



European Securities and  
Markets Authority

# Final Report

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





## Table of Contents

1	Executive Summary .....	2
2	Overview .....	4
3	Annexes .....	7
3.1	Annex I – Cost-benefit analysis .....	7
3.2	Annex II – Opinion of the Securities and Markets Stakeholder Group .....	12
3.3	Annex III – Feedback on the consultation paper .....	13
3.4	Annex IV – Guidelines .....	32

# 1 Executive Summary

## Reasons for publication

The assessment of suitability is one of the key requirements for investor protection in the MiFID II framework. It applies to the provision of investment advice (whether independent or not) and portfolio management. In accordance with the obligations set out in Article 25(2) of Directive 2014/65/2014 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.

On 13 July 2017, ESMA published a Consultation Paper (CP) with proposed draft guidelines which confirm and broaden the existing MiFID I guidelines on suitability, issued in 2012.

The consultation period closed on 13 October 2017. ESMA received 53 responses, 6 of which confidential. The answers received are available on ESMA's website unless respondents requested otherwise. ESMA also received the advice of the Securities and Markets Stakeholder Group's (MSG).

This paper summarises and analyses the responses to the CP and explains how the responses have been taken into account. ESMA recommends reading this report together with the CP published on 13 July 2017 to have a complete view of the rationale for the guidelines.

By pursuing the objective of ensuring a consistent and harmonised application of the requirements in the area of suitability, the guidelines will make sure that the objectives of MiFID II can be efficiently achieved. ESMA believes that the implementation of these guidelines should strengthen investor protection – a key objective for ESMA.

## Contents

Section 2 gives an overview of the Final Report.

Annex I contains the cost-benefit analysis; Annex II summarises the opinion of the MSG; Annex III contains the feedback statement; Annex IV contains the full text of the final guidelines.

## Next Steps

The guidelines in Annex IV will be translated in the official EU languages and published on ESMA's website. The publication of the translations in all official languages of the EU will

---



---

trigger a two-month period during which NCAs must notify ESMA whether they comply or intend to comply with the guidelines.

---

## 2 Overview

### *Background*

1. The assessment of suitability is one of the key obligations for investor protection. It applies to the provision 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. The importance of the suitability assessment for the protection of investors was already clear under MiFID I and has been confirmed in MiFID II. While the objectives of the suitability assessment, as well as the key principles underpinning the regulatory requirements, have remained unchanged, the obligations have been further strengthened and detailed by including the following main requirements:
  - reference to the fact that the use of electronic systems in making personal recommendations or decisions to trade shall not reduce the responsibility of firms;
  - the requirement for firms to provide clients with a statement on suitability (the so called 'suitability report') prior to the conclusion of the recommended transaction;
  - further details on conduct rules for firms providing a periodic assessment of the suitability;
  - the requirement for firms performing a suitability assessment to assess, taking into account the costs and complexity, whether equivalent products can meet the client's profile;
  - the requirement for firms to analyse the costs and benefits of switching from an investment to another;
  - the strengthened requirement for firms to consider the clients' risk tolerance and ability to bear losses;
  - the extension of suitability requirements to structured deposits.
3. The need to enhance clarity and to foster convergence on some of the above-mentioned aspects has triggered the review and update of the existing guidelines on certain aspects of MiFID I suitability requirements issued by ESMA in 2012 (from here on '2012 guidelines').

4. In addition, ESMA also aims to:

- consider recent technological developments of the advisory market, i.e. the increasing use of automated or semi-automated systems for the provision of investment advice or portfolio management (so called 'robo-advice');
- take into account the results of supervisory activities conducted by national competent authorities (NCAs) on the implementation of the suitability requirements (including the application by firms of the 2012 guidelines);
- incorporate the outcome of studies in the area of behavioural finance;
- provide additional detail on some aspects that were already covered under ESMA's 2012 guidelines.

#### *Public consultation*

5. On 13 July 2017, ESMA published a Consultation Paper (CP)<sup>1</sup> on the draft guidelines on certain aspects of the MiFID II suitability requirements in order to explain its rationale and gather input from stakeholders. The consultation period closed on 13 October 2017.
6. ESMA received 53 responses, 6 of which confidential. The answers received are available on ESMA's website unless respondents requested otherwise. ESMA also sought the advice of the Securities and Markets Stakeholder Group's (SMSG).

#### *European Commission's Action Plan on sustainable finance*

7. Following the publication of the CP, the European Commission (EC) published its Action Plan on sustainable finance<sup>2</sup>. The Action Plan is part of the Capital Markets Union's (CMU) efforts to connect finance with the specific needs of the European economy to the benefit of the planet and our society. Within the Action Plan, the EC stated that "by providing advice, investment firms and insurance distributors can play a central role in reorienting the financial system towards sustainability. Prior to the advisory process, these intermediaries are required to assess clients' investment objectives and risk tolerance in order to recommend suitable financial instruments or insurance products. However, investors' and beneficiaries' preferences as regards sustainability are often not sufficiently taken into account when advice is given. The Markets in Financial Instruments Directive (MiFID II) and the Insurance Distribution Directive (IDD) require investment firms and insurance distributors to offer 'suitable' products to meet their clients' needs, when offering advice. For this reason, those firms should ask about their clients' preferences (such as environmental, social and governance factors) and take them into account when assessing the range of financial instruments and insurance

---

<sup>1</sup> ESMA35-43-748.

<sup>2</sup> [https://ec.europa.eu/info/publications/180308-action-plan-sustainable-growth\\_en](https://ec.europa.eu/info/publications/180308-action-plan-sustainable-growth_en)



products to be recommended, i.e. in the product selection process and suitability assessment.”

8. The EC has also included a planned action to amend the MiFID II and IDD delegated acts in Q2 2018 to ensure that sustainability preferences are taken into account in the suitability assessment. The content of this action plan has been carefully considered by ESMA when preparing this Final Report. ESMA will also keep monitoring the legislative proposals stemming from the action plan and will consider making focused amendments to the guidelines to reflect changes to the MIFID II delegated acts on the topic sustainability.

#### *Final Report*

9. This Final Report summarises and analyses the responses to the CP and explains how the responses, together with the SMSG advice, have been taken into account. ESMA recommends reading this report together with the CP published on 13 July 2017 to have a complete view of the rationale for the guidelines.

## 3 Annexes

### 3.1 Annex I – Cost-benefit analysis

#### Background

1. Under the MiFID I framework, Article 35 of the MIFID Implementing Directive<sup>3</sup> required firms to obtain the necessary information to understand the essential facts about the client, and to have a reasonable basis for believing, given due consideration of the nature and extent of the service provided, that the transaction satisfied the suitability criteria: (i) the transaction met the client's investment objectives; (ii) the client was able to financially bear the related investment risks consistent with his investment objectives (iii) the client had the necessary experience and knowledge in order to understand the risk involved in the transaction or in the management of the portfolio.
2. The importance of the suitability assessment for the protection of investors has been confirmed within the new MiFID II framework. While the objectives of the suitability assessment, as well as the key principles underpinning the regulatory requirements, have remain unchanged, the MiFID II Delegated Regulation strengthened and detailed the relevant obligations (see Section 2 of this Final Report).
3. The suitability requirements are an essential element of the regulatory toolkit on the distribution of financial instruments to retail investors, but 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.<sup>4</sup> Therefore, the assessment of the client's profile and the subsequent match with the transaction recommended (in case of advice) or concluded (in case of portfolio management) by the firm remain of primary importance.
4. These guidelines aim to ensure a common, uniform and consistent implementation of the MiFID II requirements related to the assessment of suitability by providing explanations, clarifications and examples on how the relevant obligations related to the assessment of suitability should be fulfilled. By providing clarification of the relevant MiFID suitability requirements, ESMA is helping firms to improve their implementation of these requirements. The guidelines also aim to achieve a convergent approach in the supervision of the suitability requirements by competent authorities. Greater convergence leads to improved investor protection (consumer outcomes), which is a key ESMA objective.

