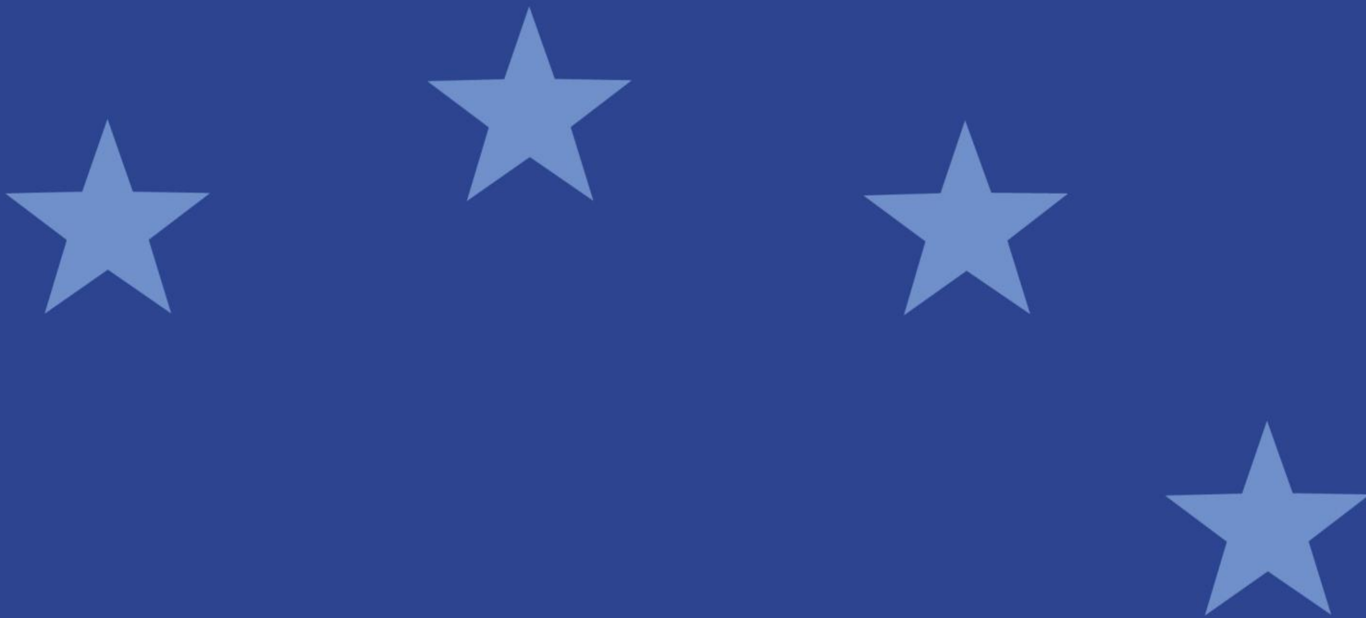
Final Report

Guidelines on certain aspects of the MiFID II appropriateness and execution-only requirements



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Acronyms and definitions used

CP	Consultation Paper
CSA	Common Supervisory Action
ESMA	European Securities and Markets Authority
ESMA Regulation	Regulation (EU) 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision 716/2009/EC and repealing Commission Decision 2009/77/EC
EU	European Union
GDPR	Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC
MiFID I	Markets in Financial Instruments Directive – Directive 2004/39/EC of the European Parliament and the Council
MiFID II	Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU
MiFID II Delegated Regulation	Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive
NCAs	National Competent Authorities
SMSG	Securities and Markets Stakeholder Group

1 Executive Summary

Reasons for publication

1. The MiFID II appropriateness and execution-only framework is an important element of investor protection in the case of the provision of services other than investment advice or portfolio management (''non-advised services''). It requires investment firms to ask a client for information on his/her knowledge and experience to assess whether the investment service or product envisaged is appropriate for him/her and to issue a warning in case the investment service or product is deemed inappropriate. The execution-only framework covers the exemption to this assessment, if certain conditions are met, including that the firm issues a warning to the client.

2. On 29 January 2021, ESMA published a Consultation Paper (CP) with proposed draft guidelines on certain aspects of the MIFID II appropriateness and execution-only requirements.

3. The consultation period closed on 29 April 2021. ESMA received 33 responses, 5 of which confidential. The responses received are available on ESMA's website unless respondents requested otherwise. In addition, ESMA also received the advice of the Securities and Markets Stakeholders Group (SMSG).

4. This paper summarises the responses to the CP and explains how the responses have been taken into account. ESMA recommends reading this report together with the CP published on 29 January 2021 to have a complete view of the rationale for the guidelines.

5. By pursuing the objective of ensuring a consistent and harmonised application of the appropriateness and execution-only requirements, the guidelines will make sure that the objectives of MiFID II can be efficiently achieved. ESMA believes that the implementation of these guidelines should strengthen investor protection – a key objective for ESMA.

Contents

6. Section 2 gives an overview of the Final Report.

7. Section 3 contains the Annexes: Annex I contains the cost-benefit analysis; Annex II summarises the opinion of the SMSG; Annex III contains the feedback statement; and Annex IV contains the full text of the final guidelines.

