

# Consultation Paper

## Guidelines on certain aspects of the MiFID II suitability requirements



## Responding to this paper

ESMA invites comments on all matters in this paper and in particular on the specific questions summarised in Annex 1. Comments are most helpful if they:

1. respond to the question stated;
2. indicate the specific question to which the comment relates;
3. contain a clear rationale; and
4. describe any alternatives ESMA should consider.

ESMA will consider all comments received by **27 April 2022**.

All contributions should be submitted online at [www.esma.europa.eu](http://www.esma.europa.eu) under the heading 'Your input - Consultations'.

### Publication of responses

All contributions received will be published following the close of the consultation unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESMA's rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESMA's Board of Appeal and the European Ombudsman.

### Data protection

Information on data protection can be found at [www.esma.europa.eu](http://www.esma.europa.eu) under the heading '[Data protection](#)'.

### Who should read this paper?

This paper is primarily of interest to competent authorities, firms that are subject to Directive 2014/65/EU on Markets in Financial Instruments (MiFID II) and their clients.

Due to its focus on investor protection issues, this paper is therefore addressed to investors and consumer organisations; to investment firms and credit institutions providing investment advice or discretionary portfolio management services; to UCITS management companies and external Alternative Investment Fund Managers (AIFMs) when providing the investment services of investment advice or individual portfolio management; and to any relevant trade association.

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# 1 Executive Summary

## Reasons for publication

The assessment of suitability is one of the most important requirements for investor protection in the MiFID II framework. It applies to the provision of any type of investment advice (whether independent or not) and portfolio management. In accordance with the obligations set out in Article 25(2) of Directive 2014/65/EU on Markets in Financial Instruments (MiFID II) and Articles 54 and 55 of the Commission Delegated Regulation (EU) 2017/565 (MiFID II Delegated Regulation), investment firms providing investment advice or portfolio management have to provide suitable personal recommendations to their clients or have to make suitable investment decisions on behalf of their clients.

In accordance with Article 16(2) of the ESMA Regulation, this paper sets out for consultation draft ESMA guidelines on certain aspects of the MiFID II suitability requirements. **This Consultation Paper builds on the text of the 2018 ESMA guidelines<sup>1</sup>, which are now being reviewed following the adoption by the European Commission of the changes to the MiFID II Delegated Regulation<sup>2</sup> to integrate sustainability factors, risk and preferences into certain organisational requirements and operating conditions for investment firms.** In addition, the review of the guidelines takes into account the results of the 2020 Common Supervisory Action<sup>3</sup> (CSA) conducted by national competent authorities (NCAs) on the application of the MiFID II suitability requirements, complementing the current guidelines with the good and practices emerged and providing some practical guidance to firms in the areas where lack of convergence still seems to persist. Lastly, the review also considers the amendments introduced through the Capital Markets Recovery Package<sup>4</sup> to Article 25(2) of MiFID II. By pursuing the objective of ensuring a consistent and harmonised application of the requirements in the area of suitability, including on the topic of sustainability, the proposed Guidelines will make sure that the objectives of MiFID II can be efficiently achieved. ESMA believes that the implementation of these guidelines will strengthen investor protection – a key objective for ESMA.

## Contents

Section 2 explains the background to the proposals. Annex I lists all the questions set out in the consultation paper; Annex II contains the draft cost-benefit analysis; Annex III contains the full text of the draft guidelines; and Annex IV contains a list of good and bad practices on the application of the MiFID II requirements on suitability.

## Next Steps

**ESMA will consider the responses received to this consultation paper in Q2 2022 and expects to publish a final report, and final guidelines, in Q3 2022.**

## 2 Background

### 2.1 Overview

1. The assessment of suitability is one of the most important obligations for investor protection. It applies to the provision of any type of investment advice (whether independent or not) and portfolio management. In accordance with the obligations set out in Article 25(2) of MiFID II and Articles 54 and 55 of the MiFID II Delegated Regulation, investment firms providing investment advice or portfolio management have to provide suitable personal recommendations to their clients or have to make suitable investment decisions on behalf of their clients. Suitability has to be assessed against clients' knowledge and experience, financial situation and investment objectives. To achieve this, investment firms have to obtain the necessary information from clients.
2. In July 2012, ESMA published the first set of guidelines on certain aspects of the MiFID suitability requirements. The purpose of these guidelines was to clarify the application of certain aspects of the MiFID suitability requirements in order to ensure the common, uniform and consistent application of the relevant requirements under MiFID I<sup>5</sup> and to promote greater convergence in the interpretation of, and supervisory approaches to, the MiFID suitability requirements, by emphasising a number of important issues, and thereby enhancing the value of existing standards. The guidelines cover a number of areas concerning, inter alia, client information, record keeping, arrangements necessary for investment firms and staff qualification.
3. In May 2018, following the adoption of MiFID II, ESMA has published revised guidelines on suitability. In particular, the 2012 guidelines have been largely confirmed and broadened in order to:
  - consider technological developments of the advisory market notably the increasing use of automated or semi-automated systems for the provision of investment advice or portfolio management (robo-advice);
  - build on NCAs' supervisory experience on the application of suitability requirements;
  - take into account the outcome of studies in the area of behavioural finance; and
  - provide additional details on some aspects that were already covered under the 2012 guidelines.

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<sup>1</sup> ESMA35-43-869

<sup>2</sup> Commission Delegated Regulation (EU) 2021/1253 amending Delegated Regulation (EU) 2017/565

<sup>3</sup> ESMA35-43-2748

<sup>4</sup> Directive (EU) 2021/338 amending Directive 2014/65/EU

<sup>5</sup> Article 19(4) of MiFID and of Articles 35 and 37 of the MiFID Implementing Directive

4. The 2018 version of the suitability guidelines also included a good practice for firms in the area of sustainability (considering that, at the time, sustainability had not yet been integrated in the MiFID II delegated acts).<sup>6</sup>
5. In March 2018 the Commission published its Action Plan 'Financing Sustainable Growth'<sup>7</sup>, setting up an ambitious and comprehensive strategy on sustainable finance. As part of the Action Plan, the Commission announced the intention to incorporate sustainability when providing financial advice and to clarify the integration of sustainability in so-called fiduciary duties in sectoral legislation.
6. Following the publication of the Commission's Action Plan, the MiFID II Delegated Regulation<sup>8</sup> has been updated to integrate sustainability factors, risk and preferences into certain organisational requirements and operating conditions for investment firms. The amendments have been published in the Official Journal of the European Union on 2 August 2021 and will apply from 2 August 2022. They are part of a broader Commission's initiative on sustainable development and lay the foundation for a EU framework which puts sustainability considerations at the heart of the financial system to support transforming Europe's economy into a greener, more resilient and circular system in line with the European Green Deal<sup>9</sup> objectives.
7. The introduction of amendments to the MiFID II Delegated Regulation has subsequently triggered the further review and update of the existing 2018 guidelines<sup>10</sup>. Moreover, the review of this set of guidelines is also the opportunity to consider other relevant factors such as:
  - the integration of the good and poor practices<sup>11</sup> emerged from the 2020 Common Supervisory Action (CSA) to complement the current guidelines. These good and poor practices will help give some practical guidance to firms in the areas where lack of convergence still seems to persist and should also be a helpful tool for firms when applying the MiFID requirements and the ESMA guidelines;
  - the finalisation of the ESMA Guidelines on certain aspects of the MiFID II appropriateness and execution-only requirements that gives the opportunity to ensure alignment between the two sets of guidelines when touching on similar requirements; and

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<sup>6</sup> While the 2018 guidelines noted that it would be a good practice for firms to collect information about the client's or potential client's ESG preferences, ESMA's CSA showed that, in 2020, the vast majority of firms in the CSA sample did not yet incorporate the collection and analysis of such information into their suitability policies and procedures.

<sup>7</sup> COM(2018) 97 final

<sup>8</sup> Commission Delegated Regulation (EU) 2021/1253

<sup>9</sup> COM(2019)640 final

<sup>10</sup> It should be noted that, as part of this review, ESMA has also considered responses that were provided by stakeholders to the Consultation Paper on the review of the 2018 guidelines in the area of sustainability.

<sup>11</sup> It should be noted that some of the poor practices listed in the annex can be configured (depending on the specific context) as violations of the MiFID II requirements.

- the amendments introduced through the Capital Markets Recovery Package to Article 25(2) of MiFID II.<sup>12</sup>
8. It should be noted that the draft guidelines do not address all issues arising from the suitability requirements. Clarity on further aspects of the suitability requirements has been provided by ESMA through the publication of ad hoc Q&As<sup>13</sup>. Moreover, ESMA acknowledges the complexity of the sustainable finance topic, the constant evolution of the market and notes that ESMA expects to keep working on supervisory convergence in this area with various available tools.
9. Furthermore, the Commission has also introduced amendments to the MiFID II Delegated Directive<sup>14</sup> to integrate sustainability factors into the product governance obligations and ESMA plans to soon review its Guidelines on MiFID II product governance requirements (a separate public consultation will be conducted on this topic).
10. When updating these guidelines ESMA has striven to ensure consistency with all other relevant EU legislation on this topic (such as the Taxonomy Regulation (TR)<sup>15</sup>, the Sustainable Finance Disclosure Regulation (SFDR)<sup>16</sup> and their implementing measures). ESMA is also closely liaising with EIOPA in order to ensure consistency across sectors.

## 2.2 Approach followed for the review of the 2018 guidelines

11. As explained by the Commission in the Explanatory Memorandum for the amendments to the MiFID II delegated acts, under the previous MiFID II framework, firms providing investment advice and portfolio management were required to obtain the necessary information about the client's knowledge and experience in the investment field, the financial situation including the client's ability to bear losses, and the client's investment objectives including the client's risk tolerance to enable the firm to provide services and products that are suitable for the client (suitability assessment). The information regarding the investment objectives of clients includes information on the length of time for which clients wish to hold the investment, their preferences regarding risk taking, risk profile, and the purposes of the investment. However, the information about investment objectives generally relates to financial objectives, while other non-financial objectives of the client, such as sustainability preferences, were usually not addressed. The suitability assessments generally did not include questions on clients' sustainability preferences, while the majority of clients would not raise such preferences themselves.
12. The recent amendments to the MiFID II Delegated Regulation have therefore the aim to integrate sustainability preferences in the advisory and portfolio management processes to ensure that clients' sustainability preferences are taken into account by firms. According

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<sup>12</sup> Under the Capital Markets Recovery Package, a new subparagraph has been added to Article 25(2) of MiFID II that adds a disclosure obligation for firms (i.e., to inform the clients) on the results of the analysis performed on the costs and benefits of switching investments when providing investment advice. A slight wording amendment has been introduced in the text of guideline 10 to align the guideline with Article 25(2) of MiFID II.

<sup>13</sup> ESMA35-43-349

<sup>14</sup> Commission Delegated Directive (EU) 2021/1269

<sup>15</sup> Regulation (EU) 2020/852

<sup>16</sup> Regulation (EU) 2019/2088



to these amendments, firms should have in place appropriate arrangements to ensure the inclusion of sustainability factors in their processes. Therefore, firms that provide investment advice and portfolio management will be required to assess clients' sustainability preferences when performing the suitability assessment.

13. ESMA has therefore expanded some of the existing guidelines to consider the changes introduced by the Commission.
14. Some of the main amendments introduced to the MIFID II Delegated Regulation are summarised in the following paragraphs. In order to facilitate readability, the paragraphs of the guidelines that have been updated in this review are underlined (see Annex III - Draft guidelines). The other non-underlined paragraphs of the guidelines have remained unchanged compared to the 2018 version.

### **Integration of the definition of 'sustainability preferences'**

15. A definition of "Sustainability Preferences" has been included under the amended MiFID II Delegated Regulation<sup>17</sup>. Considering the different product scope of MiFID II, the SFDR and the Taxonomy Regulation, this definition ensures that financial instruments with sustainability-related features are eligible for recommendation to the clients or potential clients who express sustainability preferences. Firms will need to incorporate such definition in their processes and procedures concerning the suitability assessment.

### **Collection of information from clients on sustainability preferences**

16. According to the new requirements<sup>18</sup>, firms should collect information from clients regarding their preferences in relation to the different types of investment products included in the definition of sustainability preferences.

