Consultation Paper

Guidelines on certain aspects of MiFID II suitability requirements

13 July 2017 | ESMA35-43-748

FRENCH BANKING RESPONSE

Guidelines

INFORMATION TO CLIENTS ABOUT THE PURPOSE OF THE SUITABILITY ASSESSMENT

Relevant legislation: Articles 24(1) and 24(5) of MiFID II and Article 54(1) of the MiFID II Delegated Regulation.

The French banking industry welcomes ESMA's decision to involve relevant professionals in the discussions on the implementation of Level 2 provisions related to the suitability test, in support of this consultation.
The industry would like to stress that the implementation of these guidelines calls for significant developments in terms of software tools and IT chains, which means that professionals will need time to both develop and test them to avoid any operational pitfalls. To this end, the industry stresses the need for a reasonable implementation period of at least 12 months after the publication of the guidelines, giving banks sufficient time to prepare the new information they are required to provide their clients, to update the client questionnaires and profiles, etc.

Furthermore, as FIRMS are obligated to comply with data protection regulations, it is important for ESMA to take this obligation into account in its guidelines.

General guideline 1

14. Firms should inform their clients about the suitability assessment and its purpose, including a clear explanation that it is the firm's responsibility to conduct such assessment, so that clients understand the reason why they are asked to provide certain information and the importance that such information is up-to-date, accurate and complete.

Supporting guidelines

15. Information about the suitability assessment should help clients understand the purpose of the requirements and should encourage them to provide accurate and sufficient information about their knowledge, experience, financial situation (including their ability to bear losses), and investment objectives (including their risk tolerance). Firms should highlight to the client that it is important to gather complete and accurate information so that the firm can recommend suitable products or services for the client. Without such information, firms cannot provide investment advice and portfolio management services to

clients.

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

17. Firms should also take steps to assess the client's understanding of investment risk as well as the relationship between risk and return on investments, as this is key to enable firms to act in accordance with the client's best interest when conducting the suitability assessment. To this end, clients should be clearly informed that they may be asked to answer some questions related to situations describing, for example, different levels of loss/return that may occur depending on the level of risk taken, or to other relevant situations. When presenting such questions, firms should clearly explain that the purpose of answering them is to help assess clients' attitude to risk (risk profile), and therefore the types of financial instruments (and risks attached to them) that are suitable for them.

18. Firms should avoid stating, or giving the impression, that it is the client who decides on the suitability of the investment, or that it is the client who establishes which financial instruments fit his own risk profile. For example, firms should avoid indicating to the client that a certain financial instrument is the one that the client chose as being suitable, or requiring the client to confirm that an instrument or service is suitable.

19. Firms should not use disclaimers (or other similar types of statements) aimed at limiting their responsibility for the suitability assessment in any way. For example, when collecting clients' information required to conduct a suitability assessment (such as their investment horizon/holding period or information related to risk tolerance), firms should not claim that they do not assess the suitability.

20. The previous paragraphs are particularly important for firms providing robo-advice, considering that in this case only limited interaction (or none at all) between clients and firms' personnel takes place. Such firms should therefore be cautious and clear when informing clients about the purpose of the suitability assessment, explaining in particular that the answers they provide will have a direct impact in determining the suitability of the investment decisions recommended or undertaken on their behalf.

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

    - A statement that an algorithm is used to collect the information from clients, to provide advice and/or to manage clients' portfolios;
    - An explanation of the degree of human involvement in the oversight and management of the provision of investment services (e.g., whether the client can ask for human interaction (and if so explaining how), when providing information to the firm on his status, objectives, needs, knowledge and experience);

- A description of how the firm will use the information gathered from a client to elaborate investment advice or to provide the portfolio management service (e.g., if an online questionnaire is used, firms should explain that the answers to the questionnaire may be the sole basis for the robo-advice or whether the firms have access to other client information or accounts).

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

22. Provided that all the information and reports given to clients comply with the relevant provisions (including obligations on the provision of information on a durable medium), firms providing robo-advice should also carefully consider whether their written disclosures are designed to be effective (e.g., the disclosures are made available directly to clients and are not hidden or incomprehensible). In particular, firms should:

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

- Consider whether some information should be accompanied by interactive text (e.g., through the use of design features such as tool-tips) or other means to provide additional details to clients who are seeking further information (e.g., through an F.A.Q. section; and

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

Q1: Do you agree with the suggested approach on the information to be provided on the suitability assessment and specifically with the new supporting guidelines on robot-advice? Please also state the reasons for your answer (GL1).

The French banking industry agrees with Guideline 1. However, some provisions need further clarification.

<u>Point 17:</u>

"To this end, clients should be clearly informed that they <u>may be asked</u> to answer some questions related to situations describing, for example, different levels of loss/return that may occur depending on the level of risk taken, or to other relevant situations. When presenting such questions, firms should clearly explain that the purpose of answering them is to help assess clients' attitude to risk (risk profile), and therefore the types of financial instruments (and risks attached to them) <u>that are suitable for them</u>."

The FBF suggests that "May be asked" be changed by "they will be asked", because the FBF is of the opinion that the firms will ask questions to their clients in all circumstances whatsoever.

Point 19

That point 19 should stipulate that the suitability assessment conducted by professionals should be based on information provided by the client, and that they can use this information for their assessment unless it is manifestly out-of-date, incorrect or incomplete.

Point 21

“”A description of how the firm will use the information gathered from a client to elaborate an investment advice or to provide the portfolio management service (e.g., if an online questionnaire is used, firms should explain that the responses to the questionnaire may be the sole basis for the robo-advice or whether the firms has access to other client information or accounts);””

Definition of robo-advice to be clarified by ESMA in line with the definition provided by paragraph 20 of the ESAs Joint Committee Discussion Paper on automation in financial advice (JC 2015 080) which states the following: “When an automated financial advice tool is used, human intervention is replaced by an automated process (such as algorithms or decision trees) that the consumer accesses directly. Automated financial advice tools are therefore consumer facing tools, as opposed to advisor facing tools (for example, IT tools that are used by a human advisor to aid in the advice process). Automated financial advice tools are sometimes referred to as automated advisors, robots or robo-advisors, highlighting their lack of human attributes such as emotional response, bias, judgment and the ability to assess the need to probe where further clarification or information might be required from the consumer.”

Similarly, the French banking industry considers that ESMA should stress the obligation for Firms using personal client data to comply with other existing regulatory provisions, including in particular the General Data Protection Regulation.