Next Steps

8. The Guidelines in Annex IV will be translated in the official EU languages and published on ESMA's website. The publication of the translations in all official

languages of the EU will trigger a two-month period during which NCAs must notify ESMA whether they comply or intend to comply with the Guidelines.

2 Overview

Background

9. The MiFID II appropriateness and execution-only framework is an important element of investor protection in the case of the provision of services other than investment advice or portfolio management (''non-advised services''). This framework is set out in Article 25(3) of MiFID II and in Articles 55 and 56 of the MiFID II Delegated Regulation (as regards the appropriateness requirement), as well as Article 25(4) of MiFID II and Article 57 of the MiFID II Delegated Regulation (as regards the 'execution-only' exemption).

10. When providing 'non-advised services', firms are required to ask the client or potential client to provide information regarding his/her knowledge and experience relevant to the specific type of product or service offered or demanded, so as to enable the firm to assess whether the envisaged investment service or product is appropriate for the client. Where the firm considers that the client does not have the necessary knowledge and experience to understand the risks involved in relation to the specific investment service or product offered or demanded, it shall warn the client accordingly. A warning is also required where a client or potential client does not provide the necessary information on his/her knowledge and experience, or where insufficient information is provided.

11. Articles 55 and 56 of the MiFID II Delegated Regulation further specify the information to be asked from clients and set out the record-keeping requirements.

12. Under certain conditions, detailed in Article 25(4) of MiFID II, firms are allowed to provide non-advised services with respect to non-complex investment products without the need to conduct an appropriateness assessment. In this case, the firm should warn the client that it is not required to conduct an appropriateness assessment and that s/he therefore does not benefit from the corresponding investor protection.

13. It should be noted that, while the described appropriateness and execution-only framework confirms the regime already applicable under MiFID I, some aspects of the requirements have been further strengthened in MiFID II. This is in particular the case for record-keeping obligations related to appropriateness and an improvement has been included regarding the conditions for the provision of services under the execution-only exemption.

Common Supervisory Action

14. In 2019, ESMA conducted the first common supervisory action (CSA) on the application of the MiFID II requirements on the appropriateness assessment. The 24 National Competent Authorities (NCAs) that participated in this CSA simultaneously carried out a review based on a sample of firms under their supervision.

15. For this review, ESMA developed a common methodology, which included a list of questions for firms taken from ESMA's supervisory briefing on appropriateness and

execution-only[1]. Each of the participating NCAs selected a sample of firms that was meaningful in terms of the firms providing non-advised services in their jurisdictions. The CSA focused on the following key sections relating to the appropriateness and execution-only requirements:

- Determining when the appropriateness assessment in needed
- Categorisation of financial instruments for the purpose of the appropriateness assessment
- Obtaining information from clients on their knowledge and experience
- Assessment of appropriateness
- Statistics
- Warnings to clients.

16. Importantly, this CSA showed there was a need for further convergence in the understanding and application of several areas of the appropriateness and execution-only requirements by firms in different Member States, and often within Member States themselves, creating problems for achieving a consistent level of investor protection in the EU. Therefore, ESMA decided to develop guidelines to enhance clarity and foster convergence in the application of certain aspects of the appropriateness and execution-only requirements.

Public consultation

17. On 29 January 2021, ESMA published a Consultation Paper (CP) on the draft guidelines on certain aspects of the MiFID II appropriateness and execution-only requirements in order to explain their rationale and gather input from stakeholders. The consultation period closed on 29 April 2021.

18. ESMA received 33 responses, 5 of which confidential. The answers received are available on ESMA's website unless respondents requested otherwise. In addition, ESMA also sought the advice of the Securities and Markets Stakeholders Group (SMSG).

Final report

19. This Final Report summarises and analyses the responses to the CP and explains how the responses, together with the SMSG advice, have been taken into account. ESMA recommends reading this report together with the CP published on 29 January 2021 to have a complete view of the rationale for the guidelines.

[1] ESMA Supervisory briefing Appropriateness and execution only (Ref: ESMA35-36-1640).

3 Annexes

Annex I

Summary of questions

Q1: Do you agree with the suggested approach on providing information about the purpose of the appropriateness assessment? Please also state the reasons for your answer.

Q2: Do you agree with the suggested approach on the arrangements necessary to understand or warn clients? Please also state the reasons for your answer.

Q3: Do you agree with the suggested approach on the extent of information to be collected from clients? Please also state the reasons for your answer.

Q4: Do you agree with the suggested approach regarding the appropriateness assessment relating to a service with specific features (paragraph 34 of the Guidelines)? In particular, do you agree with the examples provided (bundled services and short selling), or would you suggest including other examples? Please also state the reasons for your answer.

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

Q6: Do you agree with the suggested approach on relying on up-to-date client information? Please also state the reasons for your answer.

Q7: Do you agree with the suggested approach on client information for legal entities or groups? Please also state the reasons for your answer.

Q8: Do you agree with the suggested approach on the arrangements necessary to understand investment products? Please also state the reasons for your answer.

Q9: Do you agree with the suggested approach on the arrangements necessary to assess the appropriateness of an investment or else issue a meaningful warning? Please also state the reasons for your answer.

Q10: Do you agree with the suggested approach on the effectiveness of warnings? Please also state the reasons for your answer.

