Brussels, 28 April 2021
MvB/TC

EACB Answer

To

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

April 2021

The **European Association of Co-operative Banks** (EACB) is the voice of the co-operative banks in Europe. It represents, promotes and defends the common interests of its 28 member institutions and of co-operative banks in general. Co-operative banks form decentralised networks which are subject to banking as well as co-operative legislation. Democracy, transparency and proximity are the three key characteristics of the co-operative banks' business model. With 4,050 locally operating banks and 58,000 outlets co-operative banks are widely represented throughout the enlarged European Union, playing a major role in the financial and economic system. They have a long tradition in serving 214 million customers, mainly consumers, retailers and communities. The co-operative banks in Europe represent 85 million members and 749,000 employees and have a total average market share of about 20%.

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Introduction

The EACB welcomes the opportunity to participate in the ESMA's public consultation (ESMA35-36-2159) on guidelines on appropriateness and execution-only requirements of MiFID II.

In general, we wish to raise **the peculiarity of the consultation seeming to go beyond the original mandate of MiFID II and its Delegated Regulation**. We understand that these changes are being proposed following the Common Supervisory Action (CSA) of 2019 with respect to appropriateness which seemed to highlight insufficient supervisory convergence. However, **we would encourage ESMA to publish the actual general outcomes of the CSA on appropriateness** because we do not understand to what extent these divergences justify these rather strict guidelines.

Furthermore, it appears that another objective of the proposed guidelines is to also take into account (or converge) with the suitability assessment requirements when providing investment advice. However, the obligations of appropriateness concerning the knowledge and experience of the client, as well as, the complexity of the product, are narrower than those for suitability. ESMA also acknowledges this difference in the consultation paper. **The changes made for the objective of aligning the appropriateness rules with those for suitability, are thus also difficult to justify in terms of investor protection and supervisory convergence goals**.

We also note that the Cost Benefit analysis indicates that the proposed guidelines could be marginally impactful and that IT costs should not be significant. However, banks would have to consider making changes that may seem minor yet impose **major impact on their IT capacity during the COVID-19 pandemic**. This is even more difficult due to the **stretching of banks' resources in order to implement the Sustainable Finance Disclosures Regulation (SFDR), MiFID II review, the KID under the PRIIPs RTS, and finally the end of the UCITS KIID exemption**.

While on the topic of the MiFID II review, we would like to point out specific recitals of the MiFID II amendments as part of the COVID-19 capital markets recovery package by the European Commission ("the MiFID Quick Fix"). Recital 1 of the MiFID Quick Fix states that *"The overall aim of those MiFID II amendments should be to remove unnecessary red tape and introduce carefully calibrated measures that are deemed effective in order to mitigate the economic turmoil. Those amendments should avoid making changes that increase administrative burdens on the sector and should leave complex legislative questions to be settled during the planned review of Directive 2014/65/EU of the European Parliament and of the Council".* Furthermore, Recital 2 of the MiFID Quick Fix states that *"to reduce regulatory complexity and investment firms' compliance costs and to eliminate distortions of competition could be considered, provided that investor protection is sufficiently taken into consideration at the same time."*

The above statutory guidelines do not seem to be taken into account with respect to ESMA's proposed guidelines, thus not resulting in our view, to any added value for investors, and contradicting the goal of the MiFID Quick Fix. On the contrary, some of the requirements contained in this draft would actually discourage large parts of customers from making investments and would even motivate them to invest in investments, which are not regulated by MiFID II and could potentially be riskier to clients and contain more loss potential.

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From the customer's point of view, this misguided attempt for more investor protection would be perceived as bureaucracy and overreaching.

On a final note, the implementation of any new requirements in tools and processes requires appropriate time for implementation in advance, and this time-aspect should be considered in the course of the application of ESMA Guidelines - **a sufficient implementation period is necessary** (usually, IT changes require at least 1.5 – 2 years of preparation time).

Whilst we encourage ESMA to consider the above, please also kindly find below our responses to the consultation questions.

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

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

The EACB agrees that the suggested approach leaves it up to the firms to decide how they inform their clients about the appropriateness assessment and the used format. However, such amount of information to be provided to the client is vast and could translate into an extra burden to the client who in any case is likely to ignore this extra information. In addition to this, we oppose the requirement to record the information provided, because it is not always possible to document and keep track whether clients have seen the information about the appropriateness assessment.

We are also not sure what the expression "in good time" implies but advise that this should be left broad because service providers require flexibility in some trading situations.

In order to ensure compliance with the conditions laid down in Chapter II, Section 2 MiFID II, our members ensure that as a first step, they obtain the necessary information from the customers by instructing them about the importance of the completeness of the information. Then as a second step, the bank decides based on clients' indications, which service/investment product can be offered at all. This way our members assure compliance with these conditions. Therefore, the obligation to inform clients prior to the non-advised service about the situations where no assessment will be done and the consequences thereof (paragraph 14, second bullet) is dispensable in view of the clear requirement of Article 25(3) subparagraphs 2 and 3 MiFID II and should therefore be deleted.