To this end, we propose the following alternate wording:

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

A description of how the firm will use the information […] or whether the firms ***use*** *other client information* ***in accordance with applicable laws, for example the General Data Protection Regulation);***

I.I KNOW YOUR CLIENT AND KNOW YOUR PRODUCT

Arrangements necessary to understand clients

Relevant legislation: Articles 16(2) and 25(2) of MiFID II, and Articles 54(2) and 55 of the MiFID II Delegated Regulation.

General guideline 2

23. Firms must establish, implement and maintain adequate policies and procedures (including appropriate tools) to enable them to understand the essential facts and characteristics about their clients. Firms should ensure that the assessment of information

collected about their clients is done in a consistent way irrespective of the means used to collect such information.

Supporting guidelines

24. Firms' policies and procedures shall enable them to collect and assess all information necessary to conduct a suitability assessment for each client. For example firms could use questionnaires (also in a digital format) completed by their clients or information collected during discussions with them. Firms should ensure that the questions they address to their clients are likely to be understood correctly and that any other method used to collect information is designed in a way to get the information required for a suitability assessment.

25. When collecting information about their clients' profile for the purpose of a suitability assessment (through a questionnaire or by other means), firms should be aware and consider the most common biases that can potentially affect investors' ability to provide reliable information. In particular:

Attention should be given to the clarity, exhaustiveness and comprehensibility of the questionnaire, avoiding misleading, confusing, imprecise and excessively technical language;

- The layout should be carefully elaborated and should avoid orienting investors' choices (font, line spacing…);
- Presenting questions in batteries (collecting information on a series of items through a single question, particularly when assessing knowledge and experience and the risk tolerance) should be avoided and firms should carefully consider the order in which they ask questions in order to collect information in an effective manner;
- In order to be able to ensure relevant and necessary information is collected, questionnaires allowing the reply "no answer" too often should be avoided (particularly when collecting information on the investor's financial situation).

26. Information necessary to conduct a suitability assessment includes different elements that may affect, for example, the analysis of the client's financial situation (including his ability to bear losses) or investment objectives (including his risk tolerance). Examples of such elements are the client's:

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

(b) family situation (evolutions in the family situation of a client may impact his financial situation e.g. a new child or a child of an age to start university);

(c) age (which is mostly important to ensure a correct assessment of the investment objectives, and in particular the level of financial risk that the investor is willing to take, as well as the holding period/investment horizon, which indicates the willingness to hold an investment for a certain period of time);

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

(e) need for liquidity in certain relevant investments.

27. When determining what information is necessary, firms should keep in mind the impact that any significant change regarding that information could have concerning the suitability assessment.

28. Information collected by firms about a client's knowledge and experience should be considered altogether for the overall appraisal of his understanding of the products and of the risks involved in the transactions recommended or in the management of his portfolio. Firms should take all reasonable steps to sufficiently assess the understanding by their clients of the main characteristics and the risks related to the product types in the offer of the firm. The adoption by firms of mechanisms to avoid self-assessment and ensure the consistency of the answers provided by the client27 is particularly important for the correct assessment of the client's knowledge and experience.

29. It is also important that firms appraise the client's financial literacy and understanding of basic notions such as, for example, investment risk (including concentration risk) and risk-return trade off. To this end, firms should consider using indicative, comprehensible examples of the levels of loss/return that may arise depending on the level of risk taken, and should assess the client's response to such scenarios.

30. Given the limited human interaction, firms providing robo-advice should design an online questionnaire able to gather sufficient information to support the assessment of suitability. In order to ensure their compliance with the requirements concerning that assessment, firms should take into account factors such as:

- Whether the information collected through the online questionnaire allows the firm to conclude that the advice provided is suitable for their clients on the basis of their knowledge and experience, their financial situation and their investment objectives and needs;

- Whether the questions in the questionnaire are sufficiently clear and/or whether the questionnaire is designed to provide additional clarification or examples to clients when necessary (e.g., through the use of design features, such as tool-tips or pop-up boxes);

- Whether some human interaction (including remote interaction via emails or mobile phones) is available to clients when responding to the online questionnaire;

- Whether steps have been taken to address inconsistent client responses (such as incorporating in the questionnaire design features to alert clients when their responses appear internally inconsistent and suggest them to reconsider such responses; or implementing systems to automatically flag apparently inconsistent information provided by a client for review or follow-up by the firm).

[27] See guideline 4.

Q2: Do you agree with the suggested approach on the arrangements necessary to understand clients and specifically with how the guideline has been updated to take into account behavioural finance and the development of robo-advice models? Please also state the reasons for your answer (GL2).

The French banking industry agrees with ESMA's guidelines, but would like ESMA to add some clarifications

Point 25:

As the answers given in the questionnaire depend significantly on the level (both in terms of quantity and depth) of information that the investor wishes to provide, the concept of exhaustiveness used in this guideline is too restrictive and difficult to control. The obligation imposed on Firms should be to ensure that their questionnaires allow sufficient information to be collected to assess the suitability of the recommendation.

We therefore recommend the following addition:

““*Attention should be given to the clarity~~, exhaustiveness~~ and comprehensibility of the questionnaire, avoiding misleading, confusing, imprecise and excessively technical language;* ***the questionnaire should include relevant questions designed to collect sufficient and necessary information to provide the service****.””*

Furthermore, the phrase “too often” is not precise enough, leaving too much room for subjective interpretation.

We would like to suggest the following alternate wording:

*““In order to be able to ensure relevant and necessary information is collected, questionnaires allow****ing*** *the reply “no answer”* ***in an inappropriate manner*** *should be avoided (particularly when collecting information on the investor’s financial situation).*

Point 26:

An investor's lack of liquidity needs is just as important a situation to take into consideration in assessing suitability.

We recommend making the following addition to e):

“”(e) need ***or absence of need*** *for liquidity in certain relevant investments.””*

Extent of information to be collected from clients (proportionality)

Relevant legislation: Article 25(2) of MiFID II, and Articles 54 and 55 of the MiFID II Delegated Regulation.

General guideline 3

31. Before providing investment advice or portfolio management services, firms need to collect all ‘necessary information’[28] about the client’s knowledge and experience, financial situation and investment objectives. The extent of ‘necessary’ information may vary and has to take into account the features of the investment advice or portfolio management services to be provided, the type and characteristics of the investment products to be considered and the characteristics of the clients.

Supporting guidelines

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

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

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

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

33. While the extent of the information to be collected may vary, the standard for ensuring that a recommendation or an investment made on the client’s behalf is suitable for the client will always remain the same. The principle of proportionality in MiFID allows firms to collect the level of information proportionate to the products and services they offer, or on which the client requests specific investment advice or portfolio management services. It does not allow firms to lower the level of protection due to clients.

