

FINANCIAL REGULATION

ESMA Guidelines on certain aspects of the MiFID II suitability requirements now applicable

ESMA's new [Guidelines on certain aspects of the MiFID II suitability requirements](#) came into effect on 3 October 2023.

The purpose of the new Guidelines is to clarify certain aspects of the suitability requirements under Article 25 of [Directive 2014/65/EU \(MiFID II\)](#) and Articles 54 and 55 of [Commission Delegated Regulation \(EU\) 2017/565 \(MiFID II Delegated Regulation\)](#) to ensure uniform and consistent application of the requirements.

8 MIN READ

Background

On 2 August 2021, [Commission Delegated Regulation \(EU\) 2021/1253](#) was published, which amended the existing MiFID II Delegated Regulation.

New provisions were introduced on integrating sustainability factors, risks and preferences into certain organisational requirements and operating conditions for investment firms, credit institutions, and AIFMs and UCITS management companies with relevant MiFID II 'top up' permissions (together called **firms** in this note), including in respect of suitability assessments. Those new measures have applied from 2 August 2022.

The MiFID II Delegated Regulation was amended to require firms to:

- provide information to clients about the suitability assessment
- collect client information preferences in relation to different types of sustainable investment products and the extent to which they want to invest in those product types
- identify a range of products for a client that fulfils their sustainability preferences
- give staff appropriate training on sustainability preferences
- keep appropriate records of the client's sustainability preferences, along with any updates of these

As a result of the above amendments, on 27 January 2022, ESMA launched a [consultation](#) on changes to its Guidelines on certain aspects of the MiFID II suitability requirements. Following consultation, ESMA published its [final report](#) on the new guidelines on 23 September 2022.

The Guidelines

On 3 April 2023, ESMA formally published the new [Guidelines](#), which have applied from 3 October 2023.

The Guidelines may be used by firms as a guide for ensuring compliance with the new requirements in the MiFID II Delegated Regulation.

We have summarised the Guidelines' key points below.

Information to Clients about the Purpose of the Suitability Assessment and its Scope

The Guidelines provide that firms should inform their clients about the suitability assessment and its purpose in a clear and simple manner in order for clients to understand the reasons why they are asked to provide certain information. This should also include a clear explanation of the importance of keeping such information up-to-date, accurate and complete. While the Guidelines do not prescribe a set format for informing clients about the suitability assessment, it advises that the format enable controls to check if the required information has been provided.

In order to help clients understand the concept of “sustainability preferences” introduced under Article 2(7) of the MiFID II Delegated Regulation, and the choices to be made, firms should explain in a clear manner, avoiding technical language, the terms and the distinctions between the different elements of the definition and also between those products and products without such sustainability features.

Arrangements necessary to understand clients

The Guidelines provide that firms should establish and maintain adequate policies, procedures and tools for the collection and assessment of information necessary to conduct a suitability assessment for each client.

The Guidelines do not prescribe a method for collecting the necessary information. However, when designing the method of collection, firms should ensure that questions and information requests are specific and clear and consider the possible reasons a client may not answer a question correctly.

When determining what information is necessary to conduct a suitability assessment, firms should keep in mind the impact that any significant change in respect of that information could have on the suitability assessment. In this regard, the Guidelines provide a list of examples of information that may affect the analysis of the client's financial situation or investment objectives: marital status, dependents, age, employment situation, need to fund a future financial investment and need for liquidity in certain investments.

The information on clients' sustainability preferences should include all aspects mentioned in the definition of “sustainability preferences” in Article 2(7) of the MiFID II Delegated Regulation and should be sufficiently granular to allow for a matching of the client's sustainability preferences with the sustainability-related features of the financial instruments offered by the firm. The Guidelines set out the steps that firms should take to achieve this in a neutral and unbiased manner so as not to influence clients.

Proportionality of information to be collected from clients

The Guidelines provide guidance to assist firms in determining what information is “necessary” to conduct a suitability assessment. In this regard, the Guidelines explain in further detail the factors that should be considered in respect of:

- the characteristics and complexity of, and level of risk posed by, the financial instrument or transaction
- the nature and extent of the service
- the needs and circumstances of the client
- the type of client

Reliability of client information

Firms should take reasonable steps and have appropriate tools to check that the information collected about their clients is reliable, accurate and consistent.

Where firms rely on tools to be used by clients as part of the suitability process (such as questionnaires or risk-profiling software), they should have appropriate systems and controls to ensure that the tools are fit for purpose and produce satisfactory results. Furthermore, reasonable steps should be taken to mitigate potential risks associated with the use of such tools.

Clients' self-assessments should be counterbalanced by objective criteria and the Guidelines provide a list of example questions to assist firms in this regard. The Guidelines also state that firms should adopt mechanisms to address the risk that clients may tend to overestimate their knowledge and experience, for example, by including questions that would help firms assess the overall clients' understanding about the characteristics and the risks of the different types of financial instruments.

