European Securities and Markets Authority

Consultation Paper

Guidelines on certain aspects of the MiFID II suitability requirements

13 July 2017 | ESMA35-43-748

Responding to this paper

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

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

ESMA will consider all comments received by **13 October 2017.**

All contributions should be submitted online at www.esma.europa.eu under the heading 'Your input - Consultations'.

Publication of responses

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

Data protection

Information on data protection can be found at www.esma.europa.eu under the heading Legal Notice.

Who should read this paper

This paper is primarily of interest to competent authorities and firms that are subject to Directive 2014/65/EU of the European Parliament and of the Council (MiFID II). In particular, this paper is addressed to investment firms and credit institutions providing investment advice or discretionary portfolio management services. This paper is also important for consumer groups, investors and trade associations, because the guidelines seek to implement enhanced provisions to ensure investor protection, with potential impacts for anyone engaged in the dealing with or processing of financial instruments.

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1 Executive Summary

Reasons for publication

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

In accordance with Article 16(2) of the ESMA Regulation, this paper sets out for consultation draft ESMA guidelines on certain aspects of the MiFID II suitability requirements.

The purpose of these draft guidelines is to enhance clarity and foster convergence in the implementation of certain aspects of the new MiFID II suitability requirements, replacing the existing ESMA guidelines on the same topic, issued in 2012[1]. This Consultation Paper builds on the text of the 2012 guidelines, which have been substantially confirmed (albeit clarified and refined where necessary). In addition, it takes into account the results of supervisory activities conducted by national competent authorities (NCAs) on the application of the suitability requirements as well as the technological evolution of the advisory markets (e.g. robo-advice) and recent studies on behavioural finance.

By pursuing the objective of ensuring a consistent and harmonised application of the requirements in the area of suitability, the proposed 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 explains the background to the proposals.

Annex I lists all the questions set out in the consultation paper; Annex II contains the cost-benefit analysis; Annex III contains the full text of the draft guidelines; and Annex IV presents the correlation table between the proposed draft guidelines and the corresponding 2012 guidelines.

Next Steps

ESMA will consider the responses it receives to this consultation paper in Q4 2017/Q1 2018 and expects to publish a final report, and final guidelines, in Q1/Q2 2018.

[1] ESMA/2012/387.

2 Background

Overview

1. The assessment of suitability is one of the most important obligations for investor protection. It applies to the provision of any type of investment advice (whether independent or not) and portfolio management. In accordance with the obligations set out in Article 25(2) of MiFID II and Articles 54 and 55 of the MiFID II Delegated Regulation, investment firms providing investment advice or portfolio management have to provide suitable personal recommendations to their clients or have to make suitable investment decisions on behalf of their clients. Suitability has to be assessed against clients' knowledge and experience, financial situation and investment objectives. To achieve this, investment firms have to obtain the necessary information from clients.

2. 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 implementation 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.

5. The draft guidelines do not address all issues arising from the suitability requirements.[2]

General approach followed for the review of 2012 guidelines

6. MiFID II has reinforced the existing MiFID I requirements on the assessment of suitability, rather than introducing a completely different regime. For this reason, ESMA has chosen to build upon the text of the existing 2012 guidelines, which have been substantially confirmed (albeit clarified and refined where necessary).

7. ESMA notes that, in order to avoid any unnecessary repetitions, it has deleted the 2012 guidelines that have been incorporated directly in the MiFID II Delegated Regulation (for example, the general guidelines 1, 4, 5, 6 and 7, now incorporated within Article 54 of MiFID II Delegated Regulation). ESMA however notes that the corresponding supporting

[2] Indeed, clarity on some specific aspects of the suitability requirements, including in particular the suitability report, has been recently provided by ESMA through the publication of *ad hoc* Q&As (Ref: ESMA35-43-349).

guidelines have been generally confirmed, as they still provide a valuable contribution in terms of practical examples and clarification on how the requirements should be applied in practice.

8. Taking into considerations all the above, the guidelines have been partially reorganised and divided in the following main sections:

   I. Information to clients on the purpose of suitability assessment;

   II. “Know your client” and “know your product”;

   III. Matching clients with suitable products;

   IV. Other requirements.

9. In order to facilitate the reading of the document, a correlation table between the proposed guidelines and the 2012 guidelines, has been set out in Annex IV.

Assessment of suitability in the light of behavioural finance findings

10. Traditional finance models are based on the assumption according to which the economic agents are rational. This means (inter alia) they are able to process relevant information in an efficient and unbiased way and that their decisions are consistent with utility maximization.

11. Various studies and some market failures have nonetheless demonstrated that investors, or at least a significant number of them, are subject to heuristics and behavioural biases. This means that investors are very susceptible to how certain choices are presented to them. In many situations, their financial decisions are therefore at least partially influenced by non-relevant aspect from the decision context, which might lead to sub-optimal outcomes for them.[3] Evidence of these biases have typically been

[3] Investors deviating from the rational choice theory do so because of a lack of time and motivation to process all the information available. Most information is analysed through a fast and automatic processing system, used in default by most investors in most situations (so called “System 1”, vs the so called “System 2” i.e. the mind’s slower, analytical mode, where reason dominates), which is susceptible to biases and heuristics influencing decision making. In other words, in processing information, individuals are prone to use intuition rather than reasoning, thus resulting exposed to unreasonable decisions (See, inter alia, D. Kahneman, (2011), Thinking, fast and slow).

identified as coming from cognitive psychology literature and have then been applied in the financial context.[4]

12. With particular reference to the MiFID suitability assessment, some studies have analysed how the efficiency of the typical tool used by firms to assess the suitability of an investment (the questionnaire to collect clients' information) may be affected by behavioural biases.[5]

13. In particular, the suitability assessment may be ineffective if it does not take into account clients' behavioural biases: if the way questions are formulated does not consider those cognitive and behavioural biases (which could affect preferences and choices), the questionnaire may result to be unreliable. At the same time, the questionnaire itself ought to be unbiased: questions must be formed to prevent any perceptive or cognitive distortion from impairing the answers and affecting their validity and reliability.

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[4] Examples of biases may include:

- ✓ Overconfidence and over-optimism - investors overestimate their ability to understand the information they have and their accuracy.
- ✓ Representativeness - investors assess situations based on superficial characteristics rather than underlying probabilities.
- ✓ Conservatism - forecasters cling to prior beliefs in the face of new information.
- ✓ Availability bias - investors overstate the probabilities of recently observed or experienced events because the memory is fresh.
- ✓ Frame dependence and anchoring - the form of presentation of information can affect the decision made.
- ✓ Mental accounting - individuals allocate wealth to separate mental compartments and ignore fungibility and correlation effects.
- ✓ Regret aversion - individuals make decisions in a way that allows them to avoid feeling emotional pain in the event of an adverse outcome.
- ✓ Loss aversion - people's tendency to strongly prefer avoiding losses to acquiring gains. Some studies suggest that, form a psychological point of view, losses aretwice as powerful as gains. Loss aversion can cause inertia, often with negative consequences, and can also encourage short termism (so called 'myopic' loss aversion).

Inter alia see: N. Barberis and R. H. Thaler (2003), "A Survey of Behavioral Finance", in M. Harris, G.M. Constantinides and R. Stultz, "Handbook of the Economics of Finance"; D. Dorn and G. Huberman (2005), "Talk and action: What individual investors say and what they do"; W. Forbes (2009), "Behavioural Finance"*;* C.H. Pan and M. Statman (2010) "Beyond Risk Tolerance: Regret, Overconfidence, and Other Investor Propensities", Working Paper; A. Nosic and M. Weber (2010), "How Risky do I invest: The Role of Risk Attitudes, Risk Perceptions and Overconfidence"; N. Linciano (2010), "How Cognitive Biases and Instability of Preferences in the Portfolio Choices of Retail Investors – Policy Implications of Behavioural Finance", A. Lefevre, and M. Chapman (2017), "Behavioural economics and financial consumer protection", OECD Working Papers on Finance, Insurance and Private Pensions, No. 42 OECD Publishing.