Q11: Do you agree with the suggested approach on the qualifications of firm staff? Please also state the reasons for your answer.

Q12: Do you agree with the suggested approach on record-keeping? Please also state the reasons for your answer.

Q13: Do you see any specific difficulties attached to the requirement to keep records of any warnings issued and any corresponding transactions made by clients?

Q14: Do you agree with the suggested approach on determining situations where the appropriateness assessment is needed? Please also state the reasons for your answer.

Q15: Do you agree with the suggested approach on controls? Please also state the reasons for your answer.

Q16: When providing non-advised services, should a firm also assess the client's knowledge and experience with respect to the envisaged investment product's sustainability factors and risks? If so, how should such sustainability factors and risks be taken into account in the appropriateness assessment? Please also state the reasons for your answer.

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Annex II

Cost-benefit analysis

1. The appropriateness and execution-only requirements are an important element of investor protection in the case of the provision of non-advised services to clients. This importance was already acknowledged under the MiFID I framework and has been confirmed under the MiFID II framework. Moreover, some aspects of the requirements have been further strengthened in MiFID II. In particular, this regards record-keeping obligations related to appropriateness and an improvement of the conditions for the provision of services under the execution-only exemption.

2. In light of the importance of the appropriateness and execution-only requirements for investor protection, ESMA decided to devote its first CSA to this topic in 2019. As explained in the background, this CSA showed there was a need for convergence in the understanding and application of several areas of the appropriateness and execution-only requirements by firms in different Member States, and often within Member States themselves, creating problems for achieving a consistent level of investor protection in the EU. NCAs and firms would thus benefit from more guidance at ESMA level, increasing the level of protection provided to clients. Therefore, ESMA decided to develop guidelines to enhance clarity and foster convergence in the application of certain aspects of the appropriateness and execution-only requirements.

3. These guidelines aim to ensure a common, uniform, and consistent implementation of the MiFID II requirements related to the assessment of appropriateness and to execution-only by providing explanations, clarifications, and examples on how the relevant obligations should be fulfilled. By providing clarification of the relevant MiFID II appropriateness and execution-only requirements, ESMA is helping firms improve their implementation of these requirements. The guidelines also aim to ensure a convergent approach in the supervision of the appropriateness and execution-only requirements.

The impact of the draft ESMA guidelines

4. In light of the main objectives of these guidelines (extensively illustrated in the background), the following preliminary assessment aims at explaining the benefits and costs of the key policy choices that are presented for consultation.

5. It should be firstly observed that since the appropriateness and execution-only requirements are provided under MiFID II and the MiFID II Delegated Regulation, the impact of the proposed guidelines should be considered having in mind those legal provisions that they support. While market participants will likely incur certain costs for implementing these guidelines, they will also benefit from the increased legal certainty and the harmonised application of the requirements across Member States. Investors will in turn benefit from an improved assessment of whether their knowledge and experience is sufficient to understand the risks involved in relation to the envisaged investment service or product. The proposed guidelines should also facilitate competent authorities' efforts to improve the overall compliance with MiFID requirements increasing

investor confidence in the financial markets, which is considered necessary for the establishment of a genuine single capital market. Lastly, greater convergence leads to improved investor protection (consumer outcomes), which is a key ESMA objective.

Benefits

6. It is possible to illustrate the main benefits linked to the proposed guidelines as follows:

- Reduction of the mis-selling risk and its related financial consequences. This is a major benefit for investors and for the financial markets as whole. In particular, firms will benefit from the reduction of complaints, costs of appeals and legal expenditure for tribunal cases, lack of reputation, fines, etc;

- Reduction of risks related to regulatory or supervisory arbitrage due to an increased degree of harmonisation and more consistent supervisory convergence;

- Positive effects from improved harmonisation and standardisation of the processes that firms have put in place when applying the appropriateness and execution-only requirements;

- Positive effects from improved harmonisation and standardisation for competent authorities on the costs and activities needed to implement the new supervisory processes related to the appropriateness and execution-only requirements;

- Increasing investors' confidence in financial markets.

Costs

7. With reference to the costs, it should first be reminded that the importance of the appropriateness and execution-only requirements has been already addressed to firms and competent authorities under the MiFID I regime as one of the pillars of the retail investor protection framework.

8. In light of what has been said, it can be reasonably expected that those firms having already in place a complete set of arrangements to comply with the MiFID II provisions are likely to incur fewer overall costs when implementing these guidelines.

9. ESMA considers that potential and incremental costs that firms will face when implementing the guidelines might be of both a one-off and ongoing nature, arguably linked to:

- (direct) costs linked to the update/review of the existing procedural and organisational arrangements (e.g., the review and/or the update of the questionnaires and of the algorithms/models used to match the client's profile with appropriate investment products);

- (direct) initial and ongoing IT costs; and

- (direct) relevant organisational and HR costs linked to the implementation of the guidelines providing clarifications on the qualification of firm staff (in particular compliance function staff and staff providing relevant investment services).

10. ESMA believes that the proposed options in this area provide the most cost-efficient solution to achieving the objectives of these guidelines.

Conclusions

11. In light of the above, ESMA believes that the overall (compliance) costs associated with the implementation of the proposed guidelines will be fully compensated by the benefits from the improved reliability of the information provided from and to investors and from the subsequent effectiveness of the appropriateness assessment. These benefits will interest all market participants, increasing the fundamental trust in the financial markets.

