EU Commission consultation on

"Options to enhance the suitability and appropriateness assessments"

Consultation published 21 February 2022

EUSIPA final response
(Filed 21 March 2022)

(Quotes from this document are permitted but strictly require the source indication.)

Introductory statement:

Before outlining our position EUSIPA wishes to mark up its utter discomfort with the very short deadline set by the EU Commission to respond to this consultation. While we understand the effort needed to draft a legally sound and practically implementable Retail Investment Strategy to which this consultation obviously is meant to contribute, we hint at the likely detrimental effect overly short or inadequately set deadlines long-term have on the quality of input the Commission will receive.

Question 1.

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

Answer: No.

EUSIPA, the European umbrella association for the issuers of structured products in the EU, the UK and Switzerland, clearly wishes to express the opinion that such a new regime would not address weaknesses in the MIFID suitability and appropriateness regime as is currently applied.

Absence of evidence for weaknesses

First and foremost, EUSIPA does not support the view that there are weaknesses in area of the MIFID suitability and appropriateness verification practice that have to be addressed.

In line with statements made in this regard earlier, EUSIPA takes this consultation again as an occasion to distinctly mark up the imperative need for substantiating any such broad claims of existing "weaknesses" with **concrete quantitative evidence** sourced in from a structured observation/analysis of major representative parts of the EU's internal market in retail financial services.

Within that context, EUSIPA is convinced that any serious effort to quantitatively analyse the retail markets on this aspect (the weakness of the current suitability and appropriateness regime) could also rather easily have been undertaken. Core benchmarks in that regard, such as for example, any significant increase in consumer-related litigation, increased levels of investor complaints compared with previous reference periods at financial ombudsmen or probably even abnormally high sales outside the defined target market, might have easily delivered quantitative evidence allowing to judge the existence of major weaknesses in the current suitability and appropriateness regime, of which, to state the obvious, EUSIPA and her members from their practical experience across non-advisory and advised distribution are **not** aware.

Material arguments

Outside the ambition to tackle assumed weaknesses in the current appropriateness and suitability regime, the Commission proposal might be understood as an effort to foster retail investor mobility in terms of facilitating cross-market and cross-institutional investment activities. However, even under such a hypothesis EUSIPA does not think that implementing a standardised retail investor assessment regime, resulting in a corresponding investor profile from which personalised asset allocation plans are derived, would be of added value.

The main argument for this conclusion is rooted in the fundamental concern of EUSIPA and her members that the structural embedding of a client suitability and appropriateness profiling exercise and a corresponding asset allocation strategy **would bring about an unnecessarily static element** in the distribution process that rather hampers than promotes the engagement of retail investors on financial markets.

- Administrative burden and efficiency

The suggested standardisation would embrace three layers, namely (i) the information gathering at the retail point of sale to be handled by the distributor, (ii) the actual assessment of suitability and appropriateness aspects based on this information and finally, (iii) the establishment of a portfolio strategy and its communication to the investor.

Judging from the practical experience there would be, at all three mentioned levels, highly detailed and thus complex templates needed to be introduced to cover all relevant aspects of a financial institution's customer audience and the (theoretically) available landscape of products. Such templates would need to be of a quality that they could be used in the entirety of the internal market. However, as is the case with all efforts aiming to base business interaction on templates-sourced information, there will realistically be many scenarios that are not adequately covered or which require a specific (template) coverage only relevant in the national market context, may it be for tax reasons, national marketing/distribution rules or other reasons.

Alternatively, in order to make national market specifics less relevant, such template-based exercise in the EU would need to be done on an even higher level of standardization bringing with it an even higher likelihood that individual investor and market aspects are not taken into account and that any derived conclusion such as the asset allocation strategy finally is insufficient or mis-informed and unsuited for the investor's use.

- Customer assessment and its portability

Strong doubts remain whether the creation of a portable assessment actually delivers added value to the retail investor.
The portability aspect is logically linked to the engagement with another (new) financial service provider the investor has no relationship with yet. While in theory there may be many reasons for engaging with new financial institutions, it seems rather likely that doing so is triggered in many

cases by a new personal situation at the end of the investor (e.g., new income/wealth situation, changing investment targets including mortgaging or a broadening of financial activities by way of accessing new products which required a knowledge upgrade, for example crypto-assets, etc).
Most such aspects will raise the question as for the validity of the previous suitability and appropriateness profiling. In practice this may lead, rather often than not, to an in-depth verification if not a complete rerun of the profiling exercise.

A more fundamental legal concern with regard to customer assessment profiles being made portable between financial institutions is the issue of liability in case the assessment was done incorrectly at one institution but has to be used by another.

