



European Securities and  
Markets Authority

# MiFID Suitability Requirements Peer Review Report



## Contents

<b>Key findings and assessment of convergence</b> .....	2
Introduction .....	2
Executive Summary .....	3
<b>Peer Review Assessment</b> .....	<b>6</b>
Section 1: Distribution Methods and Investment Advice .....	7
Section 2: Monitoring Compliance With The Suitability Requirements .....	13
Section 3: Enforcement .....	20
Section 4: Communication with Stakeholders .....	23
Section 5: Summary of Findings from On-Site Visits .....	24
<b>Annex (separate document)</b>	

## Key findings and assessment of convergence

### Introduction

1. In December 2014, the ESMA Board of Supervisors mandated the Review Panel, now called the Supervisory Convergence Standing Committee (SCSC), to carry out a peer review regarding compliance with the MiFID suitability requirements. The work was mandated to assess how EEA national competent authorities (CAs) approach the supervision of firms to ensure compliance with the MiFID suitability requirements when investment advice is provided with respect to retail clients. The work was also intended to identify areas that could benefit from greater supervisory convergence.
2. An assessment group (AG) was established to conduct this peer review. In accordance with the Review Panel Methodology (ESMA/2013/1709), the AG developed a self-assessment questionnaire for all CAs, with the review period running from 1 January 2013 to 31 December 2014. The questionnaire has been developed on the basis of ESMA Guidelines on certain aspects of the MiFID suitability requirements (ref. ESMA/2012/387), and taking into account the ESMA MiFID Supervisory Briefing on Suitability (ref. ESMA/2012/850) and the CESR Q&A on Understanding of advice under MiFID (ref. CESR/10-293). The AG refers to these documents and the relevant requirements in MiFID and the MiFID implementing directive collectively as the “MiFID suitability requirements”. The purpose of the questionnaire was to capture the possible different ways CAs determine when investment advice is provided and how they consistently supervise and enforce the relevant suitability requirements. The detailed summary of the replies to this questionnaire is set out in the Annex to this report.
3. An additional constituent part of the peer review involved on-site visits to seven CAs to learn more about their supervisory practices in this area during the review period. Members of the AG visited the relevant CAs in the following Member States: BE, BG, ES, FI, FR, HR and UK. A summary of each on-site visit is set out in Section 5 of this report.
4. The country codes of EEA states are set out in the below table:

Code	EEA
AT	Austria
BE	Belgium
BG	Bulgaria
CY	Cyprus
CZ	Czech Republic

DE	Germany
DK	Denmark
EE	Estonia
EL	Greece
ES	Spain
FI	Finland
FR	France
HR	Croatia
HU	Hungary
IE	Ireland
IS	Iceland
IT	Italy
LI	Liechtenstein
LT	Lithuania
LU	Luxembourg
LV	Latvia
MT	Malta
NL	Netherlands
NO	Norway
PL	Poland
PT	Portugal
RO	Romania
SE	Sweden
SI	Slovenia
SK	Slovakia
UK	United Kingdom

## Executive summary

5. This section provides a summary of the AG’s key findings that have emerged during this Peer Review. These findings have been developed from the results of the questionnaire and the on-site visits. Clearly EEA CAs will vary in the methods they use to supervise the firms in their jurisdictions. However, in order to achieve the proper application and objectives of Union law, it is important that CAs are effectively overseeing and enforcing the conduct of firms and therefore converge around the key aspects of the MiFID suitability provisions set out below.
  
6. It is important for CAs to closely monitor the circumstances under which investment advice is given because this will determine when the MiFID suitability requirements will apply. The AG found that amongst CAs there was:
  - Good understanding of the types of distribution methods used in their jurisdictions with most able to identify the most common distribution method (predominantly face-to-face advice); and regularly review the distribution methods and business models of the investment firms operating in their jurisdictions.

- Consistent and good theoretical understanding of where the boundary between investment advice and information lies and therefore when the suitability requirements apply. Furthermore, many CAs appear to have carried out some general work to clarify the boundary between information and advice, although much of this work seems to be in the form of publication of ESMA material without an additional interaction with stakeholders to ascertain the effective understanding of the situations where advice is provided.
7. In actual supervisory terms, the AG found that there was limited work done by CAs to verify whether clients in practice are receiving or have the perception that they receive investment advice.
  8. Compliance with the MiFID suitability requirements is a key component of the overall MiFID investor protection framework. These requirements are designed to ensure that firms recommend only suitable investment products to investors taking due account of the latter's profile. CAs are therefore required to monitor compliance by firms in this important area of the MiFID conduct of business rules and should allocate their supervisory resource and tools accordingly.
  9. The AG found that the majority of CAs adopt a 'holistic' approach to supervision, meaning that they typically supervise compliance with respect to the suitability requirements as part of their general and overarching supervision of firm conduct. Therefore, the majority of CAs rely on their '*business as usual*' supervision of conduct of business across all firms rather than looking at a particular behaviour of a firm or group of firms as part of a specific project solely in relation to suitability with defined terms of reference and distinct objectives.
  10. At a more granular level, the AG found that a limited number of CAs provided specific information on the tools they use to supervise compliance with the suitability requirements. The AG found that while the majority of CAs said they use a wide range of tools to monitor the key aspects of suitability, many of them tend to describe their general approach in these areas without demonstrating the details of how they monitor the technical aspects of the supervision of the suitability requirements.
  11. In assessing the level and nature of enforcement activity undertaken by CAs in respect of the suitability requirements, the AG found a very wide range of practices. The AG found that the definition of non-pecuniary actions varied widely between CAs and that stronger non-pecuniary enforcement action such as placing restrictions on firms' activities rarely featured. The AG also found that, in most cases, enforcement was seen as resource and time "heavy" and a last resort in dealing with findings of non-compliance; consequently most CAs have made limited

use of stronger enforcement action in this area in the review period. Many CAs considered that their supervisory approach was sufficient to address issues without engaging in stronger enforcement action. In this respect, it could be argued that greater emphasis needs to be placed on the use of public sanction and enforcement as a tool for change.

12. The AG found that in many cases CAs were not fully utilising the opportunity to publicly communicate with stakeholders on their supervisory activities and findings, and enforcement activities in respect of the supervisory requirements. The AG considers that greater communication and interaction with various stakeholders in this area could be a useful tool to raise standards and improve compliance.

## **PEER REVIEW ASSESSMENT<sup>1</sup>**

### **SECTION 1: DISTRIBUTION METHODS AND INVESTMENT ADVICE**

#### **Finding 1: Good understanding by CAs of the types of distribution methods used in their jurisdictions**

13. Although very few CAs were able to provide specific data on the market share for each distribution method, as this information is not typically collected by CAs, most could nevertheless identify the most common distribution method in their jurisdiction and cited face-to-face advice as the most common distribution method.
14. Almost all CAs said they regularly review the distribution methods and business models of investment firms operating in their jurisdictions, though there was variation in the detail provided to the AG on how and to what extent they do this in practice. Some CAs indicated they monitor using desk-based research such as regular monitoring of firm websites. Others said they undertook mystery shopping exercises, thematic reviews, or specific inspections of firms to gather data on the methods used by firm to deliver investment advice, or, generally used their consumer and industry contacts to keep up with the latest developments.
15. The jurisdictions that cited face-to-face as the most common method for distributing investment advice also highlighted the growth in online offerings and relatively new forms of distribution such as robo-advice/automated and semi-automated advice, mobile phone and 'video-telephone' distribution channels.
16. The AG further notes that although five CAs were unable to determine the most common method of distribution used in their jurisdiction, they were able to identify the range of distribution methods available in their jurisdictions.
17. Most CAs expected the same types of distribution methods to persist in their markets although a significant number expect the use of on-line offerings to feature more heavily in the future. Two CAs highlighted the increasing costs of advice under MiFID II as a contributing factor towards this trend.
18. The familiarity with the various and most common distribution methods used in their jurisdictions suggests that CAs are aware of developments in the market place and

---

<sup>1</sup> In some cases this report identifies specific practices that one or more CAs adopt and that the AG found worth mentioning. In these cases the report lists the names of the Member States of CAs where, based on the responses provided to the questionnaire or the on-site visits, these examples of a specific practice were identified. This does not preclude the possibility of the same practices taking place in other CAs.

are adequately monitoring the distribution of investment advice in their respective jurisdictions.