[5] In particular, on the use of a questionnaire to assess the suitability see, *inter alia*, P. Bouchey (2004), "Questionnaire quest: New research show that standard questionnaires designed to reveal investors' risk tolerance are often flawed or misleading"; A. De Palma and N. Picard, (2010) "Evaluation of MiFID Questionnaires in France", Study for the AMF; N. Marinelli and C. Mazzoli (2011), "The Traditional Approach to risk tolerance", in G. Lucarelli and C. Brighetti (2011), "Risk Tolerance in Financial Decision Making"; N. Marinelli and C. Mazzoli (2010), "Profiling investors with the MiFID: current practices and future perspectives", Research paper for Ascosim; N. Linciano and P. Soccorso (2012), "Assessing investors' risk tolerance through a questionnaire", CONSOB *passim*; C. H. Pan and M. Statman (2012), "Questionnaires of risk tolerance, regret, overconfidence, and other investor propensities", SCU Leavey School of Business.

14. The assessment of the investors' risk profile is another critical point for the final assessment of the suitability. Classical finance theory considers the risk of an investment as an objective measure, which can be easily quantified and summarised by single parameter (variance, downside risk, Capital Asset Pricing Models etc.). Conversely, behavioural finance theories focus on the risk perception of the single investor (perception which clearly differs from one person to another) that depends both on specific psychological characteristics and the emotional sphere in a way that could make the standard risk measurement (and the consequent assessment of the suitability of the investment) less effective.

15. To avoid this risk, questions in the questionnaire should be drafted to prevent any perceptive or cognitive distortion from impairing the answer provided by investors and affecting their validity and their reliability.

16. In order to ensure an appropriate degree of reliability to the information collected through a questionnaire, a number of aspects which can affect its clarity and comprehensibility can be considered, so as to be able to improve investors' ability to provide the correct information to the firm. These include, for example:

- the layout and the structure, focusing on the format and the reading features such as font, spacing and division into paragraph, on how questions are presented and how the space for the answers is organised;

- the types of questions and the answer format (e.g., features that should be avoided are the use of questions in batteries, i.e. collecting information on a series of items through a single question, or giving the possibility to provide "no answer" more than once[6,] with particular reference to the information related to the financial situation; on the contrary, firms should use a number of questions to help them elicit clients' concrete needs/objectives);

- the wording and the language: in general, the language used should be simple, easy to understand and not ambiguous (jargon, acronyms and technical language could hamper the reliability of the information provided by the investor). This point is particularly critical for the assessment of the knowledge and experience and of the risk tolerance since investors often are invited to self-evaluate their financial

[6] This will all take into account the fact that firms cannot discourage a client from providing information necessary for his profiling.

literacy (which could lead to biases due to investors' overconfidence and optimism).

17. ESMA has expanded on some of the existing guidelines and has included examples to provide some practical guidance to firms on how to take into account the main conclusions coming from studies above when preparing profiling questionnaires for clients. These additional guidelines have also been developed as a result of supervisory experience and evidence gained by NCAs in this area.

Suitability assessment in the context of automated advice tools

18. The recent developments of technologies and digitalisation allowed firms to increasingly provide services through the internet. A growing number of consumers therefore use automated tools when managing their finance, to invest their money, to compare costs, features and benefits of different products.

19. As observed, *inter alia*, in the work recently developed by the Joint Committee of the three European Supervisory Authorities (ESAs)[7], automated tools are also used to seek recommendation or advice before purchasing or selling financial products/services. Some benefits and risks linked to the use of automated tools in the provision of (amongst others) financial services have been highlighted in the work of the ESAs.

20. The functioning of automated advice tools differ widely. Once a robo-advice tool qualifies as investment advice or portfolio management under MiFID II, the firm has to comply with the provisions of MiFID II, in particular with the requirements of the suitability assessment.

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[7] On December 2016, the Joint Committee of the European Supervisory Authorities published a Report on automation in financials advice: https://esas-joint-committee.europa.eu/Pages/News/European-Supervisory-Authorities-publish-conclusions-on-automation-in-financial-advice.aspx. The Report followed the public consultation on the "Joint Committee Discussion Paper on automation in financial advice" published by the three ESAs on December 2015, available on: https://www.esma.europa.eu/document/discussion-paper-automation-in-financial-advice. Other relevant works conducted at international level on this topic include: the "*Report on the IOSCO Social Media and Automation of Advice Tools Surveys*" published in July 2014 and the related "*Update to the Report on the IOSCO Automated Advice Tools Survey*", published in December 2016; the "*Regulatory guide*" *published in August 2016 by the Australian Securities & Investments Commission-ASICS* focused on "*Providing digital financial product advice to retail clients*"; the *"Report on Digital Investment Advice"* published in March 2016 by the Financial Industry Regulatory Authority; the *"Investor Bulletin: Robo-advisers"*, and the *"Guidance update"*, published in February 2017 by the Securities Exchange Commission. See also: Baker, Tom and Dellaert, Benedict G. C., "Regulating Robo Advice Across the Financial Services Industry" (2017). Faculty Scholarship. 1740.

21. ESMA believes that the use of automated tools for the provision of investment advice and portfolio management services might raise some specific issues related to the protection of investors. In particular, it seems possible to identify at least three main areas where specific needs of protection may occur:

- The information that should be provided to clients on the investment advice and portfolio management services when these services are provided through an automated tool (this concerns both what information should be provided and how information should be illustrated to clients);

- The assessment of the suitability (with particular attention to the use of online questionnaire with limited or without human interaction);

- The organisational arrangements that firms should implement when providing robo-advice.

22. On the first aspect, ESMA would like to highlight that firms providing robo-advice should be aware that the ability of a client to make an informed decision might be based solely on electronic disclosures made via email, websites, mobile applications and/or other electronic media. Unlike the traditional (face-to-face) investment advice and portfolio management services, the robo-advice may not provide initial or subsequent conversation with a person when collecting information about the client. The degree of human interaction available to investors may indeed vary from one platform to another. Some may offer the opportunity to contact the firm's employees (also this aspect may vary: employees may be available by email, phone or for limited in-person meetings); others may only provide technical support staff available. In some cases, the human interaction offered to clients may vary depending on the account size or the invested amount.

23. When designing the information to provide to clients, firms should therefore consider how to explain their automated model and the purpose of the investment advice and portfolio services provided in a clear and simple way, so that potential clients can understand it. Information provided could also include an explanation of the degree of human interaction available to clients, clarifying in particular the means through which clients can indeed gain access to firms' personnel, in cases where this is indeed possible.

24. Moreover, firms providing robo-advice may or may not make staff available to clients to highlight and explain important concepts and to reply to questions when clients are responding to an online questionnaire. Conversely, clients may not read or understand disclosures that are not in plain language and not necessarily user-friendly. Firms should

therefore consider how they present the relevant information to clients and adopt the necessary arrangements to provide clients with online fair, clear and not misleading information.

25. Secondly, ESMA observes that the advice provided to investors through automated tools might be elaborated primarily, if not solely, based on the clients' responses to online questionnaires. The online questionnaires may vary with respect to length and the types of information requested. Some questionnaires may provide the client with the opportunity to give additional information/explanation or context concerning the responses that the client selected. Since the services provided may be even completely automated and may not enable the firm's personnel to ask follow-up or clarifying questions about the client's responses, firms should address inconsistencies in client responses, or provide the client with help when filling out the questionnaire.

