Amafi > Association française des marchés financiers
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ESMA Consultation Paper

Guidelines on certain aspects of the MiFID suitability requirements

Comments by AMAFI

1. *Association française des marchés financiers* (AMAFI) has more than 120 members representing over 10,000 professionals who operate in the cash and derivatives markets for equities, fixed-income products and commodities. Nearly one-third of the members are subsidiaries or branches of non-French institutions.

2. The Association welcomes the opportunity to comment on the Consultation paper (hereafter referred to as the CP) on "*Guidelines on certain aspects of the MiFID suitability requirements"* issued by the European Securities and Market Authority. Before answering the questions of the CP (B.) and proposing some amendments to the guidelines, some more general comments are set out (A.). Please note that the proposed amendments are evidenced as follows: additions are in bold underlined and suppressions are crossed out in bold.

A. General comments

- **The timing of these guidelines should be reviewed**

3. It is surprising that ESMA decides to publish guidelines on suitability requirements that exist since 2007 and for which some delegated acts are foreseen by the Commission's proposal for the revision of MiFID (*Art. 25.6*). Firms' compliance with suitability requirements necessitates costly investments and has important commercial impacts because it requires dialogue and exchanges with clients. It is therefore very important that the appreciation of these requirements and the expectations of competent authorities be stable in time.

AMAFI is concerned that this will not be the case since an important new feature is planned in the Commission's proposal that consists in the possibility for firms to provide on-going suitability assessment when they provide investment advice. This addition is very likely to trigger the need for additional or modified guidelines, resulting in turn in the need for investment firms to amend again their arrangements, train their staff and communicate with their clients.

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- **The guidelines are thought out with retail clients in mind**

4. The thinking behind the proposed guidelines seems to be predicated on retail clients and in particular natural persons. As a result, the guidelines are most suited to this clientele and, on certain aspects, seem to disregard the nature of wholesale markets and the issues at stake in these markets in terms of assessing suitability of investments, especially for professional clients. More concerning, this bias could result in competent authorities enforcing the guidelines with the same philosophy and expectations towards retail and wholesale markets, without considering the differences inherent to the businesses involved.

- **The guidelines should refrain from using undefined terms such as "*advisory services*"**

5. AMAFI considers that the use of the term "*advisory services*" should be avoided, as it seems to extent the scope of the suitability assessment beyond its legal framework set by Article 19(4) of the Markets in Financial Instruments Directive 2004/39/CE (MiFID), which provides that the suitability assessment should be carried out specifically when providing investment advice or portfolio management services, two investment services precisely defined in Article 4(1) and (2) of MiFID.

The notion of "*investment advisory services*", which is recurrent in the guidelines, does not correspond to the service of "*investment advice*" nor to the service of "*portfolio management*" and is therefore inaccurate. The use of distinct notions may lead to a confusion concerning the situations when investment firms have to comply with the MiFID suitability requirements. AMAFI suggests that the guidelines properly name the services concerned by replacing the terms "*investment advisory services*" by "*investment advice*".

For information, the terms "*advisory services*" are used in the following parts of the guidelines: general guideline of section III. IV p.9, paragraphs 30(a), (b), 32, 36 and 46(a).

- **A reasonable timescale should be set for proper implementation by investment firms**

6. It appears that the planned date of entry into force of the guidelines is missing in the CP. Because ESMA's guidelines are to be complied with by investment firms and can have significant consequences in terms of organisation, their date of entry into force should also be part of the consultation paper. This would allow market participants to provide comments in case they consider that the changes to be made call for a later date of implementation. Since setting in advance a specific date is difficult, the consultation paper could indicate a planned date (or even a quarter of the year) at which the guidelines would enter into force at the earliest.

7. In addition, AMAFI suggests that a single date of entry into force of the guidelines should be set for all EU Member States, instead of making it dependent on the publication of the guidelines by each competent authority and setting a maximum deadline. This is to avoid inconsistencies (even if limited in time) among Member States and facilitate timely implementation for firms with Europe-wide operations.