### **Assessment of sustainability preferences**

17. As introduced by the new requirements<sup>19</sup>, firms are required to collect clients' sustainability preferences and consider them as part of the clients' suitability assessment.
18. Firms should first assess the suitability of a transaction in accordance with the criteria of knowledge and experience, financial situation, other investment objectives and then, as a second step, consider the client's sustainability preferences.
19. This approach is consistent with what is set out in the explanatory memorandum<sup>20</sup> and with Recital 5<sup>21</sup> of the Delegated Regulation amending MiFID II, according to which, respectively: "this Regulation modifies Delegated Regulation (EU) 2017/565 in two ways: first, it integrates client's preferences in terms of sustainability as a top up to the suitability assessment" and "investment firms providing investment advice should first assess a

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<sup>17</sup> See Article 2(7), 2(8) and 2(9) of MiFID II Delegated Regulation

<sup>18</sup> See Article 54 of MiFID II Delegated Regulation

<sup>19</sup> See Article 54 of MiFID II Delegated Regulation

<sup>20</sup> C(2021) 2616 final

<sup>21</sup> C(2021) 2616 final

client's or potential client's other investment objectives, time horizon and individual circumstances, before asking for his or her potential sustainability preferences".

### **Possibility for clients to adapt the sustainability preferences**

20. The amendments to the MiFID II Delegated Regulation<sup>22</sup> introduce the possibility for the client or potential client to adapt the sustainability preferences in the case where no financial instruments meet the client's sustainability preferences.

### **Guidelines on certain aspects of the MiFID suitability requirements**

#### *Guideline 1 – Information to clients about the purpose of the suitability assessment and its scope*

21. A new paragraph has been added to the guideline 1 to clarify that, as part of the suitability assessment, firms should help clients in understanding the concept of "sustainability preferences", the different types of products included under the definition of "sustainability preferences", the features and the choices to be made in this context.

22. No further amendments have been introduced in guideline 1.

**Q1. Do you agree with the suggested approach on the information to clients about the purpose of the suitability assessment and its scope? Please also state the reasons for your answer.**

**Q2. Do you agree with the new supporting guideline in relation to the information to clients on the concept of sustainability preference or do you believe that the information requirement should be expanded further? Please also state the reasons for your answer.**

#### *Guideline 2 - arrangements necessary to understand clients*

23. The content of guideline 2 has been amended to incorporate the new requirement to collect information from the client on the sustainability preferences. In particular, the supporting guideline outlines the approach to be followed with regards to the collection of the client's sustainability preferences and the client's level of sustainability-related expectation. The guideline also outlines the process to be followed in the case of a portfolio approach.

24. ESMA considers that the level of information to be collected from clients should include all aspects mentioned in the definition of "sustainability preferences" and should be granular enough to allow for a matching of the client's sustainability preferences with the sustainability-related features of financial instruments and to allow for a combination of the different aspects included under the definition of sustainability preferences.

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<sup>22</sup> See Article 54 (10) of MiFID II Delegated Regulation

25. Firms should ensure the same level of granularity of information is collected on the client's sustainability preferences when providing portfolio management or investment advice with a portfolio approach.

26. It should be noted that, in reflecting the legislative text, the approach suggested for gathering information from clients on their sustainability preferences is substantially based on self-assessment. This is different from the approach that firms are expected to adopt when collecting information on the 'traditional' parameters of suitability assessment. Firms are reminded that the existing ESMA guidelines focusing on the measures to be adopted to limit the risks of self-assessment remain confirmed and are not in any way impacted by the new guidance on collecting information on clients' sustainability preferences.

**Q3. Do you agree with the suggested approach on the arrangements necessary to understand clients and specifically with how the guideline has been updated to take into account of the clients' sustainability preferences? Please also state the reasons for your answer. Are there other alternative approaches, beyond the one suggested in guideline 2, that you consider compliant with the MiFID II requirements and that ESMA should consider? Please provide examples and details.**

**Q4. Do you believe that further guidance is needed to clarify how firms should assess clients' sustainability preferences?**

**Q5. Where clients have expressed preference for more than one of the three categories of products referred to in letters a), b) or c) of the definition of Article 2(7) of the MiFID II Delegated Regulation, do you think that the Guidelines should provide additional guidance about what is precisely expected from advisors when investigating and prioritizing these simultaneous / overlapping preferences?**

**Q6. Do you agree with the proposed approach with regard to the assessment of ESG preferences in the case of portfolio approach? Are there alternative approaches that ESMA should consider? Please provide possible examples.**

*Guidelines 3 and 4 – extent of information to be collected from clients (proportionality) and reliability of client information*

27. The content of guidelines 3 and 4 has been confirmed and no change has been introduced.

*Guideline 5 - updating client information*

28. A new paragraph has been added to the existing guideline 5 to clarify that, in relation to the collection of the sustainability preferences of a client, this information could be updated as part of the next regular update of the client's information or during the first meeting with the client following the entry-into-application of the amendments to the MiFID II Delegated Regulation.

**Q7. Do you agree with the suggested approach on the topic of 'updating client information'? Please also state the reasons for your answer.**

Guidelines 6 - client information for legal entities or groups

29. The content of guidelines 6 has been confirmed and no change has been introduced.

Guideline 7 - arrangements necessary to understand investment products

30. Regarding the arrangements necessary to understand investment products, the supporting guideline has been amended to ensure that the policies and procedures implemented by firms to understand the characteristics, nature and features of investment products take into consideration the investment products' sustainability factors.

**Q8. Do you agree with the suggested approach with regards to the arrangements necessary to understand investment products? Please also state the reasons for your answer.**

**Q9. Do you believe that further guidance is needed to clarify how firms should take into consideration the investment products' sustainability factors as part of their policies and procedures? Please also state the reason for your answer.**

Guideline 8 - arrangements necessary to ensure the suitability of an investment

31. The content of guideline 8 has been amended to outline the approach to be used to assess the sustainability preferences of the client as part of the suitability assessment. The paragraph clarifies that the sustainability preferences of the client have to be assessed as a second step, once the suitability of the product has been first assessed in accordance with the criteria of knowledge and experience, financial situation and other investment objectives.

32. The guideline also addresses the situation where firm makes use of the possibility to recommend a product that does not meet the initial sustainability preferences of the client. ESMA considers that firms can still recommend products that do not meet the sustainability preferences of the client only once the client has adapted such preferences. The firm's explanation and the client's decision should be documented in the suitability report. It should be noted that this possibility should only refer to the sustainability preferences and not to the other criteria of the suitability assessment.

33. An additional paragraph has been also included to further clarify that the adaptation of the client's "sustainability preferences" where financial products do not meet such preferences should only refer to the suitability assessment in question/to the particular transaction and not to the client's profile in general.

34. ESMA is aware that, at this stage, the availability of financial instruments with sustainability features may be limited and the introduction of these financial instruments in the firm's product scope might be gradual. However, ESMA considers that where, at the time the information is collected from the client, firms do not have any financial instruments included in their product range that would meet the client's sustainability preferences, firms should nevertheless collect all information concerning sustainability preferences. In this situation, the firm should clearly indicate that there are currently no products available that would

meet those preferences and the client should be given the possibility to adapt the sustainability preferences. This should be documented in the suitability report.

35. In this context, firms should monitor situations where there is a significant occurrence of clients adapting their sustainability preferences for the specific transaction. Indeed, this would seem especially important in the transitional stages towards a more sustainable financial system, where a wider offer of truly sustainable products will be available.

36. Lastly, the guidelines also address the situation in which a client does not express sustainability preferences.

**Q10. Do you agree with the additional guidance provided regarding the arrangements necessary to ensure the suitability of an investment concerning the client's sustainability preferences? Please also state the reasons for your answer.**

**Q11. Do you agree with the approach outlined with regards to the situation where the firm can recommend a product that does not meet the client's preferences once the client has adapted such preferences? Do you believe that the guideline should be more detailed? Please also state the reasons for your answer.**

**Q12. Do you agree with the approach outlined with regards to the situation where the client makes use of the possibility to adapt the sustainability preferences? Please also state the reasons for your answer.**

**Q13. Could you share views on operational approaches a firm could use when it does not have any financial instruments included in its product range that would meet the client's sustainability preferences (i.e. for the adaptation of client's preferences with respect to the suitability assessment in question/to the particular transaction and to inform the client of such situation in the suitability report)?**

**Q14. Do you agree with the proposed approach for firms to be adopted in the case where a client does not express sustainability preferences, or do you believe that the supporting guideline should be more prescriptive? Please also state the reasons for your answer.**

**Q15. Do you agree with the proposed approach with regard to the possibility for clients to adapt their sustainability preferences in the case of portfolio approach? Do you envisage any other feasible alternative approaches? Please provide some possible examples.**

**Q16. What measures do you believe that firms should implement to monitor situations where there is a significant occurrence of clients adapting their sustainability preferences? What type of initiatives do you envisage could be undertaken to address any issues detected as a result of this monitoring activity?**

*Guidelines 9 - costs and complexity of equivalent products*

37. The content of guideline 9 has been confirmed and no change has been introduced.

#### Guidelines 10 - costs and benefits of switching investments

38. Under the Capital Markets Recovery Package, the following new subparagraph has been added to Article 25(2) of MiFID II:
39. "When providing either investment advice or portfolio management that involves the switching of financial instruments, investment firms shall obtain the necessary information on the client's investment and shall analyse the costs and benefits of the switching of financial instruments. When providing investment advice, investment firms shall inform the client whether or not the benefits of the switching of financial instruments are greater than the costs involved in such switching".
40. A slight wording amendment has been introduced in the text of guideline 10 to align the guideline with Article 25(2) of MiFID II.

**Q17. Do you agree with the proposed amendment to supporting guideline 10? Please also state the reasons for your answer.**

#### Guideline 11 - qualifications of firm staff

41. ESMA has clarified in this guideline that staff giving investment advice or information about financial instruments should have the necessary knowledge and competence with regard to the criteria of the sustainability preferences and should be able to explain to clients the different aspects in non-technical terms. To that effect, firms should give staff appropriate trainings.

**Q18. Do you agree with the additional guidance regarding to the qualification of firms' staff or do you believe that further guidance on this aspect should be needed? Please also state the reasons for your answer.**

#### Guideline 12 - record-keeping

42. ESMA has confirmed the content of the 2018 guidelines on the topic of 'record keeping', since the rationale behind them has not changed, but has clarified that the firms should keep records of the sustainability preferences of the client (if any) and any updates of these preferences.

**Q19. Do you agree on the guidance provided on record keeping? Please also state the reasons for your answer.**

#### **Other changes to the guidelines**

#### **Planned alignment with ESMA guidelines on appropriateness and execution only**

43. When finalising these guidelines on suitability, ESMA plans to align them with the text of its MiFID II guidelines on appropriateness and execution only<sup>23</sup> (currently being finalised by

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<sup>23</sup> Ref: ESMA35-43-2938



ESMA) where MiFID has common provisions for both the assessment of suitability and appropriateness<sup>24</sup>.

**Q20. Do you agree on the alignment of the two sets of guidelines (where common provisions exist for the assessment of suitability and appropriateness)? Please also state the reasons for your answer.**

**Q21. Do you have any further comment or input on the draft guidelines?**

#### **Good and bad practices**

44. In February 2020 ESMA announced on its website the launch of a common supervisory action (CSA) with national competent authorities (NCAs) on the application of MiFID II suitability rules across the European Union (EU).

45. The CSA was set up to allow ESMA and the NCAs to assess the progress made by intermediaries in the application of this key requirement, including on whether and how the costs and complexity of investment products are taken into account by firms when recommending an investment product to a client. ESMA had updated its guidelines on the topic in 2018 and had also published a supervisory briefing on suitability, both of which were considered for the 2020 CSA.

46. A Public Statement was published in July 2021<sup>25</sup> summarising the results of the exercise. The 2020 CSA has shown an adequate level of firms' compliance with key elements of the suitability requirements that were already regulated under MiFID I such as firms' understanding of products and clients and the processes and procedures to ensure the suitability of investments. However, shortcomings and areas of improvement have emerged with regard to some of the new requirements introduced by MiFID II, notably the requirement to consider the cost and complexity of equivalent products, the costs and benefits of switching investments and suitability reports.

47. To provide further guidance to firms and to increase convergence on these important MiFID II requirements, ESMA has included in the annex to the guidelines a list of good and bad practices emerged from the 2020 CSA.