26. Lastly, ESMA believes that firms providing robo-advice should design and implement organisational arrangements taking into account the peculiarities of their business model. For example, the reliance on algorithms, the limited human interaction with clients (if any), and the provision of investment advice over the internet may create or accentuate risk exposure for the firm that should be addressed through written policies and procedures.

27. ESMA has expanded on some of the existing guidelines and has included examples to provide some practical guidance, on how to apply the MiFID II requirements on suitability, to firms providing investment advice or portfolio management through automated or semi-automated systems.

Interaction of suitability assessment with product governance requirements

28. MiFID II has introduced product governance requirements to further strengthen the overall investor protection framework by providing that firms, in addition to the existing point of sale rules (including suitability), shall identify from an early stage (and prior to

the provision of investment services to individual clients) the target market of end clients for the products they intend to offer or recommend[8].

29. As clarified in the Final Report for on MiFID II guidelines on product governance[9], and in line with Recital 15 of the MiFID II Delegated Directive, the aim of the additional requirements on product governance is to reduce the risk of failure of conduct rules, such as suitability (and appropriateness), which apply subsequently, at the point of sale, in the context of the provision of investment services to each individual client.

30. In order to comply with product governance obligations, firms have to use any available information and data deemed reasonably useful for this purpose both on their clients (or potential clients) and on the products that can be offered or recommended to them. In this regard, those firms that provide investment services subject to the suitability assessment will usually be in the position to define a thorough target market since they have to gather detailed information on their client base and on products to be able to conduct the suitability assessment.

31. There is therefore a twofold interaction between product governance and suitability requirements:

- information gathered by firms, both on clients and products, for the purpose of conducting the suitability assessment[10] is used to identify *ex-ante* the target markets for the products they intend to offer (i.e. the clusters/segments of clients with certain common characteristics in terms of knowledge and experience, financial situation, risk tolerance, objectives and needs which are considered compatible with the products included in their product assortment);

- a correct ex-ante identification of the target market should ensure that the product ends up with the 'correct' type of customers for whose needs and objectives it had been designed, instead of another group of clients with which the product may not be compatible.

[8] In this regard, Recital 71 of MiFID II specifically states that product governance obligations '*should apply without prejudice to any assessment of appropriateness or suitability to be subsequently carried out by the investment firm in the provision of investment services to each client, on the basis of their personal needs, characteristics and objectives*'.
[9] Ref: ESMA35-43-620.
[10] In addition, firms may also use any further information and data deemed reasonably useful that may be at their disposal and gathered through other sources.

32. It is also expected that a virtuous circle between the two obligations will be established so that the data and results from the suitability assessment can be used to help outline and refine the strategies and policies approved by the management body in accordance with the characteristics and needs of the clients to whom the services and products will be provided; conversely, the more effective the product governance arrangements, the lower the risk of 'failure' of investor protection rules that apply at the point of sale, included suitability.

33. Considering the described close relationship between product governance and suitability, it is reasonable that the input and parameters adopted for products profiling to enable the firm to perform the suitability assessment should be consistent with those used for the purposes of product governance arrangements.

Guidelines on certain aspects of the MiFID suitability requirements

Guideline 1 - Information to clients about the purpose of suitability assessment

34. The original text of general guideline 1 has been deleted since it was incorporated into Article 54(1) of the MiFID II Delegated Regulation. The proposed new text emphasises that the aim of informing clients about the purpose of suitability assessment is to encourage them to provide up-to-date, accurate and complete information so that the firm can assess whether products are suitable for them.

35. In this context, it is further underlined the importance of informing clients that they may be requested to answer questions related to situations describing, for example, different levels of loss/return that may occur depending on the level of risk taken, or to other relevant situations. To this end, firms could also consider using both amounts and related percentages, since it has been found that sometimes people have difficulties in understanding percentages (especially small ones).

36. Such information should also include a clear explanation/statement that it is the firm's responsibility to conduct the suitability assessment and no disclaimer (or any other similar type of statement) can in any way limit their responsibility.

37. In relation to robo-advice, ESMA emphasises that firms should pay particular attention on how information about the suitability assessment and its purpose is provided, considering that in such circumstances only very limited interaction with the firm's personnel (or none at all) may take place.

38. In addition, given the specific features of robo-advice and the related investor protection issues that may arise when using such tools, guidance and practical examples have been added to ensure that firms provide clients with comprehensive information to allow them to understand the purpose of such tools. For example, it is particularly important that clients are informed whether a degree of human interaction with the firm's staff is envisaged and, if so, how they can in practice get in touch with the relevant personnel.

39. ESMA also notes that further examples of the information that firms could provide to clients, where relevant, include:

- an explanation about the purpose of the algorithm used to provide the investment advice or the portfolio management services (e.g., that the algorithm generates recommended investments; that individual client accounts might be invested and rebalanced by the algorithm);

- a description of any circumstances that might cause the firm to override the algorithm used to provide investment advice or portfolio management services (e.g., that the algorithm might freeze trading or take other temporary defensive measures in stressed market conditions);

- a description of any involvement by a third party in the development, management, or ownership of the algorithm used to provide investment advice or portfolio management services, including an explanation of any conflicts of interest such an arrangement may create

40. In this regard, it should be noted that the details provided in the mentioned guidelines solely focus on the features of robo-advice, given its innovative nature and its growing relevance as a means to provide investment advice and portfolio management services. Nevertheless, they are not intended to be exhaustive with regard to the disclosure obligations about the information on the services provided, pursuant to Article 24 of MiFID II and the related provisions of the MiFID II Delegated Regulation.

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.

Guideline 2 - Arrangements necessary to understand clients

41. General guideline 2 and the related supporting guidelines focus solely on aspects related to profiling of clients for the purpose of the suitability assessment, since a separate guideline has now been dedicated to the 'arrangements necessary to understand investment products' (see guideline 7).

42. ESMA believes that firms using questionnaires to collect information from clients, should be aware of and carefully consider – when designing the questionnaires –the main behavioural biases that can potentially influence clients in providing complete and reliable information. To this end, some practical examples have been added in the draft guideline to take into account the suggestions deriving from common weaknesses uncovered by NCAs through their supervisory activities on the application of the suitability rules and from literature on behavioural finance.

43. The analysis of questionnaires, which are usually adopted by firms as a practical tool to collect information necessary for clients' profiling, has indeed shown drawbacks regarding the way in which they are structured and presented to clients. Some of the main faults identified concern, for example:

- the lack of clarity of the questions, with the use of a language which often is misleading, confusing, imprecise and excessively technical (jargon);

- a layout (including the use of certain fonts, line spacing…) in some cases aimed at steering investors' choices, or in other instances not carefully elaborated;

- questions presented in 'batteries' to collect information on a series of items through one single question, particularly when assessing knowledge and experience and the risk tolerance;

- frequent acceptance of the reply 'no answer', particularly when collecting information on the investor's financial situation.

44. The paragraphs that provide some examples on the elements that may impact the client's financial situation (including his ability to bear losses) and investment objectives (including his risk tolerance) have been streamlined and clarified where necessary. In particular, the reference to the client's age has been better explained, since the supervisory experience has indeed confirmed that this information is a significant factor contributing to the correct assessment of the client's investment objectives. As a practical example, it can be mentioned the case of an elderly client who indicates a 20 years (or longer) holding period (which indicates his willingness to hold the investment for that period of time). The described situation would point towards a possible inconsistency

within the overall client's profile, unless he has declared, for example, that his objectives relate to future inheritance management.

