Division Bank and Insurance
Austrian Federal Economic Chamber
Wiedner Hauptstraße 63 | P.O. Box 320
1045 Vienna
T +43 (0)5 90 900-DW | F +43 (0)5 90 900-272
E bsbv@wko.at
W http://wko.at/bsbv

Ihr Zeichen, Ihre Nachricht vom	Unser Zeichen, Sacharbeiter	Durchwahl	Datum
	BSBV 64/Dr. Priester/Ha	3132	21.07.14

Betrifft: **MiFID; Investor Protection**

The Division Bank and Insurance of the Austrian Federal Economic Chamber, as representative of the entire Austrian banking industry, appreciates the possibility to comment on the ESMA consultation regarding MiFID/MiFIR; Investor Protection and would like to submit the following position:

I) General comments - Inducements:

We generally agree with the need to improve investor protection and support the position that inducements should never conflict with the interest of the client. However, we would like to make the following remarks:

The consultation paper favours a broad interpretation of the prohibition of the acceptance and the retaining of fees, commissions or other monetary or non-monetary benefits provided by third parties with regard to the provision of investment advice on an independent basis or portfolio management. However, we want to emphasize that there should be a clear distinction between the different investment services, especially in case that financial institutions provide different kind of services to the clients (i.e. non-independent investment advice, portfolio management, execution of orders on behalf of clients, etc). A broad interpretation of the prohibition should, however, not be as far-reaching as to the extension of the ban on the acceptance - respectively retaining of fees, commissions or other monetary or non-monetary benefits with regard to the provision of portfolio management to a preceding investment advice on a non-independent basis or other, investment service. For example when non-independent investment advice is provided prior to the provision of portfolio management, it should be still allowed to accept and retain fees, commissions or other monetary or non-monetary benefit for the provision of non-independent investment advice in accordance with Article 24 para. 9. The fulfilment of the provisions by MiFID II is particularly important also for the Austrian banking sector.

The requirements foreseen in the consultation paper could be a “de facto”-ban which would lead to a pure fee-based advice that is at least (i) not in the interest of the clients and (ii) a barrier for competitive und dynamic markets for the following reasons:

- **Investment decision is complex:** The decision for the appropriate investment is complex, investment advice is vital especially for retail clients. However, these requirements may lead to a two-class-investor-system: Those investors being able to afford investment advice and those not being able to afford investment advice.

- **Inducements favour small investors:** In case of provision-based advice the client does not pay ex-ante fees. Therefore, it is much more likely that the investor will seek for advice (even from different advisors) and the probability of suitable investment decisions is higher compared to situations where the investor pays an advisory fee (fee-based system).

- **Less invested money:** A fee-based system focus on wealthy investors and exclude retail investors (in particular small investors or savers) from access to any level of assistance in their search for an appropriate investment product. Thus, retail investors would – if at all – invest less. In the current low interest rate environment such development would be particularly disadvantageous for clients.

- **Importance of intermediaries:** Another area of concern with the "de-facto"-ban of inducements is that it completely ignores the value of financial intermediaries for both, the client receiving investment advice and the investment firm taking advantage of a wider distribution. Inducements are vital for financial intermediaries.

- **Distortion of competition:** A ban of monetary inducements would favour very large investment firms with their own in-house distribution units, because it is not necessary for them to pay inducements.

II) Regulations in Detail

2.6. Recording of telephone conversations and electronic communications:

- **Analysis, para. 7:**
  The consultation paper considers to record also calls that "relate to or that are intended to result" in transactions. Since all relevant aspects to consultations are already covered by the general documentation of the telephone conversation we suggest deleting this sentence. This expands the recording requirements.

- **Draft Technical Advice, para.9:**
  We would delete the paragraph in the content of the recorded information. All relevant information and complete documents are already guaranteed in the course of the order confirmation that is given to the customers.

2.7. Product governance:

- **Analysis, para. 16:**
  The consultation considers that distributor product governance arrangements may apply to more than one firm where different firms work together in the distribution of a product (for example, if a product is recommended by one firm but the transaction takes place using the platform of another firm). In such cases, the final distributor in the chain (i.e. the firm with the direct client relationship) has ultimate responsibility to meet the product governance obligations.

  Such provision conflicts with the legal structure of some banks. The interpretation should be redrafted.

- **Draft Technical Advice, para. 10:**
  The provision that product costs and other charges are compatible with the needs, objectives and characteristics of the target market is unclear. It should be specified what exactly is meant that investment firms shall consider the charging structure proposed for the product.

- **Para. 14:**
  We are against the implementation of new calculation methods. Rather, one should make reference to already implemented market standards (such as Synthetic Risk and Removed Indicator (SRRI)).

- **Para. 27:**
  We suggest to delete the draft technical advice para 27 due to the fact that its provisions are contradictionary to national law in some member states. It is not understandable why the distributor should repeat to make the same testing steps like the product provider.

- **Q14:**
  We believe that the Product Governance Rules can apply only in case of distribution of products available on the primary markets. Product governance rules should only be applicable for those products for which (ii) a relationship with issuers/products providers ('manufacturers') can be actually established and managed by distributors or (ii) when distributors are also issuers.

  Secondary trading of financial instruments should not be perceived as a distribution channel. The distribution services under the MiFID comprise of investment advice, reception and transmission of orders and dealing on own account. Secondary market trading can only be seen as means of executing client orders once the investment decision has been reached. Hence, secondary markets are only possible trading venues within the meaning of Art. 4 (1) point (24) of MiFID Level 1 for executing orders resulting from distribution services under MiFID, not a distribution service on its own.

  Seen from that angle, the product governance requirements at the distributor's level should be triggered by the provision of a relevant distribution service under MiFID regardless of whether the consecutive client order is being executed on the primary or secondary market. Nonetheless, and for the avoidance of doubt, the final technical advice should clarify which investment services qualify as distribution for the purpose of product governance arrangements.

  Too detailed product governance rules might pose hurdles rather than it would help investment firms. We ask to provide firms with a reasonable leeway in setting up the product governance rules. E.g.: Undertaking scenario analyses and stress tests might only be useful for some types of products (like structured products) and feasible only for some categories of manufactures (like structures, packagers).