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

34. For example, when providing access to complex[29] or risky[30] financial instruments, firms should carefully consider whether they need to collect more in-depth information about the client than they would collect when less complex or risky instruments are at stake. This is so firms can assess the client's capacity to understand, and financially bear, the risks associated with such instruments.[31] For complex products ESMA expects firms to carry out a robust assessment amongst others of the client's knowledge and experience, including, for example, his ability to understand the mechanisms which make the investment product "complex", whether the client has already traded in such products (for example, derivatives or leverage products), the length of time he has been trading them for, etc.

35. For illiquid financial instruments[32], the 'necessary information' to be gathered will obviously include information on the length of time for which the client is prepared to hold the investment. As information about a client's financial situation will always need to be collected, the extent of information to be collected may depend on the type of financial instruments to be recommended or entered into. For example, for illiquid or risky financial instruments, 'necessary information' to be collected may include all of the following elements as necessary to ensure whether the client's financial situation allows him to invest or be invested in such instruments:

(a) the extent of the client's regular income and total income, whether the income is earned on a permanent or temporary basis, and the source of this income (for example, from employment, retirement income, investment income, rental yields, etc);

(b) the client's assets, including liquid assets, investments and real property, which would include what financial investments, personal and investment property, pension funds and any cash deposits, etc. the client may have. The firm should, where relevant, also gather information about conditions, terms, access, loans, guarantees and other restrictions, if applicable, to the above assets that may exist.

(c) the client's regular financial commitments, which would include what financial commitments the client has made or is planning to make (client's debits, total amount of indebtedness and other periodic commitments, etc).

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

[30] It is up to each firm to define *a priori* the level of risk of the financial instruments included in its offer to investors taking into account, where available, possible guidelines issued by competent authorities supervising the firm.

[31] In any case, to ensure clients understand the investment risk and potential losses they may bear, the firm should, as far as possible, present these risks in a clear and understandable way, potentially using illustrative examples of the extent of losses in the event of an investment performing poorly.

[32] It is up to each firm to define *a priori* which of the financial instruments included in its offer to investors it considers as being illiquid, taking into account, where available, possible guidelines issued by competent authorities supervising the firm.

36. In determining the information to be collected, firms should also take into account the nature of the service to be provided. Practically, this means that:

(a) when investment advice is to be provided, firms should collect sufficient information in order to be able to assess the ability of the client to understand the risks and nature of each of the financial instruments that the firm envisages recommending to that client;

(b) when portfolio management is to be provided, as investment decisions are to be made by the firm on behalf of the client, the level of knowledge and experience needed by the client with regard to all the financial instruments that can potentially make up the portfolio may be less detailed than the level that the client should have when an investment advice service is to be provided. Nevertheless, even in such situations, the client should at least understand the overall risks of the portfolio and possess a general understanding of the risks linked to each type of financial instrument that can be included in the portfolio. Firms should gain a very clear understanding and knowledge of the investment profile of the client.

37. Similarly, the extent of the service requested by the client may also impact the level of detail of information collected about the client. For example, firms should collect more information about clients asking for investment advice covering their entire financial portfolio than about clients asking for specific advice on how to invest a given amount of money that represents a relatively small part of their overall portfolio.

38. Firms should also take into account the nature of the client when determining the information to be collected. For example, more in-depth information would usually need to be collected for potentially vulnerable clients (such as older clients could be) or inexperienced ones asking for investment advice or portfolio management services for the first time. In addition, where a firm provides investment advice or portfolio management services to a professional client (who has been correctly classified as such), it is generally entitled to assume that the client has the necessary level of experience and knowledge, and therefore is not required to obtain information on these aspects.

39. Similarly, where the investment service consists of the provision of investment advice to a 'per se professional client' [33] the firm is entitled to assume that the client is able to financially bear any related investment risks consistent with the investment objectives of that client and therefore is not generally required to obtain information on the financial situation of the client. Such information should be obtained, however, where the client's investment objectives demand it. For example, where the client is seeking to hedge a risk, the firm will need to have detailed information on that risk in order to be able to propose an effective hedging instrument.

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

40. Information to be collected will also depend on the needs and circumstances of the client. For example, a firm is likely to need more detailed information about the client's financial situation where the client's investment objectives are multiple and/or long-term, than when the client seeks a short-term secure investment. [34]

41. Information about a client's financial situation includes information regarding his investments. This implies that firms are expected to possess information about the client's financial investments he holds at this firm on an instrument-by-instrument basis. Firms should also encourage clients to disclose their financial investments they hold with other firms in detail, if possible also on an instrument-by-instrument basis.

Q3: Do you believe that further guidance is needed to clarify how firms should assess clients' ability to bear losses? (GL2)

We have no specific comments on this guideline.

Reliability of client information

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

General guideline 4

42. Firms should take reasonable steps and have appropriate tools to ensure that the information collected about their clients is reliable and consistent, without unduly relying on clients' self-assessment.

Supporting guidelines

43. Clients are expected to provide correct, up-to-date and complete information necessary for the suitability assessment. However, firms need to take reasonable steps to check the reliability, accuracy and consistency of information collected about clients. Firms remain responsible for ensuring they have adequate information to conduct a suitability assessment and cannot limit their responsibility by means of a specific clause in the contract with the client, in the general terms and conditions, or otherwise.

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[34] There may be situations where the client is unwilling to disclose his full financial situation. For this particular question see Q&As on MiFID II investor protection topics (ESMA35-43-349)

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

(a) instead of asking whether a client understands the notions of risk-return trade off and risk diversification, the firm could present some practical examples of situations that may occur in practice, for example by means of graphs or through positive and negative scenarios, asking to choose which one would be correct/real in his opinion;

(b) instead of asking a client whether he feels sufficiently experienced to invest in certain products, the firm could ask the client what types of products the client is familiar with and how recent and frequent his trading experience with them is;

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

(d) instead of asking whether a client feels comfortable with taking risk, the firm could ask what level of loss over a given time period the client would be willing to accept, either on the individual investment or on the overall portfolio.

45. When assessing the risk tolerance of their clients through a questionnaire, firms should not only investigate the desirable risk-return characteristics of future investments but they should also take into account the client's risk perception. To this end, whilst self-assessment for the risk tolerance should be avoided, explicit questions on the clients' personal choices in case of risk uncertainty could be presented. Furthermore, firms could for example make use of graphs, specific percentages or concrete figures when asking the client how he would react when the value of his portfolio decreases.