45. The supporting guidelines also provide additional clarity on the assessment of the client's knowledge and experience, which together should be intended as the general ability of the client to understand the product types and the risks related to the recommended transactions or in the management of the portfolio. Indeed, what is crucial is to be sure about the client's understanding of the product types and possible transactions. This understanding could be evaluated by asking relevant questions with regard to the characteristics and risks related to the different product types, and by gaining information about the client's profession, education and previous investments. The mechanisms adopted by firms to avoid self-assessment and ensure the consistency of the answers provided by the client (which are dealt with in guideline 4) is particularly important in this context.

46. Additional guidance has also been added to address some of the investor protection issues that may arise when providing investment advice or portfolio management services through robo-advice systems. In these situations, more than in 'traditional' interaction models with clients, the suitability assessment strongly depends on the quality of the answers provided by investors, and, in turn, this depends (at least partially) on the quality and objectivity with which the questions are formulated.

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.

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

Guideline 3 - Extent of information to be collected from clients (proportionality)

47. The general principle according to which the extent of information to be collected from clients for the purposes of suitability assessment depends on the features of the services to be provided – which was included in the 2012 guidelines – has been incorporated in Article 54(2) of the MiFID II Delegated Regulation.

48. Therefore, in order to avoid a mere repetition of the legislation, the general guideline on this topic has been replaced by a new text. The draft guideline aims to emphasise the degree of proportionality that can be applied when deciding how much information about

clients may be needed to conduct the suitability assessment. In particular, firms should take into account the features of the services provided, including the type and characteristics of the products considered as well as the characteristics of the clients to which those services are offered.

49. In general, the content of the existing supporting guidelines has been confirmed (apart from some streamlining of the text for the purpose of better clarity), since they already provide sufficient guidance and practical examples.

Guideline 4 - Reliability of client information

50. ESMA has updated the guidelines on this topic considering that the 2012 general guideline on the topic of 'reliability of client information' has been incorporated in the first subparagraph of Article 54(7) of the MiFID II Delegated Regulation. In particular, the focus has been shifted to the adoption of appropriate measures to counterbalance the over-reliance on clients' self-assessment when collecting information necessary to conduct the suitability assessment.

51. The importance of addressing this risk further has arisen as an outcome of supervisory activities conducted by NCAs in this area. The specific content of some questions within suitability questionnaires often show that they are drafted in a way that does not allow to effectively assess the level of knowledge and experience possessed by clients, their financial situation and their investment objectives and related risk profile. For example, it has been found that for the purpose of assessing clients' profile, they are only asked to state whether they would define their risk preference as low, medium or high.

52. Among the examples suggested as a possible way to assess clients' understanding of the basic financial notions (which is also relevant to help correctly assess their investment objectives and risk tolerance), reference is made to the use of graphical visualization of different possible market scenarios in which the development of the assets is shown over time. Some supervisory practice already show the adoption of such tools by some firms.

53. Some practical guidance, by way of examples, has been provided to avoid some of the most common drawbacks often identified in the questionnaires.

54. Based on NCAs' supervisory experience regarding suitability questionnaires, the use of appropriate systems and controls to ensure the overall consistency of the information collected from clients is also needed. Moreover, the draft guidelines now emphasise that

these arrangements are particularly important and should be carefully designed in the case of robo-advice.

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.

Guideline 5 - Updating client information

55. ESMA has made some adjustments to the 2012 guideline on the topic of 'updating client information' also taking into account that 2012 guidelines on this topic has been incorporated in the second subparagraph of Article 54(7) of the MiFID II Delegated Regulation.

56. Some practical examples of good practices have also been included to address and mitigate the risk of influencing the client to update his own profile so as to make result as suitable a product which would otherwise be unsuitable for him (without there being a real modification in the client's situation).

57. The suggested arrangements are drawn from NCAs supervisory experience, where significant occurrences of clients re-profiling in the immediate days preceding a recommended investment have been detected, especially in situations of heightened conflicts of interests (e.g. in the distribution of instruments through self-placement, or where inducements are paid).

58. In such instances, in addition to the ex-post controls from control functions, some supervisory practice also shows the use of ex-ante measures to prevent some non-compliant behaviours from firms. For example, firms could adopt procedures that allow to verify, before the transaction is made, whether a change in the client profile has occurred e.g. in the 5 days preceding the proposed investment, and to escalate it to the relevant control function to ensure that the change is indeed justified by a modification of the client's situation.

59. In addition, the guidelines note that firms should inform clients when the additional information provided results in a change of their profile.

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

Guideline 6 - Client information for legal entities or groups

60. ESMA has updated the guidelines on this topic considering that the 2012 general guideline on the topic of ‘Client information for legal entities or groups’ has been incorporated in the first subparagraph of Article 54(6) of the MiFID II Delegated Regulation.

61. In this regard, it is important to note that the approach to be followed for the assessment of suitability of a legal person, or in cases where one or more natural persons are represented by another natural person, is detailed in the mentioned level 2 provision. Differently, more guidance is provided to clarify how suitability assessment could be conducted for a group of clients.

62. First of all, it remains confirmed that, as already clarified in 2012 guidelines, firms need to establish, implement and record a policy that takes into account the applicable national legal framework. Where the applicable national legal framework does not provide sufficient detail in this matter, firms need to adopt an approach as to how to assess the suitability for groups of clients.

63. Firms should inform appropriately their clients about their approach, i.e. the way they will collect information about groups of clients, how they will do the suitability assessment in practice, whether an agreement between clients is foreseen by this approach and the impact that this approach could have for the relevant clients.

64. In this regard, here no representative is foreseen under applicable national laws, two possible approaches (not exhaustive) are suggested and could be adopted by firms, i.e. inviting groups of natural persons to designate a representative or assessing the suitability for each individual client.

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.

Guideline 7 - Arrangements necessary to understand investment products

65. This guideline has been introduced to expand on the ‘know your product’ aspects of suitability assessment, that in 2012 guidelines were addressed alongside the arrangements necessary to understand clients.

66. In this regard, it has also been taken into account that Article 54(9) of the MiFID II Delegated Regulation provides that '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 investment services and financial instruments selected for their clients'.

67. In particular, the proposed guideline emphasises the importance of adopting robust and objective procedures, methodologies and tools to consider the different characteristics and risk factors of investments products, as well as their complexity features. It is also important that these processes and procedures ensure that the information used is reliable, accurate, consistent and up-to-date.

68. Following supervisory experience, the proposed guideline also states that firms should not solely rely on data providers in order to understand and correctly classify investment products included in their product offer in a reliable, accurate and consistent manner, but also to check and challenge such data or compare data provided by multiple sources of information.

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

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

69. The guideline confirms the main content of 2012 guideline on the topic of 'arrangements necessary to ensure the suitability of an investment, since the rationale behind it has remained unchanged.

70. Additional guidance has been provided on the issue of concentration risk (i.e. the risk that a client may suffer losses due to a lack of diversification – situations in which the client is too heavily exposed to any one type of financial risk, including credit risk currency risk, sectoral risk, geographical risk, etc.).

71. In this context, firms should pay particular attention to credit risk, considering that, if a client's portfolio is concentrated in products issued by one single entity, in case of default of that entity, the client may lose up to his entire investment. This is a peculiar feature of credit risk that is different from other types of risks, where the occurrence of the 'negative event' may affect the client more or less significantly, i.e. by reducing the investment of a certain amount, but not in its entirety. For example, a portfolio exposed to currency risk

may incur losses due to an adverse movement of the exchange rate, but would hardly cause to lose the whole portfolio.

72. Therefore, further guidance has been provided in line with the approach described in ESMA's 2016 Statement on 'MiFID practices for firms selling financial instruments subject to the BRRD resolution regime'[11], to ensure that concentration risk is effectively identified, controlled and adequately mitigated.

73. The adoption of such measures would be particularly important for firms distributing products issued by themselves or by other entities having close links or any other legal or economic relationships with them (i.e. operating through so-called "self-placement" models), due to the presence of significant conflicts of interests.

