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EACB answer to the European Commission's targeted consultation on options to enhance suitability and appropriateness assessments

March 2022

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EACB AISBL – Secretariat • Rue de l'Industrie 26-38 • B-1040 Brussels
Tel: (+32 2) 230 11 24 • Fax (+32 2) 230 06 49 • Enterprise 0896.081.149 • lobbying register 4172526951-19
www.eacb.coop • e-mail : secretariat@eacb.coop

Section A: An enhanced client assessment regime - General

Question 1. Do you consider that a unique and standardised retail investors' assessment regime, as described above, applicable to all investment services and enhanced with the provision of a personal asset allocation strategy, could address the weaknesses of the current suitability and appropriateness regimes?

Answer: No

1. We understand that this consultation is a follow-up of the consultation on the retail investment strategy of summer 2021. From the EACB perspective however, the suitability and appropriateness regime are not the areas that necessarily need the most attention in the context of the retail investment strategy (please refer to the EACB answer to the consultation for more information: https://v3.globalcube.net/clients/eacb/content/medias/publications/position_papers/financial_markets/2021/20210728_final_eacb_com-consultation_retail-investment-strategy.pdf). And even if there are things that could be improved, the EACB members do not see the proposals of this consultation as the right way forward to address them. The biggest concern their clients seem to have with the suitability test is the lengthiness and complexity of the questionnaires, which have been reported as being too intrusive, particularly when investment amounts are small, or as taking place too frequently. This would rather seem to call for simplification and more flexibility in the amount of topics to address in the suitability/ the frequency of undertaking the suitability test, but not for a complete overhaul of the present suitability framework.

2. We would also like to emphasise that the client assessment processes are established processes that have proven themselves in practice. We are not aware of any negative feedback regarding the client assessment processes. In view of this, we do not see any need for adjustment in the way of a standardisation.

3. In terms of contents, we consider that it will be very difficult if not impossible to set up meaningful and uniform requirements for client profiling for a wide range of financial instruments falling under MiFID. In addition to "classic" investment products (funds, bonds, shares etc.) these requirements would also apply to over-the-counter derivatives. It is not possible to develop any meaningful common standards here. As it has occurred with the PRIIPs regime, we do not wish to see a situation where customers receive information sheets with confusing content, since there is no uniform system covering all the products. We are therefore cautious that new uniform requirements in this context would lead to a significant deterioration in the existing processes.

4. We see the proposal to standardise the assessment regime as taking out an important element of competition between providers of investment services and in particular the role of advice and portfolio management. Though intended as increasing competition, we believe it will become more difficult for providers to distinguish themselves from each other in the way they approach the investor and hinder efforts of the institutions to continuously improve the quality of these processes.

5. The Commission proposal does not allow taking into consideration the specific needs of individual clients and it creates a more static framework regarding the client assessment and asset allocation framework. We consider that it will lead to impoverishment of offer and makes non advised services more complicated. In this sense, the framework loses the

added value offered by investment advice and portfolio management service for clients who need and want this. Moreover, it risks driving clients to execution only without appropriateness test. On the other hand, the proposal would oblige retail clients currently under execution only or RTO services (appropriateness test) to follow a suitability test. This is particularly problematic as those clients are currently using those services to benefit from simplified and flexible processes. Such approach is also not fit for corporate retail clients, which do not look for optimising a portfolio but for specific needs covering their activities (covers related to interest rate risks or currency risks).

6. We believe that the proposed transferability of information would not have an added value. Indeed, defining a personalised asset allocation strategy depends on the product range of the investment firm and its knowledge of the client. Product ranges vary a lot, as well as knowledge on clients as investment firms do not have a clear visibility on all clients' detained assets (some assets could be hold elsewhere). For those reasons, every strategy will differ from one investment firm to another, which then will oblige clients to redo the test each time they want to change. Additionally, from the EACB perspective quality advice and portfolio management would involve advisers checking regularly with their clients whether the information provided at previous occasions remains valid or needs updating. Indeed, customers may be willing to accept higher risk with a certain parts of their money (e.g. from an inheritance) than with other funds, which they would like to invest more conservatively. An adviser should discuss and clarify such aspects with the customer in every consultation. This circumstance once again shows very clearly that the transfer of the results of an earlier client assessment and an asset allocation strategy developed on the basis of this assessment has no added value for a third party. The third party cannot rely on the knowledge gained at an earlier point in time, but must clarify the investment goals with the customer himself. Anything else would be immensely dangerous for the investor, as it involves the risk of incorrect advice, which can lead to enormous financial losses for the customer.