This may create not only internal compliance issues but also would probably make it necessary to exempt financial institutions from any liability towards the investor/client when they use suitability and appropriateness assessments made elsewhere in the European Union. Especially in a cross-border context this would lead to the somewhat difficult situation that customers who, for example, have been offered products in a host market have to take recourse to the bank in their home market for flaws in the original assessment exercise, resulting foreseeably in legal disputes on whether the damages that compensation is sought for, have actually been caused specifically by the use of the assumingly flawed initial assessment in the host country or not. In the worst case, courts may have to judge on distribution practices of financial institutions in another jurisdiction.

Looking at this issue more broadly from a practical perspective it seems rather likely that the portable use of the investor profile will lead to many practical questions and legal uncertainties without delivering the added value in terms of speeding up the investor onboarding process and/or facilitating retail investor capital market activity.

- Personal Asset Allocation Strategy (PAAS)

EUSIPA is not convinced that the systematic establishment of a PAAS would help with improving the access of retail investors to or the quality of their engagement on the EU's financial markets.

The fundamental weakness of the PAAS idea is that such strategies if developed on a broader basis for mass retail audience, will almost necessarily be established by using standardised clusters of customer profile features and are then matched, by way of a predefined methodology which itself is based on certain assumptions, with a likewise standardised range of assets.

This approach will lead to numerous unwanted evolutions in the retail market investment landscape for the following reasons:

- (Standardisation and methodology-based approach to collide with retail needs)
  Judging from the above-mentioned likelihood of PAASs ultimately using standardised methods to a high extent, necessary to handle the practical implementation of such a tool on a broader basis involving millions of retail customers, PAASs will almost always deliver results that systematically disregard certain individual investor preferences.

More precisely, the definition of a fixed methodology in order match customer assessment profiles with asset allocations brings likely such limitations as assessment methodologies from practical experience are always grouping/generalising a range of individually captured aspects.

One question arising in this context, for example, is related to which dimension in the allocation process is to be the dominating one. To illustrate: rather than grouping assets by their riskiness and wrapper profile, which would be one approach, it also is commonplace in capital markets to have first and foremost a sectorial or country focus or to allocate assets only to tax-privileged structures and products[i] or to choose the as a “first dimension” specific other aspects (such as the ESG quality of an entire product range).

EUSIPA considers it highly unlikely that any methodology is technically sophisticated enough to cater for all such possible selection aspects of which the above named are but illustrative examples. The resulting one-size fits all approach or even an approximation to such however would be something that does not cater for the many varying investment needs and purposes of today’s retail population differing in levels of age, digital awareness, financial literacy and investment time horizon to name just a few.

It would, overall, be a step back in the evolution of the EU’s retail market in financial services.

- (Biased outcomes)
  PAASs are, again depending on the methodology underpinning the asset selection process, highly exposed to the danger of delivering biased outcomes, if for example the methodology promotes internal over third-party products, mainstream over more sophisticated (but not necessarily riskier) products or ESG over non-ESG products, without such distinctions being asked for or properly explained/understood by the investor.

- (Potentially broader asset mis-allocation)
  PAAS are, if developed on a broader basis for the mass retail market, also likely to increase the macroeconomic (systemic) risk of wrong asset allocation as they will likely channel investment to specific types of assets.
  Due to sheer amount of assets involved should retail investors on a larger scale follow specific asset allocations from insufficiently developed or updated PAAS, any structural misallocation may have larger macroeconomic impacts in the internal market.

- (Investor learning disincentive)
  PAAS are likely to massively disincentivize the retail investors’ willingness to understand financial products in general, including a disregard for the risk-yield relation. The latter seems particularly relevant as investors will likely assume that any “allocation strategy”, developed for them, is essentially set up to maximise the profitability of their investments which is often not the case (for example if capital preservation is identified as main investment target).

- (Hampering adequate response to market changes)
  PAAS structurally suffer from the same problem that applies to the retail investor assessment profile as indicated above, namely its cumbersome static character, which makes it difficult for investors to quickly deviate from the PAAS for reasons of changing markets.

- (Infringing with existing standard portfolio offerings)
  Last not least, PAAS massively and unnecessarily disturb the highly dynamic and sophisticated markets of financial intermediaries offering already today model portfolio solutions. It should be noted that retail investors wishing to structure their capital market exposure in a clustered and standardised way across certain asset classes can do so already today by using the manifold model portfolios investment options offered at most financial institutions, including mainstream retail banks across a broad range of risk levels, sector/country exposures and legal wrappers.

For the above reasons, EUSIPA clearly speaks out against introducing a standardised retail investor regime and the establishment of Personal Asset Allocation Strategy.

Question 2

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

• No, it would not bring them specific benefit

EUSIPA is not of the view that a new retail client assessment (enhanced with a personalised asset allocation strategy) would bring benefits to the participants in financial retail markets. Rather it would be of a detrimental impact. As for the single reasons for our position we make reference to the answer provided to question 1, above.