Guideline 2 – Arrangements necessary to understand or warn clients

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

Our members have highlighted that certain details being proposed in Guideline 2 are difficult to justify:

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a) Risk of circumvention and cooling off-period

ESMA states that a client who responds a questionnaire more than once (especially in online questionnaires) may be trying to circumvent their ability to reply to the questionnaire based on their actual knowledge and experience. The proposal to address this risk of circumvention that is being made by ESMA is that (i) either a "cooling-off period" is implemented after a client attempts to answer a questionnaire multiple times; (ii) a different set of questionnaire is provided after a first "wrong attempt" or (iii) firms may implement any other control that ensures that a client cannot repeat the questionnaire several times to "test" what kind of answers are needed to get the desired outcome. We see several issues with this reasoning:

- Guideline 2 restricts the right for clients to trade financial instruments under Article 25(3) in MiFID II and Article 56 in the Delegated Regulation, whereby the firm may push a trade through even if the client has failed an appropriateness assessment. This means that a cooling-off period or limiting the number of attempts would have no effect in practice.

- In a situation where a firm has implemented a process whereby the firm blocks a client from trading until an appropriateness assessment has been passed, a cooling-off period or limiting the number of attempts would only create an illusion of that the client would have a greater knowledge at a later stage. At the same time, just because a person repeats the same information several times, that does not equal that the person does not gain the sought knowledge. We argue that it is rather the opposite. In the case of online assessment, the consensus should be that it is not possible to completely eradicate circumvention. Given the wide variety of firms and subsequent firms, we see no benefit in ESMA defining methods to counter circumvention especially when there seems to be no evidence that underpins these assumptions.

- This type of guideline also allows for arbitrary situations between firms, e.g. one firm may decide to implement a cooling off period of a couple of hours whereas another firm implementing 1 day, and a third firm implementing 2 days etc. The same goes for a limitation to the number of attempts in that what the firm is expected to do after the client has maxed out the number of attempts. Some firms might block clients from trading contrary (although no legal requirement to do so), or simply warn the client and then let the client push through with the trade.

- In the event of multiple incorrect answers being met by a cooling period, the customer is incentivized to become active with several investment firms or to switch to other non-regulated forms of investment (e.g. virtual currencies). In addition, such "blocking periods" could give rise to civil law claims by the client against the investment firm (e.g. compensation for damages due to the non-execution of securities orders), which should not be disregarded.

- Finally, we note that the last bullet in sub-paragraph 26 of the guidelines is ultimately inconsistent with the other comments made by ESMA regarding cooling-off periods and circumvention of repetition of assessments/tests by clients.

b) Possibility of answer 'do not know'

The last bullet in paragraph 22 of the guidelines states that a *"client should be able to reply that he does not know how to answer the question"*. We are not convinced that such an option contributes in any way to the purpose of the appropriateness test. In this case, it will only cause confusion and doubt when answering questions because clients will either play a guessing game or provide unreliable information.

Most customers take a test to pass, not to fail. Therefore, customers may be incentivized to avoid selecting "Do not know" even if this is the truth, as they have a 50% chance of guessing the right answer and therefore have a bigger chance of passing the test. In reality, the client either knows the answer or they do not. It is thus easier to gauge appropriateness if the client gets the answer wrong, rather than selecting "Do not know". In fact, it is unclear what a firm would do with that answer. Depending on the structure of the appropriateness assessment, the practical effect would either be that the client still passes the test or that the client fails the test. Therefore, the possibility to answer "Do not know" becomes completely redundant.

This option also implies that all questions must always be answered with 100% certainty. This is not always the case, especially with multiple-choice questions, where customers must be able to give their best answer from the selection provided and given the available knowledge. If there is too much 'guessing', then this automatically results in higher error rates in well-composed questionnaires. In this case, the "Do not know" answer is also unnecessary.

For example, when a customer is asked about the experience he has already gained, the number of transactions carried out to date may be taken into account. This is an absolute number which is then valued accordingly by the firm. The interpretation of whether the experience is "sufficient" is at no time incumbent on the customer. Allowing the customer to respond with "I don't know" coupled with the cooling-off period, in practice might lead to a sales ban, that at no time is required by MiFID II, which on the contrary deems the provision of a warning as sufficient. We are therefore of the opinion, that the current draft guidelines go beyond the law.

c) Necessary Information

Sub-paragraph 20 of the consultation states that firms should *"provide all necessary information and that a firm should always aim to collect all necessary information to assess whether his knowledge and experience is appropriate to the specific type of services or product offered or demanded."*

First, we note that ESMA does not clearly define what information is 'absolutely' necessary. Furthermore, necessary information can diverge over different distribution/client groups (i.e. experience of customers might be more necessary to acquire for younger customers than relatively older customers). By stating that firms should *"always aim"* and *"always ask" (sub-paragraph 20),* ESMA does not consider that under MIFID II it is not necessary to gain knowledge and experience with regards to non-complex financial instruments. If the investment firm chooses to use the exception under Article 25(4) MIFID II, there will be no questionnaire about knowledge and experience and these considerations should therefore be ignored. The customer cannot be called upon to provide information if this is deliberately not intended. These considerations can therefore only be relevant if there is no appeal to an 'ex-only' exception.