---

<sup>3</sup> 18 Directive 2006/73/EC of 10 August 2006.

<sup>4</sup> N. Moloney, EU Securities and Financial Markets Regulation, Third Edition 2016, Oxford University Press, page 807.



## The impact of the draft ESMA guidelines

5. In light of the main objectives of these guidelines, the Consultation Paper presented a preliminary assessment of the benefits and costs of the key policy choices of the draft guidelines.
6. Since the requirements on the suitability assessment are provided under the MiFID II and the relevant Delegated Regulation, it can be confirmed that the impact of these 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 their needs and characteristics. The guidelines should also facilitate competent authorities' efforts to supervise the overall compliance with MiFID II requirements and this would increase the investor confidence in the financial markets, which is considered essential for the establishment of a genuine single capital market.
7. Finally, it is important to remember that those existing 2012 guidelines, which are now confirmed, should not imply any additional impacts/costs for both firms and NCAs.

### *Benefits*

8. In line with the preliminary impact assessment and with the responses received to the consultation it is possible to summarise the main benefits linked to the guidelines as follows:
  - a) reduction of the mis-selling risk and its related financial consequences. This is a major benefit for investors and for financial markets as whole. In particular, firms will benefit from the improved legal certainty, from the reduction of complaints, costs of appeals and legal expenditure for tribunal cases, loss of reputation, fines, etc.
  - b) reduction of risks linked to regulatory or supervisory arbitrage due to an increased degree of harmonisation and a more consistent supervisory convergence;
  - c) positive effects from improved harmonisation and standardisation of the processes that firms have to put in place when implementing the MiFID II suitability framework;
  - d) positive effects from improved harmonisation and standardisation for competent authorities on the costs and activities needed to implement new supervisory processes related to the assessment of suitability;
  - e) restoring investors' confidence in financial markets.

## Costs

9. The importance of a proper and reliable suitability assessment has been already addressed to firms and competent authorities under the MiFID I regime as one of the pillar of the retail “investor protection” paradigm. This crucial importance was also stressed in the 2012 guidelines and in the associated peer review that ESMA developed on the same issue.<sup>5</sup>
  10. It can be thus reasonably expected that those firms having already in place a complete set of arrangements to comply with the provisions, principles and good practices issued under the MiFID I regime (including the 2012 guidelines) will presumably incur less overall costs when implementing the new framework and these guidelines.
  11. In accordance with a large part of the responses to the CP, 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 guidelines) will be both one-off and ongoing in nature, mainly linked to:
    - a) (direct) costs linked to the update/review of the existing procedural and organisational arrangements. In particular, in order to reflect the guidelines into their compliance arrangements, firms will be expected to review and, when needed, update the questionnaires issued to clients, and the algorithms/models used to match the client’s profile with suitable financial instruments;
    - b) (direct) initial and ongoing IT costs (some respondents pointed out costs related to the update of existing websites and client on-boarding process and to the identification of costs and benefits linked to ‘switching’);
    - c) (direct) relevant organisational and HR costs linked to the implementation of the guidelines providing clarifications on the qualification of firm staff (with particular reference to the compliance function staff and to the staff providing relevant investment services).
- ESMA would also like to mention that the extent to which client information will need to be collected by firms is calibrated, in a proportionate way, to 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.
12. ESMA therefore believes that the final guidelines provide the most cost-efficient solution to achieving the general objectives.

---

<sup>5</sup> ESMA, MiFID Suitability Requirements, Peer Review Report (ESMA/2016/584).

### Conclusions

13. In light of what has been illustrated above, firms will certainly incur costs to implement the new regime on the suitability assessment (which includes the guidelines). However these overall (compliance) costs are necessary to ensure that the new requirements in this key area for the provision of services to clients deliver on their underlying investor protection objective; therefore these costs will be compensated by the benefits generated by the improved reliability of the information provided from and to investors and from the subsequent effectiveness of the suitability assessment. These benefits will interest all the market participants and this will contribute to the restoration of trust in the financial markets.
14. ESMA also considers that the guidelines are promoting an increased level of harmonisation in the interpretation and application of the suitability requirements across Member States, contributing to minimise the potential adverse impact on firms linked to compliance costs. These benefits will outweigh all associated costs in respect of these guidelines.
15. Finally, ESMA believes that the adoption of guidelines is the best tool to achieve the explained objectives, also considering that this topic was already covered by existing guidelines. Furthermore, the adoption of guidelines promote regulatory and supervisory convergence reducing the risk of diverging interpretations that might lead to discrepancies in the application and supervision of the relevant requirements across Member States (determining a risk of regulatory arbitrage, opportunistic behaviour, and circumvention of rules).

### Impact assessment - overview

Impact on Stakeholders	Effectiveness	Efficiency
(++) increased level playing field amongst firms  (++) better understanding of applicable rules by firms and investors due to the increased level of uniformity  (++) better knowledge of clients and products by firms resulting in better assessment of clients' profile  (--) compliance costs for firms (stemming from changing	(++) increased investor protection  (++) increased uniformity from a common EU approach (benefits for supervisors from establishing more uniform supervisory practices, e.g. on the robo advice)  (+++) increased clarity and quality in the provision of the relevant investment services (i.e. benefits from standardisation)	(++) compliance costs and indirect costs for firms largely compensated by the enhancement of the quality of the services provided to clients, in particular from the improved reliability of the information provided to and collected from investor (which should decrease mis-selling cases restoring the consumers' trust in financial markets and increasing their participation to trading in financial instruments)

<p>internal policies and procedures)</p> <p>(--)-compliance costs for firms stemming from the review and update of questionnaires for clients</p>	<p>(++) potential/expected mitigation of credit risk for investors</p> <p>(-) potential additional rigidity for firms when developing new business models</p>	
---	---	--



## 3.2 Annex II – Opinion of the Securities and Markets Stakeholder Group

1. As provided by Article 16(2) of the ESMA Regulation, ESMA also sought the advice of the Securities and Markets Stakeholder Group's (SMSG).<sup>6</sup> The SMSG's overall view of these guidelines was positive and it stated:

*"[...] the guidelines are sound and beneficial to the protection of the investor. The SMSG is particularly happy with the approach taken by ESMA to not merely update the previous guidelines in light of the MiFID II, but to also thoroughly re-examine all guidelines and add new guidance where necessary (in particular in respect of robo-advice). Also references to insights of behavioural economics and the insertion of a correlation table are much appreciated. Furthermore the explicit confirmation of the "portfolio approach" to investment advice and portfolio management (para 80-81), consistent with the guidelines on target market, is applauded by the SMSG."*

2. The SMSG had also some remarks on the time needed for firms to implement the guidelines; the application of the guidelines to robo-advice; the risk of information overload for clients; communication with the younger generation that should also be a point of attention; and level playing field between MiFID II and the Insurance Distribution Directive (IDD).

---

<sup>6</sup> The SMSG response has been published on the ESMA website (Ref: ESMA22-106-474).

