regard to Nos. 1. iii and 1. ix of the DTA, it should also be considered that a product's greater complexity or higher costs need not rule out its suitability, as suitability is determined also by factors other than costs. If the client is unable to understand the complexity of a product, this product is not suitable for him. If, on the other hand, the client is able to understand the complexity, a comparable, less complex product can only meet his profile to the same extent, but not better. The same goes for the cost structure. Cost structures may create conflicts of interest for the distributing investment firm, and these have to be avoided in advance.

"Less complex" is, moreover, a vague term. Whether one product is "less complex" than another, whether or not the costs at maturity are higher, can usually only be determined at maturity. The suitability assessment must be based solely on an ex-ante, and not an ex-post, approach, however.

An "explanation of the disadvantage of the recommended course of action" (No. 2. iii of the DTA) makes no sense for the client. This is because an explanation of the risk does not result from the investment advice, but from the financial instrument itself. The risk is not inherent in the investment advice but instead in the financial instrument. The German Banking Industry Committee is therefore opposed to any requirement as set out in No. 2. iii of the DTA.

The German Banking Industry Committee is in favour of restricting the scope of No. 3 of the DTA to those cases where an automatic periodic suitability assessment has been expressly agreed beforehand with the client at his request. We see no need for a general periodic suitability assessment requirement, as we believe this would suggest that the investment advice originally provided was unsuitable for the client.

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?

No.

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?

As regards the first question, the German Banking Industry Committeedoes not believe that the client's "ability to bear losses" should have to be explicitly taken into account, as it is already part of his "financial situation". Likewise, the client's "risk tolerance" is naturally part of his "investment objectives". The content of suitability reports should be limited to only what is absolutely necessary. More information and documentation is not in the interests of the client if it goes beyond what is absolutely necessary. The more information the client receives, the less attention he will be able to give it.

The requirements should, as a whole, be designed in such a way that the client can recognize the essential information. These requirements can be undermined by the inclusion of ever-new mandatory information. If, in particular, more and more insignificant (or superfluous) information is included, there is the danger that this will cause the client to lose sight of what is essential. This approach is not in the interests of the client. On the contrary, from the client´s view, it is actually harmful. The client's interests are instead better served by presenting the essential information to him clearly in writing. Further information can then be requested by the client when he talks to his investment adviser or it can be provided proactively by the adviser.

As regards the second question, the German Banking Industry Committee does not believe that further details and requirements should be included.

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?

In this case too, the rule is that information is only of interest to the client if it is essential and contains something new for him. Repeatedly providing the same information produces a dulling effect that results in the client no longer taking note of the information.

2.18. Appropriateness

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.

Even though a written agreement pursuant to Article 39 of the MiFID Implementing Directive may well be standard practice for professional clients, the German Banking Industry Committee, which represents more than 2,000 banks in Germany, is opposed to any extension of the requirement under Article 39 of the MiFID Implementing Directive to cover professional clients. There are no deficiencies in this area. For our fundamental reservations about the planned extension of Article 39 of the MiFID Implementing Directive, see our reply to Q93.

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?

In the view of the German Banking Industry Committee, such a requirement meets with fundamental reservations:

To start with, Article 25(5) of MiFID II does not set any requirement to enter into contractual agreements, but only a requirement to record such agreements. Nor can anything else follow from the empowerment in Article 25(8) of MiFID II to further specify Article 25(5) of MiFID II, as Level 2 cannot go further than Level 1 (see introduction to Article 25(8) of MiFID II: "The Commission shall be empowered to adopt delegated acts … to ensure that investment firms comply with the principles set out in paragraphs 2 to 6 of this Article …").

In addition, there are no deficiencies in the area of contractual agreements (see also Article 25(5) of MiFID II, which has remained unchanged compared with Article 19(7) of MiFID). Changes to the requirements for the provision of investment advice as a result of MiFID II do not justify imposing an obligation to enter into a written agreement for the provision of investment advice.

A requirement to enter into a written (or equivalent) agreement for the provision of investment advice would in fact constitute interference in national civil law. Under MiFID II, only the law on securities supervision may be harmonised, however. MiFID II hence does not authorise harmonisation of national civil law.

