MiFID II
Suitability

Key Points

• A specific requirement to take the client’s ability to bear losses and risk tolerance into account when assessing suitability will be introduced

• The MiFID Implementing Directive will be clarified to ensure that firms meet their suitability obligations as intended, including to act in the client’s best interest, to gather reliable information, to ensure suitability when recommending a sell/hold action, and to ensure that automated systems do not diminish a firm’s responsibility

• Firms will be required to provide additional information in suitability reports to clients
**Background**

Article 19(4) of the MiFID I Directive contains high level obligations requiring firms to obtain necessary information from clients before assessing the suitability of an investment for a client. This applies when a firm makes a personal recommendation or a decision to deal on a discretionary basis. Under MiFID I, further detailed provisions are contained in Article 37 of the MiFID Implementing Directive.

The high level obligations in MiFID I will be changed to some extent by the MiFID II Directive. The more detailed requirements of the MiFID Implementing Directive will also be supplemented and amended as set out in the ESMA Technical Advice.¹ This will lead to a number of additional specific requirements for investment firms.

Most of these updates are in the nature of "clarifications" rather than new requirements.²

The main changes being introduced by MiFID II are set out below.

**Risk tolerance, ability to bear losses and bundled products**

The existing wording at Article 19(4) of the MiFID I Directive will be updated to emphasise the need to ensure that suitability is assessed by reference to the client's "risk tolerance and ability to bear losses" and to ensure that, where a package of bundled investment services or products is recommended, that the overall bundle is suitable.

**Client’s best interests**

Firms will be required to notify clients that the purpose of the suitability assessment is to enable the firm to act in the client's best interest, and must not create any ambiguity about the fact that responsibility for suitability rests with the firm.

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¹ ESMA, Final Report: Technical Advice to the Commission on MiFID II and MiFIR, 19 December 2014 (ESMA/2014/1569) (the "Technical Advice")

² In our view, these changes are already broadly in line with what the United Kingdom’s FCA will generally expect of UK firms where they assess suitability

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**Recommendations to hold/sell**

Whereas currently, the MiFID Implementing Directive imposes suitability requirements when recommending that a client buys an investment under MiFID II, suitability obligations also apply when recommending a client to hold or sell the investment.³

**Understanding of relevant instruments and alternatives**

Firms will be required to have the necessary understanding of instruments selected for clients. Firms will need to assess, taking cost and complexity into account, whether equivalent financial instruments would meet the client's needs. Firms will be required to put policies and procedures in place to ensure they meet these requirements.

**Restricted advice**

Where a firm advises only on a limited range of instruments, it must not make a recommendation where none of those instruments are suitable.⁴

**Switching**

Before recommending a course of action that will involve switching investments, a firm must collect necessary information on the existing investments and undertake a cost/benefit analysis to ensure that the benefits of switching outweigh the costs before recommending the switch.

**Ongoing advice**

Where a firm provides ongoing advice it must maintain adequate and up-to-date information about the client in order to assess the continuing suitability of such advice.

**Information in context of service**

A firm's determination of what information is required from the client to make a suitability assessment shall be

³ This mirrors what is already the UK FCA’s position on what constitutes investment advice generally.

⁴ This mirrors the FCA’s current position where firms give limited advice.
made in light of all the features of the services to be provided.

Collection of reliable information

Firms must take reasonable steps to ensure that information collected from clients is reliable including:

• ensuring that clients are aware of the need to provide accurate up-to-date information;

• undertaking valid and reliable assessments of the client's knowledge, experience and risk tolerance;

• ensuring that tools used to assess suitability are fit for purpose;

• ensuring that questions asked are understood by clients; and

• taking steps to ensure the consistency of client information and considering whether responses are obviously inaccurate.

Multiple client entities

Where a single client relationship comprises multiple entities (such as a married couple) the firm must apply the relevant legal framework to identify who should be subject to the suitability assessment. Where the framework is unclear, the firm should put a policy in place and agree with the client who will be the subject of the assessment and how the assessment will be carried out in practice.

Small entities

When assessing suitability for a small non-natural entity (such as a small corporation or trust), a firm must take into account the knowledge and experience of the individual who represents that entity and is authorised to carry out transactions (for example the relevant trustee or company director of a small company or trust).

Automated systems

MiFID II clarifies that where a firm used an automated system to provide web-based advice or portfolio with agreement services.

Suitability reports

Suitability reports will need to include:

• an outline of the advice given;

• an explanation of why the recommendation is suitable, including how it meets the client's objectives and personal circumstances with reference to investment term, attitude to risk and capacity for loss;

• a statement bringing to the client's attention the need for periodic review of suitability (where relevant); and

• that a periodic report may be in the form of an update to and refer to a previous suitability report.

Timescales for implementation

The MiFID II Directive and the Markets in Financial Instruments Regulation ("MiFIR") came into force on 3 July 2014, and most of their provisions will come into effect in member states from 3 January 2017. Member states have until July 2016 to transpose the MiFID II Directive into national law.

The changes to the MiFID Implementing Directive will be made by the Commission as delegated acts that will become effective by 3 January 2017. The member states will need to implement these changes into national law.