46. Where firms rely on tools to be used by clients as part of the suitability process (such as on-line questionnaires or risk-profiling software), they should ensure that they have appropriate systems and controls to ensure that the tools are fit for purpose and produce satisfactory results. For example, risk-profiling software could include some controls of coherence of the replies provided by clients in order to highlight contradictions between different pieces of information collected.

47. Firms should also take reasonable steps to mitigate potential risks associated with the use of such tools. For example, potential risks may arise if clients were encouraged by customer-facing staff to provide certain answers in order to get access to financial instruments that may not be suitable for them (without correctly reflecting the clients' real circumstances and needs)[35].

[35] In this regard, see also paragraph 54 of Guideline 5, which addresses the risk of clients being influenced by firms to change answers previously provided by them, without there being any real modification in the their situation.

48. In order to ensure the consistency of client information, firms should view the information collected as a whole. Firms should be alert to any relevant contradictions between different pieces of information collected, and contact the client in order to resolve any material potential inconsistencies or inaccuracies. Examples of such contradictions are clients who have little knowledge or experience and an aggressive attitude to risk, or who have a prudent risk profile and ambitious investment objectives.

49. Firms should adopt mechanisms to address the risk that clients may tend to overestimate their knowledge and experience, for example by including questions about the characteristics and the risks of the different types of financial instruments. Such measures are particularly important in the case of robo-advice, since the risk of overestimation by clients may result higher when they provide information through an automated (or semi-automated) system.

Q4: Do you agree with how the guideline on the topic of 'reliability of client information' has been updated to take into account behavioural finance and the development of robot-advice models? Please also state the reasons for your answer (GL4).

The French banking industry agrees with ESMA's emphasis on verifying the reliability of information about the investor for the purpose of the suitability assessment. It considers that there is a best efforts obligation to inform investors about the importance of providing accurate information and about the collection of this information.

Accordingly,

Point 43

FBF is of the opinion that the wording used goes further than what is required by article 54(7)(d) of Delegated regulation 2017/565 which states that investment firms, while taking "reasonable steps to ensure that the information collected about their clients or potential clients is reliable […] taking steps, as appropriate, to ensure the consistency of client information, such as by considering whether there are obvious inaccuracies in the information provided by clients". Consequently if the client provides deliberately fake information that the investment firm considers as reliable, the investment firm should not be held liable. This Guideline cannot derogate to Level 1 and Level 2 regulation and therefore must comply with article 55(3) of Delegated regulation 2017/565 which states that an investment firm shall be entitled to rely on the information provided by its client unless it is aware or ought to be aware that information is manifestly out of date, inaccurate or incomplete

ESMA should stipulate in point 43 that this analysis should be based on information provided by the investor, and that this information may be used at the basis for the suitability assessment unless it is manifestly obsolete or inconsistent.

Suggested wording:

"Clients <u>are informed that they are</u> required to provide correct, up-to-date and complete information necessary for the suitability assessment. However, firms need to take reasonable steps to check the reliability, accuracy and consistency of information collected about clients. Firms remain responsible for ensuring […] in the general terms and conditions, or otherwise. The suitability test should be based on information provided by the client, which the investment firm may use for this purpose unless it is manifestly out-of-date, incorrect or incomplete. ""

Furthermore, while the French banking industry understands the usefulness of information that can be drawn from the behavioural finance approach, it wishes to alert the regulator to the increasingly higher costs that could be generated by the obligation to develop and implement analysis tools taking behavioural finance into account. Such costs might even become exponential, depending on potential developments in the use of this approach.

Updating client information

Relevant legislation: Article 25(2) of MiFID II, subparagraph 2 of Article 54(7), and Article 55(3) of the MiFID II Delegated Regulation.

General guideline 5

50. Where a firm has an ongoing relationship with the client (such as by providing ongoing advice or portfolio management services), in order to be able to perform the suitability assessment, it should adopt procedures defining:

    (a) what part of the client information collected should be subject to updating and at which frequency;

    (b) how the updating should be done and what action should be undertaken by the firm when additional or updated information is received or when the client fails to provide the information requested.

Supporting guidelines

51. Firms should regularly review client information to ensure that it does not become manifestly out of date, inaccurate or incomplete. To this end, firms should implement procedures to encourage clients to update the information originally provided where significant changes occur.

52. Frequency of update might vary depending on, for example, clients' risk profiles and taking into account the type of financial instrument recommended. Based on the information collected about a client under the suitability requirements, a firm will determine the client's

investment risk profile, i.e. what type of investment services or financial instruments can in general be suitable for him taking into account his knowledge and experience, his financial situation (including his ability to bear losses) and his investment objectives (including his risk tolerance). For example, a risk profile giving to the client access to a wider range of riskier products is an element that is likely to require more frequent updating. Certain events might also trigger an updating process; this could be so, for example, for clients reaching the age of retirement.

53. Updating could, for example, be carried out during periodic meetings with clients or by sending an updating questionnaire to clients. Relevant actions might include changing the client's profile based on the updated information collected.

54. It is also important that firms adopt measures to mitigate the risk of inducing the client to update his own profile so as to make appear as suitable a certain investment product that would otherwise be unsuitable for him, without there being a real modification in the client's situation[36]. As an example of a good practice to address this type of risk, firms could adopt procedures to verify, before or after transactions are made, whether clients' profiles have been updated too frequently or only after a short period from last modification (especially if this change has occurred in the immediate days preceding a recommended investment). Such situations would therefore be escalated or reported to the relevant independent control function. These policies and procedures are particularly important in situations where there is a heightened risk that the interest of the firm may come into conflict with the best interests of its clients, e.g. in self-placement situations or where the firm receives inducements for the distribution of a product. Another relevant factor to consider in this context is also the type of interaction that occurs with the client (e.g. face-to-face vs through an automated system) [37].

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

[37] In this regard, also see the clarifications already provided by ESMA in the Q&As on MiFID II investor protection topics (Ref: ESMA35-43-349 – Question on 'Transactions on unsuitable products').

55. Firms should inform the client when the additional information provided results in a change of his profile, whether it becomes more risky (and therefore, potentially, a wider range of riskier and more complex products may be suitable for him, with the potential to incur higher losses) or *vice-versa* more conservative (and therefore, potentially, a more restricted range of products might be suitable for him)

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

FBF is of the opinion that ESMA should clarify this notion of "ongoing relationship" since the extent of the investment firms obligations is fully dependent upon it.