d) (Self-) correction of the client's data must be possible

With regards to paragraph 23 of the consultation, we would like to emphasise that a (self-) correction of the client's data must be possible. Insofar as clients make an error in responding to the questionnaire, these answers must be reversible. Furthermore, a limitation of corrections in the context of non-advisory business based on the client's knowledge and experience is not expedient. The client is already sufficiently protected by warnings in that he is made aware of any lack of knowledge and experience and can take this into account when making his well-informed decision.

e) Proportionality

Paragraph 24 and 25 of the consultation both outline that the proportionality principle that must apply when developing the appropriateness test, seems to be completely overlooked in these considerations. For non-complex instruments for which the appropriateness test is not necessarily mandatory, it may go too far to work with substantive multiple-choice questions. This will usually also apply to questionnaires that only pertain to the appropriateness of the ex-only service. We therefore recommend that ESMA clarifies that in certain cases, given the proportionality principle, it may be sufficient to suffice with binary questions.

f) No general requirement to assess / check the plausibility of client information

We would like to point out with regards to the 2nd bullet of Paragraph 25 of the guidelines that investment firms cannot be required to generally assess / check the plausibility of client information on knowledge and experience. This clearly follows from Article 55(3) of the MiFID II Delegated Regulation 2017/565, which states that investment firms shall be entitled to rely on the information provided by their clients or potential clients, unless they are aware or ought to be aware that the information is manifestly out of date, inaccurate or incomplete.

g) Opportunity to review the assessment of the client´s knowledge and experience

The requirement in paragraph 28 that the client should be given the opportunity to review the assessment of their knowledge and experience derived from their past transactions lacks a legal basis at level 1 or 2, so that for this reason alone such a requirement should be eliminated.

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

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

a. Complex products: from a legal perspective and as a 'relative concept'

Sub-paragraph 26 of the consultation states that *"Considering the type and characteristics of investment products, firms should ask for more in-depth information on a client's knowledge and experience when non-advised services are provided in relation to more complex or risky products as compared to less complex or risky products. After all, assessing a client's capacity to understand the risks associated with more complex or risky products will require more in-depth information from the client. It is important to clarify that in this context, ESMA is referring to complexity as a relative term."* Furthermore, paragraph 32 of the guidelines seems to indicate that the appropriateness test requires differentiation according to the type of complex financial instruments involved. This means no one-size-fits-all, but a tailor-made approach given the unique nature of every financial instrument.

We strongly oppose the introduction of complexity as a relative term by ESMA in these guidelines.

To illustrate why, a UCITS would not qualify as a complex product (from a legal perspective) according to Art. 25(4)(a) MiFID II, implying that non-UCITS would be a complex product. In Art. 57 of MiFID II Delegated Regulation, a summary is given of criteria that a product must meet if it is not specifically mentioned in Article 25(4)(a)(vi) MiFID II. UCITS are mentioned under (iv) and are therefore (again, from a legal perspective) seen as non-complex, and thus non-UCITS can then be classified as complex. The issue is that ESMA introduces a new definition of complex products - as a relative concept - in addition to the existing legal consideration of whether a product can be regarded as complex or not.

Of course, there are instances of relativity. For example, an AIF should be categorized as a complex product from a legal perspective, but – in relative terms – could very well be of a less complex nature given its underlying investments than a UCITS, even when this UCITS qualifies from a legal perspective as a non-complex product. The above example illustrates the current imperfect situation but introducing 'relative complexity' in the case of appropriateness would not solve this imperfection. Quite the contrary, it would overcomplicate the current situation, without giving firms that provide non-advised services and end investors any legal certainty as the definition of 'relative complexity' is not defined in MiFID II nor the Delegated Regulation. This in turn, could lead to divergency between market practices. We believe ESMA should pay careful attention to this.

From a more operational standpoint, asking for knowledge and experience giving the 'relative complexity' of a wide array of securities is simply impossible to implement as every security has a unique set of risks and opportunities.

b. <u>Using product governance information for the appropriateness test</u>

Sub-paragraph 28 of the consultation states that *"Lastly, it is emphasised that, for the purpose of the appropriateness assessment, firms should only take into account a client's information on his knowledge and experience. It should be clear for clients that any other information collected (financial situation, investment objectives, …) in the context of for example product governance arrangements or other investment services, will not be taken into account in conducting the appropriateness assessment."*

This does not seem very relevant as banks hardly collect information on financial situation and investment objectives for execution-only customers, for product governance purposes. The ESMA guidelines on product governance requirements have in general failed to make a clear distinction between target market identification requirements that apply under the execution-only regime and under the provision of investment advisory or asset management services regime, since in the latter case, it is possible to conduct a relative more thorough assessment of the target market and obtain information about aspects such as the clients' financial situation and objectives.

c. <u>Differentiations in the process of the appropriateness test</u>

Our members are also critical of the proposal in paragraph 29 of the guidelines that a more in-depth appropriateness test should be carried out for more complex or riskier products than for "simpler" products. From the point of view of the distributers, the appropriateness test should be possible for self-deciders in a uniform manner. This would allow the use of standardised IT

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processes, which are particularly necessary in brokerage. Standardisation to this extent is also in the customer's interest, because this can guarantee order execution without delays.