74. This does not entail that firms can only adopt open architecture models[12], but that, when selling own products, conflicts of interests have to be managed or prevented in accordance with Article 23 of MiFID II.[13] In such circumstances, the adoption of measures to mitigate the concentration regarding credit risk could indeed ensure that firms would still be acting in the best interest of their clients. Several different situations may occur. For example, a firm could be aware that a significant part of a client's assets is invested elsewhere through other firms; therefore, even if the firm recommends that client to only invest in instruments issued by itself, such investments would represent a portion of the client's entire portfolio and the concentration regarding credit risk could be considered mitigated. Another example could be that of a client whose portfolio held through a bank is represented for a significant part of secured deposits or of group's UCITS; again in such situations, if the bank only recommends own instruments, it could

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[11] ESMA/2016/902.

[12] MiFID II itself does recognise that, when providing investment advice, the range of instruments analysed by the firm can be restricted to those issues by itself, or by other entities having close links or any other legal or economic relationship with them (based on par. 4 (a) (ii) of Article 24).

[13] In this regard, it is important to note that par. 2 of Article 41 of MiFID II Delegated Regulation specifically states that '*Investment firms engaging in the placement of financial instruments issued by themselves or by entities within the same group, to their own clients, including their existing depositor clients in the case of credit institutions, or investment funds managed by entities of their group, shall establish, implement and maintain clear and effective arrangements for the identification, prevention or management of the potential conflicts of interest that arise in relation to this type of activity. Such arrangements shall include consideration of refraining from engaging in the activity, where conflicts of interest cannot be appropriately managed so as to prevent any adverse effects on clients*'.

be able to demonstrate that the concentration regarding credit risk was correctly mitigated and the conflict of interest managed.[14]

75. Additional guidance has also been provided regarding the algorithms usually used by firms to conduct suitability assessment through automated tools, even if the interaction with clients does not occur through automated systems.

76. Furthermore, based on the results of NCAs' supervisory activities, it is reminded that tools used must be fit for purpose. This implies, for example, that the weighting of answers collected should be done in a consistent manner and avoid forgetting crucial elements regarding the client. With regard to this, ESMA believes that the clients should for example not be made aware about the weighting of their answers and the way their risk profile is determined.

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.

Guideline 9 - Costs and complexity of equivalent products

77. A guideline has been added to address the new requirement provided by Article 54(9) of the MiFID II Delegated Regulation, which requires firms to conduct an assessment, while taking into account cost and complexity, of whether equivalent products can meet their clients' profile.

78. In this regard, it has been suggested that relevant factors to identify products that are broadly equivalent could be the consideration of their target market and their risk-return profile.

79. Where firms use common strategies or model investment propositions that apply to different clients with the same investment profile, this assessment can be conducted at a higher, central level (in line with the approach suggested in guideline 10) but a firm will

[14] The described examples show the reason why it is important that, when designing the processes and procedure to identify and mitigate concentration regarding credit risk, firms take into account, in particular: (i) the specific characteristics of the securities (including their risk features and the circumstances of the issuer); (ii) the clients' financial situation, (including their ability to bear losses, and their investment objectives, including their risk tolerance).

still need to ensure that the selected investment products are suitable and meet their clients' profile on a client-by-client basis.

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.

Guideline 10 - Costs and benefits of switching investments

80. This guideline has been added to address the new requirement provided by Article 54(11) of the MiFID II Delegated Regulation and illustrates how the cost-benefit analysis foreseen by the mentioned provision could be done in practice, for example at a central level rather than at a client-by-client basis in case of investment advice with a portfolio view or in case of portfolio management using model portfolios.

81. Such a cost-benefit analysis must be done when switching of investments occurs, i.e. when selling an instrument and buying another one, or exercising a right to make a change concerning an existing instrument. This should cover situations where investment decisions are linked by a same intent, so as to avoid circumvention of this rule; for example in cases where the second 'leg' of a switch (i.e. the purchase) would be delayed of a few days to avoid being captured by the obligation to assess the costs and the benefits of the switch.

82. The cost-benefit analysis should consider both monetary and non-monetary factors, such as: the potential net return of the proposed alternative transaction vs the potential net return of the existing investment; changes in the client's circumstances and needs; changes in the products' features and/or market circumstances; benefits to the client's portfolio stemming from the switch (for example: increased diversification or liquidity; decrease in the overall credit risk). The analysis could also consider product specific benefits such as capital guarantees, which are included in the new investment suggested and not in the product(s) to be sold, if the firm is able to demonstrate that the guarantee provides added-value to the client without adding undue complexity.[15]

[15] ESMA has noted in its guidelines on complex debt instruments and structured deposits (Ref: ESMA/2015/1787) that where the guarantee mechanism is structured in a way which does not enable the investor to assess accurately how such a guarantee

83. ESMA notes that the arrangements included in the guidelines are particularly relevant to ensure that firms comply with their obligation to act in the best interest of their clients in situations where there is a heightened risk of non-compliant behaviours, due to the presence of significant conflicts of interests, for example, where the firm recommends that one or more clients sell a product, while at the same time advising the client to buy a financial instrument issued by itself (or by entities of the same group) or for which the firm receives third party payments (inducements).

84. ESMA is also of the opinion that investment decisions such as rebalancing a portfolio under management, in the case of a 'passive' strategy to replicate an index (agreed with the client in the mandate), would normally not be considered as a switch for the purpose of Article 54(11) of the MiFID II Delegated Regulation.

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.

Guideline 11 - Qualifications of firm staff

85. In the MiFID II framework firms are specifically required to ensure that their client-facing staff engaged in investment advice or giving information about products and services (including when providing portfolio management) possesses the necessary knowledge and experience to fulfil its duties[16]. This obligation is further detailed in the guidelines for the assessment of knowledge and competence, published by ESMA in accordance with Article 25(9) of MiFID II[17], which include suitability rules as one of the assessment criteria to determine whether the relevant staff is knowledgeable and competent and can act on behalf of the firm.

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mechanism affects the risk exposure when investing in the debt instruments, the debt instrument should be considered complex. This includes guarantee mechanisms where the trigger for the guarantee depends upon one or several conditions in addition to the default of the issuer and guarantee mechanisms where the level of guarantee or the actual trigger of the guarantee are subject to time limitations.

[16] In particular, par. 1 of Article 25 of level 1 directive requires firms to ensure (and demonstrate to competent authorities on request) that '*natural persons giving investment advice or information about financial instruments, investment services or ancillary services to clients on behalf of the investment firm possess the necessary knowledge and competence to fulfil their obligations under Article 24 and this Article*'.

[17] Ref: ESMA71-1154262120-153 EN (rev).

86. In order to avoid any overlap between these two sets of ESMA's Guidelines, it has been followed the approach to remind firms that, for client-facing staff, they should refer to the mentioned detailed Guidelines on knowledge and competence.

87. Moreover, further guidance has been provided regarding personnel involved in other aspects of suitability assessment, without being directly in contact with clients, since they also need to possess the skills, knowledge and expertise necessary to discharge the responsibilities allocated to them. This is in accordance with Article 21(1)(d) of MiFID II Delegated Regulation.

88. This would cover, for example, staff involved in setting up the questionnaires, defining the algorithms governing the suitability assessment or other aspects necessary to conduct the suitability assessment and controlling compliance with the suitability requirements.

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.

Guideline 12 - Record-keeping

89. ESMA, apart from introducing some additional details specific to MiFID II (such as for example the reference to suitability report) and some guidance for firms providing robo-advice, has fundamentally confirmed the content of the 2012 guidelines on the topic of 'record keeping', since the rationale behind them has not changed.

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

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.