12. ESMA also considers that the proposed guidelines can achieve an increased level of harmonisation in the interpretation and application of the appropriateness and execution-only requirements across Member States, minimising the potential adverse impact on firms linked to compliance costs. As explained in the background, the benefits of more harmonisation have been stressed by the outcomes of the 2019 CSA, showing that there was insufficient convergence in the understanding and application of several areas of the appropriateness and execution-only requirements by firms in different Member States, and often within Member States themselves, posing problems for achieving a consistent level of investor protection in the EU. The harmonisation benefits will outweigh all associated costs in respect of these guidelines.

13. Finally, ESMA believes that the adoption of guidelines is the best tool to achieve the explained objectives since it further reduces the risk of diverging interpretations that might lead to discrepancies in the application and supervision of the relevant regulation and requirements across Member States (determining a risk of regulatory arbitrage and circumvention of rules). Moreover, the adoption of guidelines enables the creation of a cohesive and comprehensive document aimed at clarifying the appropriateness and execution-only process.

Annex III

Advice of the Securities and Markets Stakeholder Group

As provided by Article 16(2) of the ESMA regulation, ESMA has also sought the advice of the Securities and Markets Stakeholder Groups (SMSG)[2]. Overall, the SMSG is of the opinion that these guidelines are sound and beneficial to the protection of investors. Even though the SMSG takes a positive view on the approach of building on relevant parts of ESMA's Guidelines on certain aspects of the MiFID II suitability requirements and adjusting them to the appropriateness and execution-only framework, it also comments that these are different regimes and that the differences should be balanced in the present Guidelines.

The SMSG had the following general remarks, namely regarding the fact that a right balance is to be kept between a high level of investor protection and the availability of products for clients who buy on their own initiative. With respect to the reference to the first common supervisory action and that its findings are considered in these Guidelines, the SMSG comments that these findings are not publicly available and advises that the main findings, as a general rule, should be made public. Finally, given the increasing automation in the assessment, the SMSG finds the introduction of guidelines dedicated to the consistency of these automated tools particularly useful.

Furthermore, the SMSG had the subsequent focused remarks (i) the proposal that ESMA presents a standardised template specifying the difference in protection in advised and non-advised services; (ii) it prefers the use of warnings as a way to prevent possible harmful transactions rather than a strictly prescriptive approach, given the nature of the relationship between firms and clients when offering non-advised services (iii) a concern regarding the concept of "more complex products"; (iv) the advice to clarify that the assessment of knowledge and experience "*of a specific type of product*", should take into consideration these specificities; and finally, (iv) though sustainable finance is important, it is necessary to avoid the risk of 'overshooting', which could undermine the credibility of both the appropriateness test and sustainability goals.

[2] The SMSG response has been published on the ESMA website at the following address: https://www.esma.europa.eu/sites/default/files/library/esma22-106-3280_smsg_advice_on_appropriateness_and_execution-only.pdf

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Annex IV

Feedback on the consultation paper

General feedback

1. Most respondents welcomed ESMA's initiative to issue the guidelines aimed at strengthening investor protection and supervisory convergence throughout the EU. Some respondents underlined the importance of these guidelines since they address key issues in the provision of non-advised services to clients, a business segment that has developed quite substantially over the past years.

2. However, some respondents suggested that there is a lack of mandate and/or legal basis for certain elements which appear to go beyond Level 1 and Level 2 measures. ESMA has carefully considered such points but has not made changes to the guidelines based on this feedback, as explained in the analysis on the feedback received in response to the specific questions below. According to ESMA, the guidelines provide a clarification of the relevant MiFID II appropriateness and execution-only requirements, aiming to ensure a convergent approach in the supervision and application of those requirements.

3. Some respondents underlined that a distinction between the suitability and appropriateness regimes foreseen by MiFID II should be kept. Accordingly, such respondents considered that the present guidelines should to a lesser degree be based on the suitability guidelines. As ESMA already explained in the CP, the suitability and appropriateness requirements share some commonalities and requirements, in particular relating to the collection of information about the client's knowledge and experience and its assessment against the investment product or service in question. While the relevant ESMA suitability guidelines have been taken as a starting point for developing the draft appropriateness and execution-only guidelines, they have been adjusted and expanded where necessary. In ESMA's view, the differences between the two regimes have sufficiently been taken into account, as further explained below.

4. Furthermore, few respondents mentioned that in light of the Covid-19 pandemic, steps taken towards achieving economic recovery may be impeded by the introduction of the guidelines. Moreover, such respondents considered that the guidelines undermine the objectives of the Capital Markets Recovery Package.[3] On this, ESMA wishes to reiterate its previously made point that these guidelines are a clarification of the MiFID II appropriateness and execution-only requirements and do not go beyond or undermine level 1 and/or level 2.

[3] Directive (EU) 2021/338 of the European Parliament and of the Council of 16 February 2021 amending Directive 2014/65/EU as regards information requirements, product governance and position limits, and Directives 2013/36/EU and (EU) 2019/878 as regards their application to investment firms, to help the recovery from the COVID-19 crisis.