We would like to explicitly point out that according to the legal requirements there are already gradations which take into account the differences in the products (e.g. the appropriateness test is not necessary for non-complex products and when purchasing packaged investment products, the investor receives, in addition to the appropriateness test, a product-related information sheet in which the manufacturer explains the product to him). Further differentiations in the process of the appropriateness test do not make sense from the customer's point of view either.

Paragraph 33 also explicitly states that depending on the complexity level of the products, the knowledge and experience of the client must be asked more specifically rather than asking the type and characteristics of the investment products. Standardised questions by asset class remain relevant, but anything deeper than that based on complexity is too far-reaching.

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

We do not agree with the suggested approach because this goes further than the Level 1 regulatory mandate. Furthermore, it resembles the suitability assessment, which covers the customer’s whole situation. In the case of the appropriateness assessment, the holistic view is unnecessary, because the focus should be on the single product or service type. More detailed analysis is conducted in the case of testing client suitability when providing financial advice.

Regarding the guideline on *"bundled services"* like granting loans, sectoral legislation already aims and succeeds to inform and protect investors. We have not discovered any motivation from ESMA that indicates that the current sectoral legislation is not sufficient in the case of granting loans in an execution-only regime.

Regarding short selling, firms should carefully assess whether that service is appropriate for the customer. We do not specifically believe that this should be part of the knowledge and experience test. Given the nature of execution-only, we believe firms could set up agreements and information documents on short selling (these do already exist) and it is up to the customer to decide whether the service is deemed appropriate.

Guideline 4 – Reliability of client information

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

Guideline 4 (specifically paragraphs 36 and 37) indicate that firms should check the reliability, accuracy and consistency of the information provided by the client, even if the client is expected to provide correct, up-to-date and complete information. We see challenges in this expectation by ESMA.

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First, it is hard to determine what the checks would be and where the accountability of both the investment firm and client begins and ends. This particularly rings true in an online environment where it is almost impossible to verify the reliability of client information. We believe clients are not only expected to provide correct, up-to-date and complete information but are also ultimately responsible for handing over this information to the investment firm that provides non-advised services.

Furthermore, it is difficult to verify transactions conducted by other service providers, because transaction data is not necessarily available. The investor might hold multiple investment accounts with various (international) firms. Individual investment firms – for example - have no oversight on securities transactions conducted through third parties, so in this case the information per se is incomplete in the case of multiple accounts. The service provider should rely on the information given by the client in such cases.

In addition to this, all the profiling should be conducted according to the rules set in GDPR. Article 22 GDPR states that *"The data subject shall have the right not to be subject to a decision based solely on automated processing, including profiling, which produces legal effects concerning him or her or similarly significantly affects him or her."* This means that if the data subject objects the profiling, the profiling software should not be used.

We thus suggest paragraph 37 of the Guidelines is replaced by the following:

> "**It is the duty of clients** ~~Clients are expected~~ to provide correct, up-to-date and complete information as is necessary for the appropriateness assessments. ~~However,~~ Firms should take reasonable steps to check the reliability, accuracy and consistency of the information collected about their clients. **Firms could do so by** ensuring they have the necessary **procedures (systems and controls)** to conduct an appropriateness assessment or they should issue a warning to the client. **However, firms cannot be held ultimately responsible for incorrect, non-up-to-date and incomplete information as, certainly given the online character of many non-advised services, it is impossible to rule out any outliers**.".

In relation to general guideline 4 and paragraph 38, we would like to explicitly state that according to Art. 55(3) Delegated Regulation 2017/565 an investment firm may rely on the information provided by its clients or potential clients to be accurate and that only in cases where the investment firm knows or should know "*that the information is manifestly out of date, inaccurate or incomplete*" may the investment firm not rely on the information provided by the client. It follows that investment firms may in principle treat the information provided by the client to an investment firm as accurate and that there is no fundamental obligation on the investment firm to verify the information provided by its clients.

Regarding paragraph 39 of the guidelines, ESMA writes that *"in order to ensure the consistency of client information, firms should view the information collected as a whole"*. We believe this is in contrast with the above-mentioned quotes where all information regarding appropriateness, only accounts for knowledge and experience (i.e. excluding the financial position of the clients, transaction history). We suggest ESMA further clarifies this paragraph.

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

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

The EACB does not agree with this approach because it feels unreasonable to put proactive requirements on firms in non-advisory services to periodically reach out to clients to update information or request confirmation of previously delivered information. Guideline 5 seems more relevant for an advisory service or at least an ongoing service and/or ongoing interaction of some sort. However, this is not the case for execution-only services which are dependent on the client engaging the firm and initiating trading services. As such, the firm assesses appropriateness in the trade situation and not on a periodic basis, unless of course a client engages the firm on multiple occasions throughout a year for example, and then trades different types of financial instruments. Our members are aware that they cannot in general know when to contact a client because of potential changes regarding knowledge and experience. It should be the client who has the ability to update information and/or that the firm should be in a position to update a previously made assessment, in the situation where a client initiates the trade. In general, we believe the whole of Guideline 5 should be deleted or at the very least the following paragraphs should be deleted/clarified.

