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Brussels, 09 April 2015

EBF comments on ESMA's Technical Advice to the Commission on MiFID 2 and MiFIR

The EBF welcomes the publication of ESMA's Technical Advice on MiFID II/R and reiterates its support to the on-going MiFID review that aims to strengthen integration, efficiency and competitiveness of EU financial markets. Adequately calibrated transparency requirements and clear rules on investor protection will help to provide a basis for further development of the EU Capital Markets Union.

The points below provide a summary of the most important points for the EBF with regard to ESMA's Technical Advice. This is followed by an annex with more detailed and in-depth comments on these points and other aspects of the Technical Advice.

Key points

- **Safeguarding of client assets:** The EBF is concerned that the proposed regime is too detailed and could result in increased legal uncertainty. EU legislation should provide clear and fully horizontal rules for the provision of collateral. These rules should be set in Level I legislation. At the moment there are increasing concerns that the EU is applying silo-based legislative technique based on ESMA's sector specific rules on level II. As a result there is a risk that the new EU regime complicates the provision of collateral and creates general legal uncertainty. It should be noted that for instance Directive 2002/47/EU on Financial Collateral Arrangements aims at reducing the administrative burden on provision of financial collateral. (For further information see Section 2.8 of the Annex)

- **Conflicts of interest:** The EBF believes that in its final text ESMA has misconstrued the significance of disclosure of conflicts of interest in the management of a healthy firm to client relationship. The suggestion that increased instances of disclosure of conflicts of interest must be considered a deficiency in an investment firm's conflicts of interest policy is counter-intuitive and defeats the G20 objective of increasing transparency in the functioning of the financial markets. (For further information see Section 2.9 of the Annex)

- **Information on costs and charges:** The responsibility for providing information to clients should always be allocated to the market participant which is the source of the information in question. The market participant should be allowed to rely on information from product providers, such as PRIIPs KID and UCITS KIID. The market participant should not be obliged to individually add information on costs and charges to the standardised information in PRIIPs and UCITS KIID. (For further information see Section 2.14 of the Annex)

- Inducements:

  - Quality enhancement: The EBF finds it should be clarified that "third party product providers" also include products where the investment management is handled by a third party and the investment strategy is wrapped in a shell administrated by a firm that is likely to be seen as having close links to the investment firm e.g. a management company within the same group as the investment firm and "white–label" products should be accepted as "third party products" ensure support of open architecture especially in smaller markets. (For further information see Section 2.15 of the Annex)

  - Investment research: The EBF agrees that there is a need to increase transparency and disclosure and address potential conflicts of interest in the field of dealing commissions and financial research. However, the EBF is concerned that ESMAs proposals might have severe unintended consequences on the availability and distribution of high-quality research in EU Member States. The proposed model is extremely burdensome to implement and administer on an on-going basis. Its workability for different asset classes is untested (notably FICC instruments) and it is likely to create diverging VAT interpretations across the EU. It is particularly problematic for smaller asset managers and brokers. Furthermore it would create an un-level playing field between individual and collective asset management structures (UCITS and AIFs) as well as insurance products. (For further information see Section 2.15 of the Annex)

- Liquid market for equity and equity-like instruments: The definition of liquid market has a central role in the new transparency regime. The EBF agrees that there is a clear need to create a harmonised EU-level framework for internationally traded shares (blue chip) and other equity-like instruments. Concurrently it is important to create an optimal regime for smaller and medium sized listed companies to foster market-based financing. In this respect, the EBF is concerned about ESMA's proposal to change the "definition of a liquid market". If illiquid instruments are artificially labelled as "liquid" there is a risk that increased and complex requirements (i.e. double cap mechanism) aimed at biggest listed companies paradoxically reduce SME liquidity even further. If not adequately addressed, the MiFID regime could have adverse impacts on SME-financing. (For further information see Section 3.1 of the Annex)

- The definition of systematic internaliser: The EBF notes that the importance of systematic internaliser regime will grow significantly compared to MiFID I. In addition to shares the new regime will apply to much broader range of asset classes. Certain EBF members believe that the Commission should aim at ensuring that only firms which deal on own account of a relatively large magnitude by executing client orders are categorised as SIs, and as such would support the proposed 3% threshold for bonds. Other EBF members support a threshold that is sufficiently low to preserve the level playing field whilst still capturing a wide cross section of market makers and providers of liquidity and do not have comments on the levels proposed by ESMA. The establishment of a clearer legal framework around the SI is welcomed by the EBF. (For further information see Section 3.3 of the Annex)

Other issues contained in the annex:

2. Investor protection

2.2 – Investment advice and the use of distribution channels
2.4 – Complaints-handling
2.5 – Record-keeping (other than recording of telephone conversations or other electronic communications)
2.6 – Recording of telephone conversations
2.7 – Product Governance
2.10 – Underwriting and placing
2.12 – Fair, clear and not misleading information
2.12 / 2.14 / 2.20 – No extension of requirements to disclose information to professional clients and eligible counterparties
2.13 – Information to clients about financial instruments
2.14-2.15 – Disclosure of inducements
2.14 – Information on costs and charges
2.15 – The legitimacy of inducements to be paid to/by a third person
2.16 – Investment advice on independent basis
2.17 – Suitability
2.18 – Appropriateness
2.19 – Client agreement
2.20 – Reporting
2.24 – Product intervention

3. Transparency

3.1 – Liquid market for equity and equity-like instruments
3.3 – The definition of systematic internaliser
3.4 – Transactions in several securities and orders subject to conditions other than the current market price

5. Micro-structural issues

5.1 – Algorithmic and high frequency trading (HFT)
5.2 – Direct Electronic Access (DEA)

Annex – More detailed information on key points and further points of interest for the EBF

2. Investor protection

2.2 – Investment advice and the use of distribution channels

The last paragraph of Implementing Directive Article 52 was introduced to exclude general recommendations from the scope of investment advice. As such, general recommendations are normally sent through distribution channels (internet, emails, mail, etc.) the original text identified these concepts. But the key of the existence or absence of investment advice should be connected with the nature of the recommendation and not with the channel used to provide it.