**Finding 2: Limited evidence of tailoring of supervisory approaches according to the distribution method observed**

19. The majority of CAs appear to reason that since the same MiFID suitability requirements apply irrespective of the distribution channel used, there is no need to adopt a different supervisory approach. However, a limited number of CAs explicitly confirmed that they tailor their supervisory approach according to the type of distribution method but few of them provided specific detail on how they achieved this in practice.
20. Many CAs further explained that given that face-to-face distribution is still the most prevalent channel through which investment advice is distributed, there is little practical need anyway to vary their supervisory methods.
21. Some CAs did suggest that depending on the practical situations they may direct their supervision in a different way. The CAs who provided a more tailored approach typically highlighted:
  - Putting “additional focus on reviewing the firm’s algorithm” and testing the website using real user IDs and passwords in order to mimic the real client experience (BE);
  - Checking the “parameters or algorithm” used to determine if personal recommendations were provided (FR);
  - Reviewing of actual telephone records between the firm and client (AT, BE, CY, DK, PL);
  - Thorough inspection of websites forums, blogs, sponsored links and pop-up banners as well as testing the “electronic registrations of contacts which took place between the financial intermediary and the client” (BE, FR).

**Finding 3: Nearly all CAs have carried out some work to clarify the boundary between information and advice although much of this work seem to publish ESMA material without an additional interaction with supervised entities**

22. There is consistent and good general understanding among CAs of where the boundary between investment advice and information lies and therefore when the suitability requirements apply.



23. The questionnaire issued by the AG presented three scenarios to CAs, where a degree of interpretation was required to assess whether investment advice had been provided. The AG found that the majority of CAs were consistent in their interpretation of these scenarios.
24. CAs have published guidelines and Q&A documents and some have also given presentations at conferences and seminars to enhance industry understanding in this area. However, much of the work cited by many CAs appears to simply reference the existing MiFID definition of investment advice or ESMA's guidance.
25. One CA (PL) sent letters to firms and trade associations to provide greater clarification on the circumstances under which investment advice is given and the distinction between the provision of information and the provision of advice. These letters included case studies covering a variety of practical circumstances where, according to the CA, there were interpretational problems on the proper classification of investment advice, providing information and giving general advice and the standards or criteria which would constitute the provision of investment advice. This same CA also held seminars with market participants to clarify the circumstances under which investment advice is given and specifically explained the key factors of investment advice using a number of case studies.

**Finding 4: A limited number of CAs routinely deploy supervisory tools in a 'targeted' manner to identify when firms are giving advice rather than providing information.**

26. The majority of CAs seek to identify the provision of investment advice through their '*business as usual*' (i.e. desk-based and routine visits) conduct of business supervision rather than looking at the specific behaviour of a firm or group of firms as part of a specific project with defined terms of reference (i.e. a specific 'theme') and objectives.
27. Only a minority of CAs provided any further detail on what specific or tailored criteria they use when determining whether investment firms are providing investment advice. Furthermore, much of the work cited by CAs in this respect appears to have been carried out outside the review period or done to varying degrees of intensity.
28. Generally, CAs do not extend their supervision to include the inspection of sales instructions and the sales scripts used by firms (indeed several CAs commented that they have not come across pre-drafted sales scripts in their supervision of firms). In a limited number of cases, CAs (AT, DE) simulate the sales communications between firms and their clients in order to review the knowledge and skills of sales staff or, where available, review the telephone records of conversations between the sales staff and clients. Some CAs conducted interviews

with investment firms in order to verify the advisor's knowledge and competences. In particular:

- One CA (DE) said that it compares the non-advised business rate of an investment firm against that of its peer group with any incongruity indicating to the CA potential misbehaviour which would then prompt on-site inspections. The same CA said that it will also routinely check files and documentation (e.g. selling instructions and product advertisements) and compares the sale of typical retail products (e.g. products including inducements/commissions/advisory or selling fees) against the sale of products typical for non-advised or execution only service (also in peer group comparison). This CA also scrutinises sales instructions for conflicts of interest and added that following information from a whistle blower about a firm's sales scripts, the CA carried out a formal investigation which led to twelve formal reprimands. This same CA also said that almost all pre-drafted sales instruction and scripts are routinely reviewed by supervisors before or during every on-site visit;
- Another CA (PL) said it reviewed the telephone records to cross-reference the pre-drafted sales scripts with the conversations that actually take place in practice;
- Another CA (ES) receives quarterly reports from all investment firms, which identifies all new products sold in the previous quarter and whether such products were complex or non-complex and sold on an advisory or non-advisory basis;
- Another CA (AT) said it reviews the internal instructions of the firm relating to contact with clients by telephone and whether the firm's staff are instructed to avoid giving "unintended" advice via telephone without having conducted a suitability assessment;
- AT also said that over the review period it carried out a thematic review specifically on suitability which included reviewing how firms observe the distinction between the provision of information and the provision of advice in practice and the distinction between non-advised and advised sales;
- Another CA (UK) carried out a thematic review which focused on understanding the drivers of non-advised and *simplified* advice markets and causes of any issues of investor detriment in these markets;
- Another CA (BE) said that it also looks at the remuneration arrangements and incentive schemes of sales staff and product lists of firms which staff use to 'push' products. This CA also said that it pays particular attention to the business model used by the firms in its determination as to whether investment advice has been

provided. It reasons that where firms claim that they offer non-advised services but which operate a face-to-face distribution model, the CA considers investment advice is being provided by the firm where it:

- Uses wording related to advice when discussing with the client
  - Asks for more information than the required information related to execution only
  - Has contact with the client concerning specific commercial actions.
- Another CA (FR) took the approach that the face-to-face business model alerts it to a strong likelihood that investment advice has been given. This CA has shared its view in this regard with the industry;
  - Another CA (IT) also said that in addition to establishing whether a face-to-face business model is followed, it would also look at other criteria such as the volume of transactions executed without providing investment advice; the nature of the products offered such as whether they were especially complex or illiquid, or whether the product was being distributed intra-group i.e. via self-placement distribution.
29. Furthermore, the majority of CAs said that they found cases where advice had been provided to clients by investment firms who were not authorised to provide investment advice or from other entities not authorised to provide any investment services.

**Finding 5: Limited work has been done to verify whether clients in practice are receiving investment advice or if clients have the perception that they are receiving investment advice**

30. It appears that generally CAs have not sought to determine in practice whether and to what extent investment advice is being provided in their respective national markets. For instance, only few consider it useful to engage directly with investors or consumer bodies in a focused way concerning the topic of suitability and the provision of investment advice in the course of their supervisory activity. In particular:

- Two CAs (ES, PL) have extended their supervisory efforts to contact clients in order to determine whether they perceived that investment advice was given in practice<sup>2</sup>.
- A few CAs (BE, FR, LT, UK) used mystery shopping to help identify whether advice was in fact given at the point of sale.
- FR also noted that it has provided guidance to its firms that if the client legitimately feels he has received advice, the entity should be regarded as having provided investment advice. This CA said it not only required access to records of client information and transactions but checked firm IT systems, and the parameters or algorithm used by firms to determine if personal recommendations were provided in order to challenge the firms' potential interpretation of non-advisory services with client perceptions.

## Conclusions

31. On balance, the AG considers that CAs are aware of the relevant criteria to determine the circumstances under which investment advice is given. And there is consistent and good understanding in theory of when investment advice is provided and therefore when the requirements on suitability apply across Europe.
32. However, the CAs have not specifically substantiated how they put available supervisory tools to use to ensure firms understand and observe the boundary between the provision of advice and information. While some CAs have clearly taken initiatives to inform their market about the boundary between provision of advice and the provision of information (although much of it done outside the review period), many CAs were not able to point to specific supervisory work undertaken to ensure firms are actually identifying the provision of advice and the subsequent application of the suitability rules under the correct set of circumstances. All too frequently, CAs chose to quote the MiFID rules and ESMA guidance rather than demonstrate oversight with specific supervisory exercises carried out inside the review period.
33. The AG identified that two CAs (DE, UK) were unable to provide information on whether firms operating on a branch basis (where the CA is the host supervisor) and on freedom to provide services (where the CA is the home authority) were providing investment advice.

---

<sup>2</sup> Although the AG notes that interacting with clients in this way to test their 'perceptions' can be a subjective exercise and has limitations.

34. The AG identified two CAs (IS, LU) who did not undertake activities to achieve sufficient overview of the distribution models in their jurisdiction during the review period.