- **Paragraph 41**: Although we agree with the general acknowledgement of ESMA in paragraph 41 that *"the issue of updating in the context of the appropriateness assessment has a different nature than for the suitability assessment",* we do not see how the knowledge and experience of "vulnerable clients" should be given particular attention. From a product governance perspective, the distribution strategy already aims to distribute products to certain target markets. There should be no target market that identifies as "vulnerable" as they should – in general – probably refrain from investing in complex products in any case. Furthermore, we cannot determine in a client-initiated trade situation whether the client is more vulnerable or not, based on the appropriateness assessment. The standards for a more vulnerable client are something that ESMA would have to clarify. We thus strongly oppose the proposal that special attention should be paid to updating the information of vulnerable clients, with older clients being particularly in need of protection. We see a clear risk of discrimination here, especially from the clients' point of view. Investors of an older age are not per se at risk. On the contrary, our experience shows that experience and knowledge often increases rather than decreases with advancing age and corresponding trading activities.

- **Paragraph 42:** Under this paragraph, ESMA asks firms to implement procedures for reminding clients to regularly update or alert the firm of any change in the information originally provided. Furthermore, ESMA states that firms should have adequate procedures to deal with those situations where the client does not answer to their questions regarding changes or updates of the information provided initially. Only in cases when information is clearly outdated, inaccurate or incomplete, would it be legally required to take action towards the customer (Art. 55(3) MIFID II Delegated Regulation).

  Setting up a mandatory regular update while there is no reason to do so will only lead to misunderstanding and irritation among customers. In practice, execution-only services are offered with a limited or defined range of non-complex instruments because the product

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governance distribution requirements already clearly define distribution principles. In these cases, it will not often happen that previously provided information from customers needs an update. It is up to the investment firm to determine if and what the frequency should be for having to update client information.

ESMA should also take in to consideration the risk that a mandatory regular update could operate as an incentive to investors to disqualify themselves with the benefit of hindsight for transactions that earlier met the appropriateness test. This could create in civil law a legal ground to claim compensation for investment losses suffered by the investor with regard to transactions executed on the basis of the outcome of the earlier appropriateness test.

In general, we believe paragraph 42 should be deleted. As clients are responsible for up-to-date, correct and complete information, it is rather unduly to ask clients 'regularly' to update information. Of course, when there is a valid reason to update, a client should be given the possibility to update his/her client information. But this is something completely different than imposing stricter rules on investment firms by means of guidelines.

- **Paragraph 44:** ESMA mentions the possibility for firms to have arrangements to re-check the knowledge and experience of the client *"becoming aware of a relevant change that could affect his level of knowledge and experience".* As an example, "unusual transactions" are given. We do not believe this paragraph is necessary and the example given is rather impractical. If a client was onboarded to a non-advised investment service platform, has not done any transactions but has completed his knowledge and experience test two years ago: Does this mean that large transactions in derivatives are 'unusual'? As firms do not know the goals of individual investors, it is rather impossible to qualify transactions as unusual for the purpose of 'relying on up-to-date client information'. The baseline requirement should be that the product is appropriate if the client's knowledge and experience is of sufficient level. Furthermore, procedures for frequent updates of information on a client's knowledge and experience are already in place (usually updated every two years) and vary depending on client's risk profile or other triggers. However, our view is that knowledge and experience can only increase (as acknowledged from ESMA) over the years - therefore, in our opinion, this guideline should not excessively lead to more frequent check-ups.

- **Paragraph 45:** ESMA expresses concern on investors being encouraged to increase the level of their knowledge and experience "too frequently" in order to gain access to complex financial instruments that would otherwise not be appropriate. Educating clients on both complex and non-complex products is one of the core elements of non-advised services. We therefore do not agree with this sentence in paragraph 45. Furthermore, if there has not been a real modification in the client's level of knowledge and experience, other guidelines (like guideline 3 and 4) already appropriately address these issues. The comment that in cases of heightened knowledge and experience in a short period of time, firms could also require the modified knowledge and experience to be reviewed by two staff members is overly prescriptive and is not based on assumptions that the possible issue would be overcome (or reduced) if two staff members would review this situation instead of one whilst the burden for firms is heightened. It also has to be kept in mind that firms do not dictate how often a client wants to trade different types of instruments and the firm's responsibility is to assess the client's knowledge and experience in relation

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to the instrument type which is relevant for the trade at hand. If a client has gained knowledge of certain instruments at different times during a three-month period and therefore engages the bank 10 times to perform transactions, it would be necessary to "update" the knowledge and experience assessment anyway whenever the client would engage with an instrument for which the client has not yet passed an assessment test. We also would like to expressly point out that that paragraph 45 conflicts with Article 55(3) Delegated Regulation 2017/565, under which an investment firm may rely on the information provided by its clients or potential clients being correct.