EBF members do not agree with the removal of "through distribution channels". Emails, internet, mail and other distribution channels are the main way to distribute general recommendations, and, consequently, the proposed change will create legal uncertainty in such cases, as it may be understood that they are now considered as investment advice. Consequently, an amendment in the definition of investment advice should be focused in the nature of the recommendation and not in the channel used to provide it. That would be the way to address the main problem: when a recommendation is personal or general irrespectively of the distribution channel.

2.4 – Complaints-handling

The EBF understands that ESMA considers that the "details" of the complaints-handling process should include the firm's internal procedures for dealing with complaints. However, the Technical Advice still does not provide sufficient guidance on how much information on the internal processes of the firm should be provided. This requirement will only be useful for the client if it is limited to a general description of the process from a client-centred point of view.

ESMAs statement in paragraph 2 of section 2.4 on the delivery of the complaints management policy to the client is quite confusing. On the one hand it is stated that an investment firm has to publish those details, on the other hand it is stated that the investment firm has to provide this information to the client also upon acknowledging a complaint. In our opinion it would be sufficient to provide clients with information on where they can find the respective published details on the handling of a complaint.

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

Article 16(7) MiFID states that "the content of the relevant face to face conversations with a client **may** be recorded…" TA has moved to **shall record**, which implies obligations not reflected in MiFID.

Within the Technical Advice, EBF members would like more clarity around what exactly is meant by "decision to deal". Furthermore "initial order" could cause some confusion. EBF members would propose to consider if it would be more appropriate to replace this term with a reference to every order received from a client.

2.6 – Recording of telephone conversations

Requirements regarding recording of telephone calls are very costly to implement and can also be sensitive from an integrity/data protection perspective. The EBF is therefore very concerned by the proposal that also internal calls concerning client orders should be covered by the new requirements. This is in our opinion not a proportionate requirement. The EBF believes that it should be sufficient to require recordings of all calls with clients which are intended to lead to a transactions and internal calls relating to trading on own account.

According to article 16(7) in MiFID level 1, recordings of telephone conversations should be provided to clients upon request. In order to avoid unnecessary costs the EBF finds that it should be clarified in level 2 that the firm should be allowed to require the client to provide the needed information in order for the investment firm to identify the requested records (time of telephone conversation/employee with the investment firm).

2.7 – Product Governance

The EBF questions the scope of and the requirements on product governance. ESMA proposes that:

- Scope: Product governance obligations shall apply to manufacturers and distributors not only when a product is launched and actively distributed and when investment firms offer advice, but also to all secondary market activities, including execution-only business.
- Reporting: Distributors shall provide manufacturers with sales information and reviews to support product reviews carried out by manufacturers
- Review obligation: firms shall review investment products prior to any further issue or re-launch, if they become aware of any event that could materially affect the potential risk to investors and at regular intervals
- Not compatible: firms shall "identify any groups of investors for whose needs, characteristics and objectives the product is not compatible".

The EBF finds that the broader **scope** would grossly inflate the cost of doing execution only business. There is a danger that a requirement of this kind would make it more difficult to invest in securities, either because of rising costs or because there would be fewer products on offer.

While ESMA acknowledges that the distributor's obligation to **report** sales to the manufacturer does not mean that every sale is reported, the more generic examples given by ESMA (in paragraph 14 of the Background/Mandate) should be reflected in No 25 of the Technical Advice, which currently states only that "Distributors shall provide the manufacturer with sales information".

Furthermore, the EBF would suggest at least limiting the **reporting** obligations to the phase of active distribution (advice, marketing, recommendations). There should be no requirement for distributors to pass information to issuers during the secondary trading phase (over which issuers have no influence).

Moreover, it does not appear to be a reasonable requirement that investment firms distributing products manufactured by non-MiFID firms must enter into a written agreement with such manufacturer. The EBF sees no need for such agreements at all, irrespective of where the manufacturer comes from or whether or not it is a MiFID firm. A requirement of this kind would encourage distributors to work together with fewer manufacturers, thus frustrating the objective of an "open architecture". This would restrict the range of financial instruments available to investors, with the result that investors would not always be able to purchase the most suitable financial instrument for their needs.

The obligation to **review** products "prior to any further issue or re-launch" is disproportionate: as long as the product has been approved, new issues of this product should be carried out without going through a new review if the features of the product remain the same. Regular review should be sufficient. It should be specified that a "re-launch" refers to a product having been through an approval process but not issued for a given period of time since it was last sold and/or if significant changes have occurred in the organization and processes supporting the product. In addition, the products review should be organised by family of products: it should be clear that it does not have to be carried out for each product sold.

The obligation under the Technical Advice paragraph 10 for firms to "identify any groups of investors for whose needs, characteristics and objectives the product is **not compatible**" is an unreasonable obligation to place on firms. The requirement should focus on "identifying groups of investors for whose needs, characteristics and objectives the product *is* compatible".

2. 8 – Safeguarding of client assets – Intra-group deposits of client funds

The EU should have a consistent treatment of safeguarding of client assets. Core rules should be based on Level I text and not on delegated legislation. At the moment there are increasing concerns that the EU is applying a silo-based legislative technique based on ESMA's sector specific rules on Level II. As a result, there is a risk that new EU regime complicates the provision of collateral and creates general legal uncertainty. It should be noted that for instance Directive 2002/47/EU on Financial Collateral Arrangements aims to reduce the administrative burden on provision of financial collateral.

The EBF notes that the Commission´s request for technical advice seems to be significantly wider than the relevant provisions in article 16(8)-(10) and the empowerment in article 16(12) of MiFID.