- **Q15:**
  When products are manufactured by non-MiFID firms or third country firms and public information is not available, should there be a requirement for a written agreement under which the manufacturer must provide all relevant product information to the distributor?

  First of all, we would like to make clear that the manufacturing of UCITS and AIFs is not subject to the product governance standards under MiFID due to the general exemption of these products under Article 2(1)(i) of MiFID Level 1 (for further details, cf. our answer to Q19 below).

  In this light, we agree with ESMA that distributors should be able to obtain from manufacturers, including non-MiFID firms, all information necessary to ensure distribution to the relevant target market. However, we see no necessity to oblige the parties concerned to enter into a written agreement in this regard in order to keep the administrative burden at a minimum. Furthermore, in the interest of legal clarity, the final technical advice should further specify what “all relevant information” to be provided by manufacturers should actually mean. Manufacturers should be able to provide such information in a standardised manner e.g. by referring to the relevant depiction in the fund prospectus or the KIID. Nevertheless the manufacturers should be obliged to provide granular information on the products. They should give reliable and complete information on the sales channels, target markets, complexity of the product, etc. The information provided by product manufacturers should make it straight forward for distributers to determine if clients are within the target market, manufacturers should be made liable for the correctness and usability of this information.

- **Q16:**
  Do you think it would be useful to require distributors to periodically inform the manufacturer about their experience with the product? If yes, in what circumstances and what specific information could be provided by the distributor?
  We do not see the added value of obligatory periodical information to the manufacturers of financial instruments. We strongly believe that the timing and content of such information exchange should strictly depend on the type of product and the target market and thus should be subject to the objective and practically oriented decision by the parties concerned.

- **Q17:**
  What appropriate action do you think manufacturers can take if they become aware that products are not sold as envisaged (e.g. if the product is being widely sold to clients outside of the product’s target market)?

  In the situation described above, manufacturers should be expected to contact their distribution partner and recommend consult with them on their opinion on the distribution process and possible modifications to it. The question arises, however, to what extent manufacturers shall be in the position to intervene in the determination of the target client group at the distributor level if according to the draft technical advice, distributors are required to set up their own product governance arrangements and to identify target client groups for each distributed product.
  In our view, it is preferable to require the product manufacturer to identify in general terms the target market of each product. Investment firms distributing products to the end-clients should be allowed to refine the characteristics of the groups of clients to which the product can reasonably be sold. Otherwise, there is the risk that distributors could come to different and potentially inconsistent conclusions in terms of the target market for the same product which might create confusion in the market and undermine investors’ confidence.

  In this context, we would also like to point out that there are no uniform criteria for classifying clients which go beyond the general client categorisation as retail or professional according to Annex II of MiFID Level 1. Therefore, the duty to determine the target market for a product should not imply a categorisation below that level in order to avoid inconsistent standards to be applied by different distribution channels.

  In any event, it is of utmost importance that product manufacturers are not considered responsible for any actions taken by distributors in their course of business. Investment firms distributing investment products act in their own capacity by performing investment services under MiFID. They are subject to separate regulatory requirements and to supervision by competent authorities. Hence, product manufacturers becoming aware of deficiencies at the distributor level should be expected to take corrective actions as appropriate, but must not incur responsibility or be held liable for the distributor's malfunctioning. They should however be held liable for wrong, incomplete or ill-fitting information on their products.

- **Q18:**
  What appropriate action do you think distributors can take, if they become aware of any event that could materially affect the potential risk to the identified target market (e.g. if the distributor has mis-judged the target market for a specific product)?

  As suggested by ESMA, distributors should be required to reconsider the analysis of the relevant target market and make reasonable adjustments to their product governance arrangements. If distributors become aware of circumstances which may also materially affect the identification of the potential target market at the product level, they should also be expected to pass the relevant information to the product manufacturer.

- **Q19:**
  Do you consider that there is sufficient clarity regarding the requirements of investment firms when acting as manufacturers, distributors or both? If not, please provide details of how such requirements should interact with each other.

  We do not think that the draft technical advice provides sufficient clarity as regards the requirements for product manufacturers. In particular, we do not agree with the implications for UCITS and potentially for AIFs as suggested in the consultation papers analysis[1].

  UCITS and AIFs are governed by separate pieces of EU legislation imposing specific requirements on the fund management process in relation to the fund manager and in case of UCITS, to the individual product. Therefore, collective investment undertakings – UCITS and AIFs alike – are explicitly exempted from the MiFID regime in Article 2(1)(i) of MiFID Level 1. Only fund managers providing ancillary investment services in addition to the management of UCITS or AIFs are bound by MiFID provisions on internal organisation and conduct of business in relation to those ancillary services.

  Thus, it should be clear that the product governance standards laid down in Articles 16(3) and 24(2) of MiFID Level 1 cannot apply to the manufacturing of UCITS and AIFs which is explicitly exempted from the MiFID scope and subject to specific regulation under EU law. The statement in ESMA's analysis according to which "the proposals [on product governance] do not override responsibilities in other directives, such as (…) UCITS" is mistakable in this regard and should therefore be deleted.

  Any other outcome would be not only in breach with the general systematics of the EU financial services legislation, but also arbitrary in terms of results. This goes down to the fact that manufacturing of UCITS or AIFs could only be affected by the MiFID standards if the relevant fund manager has been licensed to provide ancillary services in addition to its core activity of collective portfolio management. Consequently, we would face a situation where a fraction of UCITS and AIFs were submitted to the product governance provisions under MiFID whereas UCITS and AIFs managed by pure fund managers were not affected by these rules, leading to a split in standards for the same products. Clearly, this cannot be the desired goal of a sensible regulatory approach.

  On this basis, we urge to confirm in its final technical advice to the Commission that UCITS and AIFs are not subject to the product governance obligations at manufactur-

[1] Cf. recital 17 on page 46 of the Consultation Paper.

er's level due to them being exempted from the scope of application under Article 2(1)(i) of MiFID Level 1.

- **Q21:**
  For investment firms responding to this consultation, what costs would you incur in order to meet these requirements, either as distributors or manufacturers?

  Additional indirect costs might occur as a consequence of the envisaged contractual obligation in relation to non-MiFID firms to provide "all relevant information" on products to distributors.