**Q22. Do you have any comment on the list of good and poor practices annexed to the guidelines?**

**Q23. What level of resources (financial and other) would be required to implement and comply with the guidelines (organisational, IT costs, training costs, staff costs, etc., differentiated between one off and ongoing costs)? When answering this question, please also provide information about the size, internal organisation and the nature, scale and complexity of the activities of your institution, where relevant.**

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<sup>24</sup> See Article 55 of the MiFID II Delegated Regulation.

<sup>25</sup> ESMA35-43-2748



### **3 Annexes**

#### **3.1 Annex I - Summary of questions**

- Q1. Do you agree with the suggested approach on the information to clients about the purpose of the suitability assessment and its scope? Please also state the reasons for your answer.**
- Q2. Do you agree with the new supporting guideline in relation to the information to clients on the concept of sustainability preference or do you believe that the information requirement should be expanded further? Please also state the reasons for your answer.**
- Q3. Do you agree with the suggested approach on the arrangements necessary to understand clients and specifically with how the guideline has been updated to take into account of the clients' sustainability preferences? Please also state the reasons for your answer. Are there other alternative approaches, beyond the one suggested in guideline 2, that you consider compliant with the MiFID II requirements and that ESMA should consider? Please provide examples and details.**
- Q4. Do you believe that further guidance is needed to clarify how firms should assess clients' sustainability preferences?**
- Q5. Where clients have expressed preference for more than one of the three categories of products referred to in letters a), b) or c) of the definition of Article 2(7) of the MiFID II Delegated Regulation, do you think that the Guidelines should provide additional guidance about what is precisely expected from advisors when investigating and prioritizing these simultaneous / overlapping preferences?**
- Q6. Do you agree with the proposed approach with regard to the assessment of ESG preferences in the case of portfolio approach? Are there alternative approaches that ESMA should consider? Please provide possible examples.**
- Q7. Do you agree with the suggested approach on the topic of 'updating client information'? Please also state the reasons for your answer.**
- Q8. Do you agree with the suggested approach with regards to the arrangements necessary to understand investment products? Please also state the reasons for your answer.**
- Q9. Do you believe that further guidance is needed to clarify how firms should take into consideration the investment products' sustainability factors as part of their policies and procedures? Please also state the reason for your answer.**
- Q10. Do you agree with the additional guidance provided regarding the arrangements necessary to ensure the suitability of an investment concerning the client's sustainability preferences? Please also state the reasons for your answer.**



- Q11. Do you agree with the approach outlined with regards to the situation where the firm can recommend a product that does not meet the client's preferences once the client has adapted such preferences? Do you believe that the guideline should be more detailed? Please also state the reasons for your answer.**
- Q12. Do you agree with the approach outlined with regards to the situation where the client makes use of the possibility to adapt the sustainability preferences? Please also state the reasons for your answer.**
- Q13. Could you share views on operational approaches a firm could use when it does not have any financial instruments included in its product range that would meet the client's sustainability preferences (i.e. for the adaptation of client's preferences with respect to the suitability assessment in question/to the particular transaction and to inform the client of such situation in the suitability report)?**
- Q14. Do you agree with the proposed approach for firms to be adopted in the case where a client does not express sustainability preferences, or do you believe that the supporting guideline should be more prescriptive? Please also state the reasons for your answer.**
- Q15. Do you agree with the proposed approach with regard to the possibility for clients to adapt their sustainability preferences in the case of portfolio approach? Do you envisage any other feasible alternative approaches? Please provide some possible examples.**
- Q16. What measures do you believe that firms should implement to monitor situations where there is a significant occurrence of clients adapting their sustainability preferences? What type of initiatives do you envisage could be undertaken to address any issues detected as a result of this monitoring activity?**
- Q17. Do you agree with the proposed amendment to supporting guideline 10? Please also state the reasons for your answer.**
- Q18. Do you agree with the additional guidance regarding to the qualification of firms' staff or do you believe that further guidance on this aspect should be needed? Please also state the reasons for your answer.**
- Q19. Do you agree on the guidance provided on record keeping? Please also state the reasons for your answer.**
- Q20. Do you agree on the alignment of the two sets of guidelines (where common provisions exist for the assessment of suitability and appropriateness)? Please also state the reasons for your answer.**
- Q21. Do you have any further comment or input on the draft guidelines?**
- Q22. Do you have any comment on the list of good and poor practices annexed to the guidelines?**

**Q23. What level of resources (financial and other) would be required to implement and comply with the guidelines (organisational, IT costs, training costs, staff costs, etc., differentiated between one off and ongoing costs)? When answering this question, please also provide information about the size, internal organisation and the nature, scale and complexity of the activities of your institution, where relevant.**

## 3.2 Annex II - Cost-benefit analysis

48. The suitability requirements are an essential element of the regulatory toolkit on the distribution of financial instruments to retail investors and it is important to observe that the quality of the advice delivered to the client plays a critical role in ensuring the consistency of the transaction with the client's profile.
49. These draft guidelines aim to ensure a common, uniform and consistent implementation of the MiFID II requirements as recently amended in order to (i) integrate client's preferences in terms of sustainability as a top up to the suitability assessment; and (ii) integrate sustainability risks into the organisational requirements.
50. By providing clarification of the relevant MiFID suitability requirements, and specifically on the new requirements on sustainability, ESMA is helping firms to improve their implementation of these requirements and play a role in ensuring an efficient implementation of EU framework which puts sustainability considerations at the heart of the financial system to support transforming Europe's economy into a greener, more resilient and circular system in line with the European Green Deal objectives. The draft guidelines also aim to ensure a convergent approach in the supervision of the suitability requirements. Greater convergence leads to improved investor protection (consumer outcomes), which is a key ESMA objective.

### **The impacts of the draft ESMA guidelines**

51. In light of the main objectives of these draft guidelines (extensively illustrated in the background), the following preliminary assessment aims at explaining the benefits and costs of the key policy choices that are presented for consultation.
52. It should be preliminary observed that since the requirements on the suitability assessment are provided under the MiFID II and the relevant Delegated Regulation, the impact of the proposed guidelines should be considered having in mind those legal provisions that they support. While market participants will likely incur certain costs for implementing these guidelines, they will also benefit from the increased legal certainty and the harmonised application of the requirements across Member States. Investors would in turn benefit from an improved compatibility between investment products and the needs and characteristics of clients. The proposed guidelines should also facilitate competent authorities' efforts to improve the overall compliance with MiFID requirements increasing the investor confidence in the financial markets, which is considered necessary for the establishment of a genuine single capital market.
53. Finally, it is important to remind that those existing 2018 guidelines which are confirmed should not imply any additional impacts/costs for both firms and NCAs.

### **Benefits**

54. It is possible to illustrate the main benefits linked to the proposed guidelines as follows:

- reduction of the mis-selling risk and its related financial consequences. This is a major benefit for investors and for the financial markets as whole. In particular, firms will benefit from the reduction of complaints, costs of appeals and legal expenditure for tribunal cases, lack of reputation, fines, etc.
- reduction of risks linked to regulatory or supervisory arbitrage due to an increased degree of harmonisation and more consistent supervisory convergence;
- positive effects from improved harmonisation and standardisation of the processes that firms have to put in place when implementing the MiFID II suitability framework;
- positive effects from improved harmonisation and standardisation for competent authorities on the costs and activities needed to implement the new supervisory processes related to the assessment of suitability; and
- avoid greenwashing in the distribution of sustainable investment products.

## **Costs**

55. With reference to the costs, it should be firstly reminded that the key aspects of the suitability assessment and of these guidelines have remained unchanged.

56. In light of what has been said, it can be reasonably expected that those firms having already in place a complete set of arrangements to comply with the existing MiFID II provisions will presumably incur in less overall costs when implementing the updated framework and these guidelines.

57. ESMA considers that potential and incremental costs that firms will face when implementing the overall suitability framework under the MiFID II regime (including but not limited to these draft guidelines) might have both one-off and ongoing nature, arguably linked to:

- (direct) costs linked to the update/review of the existing procedural and organisational arrangements (e.g. the review and/or the update of the questionnaires and of the algorithms/models used to match the client's profile with suitable financial instruments);
- (direct) initial and ongoing IT costs; and
- (direct) relevant organisational and HR costs linked to the implementation of the guidelines providing clarifications on the qualification of firm staff (in particular compliance function staff and staff providing relevant investment services).

58. ESMA believes that the proposed options in this area provide the most cost-efficient solution to achieving the general objectives of these guidelines.

## **Conclusions**

59. In light of what has been illustrated above, ESMA believes that the overall (compliance) costs associated with implementation of the new regime on the suitability assessment (which includes the proposed guidelines) will be fully compensated by the benefits from the improved effectiveness of the suitability assessment.
60. ESMA also considers that the proposed guidelines are able to achieve an increased level of harmonisation in the interpretation and application of the suitability requirements across Member States, minimising the potential adverse impact on firms linked to compliance costs and will have a key role in the broader Commission's initiative on sustainable development. These benefits will outweigh all associated costs in respect of these guidelines.
61. Finally, ESMA believes that the adoption of guidelines is the best tool to achieve the explained objectives since this topic is already covered by existing guidelines. Furthermore, the adoption of guidelines further reduces the risk of diverging interpretations that might lead to discrepancies in the application and supervision of the relevant regulation and requirements across Member States (determining a risk of regulatory arbitrage and circumvention of rules).

### 3.3 Annex III - Draft guidelines

#### Guidelines

##### I. Scope

###### Who?

1. These guidelines apply to:
  - a. Competent Authorities and
  - b. Firms

###### What?

2. These guidelines apply in relation to Article 25(2) of MiFID II and Articles 54 and 55 of MiFID II Delegated Regulation and apply to the provision of the following investment services listed in Section A of Annex I of MiFID II:
  - investment advice;
  - portfolio management.
3. These guidelines principally address situations where services are provided to retail clients. They should also apply, to the extent they are relevant, when services are provided to professional clients, taking into account the provisions under Article 54(3) of the MiFID II Delegated Regulation and Annex II of MiFID II.

###### When?

4. These guidelines apply as from [two months from the date of publication of the guidelines on ESMA's website in all EU official languages].

The previous ESMA guidelines issued under MiFID II<sup>26</sup> will cease to apply on the same date.

##### II. Legislative references, abbreviations and definitions

###### Legislative references

###### *ESMA Regulation*

Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing

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<sup>26</sup> ESMA35-43-1163 - - Guidelines on certain aspects of the MiFID II suitability requirements.

*MiFID II*

Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU.<sup>28</sup>

*MiFID II Delegated regulation*

Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive.<sup>29</sup>

**Definitions**

*Investment product*

A financial instrument (within the meaning of Article 4(1)(15) of MiFID II) or a structured deposit (within the meaning of Article 4(1)(43) of MiFID II).

*Firms*

Investment firms (as defined in Article 4(1)(1) of MiFID II) and credit institutions (as defined in Article 4(1)(27) of MiFID II) when providing the investment services of investment advice and portfolio management listed in Section A of Annex I of MiFID II, investment firms and credit institutions (when selling or advising clients in relation to structured deposits), UCITS management companies (as defined in Article 2(1)(b) of UCITS Directive<sup>30</sup>) and external Alternative Investment Fund Managers (AIFMs) (as defined in Article 5(1)(a) of the AIFMD<sup>31</sup>) when providing the investment services of individual portfolio management or non-core services (within the meaning of Article 6(3)(a) and (b)(i) of UCITS Directive and Article 6(4)(a) and (b)(i) of the AIFMD).

*Suitability assessment*

The whole process of collecting information about a client and the subsequent assessment by the firm that a given investment product is suitable for him, based also on the firm's solid understanding of the products that it can recommend or invest into on behalf of the client.

*Robo-advice*

The provision of investment advice or portfolio management services (in whole or in part) through an automated or semi-automated system used as a client-facing tool.

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<sup>27</sup> OJ L 331, 15.12.2010, p. 84.

<sup>28</sup> OJ L 173, 12.06.2014, p. 349.

<sup>29</sup> OJ L 87, 31.3.2017, p. 1.