The Level I text is clear on that an investment firm shall not conclude title transfer financial collateral arrangements (TTCA) with retail clients. However, the proposed rules on TTCA for non-retail clients go beyond the level I text, and the restriction of TTCA should therefore not apply to these clients. Furthermore, the special rules for Securities Financing Transactions are, in our opinion, unnecessary and will create overlapping and confusing regulation. Any restrictions should be done in the relevant legislation e.g. the Financial Collateral Directive as mentioned above.

Referring to the on-going discussions in EGESC Committee, the EBF strongly questions whether Level I mandates ESMA to introduce limits of intra-group deposits of client funds. According to the technical advice, deposits of client funds by an investment firm at a third party within its own group (intra-group deposits) are limited to 20%. Even if this regime is in place in some EU Member States this should not be introduced on MiFID Level II.

We find that the technical advice goes beyond Level I as there is no specific mandate on intra-group deposits, let alone on quantitative limits. It is a general duty of an investment firm to consider diversification of client funds. Therefore the final delegated act should require an investment firm to consider diversification in case there are significant client balances and no other relevant safeguards in place. There is a strong case for holding cash with a bank group if it has a better credit rating than other banks and/or there are benefits in terms of coordination, or other efficiencies.

The technical advice proposes to have a separate compliance function for safeguarding of client assets. However, safeguarding of client assets is already a core task of the compliance function and the EBF is cautions of the establishment of a separate function. The level 1 text does not mandate an establishment of an entirely new function that would result in a new recruitment of a single dedicated officer in larger firms. Even in larger firms it should be possible to combine general compliance tasks and oversight function of client assets. This would likely result in a better overall compliance and oversight.

In the proposal, investment firms should only be permitted to rely on other equivalent measures where in a third country jurisdiction they are unable to comply with the usual segregation requirements of applicable law in that jurisdiction. It should be clarified that restrictions on "other equivalent measures" can, if at all, only relate to third country jurisdictions and should therefore be reflected in a new sub-paragraph of Article 17 (3) of the MiFID Implementing Directive (and not in Article 16). A restricted approach to the concept other equivalent measures could hamper the possibilities of EU-firms to service their clients. Other forms of protection in a third country could give the client the same protection and should not be forbidden. Especially it should be noted that custody chains are often multi-tiered and this adds complexity to renegotiate terms and condition.

2.9 – Conflicts of interest

While ESMA's final proposals to supplement and strengthen the framework to identify, prevent, manage and disclose conflicts of interest are valued and welcome, we believe that in the final text ESMA has misconstrued the significance of disclosure of conflicts of interest in the management of a healthy firm to client relationship. ESMA's final technical advice on this subject appears to deviate from the spirit of Article 23 of MiFID2 for the following reasons:

- In most situations it will be possible to identify and manage conflicts, including through disclosures to clients. Conflicts can be managed through appropriate systems and controls such as information barriers and appropriate disclosures, as (despite the existence of conflicts) the interests of all parties are aligned.

- The technical advice allows no scope to disclose steps taken to mitigate the risks relating to conflicts. Firms might have to make a choice between providing one service versus another rather than managing inherently conflicted businesses and services being offered to their clients through existing systems and controls.

- The final technical advice appears to suggest that mere disclosure of a conflict would be tantamount to an admission/conclusion by the investment firm that the organisational and administrative arrangements established by it to prevent or manage conflicts are insufficient to ensure that the risks of damage to the client will be prevented. This assumption is incorrect as information asymmetry is the essence of many conflicts of interest arising between service provider and client, for which disclosure is an obvious and also acceptable solution. This analysis and approach may result in discouraging rather than encouraging disclosures to clients.

The suggestion that increased instances of disclosure of conflicts of interest must be considered a deficiency in an investment firm's conflicts of interest policy is counter-intuitive and defeats the G20 objective of increasing transparency in the functioning of the financial markets. While we are supportive of ESMA's efforts to ensure that firms take adequate steps to both prevent and manage conflicts, we strongly urge ESMA to consider amending the final text to read as follows: *'Over reliance on disclosure of conflicts of interest* ***as the only measure of management of conflicts*** *must be considered a deficiency in an investment firm's conflicts of interest policy.'*

2.10 – Underwriting and placing

Regarding the allocation policy there is generally no objection to inform the issuer of this policy and to invite the issuer to participle in the discussions about the placing process. However, it is not market practice to obtain issuer agreement on this matter because the allocation policy is under the responsibility of the underwriter. Moreover, in some cases, an issuer who would like to change the allocation objective may create a potential conflict of interest (for example if the request may be in favour of one specific investor). Informing the issuer should not be an obligation. In addition, in case of bought deals, when the investment firm takes the risk, it is not appropriate to disclose any information to the issuer. Bought deals should be removed from this requirement.

As regards to the "financial alternative" information and the "lending'' one, these proposals may generate new potential conflict of interest situations. The obligation to propose various alternatives of financing before accepting a mandate may create the risk of informing teams of the other departments of the existence of the intention of the issuer, putting them in situation of conflicts of interests (if they are requested for a financing by the same or another client at the same time). This ESMA requirement could be acceptable (not creating a conflict of interest) only at a marketing stage.

It may not be relevant for the firm managing the offering to propose the issuer client "various financing alternatives available". The firm may have been chosen by the issuer following a decision process that has already occurred at the issuer, i.e. the issuer may have already considered the various alternatives and may already have his mind set on the type of offering it wants to undertake.

Concerning the "lending point", the requirement to share information between credit provider and arranger is by definition breaking the rules on Chinese walls. Therefore, firms will have to systematically document why they effectively don't share information which will conduct to a heavy administrative work without any value for the client.

Conflicts of interest that cannot be managed by suitable procedures or arrangements must be effectively addressed in the area of underwriting and placing as well by their disclosure to clients. In contrast, paragraph 20 of the Technical Advice says that the only way to manage a conflict in such cases is for an investment firm not to engage in an operation. This goes too far and may be interpreted as harmful for business. Paragraph 20 of the Technical Advice contradicts paragraph 20 of the Background/Mandate, which says: "Refraining from acting in a situation may still be considered as a measure to manage a conflict of interest." The technical advice is also at odds with Level 1. Article 23 (2) of MiFID II states that in cases where organisational arrangements to manage a conflict of interests are not sufficient, the client has to be advised of the conflict. This enables the client to decide independently on an informed basis whether to nevertheless mandate the investment firm concerned.