Furthermore, in the interest of improving their clients' financial knowledge, Firms have or are developing educational support offers and making them available to their clients to help them learn about, familiarise themselves with and better understand certain financial products. Clients can use these offers to improve their experience and knowledge of financial products at their own pace, while also gaining access to additional products.

Accordingly, is it important that the guidelines given in point 54 do not counteract the work that has been achieved by not allowing investors that have improved their experience and knowledge to update their profile and carry out transactions in products on which they have gained knowledge and skills.

Client information for legal entities or groups

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

General guideline 6

56. Firms must have a policy defining on an *ex ante basis*, how to conduct the suitability assessment in situations where a client is a legal person or a group of two or more natural persons or where one or more natural persons are represented by another natural person. This policy should clearly specify, for each of those situations, the procedure and criteria that should be followed in order to comply with the MiFID II suitability requirements. The firm should inform its clients *ex-ante*, clearly and accurately, about its policy, including for each situation who should be subject to the suitability assessment, whether an agreement with the client is foreseen, how this assessment will be done in practice and the possible impact this could have for the relevant clients.

Supporting guidelines

57. Firms should consider whether the applicable national legal framework provides specific indications that should be taken into account for the purpose of conducting the suitability assessment. This could be the case, for instance, where the appointment of a legal representative is required by law (e.g. for underage or incapacitated persons or for a legal person).

58. The policy should make a clear distinction between situations where a representative is foreseen under applicable national law, as it can be the case for example for legal persons, and situations where no representative is foreseen.

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

Situations where a representative is foreseen under applicable national law

60. Subparagraph 2 of Article 54(6) of the MiFID II Delegated Regulation defines how the suitability assessment should be done with regard to situations where the client is a natural person represented by another natural person or is a legal person having requested treatment as a professional client. It seems reasonable that the same approach should apply to all legal persons, regardless of the fact that they may have requested to be treated as professionals or not.

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

Situations where no representative is foreseen under applicable national law

62. Where the client is a group of two or more natural persons and no representative is foreseen under applicable national law, the firm's policy should identify from whom necessary information will be collected and how the suitability assessment will be done. Clients should be properly informed about the firm's approach (as decided in the firm's policy) and the impact of this approach on the way the suitability assessment is done in practice.

63. Approaches such as the following could possibly be considered by firms:

(a) they could choose to invite the group of two or more natural persons to designate a representative; or,

(b) they could consider collecting information about each individual client and assessing the suitability for each individual client.

Inviting the group of two or more natural persons to designate a representative

64. If the group of two or more natural persons agrees to designate a representative, the same approach as the one described in subparagraph 2 of Article 54(6) of the MiFID II Delegated Regulation could be followed: the knowledge and experience shall be that of the representative, while the financial situation and the investment objectives would be those of the underlying client(s).

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

66. If the parties involved have difficulties in deciding the person/s from whom the information on knowledge and experience or on the financial situation should be collected for the purpose of suitability assessment or on defining their investment objectives, the firm should adopt the most prudent approach by taking into account the information on the person with the least knowledge and experience, the weakest financial situation or the most conservative investment objectives. Alternatively, the firm's policy may also specify that it will not be able to provide investment advice or portfolio management services in such a situation.

Collecting information about each individual client and assessing the suitability for each individual client

67. When a firm decides to collect information and assess suitability for each individual client part of the group, if there are differences between the characteristics of those individual clients (for example, if the firm would classify them under different investment profiles), the question arises about how to ensure the consistency of the investment advice or portfolio management services provided with regard to the assets or portfolio of that group of clients. Indeed, in such a situation, a financial instrument may be suitable for one individual client but not for another one. The firm's policy should specify how it will deal with such situations. Here again, the firm should adopt the most prudent approach by taking into account the information on the person with the least knowledge and experience, the weakest financial situation or the most conservative investment objectives. Alternatively, the firm's policy may also specify that it will not be able to provide investment advice or portfolio management services in such a situation. In this context, it should be noted that collecting information on all the parties within the group and considering, for the purposes of the assessment, an average profile of the level of knowledge and competence of all of them, would unlikely be compliant with the MiFID II overarching principle of acting in the clients' best interests.

Q6: Do you agree with the suggested approach to conduct the suitability assessment for a group of clients, especially where no legal representative is foreseen under applicable national laws? Please also state the reasons for your answer (GL6).

The obligation to establish documentation and traceability of certain information provided for in point 59 is disproportionate in terms of the tools used to achieve the purpose. This purpose could be achieved through the firm's obligation to perform an annual review of the client's situation, as required by the Directive.

Furthermore, FBF is of the opinion that the point 65 should be removed since we cannot assess any practical application of this guideline.

Arrangements necessary to understand investment products

Relevant legislation: Articles 16(2) and 25(2) of MiFID II, and Article 54(9) of the MiFID II Delegated Regulation.

General guideline 7

68. Firms should ensure that the policies and procedures adopted to understand the characteristics, nature and features (including costs and risks) of investment products allow them to recommend suitable investments, or invest into suitable products on behalf of their clients.

Supporting guidelines

69. Firms shall understand the investment products they are recommending or investing into on behalf of their clients. Firms should implement policies and procedures designed to ensure that they only recommend investments, or make investments on behalf of their clients, if the firm understands the characteristics of the investment product involved[38].

[38] In addition to this obligation, MiFID II also requires firms (under subparagraph 2 of Article 24(2)) to '*understand the financial instruments they offer or recommend*' in order to be able to comply with their *ex-ante* obligation to ensure the compatibility between products offered or recommended and the related target market of end clients

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

71. Firms should also assess appropriately, through robust and objective procedures, the level of 'complexity' of products, which should be matched with the characteristics or profile attributed to the client (in particular their knowledge and experience). Although complexity is a relative term, which depends on several factors, firms should also take into account the criteria and principles identified in MiFID II [40], when defining and appropriately graduating the level of complexity to be attributed to products for the purposes of the assessment of suitability. The more complex a product, the more detailed the information firms will have to collect with regard to the knowledge, experience, financial situation and investment objectives of the client.

72. Firms should adopt procedures to ensure that the information used to understand and correctly classify investment products included in their product offer is reliable, accurate, consistent and up-to-date (for example, firms should not solely rely on data providers). When adopting such procedures, firms should take into account the different characteristics and nature of the products considered (for example, more complex products with particular features may require more detailed processes and the use of multiple sources of information).

73. In addition, firms should review the information used so as to be able to reflect any relevant changes that may impact the product's classification. This is particularly important, taking into account the continuing evolution and growing speed of financial markets.