### **Proposals**

35. The AG would encourage CAs to build upon and tailor work produced by ESMA and consider publishing helpful guidance for industry to clarify when and under what circumstances investment advice is provided to investors. For instance, CAs could carry out well-defined and specific thematic work involving a representative group of firms in their markets with a view to identifying practical examples/case studies/scenarios which would then be published in order to highlight to industry and investors where the boundary between the provision of information and investment advice lies and how the MiFID suitability requirements apply. More work could be done by, for instance, interrogating samples of client files, firms records (paper and electronic where available) or engaging with consumer bodies or investors to verify the extent and nature of advice provided to investors in their jurisdictions and the correct application of the MiFID suitability requirements on the provision of investment advice. Additionally, CAs should consider, where possible, the use of tools such as mystery shopping exercises to replicate the client experience and challenge firms more with practical examples. CAs might also consider using focus groups comprised of investors to gauge the perception of investors as to whether they 'felt' investment advice was provided at some point during the sales process.
36. Given that 'face-to-face' business models dominate most national markets, CAs may find it helpful when monitoring the provision of investment advice in their markets, to take into account that the likelihood of investment advice being provided is increased when face-to-face sales methods are used by firms.
37. Although the provision of investment advice by investment firms in other Member States under the freedom to provide services did not appear to be a significant method of distribution across the EEA, CAs may find it helpful to more closely monitor the activities of such firms when providing advice in other Member States.
38. While clearly the MiFID suitability requirements apply irrespective of the distribution method used, the AG would encourage CAs to consider tailoring their supervisory approaches, where relevant, according to the distribution method used to provide investment advice, also taking into account the increasing provision of services through on-line channels. Also based on replies provided by some CAs and summarised above, CAs could, for instance, consider some of the following practices:

- where on-line distribution is encountered, more CAs could simulate the client experience by using real user IDs and passwords to experience first-hand the advice and selling process; or reviewing the website of the firm and checking whether pop-up banners are used which are designed to guide or recommend investors to purchase particular investment products;
- where telephone distribution is encountered, more CAs could review any available telephone records and the sales scripts of the telephone sales staff;
- where face-to-face distribution is encountered, CAs could review firms' sales scripts to contribute to determining whether investment advice has been provided;
- where a combination of these distribution methods are used, the AG would anticipate the CAs using a combination of the above accordingly. Further, for all three methods of distribution, CAs should review the remuneration arrangements of firms' staff, fees imposed by firms and the internal instructions provided by firms to their staff to check whether staff are actively 'steered' to provide personal recommendation to clients without complying with requirements on investment advice.

## **SECTION 2: MONITORING COMPLIANCE WITH THE SUITABILITY REQUIREMENTS**

**Finding 1: As part of a holistic approach to conduct of business supervision, there is an incidental supervisory focus on suitability.**

39. CAs are required to monitor compliance by firms with the MiFID conduct of business rules and therefore must allocate their supervisory resource and tools across the full range of MiFID requirements. This peer review indicates that the majority of CAs adopt a 'holistic' approach to supervision, meaning that they typically supervise compliance with respect to the suitability requirements as part of their general and overarching supervision of a firm's conduct, identifying issues as and when they arise on an incidental basis.
40. While risk models are frequently used by CAs to allocate supervisory resource to areas identified as requiring enhanced supervisory focus, only some CAs appear to explicitly single out 'suitability' as an area deserving specific and tailored supervision and as such could point to their use of thematic reviews, mystery shopping, specific desk-based research and intensive routine or non-routine on-site visits to proactively identify issues in this area of the MiFID conduct requirements.

41. Furthermore, it is not clear to what extent CAs have systematically identified issues specifically related to compliance with the MiFID suitability requirements using internal intelligence such as thematic reviews conducted at their own initiative or from the output of internal risk models with specific criteria focused on suitability risks over the review period. Indeed, some CAs appeared to indicate that some supervisory tools would mainly be used when complaints or other external intelligence was received by them suggesting that they rely on a more reactive approach.
42. Therefore, while the majority of CAs did say they have carried out relevant thematic work on suitability this tended to be where suitability constituted only a limited part of the supervisory focus. The AG found that in the majority of cases there was no specific emphasis on suitability as part of supervision and notes that a minority<sup>3</sup> of CAs appear to proactively seek to identify issues or best practices on suitability through the use of tailored supervisory exercises. Furthermore, one third of CAs confirmed that they have not undertaken any thematic review work in relation to suitability over the review period.
43. The thematic reviews carried out on compliance with the suitability requirements specifically over the review period varied in their focus and intensity: for instance:
- One CA (DK) pointed to a thematic review it carried out over the review period examining IT-based investment advice tools used by banks. This investigation found the use of these tools left sales staff with very little discretion in making a product recommendation as the tools ensured investment recommendations are pre-defined according to the responses given by clients to the firm's suitability questionnaire. The thematic review also found that some firms operated automatic 'safety stops' and additional control questions if some of the questionnaire responses from the clients were inconsistent. This CA considered this as a best practice.
  - Another CA (ES) carried out a thematic review specifically to verify the extent to which firms were providing clients with a suitability statement after which they published a Q&A.
  - Another CA highlighted the work they carried out on firm suitability questionnaires which examined among other things: the wording used in client questionnaires and whether it allows for objective investment advice to be given; as well as the scoring

---

<sup>3</sup> Some CAs did include examples of thematic reviews carried out in relation to compliance with the suitability requirements outside the review period and/or are still on-going or outside the scope of this review i.e. advice in relation to portfolio management and therefore would be out-of-scope of this review and have not been formed part of the AG's conclusions on supervisory convergence.



systems used by firms once the responses from client questionnaires had been gathered.

- Another CA (FR) said it carried out a thematic review on distribution platforms involving 5 firms.
44. The AG has observed that over the review period CAs have on the whole relied on desk-based research and routine supervisory visits to monitor this aspect of firm conduct. Diverging approaches emerge on the use of additional supervisory tools. For example, the AG note that 21 CAs have confirmed that no mystery shopping exercises were carried out over the review period. Of the eight CAs that have used this supervisory tool, only four have done so for the specific purposes of monitoring compliance with the suitability requirements.
45. Nevertheless, the AG acknowledges that through a combination of internal and external supervisory tools CAs are identifying supervisory issues associated with non-compliance of the suitability rules, though to sharply varying degrees.
46. When requested to indicate any issues CAs encountered in their supervision on suitability, CAs cited a lack of resources as a general issue for them. Clearly, some CAs are relatively small and have smaller and even less complex markets to monitor, however even taking this into account, there appears to be a lack of resources specifically dedicated to the area of suitability.

**Finding 2: The majority of CAs said they adapt their supervisory approaches according to the complexity of the instrument although only a minority provided more technical details on this.**

47. To ensure the suitability requirements are applied consistently and effectively, CAs should monitor that firms gather “sufficient” information to make suitable recommendations to investors. The supervisory practice of ensuring firms gather information about the background of their clients and products, is all the more important where ‘complex products’ are being recommended since these will inevitably pose greater challenges for investors in terms of their comprehension of the key features and risks associated with such products. Therefore the minimum level of information required to meet “sufficient” information, will be greatly increased, in the case of complex instruments.
48. The review found that the majority of CAs say they adapt their supervisory approach according to the complexity of instrument. However, only a minority described what they do in practice in detail and/or provided specific examples. Where information was provided, the following was observed:



- One CA (AT) said that in the context of complex instruments being sold they monitor sales activity across all distribution channels by ‘simulating’ sales conversations with the firm’s sales advisors during on-site visits, reviewing samples of telephone conversations where they exist and using ‘test accounts’ to test on-line brokers and ‘apps’.
  - Another CA (BE) said that it routinely examines the ‘granularity’ of the questionnaires used by firms to ensure that a sufficient number of questions are asked for more complex products.
  - Another CA (ES) said it will check a sample of client files and the prospectuses of the complex products to verify whether firms have gathered sufficient information from their clients and matched the complex instrument recommended to the client’s requirements.
49. Two CAs (CZ, DK) stated explicitly that their approach does not change according to the complexity of the instrument but they added that they expect firms to take on board the complexity of the instrument when gathering information from clients. Another CA (SI) indicated that though firms in their jurisdiction do not make distinctions in the information they gather around complex and non-complex instruments, they were nevertheless confident that all relevant data is gathered and the risk attached to the recommended products is adequately explained to investors.
50. Some CAs (BE, FR, IT, PT) appear to prefer a more conservative approach by operating voluntary agreements from firms not to sell complex products to retail investors or by strongly encouraging for example through ‘warning’ notices that some complex products may not be *a priori* suitable for sale to retail investors. Indeed, one of these CAs (IT) referred to a ‘black list’ comprising what it perceives to be particularly complex instruments which it uses to encourage firms to avoid selling to retail investors.

**Finding 3: A majority of CA said they rely on a wide range of tools to verify that client profiles match the recommendations made by firms however only a minority of CAs provided further details on how they do this in practice.**

51. A large majority of CAs said they verify and compare individual client profiles with the corresponding instruments recommended by firms using supervisory tools. However, a minority described in detail what they do in practice and provided examples. Where information was provided it is observed that:
- some CAs prefer an approach which relies on the in-depth review of a sample of client files or questionnaires or on reviewing the minutes of any meeting that took place to check for inconsistencies in investment recommendations against the

client profile. These CAs normally request the corroborating information such as a copy of the financial product prospectus or the minutes of any meetings that take place or the sales scripts used by the firm.