In a universal bank, the bank's economic interest in reducing its credit risk and the interests of the borrower/issuer have to be regularly reconciled. If the bank's double role as lender and underwriter is seen as a potential conflict of interests, this is generally explicitly desired by the borrower/issuer and integral to the business model. The potential conflict of interests can be effectively addressed by its disclosure to the client. Not engaging in an operation – the only way to manage a conflict of interests according to paragraph 20 of the Technical Advice if it cannot be managed by suitable procedures or arrangements – can therefore only be a last resort should it not be possible to effectively eliminate the conflict even by its disclosure to the client.

2.12 – Fair, clear and not misleading information

The Technical Advice requires that information addressed to or likely to be received by retail clients or potential retail clients shall be "consistently presented in the same language throughout all forms of information and marketing materials that are provided to each client, unless the client has accepted to receive information in more than one language". In the Final Report, ESMA clarifies that "this proposed requirement needs to take into account that the Prospectus Directive allows the use of different languages in certain circumstances. ESMA considers that information requirements under MiFID are different from the obligations regulated under the Prospectus Directive and underlines that the proposed technical advice does not imply that firms need to translate prospectuses provided to clients." This should be explicitly reflected in the Technical Advice, which now only refers to "information" in general.

2.12 / 2.14 / 2.20 – No extension of requirements to disclose information to professional clients and eligible counterparties

The requirements to disclose information to professional clients and eligible counterparties should not be aligned with those applying to retail investors. This would fail to take the status of professional clients and eligible counterparties into account and would merely generate additional bureaucracy. Professional clients and eligible counterparties have far more experience and expertise than do retail investors. As a result, they require far less protection.

The EBF would suggest making at least the following changes: (1) deletion of paragraph 4 of the technical advice in section 2.12, (2) deletion of the wording "professional clients and eligible counterparties" from paragraph 1 and deletion in full of paragraphs 2 and 3 of the technical advice in section 2.14, and (3) deletion of paragraphs 2 and 3 of the technical advice in section 2.20.

Should the planned extension of information requirements be retained, the opt-out opportunities for professional clients and eligible counterparties envisaged in the final report should be changed into opt-ins.

2.13 Information to clients about financial instruments

The EBF disagrees with the wording of paragraph 11 of the Technical Advice, which suggests to modify Article 34 of the MiFID implementing Directive by clarifying that where sufficient information on costs and charges is included in the PRIIPs KID/UCITS KIID, it should be regarded as appropriate for the purposes of providing information to clients under MiFID II. This proposal is not fully consistent with Recital 78 of MiFID II which states that "Where sufficient information in relation to the costs and associated charges or to the risks in respect of the financial instrument itself is provided in accordance with other Union law that information should be regarded as appropriate for the purposes of providing information to clients under this Directive. However investment firms or credit institutions distributing that financial instrument should additionally inform their clients about all the other costs and associated charges relating to their provision of investment services in relation to that financial instrument."

The EBF would like to clarify the modification of Article 34 of the MiFID implementing Directive so that where sufficient information on risks, costs and charges that is provided by the product providers is included in the KID/KIID, this information should be regarded as appropriate for the purposes of providing information to clients under MiFID II. Market participants should not be obliged to individually add information on costs and charges to the standardised information in the PRIIPs KID/UCITS KIID.

2.14-2.15 – Disclosure of inducements

Disclosing inducements as part of the costs and charges of a service or a product is confusing. The effect of treating third party payments in the same way as costs is likely to be that for reasons of transparency investment firms will prefer to pass on the inducements to their clients and that clients will pay higher commissions directly to the investment firm in return. This will ultimately increase the cost of investment services, in particular for retail clients. There is no evidence that retail clients are willing to pay for this.

The disclosure of inducements should continue to be subject to a separate regime. While MiFID II requires firms to provide appropriate information on third party payments, MiFID II does not require that third party payments received by investment firms be treated as costs and charges. Treating inducements as costs of the services provided can be misleading and confusing for the client, as they mostly take the form of income received by investment firms. The proposals as to the disclosure of costs and charges should therefore be limited to actual costs and charges, i.e. expenses that are made directly by the client or by the investment firm on behalf of the client.

Member States no longer have the option to allow information on inducements in a summary form prior to the provision of the investment service or ancillary service provided the client is entitled to request further details (e.g. accurate range in percentage of the level of retrocessions on the total amount of management/structuring fees retained on the return of the investment). MiFID II should follow the logic of MiFID I. Where Article 24(9) of the MiFID II Level I Directive recognises that the method for calculating the amount of the third party payments may be provided ex ante in case the amount cannot be ascertained, it cannot follow from Article 24(4)(c) of the MiFID II Level I Directive that third party payments are costs to be disclosed ex ante at the point of sale in order to allow the client prior to the provision of the service to calculate the total cost of the investment .

2.14 – Information on costs and charges

EBF finds that the proposed provisions on costs and charges are extremely detailed and from a cost benefit point of view very burdensome to implement. Furthermore it is of utmost importance that information requirements concerning costs and charges associated with products are consistent across EU legislation.

- The responsibility for providing information to clients should always be allocated to the market participant which is the source of the information in question. The market participant should be allowed to rely on information from product providers, such as PRIIPs and UCITS KIID
- There should be a clear distinction between responsibility for the product, on the one hand, and responsibility for the services associated with distribution, on the other
- The market participant should not be obliged to individually add information on costs and charges to the standardised information in PRIIPs and UCITS KIID.
- It should be made clear that the obligation to provide clients with information on costs and charges should only apply when actively marketing the products or providing advice/portfolio management.