<sup>30</sup> Directive 2009/65/EC

<sup>31</sup> Directive 2011/61/EU

## **II. Purpose**

5. The purpose of these guidelines is to clarify the application of certain aspects of the MiFID II suitability requirements in order to ensure the common, uniform and consistent application of Article 25(2) of MiFID II and of Articles 54 and 55 of the MiFID II Delegated Regulation.
6. ESMA expects these guidelines to promote greater convergence in the interpretation of, and supervisory approaches to, the MiFID II suitability requirements, by emphasising a number of important issues, and thereby enhancing the value of existing standards. By helping to ensure that firms comply with regulatory standards, ESMA anticipates a corresponding strengthening of investor protection.

## **III. Compliance and reporting obligations**

### **Status of the guidelines**

7. This document contains guidelines issued under Article 16 of the ESMA Regulation.<sup>32</sup> In accordance with Article 16(3) of the ESMA Regulation, competent authorities and financial market participants shall make every effort to comply with guidelines.
8. Competent authorities to whom these guidelines apply should comply by incorporating them into their national legal and/or supervisory frameworks as appropriate, including where particular guidelines are directed primarily at financial market participants. In this case, competent authorities should ensure through their supervision that financial market participants comply with the guidelines.

### **Reporting requirements**

9. Competent authorities to which these guidelines apply must notify ESMA whether they comply or intend to comply with the guidelines as appropriate, stating their reasons for non-compliance where they do not comply or do not intend to comply, within two months of the date of publication of the guidelines on ESMA's website in all official languages of the EU. In this case, competent authorities should ensure through their supervision that financial market participants comply with the guidelines.
10. Firms are not required to report whether they comply with these guidelines.

## **IV. Guidelines on certain aspects of the MiFID suitability requirements**

## **V. INFORMATION TO CLIENTS ABOUT THE PURPOSE OF THE SUITABILITY ASSESSMENT AND ITS SCOPE**

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<sup>32</sup> Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC.



**Relevant legislation: Article 24(1), 24(4) and 24(5) of MiFID II and Article 54(1), of the MiFID II Delegated Regulation.**

*General guideline 1*

11. Firms should inform their clients clearly and simply about the suitability assessment and its purpose which is to enable the firm to act in the client's best interest. This should include a clear explanation that it is the firm's responsibility to conduct the assessment, so that clients understand the reason why they are asked to provide certain information and the importance that such information is up-to-date, accurate and complete. Such information may be provided in a standardised format.

*Supporting guidelines*

12. Information about the suitability assessment should help clients understand the purpose of the requirements. It should encourage them to provide accurate and sufficient information about their knowledge, experience, financial situation (including their ability to bear losses), and investment objectives (including their risk tolerance). Firms should highlight to their clients that it is important to gather complete and accurate information so that the firm can recommend suitable products or services for the client. Without this information, firms cannot provide investment advice and portfolio management services to clients.
13. It is up to the firms to decide how they will inform their clients about the suitability assessment. The format used should however enable controls to check if the information was provided.
14. Firms should avoid stating, or giving the impression, that it is the client who decides on the suitability of the investment, or that it is the client who establishes which financial instruments fit his own risk profile. For example, firms should avoid indicating to the client that a certain financial instrument is the one that the client chose as being suitable, or requiring the client to confirm that an instrument or service is suitable.
15. Any disclaimers (or other similar types of statements) aimed at limiting the firm's responsibility for the suitability assessment would not in any way impact the characterisation of the service provided in practice to clients nor the assessment of the firm's compliance to the corresponding requirements. For example, when collecting clients' information required to conduct a suitability assessment (such as their investment horizon/holding period or information related to risk tolerance), firms should not claim that they do not assess the suitability.
16. In order to help clients understand the concept of "sustainability preferences" and the choices to be made in this context, firms should explain the term and the distinction between the different elements of the definition of sustainability preferences under a) to c) and also between these products and products without such sustainability features in a clear manner, avoiding technical language. Firms should also explain what environmental, social and governance aspects mean.

17. In order to address potential gaps in clients' understanding of the services provided through robo-advice, firms should inform clients, in addition to other required information, on the following:
- a very clear explanation of the exact degree and extent of human involvement and if and how the client can ask for human interaction;
  - an explanation that the answers clients provide will have a direct impact in determining the suitability of the investment decisions recommended or undertaken on their behalf;
  - a description of the sources of information used to generate an investment advice or to provide the portfolio management service (e.g., if an online questionnaire is used, firms should explain that the responses to the questionnaire may be the sole basis for the robo-advice or whether the firm has access to other client information or accounts);
  - an explanation of how and when the client's information will be updated with regard to his situation, personal circumstances, etc.
18. Provided that all the information and reports given to clients shall comply with the relevant provisions (including obligations on the provision of information in durable medium), firms should also carefully consider whether their written disclosures are designed to be effective (e.g., the disclosures are made available directly to clients and are not hidden or incomprehensible). For firms providing robo-advice this may in particular include:
- Emphasising the relevant information (e.g., through the use of design features such as pop-up boxes);
  - Considering whether some information should be accompanied by interactive text (e.g., through the use of design features such as tooltips) or other means to provide additional details to clients who are seeking further information (e.g., through F.A.Q. section).

## **V.I KNOW YOUR CLIENT AND KNOW YOUR PRODUCT**

### **Arrangements necessary to understand clients**

**Relevant legislation: Articles 16(2) and 25(2) of MiFID II, and Articles 54(2) to 54(5) and Article 55 of the MiFID II Delegated Regulation.**

#### *General guideline 2*

19. Firms must establish, implement and maintain adequate policies and procedures (including appropriate tools) to enable them to understand the essential facts and characteristics about their clients. Firms should ensure that the assessment of

information collected about their clients is done in a consistent way irrespective of the means used to collect such information.

### *Supporting guidelines*

20. Firms' policies and procedures shall enable them to collect and assess all information necessary to conduct a suitability assessment for each client, while taking into account the elements developed in guideline 3.
21. For example firms could use questionnaires (also in a digital format) completed by their clients or information collected during discussions with them. Firms should ensure that the questions they ask their clients are likely to be understood correctly and that any other method used to collect information is designed to get the information required for a suitability assessment.
22. When designing the questionnaires aiming at collecting information about their clients for the purpose of a suitability assessment firms should be aware and consider the most common reasons why investors could fail to answer questionnaires correctly. In particular:
  - Attention should be given to the clarity, exhaustiveness and comprehensibility of the questionnaire, avoiding misleading, confusing, imprecise and excessively technical language;
  - The layout should be carefully elaborated and should avoid orienting investors' choices (font, line spacing...);
  - Presenting questions in batteries (collecting information on a series of items through a single question, particularly when assessing knowledge and experience and the risk tolerance) should be avoided.
  - Firms should carefully consider the order in which they ask questions in order to collect information in an effective manner;
  - In order to be able to ensure necessary information is collected, the possibility not to reply should generally not be available in questionnaires (particularly when collecting information on the investor's financial situation).
23. Firms should also take reasonable steps to assess the client's understanding of investment risk as well as the relationship between risk and return on investments, as this is key to enable firms to act in accordance with the client's best interest when conducting the suitability assessment. When presenting questions in this regard, firms should explain clearly and simply that the purpose of answering them is to help assess clients' attitude to risk (risk profile), and therefore the types of financial instruments (and risks attached to them) that are suitable for them.
24. Information necessary to conduct a suitability assessment includes different elements that may affect, for example, the analysis of the client's financial situation (including his

ability to bear losses) or investment objectives (including his risk tolerance). Examples of such elements are the client's:

- marital status (especially the client's legal capacity to commit assets that may belong also to his partner);
- family situation (changes in the family situation of a client may impact his financial situation e.g. a new child or a child of an age to start university);
- age (which is mostly important to ensure a correct assessment of the investment objectives, and in particular the level of financial risk that the investor is willing to take, as well as the holding period/investment horizon, which indicates the willingness to hold an investment for a certain period of time);
- employment situation (the degree of job security or that fact the client is close to retirement may impact his financial situation or his investment objectives);
- need for liquidity in certain relevant investments or need to fund a future financial commitment (e.g. property purchase, education fees).

25. The information on the sustainability preferences of the client should include all aspects mentioned in the definition of "sustainability preferences" according to Article 2(7) of the MiFID II Delegated Regulation and should be sufficiently granular to allow for a matching of the client's sustainability preferences with the sustainability-related features of financial instruments. Granularity of information should also allow for a combination of the different aspects mentioned in Article 2(7). Firms should collect the following information from clients:

- Whether the client has any sustainability preferences (yes/no).
- Whether – and if so, to what extent - the client has sustainability preferences with regard to aspect a), b) or c) of the definition according to Article 2(7) MiFID II Delegated Regulation and if the client has a preference for, where relevant, a combination of one or more of the three aspects.
- For aspects a) and b), the minimum proportion.
- For aspect c), which principal adverse impacts (PAI) should be considered including quantitative and qualitative criteria demonstrating that consideration.

Throughout the process, firms should adopt a neutral and unbiased approach as to not influence clients' answers.

26. To achieve this, firms could choose the following approach:

- First, firms could collect information on the degrees of sustainability related expectation of the client which would refer to one or more of the aspects

expressed through a) to c) of Article 2(7) of the MiFID II Delegated Regulation (“qualitative aspect of sustainability preferences”).

When doing so, firms could also assess whether the client would only prefer one certain degree of sustainability-related expectation or whether more or all of them should be part of its preferences. This aspect could be assessed through closed-ended yes/no-questions. Where the client wishes to include more or all of the aspects mentioned under a) to c) of Article 2(7) of the MiFID Delegated Regulation, this could be either assessed and matched on portfolio level or on the level of the financial instrument, depending on the service provided.

When providing portfolio management or investment advice (with or without portfolio approach) the firm could also ask the client to what extent financial instruments according to a) to c) should be included in client's investment/portfolio.

- Firms could, as a second step, also collect information on whether the client's sustainability preferences with regard to b) and c), if any, have a focus on either environmental, social or governance criteria or a combination of them or whether the client does not have such a focus.
- As a third step, firms could collect information on the client's preferences in terms of the “minimum proportion” as mentioned in a) and b) if the client requested to include these financial instruments in the investment. Where a firm decides to collect this information not in terms of particular percentage but by ranges or sizes, these ranges should be presented in a neutral way to the client and should be sufficiently granular.
- In case the client wishes to include a financial instrument that considers PAI, the information collected should cover the PAI and qualitative and quantitative elements mentioned under c). Firms could test the client's preferences and appetite for PAI integration with regard to the families of PAI indicators as whole, based on a possible focus of the client on environmental, social or governance aspects, using the categories presented in the SFDR RTS (instead of an approach based on each PAI indicator) such as emissions, energy performance, water & waste, etc.

A qualitative evaluation could then be initiated for each category that is important/key for the client or not. This qualitative evaluation could be based on the approaches in which products consider PAI (e.g. exclusion strategies / controversies policies / voting and engagement policies).

- Firms should have policies and instructions for their client-facing staff in place for situations where clients answer that they do have sustainability preferences but do not state a preference with regard to any of the specific aspects mentioned under a) to c) or with regard to a minimum proportion. For example, the firm could consider any of the aspects under a) to c) or a combination thereof and could

consider that it is not bound by any minimum proportion of sustainability-related expectation for the purpose of conducting the suitability assessment. Where firms make use of this possibility, they should inform the client about their choice and the level of the sustainability-related expectation of the product and document in the suitability report the client's choice not to further specify the sustainability preferences.