In Germany, there are no requirements regarding the form in which investment advice has to be provided. Nor is there any need for contractual arrangements concerning the provision of investment advice, since the duties of investment firms when providing investment advice are specified comprehensively by binding securities supervision law and additionally, in Germany, by Federal Court of Justice rulings (civil law).

The German Banking Industry Committee is therefore expressly opposed to any requirement to enter into a written contractual agreement for the provision of investment advice. Instead, it believes that Article 39 of the MiFID Implementing Directive should be retained for retail clients.

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?

For fundamental reasons, the German Banking Industry Committee is expressly opposed to such a requirement (for details, see our reply to Q93, which applies likewise to the provision of custody services). Instead, it believes that Article 39 of the MiFID Implementing Directive should be retained for retail clients.

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?

For fundamental reasons, the German Banking Industry Committee is expressly opposed to such a requirement (for details, see our reply to Q93, which applies likewise to portfolio management). Instead, it believes that Article 39 of the MiFID Implementing Directive should be retained for retail clients.

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?

No. The German Banking Industry Committee, which represents more than 2,000 banks in Germany, does not believe that the content of the reporting obligations to professional clients should be aligned to the content applicable for retail clients. The great majority of professional clients in particular would fail to understand it if reporting were not to take their individual circumstances into account. The agreement made individually in each case with professional clients must be what matters. That goes also for eligible counterparties (No. 2 of the Draft Technical Advice (DTA)). In the German Banking Industry Committee's view, the content of the reporting obligations to professional clients and eligible counterparties should only be aligned to the content applicable for retail clients by way of an opt-in clause.

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

The German Banking Industry Committee is strongly opposed to mandatory reporting on a quarterly basis. Contrary to what ESMA states in the consultation paper, our experience is that quarterly reporting does not in any way meet clients' wishes and needs.

It should be noted that clients are interested less in reporting and much more in the current performance of the financial instruments in their portfolio.

In particular, clients are not interested in further reporting at a point in time they have not chosen themselves (end of the quarter in this case). The additional need for information assumed by ESMA cannot therefore be confirmed by bank practice. An additional need for information supplementing the annual report only in fact exists if the client sees an immediate reason to take a look at his financial situation. In such cases, the client can check his current portfolio performance online or personally at his investment firm at any time. Given the modern means of communication available to, and also used by, the client, any increase in reporting frequency in practice is superfluous and causes unnecessary costs which make the investment service more expensive and which ultimately have to be borne by the client. This cannot be in the client's interests.

Furthermore, quarterly portfolio statements also do not put the client in a better position, as the portfolio may be subject to a large number of changes daily. For this reason, a single annual statement is sufficient for control purposes.

After all, the example referred to in para. 23 – the Lehman Brothers collapse – shows that even reporting several times per year would have not been sufficient to adequately inform clients. Even if all potentially affected Lehman Brothers clients had been informed immediately, neither the sharp drop in bond prices nor the insolvency of Lehman Brothers could have been prevented.

If portfolio statements are to be provided to clients more frequently "at reasonable commercial cost" (cf. No. 7 of the DTA), this must not involve any interference in banks' pricing policy, e.g. in the form of a restriction to charging the cost price. This would have to be made clear accordingly in the DTA.

The existing exception under Article 43(1), subpara. 2 of the MiFID Implementing Directive should be retained.

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?

Please also see our reply to Q44 of the Discussion Paper. A conflicts policy is already disclosed on the basis of Article 18(2) of MiFID II. It would be unnecessary duplication to require disclosure again in the context of best execution obligations.

No. 7 of the draft technical advice requires the separate disclosure of the implications for clients of counterparty risk if the order is executed OTC ("The relevant policy should also indicate the consequences of counterparty risk to the client from this means of execution."). The German Banking Industry Committee, which represents more than 2,000 banks in Germany, does not believe it would serve a useful purpose to disclose this particular risk as part of the information provided to the client on the firm's best execution policy. Counterparty risk is already covered in connection with the criterion of the probability of the transaction's execution and settlement. What is more, Level 1 does not require the client to be informed about potential risks in this context. Article 27(5) of MiFID II is concerned solely with information about the execution of client orders. And in any event, information about a single risk would deliver no added value to clients.