8. More specifically, it appears that these guidelines are elaborated using best practices gathered in different places and firms. They are therefore setting the highest standards in terms of suitability, which means that some firms are likely to incur significant compliance efforts and costs to comply in full. AMAFI therefore suggests that a reasonable timescale be provided to investment firms for implementing these guidelines.

B. Answers to ESMA's questions and other comments

I. Information to clients about the suitability assessment

Q1: Do you agree that information provided by investment firms about the services they offer should include information about the reason for assessing suitability?

9. It is indeed useful that clients be informed of the reasons for assessing suitability. Clients are sometimes reluctant to disclose personal information about their knowledge, experience, financial situation and investment objectives. Enabling them to have a better understanding of the process is likely to foster their cooperation in answering investment firms' requests for information.

10. However, as regards the responsibility for the suitability assessment, although it lies on the investment firm, the client should not be considered as totally passive in the process. By nature, clients are involved in the suitability assessment, not only because they have their own responsibility in providing the information on which firms will assess the suitability of investments and services, but also because, as sophisticated and objective as it could be, the assessment process is not a science producing bullet proof results but requires dialogue with the client.

In some cases, for example on wholesale markets where the financial instruments and/or the services involved and/or the client's situation can be very complex, it is important for the firm, once it has carried out the test and reached a conclusion, to be able to come back to its client in order to explain, and, potentially confirm, its conclusion. This step can be particularly important because clients may realise that they have forgotten to provide some important information only once the conclusion has been reached. The objective of obtaining client's confirmation is not therefore to limit the firm's responsibility but to make sure that the firm and the client are in agreement on the basis of the information exchanged, and finally that the financial instrument or service provided will actually meet the client's needs. If an investment firm fulfils its duties towards its client and assesses with due care the suitability of the investment or advice, it should not be deprived from the possibility to check the correctness of its assessment.

Client's confirmations are not a means to give the impression that clients decide of the suitability, and they do not transfer the responsibility for the suitability assessment on clients who remain protected (the firm's responsibility in this respect is anyway clearly set in MiFID). They are nothing but a logical termination to the suitability process.

11. As a consequence, AMAFI suggests to amend paragraph 19 of the CP as follows:

> 19. The suitability assessment is the responsibility of the investment firm. In this regard, 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 his own risk profile (for example, by indicating to the client that a certain financial instrument is the one that the client chose as being suitable~~**, or by requiring the client to confirm that an instrument or service is suitable**~~).

II. Arrangements necessary to understand clients and investments

Q2: Do you agree that investment firms should establish, implement and maintain policies and procedures necessary to be able to obtain an appropriate understanding regarding both the essential facts about their clients, and the characteristics of financial instruments available for those clients?

12. Yes we agree, provided that this is limited to the investment advice and portfolio management services. Also, the example of necessary information to be collected ("*the client's age, marital status, family situation, employment situation*") is relevant only when dealing with a natural person.

As a consequence, paragraph 22 of the CP should be amended as follows:

> 22. Investment firms should know their clients. This means that, **when providing investment advice or portfolio management services,** firms should implement policies and procedures that enable them to collect, for example through questionnaires completed by their clients, and assess all information necessary to conduct a suitability assessment for each client. For example, in many cases, **for clients who are natural persons,** it is unlikely that a firm will be able to meet its obligations if it is unaware of, or fails to consider, the client's age, marital status, family situation, employment situation, or need for liquidity in certain relevant investments.

III. Qualifications of investment firm staff

Q3: Do you agree that investment firms should ensure that staff involved in material aspects of the suitability process have the skills and the expertise to discharge their responsibilities?

13. Yes, it is essential that staff of an investment firm involved in material aspects of the suitability process have the skills and the expertise to discharge their responsibilities.

IV. Extent to information to be collected from clients (proportionality)

Q4: Do you agree that investment firms should determine the extent of information to be collected about the client taking into account the features of the service, the financial instrument and the client in any given circumstance?

14. AMAFI agrees with the general principle that the features of the service, the financial instrument and the client must be taken into account by investment firms to make their suitability assessment. Nonetheless some specific statements attached to this guideline raise some concerns.