Guideline 6 – Client information for legal entities or groups

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

The EACB does not understand the rationality behind Guideline 6 because it does not seem fit for execution only-services (instead they rather reflect a copy of suitability requirements). Furthermore, ESMA focuses in this guideline on the face-to-face selling procedure, compared to the fact that the online trading service is commonly used.

According to paragraph 48 of the guidelines, when the investment account concerns a 'legal entity' that is represented by a natural person, the knowledge experience of the person(s) acting on behalf of the legal entity should be tested. In paragraph 49, ESMA subsequently writes that "*if the group of two or more natural persons involved have difficulties in deciding the person(s) from whom the information on knowledge and experience should be collected, the firm should adopt the most prudent approach by taking into account the information on the person with the least knowledge and experience*".

We believe one person should always be appointed in such group that should act as the person who is responsible for conducting the knowledge and experience assessment ("the acting person") if the right to represent natural and legal persons is not yet defined by national law. In execution-only relationships, our members often allow such service only where non-complex instruments are involved and thus there is no need to do the knowledge and experience checks of the acting person. In the case that complex instruments are allowed without investment advice, only the knowledge and experience of the person requesting the account and entitled to the account is requested. In online services, the banks are not aware of any different levels of knowledge and experience within the group: it is up to the group of two or more persons to decide whether the individual with the most knowledge and experience or (of course less preferable) the one with lesser knowledge and experience is the main contact. Furthermore, before starting to use the services the company representatives have to be coded into the client's profile so that the system/platform recognises pre-defined representatives. The right to represent the company is based on the power of attorney or on the company's articles of association or in national law. Communication with representatives (e.g. on the phone) is already covered in the internal conduct of business policy, so there is no need to require a dedicated policy for how to conduct an appropriateness assessment for representatives.

Investment firms that voluntarily test the knowledge and experience individually for each "group member" (despite not being legally required), do not want to be obliged to assume that the person in the 'group' with the least knowledge and experience should lie at the heart of testing knowledge and experience of the complete 'group'. Preferably, firms should be left free in their options, for example to check what is the best fit for this specific person / group. However, we agree that regarding paragraph 50, a firm's policy could specify how to deal with those situations where there are significant differences between the level of knowledge and/or experience of individual clients.

On a final note, the use of "group" can be confusing, especially as it is undefined, i.e. whether it is always a legal entity or group of natural persons. This should be clearly defined, e.g. group of individuals.

Guideline 7 – Arrangements necessary to understand investment products

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

In general, Guideline 7 seems to relate more to product governance requirements rather than appropriateness. The current MiFID II and Delegated Regulation already sufficiently covers the arrangements necessary to understand investment products. So for example, ESMA does not need to outline that firms could also define, at the level of product governance arrangements, ex-ante limits (paragraph 52) to the range of investment products that can be offered under the appropriateness regime as the product governance arrangements already address this.

Regarding paragraph 54, for more complex investment products, ESMA writes that firms should not only rely on the information from external data providers but check and challenge such data where possible. or compare data provided by multiple sources. We do not see any legal basis for ESMA nor any direct substantiation by ESMA that justifies paragraph 54.

The EACB also thinks that paragraph 55 is unclear how the conflict of interest risks (in particular self-placement practices) have relevance within the framework of these guidelines. After all, these risks are already controlled by other rules from MiFID II that the investment firm must comply with, and on the basis of which among other things, strict segregation of duties apply within banks. If the investment firm chooses not to distribute certain financial instruments in particular execution-only services, this will have to do with the characteristics and risks of the product that do not match the established target group and not with the fact that the bank could also be involved in the development and/or issuance of financial instruments. Furthermore, the examples and descriptions provided under paragraph 55 are too detailed. Firms should be left free to decide the level of granularity in this regard. Please also refer to our answer to Q3 on the introduction of complex products as a relative concept by ESMA.

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

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

Article 25(3) MiFID already defines within reason the warnings in the context of the appropriateness test to be provided in a standardized form. In practice, when submitting orders, customers may be presented with the same standardized warning over and over and "warning inflation" will occur anyway. This is inherent to the standardized warning system and the bank simply cannot change this, as warnings are standardized in the first place. ESMA should not and cannot expect too much from investment firms, because the starting point is to warn the customers and not to block orders.

Under MIFID II product governance rules and on the basis of the appropriateness test, there is no obligation to refuse orders, but only to standardize warnings. It should be clarified that ensuring effectiveness does not mean that a standardized warning is no longer sufficient, nor that obligations to refuse orders may apply. In fact, the product governance regime does lead to refusal obligations. Even distribution within a potential negative target group indicated by the manufacturer, it is possible to distribute financial instruments as long as a warnings are given. Only in very specific situations could an obligation to refuse could apply in practice, which, according to ESMA, is only the case if it is abundantly clear in advance that the product can never meet the needs of the identified target group (ESMA guideleines on product governance, paragraph 32, p. 10).

Paragraph 59 states that the classification of clients and investment products must not be too broadly based. It must also be ensured that the query does not have to be too granular so that it can be implemented in practice.