27. Firms should ensure the same level of granularity of information is collected on the client's sustainability preferences when providing portfolio management or investment advice with a portfolio approach. The client's sustainability preferences should be collected with regard to the portfolio (whereas the possibility of specific individual instructions remains, e.g. if a client asks for specific ESG-related products in the portfolio). Firms should therefore ask the client which part of the portfolio (if any) the client wants to be invested in products meeting the client's sustainability preferences. Where firms work with model portfolios that combine some or all of the criteria listed under paragraph 25 above, these model portfolios should allow for a granular assessment of the client's preferences and should not be translated into a questionnaire that pushes the client into a certain combination of the criteria that would not meet the client's sustainability preferences (i.e. all preferences need to be asked for and matched with the sustainability-related features of the model portfolio).
28. When determining what information is necessary, firms should keep in mind the impact that any significant change regarding that information could have concerning the suitability assessment.
29. Firms should take all reasonable steps to sufficiently assess the understanding by their clients of the main characteristics and the risks related to the product types in the offer of the firm. The adoption by firms of mechanisms to avoid self-assessment and ensure the consistency of the answers provided by the client<sup>33</sup> is particularly important for the correct assessment of the client's knowledge and experience. Information collected by firms about a client's knowledge and experience should be considered altogether for the overall appraisal of his understanding of the products and of the risks involved in the transactions recommended or in the management of his portfolio.
30. It is also important that firms appraise the client's understanding of basic financial notions such as investment risk (including concentration risk) and risk-return trade off. To this end, firms should consider using indicative, comprehensible examples of the levels of loss/return that may arise depending on the level of risk taken and should assess the client's response to such scenarios.
31. Firms should design their questionnaires so that they are able to gather the necessary information about their client. This may be particularly relevant for firms providing robo-advice services given the limited human interaction. In order to ensure their compliance

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<sup>33</sup> See guideline 4.

with the requirements concerning that assessment, firms should take into account factors such as:

- Whether the information collected through the online questionnaire allows the firm to conclude that the advice provided is suitable for their clients on the basis of their knowledge and experience, their financial situation and their investment objectives and needs;
- Whether the questions in the questionnaire are sufficiently clear and/or whether the questionnaire is designed to provide additional clarification or examples to clients when necessary (e.g., through the use of design features, such as tool-tips or pop-up boxes);
- Whether some human interaction (including remote interaction via emails or mobile phones) is available to clients when responding to the online questionnaire;
- Whether steps have been taken to address inconsistent client responses (such as incorporating in the questionnaire design features to alert clients when their responses appear internally inconsistent and suggest them to reconsider such responses; or implementing systems to automatically flag apparently inconsistent information provided by a client for review or follow-up by the firm).

### **Extent of information to be collected from clients (proportionality)**

**Relevant legislation: Article 25(2) of MiFID II, and Articles 54(2) to 54(5) and Article 55 of the MiFID II Delegated Regulation.**

#### *General guideline 3*

32. Before providing investment advice or portfolio management services, firms need to collect all 'necessary information'<sup>34</sup> about the client's knowledge and experience, financial situation and investment objectives. The extent of 'necessary' information may vary and has to take into account the features of the investment advice or portfolio management services to be provided, the type and characteristics of the investment products to be considered and the characteristics of the clients.

#### *Supporting guidelines*

33. In determining what information is 'necessary' firms should consider, in relation to a client's knowledge and experience, financial situation and investment objectives:
- the type of the financial instrument or transaction that the firm may recommend or enter into (including the complexity and level of risk);

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<sup>34</sup> 'Necessary information' should be understood as meaning the information that firms must collect to comply with the suitability requirements under MiFID II.



- the nature and extent of the service that the firm may provide;
  - the needs and circumstances of the client;
  - the type of client.
34. While the extent of the information to be collected may vary, the standard for ensuring that a recommendation or an investment made on the client's behalf is suitable for the client will always remain the same. MiFID allows firms to collect the level of information proportionate to the products and services they offer, or on which the client requests specific investment advice or portfolio management services. It does not allow firms to lower the level of protection due to clients.
35. For example, when providing access to complex<sup>35</sup> or risky<sup>36</sup> financial instruments, firms should carefully consider whether they need to collect more in-depth information about the client than they would collect when less complex or risky instruments are at stake. This is so that firms can assess the client's capacity to understand, and financially bear, the risks associated with such instruments.<sup>37</sup> For such complex products ESMA expects firms to carry out a robust assessment amongst others of the client's knowledge and experience, including, for example, his ability to understand the mechanisms which make the investment product "complex", whether the client has already traded in such products (for example, derivatives or leverage products), the length of time he has been trading them for, etc.
36. For illiquid financial instruments<sup>38</sup>, the 'necessary information' to be gathered will include information on the length of time for which the client is prepared to hold the investment. As information about a client's financial situation will always need to be collected, the extent of information to be collected may depend on the type of financial instruments to be recommended or entered into. For example, for illiquid or risky financial instruments, 'necessary information' to be collected may include all of the following elements as necessary to ensure whether the client's financial situation allows him to invest or be invested in such instruments:
- the extent of the client's regular income and total income, whether the income is earned on a permanent or temporary basis, and the source of this income (for example, from employment, retirement income, investment income, rental yields, etc.);
  - the client's assets, including liquid assets, investments and real property, which would include what financial investments, personal and investment property, pension funds and any cash deposits, etc. the client may have. The firm should,

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<sup>35</sup> As defined in MiFID II and taking into account the criteria identified in guideline 7.

<sup>36</sup> It is up to each firm to define *a priori* the level of risk of the financial instruments included in its offer to investors taking into account, where available, possible guidelines issued by competent authorities supervising the firm.

<sup>37</sup> In any case, to ensure clients understand the investment risk and potential losses they may bear, the firm should, as far as possible, present these risks in a clear and understandable way, potentially using illustrative examples of the extent of losses in the event of an investment performing poorly.

<sup>38</sup> It is up to each firm to define *a priori* which of the financial instruments included in its offer to investors it considers as being illiquid, taking into account, where available, possible guidelines issued by competent authorities supervising the firm.



where relevant, also gather information about conditions, terms, access, loans, guarantees and other restrictions, if applicable, to the above assets that may exist.

- the client's regular financial commitments, which would include what financial commitments the client has made or is planning to make (client's debits, total amount of indebtedness and other periodic commitments, etc.).
37. In determining the information to be collected, firms should also take into account the nature of the service to be provided. Practically, this means that:
- when investment advice is to be provided, firms should collect sufficient information in order to be able to assess the ability of the client to understand the risks and nature of each of the financial instruments that the firm envisages recommending to that client;
  - when portfolio management is to be provided, as investment decisions are to be made by the firm on behalf of the client, the level of knowledge and experience needed by the client with regard to all the financial instruments that can potentially make up the portfolio may be less detailed than the level that the client should have when an investment advice service is to be provided. Nevertheless, even in such situations, the client should at least understand the overall risks of the portfolio and possess a general understanding of the risks linked to each type of financial instrument that can be included in the portfolio. Firms should gain a very clear understanding and knowledge of the investment profile of the client.
38. Similarly, the extent of the service requested by the client may also impact the level of detail of information collected about the client. For example, firms should collect more information about clients asking for investment advice covering their entire financial portfolio than about clients asking for specific advice on how to invest a given amount of money that represents a relatively small part of their overall portfolio.
39. Firms should also take into account the nature of the client when determining the information to be collected. For example, more in-depth information would usually need to be collected for potentially vulnerable clients (such as older clients could be) or inexperienced ones asking for investment advice or portfolio management services for the first time. Where a firm provides investment advice or portfolio management services to a professional client (who has been correctly classified as such), it is entitled to assume that the client has the necessary level of experience and knowledge, and therefore is not required to obtain information on these aspects.
40. Similarly, where the investment service consists of the provision of investment advice to a 'per se professional client'<sup>39</sup> the firm is entitled to assume that the client is able to financially bear any related investment risks consistent with the investment objectives of that client and therefore is not generally required to obtain information on the financial situation of the client. Such information should be obtained, however, where the client's

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<sup>39</sup> As set out in Section I of Annex II of MiFID II ('Categories of client who are considered to be professionals').

investment objectives demand it. For example, where the client is seeking to hedge a risk, the firm will need to have detailed information on that risk in order to be able to propose an effective hedging instrument.

41. Information to be collected will also depend on the needs and circumstances of the client. For example, a firm is likely to need more detailed information about the client's financial situation where the client's investment objectives are multiple and/or long-term, than when the client seeks a short-term secure investment.<sup>40</sup>
42. Information about a client's financial situation includes information regarding his investments. This implies that firms are expected to possess information about the client's financial investments he holds with the firm on an instrument-by-instrument basis. Depending on the scope of advice provided, firms should also encourage clients to disclose details on financial investments they hold with other firms, if possible also on an instrument-by-instrument basis.

### **Reliability of client information**

**Relevant legislation: Article 25(2) of MiFID II, and Articles 54(7), first subparagraph of the MiFID II Delegated Regulation.**

#### *General guideline 4*

43. Firms should take reasonable steps and have appropriate tools to ensure that the information collected about their clients is reliable and consistent, without unduly relying on clients' self-assessment.

#### *Supporting guidelines*

44. Clients are expected to provide correct, up-to-date and complete information necessary for the suitability assessment. However, firms need to take reasonable steps to check the reliability, accuracy and consistency of information collected about clients<sup>41</sup>. Firms remain responsible for ensuring they have the necessary information to conduct a suitability assessment. In this respect, any agreement signed by the client, or disclosure made by the firm, that would aim at limiting the responsibility of the firm with regard to the suitability assessment, would not be considered compliant with the relevant requirements in MiFID II and related Delegated Regulation.
45. Self-assessment should be counterbalanced by objective criteria. For example:
  - instead of asking whether a client understands the notions of risk-return trade off and risk diversification, the firm could present some practical examples of situations

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<sup>40</sup> There may be situations where the client is unwilling to disclose his full financial situation. For this particular question see Q&As on MiFID II investor protection topics (ESMA35-43-349)

<sup>41</sup> When dealing with professional clients, firms should take into account the proportionality principles as referred to in guideline 3, in line with Article 54 (3) of MiFID II Delegated Regulation.

that may occur in practice, for example by means of graphs or through positive and negative scenarios;

- instead of asking a client whether he feels sufficiently experienced to invest in certain products, the firm could ask the client what types of products the client is familiar with and how recent and frequent his trading experience with them is;
  - instead of asking whether clients believe they have sufficient funds to invest, the firm could ask clients to provide factual information about their financial situation, e.g. the regular source of income and whether outstanding liabilities exist (such as bank loans or other debts, which may significantly impact the assessment of the client's ability to financially bear any risks and losses related to the investment);
  - instead of asking whether a client feels comfortable with taking risk, the firm could ask what level of loss over a given time period the client would be willing to accept, either on the individual investment or on the overall portfolio.
46. When assessing the risk tolerance of their clients through a questionnaire, firms should not only investigate the desirable risk-return characteristics of future investments but they should also take into account the client's risk perception. To this end, whilst self-assessment for the risk tolerance should be avoided, explicit questions on the clients' personal choices in case of risk uncertainty could be presented. Furthermore, firms could for example make use of graphs, specific percentages or concrete figures when asking the client how he would react when the value of his portfolio decreases.
47. Where firms rely on tools to be used by clients as part of the suitability process (such as questionnaires or risk-profiling software), they should ensure that they have appropriate systems and controls to ensure that the tools are fit for purpose and produce satisfactory results. For example, risk-profiling software could include some controls of coherence of the replies provided by clients in order to highlight contradictions between different pieces of information collected.
48. Firms should also take reasonable steps to mitigate potential risks associated with the use of such tools. For example, potential risks may arise if clients were encouraged to provide certain answers in order to get access to financial instruments that may not be suitable for them (without correctly reflecting the clients' real circumstances and needs)<sup>42</sup>.
49. In order to ensure the consistency of client information, firms should view the information collected as a whole. Firms should be alert to any relevant contradictions between different pieces of information collected, and contact the client in order to resolve any material potential inconsistencies or inaccuracies. Examples of such contradictions are clients who have little knowledge or experience and an aggressive attitude to risk, or who have a prudent risk profile and ambitious investment objectives.

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<sup>42</sup> In this regard, see also paragraph 54 of Guideline 5, which addresses the risk of clients being influenced by firms to change answers previously provided by them, without there being any real modification in their situation.

50. Firms should adopt mechanisms to address the risk that clients may tend to overestimate their knowledge and experience, for example by including questions that would help firms assess the overall clients' understanding about the characteristics and the risks of the different types of financial instruments. Such measures may be particularly important in the case of robo-advice, since the risk of overestimation by clients may result higher when they provide information through an automated (or semi-automated) system, especially in situations where very limited or no human interaction at all between clients and the firm's employees is foreseen.

### **Updating client information**

**Relevant legislation: Article 25(2) of MiFID II, subparagraph 2 of Article 54(7), and Article 55(3) of the MiFID II Delegated Regulation.**

#### *General guideline 5*

51. Where a firm has an ongoing relationship with the client (such as by providing ongoing advice or portfolio management services), in order to be able to perform the suitability assessment, it should adopt procedures defining:
- (a) what part of the client information collected should be subject to updating and at which frequency;
  - (b) how the updating should be done and what action should be undertaken by the firm when additional or updated information is received or when the client fails to provide the information requested.