Firms should not be obliged to provide clients with information about product costs over and above that set out in the UCITS KIID or PRIIPs. Where EU lawmakers have consciously decided to exempt certain products (such as UCITS) from the new PRIIPs requirements, or exempt certain types of costs e.g. transaction costs these exemption should also apply to market participants which provide advice on, or sell, these products. No. 14 of the technical advice should be deleted.

Excessive requirements or requirements that cannot be fulfilled would ultimately lead to a significant reduction in the very wide range of products currently available in the market. This would severely limit the investment opportunities open to retail clients and clients in rural areas, in particular.

An obligation for firms to provide information about product costs even in situations other than providing advice or actively marketing an instrument, cf. No 4(ii) would go beyond the level 1 text and should therefore be deleted.

Broadly speaking the EBF supports ESMA's proposals on point of sale disclosure of costs and charges. However we believe that the proposed requirements to provide retrospective costs for clients in relation to on-going services of discretionary investment management and on-going advisory, if adopted as currently proposed, would be extremely onerous and would in our view lead to many firms ceasing to provide such services. The main issue with this proposal is not the disclosure of costs per se. Indeed, broadly speaking, firms are already obliged to disclose costs and charges to clients throughout the course of the relationship. Rather it is the collation of all of that data, retrospectively, into a single document on an annual basis, which is significantly problematic. The proposals would require the capture of personalised detailed audit trail of every single transaction in every client portfolio over a period, the storage of that information and the interrogation of the data, providing a standardised output. The complexity of devising retrospective cost information, including establishing a realistic view of trail earned per client, may make the task impossible and for firms with large numbers of discretionary and advisory clients it would be very expensive and indeed could force many to exit the market reducing competition and client choice.

We would suggest that the Commission do not adopt the current ESMA Technical Advice in relation to post sale periodic disclosure. Instead, we would recommend that the disclosure content for post-sale disclosure be aligned to that required for point of sale disclosure.

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

General Remarks

ESMA's technical advice on inducements continues to go beyond the requirements set out at level 1 and, on top of that, creates new legal uncertainty. The express wish of lawmakers (Recital 87 of MiFID II) for the greatest possible consistency between financial instruments and insurance products is undermined even at level 1 by the much stricter requirements concerning the legitimacy of inducements in the context of distributing financial instruments than the corresponding requirements governing insurance products. This unequal treatment of two product types which are often interchangeable when providing clients with advice is significantly exacerbated by ESMA's technical advice at level 2.

Investment research

The EBF agrees that there is a need to increase transparency and disclosure and address potential conflicts of interest in the field dealing commissions and financial research. However, the EBF is concerned that ESMAs proposals might have severe unintended consequences on availability and distribution of high quality research in EU28 countries. The proposed model is extremely burdensome to implement and administer on an on-going basis. It´s workability for different asset classes is untested. The proposal would specifically hit smaller Investment Firms, both on the asset management and on the broker side. These entities are usually the most active in SMEs both for providing research and for investing. It will ultimately affect the ability of SMEs to access market financing at decent costs. Furthermore it would create an EU-wide un-level playing field between individual and collective asset management (UCITS and AIFs) as well as insurance products.

The EBF notes that there are currently different models to address conflict of interests. As ESMA notes, one concrete measure has been the introduction of Commission Sharing Agreements (CSA). In the view of European banks CSAs might be one but not an exhaustive measure to address the issue.

Several of the rules defined by ESMA appear to be very distorting:

- The requirement to agree with every individual professional and retail client on specific research payment account is disproportionate and would create significant administrative burden. Separate agreement on budget and written consent on any increase of research budget would be clearly disproportionate.

- ESMA's proposed regime creates concerns in regards to firms' obligations to uphold equal treatment of clients and firms' fiduciary duties. Where clients are invested in a number of products the asset manager and the client would have to agree on several and separate research charges, as research budgets would be set on product segment level or product level. The obligation to individually agree research charges could further prevent the asset manager from adopting a uniform research charge for all clients within a product segment or product, potentially creating situations where certain clients paying less than other clients would be benefitting from the same research at a lower cost. Also, having to agree in writing an increase of the research budget with each client would severely limit asset managers' freedom and manoeuvrability and the operational handling of research budgets could face serious constraints. As research budgets would be set on product segment level or product level, each budget could in many cases capture many different clients invested in the same product segment or product. If some clients agree to an increase while others do not, the asset manager and the clients could find themselves in an awkward situation; should the budget be increased for some clients (meaning that they would pay more than their fellow investors) or would the asset manager be completely prevented from increasing the budget at all (to the perceived detriment for some clients and to the perceived benefit for the others).

- There is a high risk that the new model will jeopardise established interpretations on VAT-treatment of dealing commissions. As a result cost for research would increase by 20-25 %. This in turn would have negative effects for research coverage especially on smaller and medium sized listed companies. Furthermore diverging national interpretations could lead to un-level playing field and regulatory arbitrage between member states. Different VAT rules would apply to different investors, unless clarity is provided from the EU-level. In case the Commission would stick to the model it is important that the EU VAT Committee is convened to provide guidance.

- Additionally, the ESMA Technical Advice has not been written with consideration for investment managers trading FICC (fixed income) products. Specific points within the Advice refer to the model for how investment managers trading equities pay for research, and reference channels through which the provision of research can affect execution decisions that are unique to equities. The market structure for FICC trading differs considerably from that in equities, along several dimensions that are relevant for the treatment of research provided by broker-dealers to investment managers trading FICC products, i.e. FICC products are typically traded in wholesale, price driven markets and investment managers do not pay for research. The EBF request proper investigation of the consequences before such significant changes are implemented since an inclusion of FICC product will require a substantial change of the functioning of the market as a whole. In addition, with the upcoming Capital Markets Union where e.g. corporate bonds are intended to play a more significant role in the capital markets, this initiative will most likely be counterproductive.