15. In paragraphs 32 and 33 of the CP, the term "*generally*" is inappropriate as it implies that there could be exceptions to the principle that professional clients have a sufficient level of knowledge and experience, provided for in Paragraph 1 of Article 35(2) of the MiFID Implementing Directive (2006/73/CE):

"*Where a firm provides an investment service to a professional client it shall be entitled to assume that, in relation to the products, transactions and services for which it is so classified, the client has the necessary level of experience and knowledge for the purposes of paragraph 1(c)*".

An issue with the level of experience or knowledge of the professional client in relation to a product, transaction or service, would actually indicate an improper client's classification in relation to this product, transaction or service. Such a problem is different from the suitability assessment and the extent/nature of information to be collected (by the way, the guidelines put this aside by mentioning in brackets that the client "has been correctly classified"). This issue does not bring into question the principle itself, instead it calls for a different client's classification.

16. Besides, paragraph 33 brings about a contradiction with the provisions of MiFID (*Paragraph 2 of Article 35(2) of MiFID Implementing Directive*), as it creates exceptions to the principle that investment firms should not have to obtain information on the financial situations of their professional clients:

> "*Where that investment service consists in the provision of investment advice to a professional client covered by Section 1 of Annex II to Directive 2004/39/CE, the investment firm shall be entitled to assume for the purposes of paragraph 1(b) that the client is able financially to bear any related investment risks consistent with the investment objectives of that client*."

The example provided rests on the fact that financial information is needed to comprehend the risk that the client intends to hedge. AMAFI totally agrees that it is indeed necessary to have the necessary information on the risk involved to be able to advise on an investment to hedge it properly. However, this is part of the information the investment firm should obtain to understand the objective of its professional clients, not their financial situation. As applicable provisions already require such diligence from firms, trying to accommodate a specific situation by creating a general exception to the Directive's principle is therefore not necessary, more, it is harmful because it creates legal uncertainty in the provision of investment advice to professional clients.

17. As a consequence, paragraphs 32 and 33 of the CP should be amended as follows:

> 32. An investment firm should also take into account the nature of the client when determining the information to be collected. For example, where a firm provides investment **advice** ~~**advisory**~~ or portfolio management services to a professional client (who has been correctly classified as such), it is ~~**generally**~~ entitled to assume that the client has the necessary level of experience and knowledge, and therefore is not required to obtain information on these points.
>
> 33. Similarly, where the investment service consists in the provision of investment advice to a 'per se professional client' 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 will be required, however,**~~ **Additional information should however be collected** 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**~~ **adequate** information on that risk in order to be able to propose an effective hedging instrument.

V. Reliability of client information

Q5: Do you agree that investment firms should take reasonable steps (and, in particular, those outlined above) to ensure that the information collected about clients is reliable and consistent?

18. Although AMAFI does not agree with some general obligations placed on firms by the guidelines, it agrees, on the principle, with the proposed steps. The far-reaching wording used in the guidelines is indeed concerning as to the implications it could have :

- It is stated that investment firms should "*ensure that the information collected about clients is reliable and consistent*", which is very demanding in terms of results that should be achieved. Firms, whatever the care they take in the way they ask clients for information, will always have to rely on their clients' answers. Requiring investment firms to ensure the reliability of the information is asking them to check each piece of information, which raises several issues :
  - It is not always possible depending on the type of information concerned that is not objective (e.g. client's investment objectives) or verifiable with third party sources;
  - It is not proportionate in terms of the extent and nature of the population having access to investment advice and portfolio management services;
  - It is not appropriate in terms of the responsibilities of each party to the contract;
  - It can be seen as very inquisitorial by clients who should remain free to decide the extent of the information they provide to the firm.

  As stated in Article 37(3) of MiFID Implementing Directive, "*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*". There is therefore a natural step that should be taken by an investment firm to check for inconsistencies and incompleteness that are manifest, but the firm cannot substitute itself to the client to ensure reliability.

