

10th July 2015

Online submission at www.esma.europa.eu

AFME response to ESMA's consultation on Draft guidelines for the assessment of knowledge and competence

Dear Sir, Dear Madam

Please find attached the AFME response to this consultation which represents the views of members of the Association for Financial Markets in Europe (AFME) and has been based on the feedback from relevant AFME working groups.

Please do not hesitate to contact me or Angela Teke (Angela.Teke@afme.eu) if you would like to discuss the issues covered in this submission or would like us to provide further information about any of the matters which our members have raised. We would be happy to continue to engage with ESMA in ongoing dialogue on this and, in due course, may raise with you any further issues on the subject that AFME Members bring to our attention.

Yours sincerely,

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Draft guidelines for the assessment of knowledge and competence

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to comment on ESMA's consultation paper on **Draft guidelines for the assessment of knowledge and competence** (ESMA/2015/753). AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.

AFME is the European member of the Global Financial Markets Association (GFMA), a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia.

AFME is registered on the EU Transparency Register, registration number 65110063986-76.

Introductory comments

Whilst our Members support the general regulatory objective that firms safeguard the best interests of their clients by ensuring that relevant staff have appropriate qualifications and experience, we wish to emphasise at the outset how crucial it is that ESMA recognise the inappropriateness of a "one-size-fits-all" approach to knowledge and competence standards, bearing in mind that the guidelines are intended to apply to firms dealing with a very broad range of products and clients. Whilst ESMA has helpfully acknowledged (paragraph 13) that the level of knowledge and competence expected of individuals providing advice should be higher than that expected of individuals providing information on products and services, our Members are not of the view that the proposed guidelines adequately reflect this fundamental distinction, and would ask ESMA to reconsider them in this light.

In addition, ESMA has failed to distinguish in the proposed guidelines between the different categories of client to whom advice or information is provided, particularly the important distinction between retail and wholesale clients. This is one of the relevant factors which the draft guidelines do not appear to address. For example, whilst ESMA states (paragraph 5) that the proposed guidelines should be applied in a proportionate manner, the focus appears to be purely on the "nature, scale and complexity of a firm's business...", without addressing the fact that clients themselves will have varying degrees of financial sophistication.

This distinction between retail and wholesale markets is only one example of the variation in the factors relevant to knowledge and competence across the spectrum of the entire financial services industry, which include e.g. not only the needs and characteristics of the clients, but also the features of different products, and the practices of different markets. Firms are and should be responsible for taking reasonable steps to ensure that their employees are skilled for their particular roles, but the means of employees attaining such skills and of firms satisfying themselves of such knowledge and competence will be many and varied across the industry.

Our Members are therefore of the view that it would be neither appropriate nor proportionate to apply knowledge and competence standards devised for individuals interacting with retail clients to other individuals interacting only with wholesale clients. In particular, this would fail to recognise that professional clients and eligible counterparties by their very nature have a high level of sophistication and are therefore well positioned to assess the value of any advice or information provided to them by a firm. We would assert that the knowledge and competence requirements relating to individuals interacting with wholesale clients should be adjusted to reflect these clients' financial sophistication, noting that they will have the benefit of a number of regulatory protections under MiFID II which would apply to any advice or information provided to them by firms. We urge ESMA to take this into account when determining the final guidelines.

It is also important for ESMA to recognise that the manner and substance of any information provided by firms to their clients can vary across different products and services, markets and client categories. For example, the provision of information on custody services to the Finance Director of a large corporate client will be carried out in a very different manner from the provision of information about a non-complex product to a retail client. The proposed guidelines suggest that the same one-size-fits-all approach should be adopted towards all forms of information provision. Our Members consider this approach to be disproportionate and we would ask ESMA to consider how the knowledge and competence requirements applicable to the provision of information should be tailored to reflect this intrinsic variety.

Q1: Do you think that not less than five consecutive years of appropriate experience of providing the same relevant services at the date of application of these guidelines would be sufficient to meet the requirement under knowledge and competence, provided that the firm has assessed their knowledge and competence? If yes, please explain what factors should be taken into account and what assessment should be performed by the investment firm. Please also specify whether five consecutive years of experience should be made in the same firm or whether documented experience in more than one firm could be considered.

We welcome ESMA's recognition that an individual's past experience (i.e. in providing information and/or performing advisory roles) should be taken into account when assessing knowledge and competence in fulfilment of the MiFID II requirements. However, clearly there is a need to establish a transitional mechanism to allow for continuity of customer contact and service once the new requirements become effective. Members do not consider that ESMA has struck the right balance in proposing "five consecutive years of providing the same relevant services" as the required standard to allow for such continuity. Such a proposal has the potential to cause disruption to the industry as a whole and the ability to service customers.

In particular, our Members consider that five consecutive years of service is an unnecessarily long period to make mandatory and fails to take into account the realities of the current job market in financial services. Time spent in a large sophisticated bank could very likely produce similar levels of knowledge and competence which one might acquire at a different type of bank. Furthermore, the last five years have seen a significant restructuring of the financial services industry with many firms across Europe having either closed or reduced their headcount. Consequently, there is a danger that a period of five consecutive years could be unachievable for some and discriminatory against those who have taken a period of time away from their role for other reasons (e.g. due to parental/maternity leave or illness).