2.13 Information to clients about investment advice and financial instruments:
Draft Technical Advice, para 4: Due to the fact that the total number of financial instruments may change in the course of time, the passage "the total number of financial instruments" should be deleted in para 4.

- Q 68:
  The information regarding broad or restricted analysis should be of a general nature and be provided as a generic description of the investment firm's selection process. The firm should be allowed to provide it to clients using media and means of information used to convey other information intended for the client. The proposed requirements to provide information on "own and other" financial instruments are disproportionate and would imply considerable administrative burdens since the range of products offered is at times subject to dynamic and rapid changes. Additionally we believe that the usefulness of this piece of information to the customer is indeed limited, the quality of the instrument should not mainly be judged by the fact that it was manufactured in-house or not. If it is a distinguishing relevant factor firms will freely disclose this information. For general retail markets the ESMA suggestion seems a bit remote from the market.

  We are again of the opinion, that the proposed regulation on information to clients about investment advice and financial instruments is not useful to eligible counterparties and professional clients. They should however have the possibility to receive this kind of information upon their explicit request.

2.14 Information to clients on costs and charges

- **Analysis, Example 4:**
  The examples confound the subjects costs and inducements, and thus give a wrong impression (optical double counting). Third party payments received by investment firms shall not be regarded as part of the cost of the service (see below answer to question 80).

- **Draft Technical Advice, para 16:**
  Practically it is impossible to allocate the total costs incurred to the client. On-going commission payments do not necessarily have to have a reference to a particular client. It is rather sufficient that the commission payments enable a general framework for the quality-enhancing marketing for future clients. We recommend to disclose the information on bank-own costs as well as the total expense ratio (as in KIID).

- **Q71:**
  Do you agree with the proposal to fully apply requirements on information to clients on costs and charges to professional clients and eligible counterparties and to allow these clients to opt-out from the application of these requirements in certain circumstances?

According to our experience, information to professional clients should be tailored to the specific needs of the relevant client category. As a rule, professional clients will have no interest in receiving illustrations of cumulative effects of costs on the return or in disclosure of assumed monetary figures which bear no relevance for the actual level of costs.

Furthermore, opting-out-mechanisms are a proven and tested instrument for enhancing consumer protection in areas where consumers are likely to forgo their protective rights out of disinterest or ignorance. These factors are clearly not relevant in a business environment of professional investors.

Therefore, we believe that the detailed information meant for retail clients should be made available to professional clients and eligible counterparties upon explicit request only. As a minimum, professional clients and eligible counterparties should be generally allowed to dispense with the retail cost disclosure in order to agree with the investment firm on the level of information which suits their particular needs. The limitations proposed in para. 2 of the draft technical advice are partly not appropriate in the business relationships with professional clients.

- **Q72:**
  Do you agree with the scope of the point of sale information requirements?
  We do not deem the proposed treatment of portfolio management appropriate. It appears that the consultation paper considers the services of portfolio management as encompassing the elements of recommending or marketing financial instruments. However, this understanding is neither reflected in the definition of portfolio management in Article 4(1)(8) of MiFID Level 1 nor does it correspond with the reality of the portfolio management services. The portfolio manager takes its own discretionary decisions about the suitable investments for a client in accordance with its appointment as a fiduciary agent and on the basis of a mandate stipulated in the relevant contractual agreement. Hence, the financial instruments purchased in the course of the portfolio management activities are not the result of recommendations or marketing, but of the investment decisions taken by the appointed manager.

  Therefore, we believe that it is not in line with the MiFID Level 1 text to apply the cost disclosure requirements in relation to financial instruments to the portfolio management services. One should also bear in mind that there are different types of mandates with different degrees of discretion in the market ranging from standardised fund-based management services to fully discretionary management of portfolios with certain performance objectives. In the most instances, however, it will be simply impossible to specify at the time of concluding the management contract what investments shall be made in which instruments for the account of the client which will render the envisaged disclosure a quite fruitless exercise.

  Investment firms should only be under an obligation to provide a KID/KIID to clients. In any event, investment firms are only bound to ensure adequate disclosure of product costs directly to clients if they provide investment services in relation to the relevant product directly to these clients.

- **Q73:**
  Do you agree that post-sale information should be provided where the investment firm has established a continuing relationship with the client?

  We agree with the envisaged scope of the periodic post-sale disclosure requirements, but it should be made sure that it pertains solely to situations involving a continuing relationship with a client.

In this context, we object to the statement in para. 34 of ESMA's analysis implying that investment firms providing one-off services should be obliged to inform their clients ex-post about the exact amount of the inducements received if they were not able to provide such information at the point of sale. Such requirement of additional ex-post information is not covered by Article 24(9) of MiFID Level 1 which acknowledges the disclosure of the relevant calculation method in terms of inducements as fully adequate. Moreover, the added value of such additional disclosure is very limited given the fact that the investment decision has already been taken by the client and there is no continuing relationship with the investment firm.

In consequence, we ask to delete the second sentence in para. 34 on page 106 as well as para. 7 (ii) of the draft technical advice on page 123 which is meant to endorse the ex-post disclosure requirement (cf. also our reply to Q80 below).

We also believe that investment firms and credit institutions should be allowed to supply this information using channels and messages conveying other information to customers. It will be especially important to allow for the use of secure online communication systems most banks have established within their online banking systems.

- **Q74:**
  Do you agree with the proposed costs and charges to be disclosed to clients, as listed in the Annex to this chapter? If not please state your reasons, including describing any other cost or charges that should be included.

  We believe that the proposed approach to costs and charges related to financial instruments which shall form part of the aggregated cost disclosure should be thoroughly reconsidered

- **On-going charges at the product level**
  Especially with regard to the disclosure of on-going charges, we would like once again to point out that it is purely impossible to stipulate ex-ante the level of costs which incur in the management of a product. Speaking for investment funds, only straightforward charges calculated in relation to the NAV of the fund such as the management fee and the depositary fee can be determined in advance in percentage terms. All other cost items are entirely dependent on specific management activities during a year which are influenced by the market developments. This pertains in particular to costs and charges related to portfolio transactions, including securities lending costs and costs associated with derivative contracts. In case of performance fee which is triggered by a specific outperformance of the fund is granted and which is often subject to further conditions like a high-water mark, it is even uncertain whether any costs will be charged to the fund at all.