### 3.3 Annex III – Feedback on the consultation paper

**Q1: Do you agree with the suggested approach on the information to be provided on the suitability assessment and specifically with the new supporting guidelines on robo-advice? Please also state the reasons for your answer.**

1. Respondents welcomed the approach that ESMA adopted when updating the existing guidelines and appreciated the fact that behavioural insights have been taken into account in the area of how the information should be presented to clients in order to avoid perceptible or cognitive distortions from impairing investors' answers, especially in relation to the provision of robo-advice. Various stakeholders from the supply side however claimed that the draft guidelines appear to be mainly focused on the needs of retail clients and that such situation might lead to a degree of uncertainty on the applicability of certain requirements to the provision of services to professional clients. ESMA acknowledges that the MIFID II Delegated Regulation requirements on the suitability assessment are calibrated according to the different client categories and confirms that the guidelines do not intend to introduce new requirements and should be read in conjunction with MIFID II and its implementing measures. For further clarity, however, ESMA has stated in paragraph 3 that the guidelines principally address situations where services are provided to retail clients and apply "to the extent they are relevant" when services are provided to professional clients. In addition, in order to address the concerns raised, ESMA has also introduced further clarifications, both in the general and in the supporting guidelines, to explain how the client categorisation should be taken into account when applying specific guidelines.
2. Respondents generally agreed with the approach adopted on the information that should be provided on the suitability assessment. Nonetheless, some respondents commented on draft general guideline 1 underlining the risk of information overload and considered that various information in the draft guidelines are not required for a good investment decision by the investor. In the same direction, others emphasised the risk of the adoption by firms of a prescriptive approach that might result in clients being provided with long and unengaging documents that are neither useful nor user-friendly. In particular, several respondents observed that, in the space of robo-advice, the average retail investor would not be in the position to fully understand and evaluate the characteristics and the efficiency of algorithms, and therefore the information illustrated under paragraph 21 of the draft guidelines, third bullet point, should not be provided. On the other hand, other respondents underlined that guidance on the transparency of quantitative processes and algorithms should be addressed to the generality of investment firms (including those providing face-to-face advice). ESMA is of the view that the provision of information to clients is important in order to enable them to take informed investment decisions. ESMA however acknowledges the issue of information overload, which was also raised by the SMSG, and has amended the guidelines to allow for some information to be provided in a standardised format, for example at the beginning of the contractual relationship. ESMA also confirms that it does not intend to require firms to disclose their algorithms in detail to clients and has therefore amended

the guidelines accordingly. Finally, with regard to how the guidelines apply to robo-advice, please see the response given in paragraph 1 above.

3. Some respondents noted that the recommendation to firms to ascertain clients' understanding of risks and the relationship between risk and return of a specific investment by asking questions – provided under paragraph 17 of the draft guidelines – seems to go beyond MiFID II requirements. These respondents consider that firms should assess whether clients understand the general concept of the investment risk and the relationship between risk and return, and thus expressed a preference for the existing paragraph 16 of the 2012 guidelines. ESMA is of the view that the recommendation to firms to ascertain clients' understanding of risks and the relationship between risk and return of a specific investment by asking questions is in line with the requirements of MiFID II and the MiFID II Delegated Regulation, as the assessment of the client's understanding of investment risks is a necessary prerequisite of the assessment of suitability. ESMA has however introduced some amendments to the paragraph to clarify the drafting.
4. With reference to paragraph 19 of the draft guidelines, some respondents stated that investment firms should always be allowed to use disclaimers to illustrate the consequences of clients providing incomplete or misleading information, also in light of Article 55(3) of MiFID II Delegated Regulation. Others argued that the collection of clients' personal facts should not per se trigger the suitability assessment requirements. ESMA agrees that using disclaimers to warn investors about the consequences of providing incomplete or misleading information is indeed possible. ESMA however confirms that, firms should not use disclaimer to circumvent MiFID II requirements and to inappropriately limit the responsibility of the firm vis à vis retail clients with regard to the suitability assessment. In this regard, ESMA confirms that – in line with what already included in the 2010 CESR Q&As on understanding the definition of advice under MiFID<sup>7</sup> – even if a clear, prominent and understandable disclaimer is provided stating that no advice or recommendation is being given, a firm could still be viewed as having presented a recommendation as suitable for the client. For example, if a firm stated that its product would suit a particular client's needs, the inclusion of the disclaimer that this was not advice would be unlikely to change the nature of the communication. With regard to paragraph 19 of the final guidelines, ESMA agrees that the simple collection of clients' information does not trigger the requirement to perform the suitability assessment. However, if a recommendation is put forward in such a way that a reasonable observer would view it as being based on a consideration of a client's circumstances – subject to the other four tests set out in the 2010 CESR Q&As<sup>8</sup> being met – this will amount to investment advice.

---

<sup>7</sup> CESR/10-293.

<sup>8</sup> CESR/10-293.

5. The majority of respondent expressed their support to the new draft guidelines on robo-advice provided under paragraphs 20 to 22 of the draft guidelines. A significant number of trade associations and a consumer association particularly appreciated the additional guidance considered as an important effort to reduce “black-box” phenomenon. Divergent opinions were nonetheless expressed on the scope of the new relevant guidelines:
  - Providers of automated advice services claimed that robo-advisors should be subject to the same framework of regulation and supervision as traditional advisors, especially on the topic of the suitability. They considered therefore that the additional guidance provided might result in the introduction of an additional operational burden for firms without offering a higher level of protection to investors;
  - Some respondents instead considered that paragraphs 20 to 22 of the draft guidelines should be related to robo-advice only.
6. A number of respondents asked to clarify the definition of robo-advice in order to provide a distinction between “robo-for-advisors” (so called professional-facing robo-advice), semi-automated tools that enable advisors to understand the clients’ needs and objectives and to identify the suitable investment/strategy and “robo-advice tout court” (so called client-facing robo-advice) consisting in automated tools where no form of human interaction takes place. In some cases respondents argued that only client-facing tools should be in the scope of guidelines; in other cases respondents asked to clarify where the guidelines are intended to apply only where investment decisions are made by algorithms. In the same context, some respondents observed that digital tools designed as mere “search machines” should not be included in the definition of robo-advisors: those respondents made a difference between “profiling algorithms”, used to obtain information on clients’ profiles and “quantitative managements algorithms” which are used to make decisions regarding investment in certain types of asset or portfolio management.
7. ESMA wishes to clarify that the guidelines apply to all firms offering the service of investment advice and portfolio management, irrespective of the format used for the provision of these services, i.e the means of interaction with clients. ESMA also wishes to clarify that through the guidelines it does not intend to introduce additional requirements for robo-advisers, but rather highlight certain aspects that may be of particular importance in the case of the provision of services through fully or semi-automated tools. However, in consideration of the comments received, ESMA has added a new paragraph 7 in the final guidelines to reflect the concepts expressed above and has amended the definition of robo-advice used for the purpose of the guidelines. ESMA has also amended the text of the relevant guidelines referring to robo-advice to address the aforementioned concerns. It is also important to clarify that so called professional-facing tools are however not excluded from the scope of the guidelines. This is because it is the firm’s responsibility to ensure that all systems, algorithms and tools used for the



purposes of suitability assessment are robust and fit for purpose, in line with relevant obligations as well as with these guidelines.

8. In order to improve the draft guidelines, some respondents suggested amendments to paragraph 21:
- Some respondents suggested that the information that should be provided to clients on the robo-advice should be accessible on the website of the firm also and understandable by investors. Such information should not be of an inappropriate amount.
  - A couple of unions of employees stated that the information on the degree of human involvement to which the client would eventually access should be provided to clients.
  - A trade association representing IT firms underlined the responsibility of investment firms to be aware of the fact that clients might be biased during the collection of the information through the questionnaire. This fact should be taken into account when designing the questions, interpreting clients' answers and when selecting the suitable investments/strategies for their clients. This respondent observed that a well-designed questionnaire should enable the firm to identify and measure distortions in clients' answers in order to them into account when reviewing and adapting the standardisation process.
  - Some respondents asked ESMA to clarify the meaning of the wording "client's status".

ESMA has amended the guidelines to incorporate some of the suggested changes.

9. With reference to paragraph 22 of the draft guidelines, a trade association noted that the technical design of the information that should be provided to clients should be left up to investment firms. ESMA agrees and has therefore deleted the third bullet point of paragraph 22 of the draft guidelines.

