

# MiFID Suitability – Common Supervisory Action

The Suitability requirements were introduced in MiFID I, and expanded on in MiFID II, and are a cornerstone of investor protection.

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**M**iFID Suitability requirements ensure that investment firms providing investment advice or portfolio management have to provide suitable personal recommendations to their clients or must make suitable investment decisions on behalf of their clients.

Where a firm is providing these services, they must complete a suitability assessment, which involves obtaining information necessary to enable the investment firm to recommend to the client or potential client those investment services and financial instruments that are suitable for the client and, in particular, are in accordance with his or her risk tolerance and ability to bear losses. This includes:

1) Obtaining sufficient evidence that the client possesses sufficient knowledge and experience in the investment field relevant to the product/service being offered;

2) Gathering information on the client's financial situation, including their ability to bear losses; and  
3) Understanding the client's investment objectives, including their risk tolerance.

MiFID II added additional considerations in relation to completing cost benefit analysis when recommending switching of financial instruments to clients, enhanced suitability reporting and record keeping requirements.

In December 2021, the Central Bank of Ireland (CBI) published a 'Dear CEO' letter outlining their findings from the Common Supervisory Action (CSA) that was undertaken in credit institutions and MiFID investment firms across the European Economic Area (EEA). The CBI advised that the letter should be read in conjunction with the ESMA public statement outlining the results of the CSA. Many of the findings identified align with the ESMA findings.

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The main findings were:

### Firms must adopt a client-focused approach

The CBI observed an absence of a personalised, comprehensive and client-focused approach to suitability, prioritising positive client outcomes. Poor practices observed were inadequate training frameworks, poor reporting and disclosures to clients, and a failure to establish clear procedures for the identification of potentially vulnerable clients.

### Firms must improve their assessment of clients' knowledge and experience, financial situation and investment objectives

Firms are recommended to improve their assessment of clients' knowledge and experience, financial situation and investment objectives, collecting all necessary information to recommend products/services that are suitable. Firms were reminded to consider all relevant information in their assessment, and not solely focus on client's risk tolerance, ensuring that there are clear procedures in place for calculating client's capacity for loss.

Firms were reminded that where digital channels are used in the suitability assessment, it must ensure that the requirements are adhered to.

Shortcomings were evident in poor record keeping, and retention of evidence, how the suitability assessment was conducted and how information was used to inform the recommendation.

### Suitability reports need to be sufficiently detailed and personalised

The Suitability Report should be a personalised document that enables the investor to understand how and why a product has been deemed suitable for them, based on their individual circumstances.

The review found instances where Suitability Reports were not sufficiently detailed or personalised, with information on the client's financial situation sometimes missing or limited and relied on automated templates and standardised wording that provides little value to clients.

As outlined in the ESMA findings, firms must reassess their suitability report to ensure they are avoiding a generic, 'tick-box' approach.

“Firms must have documented processes in place which demonstrate the transaction was initiated by the client.”

## Controls on ‘Exception’ processes need to be stricter

The CBI expressed concern at the quality of oversight of ‘exception’ processes, should clients insist on proceeding with the transaction at their own initiative and against the firm’s suitability advice.

Firms must have documented processes in place which demonstrate the transaction was initiated by the client and the review found instances where there was inadequate rationale or records to support this.

Firms also failed to demonstrate that they have effective training or oversight procedures in place to ensure sales advisors are not unduly influencing clients to avail of these exceptions and invest in unsuitable products. Several additional ESMA findings:

- ESMA recommended in 2018, that firms should build client sustainability preferences into the Suitability assessment. This was not evident in the majority of cases.
- Inadequate product classification, with firms treating all products in a given group as equivalent, even if costs and complexity are different.
- A lack of a common interpretation of “switching” or use of a narrow definition which could increase the risk of circumventing the MiFID II requirements.

### Next steps:

The CBI require firms under their

supervision, providing investment advice and/or portfolio management to retail clients to perform a thorough review of sales practices and suitability arrangements. The review must be completed against the CBI and ESMA findings and details of any actions taken to address the findings must be documented. This assessment and action plan must be discussed and approved by the Board of each firm by end Q1 2022.

Compliance Officers should familiarise themselves with the findings highlighted in both documents and, when the Business have concluded the mandated review, should complete second line check and challenge against the outcomes identified. Evidence of Compliance challenge and interaction in relation to the review should be documented and agreed actions to address challenges raised should be reported to the Board and tracked through appropriate governance forums to completion.

As part of proposed remediation, Compliance should work with the Business to provide advice/support in relation to the revision of procedures/processes, methods for compiling suitability letters, etc. as per the standard review processes.

Compliance may also wish to support their business areas in respect of future regulation in this regard. On 27 January 2022, ESMA published a consultation paper in relation to their proposed Guidelines on certain aspects of the MiFID II suitability requirements.

The main topics covered are:

- **Collection of information from clients on sustainability preferences** – Firms will need to collect information from client’s on their preferences in relation to the different types of sustainable investment products and to what extent they want to invest in these products;
- **Assessment of sustainability preferences** – Once the firm has identified a range of suitable products for client’s, in accordance with the criteria of knowledge and experience, financial situation and other investment objectives, it shall identify - in a second step - the product(s) that fulfil the client’s sustainability preferences; and
- **Organisational requirements** – Firms will need to give staff appropriate training on sustainability topics and keep appropriate records of the sustainability preferences of the client (if any) and any updates of these preferences.

The review of this set of guidelines is also the opportunity to consider other relevant factors such as:

- the integration of the good and poor practices identified in the CSA to complement the current guidelines. These good and poor practices give practical guidance to firms in the areas where lack of convergence was observed; and
- the amendments introduced through the Capital Markets Recovery Package to Article 25(2) of MiFID II.

The consultation closes on 27 April 2022 and the expectation is that final Guidelines will be published in Q3 2022.