In our view, this situation prompts two necessary conclusions:

- **First, it is not reasonable to include highly volatile cost elements in the on-going** charges figure in order to avoid confusion and misinterpretation by investors. This applies to all elements of transaction costs mentioned above and, above all, to performance fees. It is simply not responsible to disclose an on-going charges figure featuring the performance fee if its occurrence in the next year is entirely unclear and vice versa (in fact, suggesting an overall cost disclosure based on a year without performance fee might provoke false expectations in terms of the product costs and eventually mislead investors).

- **Second, it seems irresponsible to present investors with on-going charges figures in** monetary terms. Given that at the point of sale only the investment sum, but not the investment outcome at the end of the charging period can be specified, investors cannot even be told in reliable manner the amount of the management fee to be paid to the product provider, let alone the amount of other fees and charges depending not only on the fund's NAV. It should be clear that disclosing specific numbers in the circumstances exhibits only a spurious accuracy, but will never produce correct results. Moreover, as the MiFID regime does not provide for a limitation of liability similar to that applicable to the UCITS KID, disclosure of knowingly false figures on the basis of assumptions bears significant liability risks for investment firms under the applicable civil law.

  Consequently, we urge not to reinvent the on-going charges in relation to investment funds under the MiFID regime, but to adhere to the understanding developed under the UCITS Directive. This proven and tested interpretation of on-going charges should be regarded as appropriate in accordance with recital 78 of MiFID Level 1. In particular, there should be no obligation to disclose cash amounts in terms of on-going charges at the product level due to the many imponderables and assumptions which have the potential to mislead investors.

- **Transaction costs**
  We do not agree with the analysis according to which transaction costs have to be made transparent as part of the overall product costs. Generally speaking, transaction costs are to a high degree caused by the underlying market risk of the instruments traded. In case of e.g. bonds traded with bid and ask spreads, it is not possible to determine which part of the spread is attributable to the broker and which goes down to a market momentum at the time of trading. Moreover, it should be borne in mind that in some transactions such as OTC derivative contracts transaction costs are simply not knowable as they are intrinsically embedded in the instrument price. Therefore, transaction costs should not be included in the required compilation of costs and charges in accordance with Article 24(4) second subparagraph of MiFID Level 1.

- **Treatment of UCITS and AIFs which feature a KID according to UCITS standards**
  Specifically in relation to the cost transparency by UCITS, one should bear in mind that the EU legislators has decided upon a temporary relief from the PRIIPs information requirements for the next five years. This temporary exemption applies to UCITS and in addition, to all retail AIFs which feature a KID in line with the UCITS standards according to national law. We believe that one should not attempt to effectively circumvent this exemption by requesting the Commission to consider aligning the UCITS disclosure standards with the future requirements of the PRIIPs Regulation. Such measures appear incompatible with the declared will of the EU legislators and would not be in line with the Commission's request to ensure coherence within the wider regulatory framework of the EU. On the contrary, UCITS distributors should remain able to rely on the UCITS KID as a sufficient and appropriate source of information on product costs and charges. The same should apply for retail AIF distributors, provided the AIFs feature a KID in line with UCITS standards according to national law.

- **Q75:**
  Do you agree that the point of sale information on costs and charges could be provided on a generic basis? If not, please explain your response.

We agree that information about the costs related to the financial instrument could be provided on a generic basis at the point of sale. However, we believe that the limitation in para. 56 of ESMA's analysis according to which generic disclosure should be allowed only if "the investment firm ensures that the costs and charges provided in the generic disclosure are representative of the costs that the client would actually incur" is not appropriate in the broader context of the draft technical advice. As explained in our reply to Q74, disclosure encompassing volatile cost elements such as transaction costs and/or performance fees and requiring specification of cash amounts on the basis of several assumptions will not produce even roughly accurate results. Thus, the proposed approach to product cost disclosure in light of our suggestions made above it should be reconsidered.

- **Q76:**
  Do you have any other comments on the methodology for calculating the point of sale figures?

  We agree in principle that the actually incurred costs should be taken as a proxy for the disclosure of the ex-ante product costs. However, we would like once again to stress that such approach is appropriate only in relation to steadily recurring costs such as the management fee and constant expenses included in the calculation of the on-going charges figure for UCITS. Volatile cost elements such as transaction costs and/or performance fees should not be taken into account in the calculation of ex-ante figures as they will prompt significant fluctuations of the overall costs which have the potential of confusing and misleading investors.

  Moreover, it should be taken into account that the MiFID regime does not provide for a limitation of liability in terms of the cost disclosure similar to that applicable under the UCITS Directive or to be applicable under the PRIIPs Regulation. Therefore, the required assumptions and estimations bear a significant liability risk for the distributors of financial instruments under the relevant civil law. The final recommendations should thus be carefully calibrated in order not to discourage investment firms from distributing products with variable on-going costs. Otherwise, distribution of investment funds involving active portfolio management could be hampered.

- **Q77:**
  Do you have any comments on the requirements around illustrating the cumulative effect of costs and charges?

  We understand that the requirement for investment firms to provide clients with an illustration of the cumulative effect of costs and charges on the return of a product at the point of sale. The corresponding explanatory text in para. 59 of ESMA's analysis is, however, not suitable as it states that the obligation to illustrate the cumulative cost effect should apply both ex-ante and ex-post and refers specifically to the services of portfolio management and investment advice.

  In our opinion, it should be clear that the respective illustration requirement is meant to assist clients with their understanding of the overall costs before the investment decision has been taken and therefore, applies only at the point of sale and not after the provision of the investment service. Consequently, there should be no obligation of credit institutions, other investment firms and portfolio managers providing investment advice to present their clients with any retrospective illustrations of costs and charges.

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

- **Draft Technical Advice, para 1:**
  Independent investment advisers and portfolio managers must not return payments received in relation to the services provided to a client "as soon as possible", but rather at "regular intervals".

- **Para 7:**
  Moreover, they should not be bound to disclose to the client the same information as they did ex-ante in course of the decision-making process of the client. Itemisation ii and iii should be deleted.