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

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[39] It is particularly important that the liquidity risk identified is not balanced out with other risk indicators (such as, for example, those adopted for the assessment of credit/counterparty risk and market risk). This is because the liquidity features of products should be compared with information on the client's willingness to hold the investment for a certain length of time, i.e. the so called 'holding period'

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

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

FBF is of the opinion that Guideline 7 should be deleted because those requirements are already fully addressed in (i) article 25(1) of Directive 2014/65/EU, (ii) article 9(5) and 10(7) of Chapter III of Commission delegated Directive 2017/593 and (iii) ESMA's guidelines with regard to Assessment of knowledge and competence and Product governance requirements (target market).

Furthermore, in point 71, ESMA uses the term "complexity" several times. It is important for ESMA to use the same definition of the term "complexity" as the Directive in its guidelines on the implementation of MiFID 2.

I.II MATCHING CLIENTS WITH SUITABLE PRODUCTS:

This entire section will require a certain period of time for development (see implementation period request in the introduction).

Arrangements necessary to ensure the suitability of an investment

Relevant legislation: Article 16(2) and 25(2) of MiFID II and Article 21 of the MiFID II Delegated Regulation.

General guideline 8

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

    (a) all available information about the client necessary to assess whether an investment is suitable, including the client's current portfolio of investments (and asset allocation within that portfolio);

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

Supporting guidelines

76. Firms are reminded that the suitability assessment is not limited to recommendations to buy a financial instrument. Every recommendation must be suitable, whether it is, for example, a recommendation to buy, hold or sell an instrument, or not to do so[42].

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

[42] See recital 87 of MiFID II Delegated Regulation as well as paragraph 31 of section IV of CESR, Understanding the definition of advice under MiFID, question and answers, 19 April 2010, CESR/10-293.

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

78. In this regard, the tools should be designed so that they take account of all the relevant specificities of each client or investment product. For example, tools that classify clients or investment products broadly would not be fit for purpose.

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

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

(b) the client has an adequate understanding of the relationship between risk and return, i.e. of the necessarily low remuneration of risk free assets, of the incidence of time horizon on this relationship and of the impact of costs on his investments;

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

(d) any personal recommendation or transaction entered into in the course of providing an investment advice or portfolio management service, where an illiquid product is involved, takes into account the length of time for which the client is prepared to hold the investment; and

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

80. When making a decision on the methodology to be adopted to conduct the suitability assessment, the firm should also take into account the type and characteristics of the services provided and, more in general, its business model. For example, where a firm manages a portfolio or advises a client with regard to his portfolio, it should adopt a methodology that would allow it to conduct a suitability assessment based on the consideration of the client's portfolio as a whole.

81. When a firm conducts a suitability assessment based on the consideration of the client's portfolio as a whole, this means that, on the one hand, the knowledge and experience of the client[43] should be assessed regarding each investment product and risks involved in the related transaction; on the other hand, with regard to the client's financial situation and investment objectives, the suitability assessment about the impact of the product and transaction can be done at the level of the client's portfolio.

82. When advising on the whole portfolio of the client or when providing portfolio management, firms should ensure an appropriate degree of diversification within the client's portfolio, taking into account the client's portfolio exposure to the different financial risks

(geographical exposure, currency exposure, asset class exposure, etc.). In cases where, from the firm's perspective, the size of a client's portfolio is too small to allow for an effective diversification in terms of credit risk, the firm should consider directing those clients towards types of investments that are 'secured' or per se diversified (such as, for example, UCITS).

83. In this context, firms should be especially prudent regarding credit risk: exposure of the client's portfolio to one single issuer or to issuers part of the same group should be considered as an additional risk. This is because, if a client's portfolio is concentrated in products issued by one single entity (or entities of the same group), in case of default of that entity, the client may lose up to his entire investment. When operating through so called self-placement models, firms are reminded of ESMA's 2016 Statement on BRRD[44] according to which "*they should avoid an excessive concentration of investments in financial instruments subject to the resolution regime issued by the firm itself or by entities of the same group*".

84. Therefore, in addition to the methodologies to be implemented for the assessment of products credit risk (see guideline 7), firms should also adopt *ad hoc* measures and

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

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

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

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

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

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

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

- have in place adequate resources, including human and technological resources, to monitor and supervise the performance of algorithms through an adequate and timely review of the advice provided; and

- have in place an appropriate internal sign-off process to ensure that the steps above have been followed.

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[45] To this end, in line with the mentioned ESMA's Statement, firms should also take into account the specific features of the securities offered (including their risk features and the circumstances of the issuer) as well as clients' financial situation, including their ability to bear losses, and their investment objectives, including their risk profile.

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

- The questionnaire eliciting sufficient information to allow the firm to conclude that the advice provided is suitable for the client;
- The prevention and detection of, and response to, cybersecurity threats;
- The protection of client accounts;
- The use of social and other forms of electronic media in connection with the marketing of the robo-advice services provided (e.g., websites; Twitter; remuneration of bloggers to publicise services; "refer-a-friend" programs).

Q8: Do you agree with the additional guidance provided with regard to the arrangements necessary to ensure the suitability of an investment? Please also state the reasons for your answer.

The proposed guidelines will require significant special-purpose IT developments for their implementation. Banks will need time to complete and test these developments.

These elements further prove, if further proof were needed, that a reasonable period of time is needed for professionals to implement these guidelines.

Furthermore, regarding paragraph 78:

A reference is made to tools. We understand that the assumption made in this paragraph only involves the business model in which the client deals with a robot adviser and not the one where a human adviser is involved in addition of the robot adviser.

The tools already developed or currently under development that will need to be used for this type of system take the client's specific characteristics into account as well as the specific characteristics of products, matching clients and products based on key parameters included in the ESMA guidelines on product governance related to the suitability assessment.

Also, the word "all" in the first sentence of paragraph 78, i.e. "all relevant specificities of each client or investment product", should be removed. The recommendation will depend on the quality of the information provided by the client to the ISP, as well as the information provided by the manufacturer. The ISP can only take these specific characteristics into consideration.

We recommend the following wording:
*"In this regard, the tools should be designed so that they take account of ~~**all**~~ the relevant specificities of each client or investment product. For example, for tools that classify clients or investment products broadly, distributors should assess the relevant specificities of each client or investment product".*

Finally, in paragraph 83, FBF is of the view that the way paragraph 83 is drafted could challenge investment firms operating in closed architecture business model. We think that the drafting of this paragraph should be amended to remove any doubt regarding the possibility to maintain this business model since this is a possibility expressly envisaged in level 2 regulation (non-independent/restricted investment advice). Moreover it should be clarified that UCITS do not fall within the scope of the BRRD.