- Other CAs rely on a more arms-length approach, which may for example, involve: ensuring that firms carry out due diligence on any third party application they use to define a client's risk profile and match it with an investment product; or looking at firms' business models in the round.
- One CA (BE) when carrying out on-site inspections requires that firms demonstrate the algorithm underpinning the IT tools used by the firm to perform their suitability tests and this CA will specifically make an in-depth check of the algorithm.
- Another CA (NL) described an assessment involving, for example, the calculation of the standard deviation to ensure consistency between those clients preferring a 'low risk' profile and the degree of risk attached to the portfolio. The same CA also routinely scrutinises the selection process of the product with reference to the risk, return and cost.
- A number of CAs (BE, FR, LT, UK) use mystery shopping to assess whether investment firms obtain and understand the essential facts about the clients before providing investment advice.

**Finding 4: The majority of CAs said they supervise whether firms match the liquidity of instruments to the preferred holding period of clients and a significant number of CAs described their general approach.**

52. CAs should monitor that firms assess and establish the client's time horizon for the investment, especially in light of the possible lack of liquidity of the product.
53. Many CAs agree on the importance of this aspect. Where CAs did provide more detailed information there was significant variation among CAs as to the methods used to monitor this aspect of suitability assessment, the intensiveness and frequency by which they were used over the review period.
54. Most CAs undertake sample client file testing to compare the holding period information of the client, with the investment advice given to the client and the features of the instruments held, such as liquidity. One CA (BE) said that it specifically checks whether firms make use of 'blocking mechanisms' in order to match client advice with the client's preferred holding period and in the absence of any such blocking mechanism this CA will then select specific client files in order to further verify whether the client's preferred holding period has been properly taken

into account. The same CA said it also checked some client questionnaires for consistency in the responses given by the client themselves as regards this aspect of the suitability requirements.

55. A minority of CAs did not provide information in this area of the supervision or simply stated that they have not had specific supervisory oversight in this regard.

**Finding 5: The majority of CAs said they use their supervisory tools to monitor how firms understand all material characteristics of the financial instrument, however, only a minority of CAs provided further details on how they do this in practice.**

56. The majority of CAs said they use their supervisory approaches to verify that firms understand all the material characteristics of their financial instruments. The approach adopted by CAs appears to encompass one, or both, of the following tools: ensuring the firms employ a competent, qualified person who directly provides investment advice; and verifying whether appropriate training is provided by firms to their staff.

57. Two CAs (DE, UK) said it expects firms to provide all clients with “minutes” or a “suitability letter” respectively setting out the rationale for their recommendation in order to make it clear to the client how the recommended product meets the client’s requirements. This approach, according to the CAs, also ensures that the firm’s employees understand the product marketed and sold to clients.

## **Conclusions**

58. Clearly, CAs are monitoring compliance by firms with the overall MiFID conduct of business requirements as was evident from the responses given by CAs to the questionnaire and the discussions carried out with certain CAs as part of the on-site visits.

59. However, probably because of individual resource constraints and national market structures, there appears to be a lack of a proactive and focused supervisory approach in this area of conduct of business across many CAs. Indeed, while some CAs did demonstrate a proactive approach and provided details and examples that indicated they had given suitability a specific focus and attention over the review

period, the majority of CAs did not provide sufficient or relevant material as part of this peer review<sup>4</sup>.

60. Many CAs did not identify having had a large number of issues in relation to suitability. While this could be seen as a positive development the AG were concerned that this finding was due to CAs employing limited supervision in the area of the suitability requirements and as a result there would be a limited number of findings or issues identified.
61. It is also the impression of the AG that though some CAs are very focused on adopting general measures aimed at limiting the distribution of complex products to retail investors in their markets, this approach should not translate into diminished focus on the supervision of the suitability requirements on less complex products.
62. The AG found that four CAs (BG, EE, HR, IS) did not sufficiently supervise the suitability requirements during the review period.
63. The AG found that one CA (IS) does not formally comply with the Guidelines on certain aspects of the MiFID suitability requirements.

## **Proposals**

64. Compliance with the MiFID suitability requirements is a key component of the overall MiFID investor protection framework, ensuring that firms recommend only suitable investment products to investors taking due account of the latter's individual profile. The AG therefore considers that CAs should proactively identify supervisory issues and investor risks specifically in this area of conduct supervision by routinely using their supervisory tools in a targeted manner. For instance:
  - Given that a third of CAs have not made use of a thematic review related to compliance with the MiFID suitability requirements and that many CAs supervised suitability as a limited part of their supervisory activity, CAs should consider embarking on thematic reviews focused on a specific theme related to suitability. Additional focus should be given in this context to investment advice concerning complex and less liquid products.
  - Given that the vast majority of CAs have not carried out a mystery shopping exercise over the review period specifically on suitability (indeed only four CAs

---

<sup>4</sup>The AG acknowledges that a number of CAs have carried out supervisory work either before or after the review period (including on-going supervisory work)

have deployed this tool specifically in relation to suitability) the AG would suggest that CAs should consider, where possible, using this tool to monitor whether investors in their market are being provided suitable investment recommendations and products.

65. Whatever tools are deployed as part of routine or non-routine supervision, CAs could seek to better adapt their supervisory methods according to the complexity of the instrument by, for instance:

- Consider simulating sales conversations during on-site visits and/or reviewing any records of sales conversations where they are available to gauge how well firms are explaining the products and their risks to investors and the extent to which they match the client's investment profile;
- Consider examining the 'granularity' and the structure of the suitability questionnaires and of the algorithms used by investment firms when selling a range of products varying in their complexity, including those sold through an on-line method;
- Consider verifying the degree to which 'self-assessment' has been unduly relied upon by the firm during the sales process.

66. CAs should still be continually vigilant and adapt and apply their supervisory methods on a routine basis, even where voluntary agreements by firms not to sell certain 'complex' products in a particular market are employed.

### **SECTION 3: ENFORCEMENT**

#### **Finding 1: CAs have a broad understanding of non-pecuniary actions**

67. The questionnaire had set out that "non-pecuniary action" meant "an action taken by the CA against a firm that did not involve a financial penalty or the repayment of monies to an investor(s). Examples of such actions include suspension of operations, removal of certain individuals from the firm, temporary prohibition from taking on new clients, order to remove irregularities or cease behaviour, name and shame action or other corrective measures". The AG noted that, in several cases, the non-pecuniary actions mentioned by CAs were more supervisory in nature.

#### **Finding 2: Some CAs displayed evidence of limited enforcement activity**

68. The AG found that some CAs conducted very limited supervisory action in assessing compliance with the suitability requirements. This meant that there were

limited if any findings in this area and consequently enforcement action did not take place.

69. A second group of CAs were found to have carried out some supervisory activity in this area. However this supervisory activity was not followed by any enforcement actions in the relevant period.
70. A third group did conduct supervisory activity and did declare that they have taken enforcement actions. However, the AG found that the nature of such actions widely differed and, in a number of cases, the AG did not find a correlation between the number of findings of non-compliance with the suitability requirements and subsequent enforcement actions. While some CAs had identified that a large number of non-pecuniary enforcement actions had followed findings of non-compliance, it transpired that in many cases these were not the strongest non-pecuniary actions. In a number of cases, strong non-pecuniary actions seemed to only occur where there was a serious issue with the firm in other areas and the breach of the suitability requirements had only been a part of the concerns (e.g. the result in one CA being the withdrawal of the firm's licence). Similarly, while pecuniary actions had taken place, it was not always clear that these were taken as a result of breaches of the suitability requirements. It was also noted that in some cases, the level of the pecuniary actions was very low (AT, EL, HU and SI).

**Finding 3: Most CAs make limited use of publication of non-pecuniary enforcement actions**

71. The AG also found that there was very little publication of non-pecuniary actions and that where publication did occur it was mostly on an anonymous basis and often only in the annual report of the CA, where publication took place well after the finding was established.
72. Publication was more likely in respect of pecuniary actions, with clear examples from CZ, EL, NL, RO and UK. In other cases, pecuniary actions had taken place but publication did not (AT, LU, PT).
73. The AG is concerned that the limited approach by CAs with respect to the publication of additional and timely details on pecuniary or non-pecuniary sanctions they have imposed may restrict the possibility to highlight CAs' concerns to its stakeholders. CAs are subsequently missing out on an opportunity to raise standards through the use of such publication.