- **Para 9:**
  This paragraph should be annulled because there is no added value for the customers if all involved entities of a distribution channel disclose the same kind of information.

- **Q79:**
  Do you agree with the proposed exhaustive list of minor non-monetary benefits that are acceptable? Should any other benefits be included on the list? If so, please explain.

  We do not agree with the proposed exhaustive lists of minor non-monetary benefits. An exhaustive list with specified types of benefits would inappropriately limit the inducements rules under MiFID II Level 1. We think only a positive non-exhaustive list of benefits would be in line with the Level 1 text (1.). Further, we disagree with the proposed qualification of research. In particular, we have great concerns of the practical impact due to the view regarding the qualification of some type of research as prohibited benefits (2.). We therefore suggest to adjust the definition of minor non-monetary benefits and consider the proposed list as a non-exhaustive list of specified types of benefits which may fulfil such criteria (3.).

- **Exhaustive list narrows the Level 1 text inappropriately**
  We are aware how difficult it is to find an appropriate solution in this context. The EU legislator aimed to restrict benefits that may impair clients' interests. An exhaustive list of specified types of benefits would not restrict benefits that may impair clients' interests but also exclude benefits which would not impair clients' interests. Non-monetary benefits which appear legitimate under the Level 1 text would in practice be excluded from the exhaustive list. This would not be in line with Level 1 which just aims to restrict benefits that may impair client's interests. Further, the Commission's mandate does not require an exhaustive list: The Commission may adopt delegated acts which include criteria to assess compliance of firms receiving inducements with the obligation to act honestly, fairly and professionally in accordance with the best interest of the client (Art. 24 (13) sentence 1 (d) MiFID II). Moreover, the Commission did not request to draft an exhaustive list of specified minor non-monetary benefits. The Commission asked for a definition and conditions for acceptable minor non-monetary benefits (Commission's Request, p. 26). Nevertheless, we believe that a list of specified types of benefits would in practice allow to clearly identifying benefits which meet the Level 1 requirements and would give legal certainty for such payments. We therefore think that a list of specified types of benefits that is not exhaustive would be helpful in applying the MiFID II criteria. Benefits not listed would still have to fulfil the general criteria of Level 1 or the proposed definition at Level 2 in order to be allowed.

  We believe that the proposed definition of minor non-monetary benefits should be completed since the proposal is defining the term "minor" (No. 4 second sentence, p. 123 CP) but not the term "benefit". The definition should be in line with the MiFID II objectives of investor protection and dealing with conflict of interest's situations. Benefits require a person to receive services or goods that give an advantage. The indication describes benefits as being of a minor nature if they are reasonable and proportionate and of such a scale that they are unlikely to influence the behaviour in any way that is to the detriment of the interests of the relevant client. Though we generally agree with this approach, we think the definition is somewhat unclear. Since proportionality usually requires a reference to something it is difficult to find a reference here. If the investment firm is paid by the client, the proportionality of benefits received by a third party cannot be measured against such payments, since this would probably not make any difference in the investment firm's behaviour. We therefore think that the term "proportionate" should be deleted. Further, we do not see that the term "reasonable" has a specific meaning and suggest deleting this as well. Generally, we understand that any benefit that is unlikely to influence the investment firm's behaviour should be regarded as reasonable.

- **Research as non-minor benefit**
  We disagree with the proposal regarding the approach to deal with research as a minor non-monetary benefit in the course of portfolio management or independent investment advisors. Such approach is neither required by the Level 1 text nor suitable to enhance investor protection and hence inappropriate. Further, it will have significant impact to the market in practice, which will also be to the detriment of investors.

  The qualification of tailored research as prohibited non-minor benefit will have a huge impact on the current market and is not intended by the EU legislator. The proposal does not provide for an impact analysis regarding the effect the qualification of tailored research as prohibited non-minor benefit will have. We understand that the effect would lead to a massive increase of costs for active manager mandates in Europe. If active managers and investment management companies under the UCITS Directive or the AIFMD would have to pay for tailored research, this would (i) increase the costs for the investor, (ii) limit competition between research providers and (iii) reduce the access for smaller and medium sized companies ("SMEs") to research. In order to stay competitive, asset managers would have to reduce the number of research they take into account. This would lead to a concentration of research providers and less competition. Moreover, the remaining market players will not be interested in providing research for all SMEs with the consequence that such companies would have no research coverage. Since the access to research might be the pre-condition for an IPO or other financing, this contradicts the European approach to remove obstacles for SMEs to acquire long-term financing (see e.g. proposal for the Regulation on European Long-term Investment Funds). In addition, if active managers and investment management companies under the UCITS Directive or the AIFMD would have to re-price the services they offer, they will face competition at least from passive management and in particular from overseas managers. Investors might simply flee Europe and look for cheaper investment possibilities overseas. There, the manager is not supervised by a European authority and the national supervisors will have less influence regarding the practice of such manager. The EU legislator simply did not intend such change of the current market situation. Since the effect to the European Market regarding commission sharing agreements or similar practices would be significant, MiFID II Level 1 should have made a reference that the current situation should be revised. We therefore urge ESMA to reconsider the approach to allow for a genuine discussion on this subject before deciding on an approach which will have significant impact on the European Financial Market, to the advantage of the US and Asian market and to the detriment of the investor.

Tailored research may only be considered as a prohibited benefit if it may influence the recipient's behaviour in any way that is detrimental to the interest of the relevant client. ESMA does not provide any explanation why tailored research may influence the recipient's behaviour, except for the suggested risk of "churning" clients' portfolios. The churning of clients' portfolio, i.e. the execution of transactions for another purpose than increasing the client's return or reducing any losses, however, would in many cases lead to potential criminal liability. The mere possibility that such behavior might take place does not justify safeguards in addition to strong safeguards already existing. In this context any empirical justification that churning in fact takes place is missing, but only states that firm may be influenced to churn. Though tailored research may influence investment firm's behaviour, such behaviour is not necessarily to the detriment of the client. In fact, research directly assists the investment manager when making his investment decision and is therefore to the advantage of the client and not to his detriment.