Question 4

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

Yes, EUSIPA would see such drawbacks of a substantial magnitude. We refer to our statement provided as answer to question 1 above, setting out the details.

Question 5

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

While EUSIPA strictly upholds its general rejection of both the idea to run standardised investor assessments and derive from their results asset allocation strategies, EUSIPA would, in case the Commission nonetheless goes ahead with proposing more concrete plans on the implementation of above concepts, only support the notion that the assessment and strategy are possible to be developed by any financial intermediary selected by the retail investor (first bullet of answer choices).

Main reasons for this view is that such an approach would come closest to the current market practice while also allowing a maximum of choice for the retail investor who otherwise is forced to engage with institutions that often do not even exist yet (independent functions at intermediaries) or are currently not part of the regular retail business landscape (public bodies).

Question 13.

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

No.

EUSIPA is, as stated before, opposed to any plans introducing personalised asset allocation strategies for retail investors derived from standardised investor profiles. Independent of the absence of any shortcoming in the current regulatory environment that would suggest the need for developing such plans, EUSIPA is convinced that using standardised elements in the evaluation of customers, the choice of assets and/or the methodology of matching customers and assets evaluated/selected in such way, is detrimental to the evaluation of the EU's retail market(s) in financial services.

As for the details of our position we take recourse to the many arguments laid out in that sense in a structured argumentation in our answer to question 1, above.

Question 14.

Which elements should form the basis for distinguishing between asset classes within the asset allocation strategy?

☐ Risk ☐ Return ☐ Paired correlation with other asset classes ☐ Additional criteria

EUSIPA strictly upholds its general rejection of both the idea to run standardised investor assessments and derive from their results asset allocation strategies.

EUSIPA would in case the Commission nonetheless goes ahead with proposing more concrete plans on the implementation of above concepts, advocate to indeed base the asset allocation on risk and return aspects only, leaving the consideration of any further aspects to the investor and/or the expertise offered by professional advisers. This would also be consistent with the current practice where the information provided at the retail point of sale, e.g., in the format of the PRIIPs KID gives more details on risk and return related aspects while other aspects relevant for the investment can be inquired through advisory services.

Question 15.

Exposure to assets, as set out in the asset allocation strategy, could be achieved either by investing directly in securities (e.g., shares, bonds), or via investment in potentially complex financial products (e.g., funds, structured products, insurance-based investment products) or a combination thereof. How should a financial intermediary assess best value-for-money when considering asset classes or sub-asset classes offering the optimal exposure for the retail investor?

EUSIPA strictly upholds its general rejection of both the idea to run standardised investor assessments and derive from their results asset allocation strategies. With specific regard to the above question, we wish to mark up our concern that it mingles different evaluation perspectives.

Appropriateness and suitability are to be strictly separated from any value-for-money (VFM) assessment. Neither can VFM be seen as a simple additional criterion refining the choice available once appropriateness and suitability have been verified. VFM needs to be thoroughly defined as it can easily be misunderstood by financial market participants and investors alike. It is, likely for that reason, not established in the EU regulatory landscape a reference mechanism (such as appropriateness/complexity, suitability or target market).

Question 16.

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

EUSIPA strictly upholds its general rejection of both the idea to run standardised investor assessments and derive from their results asset allocation strategies.

With regard to question 16 EUSIPA wishes to point out that the question itself already reconfirms the weakness of the consulted new ideas. We take reference to the comments made in that sense in our answer to question 1, especially those referring to the inflexibility brought about by the creation of a recommended or binding corset/frame of eligible assets in the form of the asset allocation strategy, the deviation from which is likely to trigger retesting, exemption procedures and in any case extensive documentation, all of which creates new legal uncertainty and will certainly require and result in new regulatory guidance.

Question 17.

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

EUSIPA strictly upholds its general rejection of both the idea to run standardised investor assessments and derive from their results asset allocation strategies.

With regard to question 17, EUSIPA wishes to point out that the question itself already reconfirms the weakness of the consulted new ideas. We take reference to the comments made in that sense in our answer to question 1, especially those referring to the collision of client profiles that ay occur in a sense that a new profile allows for broader investments than the previous one and also the reverse situation that a new profile is narrower than the previous one both of which is likely to lead to unsatisfactory/biased product offerings, legal uncertainty and investor frustration.

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[i] Examples for such tax incentives that channel huge amounts of client assets to financial products covered by them are the *Plan d'Epargne en Actions* (PEA) in France or the Branch 21 and Branch 23 insurance-linked products in Belgium which grant a tax advantage (capital gains tax exemption or reduction) to the retail investor.