#### *Supporting guidelines*

52. Firms should regularly review client information to ensure that it does not become manifestly out of date, inaccurate or incomplete. To this end, firms should implement procedures to encourage clients to update the information originally provided where significant changes occur.
53. Frequency of update might vary depending on, for example, clients' risk profiles and taking into account the type of financial instrument recommended. Based on the information collected about a client under the suitability requirements, a firm will determine the client's investment risk profile, i.e. what type of investment services or financial instruments can in general be suitable for him taking into account his knowledge and experience, his financial situation (including his ability to bear losses) and his investment objectives (including his risk tolerance). For example, a risk profile giving to the client access to a wider range of riskier products is an element that is likely to require more frequent updating. Certain events might also trigger an updating process; this could be so, for example, for clients reaching the age of retirement.
54. Updating could, for example, be carried out during periodic meetings with clients or by sending an updating questionnaire to clients. Relevant actions might include changing the client's profile based on the updated information collected.

55. With regard to the sustainability preferences of a client, this information should be updated - for ongoing relationships - through the next regular update of client information or during the first meeting with the client/the first investment advice following the entry-into-application of Commission Delegated Regulation 2021/1253.
56. It is also important that firms adopt measures to mitigate the risk of inducing the client to update his own profile so as to make appear as suitable a certain investment product that would otherwise be unsuitable for him, without there being a real modification in the client's situation<sup>43</sup>. As an example of a good practice to address this type of risk, firms could adopt procedures to verify, before or after transactions are made, whether a client's profile has been updated too frequently or only after a short period from last modification (especially if this change has occurred in the immediate days preceding a recommended investment). Such situations would therefore be escalated or reported to the relevant control function. These policies and procedures are particularly important in situations where there is a heightened risk that the interest of the firm may come into conflict with the best interests of its clients, e.g. in self-placement situations or where the firm receives inducements for the distribution of a product. Another relevant factor to consider in this context is also the type of interaction that occurs with the client (e.g. face-to-face vs through an automated system)<sup>44</sup>.
57. Firms should inform the client when the additional information provided results in a change of his profile, whether it becomes more risky (and therefore, potentially, a wider range of riskier and more complex products may result suitable for him, with the potential to incur in higher losses) or *vice-versa* more conservative (and therefore, potentially, a more restricted range of products may as a result be suitable for him).

## **Client information for legal entities or groups**

**Relevant legislation: Article 25(2) of MiFID II and Article 54(6) of the MiFID II Delegated Regulation.**

### *General guideline 6*

58. Firms must have a policy defining on an *ex ante* basis, how to conduct the suitability assessment in situations where a client is a legal person or a group of two or more natural persons or where one or more natural persons are represented by another natural person. This policy should specify, for each of those situations, the procedure and criteria that should be followed in order to comply with the MiFID II suitability requirements. The firm should, clearly, inform *ex-ante* those of its clients that are legal entities, groups of persons or natural persons represented by another natural person about who should be subject to the suitability assessment, how the suitability assessment will be done in

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<sup>43</sup> Also relevant in this context are measures adopted to ensure the reliability of clients' information as detailed under guideline 4, paragraph 44.

<sup>44</sup> In this regard, also see the clarifications already provided by ESMA in the Q&As on MiFID II investor protection topics (Ref: ESMA35-43-349 – Question on 'Transactions on unsuitable products').

practice and the possible impact this could have for the relevant clients, in accordance with the existing policy.

#### *Supporting guidelines*

59. Firms should consider whether the applicable national legal framework provides specific indications that should be taken into account for the purpose of conducting the suitability assessment (this could be the case, for instance, where the appointment of a legal representative is required by law: e.g. for underage or incapacitated persons or for a legal person).
60. The policy should make a clear distinction between situations where a representative is foreseen under applicable national law, as it can be the case for example for legal persons, and situations where no representative is foreseen, and it should focus on this latter situations. Where the policy foresees agreements between clients, they should be made aware clearly and in written form about the effects that such agreements may have regarding the protection of their respective interests. Steps taken by the firm in accordance with its policy should be appropriately documented to enable *ex-post* controls.

#### *Situations where a representative is foreseen under applicable national law*

61. Subparagraph 2 of Article 54(6) of the MiFID II Delegated Regulation defines how the suitability assessment should be done with regard to situations where the client is a natural person represented by another natural person or is a legal person having requested treatment as a professional client. It seems reasonable that the same approach could apply to all legal persons, regardless of the fact that they may have requested to be treated as professionals or not.
62. Firms should ensure that their procedures adequately incorporate this article in their organisation, which would imply amongst others that they verify that the representative is indeed – according to relevant national law – authorised to carry out transactions on behalf of the underlying client.

#### *Situations where no representative is foreseen under applicable national law*

63. Where the client is a group of two or more natural persons and no representative is foreseen under applicable national law, the firm's policy should identify from whom necessary information will be collected and how the suitability assessment will be done. Clients should be properly informed about the firm's approach (as decided in the firm's policy) and the impact of this approach on the way the suitability assessment is done in practice.
64. Approaches such as the following could possibly be considered by firms:
  - (a) they could choose to invite the group of two or more natural persons to designate a representative; or,



- (b) they could consider collecting information about each individual client and assessing the suitability for each individual client.

Inviting the group of two or more natural persons to designate a representative

- 65. If the group of two or more natural persons agrees to designate a representative, the same approach as the one described in subparagraph 2 of Article 54(6) of the MiFID II Delegated Regulation could be followed: the knowledge and experience shall be that of the representative, while the financial situation and the investment objectives would be those of the underlying client(s). Such designation should be made in written form as well as according to and in compliance with the applicable national law, and recorded by the relevant firm. The clients - part of the group - should be clearly informed, in written form, about the impact that an agreement amongst clients could have on the protection of their respective interests.
- 66. The firm's policy could however require the underlying client(s) to agree on their investment objectives.
- 67. If the parties involved have difficulties in deciding the person/s from whom the information on knowledge and experience should be collected, the basis on which the financial situation should be determined for the purpose of the suitability assessment or on defining their investment objectives, the firm should adopt the most prudent approach by taking into account, accordingly, the information on the person with the least knowledge and experience, the weakest financial situation or the most conservative investment objectives. Alternatively, the firm's policy may also specify that it will not be able to provide investment advice or portfolio management services in such a situation. Firms should at least be prudent whenever there is a significant difference in the level of knowledge and experience or in the financial situation of the different clients part of the group, or when the investment advice or portfolio management services may include leveraged financial instruments or contingent liability transactions that pose a risk of significant losses that could exceed the initial investment of the group of clients and should clearly document the approach chosen.

Collecting information about each individual client and assessing the suitability for each individual client

- 68. When a firm decides to collect information and assess suitability for each individual client part of the group, if there are significant differences between the characteristics of those individual clients (for example, if the firm would classify them under different investment profiles), the question arises about how to ensure the consistency of the investment advice or portfolio management services provided with regard to the assets or portfolio of that group of clients. In such a situation, a financial instrument may be suitable for one client part of the group but not for another one. The firm's policy should clearly specify how it will deal with such situations. Here again, the firm should adopt the most prudent approach by taking into account the information on the client part of the group with the least knowledge and experience, the weakest financial situation or the most conservative investment objectives. Alternatively, the firm's policy may also specify that it will not be able to provide investment advice or portfolio management services in such a situation.

In this context, it should be noted that collecting information on all the clients part of the group and considering, for the purposes of the assessment, an average profile of the level of knowledge and competence of all of them, would unlikely be compliant with the MiFID II overarching principle of acting in the clients' best interests.

## **Arrangements necessary to understand investment products**

**Relevant legislation: Articles 16(2) and 25(2) of MiFID II, and Article 54(9) of the MiFID II Delegated Regulation.**

### *General guideline 7*

69. Firms should ensure that the policies and procedures implemented to understand the characteristics, nature and features (including costs and risks) of investment products allow them to recommend suitable investments, or invest into suitable products on behalf of their clients.

### *Supporting guidelines*

70. Firms should adopt robust and objective procedures, methodologies and tools that allow them to appropriately consider the different characteristics, including sustainability factors, and relevant risk factors (such as credit risk, market risk, liquidity risk<sup>45</sup>, ...) of each investment product they may recommend or invest in on behalf of clients. This should include taking into consideration the firm's analysis conducted for the purposes of product governance obligations<sup>46</sup>. In this context, firms should carefully assess how certain products could behave under certain circumstances (e.g. convertible bonds or other debt instruments subject to the Bank Recovery and Resolution Directive<sup>47</sup> which may, for example, change their nature into shares). Considering the level of 'complexity' of products is particularly important, and this should be matched with a client's information (in particular regarding their knowledge and experience). Although complexity is a relative term, which depends on several factors, firms should also take into account the criteria and principles identified in MiFID II, when defining and appropriately graduating the level of complexity to be attributed to products for the purposes of the assessment of suitability.
71. When considering the sustainability factors of products in view of the subsequent matching with the client's sustainability preferences, firms could, for example, rank and group the financial instruments included in their product range in terms of: i) the proportion invested in economic activities that qualify as environmentally sustainable (as

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<sup>45</sup> It is particularly important that the liquidity risk identified is not balanced out with other risk indicators (such as, for example, those adopted for the assessment of credit/counterparty risk and market risk). This is because the liquidity features of products should be compared with information on the client's willingness to hold the investment for a certain length of time, i.e. the so called 'holding period'.

<sup>46</sup> In particular, MiFID II requires firms (under subparagraph 2 of Article 24(2)) to '*understand the financial instruments they offer or recommend*' in order to be able to comply with their obligation to ensure the compatibility between products offered or recommended and the related target market of end clients.

<sup>47</sup> Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012 (OJ L 173, 12.6.2014, p. 190–348).



defined in Article 2, point (1), of Taxonomy Regulation); ii) the proportion of sustainable investments (as defined in Article 2, point (17), of SFDR); iii) the consideration of principal adverse impacts. Such grouping should also be consistent with the firm's analysis conducted for the purposes of product governance obligations. Firms are reminded that a grouping of financial instruments for the purpose of the suitability assessment cannot replace the collection of information from clients as described in paragraphs 25 and 26 above.

72. Firms should adopt procedures to ensure that the information used to understand and correctly classify investment products included in their product offer is reliable, accurate, consistent and up-to-date. When adopting such procedures, firms should take into account the different characteristics and nature of the products considered (for example, more complex products with particular features may require more detailed processes and firms should not solely relying on one data provider in order to understand and classify investment products but should check and challenge such data or compare data provided by multiple sources of information).
73. In addition, firms should review the information used so as to be able to reflect any relevant changes that may impact the product's classification. This is particularly important, taking into account the continuing evolution and growing speed of financial markets.

## **V.I MATCHING CLIENTS WITH SUITABLE PRODUCTS**

### **Arrangements necessary to ensure the suitability of an investment**

**Relevant legislation: Article 16(2) and 25(2) of MiFID II and Article 21 of the MiFID II Delegated Regulation.**

#### *General guideline 8*

74. In order to match clients with suitable investments, firms should establish policies and procedures to ensure that they consistently take into account:
  - all available information about the client necessary to assess whether an investment is suitable, including the client's current portfolio of investments (and asset allocation within that portfolio);
  - all material characteristics of the investments considered in the suitability assessment, including all relevant risks and any direct or indirect costs to the client.<sup>48</sup>

#### *Supporting guidelines*

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<sup>48</sup> See Articles 50 and 51 of MiFID II Delegated Regulation regarding the obligation to inform clients about costs.