Generally, publicly available research may not be considered as benefit and is therefore no inducement in the first place. As described before, by definition, a benefit requires an advantage. Hence, the person receiving the benefit must be in a better position than others. This is not the case if the research is publicly available since there is no advantage for the portfolio manager. Hence, such research might not be considered as benefit at all and is therefore not subject to the requirements regarding inducements in the first place. The same applies to tailored research which is to the benefit of a specific fund or a specific portfolio. Such tailored research does not give an advantage to the portfolio manager but to the portfolio and hence the client. Therefore it cannot be regarded as benefit for the portfolio manager.

We understand the general notion and intention of unbundling certain services. Unbundling might be achieved in several ways, in particular by way of disclosure or by way of prohibition. MiFID II itself provides for the former. The bundling of services per se is allowed as long as the client is informed of the packaging and the costs and charge of each component (Art. 24 (11) first sub-paragraph). Disclosure would be the less strict measure. This is required by the Level 1 text and will achieve the necessary transparency without significantly changing the market and increasing prices to the detriment of the client.

- **Definition of non-minor benefit and non-exhaustive list**
  Based on this, we suggest the following definition and non-exhaustive list for minor non-monetary benefits.

  A minor non-monetary benefit is a service or good, which gives the recipient an advantage of such scale that it is unlikely to influence the recipient's behaviour in any way that is detrimental to the interests of the relevant client.

  By example, the following benefits can be considered as minor benefits:
  Information or documentation relating to a financial instrument (including financial research) or an investment service. This information could be generic in nature or personalised to reflect the circumstances of an individual client;
  participation in conferences, seminars and other training events on the benefits and features of a specific financial instrument or an investment service; and
  hospitality of a reasonable de minimis value, this could for example include food and drink during a business meeting or a conference, seminar or other training events mentioned under ii.

- **Q80:**
  We do not agree with the proposed approach for the disclosure of monetary and non-monetary benefits, in relation to investment services other than portfolio management and advice on an independent basis.

  We object, however, to the proposal in para. 7(ii) that investment firms providing one-off services should be obliged to inform their clients ex-post about the exact amount of the inducements received if they were not able to provide such information at the point of sale. Such requirement of additional ex-post information is not covered by Article 24(9) of MiFID Level 1 which acknowledges the disclosure of the relevant calculation method in terms of inducements as fully adequate. Moreover, the added value of such additional disclosure is very limited given the fact that the investment decision has already been taken by the client and there is no continuing relationship with the investment firm.

  It seems as one would like to justify the excessive "ex-post"- and "on-going"-disclosure requirement proposed in the CP, by subsuming inducements under the regulations on information to clients on costs and charges (where such disclosure requirements are expressly regulated in the Level 1-Directive). Thus, the CP (page 104 "2. 14. Information to clients on costs and charges", para 26) is advised that third party payments received by investment firms should be regarded as part of the cost of the service, in order to reflect the fact that the client will pay them through the charges of the price of the financial product. This recommendation is rejected, as there is no indication in the Level 1-Directive that could justify such an assumption. Having provided two different sets of regulations with regard to disclosure requirements (Article 24 para 4 with regard to costs and charges and Article 24 para 9 with regard to fees, commissions and other monetary benefits), it seems clear, that the Level 1-Directive clearly distinguishes in this point between costs and charges on the one hand and fees, commissions and other monetary benefits on the other hand. Furthermore, if fees, commissions and other monetary benefits were to be considered as part of the cost of the service, the Level 1-Directive could have implemented this by either mentioning this instance in Article 24 para 4 or by inserting a cross-reference to Article 24 para 4 in Article 24 para 9.

  In consequence, we ask to delete para. 7 (ii) of the draft technical advice on page 123 as well as the second sentence in para. 34 on page 106 which indicates the ex-post disclosure requirement (cf. also our reply to Q 79).

- **Q81:**
  We disagree with the elaboration of a non-exhaustive list of circumstances and situations that CNAs should consider in determining when the quality enhancement test is not met.

  In particular, we would like to emphasize that the technical advice on the circumstances and situations that should be considered with regards to the quality enhancement tests go beyond the Level 1 Directive. The Level 1 Directive does not provide for a general prohibition on accepting and retaining fees, commissions or other monetary benefits with regard to investment services other than independent investment advice or portfolio management.

  The technical advice could implicate a "de-facto"-ban of inducements, as the criteria proposed are too strict and therefore make it almost impossible to justify inducements received respectively paid in connection with the provision of an investment or ancillary service as being quality enhancing. The requirement for enhancing the quality of services should already be achieved by meeting the – already far-reaching and the possible services covering – regulatory requirements in a manner that it can be seen as providing a good and valuable service to the client.

The EU legislator has decided to further allow payments of inducements (in compliance with MiFID II Level 1 criteria). The proposed negative list, however, seems to disregard this approach because it remains totally unclear under what condition a payment could be allowed in future (1.). The MiFID II regime implies a positive list of criteria since the Commission is empowered to adopt delegated acts to ensure that investment firms comply with the principles set out in Art. 25. In particular, these shall include criteria to assess compliance of firms receiving inducements and not criteria for non-compliance (2.). We therefore suggest a list of positive (alternative) criteria which would be in line with the requirement of the Level 1 text and the general decision of the EU legislator that MiFID firms may still receive and pay commissions if these are designed to enhance the quality of the relevant service to the client (3.)

A negative list is not in line with the EU legislator's decision regarding payment of inducements.
The negative list disregards the EU legislator's decision regarding payment of inducements. The EU legislator has decided to allow both commission-based and fee-based advice, the former as long as the payments are designed to enhance the quality of the service and do not impair with the firm's duty to act in accordance with the best interest of its clients. The MiFID II Level 1 text states that investment firms should have the choice between independent and non-independent advice (see recital 73). One reason for this decision is that a prohibition of such payments would significantly decrease the private clients' access to investment advice including advice for pension provision solutions. Studies show that only the minority of the society is prepared to pay for advice. For example, according to a recent German study only 19 percent of the respondents would be prepared to pay at all for independent advice regarding pension provision solutions; the average amount respondents would be inclined to pay is EUR 35.[2] Such amount, however, would not be sufficient to cover all costs which a MiFID firm has to provide for advice, in particular personnel costs and costs for regulatory compliance.