- It is also stated that investment firms should not rely on clients' self assessment. And the guidelines illustrate this requirement by explaining that self assessment should be counter balanced by objective criteria. Again, AMAFI agrees that firms should not base their questioning on subjective notions by relying on clients' feelings or beliefs. However, the nature of the information (objective versus subjective) is different to the way it is obtained, i.e. even though the questions asked call for facts rather than feelings, they still rely on clients' self assessment: the client is the one assessing his number of years of experience in a financial instrument, he is the one remembering if it has knowledge in a product/asset class. Requiring firms not to rely on self assessment would actually ask them to check clients' say with third party sources.

19. More generally, the issue at stake here is the responsibility that clients should or should not have in providing accurate information and the responsibility that firms should have in requesting this information in an understandable manner and in a way leaving the smallest leeway for subjective interpretation and in checking for inconsistencies.

It is our opinion that although it is clearly the investment firm's responsibility to assess suitability, clients should not be relieved of any responsibility in providing accurate information because each party to the relationship should have rights as well as duties if the relationship is to work properly. The relationship between the firm and the client is over all based on trust. Removing any client's responsibility would be detrimental in this respect because it is likely to trigger protective or dismissive behaviors and harm the quality of the advice provided (or even impede the provision of investment advice to a whole class of clients).

20. Finally, AMAFI would like to underscore that this guideline is manifestly written with the retail client and the retail business in mind but, as it does not state so, it applies the concept of knowledge, experience and financial situations to professional clients and it extends without nuances some concepts inherent to the retail business to the wholesale markets (see for example the level of loss mentioned in c).

21. AMAFI therefore suggests amending the wording of this guideline as follows :

Investment firms should ~~**take reasonable steps to ensure that the information collected about clients is reliable. In particular,**~~:

~~**- not rely on clients' self-assessment;**~~

- **<u>rely on objective criteria for the purpose of their suitability assessment</u>**;

- ensure that all tools employed in the suitability assessment process are appropriately designed; and

- take steps to ~~**ensure**~~ **check against manifest in**consistenc**ies** of client information.

37. Notwithstanding client's responsibility to provide correct, up-to-date and complete information for the suitability assessment, investment firms should take reasonable steps to ~~**ensure the reliability of information collected about clients**~~ **<u>obtain these information.</u>** This implies, ~~**amongst other things,**~~ **<u>the following:</u>** ~~**that when collecting information about a client.**~~

- Investment firms should take care to ensure that the questions asked are likely to be understood;

- <u>Investment firms should base their assessment on</u> objective criteria;

~~**38. For the same reason, investment firms should avoid relying unduly on the client's own assessment of his knowledge, experience and financial situation. Self-assessment made by a client should be counterbalanced by objective criteria.**~~ **F**or example **<u>for a client who is not a professional</u>**:

(a) instead of asking a client whether he feels sufficiently experienced to invest in certain instruments, the firm could ask the client what types of instruments the client is familiar with;

(b) instead of asking a client whether he believes he has sufficient funds to invest, the firm could ask the client for factual information about his financial situation;

(c) instead of asking a client whether he feels comfortable with taking risk, the firm could ask the client what level of loss over a given time period he would be willing to accept, either in the individual investment or on his portfolio.

39**.** Where investment firms rely on tools to be used by clients (such as on-line questionnaires, or risk-profiling software) as part of the suitability process, they should ensure that they have appropriate systems and controls to ensure that the tools are fit for purpose and produce satisfactory results. Firms should also mitigate potential risks associated with the use of the tools. Potential risks may arise, for example, where clients (on their own initiative or where encouraged by customer-facing staff) change their answers in order to get access to financial instruments that may not be suitable for them; or where questions are drafted in a such way that they lead the client to a specific type of investment.

40. **-** In order to ensure the consistency of client information, investment firms should view the information collected as a whole. Firms should be alert to any **manifest** contradictions between different pieces of information collected, and contact the client in order to resolve any potential inconsistencies or inaccuracies (such as, **for clients who are not professional,** little knowledge or experience and an aggressive attitude to risk, or a prudent risk profile and ambitious investment objectives).