3 Annexes

3.1 Annex I - Summary of questions

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.

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.

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

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.

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

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.

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

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.

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.

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.

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.

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

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.

3.2 Annex II - Cost-benefit analysis

1. Under the MiFID I framework, Article 35 of the MIFID Implementing Directive[18] 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 (as illustrated in the Background, paragraph 2).

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.[19] Therefore, since the assessment of the client's profile and the subsequent match with the transaction recommended or concluded (in case of portfolio management) by the firm remain of primary importance.

4. These draft 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 suitability obligations should be fulfilled. By providing clarification of the relevant MiFID suitability requirements, ESMA is helping firms to improve their implementation of these requirements. The draft guidelines also aim to ensure a convergent approach in the supervision of the suitability requirements. Greater convergence leads to improved investor protection (consumer outcomes), which is a key ESMA objective.

[18] Directive 2006/73/EC of 10 August 2006.
[19] N. Moloney, EU Securities and Financial Markets Regulation, Third Edition 2016, Oxford University Press, page 807.

The impacts of the draft ESMA guidelines

5. In light In light of the main objectives of these draft Guidelines (extensively illustrated in the background), the following preliminary assessment aims explaining the benefits and costs of the key policy choices that are presented for consultation.

6. It should be preliminary observed that since the requirements on the suitability assessment are provided under the MiFID II and the relevant Delegated Regulation, the impact of the proposed guidelines should be considered having in mind those legal provisions that they support. While market participants will likely incur certain costs for implementing these guidelines, they will also benefit from the increased legal certainty and the harmonised application of the requirements across Member States. Investors would in turn benefit from an improved compatibility between investment products and the needs and characteristics of clients. The proposed Guidelines should also facilitate competent authorities' efforts to improve the overall compliance with MiFID requirements increasing the investor confidence in the financial markets, which is considered necessary for the establishment of a genuine single capital market.

7. Finally, it is important to remind that those existing 2012 guidelines which are confirmed should not imply any additional impacts/costs for both firms and NCAs.

Benefits

8. It is possible to illustrate the main benefits linked to the proposed Guidelines as follows:

   a) reduction of the mis-selling risk and its related financial consequences. This is a major benefit for investors and for the financial markets as whole. In particular, firms will benefit from the reduction of complaints, costs of appeals and legal expenditure for tribunal cases, lack of reputation, fines, etc.

   b) reduction of risks linked to regulatory or supervisory arbitrage due to an increased degree of harmonisation and 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 the new supervisory processes related to the assessment of suitability;

e) restoring investors' confidence in financial markets.

Costs

9. With reference to the costs, it should be firstly reminded that 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 peer review that ESMA developed on the same issue.[20]

10. In light of what has been said, it can be reasonably expected that those firms having already in place a complete set of arrangements to comply with the provisions, principles and good practices issued under the MiFID I regime (including the 2012 guidelines) will presumably incur in less overall costs when implementing the new framework and these guidelines.

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

    a) (direct) costs linked to the update/review of the existing procedural and organisational arrangements (e.g. the review and/or the update of the questionnaires and of the algorithms/models used to match the client's profile with suitable financial instruments)

    b) (direct) initial and ongoing IT costs;

    c) (direct) relevant organisational and HR costs linked to the implementation of the guidelines providing clarifications on the qualification of firm staff (in particular compliance function staff and staff providing relevant investment services).

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

Conclusions

[20] ESMA, MiFID Suitability Requirements, Peer Review Report (ESMA/2016/584).

13. In light of what has been illustrated above, ESMA believes that the overall (compliance) costs associated with implementation of the new regime on the suitability assessment (which includes the proposed guidelines) will be fully compensated by the benefits from the improved 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 contributing to the restoration of the fundamental trust in the financial markets.

14. ESMA also considers that the proposed guidelines are able to achieve an increased level of harmonisation in the interpretation and application of the suitability requirements across Member States, minimising the potential adverse impact on firms linked to compliance costs. 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 since this topic is already covered by existing guidelines. Furthermore, the adoption of guidelines further reduces the risk of diverging interpretations that might lead to discrepancies in the application and supervision of the relevant regulation and requirements across Member States (determining a risk of regulatory arbitrage and circumvention of rules).

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 updating existing policies and procedures, and questionnaires for clients)	(++) 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) (++) potential/expected mitigation of credit risk for investors (-) potential additional rigidity for firms when developing new business models	(+++) 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)

3.3 Annex III - 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[21] (MiFID II):

    (a) investment advice;

    (b) portfolio management.

3. Although these guidelines principally address situations where services are provided to retail clients, they should also be considered as applicable, to the extent they are relevant, when services are provided to professional clients (Article 25(2) of MiFID II and the related provisions of the Commission Delegated Regulation (EU) 2017/565[22] (MiFID II Delegated Regulation) make no distinction between retail and professional clients).

When?

4. These guidelines apply as from 60 calendar days after the reporting requirement date referred to in paragraph 11.

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[21] 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).

[22] 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).

The previous ESMA guidelines issued under MiFID I[23] will cease to apply on the same date.

II. Definitions

5. Unless otherwise specified, terms used in MiFID II and 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[24]) 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[25] 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.

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[23] ESMA/2012/387 - Guidelines on certain aspects of the MiFID suitability requirements.

[24] 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).

[25] 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).

- 'robo-advice' means the provision of investment advice or portfolio management services, in whole or in part, through an automated or semi-automated system.

7. 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

8. The purpose of these guidelines is to clarify the application of certain aspects of the MiFID 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.

9. 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

10. This document contains guidelines issued under Article 16 of the ESMA Regulation.[26] In accordance with Article 16(3) of the ESMA Regulation, competent authorities and financial market participants shall make every effort to comply with guidelines.

11. Competent authorities to whom guidelines apply should comply by incorporating them into their supervisory practices, including where particular guidelines are directed primarily at financial market participants.

Reporting requirements

[26] 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.

12. Competent authorities to which these guidelines apply must notify ESMA whether they comply or intend to comply with the guidelines, 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.

13. 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) and 24(5) of MiFID II and Article 54(1), of the MiFID II Delegated Regulation.

General guideline 1

14. Firms should inform their clients about the suitability assessment and its purpose, including a clear explanation that it is the firm's responsibility to conduct such 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.

Supporting guidelines

15. Information about the suitability assessment should help clients understand the purpose of the requirements and 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 the client that it is important to gather complete and accurate information so that the firm can recommend suitable products or services for the client. Without such information, firms cannot provide investment advice and portfolio management services to clients.

16. It is up to the firms to decide how they will inform their clients about the suitability assessment and such information can be provided in a standardised format. The format used should however enable *a posteriori* controls to check if the information was provided.

17. Firms should also take 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. To this end, clients should be clearly informed that they may be asked to answer some questions related to situations describing, for example, different levels of loss/return that may occur depending on the level of risk taken, or to other relevant situations. When presenting such questions, firms should clearly explain 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.

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. Firms should not use disclaimers (or other similar types of statements) aimed at limiting their responsibility for the suitability assessment in any way. 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. The previous paragraphs are particularly important for firms providing robo-advice, considering that in this case only limited interaction (or none at all) between clients and firms' personnel takes place. Such firms should therefore be cautious and clear when informing clients about the purpose of the suitability assessment, explaining in particular that the answers they provide will have a direct impact in determining the suitability of the investment decisions recommended or undertaken on their behalf.

21. In order to address potential gaps in clients' understanding of the services provided through an automated tool firms should inform clients, in addition to other required information, on their particular business practices and the related risks. Therefore, firms should provide clients with information on the robo-advice provided including the following:

- A statement that an algorithm is used to collect the information from clients, to provide advice and/or to manage clients' portfolios;

- An explanation of the degree of human involvement in the oversight and management of the provision of investment services (e.g., whether the client can ask for human interaction (and if so explaining how), when providing information to the firm on his status, objectives, needs, knowledge and experience);

- A description of how the firm will use the information gathered from a client to elaborate 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 firms has access to other client information or accounts);

- An explanation of how and when the client's status will be updated.