As a conclusion, the ESMA proposal should be amended and replaced by a realistic approach, based on enhanced transparency and disclosure of research costs. . Most importantly fees should be possible to set, agree, change and inform of as any other fee. To require written approval for a change is not practicable and not in the best interest of the client.

Quality enhancement

Requirements like ""on a case-by-case basis"; "quality enhancement to be proportional to the level of inducements received" or "on-going inducements should be matched by the provision of an on-going benefit to the client" should be dropped as they could be impossible to comply or generate unjustifiable bureaucracy. ESMA's statement that it may be appropriate to draw up further guidelines and recommendations at a late date should be deleted. Otherwise, investment firms will face permanent legal uncertainty.

It must be clarified that "third party product providers" also include products where the investment management is handled by a third party and the investment strategy is wrapped in a shell administrated by a firm that is likely to be seen as having close links to the investment firm e.g. a management company within the same group as the investment firm and "white–label" products should be accepted as "third party products" ensure support of open architecture especially in smaller markets.

Additionally to these clarifications and in order ensure that advice is not limited to clients with higher assets we propose to add a letter d) in paragraph 11 regarding TA about Article 24(9) MiFID II: "d) The provision of simplified advice or market colour which enable the client to take an informed investment decision based on its self-assessment". Investment firms will provide their customers with the most appropriate products according to market circumstances and expectations, either their own or otherwise, created or selected through quantitative and qualitative criteria. In this case, investment firms will have a guide for selling such products indicating when they are appropriate, under what circumstances and for which type of customer. Thus, they would be backed by experts in the appropriateness of such products.

Permitted inducements: Disclosure requirements

ESMA states that investment firms should disclose the existence, nature and amount of the inducement to the client prior to the provision of the relevant investment service. Where an investment firm was unable to ascertain on an ex-ante basis the amount of any payment or benefit it was to receive, and instead disclosed to the client the method of calculating that amount, it should also provide its clients with information of the exact amount of the inducement received on an ex-post basis and at least once a year, as long as on-going inducements are received.

Such an ex-post requirement would be disproportionate and with no value to the client in situations where the ex-ante disclosure provided a clear basis for its investment decision. For example, when distributing structured products, the cost for each client will depend on the final amount distributed among all clients, i.e. the distribution costs will be spread over a lower/higher number of clients or the distributor may decrease its remuneration. As the final size of the issue cannot be guessed ex-ante, costs are calculated on an estimated size and a maximum cost is disclosed to the client. Hence, clients are informed when they make their investment decision that in any case, they will not pay more than the maximum disclosed to them. In such circumstances, there is no value for the client in getting an ex-post disclosure with the exact amount, which can only be better than what was disclosed ex-ante.

In addition, this requirement would create issues in terms of feasibility, since in many cases, it is not clear at all how firms could individualise the cost of an issue. The distributor will have to collect data from a multitude of manufacturers employing different practices to then output this data in a format personalised for each client.

Furthermore, the amount of on-going inducements received largely depends on the period under which the client holds the financial instrument. Since clients could buy and sell the same financial instrument during the year, it would be very difficult to identify the effective amount received in relation to the initial transaction and pro-rata temporis. This implementation would be particularly costly because it would involve software development to collect and break down the data that are not subject to such fine-grained processing today.

As a conclusion, we recommend that clients have the right to require further details if needed, but a systematic obligation of information would be disproportionate.

2.16 Investment advice on independent basis

The EBF expresses its concern for paragraph 4 (iii) of the Technical Advice which requires to investment firms offering investment advice on both an independent basis and on a non-independent basis should comply, inter alia, with the obligation to "*have adequate organisational requirements and controls in place to ensure that both types of advice services and advisers are clearly separated from each other. To this end the firm should not allow a relevant person to provide both independent and non-independent advice. These requirements and controls should also ensure that clients are not confused about the type of advice that they are receiving and are given the type of advice that is appropriate for them.*"

The EBF strongly believes that the key point is to ensure clear preliminary and contractual distinction between the two types of investment advice in order to ensure investors properly understand the different content and level of service, but disagrees with the provision of maintaining them totally separated as this obligation would produce high impact and excessive costs for intermediaries without any sound justification. Moreover it runs the risk of creating confusion for the investors who should decide to receive both types of investment advice, because would it would give the misleading message that advice is actually provided by the single person they have relation with rather than by the investment firm.

Regarding firms providing both types of advice (dependent and independent), the TA insists on organisational requirements while the Directive refers to information requirements.

The obligation to provide information, prior to the provision of the service, about the differences between the two types of advice could help the client to decide between the alternative that best achieve his needs. EBF members believe that the decision about organizational requirements should be a decision of the firm, taken in respect of the business model adopted, and not a mandatory requirement.

2.17 – Suitability

At the client's request, firms should be able to refrain from drawing up a suitability report. Experience with the requirement to draw up a report of the advice given to the client has shown that, under certain conditions, clients should be able to opt to dispense with the report.

In the Technical Advice on the Suitability Assessment part (v), ESMA states that a firm shall collect the necessary information to undertake an analysis of the costs and benefits of the switch. As costs and benefits are not directly comparable, this should be amended to reflect for example the drawbacks and benefits, rather than the costs.

Suitability assessment

The text included in TA (paragraph 1(iii)) states that "investment firms shall have, and be able to demonstrate, adequate policies and procedures to ensure that they understand the nature, features, including costs and risks of instruments selected for their clients and that they assess, while taking into account cost and complexity, whether equivalent financial instruments could meet their client's profile", requests firms to "demonstrate" their compliance with the rule. Firms are obliged to comply with the rules, but should not be explicitly required to demonstrate this.

In relation to paragraph 1(ix), the assessment of "equivalent instruments" is a new obligation defined by ESMA, with a great level of uncertainty and new unjustified obligations for firms. In the case of OTC instruments this obligation could be impossible to fulfil.