7. More generally, the consultation raises a lot of questions as to how it would relate to existing obligations and the overall retail investment framework such as:
   a. How does the existing suitability and appropriateness tests relate to this new regime? In our view the proposal is completely incompatible with the existing regime and the existing supervisory practices which have a fundamentally different approach.
   b. According to the text of the consultation, the investor would remain free to choose the products he wants to invest in. Would not part of the investors need advice in selecting the specific products to invest in? What about clients, who want to be advised individually and holistically from the beginning of the advisory process to the selection of specific products? What is the idea of the European Commission, how such a need should be covered?
   c. For setting up an asset allocation, the entity needs information on the overall, financial situation of the client. Typically, most of the clients are secretive about their financial situation and do not want to provide information about other assets they have (e.g. at other banks or financial intermediaries). For a successful implementation of the asset allocation approach, it would have to be secured, that the client is willing to give information and is transparent about his overall, financial situation. We do not see, how this could be possibly ensured. This problem is pointing out the more general issue regarding data quality and reliability provided by clients and/or third parties.
   d. If the system of switching between brokers/financial intermediaries is supposed to work, a maximum harmonisation regarding the required data is necessary. And even if the extent of the required data is clear, the evaluation of this data might differ within entities due to different systems / processes / assumptions/products

ranges within the entities. Who should be in a position to provide, throughout the European Union, a uniform basis for the asset allocation of clients? A lack of uniformity here will inevitably lead to different asset allocation estimations within brokers/financial intermediaries, which might immediately lead to discussions regarding the responsibilities and liabilities of the advising as well as the receiving broker/financial intermediary.

e. How is the receiving broker/financial intermediary bound by the advising broker´s/financial intermediary´s opinion regarding the ideal asset allocation? What if the receiving broker/financial intermediary has a differing opinion, not just because of changes within the client´s personal circumstances, but due to a different market opinion or due to different internal categorisations of asset classes or different risk estimations etc.? Liability issues have to be clarified.
f. What could be the business case for the party that provides the standardised assessment and asset allocation strategy? Who should bear the cost for this?

8. Finally, it is worth mentioning that the present system for assessing the appropriateness and the suitability has been implemented following considerable effort and investment by investment firms and credit institutions. Additional costs are being incurred right now in preparation of integration of both the requirements from the new ESMA Guidelines on Appropriateness and Execution only as well as the requirements from the implementation of ESG-considerations into the suitability regime (and the ESMA Draft Guidelines on the MiFID II Suitability Requirements).

   The proposal on the new regime would imply a notable change in this system and costs for the stakeholders as it would require a complete overhaul in the way to approach the client, the organisation processed behind this new approach both in terms of staff and IT, and of the way in which different parties in the market have to relate to each other. Though it is not possible to make a concrete assessment of the cost related to the implementation of this new approach because there are many questions outstanding as to how the approach would work in practice, the costs and complexity of introducing this new approach will be substantial . All IT systems would have to be completely rebuilt on a new basis. APIs would need to be developed in order to allow data to flow between different financial actors. Staff would have to be retrained completely and customer profiles would need to be all updated to meet the new profiles.

Taking these costs and our observations in the previous paragraphs into consideration, the EACB considers that the reasons for formulating the suggested proposals must be better substantiated and justified, the proposals themselves needs to be accompanied by a cost-benefit analysis, based on multi-source evidence, including feedback from retail investors.

Question 2. Do you think a new retail client assessment (enhanced with a personalised asset allocation strategy) and its transferability could bring benefits and opportunities to retail investors and financial intermediaries?

<u>Answer: No.</u>

Question 2.1 If yes, which of the following benefits and opportunities might a new retail client assessment (enhanced with a personalised asset allocation strategy) and its transferability bring to retail investors and financial intermediaries? (please select as many answers as you like)

☐ Increasing participation of retail investors in the capital markets

☐ Preventing or limiting mis-selling and ill-advised investments

☐ Address potential "gamification" of the retail investment process

☐ Useful supporting measure for retail investors also when investing without advice

☐ Favouring more competition between financial advisers by facilitating customer switching and standardising performance metrics

☐ Reducing burdens and costs linked to the investors' onboarding (by avoiding duplication) for both retail investors and financial intermediaries

☐ Allowing different financial intermediaries to have a more comprehensive view of the investments held by a retail investor and to offer a more holistic and aligned investment strategy.

☐ Others benefits and opportunities

1. In theory the idea of a standardised assessment might sound appealing from the perspective of the retail investor but the experience with PRIIP shows that it is very difficult to standardize information across the vast array of financial instruments. We would imagine that it would even be more difficult for building a standardised assessment process as it would need to define at least which topics the address and which questions to ask in which context. The fact that the tax regimes, pension and social security systems differ widely across Europe will only add to that complexity. Additionally, even if it would be possible to achieve a standardized approach, it is difficult to say whether this would influence a greater participation to the capital markets in general.

