FINANCE FINLAND

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Consultation Paper: Guidelines on certain aspects of the MiFID II appropriateness and execution-only requirements

General comments

When drafting the guidelines on appropriateness and execution-only requirements, ESMA has taken its guidelines concerning suitability requirements in investment advice as a starting point. However, appropriateness assessment is a narrower obligation focusing on the knowledge and experience of the client and the complexity of the product. As a result, the appropriateness guideline goes further than the original idea behind level 1 legislation.

Online trading services already form a significant part of investment firms' provision of trading services. They provide the clients with smooth, well-designed and cost-efficient trading opportunities. The need for such services has further increased since COVID-19 limited the possibilities for live meetings. These guidelines should be designed and tailored in a way that imposing new guidance would not in any way harm or dilute the benefits of online services. For now, it seems that many of the points, such as inclusion of several staff members in verifying the provided information, is designed for face-to-face services, which does not match the reality in 2021 and beyond.

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

Finance Finland (FFI) partially agrees with the suggested approach.

We agree with letting the firms decide how they inform their clients about the appropriateness assessment and the format used. However, the amount of the information that should be provided to the clients is vast. Any extra information about the purpose of the appropriateness assessment might be an extra burden and clients do not necessary pay attention to it.

When it comes to the timing, the interpretation of the expression "in good time" should be broad, because in a trading situation, service providers need flexibility.

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

We do not agree with this. FFI is of the opinion that Guideline 2 is too detailed when it comes to designing the questionnaires.

Some service providers might have a policy that they simply do not sell the products to the clients if the product is not appropriate to the client based on the given information about their knowledge and experience.

Detailed comments relating to cooling-off periods and circumvention:

- ESMA's guideline is placing restrictions on the client's right to trade financial instruments. The idea of cooling-off periods and limiting the number of attempts does not fit with the right that the client has according to Art. 25(3) in MiFID II and Art. 56 in the Delegated Regulation to push a trade through even if the client has failed an AAT (appropriateness assessment). This means that a cooling-off period or limiting the number of attempts would have no effect in practice.

- In a situation where a firm has implemented a process whereby it blocks a client from trading until an AAT has been passed, a cooling-off period or limiting the number of attempts would not advance the client's knowledge or experience in any way. This type of guideline is also ambiguous at best, given that it opens up for implementation of a very wide range of different approaches and creates a situation where it is possible to generate arbitrary situations between firms; one firm implementing a cooling-off period of a few hours vs. another firm implementing a full day while a third firm implements two days, etc. The same goes for a limitation to the number of attempts. Moreover, what should happen after the client has maxed out the number of attempts? Should firms then block clients from trading contrary to there being no legal requirement to do so, or simply warn the client and then let the client push through with the trade?

- Repeated testing may be useful for learning.

- Last bullet point in sub-paragraph 22: *"client should be able to reply that he/she does not know how to answer the question"* should be removed. Either the client knows or doesn't know the answer to a question, and a client motivated to pass the AAT may be more likely to risk picking the wrong answer than to state outright that they do not know the answer, as one of these involves a better chance of passing. Furthermore, what should a firm do with the information that a client does not know the answer to a particular question? Depending on the structure of the appropriateness assessment, the practical effect would either be that the client still passes the test or that the client fails the test. In that context, the possibility to answer "I don't know" becomes completely redundant.

- The proportionality principle should be applied also in the appropriateness test. For instance, for non-complex instruments for which the appropriateness test is not necessarily mandatory, it may go too far to work with substantive multiple-choice questions. ESMA could clarify how the principle of proportionality works in practice.

- Last bullet point in sub-paragraph 26 is inconsistent with the other comments made by ESMA regarding cooling-off periods and that clients should not be able to repeat assessments/tests.

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

FFI is of the opinion that it should be possible to use the same kind of detailed question patterns for the same type of products. Questions should vary according to the type of investment service or product. This simplifies the process from the providers' point of view.

Sub-paragraph 28 of the consultation does not seem very relevant, because investment firms hardly collect information on individual execution-only clients' financial situation and investment objectives for product governance purpose.

