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Dear Sirs

APCIMS¹ response to Consultation paper ref ESMA2011/445 - Guidelines on certain aspects of the MIFiD suitability requirements

Our detailed response to the questions in the consultation paper is set out on the attached appendix.

We note that the word “ensure” is used in many cases in the guidelines in a manner that is not consistent with MIFiD. For example Article 19 (4) contrary to the reference in the guidelines does not use the word ‘ensure’. In addition where ‘ensure’ is used there is no reference to other phrases putting the word into context. The guidelines make no reference to the terms ‘a reasonable basis for believing’ and ‘giving due consideration to the nature and extent of the service provided’ which in our view qualify the word ‘ensure’. The guidelines need to be reviewed to reflect, where appropriate, that these terms are incorporated to avoid ‘goldplating’ the MIFiD requirements.

As you will be aware the FSA approved the MIFiD Connect² guidelines which addressed suitability. The MIFiD Connect guidelines on suitability and appropriateness reflect extensive discussions within the industry about the application of the MIFiD rules. We recognise that the guidelines have been developed in the UK and there may be similar guidelines produced by other countries. ESMA should note, however, that in drafting their guidelines they are not starting ‘with a blank sheet of paper’ and consideration should be given to guidelines already in existence in other countries.

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

Yours faithfully



Ian Cornwall
Director of Regulation

¹The Association of Private Client Investment Managers and Stockbrokers (APCIMS) is a trade association representing 174 member firms. Of this number 116 members are private client investment managers and stockbrokers and 58 are associate members who provide related services to our firms. Member firms deal primarily in stocks and shares as well as other financial instruments for individuals, trusts and charities and offer a range of services from execution only trading (no advice) through to full portfolio management.

Our member firms operate on more than 500 sites in the UK, Ireland, Isle of Man and Channel Islands, employing c.30 000 employees. Over £475 billion of the country’s wealth is under the management of our members. Our aim is to ensure that regulatory, tax and other changes across Europe are appropriate and proportionate for the investment community.

² See http://www.MIFiDconnect.org.uk/downloads/suitability_guideline_100807.pdf

Q1: Do you agree that information provided by investment firms about the services they offer should include information about the reason for assessing suitability? Please also state the reasons for your answer.

Many firms already provide information and/or explain to clients the reason for assessing suitability. We are broadly supportive of the guidance but we would seek clarification that the requirement would not apply to existing clients. Significant costs would be incurred by firms in 'repapering' existing clients. We note the cost benefit analysis makes no reference to such costs.

Many clients still regard the request for information as 'intrusive'; we assume it would be acceptable for the information about the reason for assessing suitability to make reference to the fact that the firm will only seek 'necessary information' in respect of the service being provided to the client. The MIFD Connect guidelines address this issue; *"The nature of the Suitability Obligation and the range and level of detail of information required from clients will depend on the type of service being provided and the nature of the client. Firms will therefore have flexibility in meeting the objectives of the rules on suitability, taking into account the nature and extent of the service being provided and the client."*

In respect of paragraph 12 of the guidelines we agree that the responsibility for the suitability of advice rests with the investment firm and the examples provided namely *"by indicating to the client that a certain financial instrument is the one that the client chose as being suitable, or by requiring the client to confirm that an instrument or service is suitable"* do not represent acceptable practise. We do, however, have concerns regarding the statement that the *"firms should avoid stating or giving the impression that..... it is the client who establishes his own risk profile"*. Article 35 of MIFID requires the investment firm to seek information from the client, including information about the level of risk the client is willing and able to accept; such information is a major component of the client's risk profile. The determination of a client's risk profile is a collaborative exercise between the firm and the client; paragraph 36 of the guidelines appears to recognise this fact.

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

We agree that investment firms should establish, implement and maintain policies and procedures necessary to be able to obtain an appropriate understanding regarding both the essential facts about their clients, and the characteristics of financial instruments available for those clients. Our specific comments in respect of the guidelines are set out below.

We are concerned that paragraph 15 as drafted will result in firms mechanically collecting the data specified without considering why the information is necessary for the service being provided to the client. In respect of paragraph 15 of the guidelines we believe the wording should be amended as follows, *"For example, it is recognised that the necessary information from the client is determined by reference to the service provided to the client but in many cases it is unlikely that a firm will be able to meet its obligations if it is unaware of, or fails to consider, the client's age, marital status, family situation, employment situation, or need for liquidity in certain relevant investments."*

By way of further clarification, there needs to be recognition that where the scope of the advice the client is seeking is limited it will not always be the case that a high level of detailed information is needed. MIFID Connect recognises this point; *"Where a client seeks very limited ad hoc investment advice on whether to invest in a particular equity or debt instrument, and the firm is not advising on the size of the transaction, detailed information about the client's overall financial position may not be necessary, provided that the firm is satisfied that the client can bear the financial risks."*

Q3: Do you agree that investment firms should ensure that staff involved in material aspects of the suitability process have the skills and the expertise to discharge their responsibilities? Please also state the reasons for your answer.