**Q2: 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 behavioural finance and the development of robo-advice models? Please also state the reasons for your answer.**

10. The majority of respondents shared ESMA's choice of taking into account the main outcomes of studies in the area of behavioural finance when updating the 2012 guidelines. This choice was appreciated and seen as helpful to identify the risk tolerance and the ability to bear losses of retail clients. Comments received on the draft guidelines are set out below.

11. As a general comment, a number of respondents observed that the proposed guidelines do not sufficiently reflect the content of Article 54(3) of MiFID II Delegated Regulation. In particular, respondents from the asset management industry claimed that the guidelines should distinguish more clearly between retail and professional clients, especially in presence of bespoke mandates. Some trade associations and investment firms asked ESMA to clarify that draft guideline 2 and the relevant supporting guidelines apply to retail clients only. With regard to the issue of how these guidelines apply to relationships with professional clients, please see paragraph 1 of this feedback statement.
12. With reference to draft general guideline 2, some respondents asked ESMA to further clarify the notion of “essential facts” hereto mentioned. ESMA notes that the terms “essential facts” was already used in the 2012 guidelines and has not raised any concern in their implementation. Therefore, ESMA decided not to amend the drafting on this aspect.
13. Regarding the first sentence of paragraph 25 of the draft guidelines, some respondents asked to clarify that investment firms should take into account the potential behavioural biases only when designing the questionnaire and not on a client-by-client basis. In some cases, drafting suggestions were submitted. ESMA amended paragraph 25 of the final guidelines to better clarify that potential behavioural biases were to be taken into account only when designing the questionnaire and not on a client-by-client basis.
14. On paragraph 25 of the draft guidelines:
  - On the first bullet point, some respondents noted that instead of referring to the “exhaustiveness of the questionnaire”, it would be preferable to refer to “necessary and relevant information” so as to enable the applicability of the proportionality principle. ESMA’s view is that elements of flexibility are provided in guideline 3, especially in consideration of the sophistication of services and products offered, but that while taking into account such flexibility, the questionnaires should always be exhaustive.
  - On the last bullet point, some other respondents pointed out that requiring to collect not only all necessary information but also all relevant information was too far reaching and would put investment firms in an unsecure situation. ESMA has amended this paragraph as well as paragraph 32 of the final guidelines in light of the comments received.
  - On the last bullet point, a number of respondents also noted that investors should always be allowed to provide “no answers” responses, although the use of “no answer replies” in an inappropriate way should be avoided. ESMA acknowledges that the wording used in the CP was unclear and has amended this paragraph following the suggestion received from the SMSG.
15. Regarding paragraph 28 of the draft guidelines, a few respondents noted that recommending firms to “ensure the consistency of the answers provided by the client”

seems to be not in line with Article 55(3) of MiFID II Delegated Regulation. ESMA notes that, as stated in Article 55 of MIFID II, investment firms shall be entitled to rely on the information provided by its clients or potential clients, it is important that mechanisms are put in place by firms to identify inconsistencies in the answers given by clients.

16. The assessment of clients' financial literacy, recommended under paragraph 29 of the draft guidelines, seems to be very problematic for a significant number of respondents, which also claimed that it would be particularly complicated to industrialise and standardise such assessment through a questionnaire. An association of investors instead welcomed the supporting guideline and added that the guidance on the assessment of clients' financial literacy should be implemented with a list of basic notions that firms should appraise. In light of the comments received, ESMA has deleted the generic expression "financial literacy" and included instead a clearer reference to the importance of assessing clients' understanding of basic financial notions. The suggestions to provide a list of basic notions that firms should appraise was not incorporated in the guidelines, considering such list has to be determined at the level of each firm based also on the consideration of services and products offered.
17. Some respondents noted that non-financial factors (i.e. environmental, social, ethical impacts associated to investments, and sustainable development) should also be taken into account in the context of the decision-making process of investors amongst the investment objectives. ESMA, considering these responses, and the Commission's Action Plan on 'Financing Sustainable Growth', has decided to include – at this stage – a good practice for firms. On this topic, please also see the Overview section of this Final Report.

**Q3: Do you believe that further guidance is needed to clarify how firms should assess clients' ability to bear losses?**

18. Respondents generally supported the approach adopted on the assessment of clients' ability to bear losses. Some of these respondents suggested ESMA to elaborate a non-binding template for a suitability questionnaire.
19. Some respondents argued that the draft guidelines seem to be excessively focused on retail clients and do not consider that investment firms might not be in the position to assess the ability to bear losses of a non-retail client (including large institutional clients such as pension schemes, insurance undertakings, sovereign wealth funds *et similia*). In consideration of these remarks, ESMA has clarified in paragraph 34 of the final guidelines that firms should consider the "type of client" (they are providing the service to) when determining what is the necessary information that needs to be collected.
20. With reference to paragraph 35 of the draft guidelines, some respondents underlined that non-financial factors (i.e. environmental, social, ethical impacts associated to investments and sustainable development) should be taken into account in the context

of the decision-making process of assessing investors' investment objectives. On the topic of sustainable finance see ESMA's reply to question 2, above.

**Q4: Do you agree with how the guideline on the topic of 'reliability of client information' has been updated to take into account behavioural finance and the development of robo-advice models? Please also state the reasons for your answer.**

21. The majority of respondents, and especially consumer and investors' associations, welcomed and appreciated the new guidelines drafted taking into account research on behavioural finance.
22. With reference to the draft general guideline 4, some respondents noted that it seems to go beyond what is stated under Article 55(3) MiFID II Delegated Regulation, according to which "an investment firm shall be entitled to rely on the information provided by its clients or potential clients unless it is aware or ought to be aware that the information is manifestly out of date, inaccurate or incomplete". These respondents suggested maintaining the text of the 2012 guidelines. ESMA notes that, as explained in the CP, guideline 4 has been updated taking into account the fact that the main principles of 2012 guidelines on the topic of 'reliability of client information' have been incorporated in level 2 text (in particular under Article 54(7) of the MiFID II Delegated Regulation). The updated guidelines therefore focus on the importance for firms to take reasonable steps, including the adoption of appropriate tools, to ensure that information collected from clients is reliable and consistent, without unduly relying on self-assessment. These principles remain fully in line with the obligation in Article 55(3) of the MiFID II Delegated Regulation to verify if client's information is '*manifestly out of date, inaccurate or incomplete*'. In any case, it should be clarified that it does not mean that firms are expected to challenge every single piece of information they collect, but rather to apply a reasonable degree of professional diligence to ensure the overall reliability and consistency of such information. Hence, ESMA believes that no further amendment to the text of this guideline is necessary.
23. Regarding paragraph 43 of the draft guidelines, a number of respondents stated that the responsibility for ensuring that the information provided is updated and correct must lie with the client. Firms should therefore be allowed to limit their responsibility by means of specific contractual clauses, considering that this is normally permitted under national contract law. Conversely, other respondents agreed with the proposed draft and observed that risk-profiling software are normally able to include controls of coherence of the replies provided by clients in order to highlight contradictions between different pieces of information collected. As noted above, notwithstanding the fact that firms are entitled to rely on the information provided by their clients, they still have a duty to determine the extent of information to be collected and to ensure the overall reliability and consistency of such information. It is ESMA's view that, as a natural consequence, firms should not in any way attempt to reduce their responsibility in this regard. This is in line with the obligation under Article 54(1) of the MiFID II Delegated Regulation according to which '*firms shall not create any ambiguity or confusion about their responsibilities in*

*the process when assessing the suitability of investment services or financial instruments*'. ESMA has however made some drafting changes to further clarify the content of guideline 4.