**Finding 4: CAs are conscious of the resource intensive nature of enforcement action and concentrate on other tools.**

74. Clearly, in many cases taking enforcement action is an intensive and time consuming exercise and CAs must allocate resources as they best see fit. It should also be acknowledged that a large number of CAs use other methods to try to ensure compliance with the suitability requirements. While acknowledging that not all issues of possible non-compliance with suitability requirements may lead to formal enforcement actions, the AG considers that stronger enforcement action should nonetheless be a key tool to address clear breaches of the suitability requirements.

### **Conclusions**

75. Enforcement is an important tool to change behaviours and ensure future compliance. When this tool is not fully utilised it is difficult to expect a raising of standards and positive changes in firms' behaviour.

76. The responses to these questionnaires and the on-site visits identified that CAs fall into two camps, those that have undertaken enforcement actions in relation to breaches of the suitability requirements and those that have not. In particular:

- For those who had conducted enforcement actions, the AG found that there were divergent practices in relation to how these CAs had taken this action. These practices varied in relation to the selection of firms for sanctioning; the amount/level of the sanction; and the details being published. The AG considers that CAs may miss out on an opportunity to raise standards when issues are settled on a bilateral basis without any publication (even on an anonymised basis) of the issues involved and the remedial action taken.
- Those that had not undertaken enforcement action did so because either they had not conducted any supervisory activity in relation to the suitability requirements; or because having conducted supervisory activities had not engaged in any enforcement actions.

77. The AG found that seven CAs (BG, EE, FI, HR, IS, LV, SK) did not carry out enforcement activity during the review period.

### **Proposals**

78. On the basis of these findings the AG considers that greater emphasis needs to be placed on the use of enforcement as a tool for change. The use of enforcement should be dissuasive enough to contribute to such change. Adequate use of pecuniary and strong non-pecuniary sanctions seem appropriate tools to contribute to a rising in standards and to effect positive changes in firms' behaviour.



79. Specifically, the AG considers greater use of strong non-pecuniary actions such as, taking in account legal limitations, “name and shame”, temporary or permanent prohibition of activities, and the possibility of taking enforcement action against individuals in firms.
80. The AG also considers that ESMA may wish to commence work to fully understand the differences between supervisory and enforcement activity (and in particular the different types of enforcement tools) used by CAs and seek convergence in this area.
81. Finally, the AG also notes that even where supervisory action identified issues, the CA are faced with difficulties in taking on enforcement action. For example, mystery shopping findings while often clearly identifying breaches of the supervisory requirements did not seem to directly lead to enforcement action but, in the best case, to further supervisory action. This can lead to a number of years passing from when an issue is identified to when an enforcement action takes place. The AG consider that where mystery shopping has identified clear findings of non-compliance the CA should find ways, within the legal framework, to effectively undertake enforcement actions or at least be a trigger for systematic follow up supervisory work.

#### **SECTION 4: COMMUNICATION WITH STAKEHOLDERS**

**Finding 1: CAs are diligent in publishing material for stakeholders however this was often published outside the review period or is not strictly related specifically to compliance with the suitability requirements.**

82. Generally, CAs appear to have published a good range of stakeholder material either directly or indirectly relating to compliance with the MiFID suitability requirements. However, the date of publication of this material often lies outside the review period or it is not strictly relevant to the suitability requirements. CAs were generally active in engaging with industry and consumer bodies in seminars, workshops and conferences, although again it was unclear to what extent these were carried out during the review period and were relevant to the area of suitability.
83. There was varying degrees of publication of supervisory or enforcement activities undertaken in relation to the suitability requirements by CAs. Some CAs were proactive in publishing details (on an anonymous basis) of the findings of supervisory activities involving suitability. Other CAs were less active in this area and only reported such activities in the annual report. In many cases, the engagement between the CAs and the investment firm was only conducted through the firms’ head of compliance. In order to try and increase the culture of compliance



at investment firms, one CA (BE) ensured that the findings of the supervisory work involving assessment of the suitability requirements were sent to the CEOs of the relevant investment firms. In addition, the findings of the mystery shopping campaign relevant to each firm were directly presented to the CEO of the firm by this CA.

## **Proposals**

84. The AG proposes that all CAs should publish the ESMA guidance that seeks to clarify the boundary between information and advice and that, on the basis of this material, they should continually inform their market participants through annual seminars or webinars on the circumstances when advice is provided.
85. The AG considers that CAs could, through their websites or press releases, attempt greater publication of supervisory activities, findings, and the details of pecuniary and non-pecuniary sanctions undertaken. The AG considers that greater emphasis on the publication of findings of supervisory activities, the problems identified and remedial actions taken, (even on an anonymised basis where legal constraints apply) is a means of raising awareness of issues and has the potential to improve standards, change behaviours and ensure better future compliance. Furthermore, wide and timely publication of enforcement findings would raise awareness about breaches of the suitability requirements. The AG also considers that CAs should consider using their websites and press releases as an effective way to highlight such findings in a timely cost effective manner.
86. As a measure of the fundamental importance of issues related to the suitability requirements, the AG considers that CAs should seek to raise all such supervisory issues with a firm directly with the CEOs or boards of that firm. Furthermore, in order to raise general awareness across the market all relevant findings relating to the suitability requirements should be sent to all relevant market participants on an anonymised basis through a “Dear CEO/Dear Board member” circular.

## **SECTION 5: SUMMARY OF FINDINGS FROM ON-SITE VISITS**

87. A constituent part of the peer review involved on-site visits to seven CAs to learn more about their approach to the supervision of firms to ensure compliance with the MiFID suitability requirements when providing investment advice. Members of the AG visited the relevant CAs (name in brackets) in the following Member States, BE (FSMA) in July 2015, UK (FCA) in September 2015, FI (FIN-FSA) in September 2015, HR (HANFA) in October 2015, FR (AMF) in October 2015, ES (CNMV) in October 2015, and BG (FSC) in November 2015. A summary of the main findings of each visit, in chronological order, is set out below.

## **Onsite visit to BE, FSMA**

88. The AG found that the FSMA had a thorough knowledge of the market for investment advice which is closely monitored and the types of firms (credit institutions and investment firms) in Belgium. The FSMA was found to have thorough, robust procedures and to have very knowledgeable, highly trained and competent staff. The AG noted that the FSMA organises its supervisory activities and allocates its resources according to an annual audit plan. Where necessary, the FSMA responds to resourcing constraints by using external auditors and service providers to increase its market coverage.
89. The FSMA provided the AG with a clear description of its supervisory activities in relation to the suitability requirements. The FSMA employs an extensive risk based approach to map market trends and has focused its supervisory approach on 14 main conduct of business themes, among which an assessment of compliance with the suitability requirements. This supervisory approach allows the FSMA to determine where to employ supervisory tools such as on-site inspections, desk based reviews, thematic reviews, as well as mystery shopping. The AG found the use of mystery shopping and thematic reviews to be very extensive and useful in identifying suitability issues to be addressed by firms. The AG also found that the additional reporting requirements placed on firms following such supervisory actions were very extensive and allow the FSMA to assess whether issues have been rectified on an on-going basis. The AG noted that as the FSMA's supervisory activities increase, its ability to assess the amount of information it receives will need to be carefully managed. The AG also found the use by the FSMA of external auditors to assess firms' compliance with the suitability requirements allowed it to cover a large number of firms. The AG also noted the FSMA's approach in this area by training such staff in order to avoid a repeat of concerns about low quality work from such auditors. A further innovative approach taken by the FSMA related to the voluntary moratorium whereby firms agree not to sell complex products to retail clients. This has been highly successful in preventing unsuitable products possibly being sold to clients, with all relevant actors, in both the banking and insurance sectors, involved in distributing structured products in Belgium agreeing to its conditions.
90. The FSMA provided the AG with detailed information on its enforcement procedures. Until now, the FSMA has made use of non-pecuniary enforcement actions. The AG noted that no pecuniary sanctions were taken against any firm for breaches of the suitability requirements during the review period despite uncovering cases of potential mis-selling. Instead the FSMA focussed on addressing the issues with the firms requiring them to take corrective measures in a deadline determined by the FSMA, issuing orders and recommendations. Corrective measures are

integrated by firms into their action plan which is approved and followed by the FSMA. The FSMA argued that the implementation of the action plan represents for the firms a huge investment in reviewing their processes, adapting IT tools and organising training for their employees. However, the AG noted that the FSMA's non-pecuniary actions were limited to corrective measures and did not involve any penalty such as "name and shame", removal of individuals from firms, suspension of operations, temporary prohibitions from taking on clients or providing investment services or removal of authorisations. The reason given for this enforcement approach was that the FSMA had developed in 2011 a new specific approach to the supervision of MiFID CoB rules, and had only commenced its focus on suitability in recent years, arguing that firms should be given a period of time to change their behaviours and adapt to the new FSMA conduct supervision focus and address any issues identified before sanctions would take place. The AG noted that MiFID had been in place since 2007 and firms have had adequate time to ensure compliance.