Moreover the EBF believes necessary to highlight that the current final wording of point 4 related to suitability reports raises uncertainties "where the on-going assessment affirms the continued suitability of a previous recommendation or portfolio" as it could be interpreted as an obligation to provide ongoing assessment of the previous recommendations rather than of the recommended financial instruments (or portfolio) as required by Art. 24 (4, iii) of the MiFID II. It must be highlighted that each recommendation is given at a certain time and that what the MiFID II refers in Art. 24 (4, iii) is the periodic assessment of the financial instruments (or portfolio) owned by investors as a consequence of the recommendation received rather than of the recommendation itself.

2.18 – Appropriateness

Complex vs non-complex instruments – Member States have a different interpretation from that of ESMA which is causing difficulties.

Point 13 (p159) clarifies that instruments should only be considered as automatically complex under Article 25(4)(a) if they meet the criteria specified in the Article. The EBF understands that this interpretation comes from L1, however this causes difficulties for certain distribution channels or platforms where products are automatically considered complex, but in reality should not be subject to such an interpretation.

2.19 Client agreement

The requirements under this section are considered not clear. For professional clients there is unlikely to be a periodic assessment of the suitability. EBF members would appreciate clarity regarding whether this means that there will only be an agreement for the provision of custody services, if at all.

For retail clients it is unclear how to interpret the requirement 'except when no periodic assessment is provided'. A retail client always has custody services but can receive investment advice with no periodic assessment. More clarity is needed on what should be in the agreement, and whether this should only include the custody service. The exception provided should be removed.

2.20 Reporting

See section 2.12 / 2.14 / 2.20 – No extension of requirements to disclose information to professional clients and eligible counterparties.

The EBF highlights that paragraph 8 of the Technical Advice requires an excessive regularity (from annually basis to quarterly basis) to provide statements to clients on their financial instruments and funds. The EBF is strongly opposed to mandatory reporting on a quarterly basis. This measure would increase significantly costs for investment firms without any clear provision in MiFID II to increase the regularity of this statement. It should be noted that clients are interested less in reporting and much more in the current performance of the financial instruments in their portfolio. In particular, clients are not interested in further reporting at a point in time they have not chosen themselves (end of the quarter in this case). The additional need for information assumed by ESMA cannot therefore be confirmed by bank practice. An additional need for information supplementing the annual report only in fact exists if the client sees an immediate reason to take a look at his financial situation. In such cases, the client can check his current portfolio performance online or personally at his investment firm at any time. Given the modern means of communication any increase in reporting frequency in practice is superfluous and causes unnecessary costs which make the investment service more expensive and which ultimately have to be borne by the client. This cannot be in the client's interests.

2.24 Product intervention

The product intervention recommended by ESMA goes too far, and would introduce concerns for financial stability.

3. Transparency

3.1 – Liquid market for equity and equity-like instruments

The EBF notes that the concept of "liquid market" is central under MiFID II. For example the transparency regime is dependent on whether the "share" or other instrument has a liquid market or not. The original MiFID regime on liquid shares was based on assessment of Pan-European liquidity. The EBF agrees that there is a clear need to create a harmonised EU-level framework for internationally traded shares (blue chip shares) and other similar instruments.

MiFID II should capture only instruments that are truly liquid. It should be noted that within EU28 markets the majority of shares listed on MiFID regulated markets are relatively illiquid. Notably this is the case for SME-Companies. If illiquid instruments are artificially labelled as "liquid" there is a risk that increased and complex transparency requirements (double cap mechanism and other restrictions) paradoxically reduce liquidity even further. As a result the MiFID regime could have adverse impact on SME-financing.

Due to the double volume cap on NTW and RPW and the limitation on OTC, the SI will become increasingly important in order to be able to serve clients and to avoid market impact. However, due to the obligations for SI when providing quotes up to Standard Market Size it is key that only true liquid shares are deemed liquid.

In addition, the cap on negotiated transactions will mean that an investor cannot rely on the possibility for manual trades when selling. This will lead to less attractively and thus less liquidity. All in all, when share are falsely deemed as liquid the shareholders and the company will be damaged.

3.3 – The definition of systematic internaliser

EBF members are divided on this question. Certain EBF members believe that the Commission should aim at ensuring that only firms which deal on own account of a large magnitude by executing client orders are categorised as SIs. This includes to define "systematic internaliser" in such a way that the number of firms covered by the definition remains largely constant over time and frequent changes in status are avoided. If it is decided that thresholds should be set within the range proposed by ESMA the applicable specific thresholds for specific financial instruments should be set at the upper bounds of the ranges provided by ESMA. For bonds, this would be 3%. Moreover, in order to ensure a level playing field, thresholds have to be set centrally for all Member States. Owing to their extremely low levels, the thresholds proposed by ESMA would result in many banks being defined as systematic internalisers in bonds. The common practice of offering transactions at a fixed price means that the suggested criteria would very quickly be met. This does not take adequate account of the principle of proportionality. The thresholds should initially be set at a higher level. It is also important to ensure that the criteria can be applied in practice. This will not be feasible with the criterion "on average once a week". The EBF suggests setting a criterion of "at least once a week". To save small and medium-sized banks from having to set up costly systems to monitor whether the relative thresholds have been exceeded, consideration should be given to the idea of also establishing de minimis absolute thresholds. The EBF proposes to set an absolute minimum threshold of 5 million Euro total nominal amount traded in that financial instrument executed by the investment firm OTC on own account when executing client orders (over the six-months-calculation period). Additionally, only financial instruments with a time to maturity of at least one year should be considered.

Other EBF members would support a threshold for SI that is sufficiently low to preserve the level playing field and do not have comments on the levels proposed by ESMA. This would further the interests of price transparency by extending the SI regime to as wide a range as possible. By contrast, imposing an un-level playing field of compliance costs on a smaller section of the market would likely lead to less attractive spreads being offered by firms within the regime as they seek to manage the additional risks and costs. Better execution might be available elsewhere, and hence the transparency would not reveal the best execution venues to users or contribute in an effective a way as it might to price formation. These members support the thresholds for being an SI for all categories of non-equity instruments as being set at a level which captures a wide cross section of market makers and providers of liquidity.

