Verband der Auslandsbanken in Deutschland e.V.
Association of Foreign Banks in Germany

December 30, 2021

Comments by VAB (Association of Foreign Banks in Germany) on

ESMA Call for evidence on the European Commission mandate on certain aspects relating to retail investor protection (ESMA35-43-2827)

Q1: Please insert here any general observations or comments that you would like to make on this call for evidence, including any relevant information on you/your organisation and why the topics covered by this call for evidence are relevant for you/your organisation.

We are an industry association in Germany, representing about 200 international banks, investment firms and asset managers. Our members are particularly affected by the issues discussed in the Call for evidence, because for a lot of them the service to retail clients in the area of investment services is part of the business model in Germany. Many also service wealthy retail clients with whom they entertain long-lasting client relationships, some over many decades.

One overarching concern of our members and their clients is not addressed in the more specific questions raised, and that is the insufficient possibility to opt out of documentation requirements. In our members' experience, clients regularly ask what is possible to reduce the overwhelming administrative burden caused by law or the regulators. Especially experienced and/or wealthy clients oftentimes do not understand how rules and regulations that were originally designed to protect inexperienced retail clients are applied to them and there is no or at least very limited possibility to "opt-out". There should be an additional possibility for individual agreements between firms and clients to avoid documentation needs. Today, the situation is such that documents are regularly prepared by firms but instantly thrown away by clients, which is not a sustainable approach.

Moreover, the classification criteria for opting up to professional client status are too limited and not meaningful. More often than not, the professional working background in the financial sector is not given and the specified minimum number of transactions is unattainable due to long-term investment

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horizons of these clients. Rational and meaningful long-term investing is disincentivised by this criterion. In addition, firms are told by regulators to enable opting in professional client status only where the client account with that firm exceeds 500K. This disincentivizes risk-spreading on the clients' part and ignores their overall risk-bearing ability. The opt-in criteria for the professional client status should be amended accordingly.

Q2: Are there any specific aspects of the existing MiFID II disclosure requirements which might confuse or hamper clients' decision-making or comparability between products? Are there also aspects of the MiFID II requirements that could be amended to facilitate comparability across firms and products while being drafted in a technology neutral way? Please provide details.

See our answer to Q 5.

Q3: Are there specific aspects of existing MiFID II disclosure requirements that may cause information overload for clients or the provision of overly complex information? Please provide details.

Yes, e.g. if a client often trades in the same kind of financial instrument, the overload of always the same information packages will hinder the client and the firm to execute the trades in an effective manner. More flexibility would be welcome to enable clients to forego pieces of (unnecessary or duplicate) information.

Q4: n.a.

Q5: What do you consider to be the vital information that a retail investor should receive before buying a financial instrument? Please provide details.

In our opinion, there has to be a distinction between the question of "how much information" and the timing of that information.

The big issue behind this questions is when and how often investors should be confronted with that information. Investors would appreciate the following:

- No interference with time-to-market, i.e. no delayed order execution because of regulatory documentation requirements where the client chose a means of order execution that should provide for swift execution in the framework of execution-only or non-advisory order execution.

- No interference with technical means of order processing the client chose, i.e. regulatory burden should not result in the closure of specific order routing technology due to the impossibility to fulfill documentation requirements. E. g. it is technically impossible to provide information on costs directly before every transaction where the client uses 1-click-trading or applies an API interface to forward trades generated by algorithms (and yes, there are actually retail clients that are highly sophisticated and operate such trading activities, but nevertheless do not qualify for a professional client status under the present law).

Both aspects above imply that information/documentation should be limited to a necessary minimum and the information process should be decoupled from the order execution process. This can be done by providing information well before transactions, most preferably at the time of client onboarding, otherwise at a time new products are intended to be invested or traded. Accordingly, clients and investment service providers should be allowed to choose the timing of information so that it serves the client's needs.

Unfortunately, in this context it also seems quite obvious to us that a transfer of more aspects of the suitability assessment into the appropriateness test, as currently discussed by ESMA, could prove to be a counterproductive policy move to the detriment of sophisticated clients' interests.

Q6 to Q8: n.a.

Q9: On the topic of disclosures on sustainability risks and factors, do you see any critical issue emerging from the overlap of MiFID II with the Sustainable Finance Disclosure Regulation (SFDR) and other legislation covering ESG matters?

Yes, it makes the disclosures even more complex and less attractive for clients to read through, especially where clients do not want to align their investment strategy to ESG criteria.

Q10: Are there any other aspects of the MiFID II disclosure requirements and their interactions with other investor protection legislations that you think could be improved or where any specific action from the Commission and/or ESMA is needed?

See our answer to Q1 and Q5.