75. Firms are reminded that the suitability assessment is not limited to recommendations to buy a financial instrument. Every recommendation must be suitable, whether it is, for example, a recommendation to buy, hold or sell an instrument, or not to do so<sup>49</sup>.
76. Firms that rely on tools in the suitability assessment process (such as model portfolios, asset allocation software or a risk-profiling tool for potential investments), should have appropriate systems and controls to ensure that the tools are fit for purpose and produce satisfactory results.
77. In this regard, the tools should be designed so that they take account of all the relevant specificities of each client or investment product. For example, tools that classify clients or investment products broadly would not be fit for purpose.
78. A firm should establish policies and procedures which enable it to ensure inter alia that:
- the advice and portfolio management services provided to the client take account of an appropriate degree of risk diversification;
  - the client has an adequate understanding of the relationship between risk and return, i.e. of the necessarily low remuneration of risk free assets, of the incidence of time horizon on this relationship and of the impact of costs on his investments;
  - the financial situation of the client can finance the investments and the client can bear any possible losses resulting from the investments;
  - any personal recommendation or transaction entered into in the course of providing an investment advice or portfolio management service, where an illiquid product is involved, takes into account the length of time for which the client is prepared to hold the investment; and
  - any conflicts of interest are prevented from adversely affecting the quality of the suitability assessment.
79. Sustainability preferences should only be addressed once the suitability has been assessed in accordance with the criteria of knowledge and experience, financial situation and other investment objectives. Once the range of suitable products has been identified following this assessment, in a second step the product or, with regard to portfolio management or investment advice with a portfolio approach, investment strategy that fulfils the client's sustainability preferences should be identified.
80. Where a firm intends to recommend a product that does not meet the initial sustainability preferences of the client in the context of investment advice as referred to in Recital 8 of the MiFID II Delegated Regulation, it can only do so once the client has adapted his/her sustainability preferences. The firm's explanation regarding the reason to resort to such possibility as well as the client's decision should be documented in the suitability report.

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<sup>49</sup> See recital 87 of MiFID II Delegated Regulation as well as paragraph 31 of section IV of CESR, Understanding the definition of advice under MiFID, question and answers, 19 April 2010, CESR/10-293.

Firms are reminded that this possibility only refers to the sustainability preferences and that with regard to the other criteria of the suitability assessment, the product has to meet the client profile and otherwise shall not be recommended as stated in Article 54(10) of the MiFID II Delegated Regulation.

81. With regards to the possibility for the client to adapt the sustainability preferences referred in Article 54(10) of the MiFID II Delegated Regulation, firms are reminded that this possibility should not be the standard procedure. Where a client adapts the sustainability preferences, this adaption should only refer to the suitability assessment/investment advice in question and not to the client's profile in general. In case of investment advice, it should also be documented in the suitability report and be subject to the regular monitoring procedures.

82. In case of portfolio management, the client's sustainability preferences, including the minimum proportion that shall be invested in sustainable investments, need to be collected and assessed when agreeing on the mandate and the investment strategy. If the firm cannot meet those preferences, it should discuss this with the client when agreeing on the mandate in which the investment strategy is defined and ask the client to adapt his/her preferences. The decision of the client should be documented.

When providing ongoing investment advice with a portfolio approach, firms should assess the client's sustainability preferences including the minimum proportion when conducting the initial suitability assessment. Then the firm should monitor whether those preferences are still met or not at portfolio level and issue appropriate recommendations as the case may be.

In case of portfolio management or ongoing investment advice with a portfolio approach, if the client adapts the sustainability preferences after the initial suitability assessment, firms should evaluate the impact of this change and whether this triggers a rebalancing of the portfolio.

83. Where a client does not answer the question whether it has sustainability preferences or answers "no", the firm may consider this client as "sustainability-neutral" and recommend products both with and without sustainability-related features. The firm's product offer should be documented and explained to the client with a mention of the products/portfolio's sustainability features.

84. If the client states that he/she has sustainability preferences, and the firm does not have any products with sustainability related factors available, this should also be documented in the suitability report.

85. When making a decision on the methodology to be adopted to conduct the suitability assessment, the firm should also take into account the type and characteristics of the services provided and, more in general, its business model. For example, where a firm manages a portfolio or advises a client with regard to his portfolio, it should adopt a methodology that would allow it to conduct a suitability assessment based on the consideration of the client's portfolio as a whole.

86. When conducting a suitability assessment, a firm providing the service of portfolio management should, on the one hand, assess - in accordance with paragraph 36(b) of these guidelines - the knowledge and experience of the client regarding each type of financial instrument that could be included in his portfolio, and the types of risks involved in the management of his portfolio. Depending on the level of complexity of the financial instruments involved, the firm should assess the client's knowledge and experience more specifically than solely on the basis of the type to which the instrument belongs (e.g. subordinated debt instead of bonds in general). On the other hand, with regard to the client's financial situation and investment objectives, the suitability assessment about the impact of the instrument(s) and transaction(s) can be done at the level of the client's portfolio as a whole. In practice, if the portfolio management agreement defines in sufficient details the investment strategy that is suitable for the client with regard to the suitability criteria defined by MiFID II and that will be followed by the firm, the assessment of the suitability of the investment decisions could be done against the investment strategy as defined in the portfolio management agreement and the portfolio of the client as a whole should reflect this agreed investment strategy.

When a firm conducts a suitability assessment based on the consideration of the client's portfolio as a whole within the service of investment advice, this means that, on the one hand, the level of knowledge and experience of the client should be assessed regarding each investment product and risks involved in the related transaction. On the other hand, with regard to the client's financial situation and investment objectives, the suitability assessment about the impact of the product and transaction can be done at the level of the client's portfolio.

87. When a firm conducts a suitability assessment based on the consideration of the client's portfolio as a whole, it should ensure an appropriate degree of diversification within the client's portfolio, taking into account the client's portfolio exposure to the different financial risks (geographical exposure, currency exposure, asset class exposure, etc.). In cases where, for example, from the firm's perspective, the size of a client's portfolio is too small to allow for an effective diversification in terms of credit risk, the firm could consider directing those clients towards types of investments that are 'secured' or per se diversified (such as, for example, a diversified investment fund).

Firms should be especially prudent regarding credit risk: exposure of the client's portfolio to one single issuer or to issuers part of the same group should be particularly considered. This is because, if a client's portfolio is concentrated in products issued by one single entity (or entities of the same group), in case of default of that entity, the client may lose up to his entire investment. When operating through so called self-placement models, firms are reminded of ESMA's 2016 Statement on BRRD<sup>50</sup> according to which "*they should avoid an excessive concentration of investments in financial instruments subject to the resolution regime issued by the firm itself or by entities of the same group*". Therefore, in addition to the methodologies to be implemented for the assessment of products credit risk (see guideline 7), firms should also adopt *ad hoc* measures and procedures to ensure that concentration with regard to credit risk is effectively identified,

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<sup>50</sup> See 'MiFID practices for firms selling financial instruments subject to the BRRD resolution regime' (ESMA/2016/902).

controlled and mitigated (for example, the identification of *ex ante* thresholds could be encompassed)<sup>51</sup>.

88. In order to ensure the consistency of the suitability assessment conducted through automated tools (even if the interaction with clients does not occur through automated systems), firms should regularly monitor and test the algorithms that underpin the suitability of the transactions recommended or undertaken on behalf of clients. When defining such algorithms, firms should take into account the nature and characteristics of the products included in their offer to clients. In particular, firms should at least:

- establish an appropriate system-design documentation that clearly sets out the purpose, scope and design of the algorithms. Decision trees or decision rules should form part of this documentation, where relevant;
- have a documented test strategy that explains the scope of testing of algorithms. This should include test plans, test cases, test results, defect resolution (if relevant), and final test results;
- have in place appropriate policies and procedures for managing any changes to an algorithm, including monitoring and keeping records of any such changes. This includes having security arrangements in place to monitor and prevent unauthorised access to the algorithm;
- review and update algorithms to ensure that they reflect any relevant changes (e.g. market changes and changes in the applicable law) that may affect their effectiveness;
- have in place policies and procedures enabling to detect any error within the algorithm and deal with it appropriately, including, for example, suspending the provision of advice if that error is likely to result in an unsuitable advice and/or a breach of relevant law/regulation;
- have in place adequate resources, including human and technological resources, to monitor and supervise the performance of algorithms through an adequate and timely review of the advice provided; and
- have in place an appropriate internal sign-off process to ensure that the steps above have been followed.

### **Costs and complexity of equivalent products**

**Relevant legislation: Article 25(2) of MiFID II and Article 54(9) of the MiFID II Delegated Regulation.**

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<sup>51</sup> To this end, in line with the mentioned ESMA's Statement, firms should also take into account the specific features of the securities offered (including their risk features and the circumstances of the issuer) as well as clients' financial situation, including their ability to bear losses, and their investment objectives, including their risk profile.

### *General guideline 9*

89. Suitability policies and procedures should ensure that, before a firm makes a decision on the investment product(s) that will be recommended, or invested in the portfolio managed on behalf of the client, a thorough assessment of the possible investment alternatives is undertaken, taking into account products' cost and complexity.

### *Supporting guidelines*

90. Firms should have a process in place, taking into account the nature of the service, the business model and the kind of products that are provided, to assess products available that are 'equivalent' to each other in terms of ability to meet the client's needs and circumstances, such as financial instruments with similar target markets and similar risk-return profile.
91. When considering the cost factor, firms should take into account all costs and charges covered by the relevant provisions under Article 24(4) of MiFID II and the related MiFID II Delegated Regulation provisions. As for the complexity, firms should refer to the criteria identified in the above guideline 7. For firms with a restricted range of products, or those recommending one type of product, where the assessment of 'equivalent' products could be limited, it is important that clients are made fully aware of such circumstances. In this context, it is particularly important that clients are provided appropriate information on how restricted the range of products offered is, pursuant to Article 24(4)(a)(ii) of MiFID II<sup>52</sup>.
92. Where a firm uses common portfolio strategies or model investment propositions that apply to different clients with the same investment profile (as determined by the firm), the assessment of cost and complexity for 'equivalent' products could be done on a higher level, centrally, (for example within an investment committee or any other committee defining common portfolio strategies or model investment propositions) although a firm will still need to ensure that the selected investment products are suitable and meet their clients' profile on a client-by-client basis.
93. Firms should be able to justify those situations where a more costly or complex product is chosen or recommended over an equivalent product, taking into account that for the selection process of products in the context of investment advice or portfolio management further criteria can also be considered (for example: the portfolio's diversification, liquidity, or risk level). Firms should document and keep records about these decisions, as these decisions should deserve specific attention from control functions within the firm. The respective documentation should be subject to internal reviews. When providing investment advice firms could, for specific well-defined reasons, also decide to inform the client about the decision to choose the more costly and complex financial instrument.

### **Costs and benefits of switching investments**

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<sup>52</sup> In accordance with MiFID II, firms are therefore not expected to consider the whole universe of possible investment options existing in the market in order to comply with the requirement under Article 54(9) of MiFID II Delegated Regulation.

**Relevant legislation: Articles 16(2) and 25(2) of MiFID II and Article 54(11) of the MiFID II Delegated Regulation.**

*General guideline 10*

94. Firms should have adequate policies and procedures in place to ensure that an analysis of the costs and benefits of a switch is undertaken such that firms are reasonably able to demonstrate that the expected benefits of switching are greater than the costs. Firms should also establish appropriate controls to avoid any circumvention of the relevant MiFID II requirements.