Client information for legal entities or groups

Firms must have a policy that defines, 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 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 clearly inform, ex-ante, those clients about who should be subject to the suitability assessment, how the suitability assessment will be done in practice and the possible impact this could have for the relevant clients.

Arrangements necessary to understand investment products

In addition to adopting policies and procedures to understand the characteristics, nature, complexity and features of investment products to allow firms to recommend suitable investments to clients, firms should also adopt robust and objective procedures, methodologies and tools

that allow them to appropriately consider the different characteristics, including sustainability factors, and relevant risk factors of each investment product they may recommend or invest in on behalf of clients.

Considering the level of 'complexity' of products is particularly important, and this should be matched with a client's information (in particular regarding their knowledge and experience). The Guidelines state that although complexity is a relative term, which depends on several factors, firms should take into account the criteria and principles identified in MiFID II when defining and appropriately graduating the level of complexity to be attributed to products for the purposes of the suitability assessment.

When considering products' sustainability factors, the Guidelines suggest that firms could rank and group the financial instruments that they offer in terms of the proportion invested in economic activities that qualify as environmentally sustainable, the proportion of sustainable investments and the consideration of principal adverse impacts and other ESG sustainability features. Such grouping should also be consistent

with the firm's analysis conducted for the purposes of product governance obligations.

Arrangements necessary to ensure the suitability of an investment

Firms should establish policies and procedures to match clients with suitable investments. To ensure this, the Guidelines outline that the policies should consider all available information about the client necessary to assess whether an investment is suitable (including the client's current portfolio of investments) and all relevant investment characteristics (e.g. relevant risks and direct/indirect costs to the client).

The Guidelines provide that if a firm uses tools in the suitability assessment, they should have appropriate systems and controls to ensure these tools are fit for purpose. The tools should be designed to take into account all relevant specificities of each client or the investment product.

The Guidelines also consider the approach firms should take in regard to the sustainability preferences of clients. According to the guidelines, firms should only address sustainability preferences

once the suitability has been assessed in accordance with the criteria of knowledge and experience, financial situation and other investment objectives. Once the range of suitable products has been identified following this assessment, the product or investment strategy that fulfils the client's sustainability preferences should be identified.

Where a firm intends to recommend a product that does not meet the initial sustainability preferences of the client it can only do so once the client has adapted their sustainability preferences. The firm's explanation regarding the reason to resort to such option, as well as the client's decision to adapt their sustainability preferences, should be documented in the suitability report. Where a client adapts the sustainability preferences, this adaptation should only refer to the investment advice in question and not to the client's profile in general. The Guidelines also remind firms that this option only refers to the sustainability preferences and that, with regard to the other criteria of the suitability assessment, the product has to meet the client profile and otherwise cannot be recommended.

In case of portfolio management, the client's sustainability preferences, including the minimum proportion that shall be invested in investments with sustainability features, need to be collected and assessed when agreeing on the mandate and the investment strategy. If the firm cannot meet those preferences, it should discuss this with the client when agreeing on the mandate and ask the client if they would like to adapt their preferences. The decision of the client should be recorded in the mandate.

The Guidelines also provide that suitability policies and procedures should ensure that, before a firm makes a decision on the investment products that will be recommended or invested in on behalf of the client, a thorough assessment of the possible investment alternatives is undertaken, taking into account the products' cost and complexity. A product's equivalence should be assessed 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.

Organisational requirements

The Guidelines provide that firms should ensure that staff involved in material aspects of the suitability process have an adequate level of skill, knowledge and expertise, including sufficient knowledge of the relevant regulatory requirements and procedures, to discharge their responsibilities. In this regard, firms should provide appropriate training, including in respect of sustainability preferences so to enable staff to explain the different aspects in non-technical terms.

Firms should also have in place adequate record-keeping and retention arrangements to ensure orderly and transparent record-keeping regarding all aspects of the suitability assessment and related decisions, including information regarding clients and sustainability preferences, any investment advice provided, any investments made following the suitability assessment and the related suitability reports provided to the client.

Next Steps

ESMA announced, on 3 October, that it will launch a Common Supervisory Action (CSA) with the national competent authorities on the integration of sustainability in firms' suitability assessment and product governance processes and procedures in 2024. The stated goal of the CSA is to assess the progress made by intermediaries in the application of the key sustainability requirements and will cover a range of aspects including:

- how firms collect information on their clients' sustainability preferences
- the arrangements firms have in place to understand and categorise investment products with sustainability factors
- how firms ensure the suitability of an investment with respect to sustainability
- how firms specify any sustainability-related objectives a product is compatible with as part of the target market assessment of the investment product

Conclusion

ESMA expects the Guidelines to assist firms in their interpretation and application of MiFID II suitability requirements going forward. By emphasising the key issues and standards that firms should take account of, ESMA hopes to ensure a common, uniform and consistent application of the suitability requirements under MiFID II.

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