5. Few respondents and the SMSG considered that the guidelines should be gender neutral, for example, by referring to “his/her” instead of “his”. ESMA agrees and has included gender-neutral references throughout the text.

6. Concerning the information that needs to be provided by the clients or potential client regarding that person’s knowledge and experience in the investment field relevant to the specific type of product or service, some respondents referred to the right enshrined in Article 22 of the GDPR[4] which provides a data subject with the right to object against a decision based solely on automated processing, including profiling, which produces legal effects concerning him or her or similarly significantly affects him or her. This may especially be relevant when firms use profiling software to comply with the appropriateness requirements. In this context, some respondents also made a reference to the data minimalization and purpose limitation principles included in Articles 5 and 6 of the GDPR to which the firms are also subject.

7. ESMA would in this regard like to point out that the Guidelines respect the fundamental rights and observe the principles recognised in the Charter[5] and in particular article 8 regarding the right to the protection of personal data. Any obligations of investment firms under the GDPR shall not be affected by these Guidelines. The processing of personal data as referred to in the Guidelines has a clear legal basis in Article 25(3) of MiFID II and in Articles 55 and 56 of the MiFID II Delegated Regulation. Furthermore, ESMA also notes that when firms use profiling software to comply with their legal appropriate assessment obligations, the right of the data subjects to object to any automated processing, including profiling should not be impacted and be respected in line with the requirements of Article 22 of the GDPR.

Q1: Do you agree with the suggested approach on providing information about the purpose of the appropriateness assessment? Please also state the reasons for your answer.

8. Most respondents generally agreed with ESMA’s suggested approach on providing information about the purpose of the appropriateness assessment.

9. Few respondents reiterated the need to have a clearer differentiation between retail investors and professional investors and suggested that ESMA make certain elements of the guidelines inapplicable to professional clients. ESMA wishes to underline that the differentiation between retail clients and professional clients related to the assessment of appropriateness is laid down in article 56(1) of the MiFID II Delegated Regulation and believes that there is no need for further explanation in the guidelines.

10. Referring to current paragraph 12[6] of the guidelines, few respondents noted that ESMA should clarify that “in good time” signifies before the assessment or service is provided.

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[4] Regulation (EU) 2016/679

[5] Charter of Fundamental Rights of the European Union

[6] Considering the numbering has changed of the current guidelines compared to the draft guidelines consulted, ESMA refers in this Final Report to the current numbering only. To avoid any confusion.

Some respondents underlined the importance of broadly interpreting “in good time”. ESMA is of the opinion that Guideline 1 already mentions the fact that the information should be provided before the provision of non-advised services. Further clarification of “in good time” is therefore not deemed necessary. However, also in light of the remarks listed in paragraph 12 of this section, ESMA clarified that in case of an ongoing relationship with the client, the information listed in Guideline 1 should not be provided before the initial provision of the non-advised service, in this case, the information could be provided before the provision of the initial non-advised service and, with respect to the information under the first two bullet points of paragraph 13, whenever the client is requested to update the information on his/her level of knowledge and experience.

11. With reference to the “clear and simple” information to clients, the SMSG highlighted that in the case where clients conduct transactions in countries where more than one official language is spoken, firms should communicate the information in the preferred language of the client. ESMA understands the issue raised by the SMSG and wishes to underline that Article 44 (2) sub f of the MiFID II Delegated Regulation already requires that the information is consistently presented in the same language throughout all forms of information and marketing materials that are provided to each client, unless the client has accepted to receive information in more than one language. In addition, article 47 (1) sub b of the MiFID II Delegated Regulation requires firms to provide clients and potential clients with information on the languages in which the client may communicate with the investment firm and receive documents and other information from the firm. ESMA is of the opinion that the client can in these situations indicate if he/she wishes to receive the information in a different language based on the MiFID II Delegated Regulation. ESMA has therefore not included a reference to a preferred language in these Guidelines.

12. Few respondents considered that the information to be provided to clients under paragraph 13 of the guidelines is too extensive. In relation to the second bullet of this paragraph, some respondents believed that the requirement that firms should, before the non-advised service is provided, inform clients about situations in which no assessment will be conducted and the consequences thereof, is unnecessary. Still, with an aim of enhancing the clarity and effectiveness of statements to clients, the SMSG advised ESMA to require firms to specify the “consequences” and the lack of “protections” in case they are unable to assess appropriateness due to a lack of sufficient, accurate or reliable information from clients. Regarding the third bullet of paragraph 13 of the guidelines, some respondents proposed deleting the requirement to provide a summary of differences between the requirements applicable to advised and non-advised services since, inter alia, these are already provided in the terms and conditions or in a written contract entered into with the client before the appropriateness test or suitability test was conducted. Some respondents noted that the guideline should clearly state that firms may use standardised formats, for example terms and conditions, to present the information. The SMSG suggested including a statement that “firms are not providing advised services and do not assess clients’ financial situation, nor her/his investment objectives” would be sufficient. In ESMA’s view, informing clients clearly and simply about the appropriateness assessment and its purpose will enhance the effectiveness of

the assessment. It considers the elements listed in this paragraph 13 as necessary to achieve this aim. Still, acknowledging the need to avoid providing too much information to clients, it has simplified the element included in the third bullet point. Furthermore, as explained above, ESMA has added new paragraph 14 specifying that in an ongoing relationship the information does not have to be provided before the provision of each non-advised service. Lastly, while agreeing that the information about the appropriateness assessment and its purpose may be provided in a standardised format, ESMA has not included such a reference in the guidelines since this is already provided for by Article 24(5) of MiFID II as a Member State option.