The ESMA guideline does not take into account the fact that UCITS/AIFM funds and structured deposits are already subject to specific rules (particularly prudential rules) related to credit risk. As a result, this guideline should be limited to conventional issuers (issuers of stocks and bonds) and not involve UCITS or AIFM products, which should be excluded.

Costs and complexity of equivalent products

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

General guideline 9

87. Suitability policies and procedures should ensure that, before a firm makes a decision on the investment product(s) that will be recommended, or invested in the portfolio managed on behalf of the client, a thorough assessment of the possible investment alternatives is undertaken, taking into account products' cost and complexity.

Supporting guidelines

88. Firms should have a process in place to assess products available that are broadly 'equivalent' to each other in terms of ability to meet the client's needs and circumstances, such as financial instruments with similar target markets and similar risk-return profile.

89. When considering the cost factor, firms should take into account all costs and charges covered by the relevant provisions under Article 24(4) of MiFID II and the related MiFID II Delegated Regulation provisions. As for the complexity, firms should refer to the criteria identified in the above guideline 7. For firms with a restricted range of products, or those recommending one type of product, where the assessment of 'equivalent' products could be limited, it is important that clients are made fully aware of such circumstances. In this context, it is particularly important that clients are provided appropriate information on how restricted the range of products offered is, pursuant to Article 24(4)(a)(ii) of MiFID II[46].

[46] In accordance with MiFID II, firms are therefore not expected to consider the whole universe of possible investment options existing in the market in order to comply with the requirement under Article 54(9) of MiFID II Delegated Regulation.

90. Where a firm uses common portfolio strategies or model investment propositions that apply to different clients with the same investment profile (as determined by the firm), the assessment of cost and complexity for 'equivalent' products could be done on a higher level, centrally, (for example within an investment committee or any other committee defining common portfolio strategies or model investment propositions) although a firm will still need to ensure that the selected investment products are suitable and meet their clients' profile on a client-by-client basis.

91. Firms should be able to justify those situations where a more costly or complex product is recommended over an equivalent product, taking into account that for the selection process of products in the context of investment advice or portfolio management further criteria can also be considered (for example: the portfolio's diversification, liquidity, or risk level). When providing investment advice, a clear explanation of the reasons for recommending a more costly or complex product should be included in the suitability report the firm has to provide to the client before the transaction is made.

Q9: Do you agree with the suggested approach for ensuring that firms assess, while taking into account costs and complexity, whether equivalent products can meet their clients' profile? Please also state the reasons for your answers.

Firms obligation is to recommend the appropriate product.

FBF is of the opinion that this requirement goes further than the requirements stated in article 54(11) of the Delegated Regulation 2017/565 which states that the Investment firm must be "reasonably able to demonstrate that the benefits of switching are greater than the costs". This article does not contain any obligation to include any demonstration within the suitability report.

This analysis is further corroborated by article 54(12) of the Delegated Regulation which details the content of the elements which must be mentioned in the suitability report. This list does not capture the demonstration than the benefits of the switch are greater than the costs. Therefore, the requirement stated in paragraph 91 must be removed.

Furthermore, the relevant professionals have to implement the product governance obligations provided for by MiFID 2, which are similar to those referred to in GL9. We question the relationship between the different provisions in two separate texts.

This situation creates confusion between the scope covered by product governance obligations and the obligations stemming from this guideline. In addition, as underscored in point 96, Investment Committees are supposed to meet this guideline through the product approach adopted.

Similarly, the wording of paragraph 88 should be clarified by adding "in the same asset category", to prevent Firms from having to compare completely different products.

Suggested wording:
"Firms should have a process in place to assess products available ***in the same asset category***

that are broadly 'equivalent' to each other in terms of ability to meet the client's needs and circumstances, such as financial instruments with similar target markets and similar risk-return profile."

For these reasons, Guide Line 9 should be deleted.

Costs and benefits of switching investments

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

General guideline 10

92. Firms should have adequate policies and procedures in place to ensure that an analysis of the costs and benefits of a switch is undertaken such that firms are reasonably able to demonstrate that the expected benefits of switching are greater than the costs. Firms should also establish appropriate and proportionate controls to avoid any circumvention of the relevant MiFID II requirements.

Supporting guidelines

93. Firms should take all necessary information into account, so as to be able to conduct a cost-benefit analysis of the switch, i.e. an assessment of the advantages and disadvantages of the new investment(s) considered. When considering the cost dimension, firms should take into account all costs and charges covered by the relevant provisions under Article 24(4) of MiFID II and the related MiFID II Delegated Regulation provisions. In this context, both monetary and non-monetary factors of costs and benefits could be relevant. These may include, for example:

    - the potential net return of the proposed alternative transaction (which also considers any possible up-front cost to be paid by the client(s)) vs the potential net return of the existing investment (that should also consider any exit cost which the client(s) might incur to divest from the product already in his/their portfolio);

    - a change in the client's circumstances and needs, which may be the reason for considering the switch, e.g. the need for liquidity in the short term as a consequence of an unexpected and unplanned family event;

    - a change in the products' features and/or market circumstances, which may be a reason for considering a switch in the client(s) portfolio(s), e.g. if a product becomes illiquid due to market trends;

    - benefits to the client's portfolio stemming from the switch, such as (i) an increase in the portfolio diversification (by geographical area, type of instrument, type of issuer, etc.); (ii) an increased alignment of the portfolio's risk profile with the client's risk objectives; (iii) an increase in the portfolio's liquidity; or (iv) a decrease of the overall credit risk of the portfolio;

94. When providing investment advice, a clear explanation of the reasons why the benefits of the recommended switch are greater than its costs should be included in the suitability report the firm has to provide to the client before the transaction is made.

95. Firms should also adopt systems and controls to monitor the risk of circumventing the obligation to assess costs and benefits of recommended switch, for example in situations where an advice to sell a product is followed by an advice to buy another product at a later stage (e.g. days later), but the two transactions were in fact strictly related from the beginning.

96. Where a firm uses common portfolio strategies or model investment propositions that apply to different clients with the same investment profile (as determined by the firm), the costs/benefits analysis of a switch could be done on a higher level than at the level of each individual client. More especially, when a switch is decided centrally, for example within an investment committee or any other committee defining common portfolio strategies or model investment propositions, the costs/benefits analysis could be done at the level of that committee. Indeed, if such a switch is decided centrally, the costs/benefits analysis done at that level would usually be applicable to all comparable client portfolios without making an assessment for each individual client. In such a situation also, the firm could determine, at the level of the relevant committee, the reason why a switch decided will not be performed for certain clients. Although the costs/benefits analysis could be done at a higher level in such situations, the firm should nevertheless have appropriate controls in place to check that there are no particular characteristics of certain clients that might require a more discrete level of analysis.

