21 March 2022

TARGETED CONSULTATION ON OPTIONS TO ENHANCE THE SUITABILITY AND APPROPRIATENESS ASSESSMENTS

EBF POSITION

EBF generally doesn't support the standardized client assessment regime nor the personalized asset allocation strategy. The EBF discourages the creation of standardized investor profiles or strategies: standardization would most probably only create massive costs and make investment advisory even more complicated, could hinder innovation and/or competitiveness based on expertise and/or tailor-made services and has the potential to ultimately lead to dangerous concentration of risks of many in standardized products. To expand on costs, it is hardly questionable that a unique standardized clients' assessment could allow costs savings for investment firms. The proposed approach would introduce unnecessary rigidity for investment firms, negatively impacting clients.

EBF supports investment service providers in building their system on the current MiFID II legislation: important : these systems are currently under changes due to the integration of ESG-preferences to the suitability assessment process which applies from 2nd August 2022. The costs associated to this process would end up being lost costs if the current regime had to be shortly replaced by the enhanced client assessment regime and/or personalized asset allocation strategy.

Members believe that it would be more effective to develop other regulatory options, such as:

- The revision of client categorization. The current client categorization criteria are too strict and often difficult to be satisfied, with the consequence that: i) several undertakings and persons must be considered as retail clients, even though they are really large and well experienced investors, with the consequence that they are not able to access investment products that are restricted to professional clients; ii) a too small portion of clients can be considered "professional clients" or "professional clients on request". The prime solution to this problem is the revision of the criteria for identifying "professional clients on request" with the aim of enlarging the scope of this category of clients and making it more stable along time. The review of specific criteria for identifying "professional investors on request" should be pursued as first and fundamental objective; The MiFID client categorization should be an exhaustive framework for investor protection, also for related EU legislation (such as selling restrictions pursuant to the Prospectus Regulation). It is illogical that a client would be considered "professional client on request" due to its knowledge and experience and expertise and be at the same time excluded from product offerings due to the mere fact that this client is a natural person acting without a business or commercial purpose (the combination of investor and consumer protection should be revisited in this respect).
- Improving the role of suitability assessment with a portfolio approach in order to ensure it has a larger adoption. This could enhance retail investor protection. Currently, the whole regulatory framework has clearly in mind a suitability assessment focused only on single investments (e.g. product governance requirements, suitability requirements, the recent rules on suitability preferences) and provides very few and insufficient exceptions in order to allow investment firms

to perform suitability assessment with a portfolio approach. The idea of improving the suitability assessment with a portfolio approach is interesting, but it essential not to prescribe too many constrains and leave flexibility of implementation.
- The determination of minimum standards for the design, testing and monitoring of automated investment advisory services, notably based on scenario testing or sufficient historic or statistical data. This could also prevent new entrants or clients from setting arbitrary trade signals and parameters, without appropriate due diligence.

1. EFFICIENCY AND NECESSITY OF THE UNIQUE STANDARDIZED ASSESSMENT REGIME

EBF doesn't support the EC two proposals for a single assessment regime for retail investors and the provisions of a personal asset allocation strategy transferable to any financial intermediary. These proposals would lead to some major problems linked to the experimental nature of the approach, an increase of costs it would impose to the financial sector and to clients.

Firstly, we don't believe a unique standardized questionnaire would address the differences among types of retail clients (e.g. persons, high net worth persons, undertakings, undertakings with hedging needs). It would not enable an adaptation of the questions in a way to efficiently collect information on client's knowledge and experience (should the client agree on providing this information). Such approach would not guarantee a uniform decoding of the responses and it would not automatically lead to the client's personal asset allocation strategy. In this regard, it is still to be clarified whether the EU Commission is also considering making the decoding of the replies provided by retail clients standardized. Should the standardization of the decoding be adopted, it would flatten the provision of investment advice, reducing and discouraging competition among different intermediaries and de facto cancelling the massive investments incurred throughout last years by investment firms with a view to offering clients high-quality services.

Secondly, it should also be highlighted that, unfortunately, the weaknesses of the current regime are not clearly identified in the EC consultation document: therefore, defining how the unique standardized assessment regime could improve the current situation and whether it would bring any benefit to retail investors and financial intermediaries, is difficult. The general and unclear character of the consultation makes the amount of available information too little to deeply assess to whom the regime will apply, its potential utility, need and effectiveness.