13. Some respondents did not provide their support for the requirement to keep a record of the information provided, as included in the paragraph 15 of the guidelines. Indeed, few respondents expressed that it was not practically feasible for firms to keep proof that the client has seen the information on the appropriateness test. ESMA refers to the fact that paragraph 16 does not require firms to keep evidence concerning the fact that the client has seen the information but requires the firm to keep proof of the information that is provided to the client. Hence, ESMA has decided not to amend paragraph 15.

Q2: Do you agree with the suggested approach on the arrangements necessary to understand or warn clients? Please also state the reasons for your answer.

14. A majority of respondents appeared to agree with the general principles regarding the arrangements necessary to understand or warn clients. Some respondents welcomed the guidance on policies and procedures aiming at collecting all necessary information to conduct the appropriateness assessment and the emphasis on mechanisms to avoid self-assessment by clients. However, according to some respondents, the guidelines are too detailed when it comes to designing questionnaires, arguing that these might result in creating hurdles for investors and contravene the principle of trust regarding the information provided by clients.

15. Some respondents questioned the suggestion included in guideline 2, that firms' policies and procedures should aim to collect all information necessary to conduct an appropriateness assessment related to the specific product types that the firm offers. First, they argued that this suggestion does not take into account that firms are not required to ask for information on a client's knowledge and experience in case of the execution-only exemption for non-complex products. Second, these respondents argued that the term 'necessary' is unclear, as firms should not be required to collect information regarding products that are not being offered or demanded to the client. While confirming the importance of having policies and procedures aiming to collect all necessary information on the clients' knowledge and experience, ESMA has amended the wording of this guideline and paragraph 19 to align it more with MiFID II and the MiFID II Delegated Regulation.

16. Some respondents did not agree with the last bullet point in paragraph 22 of the guidelines that clients should be able to reply that s/he does not know how to answer the question. These respondents argued that including such an option creates confusion as it is unclear how such answers should be taken into account in assessing the client's

information. Moreover, they considered it as redundant since clients are expected not to choose for the ‘do not know’ possibility as they are incentivised to pass the test. However, ESMA is of the opinion that clients should not be incentivised to guess if they do not know the correct answer and has therefore not amended the last bullet point of paragraph 22 of the guidelines.

17. A majority of respondents did not agree with the proposed measures in paragraph 23 of the guidelines to limit the risk of circumvention when clients are allowed to respond again to a questionnaire after a first attempt that led the firm conclude that the client does not have sufficient knowledge and experience. These respondents doubted whether the proposals on limiting the number of attempts clients can perform within a certain period of time or the use of a cooling-off period are in line with the possibility to proceed with the transaction despite the warning provided for in MiFID II. Moreover, they believed such measures, without further specification, will lead to divergences in implementation across different firms and that it is unclear what the next steps are after the number of attempts have been maxed out. ESMA wishes to clarify that the measures to limit the risk of circumvention as included in paragraph 23 are not intended to prevent the client from proceeding with the transaction despite the warning. The decision to proceed with the transaction is left to firms in accordance with article 56 (2) (b) and (c) of the MiFID II Delegated Regulation (see also paragraph 74 of the guidelines). These measures are intended to ensure that the information collected on a client’s knowledge and experience reflects the actual level of knowledge and experience of the client and not his/her ability to ‘pass’ a particular questionnaire. Indeed, while the firm has imposed a measure such as a cooling-off period, the client could still be allowed to proceed with the transaction, provided that a warning has been issued. ESMA has clarified paragraph 23 of the draft guidelines accordingly.

18. While agreeing with the general requirement of having procedures to limit the risk of unreliable information in case of multiple attempts, the SMSG indicated preferring less far-reaching measures, such as the possibility to work with different sets of questionnaires after a first wrong attempt and/or the use of different means to ask for the information. In this regard, ESMA wishes to underline that the measures included in paragraph 23 of the guidelines are intended as examples and that firms may decide to make use of alternative measures and has made this more explicit.

19. Some respondents argued that clients should be allowed to correct an answer if they made a mistake. ESMA would like to clarify that the manner in which the questionnaire is presented, and the specificities of the tool used is for the firms to design and the current Guidelines do not prohibit clients to correct an answer during the assessment.

20. Some respondents were of the opinion that paragraph 25 of the guidelines on not asking the client to complete a self-assessment are in contradiction with the principle of trust provided for in Article 55(3) of the MiFID II Delegated Regulation, according to which a firm shall be entitled to rely on the information provided by its clients unless it is aware or ought to be aware that the information is manifestly out of date, inaccurate or incomplete. Consequently, such respondents argued that a firm should be able to rely

on plausible answers provided by the client. Moreover, some respondents questioned the specific guidance on avoiding self-assessment by clients. Points mentioned include:

- Questionnaires should not be understood as an obligation to test or examine the client. This does not follow from MiFID II and may discourage clients from investing.