Non-independent advisors must therefore remain allowed to be remunerated through commission payments. The proposal it is unclear how any payment of distribution commissions may be regarded as being designed to enhance the quality of the service. First, it is not clear which payments would fulfil the negative criterion that they are used to pay or provide goods or services essential for the recipients firm in its ordinary course of business (No. 10 (i), p. 124). Any reasons why the use of payments for goods or services essential in the ordinary course of business cannot be considered as designed to enhance the quality are missing. We believe that there are situations where e.g. a service would not be provided at all to clients without the commission payment. It might simply be too expensive for an investment firm to provide for investment advice if commission payments are prohibited, in particular in less populated regions. In addition, the objective of the inducements provision is to enhance investor protection. The prohibition in this case would, however, lead to a complete different effect, since investors would not be advised at all and therefore less protected. Hence, the criterion "designed to enhance the quality of the service" should not be defined in a way that payments cannot be used to provide for the provision of the service or the pay-

[2] Steinbeis Research for financial services, Altersvorsorgereport: Deutschland 2014, p. 8, see: www.sparda-bank-hamburg.de/pdf/news/Altersvorsorgereport_2014_Final.pdf.

ment for goods, since this might be in the client's very interest. This criterion should therefore be deleted.

Secondly, the negative criterion of a firm not providing a higher quality above the regulatory requirements disregards the fact that in many terms, the Level 1 text or the proposal provides the highest possible standard already. Due to this, it might in practice not be possible to generally increase such high standards. For example, according to ESMA's proposed technical advice, investment firms have to be able to demonstrate that they assess whether alternative financial instruments, less complex or with lower costs could meet their client's profile. According to ESMA, it is hence not sufficient to provide for a suitable product but it seems as if the firm has to rule out that no other product available in the market is more suitable. The quality for such standard might not possibly be enhanced above the regulatory requirements. In fact, in such case it would in practice not be possible to pay or receive inducements since there would be no room for it to be designed to enhance the quality. Consequently, the applicability of the second negative criterion would in such case lead to a prohibition of inducements, which was not intended by the EU regulator. We therefore believe that in some cases the compliance with regulatory requirements should be sufficient to generally enhance the quality of the service.

Thirdly, it is unclear how the criteria enumerated are related to each other. In particular, it is uncertain how the positive criteria of enabling the client to receive access to a wider range of suitable financial instruments or the provision of non-independent advice on an ongoing basis (para. 11, p. 124) relate to the negative criteria (para. 10, p. 124). In our view, payments fulfilling any of the positive criteria have to be considered as being designed to enhance the quality regardless of whether in addition any of negative criteria is fulfilled. This means that granting a client access to a wider range of suitable financial instruments should be per se considered as designed to enhance the quality even if the payments to get such access are used to pay for goods or services that are essential for the recipients firm. This also shows that the list of positive alternative criteria would not provide for questions regarding the relation between several positive or negative criteria but would allow for a clear distinction what fulfils the requirement to be designed to enhance the quality of the service.

- **Negative list not appropriate to assess compliance but only non-compliance**
  MiFID II Level 1 empowers the Commission to adopt delegated acts which include the criteria to assess compliance of firms receiving inducements with the obligation to act honestly, fairly and professionally in accordance with the best interest of the client (Art. 24 (13) sentence 1 d). This means that the Commission has to define criteria according to which firms may know that inducements received or paid may be regarded as enhancing the quality.

  A list of negative criteria does not allow firms to assess whether the way they act is in compliance with the condition that the receipt or payment of inducements is designed to enhance the quality. It only shows when it is not designed to enhance the quality. Hence, it further narrows the Level 1 text. Further restricting requirements on payment or receipt of inducements is allowed for Member States when implementing MiFID II (see recital 76); however, the Level 1 text does not indicate that there is allowance to further narrow such requirements in the Level 2 Delegated Acts.

- **Positive list of criteria would be in line with Level 1 and able to achieve greater convergence across Europe**
  ESMA rightly points out that MiFID II aims to strengthen the current MiFID regime by distinguishing between investment advice on an independent basis and other invest-

ment services. There is no indication though that the EU legislator felt that the criterion "designed to enhance the quality" should be tightened. MiFID II Level 1 only incorporates the wording which previously was part of the MiFID I Implementing Directive. The Commission requests measures further detailing the criterion of enhancing quality in order to achieve greater convergence in its application across Europe (Commission's Request, p. 25). This does not mean that the preconditions for inducements payments have to be tightened. Notwithstanding the fact that the negative list not in line with MiFID II for formal and material reasons, we believe that a positive list is at least as appropriate to achieve convergence like a negative list. Unlike a negative list, a positive list will give the market participants legal certainty and will allow them to comply with the criteria instead of trying to avoid the negative criteria and still being not sure whether the payment would be considered as designed to enhance the quality. By this it will achieve greater convergence since the market participants can rely on these criteria.

For such list, it seems appropriate to use ESMA's ideas regarding the criteria "designed to enhance the quality of the service" by transferring the negative approach into a positive one. We therefore suggest the following approach:

A payment can generally be regarded as fulfilling the criteria "designed to enhance the quality of the service", if

- it provides for an additional or higher quality service above the regulatory requirements provided to the end user client;
- it provides a tangible benefit or value to the recipient's end user client;
- in relation to an on-going inducement, it is related to the provision of an on-going service to an end user client.
- it enables the client to receive access to a wider range of suitable financial instruments; or
- it enables the client to receive the provision of non-independent advice on an on-going basis.

Our position can also be summed up by the following points:

- If credit institutions receive inducements from issuers of financial instruments that can be regarded as market standard brokerage or sales commissions, this should be considered a compensation for a service provided by the credit institution. It should not be considered preferential treatment of the credit institution at the customer's expense.
- Credit institutions shall be allowed to receive trailer fees if they continue to act in the customer's best interest and if they use at least part of these fees or use them as an opportunity to improve the knowledge and service quality concerning the respective financial instrument to the customer's benefit.
- Inducements, such as trailer fees, that are used to build or maintain efficient and highquality infrastructures for buying and selling financial instruments are also enhancing the service quality.