24. With regard to paragraph 44 of the draft guidelines, a number of respondents found the “objective criteria” that firms should follow when implementing their questionnaires in order to avoid reliance on investors’ self-assessment excessively burdensome observing that such “knowledge quiz” might be seen as discriminatory by investors. On the opposite direction, other respondents agreed with the proposed guidance. ESMA has decided to confirm the content of this paragraph, which aims at providing some practical examples on the objective criteria to be used to counterbalance clients’ self-assessment, but has introduced some formal adjustments in order to enhance the clarity of the drafting.
25. With regard paragraph 47 of the draft guidelines, a union of employees stated that the reference to potential risks that may arise if clients were encouraged to provide certain answers should be made without mentioning the “customer facing staff”, since such encouragement might happen in digital contexts too. ESMA agrees with this comment and has therefore deleted the reference to customer facing staff, so as to clarify that the principle stated in the guideline applies irrespective of the means of interaction with clients.

**Q5: Do you agree with the suggested approach on the topic of ‘updating client information’? Please also state the reasons for your answer.**

26. The majority of respondents agreed with ESMA’s suggested approach and the text of the proposed guideline 5. A summary of some of the detailed comments is set out below:
  - A few respondents asked ESMA to clarify the concept of “ongoing relationship”, a term used in the draft guideline 5 and in several articles of MiFID II. On this topic please refer to the recently published ESMA MiFID II Q&A on the use of the term “ongoing relationship” in MiFID II and its implementing measures.<sup>9</sup>
  - One of the consumer associations responding to the consultation suggested that in order to ensure that firms regularly update client information, the ESMA guidelines should suggest a timeline for this update. The consumer association also noted that robo-advice firms should be encouraged to remind their clients (e.g. via email alerts) to update their information. In ESMA’s view it is firms’ responsibility to decide how frequently the update of client information should be conducted.

---

<sup>9</sup> See Q&A 1 of Chapter 15 of ESMA35-43-349.

ESMA has however set out relevant factors to be considered by firms in paragraph 54 of the final guidelines.

27. A few respondents, while supporting ESMA’s objective of “opportunistic” updating of client profiles, disagreed with the approach suggested in paragraph 54 of the draft guidelines and noted that it is common practice for firms to take advantage of client meetings to update client information and provide investment advice and that while these two actions are simultaneous, they are not fraudulent. In this regard, it should be noted that this supporting guideline does not deal with ‘ordinary’ situations where client’s information is updated following real changes in his/her personal circumstances, which may arise, for example, in the course of meetings where investment advice is also being provided. On the contrary, its specific purpose is to address and mitigate the risk of fraudulent actions, i.e. influencing 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. ESMA believes that the guideline is clear enough on this aspect and has not made substantial amendments to the text.

**Q6: Do you agree with the suggested approach to conduct the suitability assessment for a group of clients, especially where no legal representative is foreseen under applicable national laws? Please also state the reasons for your answer.**

28. While respondents generally supported the approach set out in guideline 6, several specific comments were raised. The main ones are summarised below.
29. With regard to paragraph 56 of the draft guidelines, several respondents commented on the section of the guideline that states “the firm should inform its clients *ex-ante*, clearly and accurately, about its policy, including for each situation who should be subject to the suitability assessment, whether an agreement with the client is foreseen, how this assessment will be done in practice and the possible impact this could have for the relevant clients”:
- Some respondents stated that the above guideline does not seem in line with Article 54(6) of the MiFID II Delegated Regulation does not require the firm to inform its clients *ex-ante* about its policy on who should be subject to the suitability assessment and how this assessment will be done in practice. These respondents suggested deleting the third sentence of paragraph 56 of the draft guidelines. ESMA disagrees with the comment and note that, in its view, clients that fall within the scope of this guideline (group of clients) should be informed about the way the firm will operate in their specific situation (i.e. who will be subject to the suitability assessment and how this assessment will be done in practice), according to the firm’s existing policy. ESMA notes that this information can be provided in a standardised form (for example in the firm’s general terms and conditions or within the questionnaires used by firms to collect the necessary information from clients).

This seems even more necessary when the firm's policy in this field implies an agreement amongst clients about who will represent the group of clients.

- Some respondents asked ESMA to clarify what is meant with “an agreement with the client”. These respondents queried whether the agreement refers to the advisory agreement or an agreement to provide an ongoing suitability assessment. ESMA notes that guideline 6 relates to agreements between clients to decide on a representative for the group.

30. With regard to paragraph 65 of the draft guidelines, various comments were raised on the concept that a firm's policy should “take into account the matrimonial regime applicable to the couple”. Some respondents noted that this would be burdensome for firms and complex, especially in international scenarios. Others stated that the matrimonial regime regulates the “inner relationship” of a couple and a distinction should be made with “external relationship” (such as that with an investment firm) which are not regulated by the matrimonial regime. These respondents noted that regardless of the property regime established by law, couples can decide with the investment firm various solutions with either joint or separate powers of signature. These respondents suggested deleting this supporting guideline. ESMA agrees with this comment and has deleted the reference to the matrimonial regime from the final guidelines. ESMA notes that it is the firms' responsibility to decide whether or not the matrimonial regime should be taken into account and could have an impact on the investment service provided to the client, taking into account national applicable law. ESMA has also amended the text of paragraph 66 of the final guidelines as it is of the opinion that if an agreement by members of a group of clients about their common investment objectives seems possible, the same is not valid with regard to their respective financial situation. In any case, for the purposes of assessing the underlying financial situation of a group of clients, firms should take into consideration the overall information acquired from all of them. Therefore, for example, if a couple operates through a joint account, the assessment of their financial situation should also be based on the ability of the joint account to bear losses.

**Q7: Do you agree with the suggested approach on the arrangements necessary to understand investment products for the purposes of suitability assessment? Please also state the reasons for your answer.**

31. The majority of respondents supported the principle that firms should ensure they have policies and procedures to understand characteristics, nature and features of investment products to allow them to recommend suitable investments. Some respondents however raised comments on two aspects included in the supporting guidelines of guideline 7:

- Some noted that this section of the guidelines seems to introduce a new obligation for firms to classify products for the purpose of the suitability assessment. These respondents stated that no such obligation exists in Level 1 or Level 2 and furthermore this guideline blurs the line between the suitability requirements and those on product governance.

ESMA notes that Article 54(9) of the MiFID II Delegated Regulation, which deals with the assessment of suitability, states that “*Investment firms shall have, and be able to demonstrate, adequate policies and procedures in place to ensure that they understand the nature, features, including costs and risks of (...) financial instruments selected for their clients*”. ESMA believes that this requirement for firms to understand the products selected for their clients is crucial to ensure that firms only recommend suitable investments or make suitable investments on behalf of their clients and cannot be fulfilled only by complying with the MiFID II product governance rules.

ESMA also notes that MiFID II has introduced product governance requirements in order to further enhance the overall level of protection afforded to clients, and supplement the existing point of sales rules, including suitability, which apply subsequently, when firms provide investment services to each individual client. Although product governance and suitability rules share similar objectives, they complement and do not substitute each other<sup>10</sup>. Furthermore, depending also on the specific nature and features of the products considered, the level of details necessary to fulfil product governance requirements may be less granular than that necessarily required to ensure that a specific product is suitable for an individual client<sup>11</sup>.

In conclusion, ESMA, while confirming the substance of the consulted guidelines, has tried to clarify the text by deleting the reference to the fact that firms should “classify” products, and by specifying that the analysis conducted for the purposes of the identification and assessment of the target market on an ex-ante basis

---

<sup>10</sup> See also paragraph 33 of the ESMA guidelines on MiFID II product governance requirements [Ref: ESMA35-43-620] which states: “The obligation of the distributor to identify the actual target market and to ensure that a product is distributed in accordance with the actual target market is not substituted by an assessment of suitability or appropriateness and has to be conducted in addition to, and before such an assessment”.