- The suggestion that the appropriateness assessment cannot be done via means of self-assessment does not correspond with the current practice and nature of online questionnaires.

- Only the client is in a position to assess his knowledge and experience and it is difficult to understand how a client can overestimate his knowledge and experience.

21. ESMA acknowledges the principle of trust provided for in Article 55(3) of the MiFID II Delegated Regulation. However, in ESMA's view, the firm's entitlement to rely on the information provided by its clients unless it is aware or ought to be aware that the information is manifestly out of date, inaccurate or incomplete, does not say anything about the way in which the information can be collected from the client. Avoiding self-assessment is key to ensuring collecting reliable information on a client's knowledge and experience. Indeed, ESMA wishes to underline that the appropriateness framework requires the firm, not the client, to assess whether the client has sufficient knowledge and experience in relation to a specific type of product offered or demanded. In ESMA's view, avoiding self-assessment therefore directly follows from the MiFID II appropriateness requirements.

22. Other remarks made in relation to Guideline 2 include:

- The SMSG proposed including a paragraph requiring firms to have in place policies and procedures aimed at (i) assessing the quality of different means of asking clients for information on their knowledge and experience and (ii) controlling whether these means are fit for purpose. ESMA agrees with the comments made but considered this more relevant for Guideline 5. It has amended Guideline 5 accordingly.

- Few respondents argued that the last sentence in paragraph 28 of the guidelines is overprotective as it seems to suggest that clients need to be questioned, even in cases where they are unwilling to respond to a questionnaire. ESMA agrees that the wording used was quite strong and has amended the current paragraph.

- According to few respondents, the suggestion included in paragraph 29 of the guidelines that clients should be given the opportunity to review the assessment of their knowledge and experience has no legal basis and should therefore be deleted. ESMA is of the view that firms should take the necessary steps to ensure that the information they have on the client or potential client is accurate, especially when this information has been pre-filled by the firms. To ensure this accuracy it is important that clients have the opportunity to correct the pre-filled information, if needed. ESMA has therefore not amended paragraphs 28 and 29.

Q3: Do you agree with the suggested approach on the extent of information to be collected from clients? Please also state the reasons for your answer.

23. A majority of respondents generally agreed with the suggested approach on the extent of information to be collected from clients.

24. However, many respondents expressed concerns in relation to the notion of complexity as a "relative term" as referred to by ESMA in paragraphs 33-34 of the guidelines. Points mentioned include:

    - Some respondents expressed the view that the reference to "more complex or risky products" is not consistent with existing regulatory measures and in particular Article 25(4) MiFID II which clearly regulates which financial instruments should be categorised as complex or non-complex.

    - Furthermore, some respondents noted that introducing complexity degrees without clearly defining them will lead to heterogenous interpretations by market participants, legal uncertainty, and divergent market practices across Member States.

    - Moreover, some respondents opposed ESMA's proposal for firms to perform more in-depth appropriateness assessments when providing clients with access to more complex or risky products. Few respondents noted that such a requirement cannot be derived from the existing regulatory framework nor can it be introduced at Level 3.

25. The SMSG agreed that complexity is a relative term for the purposes of the product governance requirements but had a general concern with the concept "more complex products" in the context of the appropriateness requirements as both Article 25(4) of MiFID II and Article 57 of the MiFID II Delegated Regulation make a distinction between complex and non-complex products only. Moreover, the 2015 ESMA Guidelines on complex debt instruments clarify which products are deemed non-complex for the execution-only exemption. The SMSG did not agree with introducing further levels of complexity gradients unless these are clearly specified. Moreover, the SMSG advised that, if ESMA nonetheless wishes to keep further gradients of complexity of products, existing Guidelines regarding complex products should be amended and updated accordingly. The SMSG suggested that perhaps the different levels of complexity could be specified by taking into account the firm's product governance analysis (i.e., target market of end clients with respect to knowledge and experience).

26. ESMA wishes to stress that the category of complex products, following from Article 25(4)(a) of MiFID II, covers a wide variety of investment products with different levels of complexity. For example, all units in AIFs qualify as complex investment products, while AIFs will differ as to the level of complexity depending on the investment strategies used and the asset classes invested in. While the appropriateness assessment is required for all complex investment products, ESMA considers it crucial to ask more in-depth questions for more complex products so as to ensure that the firm has collected all

necessary information to assess whether the client understands the risks involved. Moreover, such an approach follows directly from the proportionality principle provided for in Article 55(1) of the MiFID II Delegated Regulation, which includes a reference to the complexity of the type of product or transaction envisaged in relation to the extent of the information to be collected on a client's knowledge and experience. In light of this, ESMA has decided not to amend paragraphs 33-34 of the guidelines.

Q4: Do you agree with the suggested approach regarding the appropriateness assessment relating to a service with specific features (paragraph 36 of the Guidelines)? In particular, do you agree with the examples provided (bundled services and short selling), or would you suggest including other examples? Please also state the reasons for your answer.

27. A majority of respondents generally agreed with the suggested approach regarding the appropriateness assessment relating to a service with specific features. The SMSG believed the approach is fully consistent with Article 25(3) MiFID II mentioning bundled products or services. It also agreed with the examples provided.