97. Where a portfolio manager has agreed a more bespoke mandate and investment strategy with a client due to the client's specific investment needs, a cost-benefit analysis of the switch at client-level should be more appropriate, in contrast to the above.

98. Notwithstanding the above, if a portfolio manager considers that the composition or parameters of a portfolio should be changed in a way that is not permitted by the mandate agreed with the client (e.g. from an equities-focused to a fixed income-focused strategy), the portfolio manager should to discuss this with the client and review or conduct a new suitability assessment to agree a new mandate.

Q10: Do you agree with the suggested approach for conducting a cost-benefit analysis of switching investments in the context of portfolio management or investment advice? Please also state the reasons for your answer.

The FBF agrees with ESMA's overall approach.

In particular, it welcomes the inclusion of the following elements for the purpose of the cost-benefit analysis of switching investments:

- *monetary and non-monetary factors;*
- *the possibility of conducting the analysis using a portfolio-based approach;*
- *the distinctive features of tailored contracts.*

Nevertheless, considering the obligation stated in paragraph 94 for ISPs to include in the suitability report the reasons justifying the proposed switch to a more expensive or more complex product, the FBF finds that ESMA goes beyond the bounds of Level 1 and 2 texts.

The MiFID directive recommends verifying the opportunity for switching investments in relation to the client's interests. ESMA cannot validly add this new obligation for ISPs in these guidelines.

In our view, therefore, the requirement in paragraph 94 has no legal basis and should be deleted.

Where applicable, the ISP should be capable of justifying the reasons leading to the proposed switch.

The FBF draws ESMA's attention to the new developments that will be necessary to implement this new obligation, which will take time.

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I.III OTHER RELATED REQUIREMENTS

Qualifications of firm staff

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

General guideline 11

99. Firms are required to ensure that staff involved in material aspects of the suitability process have an adequate level of skills, knowledge and expertise.

Supporting guidelines

100. Staff must understand the role they play in the suitability assessment process and possess the skills, knowledge and expertise necessary, including sufficient knowledge of the relevant regulatory requirements and procedures, to discharge their responsibilities.

101. Staff giving investment advice or information about financial instruments, structured deposits, investment services or ancillary services to clients on behalf of the firm (including when providing portfolio management) must possess the necessary knowledge and competence required under Article 25(1) of MiFID II (and specified further in ESMA Guidelines for the assessment of knowledge and competence[47]), including with regard to the suitability assessment.

102. Other staff that does not directly face clients (and therefore is not subject to the new provisions mentioned in paragraph 97) but is involved in the suitability assessment in any other way must still possess the necessary skills, knowledge and expertise required depending on their particular role in the suitability process[48]. This may regard, for example, setting up the questionnaires, defining algorithms governing the assessment of suitability or other aspects necessary to conduct the suitability assessment and controlling compliance with the suitability requirements.

103. Where relevant, when employing automated tools (including hybrid tools), investment firms should ensure that their staff involved in the activities related to the definition of these tools:

(a) have an appropriate understanding of the technology and algorithms used to provide digital advice (particularly they are able to understand the rationale, risks and rules behind the algorithms underpinning the digital advice); and

(b) are able to understand and review the digital/automated advice generated by the algorithms.

Q11: Do you believe that further guidance would be needed with regard to the skills, knowledge and expertise that should be possessed by staff not directly facing clients, but still involved in other aspects of the suitability assessment? Please also state the reasons for your answer.

The FBF has no comment on the points raised, which are sufficient in its view. It does not wish to see additional guidelines.

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

[48] ESMA notes that some Member States require certification of staff providing investment advice and/or portfolio management, or equivalent systems, to ensure a proper level of knowledge and expertise of staff involved in material aspects of the suitability process.

Record-keeping

Relevant legislation: Articles 16(6), 25(5) and 25(6) of MiFID II, and Articles 72, 73, 74 and 75 of the MiFID II Delegated Regulation.

General guideline 12

104. Firms should at least:

(a) maintain adequate recording and retention arrangements to ensure orderly and transparent record-keeping regarding the suitability assessment, including the collection of information from the client, any investment advice provided and all investments (and disinvestments) made, and the related suitability reports provided to the client;

(b) ensure that record-keeping arrangements are designed to enable the detection of failures regarding the suitability assessment (such as mis-selling);

(c) ensure that records kept, including the suitability reports provided to clients, are accessible for the relevant persons in the firm, and for competent authorities;

(d) have adequate processes to mitigate any shortcomings or limitations of the record-keeping arrangements.

Supporting guidelines

105. Record-keeping arrangements adopted by firms must be designed to enable firms to track ex-post why an investment was made. This could be important in the event of a dispute between a client and the firm. It is also important for control purposes - for example, any failures in record-keeping may hamper a competent authority's assessment of the quality of a firm's suitability process, and may weaken the ability of management information to identify risks of mis-selling.

106. Therefore, a firm is required to record all relevant information about the suitability assessment, such as information about the client (including how that information is used and interpreted to define the client's risk profile), and information about financial instruments recommended to the client or purchased on the client's behalf, as well as the suitability report provided to clients. Those records should include:

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

(b) the types of financial instruments that fit that profile and the rationale for such an assessment, as well as any changes and the reasons for them.

107. Firms should have in place policies and procedures that could appropriately ensure the business continuity, the backup and the functioning of disaster recovery plans covering

any systems that support the delivery of digital advice to clients.

108. Firms should understand the additional risks that could affect the provision of investment services through online/digital tools such as malicious cyber activity and should have in place arrangements able to mitigate those risks.

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

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

No comment.

Q13: What level of resources (financial and other) would be required to implement and comply with the Guidelines (market researches, organisational, IT costs, training costs, staff costs, etc., differentiated between one off and ongoing costs)? When answering this question, please also provide information about the size, internal organisation and the nature, scale and complexity of the activities of your institution, where relevant.

The implementation of MiFID 2 and these guidelines will have very substantial impacts on procedures governing the distribution of financial products, given the resulting need to adapt information systems and to inform, assist and train branches and the relevant operational teams for the respect of these new rules .

Given the high stakes involve, it is critical for implementing texts and guidelines to be stabilised. Any new obligation in these guidelines relative to Level 1 and 2 texts already published should be eliminated or postponed, given the implementation date of MiFID 2, and in particular those with impacts on existing documentation.