Guideline 9 – Effectiveness of warnings

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

The EACB agrees with the suggested approach in principle, but has specific concerns with some paragraphs:

- **Paragraph 65:** states that *"firms should also take reasonable steps to ensure that the warnings they issue are correctly received and understood".* If firms have to take steps to ensure whether the client had understood the warning, that leads to additional questions to the customer. We believe warning the customer and ensuring that the client has received them, is sufficient to protect investors. We therefore propose to delete the wording 'and understood'.

- **Paragraph 66:** We agree with the statement that ambiguous messages should be avoided, however we see a contradiction in avoiding overly long warnings that obscure messages and the possibility for firms to state *"that no information was provided by the client or that the information collected is insufficient and that the firm therefore is not in a position to determine the appropriateness of the envisaged transaction, or that the assessment of the information provided by the client shows that the envisaged transaction is inappropriate for the client."* Furthermore, it is unclear whether investment firms can use both options (no information and/or not appropriate) or if they must choose one option in their warning.

- **Paragraph 71:** states that *"firms should have policies and procedures identifying ex-ante whether there are any conditions and criteria under which a client would not be allowed to*

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proceed with a transaction after having received a warning". If either knowledge and experience points out that the product is inappropriate, insufficient information from the client was obtained and subsequently a warning was sent out, we believe a firm does not necessarily need to have a general policy to determine 'which clients' would not be allowed to proceed. We believe such a policy might have unintended consequences for customers that have chosen to use non-advised services. It is also not clear what could be meant by *"any conditions and criteria under which a client would not be allowed to proceed with a transaction after having received a warning".* According to the clear and conclusive requirements of MiFID II, the client should be warned and be allowed to decide to proceed despite this warning if he does not have the necessary knowledge and experience. A rejection of the order as a result of the appropriateness test would also give rise to considerable risks under civil law. Furthermore, product governance rules already sufficiently provide the desired level of investor protection. The example given for such a policy to refrain customers to trade after a warning is: *"a high level of complexity or risk of products offered or demanded"*. We repeat in this instance that the concept of complexity is a vague and ambigous description for a possibly wide range of investment products. It is difficult to define and distinguish which complex or special products could be sold after the warning procedure and which should not because of special "conflict of interest". According to MiFID, it is always possible to refuse to sell the products to the clients if the product is not appropriate to the client according to the given information about the knowledge and experience. Therefore, this example should be deleted.

In the case of the distinction highlighted between own issues and third-party issues, in our view the conflict of interest mentioned here in the case of own products is non-existent because the topic under discussion relates to advisory-free business, in which the client makes decisions on his own responsibility. If the product is proprietary, this is always sufficiently and clearly disclosed to customers, regardless of the distribution channel. This is why clients can decide on a fully informed basis how to proceed. Restricting the customer's freedom of choice here would clearly go too far.

ESMA also advises firms to evaluate the overall effectiveness of the warnings issued on an ex-post basis, for instance, by assessing the ratio of warnings that were followed by a transaction to the total of all warnings issued, and should make adjustments to their relevant policies and procedures where necessary. We do not agree with this very detailed and specific interpretation of ESMA because it is overly perspective. Firms should be allowed to prescribe how or when those policies need updating as firms need to have an adequate policy in the first place.

For the aforementioned reasons, paragraph 71 should be deleted.

- **Paragraph 72:** The requirement in the last sentence of paragraph 72 to train the staff regularly goes too far and should therefore be deleted. There is no legal basis for such an obligation. The 'Guidelines for the assessment of knowledge and competence' do not provide for this in paragraph 20b either, but instead require an internal or external review of staff members' development and experience needs at least once a year. This is to ensure that employees always have appropriate qualifications for their work. As an alternative to deleting the last sentence in paragraph 72, a reference to paragraph 20b of the 'Guidelines for the assessment of knowledge and competence' could be considered. This would avoid possible misunderstandings that a different interpretation is now to take place.

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Guideline 10 – Qualifications of firm staff

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

MiFID II requirements relating to qualifications of firm staff are already comprehensive. It is not necessary to bring such new requirements in the form of guidelines and thus, this guideline 10 should be deleted.

Guideline 11 – Record keeping

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

In general, the EACB believes that any record-keeping requirements should be elaborated in Level 1 or Level 2 regulation rather than in any guidelines, and only after a cost-benefit analysis.

In more detail:-

- **Paragraph 77**: We disagree with the content of paragraph 77 because although banks definitely need to keep records to track ex-post appropriateness results, we think this sould be on a high level basis and should not be overly prescribed by ESMA. Furthermore, we see no legal basis to ex-post track "any warning issued by the firm", nor foresee any practical problems to track warnings given to clients executing trades by means of telephone communication.
- **Regarding the "Do not know" option,** it can be noted that its introduction at this stage comes highly unanticipated and unwelcome. Most questionnaires are set up digitally and the technical implementation of such additional matters at short notice has a considerable (IT) impact and can lead to disproportionate costs and efforts. More importantly, such an option does not contribute in any way to the purpose of the appropriateness test. Please refer to our answer to Q2 for further reasoning.

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

Reference is made to our answer to question 12.