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

We are of the opinion that the guideline goes beyond level 1 regulation. Furthermore, it resembles the suitability assessment, which covers the customer's whole situation. However, in the case of appropriateness assessment, the holistic view is unnecessary, because the focus should be on a single product or service type. More detailed analysis is conducted in the case of suitability assessment when financial advice is provided for the customer.

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

We partially agree.

When it comes to checking the reliability, accuracy and consistency of information collected about clients, it is not possible to check the reliability of a transaction conducted by other service providers like banks or investment firms. In these cases, the service provider should rely on the information given by the client.

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

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

We do not agree with this approach. It should be up to the service provider how it controls the process relating to updates. The requirement that changes in knowledge and experience are approved by two staff members seems exaggerated and requires additional human resources.

Detailed comments relating to client information:

- What are the more vulnerable clients referred to in paragraph 41? If this is meant as something other than a client category, then ESMA has to be specific about the higher standards. In a client-initiated trade situation, we cannot know solely based on an AAT whether the client is more vulnerable or not.

- Paragraphs 42 to 45: Proactive requirements cannot be imposed on firms in non-advisory services to periodically reach out to clients to update information or request confirmation of previously delivered information. These paragraphs seem to point to an advisory service or at least an ongoing service and/or ongoing interaction of some sort. However, this is not the case for execution services, which are dependent on the client engaging the firm and initiating trading services. As such, the firm assesses appropriateness in the trade situation and not on a periodic basis, unless of course a client engages the firm on multiple occasions during the same year, for example, and then trades different types of financial instruments. In general, a firm cannot know when to contact a client because of potential changes regarding knowledge and experience. The relevant thing should be that the firm, in the situation when the client engages the firm, includes in its process that the client should have the ability to update information and/or that the firm should be in a position to update a previously made assessment.

- Specifically regarding paragraph 45, we fail to understand ESMA's reasoning with regard to the risk of clients updating their knowledge and experience "too frequently". It has to be kept in mind that firms do not dictate how often a client wants to trade different types of instruments, and the firm's responsibility is to assess the client's knowledge and experience in relation to the instrument type relevant for the trade at hand. If a client has gained knowledge of certain instruments at different times over the course of a few months and therefore engages the bank multiple times to perform transactions, it would be necessary to "update" the knowledge and experience assessment whenever the client engages with an instrument type for which they not yet passed an assessment test. To then require that two staff members should be involved in making the assessment or controlling the assessment is simply absurd. Firstly, every single staff member involved in a knowledge and experience assessment should have the sufficient knowledge and competence to make the call himself/herself. Secondly, having two staff members involved would put an unproportionate burden on the client, who very well may want to execute a time-sensitive transaction.

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

We do not agree with this because the requirements are unproportionate in the context of non-advised situations. This section is copied from the existing suitability guidelines. We question whether this fits execution only-services. In addition to this, the guideline seems to focus only on the face-to-face selling procedure despite the fact that the online trading service is commonly used.

In an online trading tool, before starting to use the services, the company representatives have to be coded into the client's profile so that the system/platform recognises pre-defined

representatives. The right to represent the company is based on the power of attorney or on the company's articles of association.

Handling of representatives (e.g. on the phone) is already covered in the internal conduct of business instruction, but there is no need to require a dedicated policy for how to conduct an appropriateness assessment for representatives.

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

As a general comment, Guideline 7 seems to relate more to product governance requirements rather than appropriateness. Due to that we question the need for this guideline. In addition, we think that the requirement in paragraph 54 regarding not relying on one data provider goes too far.

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

No comments.

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

Yes, we do. However, it is difficult to define and distinguish which complex or special products could be sold after the warning procedure and which could not because of special conflict of interest. According to MiFID, it is always possible to refuse to sell the products to the client if the product is not appropriate for them based on the given information about their knowledge and experience.

Paragraph 65 states that *"firms should also take reasonable steps to ensure that the warnings they issue are correctly received and understood"*. The obligation to ensure whether the client has understood the warning goes too far. The firm's responsibility is to make sure that warnings are correctly issued and written in understandable language, but it can't take the responsibility of the client's proper understanding of it. We propose deleting the wording *"and understood"*.