Given the nature of today's competitive and flexible labour market, where it is not unusual for individuals to be in role for an average of 2-3 years, Members consider that the way in which any previous experience will be measured must be consistent with the practical realities of the industry and reflect MiFID's overarching policy objective of promoting a more competitive EU financial market. It would be unrealistic and overly restrictive to expect that relevant experience should have been obtained at the same firm for five years. To impose such a requirement would automatically disadvantage any individuals who have recently changed jobs and may distort the labour market in the period prior to implementation as individuals may feel unable to leave their current posts. We therefore suggest that ESMA adopt a more flexible approach by requiring a period of two years which: (i) can be obtained at more than one firm, (ii) may or may not have been consecutive, and (iii) accommodates those who have temporarily stepped away from their roles. Such an approach would be more proportionate and yet remain adequate to ensure an appropriate level of consumer protection.

A pragmatic approach must be taken with regard to the ability to accumulate experience from different firms. Any documentary proof which a firm or an individual may have to obtain from a previous employer in order to validate the requisite period of experience must be collected in accordance with local legislation and customary practices surrounding referencing processes. A rigid and prescriptive regime which is overly reliant on quantitative criteria is unlikely to serve the regulatory objective and will result in many qualified individuals being excluded due to their inability to obtain the documents or confirmation required. This may, for example, be the case where firms which have ceased to exist or been significantly restructured. It is also important that

individuals be allowed to take into account prior experience relating to similar types of products and services as well as the markets.

Members also note that the previous experience prior to the date of the guidelines can only be relied upon to the extent that the firm performs a knowledge and competence assessment on the individual concerned. It would make more sense for this to be a true transitional provision which allows for those who have obtained the requisite amount of previous experience to be automatically eligible to continue with their role (i.e. without such an assessment) where this experience has been appropriately verified. The rationale for this is as follows. The MiFID II knowledge and competence requirements will become effective on 3rd January 2017. This would effectively mean that, should an assessment take place on that date, then the relevant individual's understanding and knowledge would be judged against the new MiFID II standards which in reality would not have had time to be embedded. It would therefore be more sensible for firms to conduct an assessment within the proposed annual review cycle for the purposes of maintaining and updating their knowledge and competence.

As articulated in our introductory comments, we would suggest a calibrated approach when assessing periods of qualifying prior experience based on the type of service (information giving vs. investment advice) and the type of client (retail vs. wholesale), but with no more than two non-consecutive years of service required overall.

Our Members also note that, from the UK perspective, a new Certification Regime becomes effective from March 2016 for UK regulated banks and some UK regulated investment firms, which will be extended later for all regulated investment firms following the implementation of the recommendations of FEMR. This will require a significant population of individuals to be periodically certified by firms as being fit and proper to perform their roles and potentially introduces another layer of complexity into firms' internal assessment processes.

Q2:ESMA proposes that the level and intensity of the knowledge and competence requirements should be differentiated between investment advisors and other staff giving information on financial instruments, structured deposits and services to clients, taking into account their specific role and responsibilities. In particular, the level of knowledge and competence expected for those providing advice should be of a higher standard than that those providing information. Do you agree with the proposed approach?

In line with our overall view that a one-size-fits-all approach is not appropriate, we agree that the level of knowledge and competence expected for those providing investment advice should be of a higher standard than for those purely providing information. This need for proportionality should also be reflected in the guidelines in a substantive manner, insofar as clients have different levels of knowledge and experience.

However, the criteria set out in paragraphs 20 to 23 of the draft guidelines for the provision of investment advice and the provision of information are broadly the same and there is little indication of how that higher standard should be achieved or what might constitute a higher standard. Members would welcome further clarity and guidance on how to differentiate between the standards to be applied when merely providing information as opposed to providing investment advice.

Q3: What is your view on the knowledge and competence requirements proposed in the draft guidelines set out in Annex IV?

We broadly welcome the content of the draft guidelines but believe that the requirement that "the compliance function should assess and review compliance with these guidelines" is overly prescriptive. It should be for firms to decide how best to implement effective internal controls to ensure compliance with any requirements or guidelines in relation to training and competence specifically, and compliance with other relevant requirements or guidelines more generally. For example, it is customary for responsible executives to rely on

any combination of: supervisory reports, internal audit reports, external consultants' reviews, front office controls, quality assurance, HR, Training as well as Compliance in order to meet those requirements. As a second line of defence function, it is not clear why the review of compliance with these guidelines should fall solely to the Compliance function, and in fact imposing such a requirement on firms may restrict the quality and depth of the assessment.

We also wish to raise a number of general concerns:

- The requirement in paragraph 22 (c) to understand total costs to be borne by the client should be interpreted on a pragmatic basis and in the context of the wider nature of the client relationship as well as the specific transaction.
- The proposed annual review of staff development and experience needs mentioned in paragraph 25 (b) should not be at variance with existing requirements at the Member State level.
- We would recommend that the proposed reporting requirements to National Competent Authorities (at paragraph 25 (c)) do not impose an additional administrative burden for firms, but instead build on existing reporting processes (although we note that this is only an obligation to provide records where requested).

