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**Markets in Financial Instruments Directive II Implementation – Consultation Paper III
(CP16/29***)**

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Response by:

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1. Introduction

The European Investors' Association is a pan-European association that was launched in 2015 and that promotes the interests of retail investors, both in the regulatory domain as well in corporate litigation proceedings and shareholder disputes.

In regulatory and legislative matters, European Investors aims to contribute to efficient, transparent, fair and orderly financial markets in which retail investors are confident to put their capital to work, either directly or through intermediated channels, and are enabled to take informed investment decision that suit their personal circumstances and needs.

Since retail investors are greatly affected by regulatory initiatives, but are often not in the position to exercise any influence on its making, we always welcome the opportunity to participate on their behalf in consultations organised by European and national bodies responsible for regulating financial conduct.

2. Comments

In general, our judgment of the FCA's Third Consultation Paper on MiFID II Implementation is a very positive one. We have therefore decided to limit our comments to three critical areas:

- Inducements and research;
- suitability; and
- product governance.

3. Inducements and research

Q10: Do you agree with our approach to extending the research and inducements requirements to firms carrying out collective portfolio management activity?

European Investors strongly agrees with the suggested approach. Evidence suggests that collective portfolio managers exercise little oversight over their procurement of research as they pay for research through dealing commissions. This results in disproportionately high costs for (retail) clients.

Q11: Do you have any views on areas where we have proposed new guidance provisions to clarify our interpretation of steps firms could take to ensure compliance with the new inducements and research proposals and the detail of the proposals? If not, please give reasons why and any alternative suggestions.

European Investors would like to express its strong support for the way the FCA proposes to implement the new MiFID II rules on payment for third-party research and the guidance that it provides in this respect, in particular with regards to the collection of research charges alongside transaction costs.

The MiFID II Delegated Directive allows firms to collect research charges alongside transaction costs. While European Investors would have preferred a ban on commission sharing agreements of any sort, we think the FCA has formulated appropriate requirements to ensure that the interests of retail investors are sufficiently protected despite the continued existence of such arrangements.

European Investors is particularly pleased to see that research charges deducted through a broker alongside transaction costs should be ceded to a research payment account immediately following the associated transaction, and will only be paid out to the relevant broker if justified based on the investment firm's quality criteria and valuation approach. There needs to be a level playing field between

brokers and independent research providers; the decision to purchase research from a particular broker should not be linked in any way to the use of execution services provided by that broker.

7. Suitability

Q28: Do you have any comments on the new COBS 9A in Appendix 1?

European Investors thinks the obligation to assess, while taking into account cost and complexity, whether equivalent financial products can meet their client's profile, as laid down in 9A.2.19 and derived from Article 54 (9), is a very important one.

As a further improvement, European Investors suggests requiring firms that provide independent advice, when they recommend a product originated by the firm itself, to explain why this product would be more suitable than equivalent products originated by third parties. Such requirement ensures that firms that call themselves independent do not give any preferential treatment to inhouse products.

Furthermore, European Investors wishes to comment on the obligation for portfolio managers to undertake an analysis of the costs and benefits of switching investments, as laid down in 9A.2.18. We are very supportive of this provision which requires firms to account more for changes they make in a clients' portfolios. Evidence suggests that changes do not always have a clear rationale and sometimes serve no other purpose than giving clients the false idea that the portfolio manager is managing very actively and therefore deserves the high costs he is charging to clients.

That said, the requirement should be applied in a proportionate manner. For example, if a switch is needed in order to comply with the mandate given to the portfolio manager by the client, for example to ensure the portfolio continues to mirror a certain index, requiring a thorough analysis of the costs and benefits of such a switch might not be proportionate.

13. Product governance

Q51: Do you agree with our proposal to apply the MiFID II product governance provisions as rules for firms engaged in MiFID business? If not, please give reasons why

European Investors would like to share some of the concerns it intends to express to ESMA on the draft guidelines it published for consultation in October 2016. While European Investors is supportive of the new product governance requirements introduced by MiFID II, we feel some of ESMA's proposals in regards to the target market identification might not be in the interest of retail clients.

The Consultation Paper of ESMA acknowledges that the perspective of the target market assessment is the individual product and that portfolio level considerations might justify a deviation from the target market, provided that suitability requirements are met.

At the same time, ESMA states that such deviations "should not occur on a regular basis". European Investors is of the view that deviations that are in the best interests of the client should not be discouraged. We need to allow advisers/portfolio managers the ability to pull together an appropriate portfolio mix that helps clients to meet their investment objectives. Building such an appropriate portfolio mix might require the frequent distribution of products outside of the target market, albeit of course in small amounts relative to the total size of the client's overall portfolio.

In other words, we are of the view that the assessment of suitability, taking into account the personal features of the client including considerations of how the recommended product in conjunction with the

overall portfolio meets the client's circumstances, risk profile, objectives and expectations, should remain the primary tool to ensure retail clients get recommended suitable investment products.

Q52: Do you agree with our proposal to apply the MiFID II product governance provisions as guidance for non-MiFID firms involved in the manufacture or distribution of MiFID products? If not, please give reasons why.

European Investors would like to warn FCA for the unlevel playing field that might result from the exclusion of non-MiFID firms involved in the manufacture and distribution of MiFID products. The product governance requirements are quite far-reaching. MiFID II firms might need to cease the distribution of certain products to groups of clients that are outside of the target market. These clients might turn to non-MiFID firms involved in the distribution of MiFID products.
