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Additional Information

Level 1 Regulation
Markets in Financial Instruments Regulation (MiFIR) Regulation (EU) No 600/2014 - Investor Protection and Intermediaries

Topic
Suitability

Subject Matter
Suitability and appropriateness

Question
Are investment firms allowed to use a tick-the-box approach and/or generalizing phrases when stating how the advice meets the retail client's preferences, objectives and other characteristics in the suitability report?

ESMA Answer

28-03-2019

Original language

[ESMA35-43-349 MiFID II Investor protection Q&As, Ch 2, question 10]

No. When providing the suitability report according to Article 25(6) of MiFID II and Article 54(12) of the MiFID II Delegated Regulation, firms should state on an individualized basis how the recommendation given is suitable for the retail client.

The suitability report should enable a client to understand if and why the recommendations given are suitable for the client. Therefore the firm should explicitly set forth not only if but how the recommendation (including the recommendation not to sell, buy or hold a product) matches the client's investment objectives, including his risk tolerance, his financial situation including the ability to bear losses and his knowledge and experience and any other relevant client's characteristics. To enable the client to compare this explanation with the information submitted by him/her, firms should also refer in the suitability report to the relevant client information that was used for the assessment of the suitability and on which the recommended transaction is based.

Investment firms should avoid general statements such as "the recommended product is suitable because it matches your risk tolerance" or "the product is suitable because it matches the information you provided to us" as such phrases do not provide the client with information on how the firms has determined that the recommended product is in fact suitable for the client but rather only reflects that the recommended product is deemed suitable for the client.

Instead, firms should use phrases such as "The recommended product matches your risk tolerance: It is categorized as a risk class 3-product, this matches your risk tolerance which is level 3" (or alternatively in case of a portfolio diversification strategy, "the recommended product matches your risk tolerance: It is categorized as a risk class 4 product, but, considering the composition of your portfolio as a whole, it brings your overall portfolio risk ratio to 3, which is consistent with your risk tolerance which is level 3") or "your investment

horizon of 5 years is in line with the recommended holding period of the product of at least four years.”24

This does not prevent investment firms from using a standardized template for the suitability report. Where firms use pre-phrased statements they should ensure that they are granular enough to refer to the different aspects of the suitability assessment and to the different characteristics of the recommended product. Firms should in any case provide the option for advisers to add “further aspects” where they can include specific client information that may not be covered by the template. This is also necessary to cover information on “other client’s characteristics”, if expressed by the client.