We agree that investment firms should ensure that staff involved in material aspects of the suitability process should have the skills and the expertise to discharge their responsibilities but to the extent appropriate having regard to the nature and extent of the service provided. The guidelines should be amended to reflect this position

Q4: Do you agree that investment firms should determine the extent of information to be collected about the client taking in to account the features of the service, the financial instrument and the client in any given circumstance? Please also state the reasons for your answer.

We strongly agree that investment firms should determine the extent of information to be collected about the client taking into account the features of the service, the financial instrument and the client in any given circumstance. Our specific comments in respect of the guidelines are set out below.

Reference is made in the guidelines to ‘risky’ financial instruments without giving an indication as to what is meant by this term. Given the diversity of investment services offered by firms and the wide range of financial instruments it would be helpful if the guidelines could be clearer as to what factors determine whether a financial instrument is a ‘risky’ financial instrument.

Guideline 26 should be amended. We agree that *“the extent of the service requested by the client may also impact the level of detail collected about the client.”* But, it would not necessarily always be the case that *“firms would need to collect more information about clients asking for investment advice covering their entire financial portfolio than for clients asking for specific advice on how to invest a given amount of money.”* We could envisage scenarios where a client is looking to invest a given amount of money which exceeds the value of their portfolio where more information may be sought from the client. We believe the word ‘would’ underlined above should be changed to ‘may’.

Q5: Do you agree that investment firms should take reasonable steps (and, in particular, those out-lined above) to ensure that the information collected about clients is reliable and consistent? Please also state the reasons for your answer.

The guidelines fail to recognise that the degree of reliance that can be placed on a client’s self-assessment is determined in part by the knowledge and experience of the client. For example, firms may be able to place reliance on a client working in finance with professional qualifications whereas further ‘counterbalancing’ may be needed for clients with limited knowledge and experience. The guidelines also make no reference to the fact that it is possible to provide information to enhance an individual’s knowledge. MIFID Connect guidelines address this point; *“One of the factors that might contribute to a client having appropriate knowledge is if the firm has provided information to the client about the nature of the product or service and the risks that it entails, and has a reasonable basis for believing that the client has read and understood it.”*

We recognise that clients need to understand and be comfortable with the risks they are taking but the content of the guideline at 34 c is too crude and does not reflect the interaction that takes place with clients. Whilst it is possible to determine whether a client is willing and able to invest in any instrument which carries a degree of risk it is rare in our experience for example for a client to be able to state that they are willing to accept a loss of x% over a specified time period. More thought needs to be given in the guidelines as to the exact nature of the information being sought and the actions that firms should take in respect of the analysis. Over a ten or twenty year period there can be significant fluctuations in market value but most clients would not wish to

incur the costs and potential impact on performance if firms were required to initiate 'stop loss' constraints in order to ensure loss figures are not breached. The guidance needs to be reviewed; there is a real danger that not breaching a loss requirement becomes the investment objective which is not, in the majority of cases, a reflection of the client's needs. We are entirely unclear how an investment adviser is meant to 'control' the potential loss on a portfolio and/or on an individual investment. We assume the guidelines are not intended to suggest that a series of derivative transactions should be undertaken to cap any downside loss.

The MIFID Connect guidelines state *"Firms should, where relevant, assess what the impact of a reasonably foreseeable loss relating to recommended investments would be. Where relevant, firms should consider the risks of extreme market movements (even if relatively unlikely), particularly in the case of contingent liability investments. For example, if a firm proposes to recommend that a client invests in OTC currency or commodity derivatives that are highly volatile and the risk of loss goes beyond the initial investment and is open-ended, the firm should satisfy itself that the client has the financial resources necessary to bear the loss consistent with his investment objectives."*

There needs to be greater recognition within the guidelines that firms need not use questionnaires and risk profiling tools. It is perfectly possible for firms to meet their suitability obligations through discussions with clients which should, of course, be properly documented and periodically updated.

Q6: Do you agree that where an investment firm has an ongoing relationship with the client, it should establish appropriate procedures in order to maintain adequate and updated information about the client? Please also state the reasons for your answer.