It should be understood that a fee, commission or non-monetary benefit could be considered acceptable as long as any such service is provided without bias or distortion as a result of the fee, commission or non-monetary benefit being received.

- **Q82:**
  Do you anticipate any additional costs in order to comply with the requirements proposed in this chapter? If yes, please provide details.

  We strongly believe that if the approach is not reconsidered additional costs would arise for clients and investment firms. As stated in our answer to Q79, we believe that the approach regarding tailored research as non-minor monetary benefit will significantly increase the costs for active portfolio management and investment advice. We therefore urge to reconsider this approach. Further, the significant inhibitions for commission payments in relation to non-independent advice have the potential of changing the market of investment service provision in Europe except for the markets where commission based advice is already banned. As explained above, we believe that this will also have a significant impact on costs for clients and investment firms.

2.17 Suitability

- **Q86:**
  The existing suitability requirements are sufficient. There is no need to expand the requirements any further.

- **Draft Technical Advice, para 3:**
  Any further personalization of the mass business is not possible without completely losing the automation.

2.18 Appropriateness

- **Q90:**
  Do you agree the existing criteria included in Article 38 of the Implementing Directive should be expanded to incorporate the above points, and that an instrument not included explicitly in Article 25(4)(a) of MiFID II would need to meet to be considered non-complex?

  Yes, we agree. As regards investment funds, we believe that open-ended non-UCITS (i.e. alternative investment funds – AIF) can generally fulfil the new criteria and could therefore still meet the definition of a non-complex financial instrument. In this regard we strongly disagree with the conclusion regarding shares in AIFs (see para. 7, p. 137). MiFID II Level 1 does not signal that shares in AIFs should not be considered as non-complex (1.). The general treatment of AIFs as complex products would be inappropriate (2.). It should be made clear that AIFs may meet the requirements of instruments being considered as non-complex.

1. **No indication by the Level 1 text regarding complexity of AIFs**
   MiFID II Level 1 indicates only what instruments should be considered as non-complex without any prejudice to other instruments of the same legal type. MiFID II only enumerates instruments which can be considered as non-complex. All instruments not included explicitly in Art. 25 para. 4 (a) MiFID II have to meet the test in order to be considered non-complex. Explicitly included instruments comprise shares admitted to trading on a regulated market, excluding shares in AIFs. The reference to shares in AIFs only makes clear that AIFs cannot automatically be considered as non-complex just because they are listed. The legislator did not intend to include a presumption regarding the complexity of AIFs in general. The intention was just to avoid that a management company would list shares in AIF in order to allow these to be considered non-complex. This is supported by the wording of the exclusion in Art. 25 (4) (a) (i) MiFID II: It only comprises “shares” in non-UCITS and not “shares or units” in non-UCITS. The latter is the usual wording if any general reference is made to interests in funds because of the different legal forms that funds may take (corporate, contractual or

trust structure). A fund's legal form, however, does not prejudice whether its interests should be considered as complex or non-complex. Hence, it can be derived from the wording that the EU legislator did not intend to signal that AIF in general have to be considered as not non-complex.

2. General treatment of AIFs as complex would be inappropriate

A general treatment of AIFs as complex would be inappropriate. AIFs cover a broad range of products. On the one hand, these include single hedge funds with leverage and short-selling strategies or closed-ended funds which might lead to further liability for the client. Such product will likely be considered as complex. On the other hand, AIFs also include (i) highly regulated retail funds that only differ from UCITS insofar as they may invest in precious metals or (ii) highly regulated open-ended real estate investment funds. Those funds today meet the requirements of instruments being non-complex and according to our understanding will also comply with the two new criteria suggested. They should therefore still qualify as non-complex under the MiFID II regime.

Therefore, we urge to confirm in its final advice to the Commission that there is no presumption that AIFs are not to be considered non-complex. At least ESMA should delete the presumption in para. 7 of the analysis (p. 137) regarding shares in AIFs.

- **Q91:**

  Are there any other areas where the MiFID Implementing Directive requirements covering the appropriateness assessment and conditions for an instrument to be considered non-complex should be updated, improved or revised based on your experiences under MiFID I?

  We see currently neither any further regulatory need to revise the requirement for an instrument to be considered non-complex nor the requirements for the appropriateness assessment.

2.19. Client agreement

- **Q92:**

  Do you agree that investment firms should be required to enter into a written (or equivalent) agreement with their professional clients, at least for certain services? If yes, in which circumstances? If no, please state your reason.

  We believe that the requirement to enter into a written agreement with professional clients is questionable. According to the Level I text, professional clients are capable of making their own investment decisions and understanding the risks involved.

  Professional clients are allowed to request non-professional treatment.

  Therefore we do not consider that there is a need to regulate how investment firms contract with their professional clients or to prescribe rules regarding the contents of their contracts.

  As rightly stressed in the consultation paper, in practice relationships between investment firms and professional clients very often result in written agreements, in particular to provide legal certainty. Imposing a legal requirement where there are not market failures would be over-prescriptive.

The potential costs of new requirements imposed on new and existing client relationships are considerably high.

- **Q93:**
  Do you agree that investment firms should be required to enter into a written (or equivalent) agreement for the provision of investment advice to any client, at least where the investment firm and the client have a continuing business relationship? If not, why not?

  Imposing a written (or equivalent) agreement for the provision of investment advice to retail clients can be a reasonable step. It will likely promote legal certainty and investor protection. We agree with the proposal to exclude one-off investment advice to clients from the requirement for a written agreement.

  The same considerations referred in answer Q92 apply to an advisory relationship between an investment firm and a professional client. The client can decide whether or not to take the advice as a professional, because he has the knowledge and experience to do so. Accordingly, there seems no need to require a compulsory written (or equivalent) agreement for the provision of investment advice to professional clients.

2.20 Reporting to clients
Draft technical Advice, para 7: We oppose the introduction of a quarterly statement since the costs would not be in reasonable proportion to the benefits received. An annual statement and on-request statements sufficiently provide for a regular and high quality reporting to clients.

Please take our remarks into due consideration.

Yours faithfully,

Dr. Franz Rudorfer
Managing Director
Division Bank and Insurance