2.22. Client order-handling

2.23. Transactions executed with eligible counterparties

2.24. Product intervention

Q107: Do you agree with the criteria proposed?

The German Banking Industry Committee, which represents more than 2,000 banks in Germany, would like to begin by pointing out that it is not possible, given the time granted to comment on ESMA's consultation paper, to analyse and evaluate in the necessary detail a five-page list of criteria for a possible product ban.

We do not agree with the criteria proposed. A number of the criteria listed in the draft technical advice (DTA) are too general and worded too broadly. Take, for instance, the following:

- No. 4 i of the DTA: No, complexity is not, in itself, a criterion for prohibiting a product. Fraudulent investment products are typically simple products which lack transparency.
- No. 4 vii of the DTA: No, the inability to sell a financial instrument is not a criterion for banning it since this may be explicitly provided for in the contract. The important point is that this is explained to the investor in advance.
- No. 5 ix of the DTA: This is too vague to be a criterion for product ban.

In view of the legal consequences of a product ban and the associated implications for the market and market participants, it is essential that these criteria are spelled out more precisely.

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

It is striking that there is no mention of typical fraudulent investment schemes and products and schemes such as Ponzi schemes.

3. Transparency

3.1. Liquid market for equity and equity-like instruments

Q116: Can you identify any additional instruments that could be caught by the definition of certificates under Article 2(1)(27) of MiFIR?

The German Banking Industry Committee, which represents more than 2,000 banks in Germany, wishes to point out that certificates such as Tier-1 bonds and German Genussscheine are handled on the market like debt securities: investors hold them until their maturity; there are no exchange-traded options that enable traders to use arbitrage strategies (and would simultaneously increase liquidity); most banks hold them in their bond trading book. For these reasons, ESMA should treat these instruments like bonds and apply the corresponding requirements to them.

3.2. Delineation between bonds, structured finance products and money market instruments

Q121: Do you agree with ESMA's assessment concerning financial instruments outside the scope of the MiFIR non-equity transparency obligations?

In the view of the German Banking Industry Committee, which represents more than 2,000 banks in Germany, both amortised cost and the short-term yield curve are a suitable basis for determining the value of an instrument. In principle, we also agree with the criterion of a maximum maturity of 397 days. This should be a rule to which exceptions are permitted, however. Repos, for example, are typical money-market instruments yet may occasionally have maturities of up to two years. We also have misgivings about the proposal to limit money-market status to instruments "expressly stated" to be an eligible instrument. The lack of an express designation of this kind should not result in an instrument losing this status despite an unquestioned tradability in the money market. We have no objection, by contrast, to the classification of asset-backed commercial paper as a structured finance product.

3.3. The definition of systematic internaliser

Q128: For the systematic and frequent criterion, do you agree that the thresholds should be set per asset class? Please provide reasons for your answer. If you consider the thresholds should be set at a more granular level (sub-categories) please provide further detail and justification.

ESMA invites respondents to choose between a granular approach, which would permit the correct threshold to be set for each individual instrument, and an approach using broader categories, which promises to be easier to apply. The German Banking Industry Committee, which represents more than 2,000 banks in Germany, would like to propose a middle way. The bond category is too broad: it would ignore the differences in the markets for government bonds, corporate bonds and covered bonds. The German Banking Industry Committee would therefore suggest differentiating between these three categories of bonds. Securitised derivatives should be handled like bonds because this is how they are treated in the market. To ensure consistent categorisation across the EU, it will be essential to make a single, central body responsible for assigning individual financial instruments to the various categories.

Q129: With regard to the 'substantial basis' criterion, do you support thresholds based on the turnover (quantity multiplied by price) as opposed to the volume (quantity) of instruments traded. Do you agree with the definition of total trading by the investment firm? If not please provide alternatives and reasons for your answer.

ESMA proposes making the "size of OTC trading carried out by the investment firm on own account" the numerator of the "substantial" criterion. This approach goes too far. Intra-group transactions and transactions for asset allocation and liquidity management purposes of a bank should be deducted from this figure since they are not carried out for trading purposes.

Q130: Do you agree with ESMA's proposal to apply the systematic internaliser thresholds for bonds and structured finance products at an ISIN code level? If not please provide alternatives and reasons for your answer.

