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Dear Sirs

PIMFA's[1] response to Consultation Paper: Guidelines on certain aspects of the MiFID II suitability requirements

We set out in the accompanying appendix our response to the detailed questions in the CP. In addition, two further observations on the content of the guidelines are as follows:-

- It should be made clear that in assessing a client's knowledge and experience a firm may provide additional information to the client to ensure they have the requisite knowledge and experience.
- There are references to credit risk in the guidelines and the supporting consultation paper. Broadly, we do not question ESMA's guidelines where there is an exposure to credit risk, although we believe the guideline in respect of diversification needs to be reviewed. However, there is no recognition that for many products there is no credit risk exposure to the product manufacturer. Whether or not an investor has a credit risk exposure in respect of their product to the manufacturer depends on the legal characteristics of the product.

In the event you have any queries on the content of our response please do not hesitate to contact us.

Yours faithfully

Ian Cornwall

Ian Cornwall
Director of Regulation

[1]The Personal Investment Management and Financial Advice Association (PIMFA) is the trade association for firms that provide investment management and financial advice to help individuals and families plan for their financial life journeys.
Our mission is to create an optimal operating environment so that our member firms can focus on delivering the best service to clients, providing responsible stewardship for their long-term savings and investments.

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.

Assessment of suitability – use of questions

Clients, particularly inexperienced and/or vulnerable clients, can find a mechanistic approach involving the completion of questions intimidating. A properly constructed dialogue will incorporate questions and elicit information in a manner that clients do not feel intimidated. The draft guidelines state that '*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.'* We believe this guideline is too prescriptive. The guidelines should not structure how engagement should take place with clients.

We recognise that in assessing suitability questions will need to be asked, but for inexperienced and/or vulnerable clients engagement is required so that the information can be gleaned in a manner that the client is comfortable with and reflects their knowledge and experience. The guideline appears to require a firm to inform a potential client at the outset of their engagement that they will be asked questions at different levels of loss/return that may occur depending on the risk taken and that the purpose of answering the questions is to help the firm assess clients' attitude to risk (risk profile), and therefore the types of financial instruments (and risks attached to them) that are suitable for them. Many clients, including inexperienced and vulnerable customers, will not understand terms such as attitude to risk or the concept of suitability until they have engaged with the adviser. In respect of loss/returns and the risk taken a dialogue is often required to ascertain a client's understanding of such concepts before asking any questions in a manner they understand. We recognise that the ESMA guidelines may wish to identify the issues that firms should address in order to assess suitability but in our view it is unhelpful to prescribe how firms should engage with clients to obtain the information to make the assessment.

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.

We agree with the suggested approach.

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

Certain clients are reluctant to divulge financial information which makes it difficult for firms to meet their obligations to assess the client's ability to bear financial losses. It is quite common for wealthier clients to advise firms that the amount they are advising on or managing only represents a proportion of their wealth, is not needed for the purposes of funding day to day living or for funding a specific future event. It would be helpful if the Guidelines could give some indication as to whether, in the absence of any information to contrary, firms are able to rely on such representation from the client in meeting their obligations to assess the client's ability to bear financial 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.

We agree with the revised guideline.

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

We agree with the suggested approach.

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.

We agree with the suggested approach.

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.

We note that paragraph 68 states '*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.'*

We are unclear what this paragraph means. Where data providers are merely transmitting data produced by product manufactures our view is that, in the absence of any information to the contrary, firms should be able to rely on the data. In the event that the data provider performs some analysis on the data provided by the manufacturer, then we agree that firms should have controls in place to satisfy themselves that the analysis has been properly performed. The final Guidelines should provide further clarification on this issue.

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.

Paragraph *71* states *'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 statement is not true for a significant number of products. For example, if a product manufacturer of a UCITS fund became insolvent that would have no impact on the UCITS fund. Similarly if a client has exposure to a range of different funds manufactured by the same entity it does not mean that the client would lose their entire investment if the manufacturer becomes insolvent. Whether or not an investor has a credit risk exposure in respect of product they hold to the manufacturer depends on the legal characteristics of the product.

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.

We agree with the suggested approach.

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.

ESMA needs to provide further information in the guidelines to assist firms meet their obligations**.** The premise underpinning the guidelines appears to be only focusing on the switching of one investment product for another. The guidelines fail to address the practical issues firms are seeking to address in the context of this obligation.

What is the criteria which determines if transactions constitute a switch? The consultation states that it covers situations *where investment decisions are linked by a same intent* and firms are unclear what this means. For example, if a firm conducts a series of transactions to reduce the exposure of a portfolio to Europe and increase the exposure of the portfolio to USA would these transactions constitute a switch? The guidelines should include examples of situations that would be deemed to be switches, and possibly what would not be deemed switches, to aid firms' understanding of their obligations.

With regard to the obligation to perform a cost benefit analysis in respect of a switch, costs can generally be reasonably estimated. However, firms are unclear about benefits which cannot be quantified for example:-

- If a firm sell Shell and buys BP on the basis that it feels BP performance is likely to be better than Shell.What does ESMA expect to see in respect of 'benefits'?

- If a firms sells a tranche of higher risk holdings and re-invests in lower risk holdings because the client's risk profile has changed what does ESMA expect to see in respect of 'benefits'?

It would be helpful if the guidelines could contain examples as to how the situations outlined above should be addressed.

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.

No further guidance is required.

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

Credit Risk

Paragraph 82 of the guidelines state '*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).'* The primary objective of diversifying a portfolio is not to mitigate credit risk. Diversification allows an investor to reduce all investment risks while potentially improving investment returns. Diversification results in exposure to different asset classes that behave differently in various market conditions and respond differently to various economic events.

We would refer you to our response to question 8; whether or not an investor has a credit risk exposure in respect of their product to the manufacturer depends on the legal characteristics of the product.

Costs and benefits of switching investments

We would refer you to our response to Question 10.

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.

Feedback from firms indicate that the Guidelines will not impose significant additional costs.