22. 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 providing robo-advice 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). In particular, firm should:

- Emphasise the relevant information (e.g., through the use of design features such as pop-up boxes);

- Consider 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); and

- Where the robo-advice is provided through mobile platforms, adapt the presentation and formatting of information made available to clients consistently with the used mobile platform.

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) and 55 of the MiFID II Delegated Regulation.

General guideline 2

23. 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

24. Firms' policies and procedures shall enable them to collect and assess all information necessary to conduct a suitability assessment for each client. 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 address to their clients are likely to be understood correctly and that any other method used to collect information is designed in a way to get the information required for a suitability assessment.

25. When collecting information about their clients' profile for the purpose of a suitability assessment (through a questionnaire or by other means), firms should be aware and consider the most common biases that can potentially affect investors' ability to provide reliable information. 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 and 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 relevant and necessary information is collected, questionnaires allowing the reply "no answer" too often should be avoided (particularly when collecting information on the investor's financial situation).

26. 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:

(a) marital status (especially the client's legal capacity to commit assets that may belong also to his partner);

(b) family situation (evolutions 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);

(c) 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);

(d) employment situation (the fact that a client might lose his job or is close to retirement may impact his financial situation or his investment objectives);

(e) need for liquidity in certain relevant investments.

27. 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.

28. Information collected by firms about a client's knowledge and experience should be considered altogether for the overall appraisal of his understanding of the products and of the risks involved in the transactions recommended or in the management of his portfolio. 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[27] is particularly important for the correct assessment of the client's knowledge and experience.

29. It is also important that firms appraise the client's financial literacy and understanding of basic notions such as, for example, 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.

[27] See guideline 4.

30. Given the limited human interaction, firms providing robo-advice should design an online questionnaire able to gather sufficient information to support the assessment of suitability. 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 and 55 of the MiFID II Delegated Regulation.

General guideline 3

31. Before providing investment advice or portfolio management services, firms need to collect all 'necessary information'[28] 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

[28] Necessary information' should be understood as meaning the information that firms must collect to comply with the suitability requirements under MiFID II.

services to be provided, the type and characteristics of the investment products to be considered and the characteristics of the clients.

Supporting guidelines

32. In determining what information is 'necessary' and relevant, firms should consider, in relation to a client's knowledge and experience, financial situation and investment objectives:

    (a) the type of the financial instrument or transaction that the firm may recommend or enter into (including the complexity and level of risk);

    (b) the nature and extent of the service that the firm may provide;

    (c) the nature, needs and circumstances of the client.

33. 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. The principle of proportionality in 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.

34. For example, when providing access to complex[29] or risky[30] 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 firms can assess the client's capacity to understand, and financially bear, the risks associated with such instruments.[31] For complex products ESMA expects firms to carry out a robust assessment amongst others of the client's knowledge and experience, including, for example, his ability to understand the mechanisms which make the investment product "complex", whether the client has already traded in such products (for

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[29] As defined in MiFID II and taking into account the criteria identified in guideline 7.

[30] 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.

[31] 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.

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

35. For illiquid financial instruments[32], the 'necessary information' to be gathered will obviously 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:

(a) 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);

(b) 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.

(c) 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).

36. 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:

(a) 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;

[32] 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.

(b) 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.

37. 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.

38. 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. In addition, where a firm provides investment advice 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 aspects.

39. Similarly, where the investment service consists of the provision of investment advice to a 'per se professional client'[33] 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.

[33] As set out in Section I of Annex II of MiFID II ('Categories of client who are considered to be professionals').

40. 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. [34]

41. 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 at this firm on an instrument-by-instrument basis. Firms should also encourage clients to disclose their financial investments they hold with other firms in detail, if possible also on an instrument-by-instrument basis.

Reliability of client information

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

General guideline 4

42. 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

43. 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. Firms remain responsible for ensuring they have adequate information to conduct a suitability assessment and cannot limit their responsibility by means of a specific clause in the contract with the client, in the general terms and conditions, or otherwise.

44. Self-assessment should be counterbalanced by objective criteria. For example:

[34] 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)

(a) 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, asking to choose which one would be correct/real in his opinion;

(b) 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;

(c) instead of asking whether clients believe they have sufficient funds to invest, the firm could ask for factual information about the client's financial situation;

(d) 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.

45. 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.

46. Where firms rely on tools to be used by clients as part of the suitability process (such as on-line 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.

47. 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 by customer-facing staff 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)[35].

48. 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.

49. Firms should adopt mechanisms to address the risk that clients may tend to overestimate their knowledge and experience, for example by including questions about the characteristics and the risks of the different types of financial instruments. Such measures are 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.

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

50. 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;

[35] 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 the their situation.

(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

51. 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.

52. 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.

53. 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.

54. 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[36]. 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 independent

[36] Also relevant in this context are measures adopted to ensure the reliability of clients' information as detailed under guideline 4, paragraph 44.

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)[37].

55. 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 might result suitable for him).

Client information for legal entities or groups

Relevant legislation: Articles 4(1)(9) and 25(2)of MiFID II and Article 54(6) of the MiFID II Delegated Regulation.

General guideline 6

56. 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 clearly 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 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.

Supporting guidelines

[37] 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').

57. 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).

58. 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.

59. The policy adopted by a firm, including with regard to agreements between clients foreseen by such a policy, should enable to suit the interests of the relevant clients, taking also into account their need for protection. Steps taken by the firm in accordance with its policy should be appropriately documented to enable *ex-post* controls. The policy should clearly indicate how the firm would deal with situations where the characteristics of individual clients within a group are different. Where the policy foresees agreements between clients, they should be clearly made aware of the effects of any agreement reached.

Situations where a representative is foreseen under applicable national law

60. 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 should apply to all legal persons, regardless of the fact that they may have requested to be treated as professionals or not.

61. Firms should ensure that their procedures adequately incorporate this guideline in their organisation, which would imply amongst others that they verify that the representative can indeed represent the underlying client. Where the underlying client is a group of natural persons, the policy should – taking into account the approaches presented hereunder – specify from whom information about the financial situation and the investment objective(s) will be collected and how the suitability assessment will be conducted in relation with those criteria.

Situations where no representative is foreseen under applicable national law

62. 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.

63. 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.

<u>Inviting the group of two or more natural persons to designate a representative</u>

64. 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).

65. The firm's policy could however require the underlying client(s) to agree on which financial situation should be taken into account and on their investment objectives. Where the client is a couple, the firm's policy should take into account the matrimonial regime applicable to that couple.

66. If the parties involved have difficulties in deciding the person/s from whom the information on knowledge and experience or on the financial situation should be collected for the purpose of suitability assessment or on defining their investment objectives, the firm should adopt the most prudent approach by taking into account 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.

<u>Collecting information about each individual client and assessing the suitability for each individual client</u>

67. When a firm decides to collect information and assess suitability for each individual client part of the group, if there are 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. Indeed, in such a situation, a financial instrument may be suitable for one individual client but not for another one. The firm's policy should 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 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. In this context, it should be noted that collecting information on all the parties within 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

68. Firms should ensure that the policies and procedures adopted 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

69. Firms shall understand the investment products they are recommending or investing into on behalf of their clients. Firms should implement policies and procedures designed to

ensure that they only recommend investments, or make investments on behalf of their clients, if the firm understands the characteristics of the investment product involved[38].