Yes, we agree with ESMA's proposed approach to bonds and SFPs on the condition that higher thresholds are initially set. It should be borne in mind that neither the market nor supervisors have any experience of applying a systematic internaliser regime to bonds. ESMA should therefore consider initially setting the thresholds at a higher level than currently proposed and then gradually adjusting them over time to take account of empirical evidence. In this regard, it will be crucial to always ensure a level playing field when setting the thresholds.

Q131: For derivatives, do you agree that some aggregation should be established in order to properly apply the systematic internaliser definition? If yes, do you consider that the tables presented in Annex 3.6.1 of the DP could be used as a basis for applying the systematic internaliser thresholds to derivatives products? Please provide reasons, and when necessary alternatives, to your answer.

The aggregation of derivatives should not result in an investment firm being obliged to carry out transactions which were not originally intended.

Q133: Do you consider a quarterly assessment by investment firms in respect of their systematic internaliser activity is adequate? If not, what assessment period would you propose?

A three-month assessment period is far too short. It would be more appropriate to base the assessment on the previous twelve months (on a rolling basis, with a new calculation every quarter based on figures from the previous twelve months). This is the only way to avoid occasional spikes distorting the result.

If the calculations show that the investment firm is a systematic internaliser, it will need at least three months to put the necessary arrangements in place to comply with the proposed regime. The one-month period mentioned in para. 12 on page 193 is much too short.

Q134: Within the ranges proposed by ESMA, what do you consider to be the appropriate level? Please provide reasons for your answer. If you consider that the threshold should be set at a level outside this range, please specify at what level this should be with justifications and where possible data to support them.

It should be borne in mind that neither the market nor supervisors have any experience of applying a systematic internaliser regime to bonds. ESMA should therefore consider initially setting the thresholds at a higher level than currently proposed and then gradually adjusting them over time to take account of empirical evidence. In this regard, it will be crucial to always ensure a level playing field when setting the thresholds.

Q135: Do you consider that thresholds should be set as absolute numbers rather than percentages for some specific categories? Please provide reasons for your answer.

Comparing the number of a firm's own transactions with the total number of transaction in the EU ISIN level will be a challenging exercise. In the interests of proportionality, we would recommend the introduction of de minimis thresholds in the form of absolute numbers. These de minimis thresholds would reflect the fact that, below a certain volume or number of transactions in a financial instrument or category of financial instruments, systematic internalisation satisfying the "frequent and systematic" criterion cannot be said to exist. If the number or volume of an investment firm's transactions is below this threshold, the firm could dispense with the calculations. This would free firms with small turnovers from a disproportionately heavy burden of complex and time-consuming calculations.

3.4. Transactions in several securities and orders subject to conditions other than the current market price

Q137: Do you agree with the definition of portfolio trade and of orders subject to conditions other than the current market price? Please give reasons for your answer?

The German Banking Industry Committee, which represents more than 2,000 banks in Germany, does not consider it appropriate to include repos and securities lending transactions in the systematic internaliser regime. As the consultation paper rightly points out, they should be considered as being subject to conditions other than the market price. In the consultation paper, this conclusion applies only to securities financing transactions in equities, however, not to securities financing transactions in debt securities. But for the same reasons, the latter transactions should also be exempt from the systematic internaliser requirements.

3.5. Exceptional market circumstances and conditions for updating quotes

Q138: Do you agree with the list of exceptional circumstances? Please give reasons for your answer. Do you agree with ESMA's view on the conditions for updating the quotes? Please give reasons for your answer.

The German Banking Industry Committee, which represents more than 2,000 banks in Germany, agrees that it makes sense to draw up a list of exceptional circumstances. However, it must be ensured that by the list is by no means exhaustive.

3.6. Orders considerably exceeding the norm

Q139: Do you agree that each systematic internaliser should determine when the number and/or volume of orders sought by clients considerably exceed the norm? Please give reasons for your answer?

Yes, we agree.

3.7. Prices falling within a public range close to market conditions

3.8. Pre-trade transparency for systematic internalisers in non-equity instruments

4. Data publication

4.1. Access to systematic internalisers' quotes

4.2. Publication of unexecuted client limit orders on shares traded on a venue

4.3. Reasonable commercial basis (RCB)

Q162: Within the options A, B and C, do you favour one of them, a combination of A+B or A+C or A+B+C? Please explain your reasons.