Guideline 12 – Determining situations where the appropriateness assessment is required

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

We do not agree with this approach for various reasons, particularly in relation to paragraphs 82, 83 and 86.

In situations where a non-advised transaction is made through a direct personalised communication with an employee of the firm (so called hand-held situations) firms should have internal instructions for employees to be able to distinguish between transactions falling within the execution-only exemption and other non-advised transactions. However, it is a completely different case for self-service tools and platforms where clients log on themselves to initiate orders and execute transactions. That a client logs on to a self-service channel to execute a transaction could be based on either one of the three situations happening prior to that the client initiates the order:

1. The client has made its own assessment of equity A and logs on to the firm's self-service channel and initiates a trade;
2. The client has had a chat with an equity broker at the firm where they talked about the equity market in general and equities A, B and C specifically. The client some time thereafter logs on to the firm's self-service channel to initiate a trade in equity A;
3. The client has received a personalised communication through an e-mail subscription whereby the firm communicates its house views on a certain equity model portfolio. The client some time thereafter logs on to the firm's self-service channel and initiates a trade in equity A which is covered by the communication.

The examples above could be further complicated by adding the scenario that the client logs on to the firm's self-service channel and initiates a trade in equity A as well as a trade in equity D, which is not covered by the communication in points 2 or 3 above.

It is good to remember that there are no possible connections between the type of communication in points 2 and 3 on the one hand and a firm's self-service channel on the other hand. Therefore., the underlying logic of a self-service channel cannot know whether a client that logs on to it has been in contact with e.g. a broker and/or has received a communication in written form via e-mail.

If ESMA's suggested paragraph 86 were to become the norm, it would in practice mean that firms can no longer make use of the execution-only regime in pure self-service channels. It would create a situation where firms would need to design and apply a general appropriateness test for all non-professional clients just in order for them to get access to and use a pure self-service channel. Given that the instruments in scope here are non-complex, this type of end result of the proposed guidelines would go against the intention of the execution-only regime as stated in the MiFID II Directive. Furthermore, it would act contrary to providing clients with efficient access to financial instruments which have been deemed to not pose material risks from a client protection perspective.

As for hand-held situations the firm's internal instructions should define the boundaries of what can be handled as execution-only and what cannot. The employee having the conversation with the client will in the vast majority of cases be completely unaware of whether a client has received a previous communication. From this starting point the employee should be able to assume that the order is made on the client's initiative, unless the client informs the employee of the previous communication or the employee otherwise has knowledge about the previous communication.

A question that would also need to be addressed is for how long the firm should consider that previous communications would prevent the use of the execution-only regime and the impact it would have on the need for traceability. At what point in time can firms consider that the communication is no longer valid from the perspective of defining a transaction as in scope or out of scope from the execution-only regime?

Considering all these aspects, requiring firms to trace whether the order is made in response to a personalised communication would be disproportionate. It should be sufficient that quality assurance testing is made based on for example a review of how well employees adhere to the firm's internal instructions (with components such as documentation of appropriateness assessments and taped calls). Furthermore, we would advocate for the following:

i. transactions initiated by clients through the use of pure self-service channels should always be seen to be made on the initiative of the clients;
ii. for client transactions that are made in hand-held situations firms should have internal instructions to define the boundaries between situations that fall within the execution-only regime and situations that cannot be handled within the execution-only regime; and
iii. that the proposed paragraph 86 under Guideline 12 is deleted because we would like to avoid in any case that complex products can definitely no longer be acquired in the course of non-advised services.

Guideline 13 - Controls

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

We advocate for the deletion of the requirement in paragraph 91 in order to avoid unnecessary redundancies in the processes. Thus, investment firms must consider target market deviations in sales when reviewing their product governance. This also includes deviations from the target market criterion knowledge and experience. In this respect, the possible circumstance that clients do not have the required knowledge and experience for a certain product is already taken into account in the review without having to resort to the adequacy test, which would result in significant modifications of the processes. Given the established processes on target market deviations, such an additional requirement would be disproportionate.

Sustainable Finance

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

The EACB understands the consideration if also sustainability factors and risks should be taken into account in the appropriateness assessment due to the current push by the EU to transition to a green and sustainable economy. But we also do not see such application of sustainability working in the context of non-advised services. This is because sustainability factors and risks are an investment preference that is taken into account only in advised services. If otherwise, the distinction between investment advice and non-advised services would be lifted.

Furthermore, it is dangerous to consider the client knowledge and experience regarding sustainability factors and risks as a separate element, or adding requirements for firms to assess this separately. The inclusion of a specific product's characteristics into the appropriateness assessment is already required by Article 25(3) in MiFID II and would be covered by the proposed Guideline 7 and Guideline 8. If a product's characteristics include specific sustainability factors and risks, these should be covered by the aforementioned rule and proposed guidelines just as any other specific features and risks related to a specific product (e.g. liquidity, volatility, specific exposures, exit possibilities etc.). Sustainability factors and risks are just two additional components to already existing factors and risks that a financial instrument can have. If sustainability is singled out as a separate characteristic, it would risk diminishing other factors and risks from the appropriateness assessment.

Contact:

The EACB trusts that its comments will be taken into account.

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