<sup>11</sup> In this regard, it should be reminded that, for example, the mentioned ESMA guidelines on product governance explicitly recognise that ‘*for simpler, more common products it is likely that the target market will be identified with less detail:*

- *For some types of investment products the manufacturer may identify the above-mentioned target market categories referred to in paragraph 18 following a common approach for financial instruments of one type with sufficiently comparable product features (for example due to an external benchmark, or because they belong to a stock-exchange segment with certain requirements).*
- *Depending on the investment product, the description of one or more of the above-mentioned categories may be more generic. The simpler a product is, the less detailed a category may be’.*



should be considered in the suitability processes and procedures, so as to ensure consistency and avoid duplications.

- Some respondents commented on the reference, included in paragraph 71 of the draft guidelines, to the “complexity of products”. Some respondents disagreed with the ESMA approach and stated that “the distinction between complex and non-complex products is not a viable criterion in the context of the suitability assessment”. These respondents stated that, in this context, the reference to the ESMA MiFID II guidelines on complex products<sup>12</sup> is problematic, as these guidelines have been drafted for a different purpose (i.e. the assessment of appropriateness). Other respondents, instead, stated that – for the purpose of standardisation – ESMA should indeed use for the guidelines a definition of complex products consistent with that used in the guidelines issued under Article 25(4). ESMA acknowledges these diverging comments, and has decided to confirm the content of this guideline that – on this topic – is consistent with the content of the 2012 guidelines. ESMA has however made some formal adjustments to further improve the clarity of the drafting and avoid overlaps with the content of guideline 3.

**Q8: Do you agree with the additional guidance provided with regard to the arrangements necessary to ensure the suitability of an investment? Please also state the reasons for your answer.**

32. While respondents generally supported the approach set out in guideline 8, several specific comments were raised. The main ones are summarised below.
33. With regard to the general guideline in paragraph 75, some respondents suggested redrafting the text in order not to refer to “all available information about the client” but instead to “relevant information” or “information that the client is willing to give” as firms should not be obliged to investigate beyond what the client has been willing to provide. ESMA is convinced that the wording of paragraph 75 of the draft guidelines is consistent with the MiFID II requirements on suitability and has therefore confirmed the text of the paragraph in the final guidelines.
34. Some respondents stated that definition of personal recommendation used in paragraph 76 of the draft guidelines covers a recommendation to buy, hold or sell a financial instrument, but also the recommendation not to buy, sell or hold a financial instrument (“or not to do so”). These respondents stated that the recommendation “not to do so” is not covered by Article 9 of the MiFID II Delegated Regulation and should therefore be deleted. ESMA disagrees with the comment raised and notes that Article 9 of the MiFID

---

<sup>12</sup> ESMA Guidelines on complex debt instruments and structured deposits (Ref: ESMA/2015/1787).

Delegated Regulation should be read together with Recital 87 of the MiFID II Delegated Regulation and therefore recommendations not to buy a financial instrument are within the scope of these guidelines.

35. Some respondents commented on paragraph 78 of the draft guidelines that states “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.” These respondents noted that, when using an algorithm and providing robo-advice, it is not possible to take into account all specificities of each client. These respondents concluded that, if applied without proportionality, the guideline would result in a de facto ban of robo-advice. ESMA wishes to clarify that paragraph 78, which was already part of the 2012 guidelines, refers to any tools that firms use for the assessment of suitability, including professional-facing tools that are used by firms for the provision of face-to-face advice. It is therefore not intended to apply only to robo-advice.
36. Some respondents claimed that the draft guidelines, and specifically paragraph 81, do not adequately reflect the differences between the services of investment advice and portfolio management. More specifically, these respondents noted that the content of paragraph 81 that states “knowledge and experience of the client should be assessed regarding each investment product and risks involved in the related transaction”, contradicts paragraph 36(b) of the draft guidelines that states “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”. ESMA agrees with the comments raised and has amended this part of the guidelines to differentiate between portfolio management and investment advice. Specifically in reference to paragraph 80 of the final guidelines, ESMA notes that – when including complex products within a portfolio management service – firms should consider if, within particular types of financial instruments, there are any subsets of instruments that have a materially different risk profile or higher degree of complexity, which may mean the firm should test the clients knowledge and understanding in more depth if such instruments could be included in their portfolio.
37. Diverging comments were expressed on paragraphs 82 to 84 of the draft guidelines. Some respondents supported the text and agreed with the importance of assessing credit risk and concentration risk of investment product when advising clients or providing portfolio management services. Other respondents instead stated that these guidelines should not be included as they relate to how a firm should perform its services rather than to how it should apply the MiFID II suitability requirements. Furthermore, some

respondents stated that not all banks are operating in open architecture and that an exposure of the client's portfolio to one single issuer or to issuers part of the same group should be considered as an additional risk and that such an "additional risk-classification" would increase the administrative burden without any added value for the client. ESMA would like to clarify that paragraphs 82 and following do not introduce an obligation for firms to operate in open architecture. Nonetheless, ESMA confirms that credit and concentration risk are key elements that need to be considered within the suitability assessment. ESMA has therefore decided to confirm this guideline and has made only some minor drafting amendments.

38. Several respondents strongly supported the content of paragraph 85 on the suitability assessment conducted through automated tools. On paragraph 86, instead, while the majority supported the objective, some felt it went beyond the scope of the suitability requirements and should therefore be deleted. ESMA is of the view that paragraph 85 provides useful guidance for the use of client-facing automated tools. It has been slightly amended in the light of the responses received during the public consultation. With regard to paragraph 86, ESMA agrees with the comments received and has therefore deleted the paragraph.

**Q9: Do you agree with the suggested approach for ensuring that firms assess, while taking into account costs and complexity, whether equivalent products can meet their clients' profile? Please also state the reasons for your answers.**

39. The majority of respondents agreed with the approach suggested by ESMA in guideline 9. A consumer association replying to the consultation, and some other respondents, underlined the importance of these measures especially for retail investors. Various respondents however raised some issues relating to specific parts of the guidelines, these are summarised below.
40. With regard to paragraph 88 of the draft guidelines, several detailed comments were raised:
- Some respondents noted that the reference to products that are "broadly equivalent" is unclear. ESMA has amended the drafting in order to align the terminology of the guidelines with that used in Article 54(9) of the MiFID II Delegated Regulation.
  - Some respondents noted that firms should not only consider "target markets" and "risk-return profiles" to compare products, but should also take into account other aspects (such as the asset type). ESMA notes that the reference to the "target market" and "risk-return profiles" of products are not to be considered an exhaustive list and firms can indeed consider other elements (such as asset type) to identify which products are equivalent.

41. Almost all respondents commenting on paragraph 90 of the draft guidelines, supported the suggested approach. Some of these however, asked ESMA not to limit the possibility to assess cost and complexity centrally only to firms using common portfolio strategies or model investment propositions. ESMA is of the view that paragraph 90 already allows for a high degree of flexibility and has therefore decided to maintain the wording of this paragraph.
42. With regard to paragraph 91 of the draft guidelines, a large number of respondents disagreed with the last sentence of the draft guidelines and noted that it has no legal basis in the Level 1 or Level 2 requirements. These respondents also noted that the suitability report will be developed through a standardised and automated process and it will therefore not be technically possible to document this additional aspect in the report. These respondents asked ESMA to delete the sentence from the guidelines. ESMA has amended the guideline to address the comment received. ESMA notes however that it is important that decisions taken by firms to choose a more costly or more complex product should be documented by the firm and reviewed internally by the respective control functions. Firms may also decide to inform clients about these decisions, depending on the category of the client.
43. Finally a few respondents asked ESMA to limit this guideline to dealing with retail clients and to exclude from the scope of application of this guideline the more complex OTC derivatives used by SMEs to hedge risks. ESMA notes that Article 54(9) of the MiFID II Delegated Regulation does not allow for such a restriction in scope.