Thirdly, EBF doesn't believe that a unique standardized questionnaire would take into account the differences among investment service providers, the particularities of their investment services models and/or the investment universe they service. Moreover, a "one-size-fits all" approach which seemingly informs the idea of a standardization of the investment advice is at odds with the fundamental principles of the EU regulation of financial services where the margin of manoeuvre of the intermediaries are duly acknowledged and preserved.

Finally, important to mention is that the consultation period of four weeks for such a complex topic is not sufficient.

Drawbacks

EBF envisions several drawbacks that could emerge from the creation and use of a new suitability assessment for retail investors and financial intermediaries:

a) It is important that a degree of flexibility, as opposed to a full standardization, is kept to properly take into account the different needs of retail clients and not to negatively impact the quality of advisory service;
b) The introduction of a single assessment regime could lead to a blurring of the boundaries between investment advice service and execution-only service, which could result in the dissemination of non-advice offers or the provision of discounted or lower quality advice thereby lowering investor protection.
c) This could also lead to difficulties in determining liability between investment firms in the event of a dispute with a client over mis-selling.
d) A full standardization of the regime would not allow clients to take decisions based on the competences they have and the different investment objectives related to distinct parts of their own portfolio;
e) Many retail clients who already have several accounts are happy to find different advice or portfolio management strategies and product ranges from different intermediaries. This is usually the reason why they open financial instrument accounts with several investment firms or online brokers. There is a risk that these clients will be dissatisfied and lose financial opportunities due to the standardization of client profiling and the definition of a single asset allocation strategy.
f) The complexity and costs of the regulation would allow only clients with bigger investment portfolios to target the advice service;
g) The use of different questionnaires at the level of each financial intermediary constitutes an additional investor protection for clients, when assessing their knowledge and/or experience. It may help both investors and financial intermediaries to better understand the financial education needs of these clients.
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In conclusion, it is important to mention that the consultation paper does not provide sufficient details regarding the shape that this "new suitability assessment applicable to all investment services" should actually take. The vagueness of this definition makes it extremely challenging to elaborate on the potential drawbacks associated to this new assessment

Key components

Should a standardized personal investment plan be put in place, it should include key components such as the description of the investor, investment objectives, investment constraints, the assets under management, ESG factors, the investment universe and rules to identify, modify and/or implement strategic asset allocation over time and the date and time on which the plan was created or last modified.

However, it should be noted that the components of a standardized investment plan are already enshrined in the relevant pieces of the EU regulation on the matter (e.g. MiFID II regulatory framework).

Transferring results

The EBF believes that allowing retail clients to transfer their assessments and personalized asset allocation to financial intermediaries does not contribute to the increase of their experience. We also consider this portability as eventually leading to standardization and ultimately to an reduction of the product ranges available, as well as to a general deterioration of the quality of the investment advice given to clients. This would result in an "IKEA-isation" of investment products and options and in the end lead to potentially dangerous concentration of risks of many in standardized products.

Since the profiling questionnaire is strictly linked to the suitability procedures and the advisory model implemented by each investment firm, should a client decide to move to another investment firm, the firm would not find client's assessment particularly useful. The Commission's proposal would therefore work only if the standardization involved both the questionnaire and the suitability assessments procedures. In this vein, the fundamental pre-condition for this "transferability" of investment products is that the "new" investment firm and the "old" investment firm are perfectly identical i.e. the former and the latter must have contractual relationships with the same manufacturers and for the same investment products.This would imply a rigid model to provide investment services and would not improve the level of protection provided to retail clients. On the contrary, it would flatten down the quality of the services provided.

Moreover, the actual need of transferring practices is not recognized as most of the customers only have one investment service provider and would unlikely have more as the costs of doing so would easily outweigh the benefits. Transferring results of assessments and personalized asset allocation could only be beneficial for retail clients using multiple investment firms: this would help the latter to make more effective asset allocation (if they follow at least the investment advice provided on the basis of integrated data).