91. The AG found that the FSMA published the ESMA "Guidelines on certain aspects of the MiFID Suitability requirements", and integrated them in the FSMA's supervisory practices. The AG also considered that the use of "Dear CEO letters" and meeting with the CEO's of its investment firms is an innovative approach to highlight areas of concern and set out how they should be addressed. The FSMA also set out the strong communication focus that it applies to enforcement cases. The AG noted that the FSMA has not made use of their "name and shame" powers in respect of the suitability requirements. The AG considered this would be a useful preventative measure to address wrongdoing in the market. The AG also considered that the FSMA could initiate closer interaction with retail investor/consumer groups in order to better understand issues of concern.
92. The FSMA and the financial ombudsman called Ombudsfina meet regularly to discuss FSMA's approach to supervision of MiFID CoB rules, and share information such as statistics on complaints on financial products and services. However, the AG considered that the FSMA could benefit from greater information sharing on individual complaints against firms received by Ombudsfina.

### **Onsite visit to UK, FCA**

93. The AG found that the FCA had a thorough knowledge of the market for investment advice which is closely monitored and the types of firms (credit institutions and investment firms) in the UK. It is the largest financial services market in the EU and the FCA appears to be a highly professional and well-organised financial watchdog. The FCA was found to have thorough, robust procedures and knowledgeable, highly trained and competent staff. The AG found that the FCA had a clear strategic approach in how it carries out its activities and communicates such findings.

94. The FCA provided the AG with a clear description of its strategic planning and supervisory activities in relation to the suitability requirements. The FCA employs a very extensive risk based approach to map market trends and supervisory issues. The AG also considers that the FCA operates a highly organised and innovative system of supervisory tools including mystery and shadow shopping, monitoring of advertisements as well as intensive thematic reviews in order to detect horizontal problems. The AG considered that mystery shopping and the new focus on shadow shopping to be particularly innovative and a very good example of how CAs can gather first hand and up-to-date information to supervise the firms' activities.
95. In addition, the thematic reviews were of a high supervisory standard, with detailed file templates completed in a consistent manner. The AG consider that this tool should enable the CA gain a broad and deep market overview and detect possible structural problems. However, the AG noted that owing to the size of the market and the risk pillar approach the majority of supervision focuses on the large firms, while using a "trigger" based approach to identify and address issues with smaller firms. The AG also noted that although the FCA provides guidance to the market to address specific scenarios that have arisen with the smaller firms, it rarely conducts any direct follow up with those firms to assess that the issues have been resolved.
96. The FCA explained that given its resources compared to the size of the market, it can only focus on a small proportion of the market, and as a consequence it aims to identify problems which potentially have the most impact. The AG also noted that the FCA used external auditors to carry out supervisory activities which allowed it to address supervisory issues when ad-hoc issues arose without taking resources from other planned activities. The AG noted that while extensive supervisory activity had taken place during the review period, there was not an extensive focus on specifically assessing compliance with the suitability requirements during this period.
97. The FCA provided the AG with detailed information on its enforcement procedures. The AG found that the FCA had carried out enforcement actions in respect of firms where issues related to the provision of investment advice had been uncovered. Although in most cases the sanction was not officially related to a breach of the suitability requirements but more general conduct of business requirements. However, the AG recognised that the sanctions issued included large fines and "name and shame" sanctions, and consider that these actions send a clear signal to consumers and market participants about the importance of meeting regulatory obligations, as well as being a preventative measure to address wrongdoing in the market. Furthermore, the AG considered that the FCA's power to require firms to provide redress to clients as part of a settlement agreement is an excellent tool in terms of consumer protection and building trust in the financial market integrity.

However, the AG also recognised that the FCA takes a selective approach to the imposition of a disciplinary outcome: their overall enforcement strategy is conscious of the message being communicated to industry through enforcement, and therefore its activities are focused on the areas that present the most risk to consumers. This selective approach means that the FCA will only refer a case to Enforcement where the failings are serious and typically systemic, and if the enforcement action will have a deterrent effect. Consequently, many enforcement actions are not carried out despite their being evidence of breaches. The FCA's criteria for referring cases to Enforcement are published on its website<sup>5</sup>. Furthermore, the AG noted that another factor that leads to this selective approach to taking enforcement actions is owing to finite resources in the relevant department.

98. The AG considered that the FCA has a very clear focus on how it communicates to the market. The AG found that the quality and quantity of such communications was of a very high standard and tailored to the intended stakeholders. In addition, the MiFID suitability requirements have been subsumed into the FCA handbook and published. The AG also found that the FCA had published a large amount of guidance to assist firms in determining when advice was being provided and how suitability might be assessed. The AG noted that the FCA had a high level of involvement with stakeholders, through conferences, roadshows and other industry engagement.

#### **Onsite visit to FI, FIN-FSA**

99. The AG found that FIN-FSA had a thorough knowledge of the market for investment advice and the types of firms (credit institutions and investment firms) in Finland. FIN-FSA was found to have thorough procedures and to have very knowledgeable and competent staff who displayed the flexibility to work in different areas. However, the AG noted that there was limited internal training provided for staff. The AG also noted that the resources of FIN-FSA are mainly devoted to prudential supervision and that MiFID conduct of business supervision including supervision of the suitability requirements is carried out through the authorisation process with very limited resources for on-going supervision.

100. In terms of its supervisory activities, FIN-FSA conducted a survey on the sale of investment products to elderly clients in 2014. Follow up work in relation to this survey will also take place in 2015 (which is outside the review period). Also outside of the review period, FIN-FSA carried out a thematic review in relation to the suitability of advice in 2009, as well as on-site inspections on the suitability of the

---

<sup>5</sup> <http://fca.org.uk/firms/being-regulated/enforcement/how-we-enforce-the-law/referral-criteria>

sale of investment product by firms to their clients, and on the selection, remuneration and monitoring of record keeping and documentation of tied agents by investment firms.

101. The AG found that FIN-FSA has identified a number of ways to supervise its market. These include focus on authorisation, regular reporting, close interaction with compliance officers and assessment of complaints data from the Finnish Ombudsman. FIN-FSA focusses on the authorisation process of firms to ensure that any potential risks are addressed. FIN-FSA added that special emphasis is placed on the firm's internal procedures during the authorisations process. FIN-FSA also requires regular reporting from the firms it supervises such as board meeting minutes. Although, the AG noted that these reports were mostly focussed on prudential and client asset requirements and that systematic reporting of conduct of business issues was not required but only occurred on request. The AG felt that more systematic reporting of conducts of business metrics should be required.
102. However, the AG noted that FIN-FSA maintains close interaction with the compliance officers of investment firms and found that is a good method to facilitate oversight of the market, although this tool has not led to any issues being identified. FIN-FSA also stated that it operates a risk based approach to monitoring of conduct of business activities and can review complaints data from the Finnish Financial Ombudsman to assess whether there are issues related to suitability. However, the AG noted that this risk based approach was not systematically organised and did not involve any assessment of any database or risk based metrics and that there were few sources for information on compliance with the suitability requirements. The AG noted that the extremely low level of complaints may suggest that compliance with the suitability requirements is not an issue for the Finnish market.
103. However, the AG were concerned that the focus on the authorisation process of firms, followed by limited ongoing supervision and a lack of reporting in the area of conduct of business might prove insufficient to identify issues in relation to the suitability requirements (as well as other conduct of business areas). Furthermore, the AG were concerned that as neither the internal nor external supervisory tools of FIN-FSA had led to the identification of any cases of non-compliance with the suitability requirements that there were concerns in terms of the effectiveness of the supervision on the suitability requirements as a whole. However, the AG was informed that concerns raised in the media and consumer complaints had led to a survey on the sale of investment products to elderly clients being conducted in 2014. It was also noted that the FIN-FSA can issue public warnings and apply supervisory powers. However the AG felt that using supervisory tools such as mystery shopping or conducting further thematic or on-site work would enable FIN-FSA to greater assess compliance with the suitability requirements.



104. The AG found that FIN-FSA had thorough procedures in relation to its sanctioning powers with efficient timelines and effective Chinese walls in place. The AG also noted that FIN-FSA had imposed monetary sanctions and name and shame penalties on firms who had breached FIN-FSA requirements. However, these actions were not taken in respect of any breaches of the suitability requirements. FIN-FSA stated that this is partly due to the limited resources in its supervisory activities and thus the need to prioritise supervisory activities over time. The AG considers that increased resources in the supervision and enforcement departments could enhance supervisory and enforcement activity in the area of suitability. Also it appears that Finnish law does not seem to envisage the imposition of financial sanctions against firms for breaches of the suitability requirements, unless a lack of proper internal governance arrangements was also observed. In this context, the threat of possible enforcement action for breaches of the suitability requirements in individual cases would appear to be very limited.