**Q10: Do you agree with the suggested approach for conducting a cost-benefit analysis of switching investments in the context of portfolio management or investment advice? Please also state the reasons for your answer.**

44. The majority of respondents agreed with the approach suggested by ESMA in draft guideline 10 and underlined the importance of this guideline for retail investors. Furthermore, several respondents welcomed the approach set out in paragraph 96 of the draft guidelines. Those respondents that disagreed with certain aspects of the guidelines raised the points set out below.
45. Several respondents noted that the approach set out in the guidelines has been designed for portfolio management provided to retail clients. These respondents noted that, however, with respect to professional clients or other institutional clients such as pension schemes, it is important that the guidelines recognise the very common situation where the investor decides which strategy he wants the asset manager to apply. A respondent suggested therefore that asset managers should be able to agree with the professional and institutional client on an abstract cost-benefit analysis in advance, and that paragraph 97 of the draft guidelines should only apply for retail clients. ESMA has amended the supporting guideline to specify that for professional clients, the cost-benefit analysis may be carried out on investment strategy level.

46. Several respondents asked ESMA to clarify, and limit, the scope of what is covered by the term ‘switching’:
- Some respondents noted ‘switching’ should be limited to the selling of one investment with the considered intention of buying another instrument to replace it.
  - These respondents also noted that switching should be differentiated from the continuous process of adjustment (for example, buying and selling bonds to match the desired yield curve and duration) and for which a cost-benefit analysis for each transaction would be counterproductive.
  - Furthermore some respondents suggested that the concept of ‘switching’ should be limited to change between similar instruments, as it would make little sense to compare costs and benefits of instruments of different asset classes (for example, a change in asset allocation to satisfy a client’s need for liquidity should be excluded from the scope of this guideline).
  - Finally, some respondents asked ESMA to explicitly state in the guidelines (and not in the background section) that the rebalancing of a portfolio, in the case of a ‘passive’ strategy to replicate an index would not be considered a switch (see page 27 of the Consultation Paper).

ESMA has carefully reviewed the comments received but notes that the broad scope of Article 54(11) of the MiFID II Delegated Regulation is not compatible with the suggestions made by respondents that would result in Article 54(11) applying only in an extremely limited number of cases. ESMA has however now explicitly stated in the guidelines that the rebalancing of a portfolio, in the case of a ‘passive’ strategy to replicate an index would not be considered a switch.

47. Several respondents objected to the content of paragraph 94 of the draft guidelines and stated that there is no legal basis to ask firms to include the information on the cost-benefit analysis of the switch in the suitability report. One respondent stated that firms should be left free to decide how to convey the information to clients. ESMA is of the view that the guideline is compatible Article 54(11) of the MiFID II Delegated Regulation and that it is important for the fulfilment of the Level 2 requirements that where investment advice is provided to a retail client, the client should be informed in the suitability report of why the benefits of the recommended switch are greater than its costs.
48. With specific reference to the analysis of costs and benefits a few respondents asked to clarify that firms are expected to consider “expected” benefits, as it is impossible – ex-ante – to be able to demonstrate that one investment will perform better than another one. ESMA agrees and has amended the text of the supporting guideline accordingly.

49. A few respondents also noted that some of the switches could be justified by tax considerations (e.g. changes in the tax regime). ESMA's agrees and notes that taxes are a factor that firms could take into consideration in the cost benefit analysis of the switch.

**Q11: Do you believe that further guidance would be needed with regard to the skills, knowledge and expertise that should be possessed by staff not directly facing clients, but still involved in other aspects of the suitability assessment? Please also state the reasons for your answer.**

50. No substantial comments were raised on the content of draft guideline 11.
51. Some respondents however noted that the guidelines included from paragraphs 99 to 103 of the draft guidelines should be placed within the ESMA guidelines on the assessment of knowledge and competence<sup>13</sup> to avoid a fragmentation of legal sources. ESMA notes that the scope of these two guidelines is different since the ESMA guidelines on the assessment of knowledge and competence only cover staff providing investment advice or giving information about financial instruments, structured deposits, investment services or ancillary services to clients, whereas the suitability guidelines also covers other staff involved in the suitability assessment process.
52. Furthermore, some trade unions replying to the consultation, suggested that ESMA state that firms should provide training, where appropriate, on the new elements of the suitability assessment and the suitability guidelines. ESMA 's believes that this is already clear under the current drafting and that there is no need for further clarification.

**Q12: Do you have any further comment or input on the draft guidelines?**

53. A number of respondents provided comments on draft guideline 3, noting the following:
- The nature of the service provided should enable firms to collect less information about clients, notably in cases of advice or portfolio services related to mass retail products or to a small amount of money. ESMA believes that paragraph 34 and 39 of the final guidelines are already clear on both the points raised.
  - The reference to risky products and to illiquid products under paragraphs 34 and 35 of the draft guidelines should be further clarified and examples provided. ESMA has confirmed the approach followed in the 2012 guidelines and notes that it is up to each investment firm to define a priori the level of risk of the financial instruments and which of the financial instruments included in its offer to investors it considers as being illiquid. Investment firms should take into account, where available, possible guidelines issued by competent authorities supervising the firm.

---

<sup>13</sup> ESMA/2015/1886.

- The reference to vulnerable investors (provided under paragraph 38 of the draft guidelines) seems to go beyond the MiFID framework on client classification according to some respondents, is too rigid for others, and introduces an excessively narrow perspective according to other respondents who considered that space should also be given to the concept of “experienced and competent investors”. ESMA notes that, in order to ensure consistency with MiFID II and its Delegated Regulation, it has intentionally avoided introducing client categorisation rules different from those set by Level 1 and Level 1 (retail clients, professional clients and eligible counterparties). However ESMA is aware that these categories are not necessarily homogenous and has therefore decided to confirm the text of this part of the guidelines in order to ensure an appropriate level of investor protection.
  - The need for firms to obtain information on (per se professional) clients’ financial situation where the investment objectives demand it (paragraph 39 of the draft guidelines) does not seem consistent with Article 54(3) of MiFID II Delegated Regulation. ESMA disagrees and notes that it would not be possible for a firm to effectively hedge a risk for the client if it does not have information about the underlying financial situation of the client. ESMA has therefore confirmed the text of the guideline.
  - Firms should not be recommended to encourage their clients to disclose their investments with other firms in detail as proposed under paragraph 41 of the draft guidelines. According to those respondents, advisors and portfolio managers should be able to build their assessment and recommendation on the information provided by the client. Others, on the same point, argued that investment firms should collect information about clients’ total assets on a classes-by-classes basis (and not on an instruments-by-instruments basis). On the other hand, some respondents strongly supported the approach suggested in the draft guidelines and noted that a full view of the client’s financial situation is important for the provision of advice and of portfolio management. ESMA has amended the guideline to address the comments received.
54. Some respondents offered their feedback on draft guideline 12 and considered that the guidance on the record-keeping arrangements that firms should put in place to track ex-post why an investment choice was made (paragraph 105 of the draft guidelines) as disproportionate, unjustified and not in line with the current legislative framework in particular for the provision of portfolio management service where a quarterly reporting obligation on investment decisions is already foreseen. On the same topic, other respondents commented that paragraphs 107 to 109 of the draft guidelines do not seem to be linked with the suitability assessment and suggested to not include them in the guidelines. Others suggested to delete “all investments (and disinvestments) made” in paragraph 104(a) of the draft guidelines.

ESMA notes that the requirement to be able to track ex-post why an investment choice was made was already a requirement in the 2012 guidelines. The same applies for paragraph 104(a) of the draft guidelines and that these are both consistent with the requirements on record keeping included in Article 16(6) of MiFID II, which has a general application and states that firms “shall arrange for records to be kept of all services, activities and transactions undertaken by it which shall be sufficient to enable the competent authority to fulfil its supervisory tasks and to perform the enforcement actions under this Directive, Regulation (EU) No 600/2014, Directive 2014/57/EU and Regulation (EU) No 596/2014 [...]”.