2. We are of the strict opinion that a mandatory standardized and personalised asset allocation strategy would make it more difficult or even impossible to take individual customer wishes/situations into account. Furthermore, a mandatory asset allocation strategy would entail significant additional costs, which would be ultimately borne by the investors. Customer with smaller investment amounts would be no longer receiving advice. Further, creating a differentiated asset allocation strategy could not be created for smaller investment amounts. The proposed approach may also drive away clients, especially those investing smaller amounts or taking advantage of short-term market opportunities, who would nevertheless bear the extra costs. In our opinion, implementation of an investment plan by personalised asset allocation is only appropriate where the necessary assets are available. This is already implemented in the form of asset structuring, but on a voluntary basis. It is less suitable for investors who only have small amounts of money to invest or investors who do not seek advice.

3. Additionally, we have serious doubts with regard the transferability of the results of client assessment and the personal asset allocation strategy to other providers; we consider it dangerous for a provider to make recommendations that are based on the third-party recommendations. This poses a danger of wrong advice without it being clear who would be responsible for this wrong advice or could be held accountable. Also, it cannot be assumed that the new financial intermediary chosen by the client will offer the exact same suite of products as the previous financial intermediary given that each financial intermediary offers their unique set of products.
   Defining a personalised asset allocation strategy would depend on the product range of the investment firm and its knowledge of the client. Product ranges vary a lot, as well as knowledge on clients as investment firms do not have a clear visibility on all clients' detained assets (some assets could be hold elsewhere). For those reasons, every strategy

will differ from one investment firm to another, which then will oblige clients to redo the test each time they want to change.

Moreover, the creation of a personalised investment strategy is provided as part of an advisory service that requires corresponding competencies on the part of the provider and his staff and is associated with significant costs. This is not just mere input data from the customer, such as the data covered by the data portability law under the GDPR, but enriched data that has gone through a value creation process at the provider. A framework that would foresee any portability, would need to incorporate conditions that avoids "free-riding".

4. Finally, transferability could lead to a decrease in advice quality due to a move of clients towards financial intermediaries only providing robo advice. This trend has been experienced in the US (see https://www.sec.gov/files/exams-eia-risk-alert.pdf), where warnings have been made on practices of certain robo-advisors . We believe that such trend could be dangerous for retail clients:
   - The level of financial education remains weak in Europe, which therefore justify the importance of human and personalised advice;
   - Accompanying clients is key in a context of instability (inflation) and with the future introduction of ESG preferences into the suitability test.

Question 3. Should retail investors be able to transfer the results of their assessment together with their personalised asset allocation strategy to brokers/financial intermediaries of their choosing in order to facilitate switching between or using multiple brokers/financial intermediaries and generally enhance the investor experience?

Answer: No

As mentioned above, we do not think that the proposed new retail client assessment (enhanced with a personalised asset allocation strategy) and its transferability would bring an advantage to retail investors and financial intermediaries. We do not see a broad need from customers for transferability. Most retail clients have investment services through only one service provider. Transfers would also incur costs between financial intermediaries. The new service provider may not be able to rely on the assessment and strategies made by another operator. Therefore, many parties would need to do these assessments again and there would not be real benefits for retail investors and financial intermediaries.

Should the Commission nevertheless adhere to the idea of portability, it should at least provide for financial compensation by the recipient of the data, as it has recently done in Art. 9 of the Data Act draft.

Question 4. Would you see any drawbacks that could emerge from the creation and use of such a new suitability assessment applicable to all investment services (including its sharing/portability if any) for retail investors and financial intermediaries?

Answer: Yes

Please see our answers to questions 1 and 2.

Question 5. Who should prepare the clients' assessment and their asset allocation strategy?

☐ Any financial intermediary selected by the retail investor

☐ An independent function within the financial intermediary selected by the retail investor

☐ An independent financial intermediary selected by the retail investor

☐ Other (e.g. public entity)

Please see our answer to question 1.