The EBF does not have any objections per se to the proposals to use the same criteria for determining SSTI for SIs (Article 18 MiFIR) and other liquidity providers (Article 9 MiFIR). However, the EBF takes the view that the proposed thresholds for SSTI are set too high and should be much lower. This is the case both for Article 9 and Article 18. In fact, current levels of SSTI for bonds or derivatives would not protect

SIs from undue risk and are therefore clearly not in line with the intentions of the regulation or the political agreement on level 1.

To ascertain whether or not it is a systematic internaliser, an investment firm needs to know "the total nominal amount traded in that financial instrument" for each ISIN in question. The EBF shares ESMA's view that there is no guarantee of these figures being available from consolidated tape providers by the time MiFID II comes into force. But the provision proposed in this subparagraph can only be enforceable if it can be ensured that the figures are available and obtainable. It is essential that they are made public by an authoritative source so that all calculations are based on the same set of data.

ESMA proposes that systematic internaliser calculations should be performed once a quarter on the basis of data from the previous six months. In the interests of obtaining reliable results, the EBF would suggest that these calculations do not include data from the first six weeks after a new issue. If the calculations show that the investment firm is a systematic internaliser, it will need at least three months to put the necessary arrangements in place to comply with the proposed regime. The proposed two-month period is too short.

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

The EBF welcomes the clarification by ESMA in para 12 of its analysis on page 240 that securities financing transactions (SFTs) will be excluded from the scope of market transparency requirements. However this view is not reflected in the wording of the proposed technical advice. We would suggest incorporating the clarification directly into the wording of the level 2 text.

We believe it should also be made clear that SFTs will be excluded from the transparency requirements irrespective of the underlying financial instrument since these transactions are invariably "subject to conditions other than the current market price". The clarification should therefore spell out that the exclusion covers not only equities, but also bonds and related instruments.

5. Micro-structural issues

5. 1 – Algorithmic and high frequency trading (HFT)

In paragraphs 67 and 68 of its analysis, ESMA states that MiFID II provides for a binary outcome concerning the question of whether a firm is an HFT firm or not. The reasons given are neither logical nor correct. The Commission has the power to further specify the definition of HFT but does not have the power to create the concept of an 'HFT firm'. It must be borne in mind that the scope of the qualified record-keeping obligations is particularly important. It would cause a huge operational burden if the qualified obligations were to be applied to all orders of an investment firm classified as a high frequency trader, not only to orders that are connected to HFT. We would ask the Commission to ensure that a concept of 'HFT firm' is not created by way of level 2 regulations and to clarify that the specific record-keeping requirements in subparagraph 5 of Article 17(2) are relevant to a firm's HFT activity rather than to a firm classified as 'HFT' (which again is not a classification provided for in level 1 of MiFID II).

One of the consequences of ESMA's proposal is to qualify market making strategies as High Frequency Trading. It should be reminded that market makers are critical for the financing of to the economy (as it has been confirmed recently by the ECB[1]) and should not be affected by the regulatory treatment applied to HFT. Most high-frequency traders that are not market makers, have very little to no regulatory obligations and are subject to very light regulatory oversight. Furthermore, their activity on trading venues is not constrained by any liquidity commitment such as the obligation to provide continuous quotation on a pre-defined set of stocks or instruments. To the contrary, market makers are regulated entities which have strict liquidity obligations towards the exchanges with who they have signed liquidity provision contracts. This interpretation is consistent with the definition of a market making strategy under Article 17(3) and 17(4) of the Directive.

The classification of market makers as HFT would not bring any additional comfort to the regulators, as MIFID II already prescribes very strong organisational and operational standards to market makers using algorithmic trading techniques. Thus, classifying them as HFT will not change anything to the way these entities will operate after the entry into force of MIFID II. Moreover, it could even have negative consequences on the public image of market makers if their name was associated to the largely negative media coverage of high frequency trading. As a result, there is a high risk that some of them seriously reconsider their role as liquidity providers and cease performing it to avoid facing sensitive political and reputational issues. As a conclusion, in the interest of the financing of the European economy, Market Makers should be exempted from the qualification of “HFT”.

We agree that, regardless of the option chosen, it will be necessary to meet all requirements in terms of infrastructure intended to minimise network and other types of latencies. We propose clarifying those requirements on the basis of two criteria. The first criterion should be the distance between the matching machine of the trading venue and the server at which the algorithms are executed, meaning the server at which algorithms initiate, generate, route or execute orders is placed within direct proximity to the matching machine of the trading venue. The second criterion should be the amount of data that is transferred by line per second, i.e. a bandwidth of 10 gigabit per second.

We agree that calculations should be based on liquid instruments only. We welcome ESMA’s clarification of who would have to make the calculations and for which periods. It remains unclear, however, what basis venues would have to use to make their calculations. It must be ensured that the calculations are both reliable and comparable. Moreover, investment firms must be given access to the data and methods used. Given the high relevance of the calculations and the potential for error (false positives), investment firms must have an opportunity to check and, if necessary, object to the calculations.

5.2 – Direct Electronic Access (DEA)

The EBF agrees with ESMA that it is important to clarify what is Direct Electronic Access (DEA) and how it is differentiated from other electronic order transmission systems. The EBF fully supports the interpretation, that common on-line brokerage systems are not DEA systems in the MiFID II context. It should be ensured that the scope does not cover retail clients who transmit their orders to banks online if the orders are simply forwarded via the internet without any processing of their content. It is therefore to be regretted that ESMA has dropped the sound idea of using “shared connectivity” as an indicator of online brokerage since this would offer a suitable means of differentiating between DEA and online brokerage.

[1] See p5 of the Opinion of the European Central Bank of 19 November 2014 on a proposal for a regulation of the European Parliament and of the Council on structural measures improving the resilience of EU credit institutions (CON/2014/83) [Link].