Where an investment firm has an ongoing responsibility for ensuring the composition of the client's portfolio continues to be suitable or an ongoing responsibility that an investment continues to be suitable it should establish appropriate procedures in order to maintain adequate and updated information about the client. It is common for firms to have advisory dealing clients where they will provide advice as and when requested by the client but there is no ongoing responsibility to ensure the composition of the client's portfolio continues to be suitable or investment continues to be suitable. There is an ongoing relationship in that there is a signed customer agreement in place to provide an investment service upon the request of the client but often client information will not be routinely updated until the point that the client contacts the firm for further advice; in some cases a number of years can elapse between contacts. The guidelines need to be amended to reflect the nature of this service and avoid unnecessary costs being imposed upon the firm which could result in the service offering being withdrawn. For the avoidance of doubt we do not dispute that when the client requests advice it should be provided on up to date client information.

The nature of the relationship between the firm and a client is dynamic and, within our sector, can last for many years. The nature and extent of the investment service provided may therefore change over time. The information held on the client may be qualitative as well as quantitative. It is exceedingly difficult for qualitative information to be defined since it may not relate to specific data about the client but nonetheless qualitative information constitutes essential information about the client. The guideline states that firms need to define *"the information that is subject to updating"* but this will vary from client to client and defining qualitative information may result in firms recording a significant amount of narrative text for each client. We do not understand the logic of this guideline and how it reflects the MIFID requirements.

The guidelines require the firm to define the action the firm should take when additional or updated information is received. We are unclear how to address this obligation. It is difficult to define in advance the actions that should be taken. The receipt of additional and/or updated information will often result in a further dialogue with the client and the actions taken will be identified following this process. The reference to the firm changing the client profile is

unhelpful. Our own support material to firms states *“The FSA has found instances where the investment managers are inappropriately seeking to change the client information to fit the risk profile of the portfolio rather than changing the portfolio to reflect the client’s position, particularly in respect of the risk associated with the portfolio. For example, if a discretionary adviser determines that a portfolio has become high risk when the client mandate indicates a medium risk portfolio the obligation upon the discretionary manager is to initiate discretionary transactions to meet the mandate not to change the mandate to high risk. It is open to the discretionary manager to discuss the mandate with the client but the mandate is determined by the client not the discretionary manager. In discussing the mandate with the client the discretionary manager needs to be mindful of the firm’s suitability obligations.”*

The MIFID Connect guidelines recognise that the level of detail required for an assessment of suitability may potentially vary considerably depending on whether the ongoing investment advice relates to: (a) the entirety of a customer's portfolio of investments as opposed to a small subset of total assets; and (b) whether the firm is advising the client on his/her investment strategy or only advising within the constraints and parameters of a strategy set by the client. It would be helpful if the ESMA guidelines could address this issue.

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

Our understanding is that the guidelines require the appointment of a representative where the legal person at law who is the client comprises of a number of natural persons. If a representative is not appointed the suitability assessment should be based on the person belonging to the group who has the lowest level of knowledge and experience. We are unclear the extent to which this is compatible with UK law. We are concerned about the reference to the term beneficiary particularly where the client is a trust. Under UK trust law the trust and the beneficiary are different persons at law and the notion of ‘end client’ does not appear to us to reflect the position at law or be relevant when providing investment services to the trust. The financial situation and investment objectives of the beneficiaries of a trust are not relevant; the trustees, having regard to the content of the trust deed, will determine the investment objectives.

We would also seek further clarification as to how this guideline applies to corporate clients who are categorised as retail clients. MIFID Connect guidelines address this issue; *“when dealing with corporate customers (who are classified as retail clients), a firm may determine the level of knowledge and experience within the corporate either by considering the past investment history of the corporate client or the knowledge and experience of the people in that corporate with whom it deals on a regular basis and to whom any recommendations are to be made. The firm can take into account the knowledge and experience of individuals authorised to make investment decisions on behalf of the corporate as a whole. As a result, a firm may also combine together the past investing experience of the corporate with the knowledge and experience of individuals currently working within the corporate with whom it deals to determine the overall level of knowledge and experience of the corporate. It should not, however, rely on a conclusion that is manifestly wrong; for example, if the relevant knowledge and experience resided in individuals who are no longer working for the corporate client.”*

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

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

Q9: Do you agree that investment firms should establish and maintain record-keeping arrangements covering all relevant information about the suitability assessment? Please also state the reasons for your answer.

We agree that investment firms should establish and maintain record-keeping arrangements covering all relevant information about the suitability assessment. Whilst we accept that all data held by firms, even in different systems, must be accessible, we are unclear why records have to be “centralised” and what obligation is meant by this word.