Question 6. What should be the key components of a standardised personal investment plan? (please select as many answers as you like)

☐ A description of the investor

☐ A description of **duties and responsibilities of the investment adviser** drawing up the personal investment plan, custody arrangements and the duties of the client to signal changes in her personal circumstances

☐ **Procedures and reviews** that are necessary to keep the IPS topical and up-to-date

☐ Investment objectives

☐ Investment constraints

☐ **Technical guidelines** specifying technical aspects on how the investment should be carried out, such as permissible use of leverage or derivatives; exclusion of specific types of assets from investment, if any

☐ ESG factors, such as specific types of assets to be excluded from investments

☐ **Evaluation and review**

☐ **Rules on identifying strategic asset allocation** – including the baseline allocation of portfolio assets to asset classes

☐ **Rebalancing** – policies on rebalancing asset class weights

Please see our answer to question 1.

Question 7. What are the main investment objectives and constraints that should be addressed in a personal investment plan? (please select as many answers as you like)

☐ **Return objectives:** Long-term investment return per year, in nominal terms, net of fees

☐ **Constraints:** Liquidity – expected investor outlays, etc.

☐ Time horizon

☐ Tax situation

☐ Legal and Regulatory factors, if any

☐ Unique investor circumstances, e.g., ethical or environmental preferences

Please see our answer to question 1.

Question 8. Storage and accessibility of the new suitability assessment, including the asset allocation strategy.

Do you agree with the following statement?

***Answer: No*.**

All data in the suitability assessment and the personalised asset allocation strategy (the "personal investment plan") should be stored electronically and, subject to the client's consent, the investment plan personal should be accessible to all financial intermediaries that the client employs ("open finance").

Question 9. How often should the client's assessment and asset allocation strategy be updated?

A personal investment plan should be reviewed regularly in order to ensure that it remains consistent with the client's investment objectives and constraints. A personal investment plan should also be reviewed as soon as a financial intermediary becomes aware of a material change in the client's circumstances. A client may request an update of her personal investment plan when her objectives, time horizon, personal circumstances of liquidity needs change.

Question 9.1 When the investor is NOT under advice (please select as many answers as you like)

☐ a. once per year

☐ b. upon significant changes in the retail investor's personal circumstances or objectives, communicated by the investor to its financial intermediary

☐ c. upon suggestion of the financial intermediary selected by the investor, subject to providing the investor with any necessary written justification evidencing the need for an update, and subject to the investor's agreement + duly stored

☐ d. other

Please see our answer to question 1.

Question 9.2 When the investor is under advice/portfolio management (please select as many answers as you like)

☐ a. once per year

☐ b. upon significant changes in the retail investor's personal circumstances or objectives, communicated by the investor to its financial intermediary

☐ c. at the initiative of the financial intermediary providing the advice and subject to written justifications evidencing the improvement, communicated to the investor and duly stored

☐ d. other

Please see our answer to question 1.

Question 10. Please provide us with an estimate of the necessary costs to set-up and update this possible new client assessment (including the personalised asset allocation strategy) in a structured and machine-readable format as well as for its storage in a way accessible for future reference by the retail investor and competent authorities.

Please see our answer to question 1.

Question 11. Please provide us with a cost comparison between the costs associated to this possible new client assessment regime (including the personalised asset allocation strategy) in and your current costs associated to compliance with the current suitability and appropriateness regimes?

Please see our answer to question 1.

Question 12. Do you consider that the new client assessment regime would allow material cost savings for financial intermediaries taking into account the standardised and single nature of the possible assessment regime, once the initial sunk costs are absorbed?

Answer: No.

The EACB members would be of the view that credit institutions would in any case want to redo the assessment of the customer to be sure that no incorrect advice is provided and products offered. So, the savings would be limited and securities advisory would become more expensive.

Section B: A personalized asset allocation strategy

Question 13. Should the rules on personalised asset allocation strategy foresee standardised investor profiles based on retail investors' personal constraints, risk/return appetite and objectives?

Answer: No

As EACB members are against a standardized assessment process, it follows that they are also against a standardization of investor profiles. We believe it will not be possible to develop a meaningful methodology that fits all financial instruments, that would fit the present market structure where certain providers chose to specialize in certain products or that would fit client individual preferences. A client may for example chose a credit institution of which he knows they offer investment advice for managing an equity portfolio and a direct bank for managing another part of his assets in ETFs. Moreover, financial actors have already developed good customer-friendly solutions based on current regulations for customers.

The proposed overall strategy is also really not suited to financial intermediaries with a wide range of products. It goes against present supervisory regimes and guidelines which require that the investment firm takes into account existing information that it has.

The customer profiles should be based on the existing legal elements of suitability assessment. In addition, providers must be free to take other elements into account in order to be able to make attractive offers to their customers and to be able to set themselves apart from the offerings of other providers with innovative solutions.

Question 13.1 If yes, please specify what profiles classification you would recommend and provide explanations?

Please see our answer to question 1.