105. In the area of communication, the AG noted that FIN-FSA had been proactive in publishing details of its enforcement activities. The AG also noted that FIN-FSA had engaged in discussions with local trade organisations on the impact of the ESMA “Guidelines on aspects of the MiFID Suitability requirements”. The AG also noted that FIN-FSA was active in communicating with the compliance officers of its investment firms. The AG also noted that FIN-FSA had been active in publishing its interpretation of MiFID issues. In addition, the AG considered that the focus on elderly and vulnerable clients was an innovative approach which appeared to arise as a result of interaction with stakeholders from media. The AG also considered although that reporting of the result of the thematic review on suitability in 2009, to all investment firms was a good practice which helped raise standards in the Finnish market (although it should be noted that this took place outside the review period).

#### **Onsite visit to HR, HANFA**

106. The AG found that HANFA had a thorough knowledge of the market for investment advice and the types of firms (credit institutions, UCITS managers and investment firms) in Croatia. The AG also found that HANFA was reasonably well resourced with knowledgeable staff. Although the AG considered that enhanced internal training could be provided for new staff.

107. HANFA provided the AG with a clear description of its supervisory activities in relation to the suitability requirements. The AG found that HANFA has established an adequate organisational structure for the supervision of firms which allows for formal, well-structured and consistent communication at all levels within and between all the relevant departments. The AG found that HANFA bases its supervisory approach on the risk assessment of all subjects of supervision and on weekly, monthly and quarterly supervisory reports. The AG considered that the

information required in these reports is sufficient to establish a reasonable risk assessment on the behaviour of the firms it supervises. However, the AG noted that this information is to a large degree self-certified by the firm and therefore could be open to abuse if verification of such reporting does not take place. The AG also considered that HANFA should act on information on client complaints, when and where possible, in order to assess compliance by firms with the suitability requirements.

108. The AG found that although HANFA had conducted a good level of on-site supervision, and has an adequate set of supervisory tools, there was limited use of such tools in respect of assessing compliance with the suitability requirements. The AG specially noted that neither thematic reviews nor mystery shopping had ever been used to assess compliance with the suitability requirements. The AG noted that although onsite inspections are carried out by HANFA, it seems that they are performed on a very limited basis in respect of suitability issues and was limited to a formal check on whether the firm has adopted the relevant investment advice policy. However, the AG noted that this approach is due to the very small retail advice market in Croatia and the fact that retail clients who are interested in advisory services are using portfolio management services. On this basis, the AG found that while HANFA generally allocates resources in a proportionate manner, supervisory tools such as thematic reviews, mystery shopping and assessment of investor complaints should be expanded in order to improve HANFA supervision in relation to the suitability requirements. The AG notes that HANFA has embarked on a thematic review in respect of the suitability requirements in 2015.
109. The AG found that HANFA has detailed and thorough procedures in relation to enforcement and that it has a wide range of available sanctions. In light of the absence of enforcement actions against providers of investment advice, HANFA is encouraged to further develop its supervisory approach on investment advice in order to ensure that the supervision on such area is performed on an ongoing and continuous basis and to take enforcement action where breaches of the suitability requirements occur.
110. The AG found that HANFA initiative to train the compliance officers of its investment was an innovative practice. On communication with stakeholders, the AG found that HANFA did not interact with trade associations when the suitability guidelines became effective in Croatia. The AG considered that continued interaction in order to pre-empt any issues that members of the trade association may have and ensure greater coverage of the suitability requirements and tailor the interaction and guidance more clearly to the Croatian market. The AG also found that HANFA could provide stakeholders with greater guidance on where there is



confusion as to when information is being provided and when advice is provided, and when advised and non-advised sales of financial instruments take place.

### **Onsite visit to FR, AMF**

111. The AG found that the AMF had a thorough knowledge of the market for investment advice and the types of relevant firms (credit institutions and investment firms) in France. The AMF was found to have thorough, robust procedures and knowledgeable, highly trained and competent staff. The AMF also requires very comprehensive training for compliance officers and investment advisors.
112. The AMF provided the AG with a clear description of its supervisory activities in relation to the suitability requirements. The AG found that the AMF has a robust approach to supervision and is proactive in its use of tools. Many of these tools such as mystery shopping and fake advertisements are innovative and demonstrate the AMF's desire to use its resources in the most efficient way possible. Significantly, the AMF considers that almost all oral communications between the firm and its retail clients/potential retail clients relating to particular financial instruments are very likely to constitute investment advice.
113. The use of mystery shopping has been one of the most significant tools for the supervision of the large banking groups. However, the AG noted that mystery shopping findings cannot be used for enforcement action (because of the criminal law on admissible evidence) and typically, no direct action other than presentation of the results to each firm is taken to address any shortcomings identified. The tool is used to gather information on market-wide distribution issues rather than to initiate direct supervisory or enforcement action, although the information gathered is taken into account in the AMF annual risk-mapping exercise and may contribute to published guidance for all firms; it is also increasingly used in informal bilateral discussions with individual firms.
114. In addition to the supervisory responsibilities of the AMF (and the prudential regulator ACPR), certain aspects of financial supervision are entrusted to other entities in France. This can be seen as the oversight of MiFID-exempt independent financial advisers is entrusted to their relevant associations. Although a very small part of the French market, the AG noted that the AMF had concerns about the robustness of this supervision and recently implemented enhanced oversight procedures for such associations.
115. The AG found that the main strategic approach employed by the AMF in relation to ensuring compliance with the suitability requirements is to focus its efforts on curtailing mis-selling and client detriment through product approval, review of

draft marketing communications, limiting the marketing of complex and risky products to retail investors, and issuing guidance to firms.

116. The AMF provided the AG with detailed information on its extensive enforcement procedures. The AG found that although the AMF had carried out a number of inspections related to suitability, few enforcement actions in respect of issues related to the provision of investment advice other than follow-up letters requiring corrective measures were taken, despite consistencies across the market in the failings identified. Indeed, mystery shopping results point to continued failures by firms to comply with the suitability requirements by failing to gather the required suitability information, failing to identify the risk appetite of clients and occasionally giving unsuitable investment advice. Although the AMF considers its approach to be proportionate given the nature of the breaches brought to light so far, the AG considers that greater enforcement action would send a clear signal to consumers and market participants about the importance of meeting regulatory obligations, as well as being a preventative measure to address poor behaviour in the market.

117. The AG also notes that while the AMF uncovers such findings of non-compliance, it does not assess the potential cost to the client as a result of the potentially unsuitable advice which was provided to the client and it cannot require the firms to pay redress to clients. The AMF Ombudsman, however, frequently succeeds in obtaining redress for clients, and the AMF Enforcement Committee takes redress paid into account when setting the amount of financial penalties. In addition, where the AMF Board opts to use the settlement procedure instead of the sanction procedure, such redress is systematically taken into account in setting the amount of the penalty.

118. The AG considered that the AMF has a very clear focus on how it communicates to the market. The AG found that the quality and quantity of guidance, warnings and reports on supervisory actions was of a very high standard and tailored to the intended stakeholders. The AG also found that the AMF had published a large amount of guidance where it sees risks. This can be seen in the work relating to the retail OTC derivative sector (CFDs, forex, binary options)<sup>6</sup>. The AMF's approach is to focus on preventing complex products carrying a high degree of risk from reaching the retail market rather than to monitor that these products are only distributed to customers for whom they are suitable. This may in some cases lead to a limit to the range of available products for higher risk investors, although the AMF considers that most retail investors fail to understand complex and risky

---

<sup>6</sup> See for example the research published by the AMF in October 2014 on the losses incurred by investors in these products.

products and in any event, the AMF does not prevent the purchase of such products by retail investors.

119. The AG also noted that both the AMF helpline and the Ombudsman received only a very limited number of complaints relating to investment advice from clients in France. The Ombudsman's office is based in the AMF but it operates independently. The AG also noted that while information on the complaints the Ombudsman receives is not currently passed to the AMF, there appears to be some confusion about whether the Ombudsman is precluded from providing such information on a named basis. The AG considers that any information that can identify possible supervisory issues should be utilised by the AMF. Work is currently underway to clarify this point and allow the Ombudsman to share detailed information with the AMF in defined circumstances.