Finally, a risk is envisaged in clients choosing intermediaries acting through ill-suited robo-advisors with insufficient back-end testing or controls, as they would likely not take the time to explain precisely to clients the risks involved or to educate them on the products: the US model, which relies on a significant use of robo-advisors by retail investors based on the distribution of ETFs, seems to have many drawbacks[1]. Such reliance on robo-advisors and ETFs would be particularly ill-suited to EU retail investors who, unlike US investors, are generally not financially literate and may not be aware of the risks of funds that are highly correlated to market indices. In an environment of high financial market volatility, it is however important that retail investors with the least market knowledge and experience have an ongoing relationship with their advisors.

EBF is of the opinion that the blurring of the distinction between investment advice service and execution-only service, could likely distort the relationship of trust between retail investors and their advisors.

Preparation of assessments and asset allocation strategy

EBF believes that the financial intermediaries selected by the retail investor should be in charge of preparing both the clients' assessment and the allocation strategy. This statement is justified by the fact that financial intermediaries are likely to be experienced not only in assessing the client (sometimes because of past relationships with the client), but also in allocating assets. This would restrict the access to advice in markets where independent advice is not always available. In fact, the involvement of other entities in the process would stiffen the delivery of investment services and investment advice, negatively impacting the quality of the provided service.

Storage, Accessibility and Frequency

[1] see https://www.sec.gov/files/exams-eia-risk-alert.pdf

EBF supports the importance of regularly updating the client's assessment and asset allocation strategy to ensure consistency with the client's investment objectives, constraints and/or change in personal circumstances of liquidity needs. Moreover, the update frequency should be in line with MiFID requirements. It should also be noticed that the review and, where necessary, the update of the questionnaires aimed at profiling clients represent a well-established practice for ISP.

2. PERSONALIZED ASSET ALLOCATION STRATEGY

EBF doesn't believe that the rules on personalized asset allocation strategy should foresee standardized investor profiles based on retail investor's personal constraints, risk/return appetite and objectives: investment service providers already have their own classification system based on the current legislation, their own products, research and investment strategies and the need to change so is not supported. .

However, if a personalized asset allocation strategy had to be put in place, the following elements should form the basis for distinguishing between asset classes: risk return, paired correlation with other asset classes, minimum diversification criteria, costs, expected volatility per category, knowledge and experience limitations of the client, preferences of the client.

Financial intermediary assessment on exposure to assets

The EBF believes that the financial intermediary assessment should take into consideration the clients' knowledge and experience in the investment products, their interest to follow and act independently in the market, the amount of money used to the investment and taxation, and finally the clients' situation and needs.

Moreover, EBF would like to draw attention on two elements of concern related to exposure to assets: the two possible options of investing directly in "securities" vs investing in "potentially complex financial products" and the examples of "complex financial products".

Seemingly, these examples do not match the types of "complex" products, and related distinctive features, qualified as such in the MiFID II regulatory framework currently in force. By mere way of an example, it would be highly questionable to qualify "funds" as complex products. On the contrary, it cannot be ruled out that some "securities" may be qualified as "complex" if they feature the relevant characteristics set out in the above-mentioned MiFID II regulatory framework.

Rules on the asset allocation strategy and proposal

Should the intermediary offer products that do not fit into one of the common asset categories, the intermediary should prove that the risk, return and correlation properties of the product are equivalent to those attributed to one of the established asset classes: should this be the case, the instrument can be considered as belonging to that asset class. Moreover, such products should only be made available to the investor at his or her explicit request. However, it should be considered that according to the general market practice, investment firms define ex ante their own criteria to select asset classes, considering not necessarily only the common ones, but also the alternative ones in order to better allocate investments according to the different needs of retail investors.

Should the client rely on different financial intermediaries, the latter should always be entitled, after receiving consent from the client, to propose a different asset allocation strategy to the client based on their own product universe and distribution strategy. If this was not the case, all financial advisors would have to act in a similar manner making any competition in services very difficult.

About EBF

The European Banking Federation is the voice of the European banking sector, bringing together national banking associations from across Europe. The federation is committed to a thriving European economy that is underpinned by a stable, secure, and inclusive financial ecosystem, and to a flourishing society where financing is available to fund the dreams of citizens, businesses and innovators everywhere.

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