Question 14. Which elements should form the basis for distinguishing between asset classes within the asset allocation strategy? (please select as many answers as you like)

☐ Risk

☐ Return

☐ Paired correlation with other asset classes

☐ Additional criteria

Please see our answer to question 1.

Question 15. Exposure to assets, as set out in the asset allocation strategy, could be achieved either by investing directly in securities (e.g. shares, bonds), or via investment in potentially complex financial products (e.g. funds, structured products, insurance-based investment products) or a combination thereof.

How should a financial intermediary assess best value-for-money when considering asset classes or sub-asset classes offering the optimal exposure for the retail investor?

***Answer: Don't know*.**

This question is difficult to answer and is best addressed in an exchange between the investment firm/credit institution and the individual client in advisory context. It must be kept in mind that the risks of an equity fund are significantly lower than the risks of a direct investment in a share due to diversification, for example. On the other hand, an investor can enable his own risk preferences, preferences for regions, sectors, etc. or also the goal of generating a certain pay-off profile or profiting from falling or sideways-trending markets by way of individual stock investments or via certain structured products. In the non-advisory securities business, values for corresponding parameters are currently not explored at all. Here, only knowledge and experience are in the foreground.

Further, when choosing different financial instruments: This depends on the customer's investment experience and knowledge, as well as how actively the customer wants to monitor the market. For inexperienced clients and those who do not want to actively monitor the investment market, funds, structured products or insurance products in which funds are invested are more suitable. If the client is a more experienced investor and wants to actively monitor the market himself or has an investment portfolio that is also suitable for direct investments, then equities and bonds may also be possible and as part of the client's allocation recommendation. The amount to be invested, the taxation and the product range of the service provider also determine what kind of investment targets can be recommended to the customer.

This confirms our view that the introduction of a personalised asset allocation strategy that would travel with the client is not a good idea as not practicable.

Question 16. The rules on the asset allocation strategy should allow for the establishment of asset classes that are fit to achieve the investment objectives of retail investors. How should those rules take into account situations where the investment intermediary wishes to offer products that do not fit into one of the common asset categories?

☐ Where the intermediary proves that the risk, return and correlation properties of the product are equivalent to those attributed to one of the established asset classes, he/she can consider that instrument as belonging to that asset class
☐ Such products should only be made available to the investor at his or her explicit request, and not as a part of the investable universe determined by the asset allocation strategy
☐ Other solutions

Please see our answer to question 1.

Question 17. Although the form and content of the asset allocation strategy should be prescribed to a certain extent, financial intermediaries will always exercise a degree of discretion when establishing the asset allocation for a given investor. Competition between financial intermediaries in establishing an optimal asset allocation strategy for a given set of client data could yield better quality asset allocation propositions for the client. On the other hand, changing without objective

reasons the investment guidance set out by the asset allocation strategy should be avoided in order to ensure that his or her investment goals are attained.

Should a financial intermediary other than the one that drew up the client assessment be able to propose a different asset allocation strategy than the one originally established, where the data required to produce the asset allocation strategy are made available to that financial intermediary?

Answer: Yes.

Naturally, another financial intermediary must be able to suggest different recommendations or strategies if deemed appropriate. A commitment to an assessment done earlier by another intermediary should not be introduced.

From our point of view, the distributor is even obliged to carry out its own assessment as well as its own assessment within the scope of an investment advice (if necessary, including the creation of its own client profile / target / model portfolio).

The possibility for another financial intermediary to be able to propose a different asset allocation strategy at the same time undermines the proposal that is made in this consultation paper and proves that the proposal put forward is not the right approach.

In any case, the aspect, how the client is choosing specific products that fit in his asset allocation, is not covered by this consultation paper at all. It should be clarified that the receiving broker/financial intermediary is acting solely on advice-free basis, if a client provides him with an asset allocation set up by another broker/financial intermediary. As the asset allocation lacks specific products, but just asset classes, the client would need to choose the specific products for himself, without having the knowledge to do so, which in a lot of cases might lead to refrain from investing at all. In case the receiving broker/financial intermediary would have to provide investment advice on the selection of specific products for the client, a lot of questions need to be clarified: What if the receiving broker/financial intermediary has a differing opinion on the asset allocation, not just because of changes within the client´s personal circumstances, but due to a different market opinion or due to different internal categorizations of asset classes or different risk estimations etc.? Liability issues have to be clarified.

Question 17.1 If yes, should the investor be required to give explicit consent for the development of a new asset allocation strategy?

Please see our answer to question 1.

Question 18. Would you have any general comments on an enhanced client assessment regime and/or personalised asset allocation strategy?

Answer: Yes.

For other, more general comments, please see our answer to question 1.