Members also wish to raise the following specific concerns:

Provision of information: the definition of information under paragraph 6e of the draft guidelines has been drawn so widely that it is capable of capturing those members of staff who merely distribute leaflets or those who provide nothing other than basic facts about a product or a service at the request of a client. It could also capture administrative assistants working for sales staff. Members urge ESMA to adopt a pragmatic approach towards the scope of the guidelines in order to ensure that only those members of staff who are involved in meaningful interactions with customers as part of a sales and marketing process are subject to the requirements of the guidelines. As per our introductory comments, it is also important to recognise that the provision of information (even in a substantive manner) can differ between products and services and between categories of clients.

Internal policies and procedures: Members are concerned about the inclusion of paragraph 15 in the draft guidelines. The mandate to ESMA under MiFID II is to write guidelines which enable firms to fulfil their obligations under Articles 24 and 25 of the Directive. The discharge of obligations under these Articles does not necessarily include detailed knowledge of internal policies and procedures relating to conflicts of interest, complaints management, product governance, telephone recording and order handling. Whilst Members accept and agree that these are important components of internal procedures with which staff should comply, they consider that detailed knowledge of all such procedures is a separate matter falling outside the remit of the knowledge and competence requirements which these guidelines are mandated to address (under Articles 24 and 25 of the Directive), and would be more appropriately dealt with elsewhere. Overall, our Members are of the view that the extent of an individual's knowledge should be appropriate to the role discharged by a relevant member of staff.

Cross border application: Members urge ESMA to ensure that the guidelines make it clear to National Competent Authorities that national implementation needs to be sufficiently flexible to accommodate an industry workforce which operates in accordance with the freedom of movement of people. Any qualifications or prior experience recognised in one Member State should therefore include comparable qualifications or experience obtained by individuals in other Member States or in non-EU jurisdictions.

General tax implications: Paragraphs 20 (b) and 22 (b) of the draft guidelines both refer to the need for staff to understand "any general tax implications". Whilst advisors would, of course, be expected to have an understanding of essential product features including the potential for tax charges to arise, Members wish to note that staff do not routinely provide any tax advice as part of their client service offerings (whether information or advisory) except in some instances where this has been expressly agreed with the client. Where

tax is a significant factor in dealing with or advising clients in relation to an investment product, firms would (without providing tax advice per se), take relevant knowledge and experience into account when assessing individual competence. The draft guidelines should not inadvertently expand the remit of firms' services in this regard or require them to undertake further investigation into the tax affairs of clients before providing investment advice or information about products or services.

Specifying qualifications: Given the wide variety of qualifications and prior activities which make up the training and experience of a diverse population of professionals working in an increasingly global financial services industry, it is important that ESMA makes it clear in its guidance to National Competent Authorities that appropriate qualifications should be interpreted flexibly. For example, the guidance could recommend that firms take into account the relevant educational background of an employee when assessing competence. As per our comments in Q1, we would suggest a calibrated approach when assessing qualifying periods of prior experience based on the type of service (information giving vs. investment advice) and the type of client (retail vs. wholesale).

Q4: Are there, in your opinion, other knowledge or competence requirements that need to be covered in the draft guidelines set out in Annex IV?

Please see our responses to Qs 2 and 3.

Q5: What additional one-off costs would firms encounter as a result of the proposed guidelines?

Our Members consider that, should the final guidelines be significantly inconsistent with current competence and knowledge requirements at the national level, systems changes would have to be introduced by firms, particularly as regards the record-keeping, annual review, and reporting requirements.

In addition, Members consider that the costs to the industry would not be solely financial. There is a danger that unless a practical and proportionate approach is adopted for the transitional period (as articulated in Q1), firms may find themselves in the period immediately following adoption of the guidelines with capable staff who are prevented from performing their duties without acquiring further qualifications and/or being subject to "chaperoning" by more experienced or qualified peers. This in turn will reduce the ability of firms to service their clients, which may delay or deny investors access to products and services.

Q6: What additional ongoing costs will firms face a result of these proposed guidelines?

Members do not consider the requirement under paragraph 25 (h) of the draft guidelines to be workable in practice. To suggest that the person providing training must be present at all client meetings and communications during the training period seems excessive and onerous. This would seemingly prevent a person under training from being able to respond to basic email or telephone queries without a trainer being present, rendering that person unable to perform basic functions independently. Firms should be able to decide at what point and to what level a trainee can perform tasks unsupervised. Similarly, such a level of scrutiny by a trainer will inevitably mean that a trainer will not only have limited flexibility or discretion to allow the trainee to assume more responsibility, but in addition will have less time to perform his/her usual activities as his/her time will be taken up chaperoning others. Clearly, there are cost implications for firms where such resourcing is concerned.

In other professions, those under training are able to perform duties independently, subject to the discretion of those training them (for example, junior doctors are not supervised in all of their activities all the way through to obtaining their final qualification). Members consider that a similar approach should be adopted here in

order to strike a proportionate balance between consumer protection, ongoing resourcing of training and customer service.