The German Banking Industry Committee, which represents more than 2,000 banks in Germany, favours Option A. The market determines prices on the basis of fair, reasonable and non-discriminatory price formation, free of any anti-competitive factors. Government intervention in price formation should generally be avoided.

5. Micro-structural issues

5.1. Algorithmic and high frequency trading (HFT)

Q167: Which would be your preferred option? Why?

The German Banking Industry Committee, which represents more than 2,000 banks in Germany, has a clear preference for Option 1. This option takes appropriate account of the considerations set out in Recital 61 of MiFID II. Option 1 specifies clear parameters which will enable HFT to be identified unequivocally. The view expressed in para. 15 of chapter 5.1 that parameters might be easy to circumvent, especially where proximity hosting is involved, is not correct. The definition of a high-frequency algorithmic trading technique in Article 4(40)(a) of MiFID II explicitly covers proximity hosting.

Q168: Can you identify any other advantages or disadvantages of the options put forward?

The main drawback of Option 2 is that the criteria are extremely vague. The envisaged variables in the form of the median daily lifetime of the orders are not a robust basis on which to determine whether or not HFT is taking place. Hard criteria are a prerequisite for a robust assessment. Option 2 also has the disadvantage that individual calculations depend on calculations relating to the market as a whole. It is totally unclear who would have to make what calculations and when. Nor is there any indication of what reference periods would form the basis of calculations, yet the median would differ significantly depending on whether calculations were based on a minute, a second or a millisecond, for instance. We also consider it inappropriate to classify as high-frequency traders all traders whose median lifetime of orders

lies just under the median for the market as a whole. The results could be extremely arbitrary. It could, for example, happen that by placing and immediately cancelling a single order at a single trading venue, an investment firm would be classified as a high-frequency trader both at that venue and all other venues across the EU.

Q169: How would you reduce the impact of the disadvantages identified in your preferred option?

We see no drawbacks to Option 1.

Q170: If you prefer Option 2, please advise ESMA whether for the calculation of the median daily lifetime of the orders of the member/participant, you would take into account only the orders sent for liquid instruments or all the activity in the trading venue.

Our preference is for Option 1.

Q171: Do you agree with the above assessment? If not, please elaborate.

We understand the approach of making a participant deemed to pursue HFT at one trading venue in the EU subject to the MiFID II HFT regime throughout Europe. We nevertheless have reservations about the idea that a high-frequency trader would not be allowed to operate as a non-high-frequency trader elsewhere in the EU. We believe a high-frequency trader should only have to meet the requirements of the HFT regime at venues where it really uses HFT strategies. Since the requirements to be met by high-frequency traders vary from one trading venue to another, some investment firms may have a legitimate interest in not using HFT strategies at all venues.

5.2. Direct electronic access (DEA)

Q174: Do you consider that electronic order transmission systems through shared connectivity arrangements should be included within the scope of DEA?

ESMA should clarify that the scope will not cover retail clients that transmit their orders to banks online if the orders are simply forwarded via the internet without any processing of their content.

Trading systems used only to forward orders to one or more trading venues or to confirm orders should also be outside the scope. The same should apply to algorithms meeting the MiFID II best execution requirements for systems that can only be used for forwarding orders to one or more trading venues or for confirming orders.

The German Banking Industry Committee, which represents more than 2,000 banks in Germany, is not aware of any developments of the kind alluded to in para. 9 which would call into question the conclusions of the IOSCO Consultation Report cited in para. 8 and entitled “Policies on Direct Electronic Access” (February 2009).

6. Requirements applying on and to trading venues

6.1. SME Growth Markets

6.2. Suspension and removal of financial instruments from trading

6.3. Substantial importance of a trading venue in a host Member State

6.4. Monitoring of compliance – information requirements for trading venues

6.5. Monitoring of compliance with the rules of the trading venue - determining circumstances that trigger the requirement to inform about conduct that may indicate abusive behaviour

7. Commodity derivatives

7.1. Financial instruments definition - specifying Section C 6, 7 and 10 of Annex I of MiFID II

7.2. Position reporting thresholds

7.3. Position management powers of ESMA

8. Portfolio compression