Q11: n.a.

Q12: Do you observe a particular group or groups of consumers to be more willing and able to access financial products and services through digital means, and are therefore disproportionately likely to rely on digital disclosures? Please share any evidence that you may have, also in form of data.

In the area of inexperienced investors, we do not see any particular group being more drawn to digital means, and being more reliant on digital disclosure.

However, in the area of more sophisticated investors, we observe the contrary: They do react to attempts to forcibly inform them, especially where the information process interferes with the order execution process.

Q13-Q22: n.a.

Q23: Do you think that any changes should be made to MiFID II (e.g., suitability or appropriateness requirements) to adequately protect inexperienced investors accessing financial markets through execution only and brokerage services via online platforms? If so, please explain which ones and why.

No, we do not think that changes to MiFID II are necessary. More precisely, we fear that such changes would most presumably be motivated and designed as to discourage using modern technology, i.e. online platforms for execution-only and brokerage, in an attempt to paternalistically direct investor behaviour away from direct investments and towards indirect and actively sold investment products (i.e. funds, insurances etc.), which, as is demonstrated by numerous studies time and time again, regularly underperform their benchmarks.

We think that the right path to create investor participation in capital markets, as well as promote financial literacy, is to keep access open and allow for some degree of individual engagement and learning experience within the already existing regulatory boundaries of caution laid down in MiFID II (i.e. restrictions to execution-only for complex instruments, appropriateness tests, client information requirements).

Unfortunately, in this context it also seems quite obvious to us that a transfer of more aspects of the suitability assessment into the appropriateness test, as currently discussed by ESMA, could prove to be a counterproductive policy move, especially to the detriment of sophisticated retail clients' interests. ESMA should bear in mind that the active participation of sophisticated retail clients is paramount for achieving the goals of the Capital Market Union.

Q24: Do you observe business models at online brokers which pose an inherent conflict of interest with retail investors (e.g., do online brokers make profits from the losses of their clients)? If so, please elaborate.

No, we do not observe online brokers making profits from losses of their clients. If so, such demeanor would already be illegal/non-compliant under existing law.

Q25: Some online brokers offer a wide and, at times, highly complex range of products. Do you consider that these online brokers offer these products in the best interest of clients? Please elaborate and please share data if possible.

It is perfectly in line with the goals of the Capital Market Union to enable investors to access a wide range of products. We think that this must be done within the limits of MiFID II, because online brokerage is of course subject to and conducted within the requirements of execution-only and non-advisory services. And, in fact, we observe that these limits are complied with, as demonstrated by the regulatory authorities continuously and thoroughly supervising the compliance with MiFID II.

Yes, we do think that it is in the best interest of clients to have such access to capital markets. In fact, we think that the investors concerned would be unpleasantly surprised if such access was restricted by law, which could result in a considerable pushback by the investors themselves.

Q26: One of the elements that increased the impact on retail investors in the GameStop case was the widespread use of margin trading. Do you consider that the current regular framework sufficiently protects retail investors against the risks of margin trading, especially the ones that cannot bear the risks? Please elaborate.

Margin trading is indeed increasing risk for investors and should only be done if it can be demonstrated that the investor can understand and bear the risk involved. It can be helpful in this regard to provide some risk ranking and/or margin restrictions for particular financial instruments, i.e. restrict or disable margin trading if warranted by the riskiness of a given instrument. However, as far as we know, such risk-oriented approaches to margin trading are already industry practice.

Q 27-Q29: n.a.

Q30: Do you consider that there are further aspects, in addition to the investor protection concerns outlined in the ESMA statement with regards to PFOF, that the Commission and/or ESMA should consider and address? If so, please explain which ones and if you think that these concerns can be adequately addressed within the current regulatory framework or do you see a need for legislative changes (or other measures) to address them.

We do not see the need for legislative changes, as the regulatory provisions already in place in the field of inducements adequately address the issue.

Q 31-Q34: n.a.

Q35: The increased digitalisation of investment services, also brings the possibility to provide investment services across other Member States with little extra effort. This is evidenced by the rapid expansion of online brokers across Europe. Do you observe issues connected to this increased cross-border provision of services? Please elaborate.

The better integration of the Single Market in financial services has been a long term goal for the Commission, that took a long time and incredible effort to promote. The Commission explicitly aimed at promoting that goal through measures in the area of cross-border use of the internet.

Now that many years of effort are finally bearing fruit, the effects should be welcomed. Especially the principle of home Member State supervision, which is a cornerstone of the European passport for MiFID services, should not be challenged once it becomes fully operational. The whole concept included a process of letting go on the part of national regulators, and this should not come as a surprise now that the concept enters its maturity stage.

Q36-Q49: n.a.