70. To this end, firms should adopt robust and objective procedures, methodologies and tools that allow them to appropriately and individually consider the different characteristics and relevant risk factors (such as credit risk, market risk, liquidity risk[39] …) of investment products and classify them correctly, taking also into consideration their specific characteristics and nature. In this context, firms should correctly assess how certain products could 'react' under certain circumstances (e.g. convertible bonds or other debt instruments subject to BRRD which may, for example, change their nature into shares).

71. Firms should also assess appropriately, through robust and objective procedures, the level of 'complexity' of products, which should be matched with the characteristics or profile attributed to the client (in particular 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[40], when defining and appropriately graduating the level of complexity to be attributed to products for the purposes of the assessment of suitability. The more complex a product, the more detailed the information firms will have to collect with regard to the knowledge, experience, financial situation and investment objectives of the client.

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 (for example, firms should not solely rely on data providers). 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 the use of multiple sources of information).

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[38] In addition to this obligation, MiFID II also 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 *ex-ante* obligation to ensure the compatibility between products offered or recommended and the related target market of end clients.

[39] 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'.

[40] In particular, Article 25(4) of MiFID II and related MiFID II Delegated Regulation provisions as well as the related 2015 ESMA Guidelines on complex debt instruments and structured deposits, all pertaining to the execution-only regime.

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.

74. The elements used for the classification of products for the purposes of suitability assessment should be consistent with those used for the purposes of the identification and assessment of the target market in accordance with requirements on product governance.

V.III 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

75. In order to match clients with suitable investments, firms should establish policies and procedures to ensure that they consistently take into account:

    (a) 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);

    (b) all material characteristics of the investments considered in the suitability assessment, including all relevant risks and any direct or indirect costs to the client.[41]

Supporting guidelines

[41] See Articles 50 and 51 of MiFID II Delegated Regulation regarding the obligation to inform clients about costs.

76. 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[42].

77. Firms that rely on tools in the suitability assessment process (such as model portfolios, asset allocation software or a risk-profiling tool for potential investments), should have appropriate systems and controls to ensure that the tools are fit for purpose and produce satisfactory results.

78. 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.

79. A firm should establish policies and procedures which enable it to ensure inter alia that:

    (a) the advice and portfolio management services provided to the client take account of an appropriate degree of risk diversification;

    (b) 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;

    (c) the financial situation of the client can finance the investments and the client can bear any possible losses resulting from the investments;

    (d) 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

    (e) any conflicts of interest are prevented from adversely affecting the quality of the suitability assessment.

80. 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

[42] 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.

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.

81. When a firm conducts a suitability assessment based on the consideration of the client's portfolio as a whole, this means that, on the one hand, the knowledge and experience of the client[43] 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.

82. When advising on the whole portfolio of the client or when providing portfolio management, firms 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, 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 should consider directing those clients towards types of investments that are 'secured' or per se diversified (such as, for example, UCITS).

83. In this context, 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 considered as an additional risk. 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[44] 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*".

84. 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

[43] Reference is made here to Guideline 3, paragraph 35.
[44] See '*MiFID practices for firms selling financial instruments subject to the BRRD resolution regime*' (ESMA/2016/902).

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)[45].

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

- establish an appropriate system-design documentation that clearly sets out the purpose, scope and design of the algorithms. Decision trees or decision rules should form part of this documentation, where relevant;

- have a documented test strategy that explains the scope of testing of algorithms. This should include test plans, test cases, test results, defect resolution (if relevant), and final test results;

- have in place appropriate policies and procedures for managing any changes to an algorithm, including monitoring and keeping records of any such changes. This includes having security arrangements in place to monitor and prevent unauthorised access to the algorithm;

- review and update algorithms to ensure that they reflect any relevant changes (e.g. market changes and changes in the applicable law) that may affect their effectiveness;

- have in place policies and procedures enabling to detect any error within the algorithm and deal with it appropriately, including, for example, suspending the provision of advice if that error is likely to result in a client loss and/or a breach of relevant law/regulation;

[45] 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.

- 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.

86. Firms providing robo-advice should also adopt and implement policies and procedures that address issues (at least) related to the following:

    - The questionnaire eliciting sufficient information to allow the firm to conclude that the advice provided is suitable for the client;

    - The prevention and detection of, and response to, cybersecurity threats;

    - The protection of client accounts;

    - The use of social and other forms of electronic media in connection with the marketing of the robo-advice services provided (e.g., websites; Twitter; remuneration of bloggers to publicise services; “refer-a-friend” programs).

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

87. 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

88. Firms should have a process in place to assess products availablethat are broadly ‘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.

89. 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[46].

90. 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.

91. Firms should be able to justify those situations where a more costly or complex product is 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). When providing investment advice, a clear explanation of the reasons for recommending a more costly or complex product should be included in the suitability report the firm has to provide to the client before the transaction is made.

Costs and benefits of switching investments

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

General guideline 10

[46] 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.

92. 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 and proportionate controls to avoid any circumvention of the relevant MiFID II requirements.

Supporting guidelines

93. 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 potential net return of the proposed alternative transaction (which also considers any possible up-front cost to be paid by the client(s)) vs the potential 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;

94. 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 client before the transaction is made.

95. 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.

96. 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. 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. Indeed, 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.

97. 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.

98. 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 to discuss this with the client and review or conduct a new suitability assessment to agree a new mandate.

V.IV OTHER RELATED REQUIREMENTS

Qualifications of firm staff

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

General guideline 11

99. 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

100. 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.

101. 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[47]), including with regard to the suitability assessment.

102. 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[48]. 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.

103. 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

[47] Ref: ESMA71-1154262120-153 EN (rev).
[48] 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

104. 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, 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

105. Record-keeping arrangements adopted by firms must be designed to enable firms to track ex-post 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 to identify risks of mis-selling.

106. 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:

(a) any changes made by the firm regarding the suitability assessment, in particular any change to the client's investment risk profile;

(b) 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.

107. Firms should have in place policies and procedures that could appropriately ensure the business continuity, the backup and the functioning of disaster recovery plans covering any systems that support the delivery of digital advice to clients.

108. 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.

109. Particular attention should be paid by firms to recording and documentation obligations when providing robo-advice.

3.4 Annex IV - Correlation table between the ‘new’ draft guidelines and the 2012 guidelines

New guidelines	2012 guidelines
I. Information to clients about the purpose of suitability assessment *General guideline 1*	**Information to clients about the suitability assessment** *General guideline 1*
II. KNOW YOUR CLIENT & KNOW YOUR PRODUCT	
Arrangements necessary to understand clients *General guideline 2*	**Arrangements necessary to understand clients and investments** *General guideline 2* (partially)
Extent of information to be collected from clients (proportionality) *General guideline 3*	**Extent of information to be collected from clients (proportionality)** *General guideline 4*
Reliability of client information *General guideline 4*	**Reliability of client information** *General guideline 5*
Updating client information *General guideline 5*	**Updating client information** *General guideline 6*
Client information for legal entities or groups *General guideline 6*	**Client information for legal entities or groups** *General guideline 7*
Arrangements necessary to understand investment products *General guideline 7*	**Arrangements necessary to understand clients and investments** *General guideline 2* (partially)
III. MATCHING CLIENTS WITH SUITABLE PRODUCTS	
Arrangements necessary to ensure the suitability of an investment *General guideline 8*	**Arrangements necessary to ensure the suitability of an investment** *General guideline 8*

New guidelines	2012 guidelines
Costs and complexity of equivalent products *General guideline 9*	-
Costs and benefits of switching investments *General guideline 10*	-
IV. OTHER RELATED REQUIREMENTS	
Qualifications of firm staff *General guideline 11*	**Qualifications of investment firm staff** *General guideline 3*
Record-keeping *General guideline 12*	**Record-keeping** *General guideline 9*