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

MiFID II requirements relating to qualifications of firm staff are already comprehensive. It is not necessary to introduce new requirements in the form of a guideline.

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

FFI is of the opinion that record-keeping requirements should not be put in place in ESMA's guidelines but rather regulated in level 1 or level 2 legislation after elaborate cost-benefit analysis.

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

No comments.

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

We do not agree with this approach.

Detailed comments:

- Pp. 82, 83 and 86 – In situations where a non-advised transaction is made through a direct personalised communication with an employee of the firm (so-called hand-held situations), firms should have internal instructions for employees to distinguish between transactions falling within the execution-only exemption and other non-advised transactions. However, it is a completely different case for self-service tools and platforms where clients log on themselves to initiate orders and execute transactions.

  That a client logs on to a self-service channel to execute a transaction can be based on one of three situations happening prior to the client initiating the order:

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

  The examples above could be further complicated by adding the scenario that the client logs on to the firm's self-service channel and initiates a trade in equity A as well as a trade in equity D, which is not covered by the communication in points 2 or 3 above. There are no possible connections between the type of communication in points 2 and 3 on the one hand and a firm's self-service channel on the other hand. How should the underlying logic of a self-service channel know whether a client who logs on has been in contact with e.g. a broker and/or has received a written communication via e-mail?

  If ESMA's proposed paragraph 86 were to become the norm, it would in practice mean that firms can no longer make use of the execution-only regime in pure self-service channels. It would create a situation where firms would need to design and apply a general appropriateness test for all non-professional clients just in order for

them to get access to a pure self-service channel. Given that the instruments in scope here are non-complex, this type of end result of the proposed Guidelines would go against the intention of the execution-only regime as stated in the MiFID II Directive. Furthermore, it would conflict with the policy of providing clients with efficient access to financial instruments that have been deemed to pose no material risks from a client protection perspective.

As for hand-held situations, the firm's internal instructions should define the boundaries of what can be handled as execution-only. The employee having a conversation with a client will in most cases be completely unaware of whether the client has received a previous communication. From this starting point the employee should be able to assume that the order is made on the client's initiative unless the client informs the employee of the previous communication or the employee otherwise has knowledge about the previous communication.

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

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

i. transactions initiated by clients through pure self-service channels should always be regarded as transactions made on the initiative of the clients;

ii. for client transactions that are made in hand-held situations, firms should have internal instructions to define the boundaries between situations that fall within the execution-only regime and situations that cannot be handled within the execution-only regime; and

iii. that the proposed paragraph 86 under Guideline 12 is deleted.

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

No comments.

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

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FFI does not support the idea of assessing sustainability factors and risks in the appropriateness assessment.

Knowledge and experience regarding sustainability factors and risks should not be a separate element or requirement for firms to assess. The inclusion of a specific product's characteristics into the appropriateness assessment is already required by Art. 25(3) in MiFID II and would be covered by the proposed Guideline 7 and Guideline 8. If a product's characteristics include specific sustainability factors and risks, these should be covered by the aforementioned rule and the proposed guidelines just as any other specific features and risks related to a specific product (liquidity, volatility, specific exposures, exit possibilities, etc.). Sustainability factors and risks are just two additional components to already existing factors and risks that a financial instrument can have. If sustainability is singled out as a separate characteristic, it would risk diminishing other factors and risks from the appropriateness assessment.

Appropriateness assessment focuses mainly on the complexity of the product and is not correlated with the sustainability of the product. Many of the sustainable investment funds are basic non-complex UCITS funds. The complexity of the sustainable investment is based on the complexity of structure, not on the sustainability of the product.

The industry is still awaiting the final delegated act that would amend MiFID II to integrate sustainability risks and factors in product governance and suitability requirements. Until these requirements are clear, we believe it is too early to require firms to assess the client's knowledge and experience with respect to investment products' sustainability factors and risks when offering execution-only services.

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