VI. Updating client information

Q6: Where an investment firm has an ongoing relationship with the client, it should establish appropriate procedures in order to maintain adequate and updated information about the client?

22. No comment on this question.

VII. Client information for legal entities or groups

Q7: Do you agree that regarding client information for legal entities or groups, the investment firm and the client should agree on how the relevant client information will be determined and, as a minimum information should be collected on the financial situation and investment objectives of the beneficiary of the investment advice or portfolio management services ('end client')?

23. Yes AMAFI agrees. However paragraph 43 runs contrary to this statement. The principle that clients and firms should agree on how the relevant client information will be determined should also apply where, for a group of natural persons, no representative has been appointed.

In such a case, the firm often does not have a relation with the person in that group who has the lowest level of knowledge and experience. For instance, for a joint account owned by a married couple, very often it is only the spouse with the greatest level of knowledge and experience who is in relation with the firm, while the other spouse is not involved in the relationship. Basing the suitability on the person belonging to the group who has the lowest level of knowledge and experience could significantly restrict the range of products and services available to the group and conflict with the group's investment objectives.

For this reason, investment firms should be allowed to determine with their client on which person(s) of the group the suitability assessment should be based.

24. Also, AMAFI would like to point out that this question is very much adapted to the retail business and not to the wholesale markets.

25. Finally, the notion of “end client” is not appropriate in several circumstances where the “end client” is not known by the investment firm (such is the case for example for relationships with investment vehicles such as mutual funds in which many underlying investors have invested). The notion of “end client” should therefore be removed.

26. As a consequence, AMAFI recommends amending the guideline and paragraph 43 as follows:

> Where a client is a legal entity or a group of two or more natural persons or where a natural person is represented by another natural person, the investment firm and the client should agree on how the relevant client information will be determined. As a minimum, information should be collected on the financial situation and in-vestment objectives of the beneficiary(ies) of the investment advice or portfolio management services ~~**(‘end client’)**~~, and on the knowledge and experience of the natural person (i) representing the entity or natural person(s), or (ii) authorised to undertake transactions on behalf of the entity or such persons (‘representative’).
>
> 43. Where no representative has been appointed, as may be the case for a group of natural persons (for example, a married couple), investment firms should ~~**adopt a cautious approach by basing**~~ **decide with their client on whom they should base** the suitability assessment ~~**on the person belonging to the group who has the lowest level of knowledge and experience**~~.

VIII. Arrangements necessary to ensure the suitability of an investment

Q8: Do you agree that in order to match clients with suitable investments, investment firms should establish arrangements to ensure that they consistently take into account all available information about the client and all characteristics considered in the suitability assessment?

27. The notion of “*all available information about the client*” is larger than information that firms are legally required to collect for suitability purpose and goes beyond MiFID. An investment firm must take into account the information obtained from its client as regards its investment objectives (professional clients) and knowledge, experience and financial situation (retail clients). The absence of any duty to search for other information results from the fact that when an investment firm has not obtained the required information from its client, it must not recommend investment services or financial instruments to the client pursuant to Article 35(5) of the MiFID Implementing Directive.

Also, “*all available information*” covers information obtained to comply with other legal requirements (like the ones relating to AML/CTF) that should not be used for other purpose than the one they have been collected for.

Finally, the level of detail needed for suitability purpose may differ depending on the circumstances, as rightly referred to in § 31 of the Guidelines. It is therefore not appropriate to consider that all available information should be considered.

As a consequence, AMAFI suggests amending the guideline as follows:

> In order to match clients with suitable investments, investment firms should establish policies and procedures to ensure that they consistently take into account:
>
> - ~~all available~~ information ~~about~~ **that** the client **provides**, **and information that they own**, ~~including~~ **such as** his current portfolio of investments (and asset allocation within that portfolio), that is likely to be relevant in assessing whether an investment is suitable;
>
> - all characteristics of the investments considered in the suitability assessment, including all relevant risks and any direct or indirect costs to the client.