*Supporting guidelines*

95. For the purpose of this guideline, investment decisions such as rebalancing a portfolio under management, in the case of a “passive strategy” to replicate an index (as agreed with the client) would normally not be considered as a switch. For the avoidance of doubt, any transaction without maintaining these thresholds would be considered as a switch. For per se professional clients, the cost benefit analysis may be carried out on investment strategy level.
96. Firms should take all necessary information into account, so as to be able to conduct a cost-benefit analysis of the switch, i.e. an assessment of the advantages and disadvantages of the new investment(s) considered. When considering the cost dimension, firms should take into account all costs and charges covered by the relevant provisions under Article 24(4) of MiFID II and the related MiFID II Delegated Regulation provisions. In this context, both monetary and non-monetary factors of costs and benefits could be relevant. These may include, for example:
- the expected net return of the proposed alternative transaction (which also considers any possible up-front cost to be paid by the client(s)) vs the expected net return of the existing investment (that should also consider any exit cost which the client(s) might incur to divest from the product already in his/their portfolio);
  - a change in the client’s circumstances and needs, which may be the reason for considering the switch, e.g. the need for liquidity in the short term as a consequence of an unexpected and unplanned family event;
  - a change in the products’ features and/or market circumstances, which may be a reason for considering a switch in the client(s) portfolio(s), e.g. if a product becomes illiquid due to market trends;
  - benefits to the client’s portfolio stemming from the switch, such as (i) an increase in the portfolio diversification (by geographical area, type of instrument, type of issuer, etc.); (ii) an increased alignment of the portfolio’s risk profile with the client’s risk objectives; (iii) an increase in the portfolio’s liquidity; or (iv) a decrease of the overall credit risk of the portfolio;



97. When providing investment advice, a clear explanation of whether or not the benefits of the recommended switch are greater than its costs should be included in the suitability report the firm has to provide to the retail client before the transaction is made.
98. Firms should also adopt systems and controls to monitor the risk of circumventing the obligation to assess costs and benefits of recommended switch, for example in situations where an advice to sell a product is followed by an advice to buy another product at a later stage (e.g. days later), but the two transactions were in fact strictly related from the beginning.
99. Where a firm uses common portfolio strategies or model investment propositions that apply to different clients with the same investment profile (as determined by the firm), the costs/benefits analysis of a switch could be done on a higher level than at the level of each individual client or each individual transaction. More especially, when a switch is decided centrally, for example within an investment committee or any other committee defining common portfolio strategies or model investment propositions, the costs/benefits analysis could be done at the level of that committee. If such a switch is decided centrally, the costs/benefits analysis done at that level would usually be applicable to all comparable client portfolios without making an assessment for each individual client. In such a situation also, the firm could determine, at the level of the relevant committee, the reason why a switch decided will not be performed for certain clients. Although the costs/benefits analysis could be done at a higher level in such situations, the firm should nevertheless have appropriate controls in place to check that there are no particular characteristics of certain clients that might require a more discrete level of analysis.
100. Where a portfolio manager has agreed a more bespoke mandate and investment strategy with a client due to the client's specific investment needs, a cost-benefit analysis of the switch at client-level should be more appropriate, in contrast to the above.<sup>53</sup>
101. Notwithstanding the above, if a portfolio manager considers that the composition or parameters of a portfolio should be changed in a way that is not permitted by the mandate agreed with the client (e.g. from an equities-focused to a fixed income-focused strategy), the portfolio manager should discuss this with the client and review or conduct a new suitability assessment to agree a new mandate.

## **V.II OTHER RELATED REQUIREMENTS**

### **Qualifications of firm staff**

**Relevant legislation: Articles 16(2), 25(1) and 25(9) of MiFID II and Article 21(1)(d) of MiFID II Delegated Regulation.**

*General guideline 11*

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<sup>53</sup> For relationships with professional clients see paragraph 89.



102. Firms are required to ensure that staff involved in material aspects of the suitability process have an adequate level of skills, knowledge and expertise.

#### *Supporting guidelines*

103. Staff must understand the role they play in the suitability assessment process and possess the skills, knowledge and expertise necessary, including sufficient knowledge of the relevant regulatory requirements and procedures, to discharge their responsibilities.
104. Staff giving investment advice or information about financial instruments, structured deposits, investment services or ancillary services to clients on behalf of the firm (including when providing portfolio management) must possess the necessary knowledge and competence required under Article 25(1) of MiFID II (and specified further in ESMA Guidelines for the assessment of knowledge and competence<sup>54</sup>), including with regard to the suitability assessment. Staff should also have the necessary knowledge and competence with regard to the criteria of the sustainability preferences as specified in Article 2(7) of the MiFID II Delegated Regulation and be able to explain to clients the different aspects in non-technical terms. To that effect, firms should give staff appropriate trainings.
105. Other staff that does not directly face clients (and therefore is not subject to the new provisions mentioned in paragraph 97) but is involved in the suitability assessment in any other way must still possess the necessary skills, knowledge and expertise required depending on their particular role in the suitability process<sup>55</sup>. This may regard, for example, setting up the questionnaires, defining algorithms governing the assessment of suitability or other aspects necessary to conduct the suitability assessment and controlling compliance with the suitability requirements.
106. Where relevant, when employing automated tools (including hybrid tools), investment firms should ensure that their staff involved in the activities related to the definition of these tools:
- (a) have an appropriate understanding of the technology and algorithms used to provide digital advice (particularly they are able to understand the rationale, risks and rules behind the algorithms underpinning the digital advice); and
  - (b) are able to understand and review the digital/automated advice generated by the algorithms.

## **Record-keeping**

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<sup>54</sup> Ref: ESMA71-1154262120-153 EN (rev).

<sup>55</sup> ESMA notes that some Member States require certification of staff providing investment advice and/or portfolio management, or equivalent systems, to ensure a proper level of knowledge and expertise of staff involved in material aspects of the suitability process.

**Relevant legislation: Articles 16(6), 25(5) and 25(6) of MiFID II, and Articles 72, 73, 74 and 75 of the MiFID II Delegated Regulation.**

*General guideline 12*

107. Firms should at least:

- (a) maintain adequate recording and retention arrangements to ensure orderly and transparent record-keeping regarding the suitability assessment, including the collection of information from the client, any investment advice provided and all investments (and disinvestments) made following the suitability assessment made, and the related suitability reports provided to the client;
- (b) ensure that record-keeping arrangements are designed to enable the detection of failures regarding the suitability assessment (such as mis-selling);
- (c) ensure that records kept, including the suitability reports provided to clients, are accessible for the relevant persons in the firm, and for competent authorities;
- (d) have adequate processes to mitigate any shortcomings or limitations of the record-keeping arrangements.

*Supporting guidelines*

108. Record-keeping arrangements adopted by firms must be designed to enable firms to track ex-post why an (dis)investment was made and why an investment advice was given even when the advice didn't result in an actual (dis)investment. This could be important in the event of a dispute between a client and the firm. It is also important for control purposes - for example, any failures in record-keeping may hamper a competent authority's assessment of the quality of a firm's suitability process, and may weaken the ability of management to identify risks of mis-selling.

109. Therefore, a firm is required to record all relevant information about the suitability assessment, such as information about the client (including how that information is used and interpreted to define the client's risk profile), and information about financial instruments recommended to the client or purchased on the client's behalf, as well as the suitability report provided to clients. Those records should include:

- any changes made by the firm regarding the suitability assessment, in particular any change to the client's investment risk profile;
- the types of financial instruments that fit that profile and the rationale for such an assessment, as well as any changes and the reasons for them.
- The situations where a client's sustainability preferences are adapted in accordance with Article 54(10) of the MiFID II Delegated Regulation, including a clear explanation of the reasons for such adaption.

110. Firms should understand the additional risks that could affect the provision of investment services through online/digital tools such as malicious cyber activity and should have in place arrangements able to mitigate those risks.<sup>56</sup>

### 3.4 Annex IV - List of good and bad practices observed from the supervision of the MiFID II requirements on suitability

| <i>Areas of suitability</i>    | <i>Good practices</i>   |
|--------------------------------|---|
| <b><u>Client profiling</u></b> | The implementation of automated controls to identify inconsistencies in clients' answers. The effect is that the client directly (if the questionnaire is completed online), or the firm's staff (in case of face-to face interaction) is alerted that some clarification from the client is necessary before s/he can continue to fill in the questionnaire. Advisors seek clarification where the interaction occurs face-to-face.            |
|                                | Identifying ad hoc event-driven indicators that may suggest the opportunity of updating client information for suitability assessment (e.g., retirement, access to financing, etc.). At the occurrence of any such event, the clients would be contacted for a meeting to verify whether a review of the profile might be necessary, keeping a record of such interaction.  |
|                                | Use of complementary questions aimed to more effectively assess the ability of clients to understand products (especially the more complex ones) and their related risk profile to avoid relying on self-assessment. For example, questions dedicated to one or more of the following aspects: relationship between risk and return; mechanisms/actions that may reduce the risk of investments; impact of risk diversification on investments; |

<sup>56</sup> Firms should consider such risks not only in relation to the provisions stated in the guideline, but also as part of a firm's wider obligations under Article 16(4) of MiFID II to take reasonable steps to ensure continuity and regularity in the performance of investment service and activities, and corresponding delegated act requirements linked to this.

| <b>Areas of suitability</b>                               | <b>Good practices</b>  |
|---|--|
|   | returns related to investments in foreign currencies and related risks; liquidity risk; key features of structured products; financial leverage and its effect on investments; key features and related risks of derivative instruments and instruments with embedded derivatives.   |
| <b><u>Costs and benefits of switching investments</u></b> | When identifying the perimeter of switches subject to cost/benefit analysis, adopting mechanisms to limit the risk of keeping separate the two parts of a switch transaction (i.e. the sale and subsequent connected purchase) as a means to circumvent the rule. For example, limiting the possibility of “splitting up” purchase and sale recommendations in different days.   |
|   | On the cost/benefit analysis of the switch, the provision of a simple and clear overview of the portfolio before and after the recommended transaction, which includes the expected (excess) return and costs related to the switch. By doing so, a client will understand what the effect of the switch would be on the expected return of his portfolio.   |
| <b><u>Indicators/monitoring/control functions</u></b>     | Identifying, within the firm’s systems for periodic assessment of suitability, triggering factors that may alert the firm to the need of event-driven updates of the portfolio. For example, relevant market factors (delisting of a stock).   |
|   | Frequent and thorough reviews of all aspects of firms’ suitability practices (organisational, IT, etc) by control functions (compliance and internal audit) with formalisation, as output, of clearly defined actions to address any issues identified and improve the firm’s suitability arrangements.  |
|   | Continuous monitoring by control functions (compliance and internal audit) of advisors’ performance to assess advisory activity and behaviours by taking into account client outcomes in the form of qualitative elements (e.g. complaints, satisfaction surveys) and quantitative metrics (e.g. return on investments, level of risk, cost and complexity of products, compatibility of investments with client profile). |
|   | Adopting adequate diversification measures also where the client’s portfolio is mostly or entirely invested in funds (especially in non-UCITS funds).  |

| <b><i>Areas of suitability</i></b> | <b><i>Poor practices</i></b>   |
|------------------------------------|--|
| <b><u>Client profiling</u></b>     | Asking a limited range of knowledge and experience questions that do not cover the key features of the different categories of financial instruments that may be offered to the client.  |
|                                    | Not properly investigating the clients' understanding of bail-in mechanism and its potential impact on the investments, e.g. where questionnaire presented to clients do not include questions specifically focused on the potential impacts for investments in a bank bond where the bail-in tool is activated.                           |
|                                    | Defining a client's risk tolerance solely based on the composition of such client's existing portfolio.  |
|                                    | Not reviewing a client's suitability information for an excessively long period, in case of ongoing relationship with the client.  |
|                                    | Performing an assessment of the suitability without taking into account all information collected from clients for the purposes of suitability assessment.   |
| <b><u>Product mapping</u></b>      | Allocating products in overly general categories such as, for instance, complex and non-complex products only, or simply in broad asset classes (e.g. bonds, funds...) also for their assessment in terms of risk.   |
| <b><u>Matching</u></b>             | Over-reliance on one aspect of the suitability criteria, to the extent that it is unclear how the other suitability information is considered (e.g. where a client fits into a certain risk profile category based on its investment objectives and risk tolerance, however it is not clear how the ability to bear losses is considered). |
|                                    | Excluding the application of suitability controls below certain predefined thresholds (e.g. excluding monitoring of compliance with concentration risk limits for portfolios under certain amounts).   |
|                                    | Suitability policies and processes which permit exceptions or 'overrides' by sales staff ex-post, without adequate   |

| <b><i>Areas of suitability</i></b>                        | <b><i>Poor practices</i></b>   |
|---|--|
|   | controls measures (e.g. by control functions), including on the documentation stating the reasons for the override.  |
| <b><u>Cost/complexity of equivalent products</u></b>      | On the cost-complexity of products, comparing only products issued by one single-entity (or by entities of the same group).  |
|   | On the cost-complexity of products, grouping of “equivalent products” into an excessively large number of clusters with only a few products each with the effect of making the comparison of products of little effect and therefore circumventing the objective of the assessment required by Article 54(9) of the MiFID II Delegated Regulation.                                 |
| <b><u>Costs and benefits of switching investments</u></b> | Limiting the assessment of cost/benefit analysis over switches only to sale and related purchase provided within the same recommendations, without implementing controls based on possible indicators that may demonstrate that a sale and purchase are linked (e.g. the two transactions are undertaken in a short time span, or the size of the sale and purchase are the same). |
|   | Excluding the application of the control over switches below certain predefined specific thresholds. For example, where the increase of costs as a result of a switch is below a certain threshold predefined by the firm, independently from the related benefits.  |