Considering the comments received, ESMA has decided to delete some of the supporting guidelines. ESMA has however retained the supporting guideline on malicious cyber activities considering the importance of this topic in the context of online/digital tools. ESMA has also clarified in a footnote that 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.

**Q13: What level of resources (financial and other) would be required to implement and comply with the Guidelines (market researches, 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.**

55. A European trade association of banks provided some qualitative feedback on the costs for the implementation of the draft guidelines, whilst a trade association of financial advisors indicated that the guidelines should not impose significant additional costs.
56. According to the majority of respondents the main costs will derive from the expenses for: IT (e.g. design of websites, interfaces and client on-boarding processes); organisation and processes, and training of staff.





## 3.4 Annex IV – Guidelines

### I. Scope

#### Who?

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

#### What?

2. These guidelines apply in relation to the provision of the following investment services listed in Section A of Annex I of Directive 2014/65/EU<sup>14</sup> (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 Commission Delegated Regulation (EU) 2017/565<sup>15</sup> (MiFID II Delegated Regulation) and Annex II of MiFID II.

#### When?

4. These guidelines apply as from 60 calendar days after the reporting requirement date referred to in paragraph 13.

The previous ESMA guidelines issued under MiFID I<sup>16</sup> will cease to apply on the same date.

---

<sup>14</sup> 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 (OJ L 173, 12.06.2014, p. 349).

<sup>15</sup> Commission Delegated Regulation (EU) 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 (OJ L 87, 31.03.2017, p.1-83).

<sup>16</sup> ESMA/2012/387 - Guidelines on certain aspects of the MiFID suitability requirements.

## II. Definitions

5. Unless otherwise specified, terms used in MiFID II and the MiFID II Delegated Regulation have the same meaning in these guidelines.
6. In addition, for the purposes of these guidelines, the following definitions apply:
  - ‘investment product’ means 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’ mean firms subject to the requirements set out in paragraph 1 and include investment firms (as defined in Article 4(1)(1) of MiFID II), including credit institutions when providing investment services and activities (within the meaning of Article 4(1)(2) of MiFID II), investment firms and credit institutions (when selling or advising clients in relation to structured deposits), UCITS management companies and external Alternative Investment Fund Managers (AIFMs) (as defined in Article 5(1)(a) of the AIFMD<sup>17</sup>) when providing the investment services of individual portfolio management or non-core services (within the meaning of Article 6(3)(a) and (b) of the UCITS Directive<sup>18</sup> and Article 6(4)(a) and (b) of the AIFMD);
  - ‘suitability assessment’ means 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’ means 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.
7. These guidelines apply in full to all firms providing the services of investment advice and portfolio management, irrespective of the means of interaction with clients. The application of some guidelines is considered particularly relevant where firms provide ‘robo-advice’ (as defined above for the purposes of these guidelines), due to the limited interaction (or none at all) between clients and firms’ personnel. This is specifically pointed out in the text where relevant.

---

<sup>17</sup> Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 (OJ L 174, 01.07.2011, p.1-73).

<sup>18</sup> Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (OJ L 302, 17.11.2009, p. 32).



8. Guidelines do not reflect absolute obligations. For this reason, the word 'should' is often used. However, the words 'shall', 'must' or 'required to' are used when describing a MiFID II requirement.

### **III. Purpose**

9. 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.
10. 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.

### **IV. Compliance and reporting obligations**

#### **Status of the guidelines**

11. This document contains guidelines issued under Article 16 of the ESMA Regulation.<sup>19</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.
12. 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**

13. 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.

---

<sup>19</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.

14. Firms are not required to report whether they comply with these guidelines.

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

### **V.I INFORMATION TO CLIENTS ABOUT THE PURPOSE OF THE SUITABILITY ASSESSMENT**

**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*

15. 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*

16. 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.
17. 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.
18. 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.
19. 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.

20. 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.

21. 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.II 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*

22. 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*

23. 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.
24. 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.
25. 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).
26. 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.

27. 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).
28. ESMA considers it would be a good practice for firms to consider non-financial elements when gathering information on the client's investment objectives, and – beyond the elements listed in paragraph 27 – collect information on the client's preferences on environmental, social and governance factors.
29. 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.
30. 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>20</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

---

<sup>20</sup> See guideline 4.

overall appraisal of his understanding of the products and of the risks involved in the transactions recommended or in the management of his portfolio.

31. 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.
32. 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 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*



33. Before providing investment advice or portfolio management services, firms need to collect all ‘necessary information’<sup>21</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*

34. 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);
  - the nature and extent of the service that the firm may provide;
  - the needs and circumstances of the client;
  - the type of client.
35. 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.
36. For example, when providing access to complex<sup>22</sup> or risky<sup>23</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>24</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

---

<sup>21</sup> ‘Necessary information’ should be understood as meaning the information that firms must collect to comply with the suitability requirements under MiFID II.

<sup>22</sup> As defined in MiFID II and taking into account the criteria identified in guideline 7.

<sup>23</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>24</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.

(for example, derivatives or leverage products), the length of time he has been trading them for, etc.

37. For illiquid financial instruments<sup>25</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, 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.).
38. 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

---

<sup>25</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.

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.

39. 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.
40. 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.
41. Similarly, where the investment service consists of the provision of investment advice to a 'per se professional client'<sup>26</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 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.
42. 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>27</sup>
43. 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.

---

<sup>26</sup> As set out in Section I of Annex II of MiFID II ('Categories of client who are considered to be professionals').

<sup>27</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)



## 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*

44. 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*

45. 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>28</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.

46. 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 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);

---

<sup>28</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.

- 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.
47. 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.
  48. 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.
  49. 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>29</sup>.
  50. 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.
  51. 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.

---

<sup>29</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.

## 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*

52. 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*

53. 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.
54. 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.
55. 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.
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>30</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>31</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 practice and the possible impact this could have for the relevant clients, in accordance with the existing policy.

#### *Supporting guidelines*

---

<sup>30</sup> Also relevant in this context are measures adopted to ensure the reliability of clients' information as detailed under guideline 4, paragraph 44.

<sup>31</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').

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 and relevant risk factors (such as credit risk, market risk, liquidity risk<sup>32</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>33</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>34</sup> which may, for example, change their nature into shares).
71. 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.

---

<sup>32</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>33</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>34</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).

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>35</sup>

#### *Supporting guidelines*

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>36</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

---

<sup>35</sup> See Articles 50 and 51 of MiFID II Delegated Regulation regarding the obligation to inform clients about costs.

<sup>36</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.

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. 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.
80. 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.

81. 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>37</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, controlled and mitigated (for example, the identification of *ex ante* thresholds could be encompassed)<sup>38</sup>.

82. 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

---

<sup>37</sup> See 'MiFID practices for firms selling financial instruments subject to the BRRD resolution regime' (ESMA/2016/902).

<sup>38</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.

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.**

#### *General guideline 9*

83. 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*

84. 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.
85. 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>39</sup>.
86. 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.
87. 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**

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

---

<sup>39</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.

### *General guideline 10*

88. 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*

89. 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.

90. 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;



91. When providing investment advice, a clear explanation of the reasons why 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.
92. 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.
93. 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.
94. 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>40</sup>
95. 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**

---

<sup>40</sup> For relationships with professional clients see paragraph 89.



**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*

96. 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*

97. 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.
98. 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>41</sup>), including with regard to the suitability assessment.
99. 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>42</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.
100. 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

---

<sup>41</sup> Ref: ESMA71-1154262120-153 EN (rev).

<sup>42</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.



- (b) are able to understand and review the digital/automated advice generated by the algorithms.

## **Record-keeping**

**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*

101. 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*

102. 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.

103. 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.

104. 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>43</sup>

---

<sup>43</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.