#### **Onsite visit to ES, CNMV**

120. The AG found that the CNMV had a thorough knowledge of the market for investment advice and the types of firms (credit institutions and investment firms) in Spain. The advice market is quite small in Spain and accounts for less than 10% of revenues received by all firms. In fact a large number of investment firms do not provide any investment advice. The CNMV was found to have thorough, robust procedures and to have very knowledgeable, highly trained and competent staff. The AG noted that there were a number of vacancies in the CNMV and that it was restricted in its activities due to resourcing constraints.
121. The CNMV provided the AG with a clear description of its supervisory activities in relation to the suitability requirements. The CNMV employs an impressive risk based approach to map market trends, through quarterly and annual reporting requirements and consideration of client complaints. These allow the CNMV to determine where to employ supervisory tools such as on-site inspections, desk based reviews and thematic reviews. These innovative techniques to assess issues in its market, include requiring firms to report on the sales of complex and non-complex) product in the previous quarter, writing to clients to assess whether the complex product they purchased was, as reported by the firm, sold on a non-advised basis, as well as additional annual reporting. The AG considers the tool of writing to clients to be particularly innovative and its continued use should be encouraged.
122. It was also noted that the CNMV require that when investment firms wish to include a generic clause in the contractual documentation indicating that the client recognises that it has not received advice the client must provide a handwritten note confirming that advice has not been provided when purchasing a complex product. This is a legal requirement which was based on a CNMV Circular. The AG

considered that, while well intentioned and a reaction to address the sale of complex products on a non-advised basis, this requirement may inadvertently affect clients who are unaware that, in legal terms, they have actually received a personal recommendation. The AG were concerned that the existence of the handwritten note could be used by firms to protect themselves in any supervisory case or litigation that sought to establish whether advice had been provided to the client.

123. It should also be noted that the CNMV intends to commence mystery shopping. The AG considers this to be a positive development especially given the CNMV's view that it is likely that advice is being provided to clients without a suitability assessment being conducted. The AG therefore considers that mystery shopping will allow the CNMV to determine in which branches of credit institutions breaches of compliance with the suitability requirements are taking place. The AG consider this to be a welcome development as the CNMV currently considers that addressing internal audit and procedural issues are more important than addressing individual branch compliance issues. There are over 30,000 branches of credit institutions in Spain and most credit institutions use common processes and as a consequence the CNMV does not generally inspect branches of the large banks. The AG noted that the choice of branches where the bank's systems will be tested is determined by the credit institution itself. The AG considers that the CNMV should choose the branch of the firm where systems will be tested. The AG also notes that the forthcoming mystery shopping will ensure that branches of credit institutions subject to this exercise will be chosen by the CNMV.

124. The CNMV provided the AG with detailed information on its enforcement actions. The AG were impressed that the CNMV can undertake non-pecuniary enforcement actions in respect of the costs of share classes of collective investment schemes being charged to clients, an aspect the AG considers to be quite advanced. The AG were also impressed that thematic reviews can lead to enforcement action without the need for a follow-up inspection as it has to be in other jurisdictions. The AG found that while a large amount of non-pecuniary activity had been conducted in relation to the suitability requirements during the review period, the vast majority of these resulted in letters which requested that the firm addressed the identified issues. The AG also noted that despite identifying a large number of breaches of the suitability requirements only 3 pecuniary sanctions were imposed during the review period, although the AG notes that some pecuniary actions have been proposed for the costs of share classes of collective investment schemes being charged to clients these are still ongoing. The AG also considers that the publication of the names of the firms where the CNMV had identified breaches of the suitability requirements (and in which non-pecuniary sanctions had been imposed) would be a useful preventative measure to address wrongdoing in the market.

125. The AG found that the CNMV published the ESMA “Guidelines on certain aspects of the MiFID Suitability requirements” as well as issuing circulars on suitability and appropriateness, as well as publishing a Q&A. The CNMV also publishes its annual plan of activities that outlines its objectives and identifies the projects whose implementation is considered a priority. The CNMV also holds workshops with firms. The AG considered that the CNMV were generally proactive in communicating with stakeholders but noted that it mainly relies on the publication of its annual report to share the results of its supervisory actions with the market. Although it should be noted that when letters of findings are sent to firms, the CNMV asks the firm to inform its Board of Directors about the content of the letter in its next formal meeting and to send the CNMV a confirmation of having done so. However, the AG considered that greater interaction with senior management such as the use of “Dear CEO letters” or meeting with the CEOs of the investment firms would be a positive step to highlight areas of concern and how they should be addressed.
126. Although the situation in Spain is compliant with the European regulation, the AG considered that the lack of a financial ombudsman in Spain and the inability of the CNMV to impose binding decisions in relation to client complaints may be a factor in preventing greater levels of compliance with the suitability requirements.

### **Onsite visit to BG, FSC**

127. The AG found that the FSC had a thorough knowledge of the market for investment advice and the types of firms in Bulgaria. The FSC is an integrated supervisor. The AG noted that the team in charge of the supervision of MiFID conduct of business supervision is of limited size and has a lot of other responsibilities. The AG noted that the FSC had during the review period given priority to prudential aspects and client asset protection over conduct of business aspects. The AG noted that there had not been any supervisory activity to assess whether investment firms providing advice were compliant with the MiFID suitability requirements during the review period.
128. Nevertheless, the AG noted the FSC had made positive developments in this area and has undertaken a thematic review in respect of the MiFID suitability requirements in 2015. The FSC has also published the ESMA suitability guidelines on its web-site in 2013. The AG found that the FSC staff appeared to have a good knowledge of the suitability requirements and were highly motivated. The AG also noted that resources were particularly limited in the supervision of conduct of business and that staff might benefit from a greater market experience.

129. The AG noted that the FSC has begun the development of a risk based methodology with a pilot launched in 2015. The methodology applies to six reviews currently under way.
130. The AG noted that the FSC does not challenge common practice by banks and investment firms which make use of a form to be completed by clients upon the submission of an order, which records whether the order is initiated by the client or as a result of advice received from the firm. The AG were concerned that clients may be unaware that they have received personal recommendations and argued that the practice of requiring clients to mark a document saying that no advice has been provided appears to protect the firms rather than the clients of those firms.
131. In addition, the FSC has reported that only 266 instances of financial advice were given within the review period. The AG questioned whether it was realistic to consider that investment firms had only provided investment advice in this number of instances. However, the AG also noted that the FSC had asked client questions whereby a sample of clients were asked specific questions which aimed to assess whether they were given advice regarding a financial instrument. None of the clients were identified as having received investment advice. The AG consider that the FSC should maintain use of this tool to assess whether investment advice is being provided.
132. The AG found that the FSC had not conducted any enforcement actions in the area of suitability. This is clearly a result of the lack of supervisory activities in this area. However it might be possible that constraints are also put by the legal system. The AG found that the Bulgarian market could benefit from stronger communication efforts from the FSC in relation to the suitability requirements. These include interaction with firms in form of work-shops, seminars etc. and through greater use of its website. The AG were impressed that the FSC currently require that staff of investment firms who wish to be a financial advisor must pass a course required by the FSC. The AG noted that a further good practice would be to also require the staff in the FSC who supervise conduct of business requirements to also pass this exam.

## **SECTION 5.1: STATEMENT FROM CAs REGARDING SUMMARY OF FINDINGS FROM ON-SITE VISITS**

### **CNMV statement**

133. “In its on-site peer review report the AG includes the following opinion: *It was also noted that the CNMV require that when investment firms wish to include a generic clause in the contractual documentation indicating that the client recognises that it has not received advice the client must provide a handwritten note confirming that advice has not been provided when purchasing a complex product. This is a*

*legal requirement which was based on a CNMV Circular. The AG considered that, while well intentioned and a reaction to address the sale of complex products on a non-advised basis, this requirement may inadvertently affect clients who are unaware that, in legal terms, they have actually received a personal recommendation. The AG were concerned that the existence of the handwritten note could be used by firms to protect themselves in any supervisory case or litigation that sought to establish whether advice had been provided to the client.*

134. The CNMV would like to point out that we believe this assessment is not accurate.
135. The handwritten note requirement is a regulatory reaction, which was authorized by the TROIKA in its oversight of some Spanish banks in the summer of 2012, to a previous practice (which is legal according to the EU legislation). This practice consists of including a generic clause in the contractual documentation (that clients sign) indicating that the client recognizes that it has not received investment advice. This clause does already exist and could be used by firms to protect themselves in case of litigation.
136. This type of clause was usually signed by clients without being aware of its consequences. Requiring a handwritten note highlights this situation to the client and makes them aware of the fact that the firm considers that it has not provided advice in respect of that operation, so if the client perceives that the firm has made a recommendation regarding the operation (which is usually a common perception of retail clients) they will appear reluctant to write the note and will ask the firm about it. The handwritten note also has a deterrent effect as it discourages firms from including those types of generic clauses in the documents. In fact, our supervisory experience is quite positive and the use of such clauses has diminished.”