28. In paragraph 45, the guideline recommends that the tools used to match investments and clients take into account the relevant specificities of each client and financial instrument and that tools that classify clients or financial instruments broadly are not fit for purpose. This statement is a concern for investment firms because it creates a disproportionate requirement on firms whose matching tools cannot operate without using categories.

In practice, firms take into account the relevant specificities of each client when they assess their profile. This results in categorizing clients in different types of investors. They also take into account the relevant specificities of financial instruments to assess the type of investors it is relevant for but this is done each time a new type of financial instrument is created. As a result, each financial instrument relates to a type of financial instrument targeting certain types of clients.

The tools that match clients and financial instruments take into account the categorisation done upstream. It is unrealistic and disproportionate to consider that these matching tools should take into account the specificities of each client and financial instrument: this work is done upstream.

29. As a consequence, paragraph 45 should be amended as follows:

> 45. In this regard, the tools should be designed so that they take account of all relevant specificities of each **category of** client**s** or financial instrument**s**. For example, tools that classify clients or financial instruments **too** broadly would not be fit for the purpose.

30. Paragraph 46(a), requires investment firms to ensure that the services provided respect an "*appropriate degree of risk diversification*". Although risk diversification is a general principle, it is however inadequate to consider that the investment advice and portfolio management services should always provide for risk diversification :

- Some portfolio mandates are set up with a very specific objective, involving investments in a limited number of asset classes and therefore providing no risk diversification at all. This is so, either because the client has other assets in other firms and benefits from risk diversification overall across its entire investments, or because the client does not want risk diversification at all.
- Investment advice may not be provided with a view on the entire portfolio of the client. In wholesale markets for example, investment advice may be provided to professional clients for a specific financial instrument, meeting a specific objective (for example risk hedging) and it is therefore not always appropriate to consider risk diversification.

As a consequence, paragraph 46(a) should be amended as suggested below.

31. In paragraphs 46(b) and (c), the guidelines are incomplete: as they relate to the client's knowledge and financial situation, it should be added that they are applicable when the client is not a professional.

32. AMAFI's proposed amendments are the following :

> 46. Policies and procedures established by the firm should enable it to ensure inter alia that:
>
> (a) the ~~**advisory**~~ **investment advice** and portfolio management services provided to the client take into account an appropriate degree of risk diversification **when it is consistent with the client's objectives**;
>
> (b) the client **who is not a professional client** has an adequate understanding of the relationship between risk and return, i.e. he understands that the remuneration of risk free assets is necessarily low, and the impact of costs on his investments;
>
> (c) the financial situation of the client **who is not a professional client** allows him to finance his investments at any moment and to bear any possible losses resulting from his investments.

IX. Record-keeping

Q9: Do you agree that investment firms should establish and maintain record-keeping arrangements covering all relevant information about the suitability assessment?

33. AMAFI is concerned by the extent of the record-keeping required that involves "*all stages of the suitability process*". AMAFI agrees that firms should have record of any changes made to the client's suitability profile and of their suitability assessments but requiring that all stages (even purely administrative ones) should be recorded seems rather disproportionate.

34. Paragraph 48 is modified for clarity purpose.

> Investment firms should:
>
> - maintain adequate recording and retention arrangements to ensure centralised, orderly and transparent record-keeping ~~**regarding all stages**~~ of **their** suitability process, including any investment advice provided and all investments (and disinvestments) made;
>
> - ensure that record-keeping arrangements are designed to enable the detection of failures regarding the suitability assessment (such as misselling);
>
> - ensure that records kept are accessible for the relevant persons in the firm, and for competent authorities;
>
> - have adequate processes to mitigate any shortcomings or limitations of the record-keeping arrangements.

47. Record-keeping arrangements adopted by investment firms should be designed to enable firms to track ex-post how and why an investment was made. 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 information, intended for the compliance officer or senior management, to identify risks of mis-selling.

48. Therefore, an investment firm should record all relevant information about the suitability assessment, such as information about the client (including how **the investment firm** ~~it~~ interprets this information), and information about financial instruments accessible to the client (including any changes to the relevant information and the reasons for those changes).