28. However, some respondents expressed the concern that the proposed guideline goes beyond Level 1. Further respondents expressed the view that the proposed requirements seem more relevant to the suitability assessment, which looks at the client's entire situation, rather than the appropriateness assessment, which focuses on the particular product or service at stake. Referring to paragraph 36 of the guidelines, few respondents noted that the general description of "non-advised service that has specific features" seemed too ambiguous and lacked legal clarity. According to ESMA, Article 25(3) of MiFID II provides a clear legal basis for paragraph 36 of the guidelines, referring to the specific type of service offered or demanded, next to the specific type of product. As clarified in the CP, this paragraph is intended to capture those situations in which assessing the client's knowledge and experience in relation to the specific type of investment product offered or demanded will not be sufficient to assess whether the client understands the risks involved in the transaction, because the risks do not only stem from, or are different from those involved in the specific type of investment product offered or demanded. For example, asking questions on a client's knowledge and experience in relation to a specific type of shares where a client opens a short position in such a type of shares, will not yield much information on whether the client understands the risks involved in such a transaction.

29. With respect to the example mentioned of bundled services, few respondents expressed the view that existing sectoral legislation already seeks to inform and protect investors. ESMA agrees with the comment raised and would like to underline that these guidelines are in line with and clarify the application of existing sectoral legislation. Moreover, and the example is merely an example. ESMA has decided not to amend the Guidelines as result of this feedback.

30. Respondents generally approved the example of short selling. Other examples that respondents proposed to include in the guideline are investment credits (i.e., leveraging) and derivatives such as writing options. Considering most respondents agree with the

examples mentioned and these examples are not meant to be exhaustive, ESMA has not amended paragraph 36.

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

31. Most respondents generally agreed with the suggested approach on the reliability of client information. However, some respondents, including the SMSG, expressed the view that the guideline goes beyond Article 25(3) of MiFID II and the principle of trust set out in Article 55(3) of the MiFID II Delegated Regulation which states that "an investment firm shall be entitled to rely on the information provided by the clients unless it is aware or ought to be aware that the information is manifestly out of date, inaccurate and incomplete". In particular, some respondents considered that firms should be able to rely on the information provided by clients and that the firm has no responsibility to challenge the information unless it is manifestly outdated, inconsistent, inaccurate, or incomplete. This follows the opinion of few respondents according to which not the firm, but the investor, is ultimately responsible for the information provided. With regard to the reasonable steps to check the reliability, accuracy and consistency of the information collected, included in paragraph 40 of the guidelines, few respondents asked for clarification on what the "reasonable steps to check the reliability, accuracy and consistency of the information" should be and on what the respective responsibility and accountability of the investment firm and the client are. Moreover, some respondents noted that it is almost impossible to verify the reliability, integrity, correctness, and consistency of the information generally and especially in an online environment. Further, some respondents considered that it is not in reality feasible to verify whether the transaction history of other service providers is reliable because transaction data is not always available.

32. ESMA wishes to clarify that Guideline 4 is not intended to go beyond Article 55(3) of the MiFID II Delegated Regulation and that a firm should indeed be entitled to rely on the information provided by the clients unless it is aware or ought to be aware that the information is manifestly out of date, inaccurate and incomplete and has included more details in paragraph 40 of the guidelines on the reasonable steps to check the reliability, accuracy, and consistency of the information. In ESMA's view, such reliability, accuracy, and consistency checks would not have to take the form of asking for supporting evidence, for example on a client's investment experience, but relate to the reliability, accuracy and consistency of the information collected from the client. An example would be to ask the client for further clarification where the information collected on his knowledge and experience shows that s/he has more knowledge about complex bonds than about plain vanilla bonds. To clarify this, ESMA has added an example. With regard to (old) footnote 13 that was included in the draft guidelines which set out that "[w]hen dealing with professional clients, firms should take into account the proportionality principles as referred to in guideline 3, in line with Article 56(1), first subparagraph of MiFID II Delegated Regulation", few respondents expressed the view that dealing with professional clients is not a matter of proportionality but the result of a classification of a client as a professional client. Therefore, few respondents suggested deleting footnote

13. One respondent suggested that the guideline should clearly state that professional clients may rely on self-assessment. ESMA agrees that footnote 13 could be confusing and has therefore decided to delete it.

33. Paragraphs 41 and 42 of the guidelines state that firms should have consistency controls on the replies provided by clients in questionnaires in order to highlight contradictions in information collected. Few respondents sought clarification on whether this means that firms should cross-examine answers from clients when questionnaires are used. Such respondents noted that adopting this approach would be burdensome. ESMA wishes to underline the importance for firms to have policies and procedures in place that enable them to collect reliable and consistent data. ESMA considers consistency controls as essential to achieve this and has therefore not amended these paragraphs.

Q6: Do you agree with the suggested approach on relying on up-to-date client information? Please also state the reasons for your answer.

34. The guideline received mixed feedback. While some respondents agreed entirely with the proposed approach, other respondents considered the guideline to be disproportionate as it seems to take the suitability assessment as a starting point. Since these respondents believed that the guideline seems more relevant for advisory services rather than non-advised services.

35. Referring to Guideline 5 and the supporting paragraphs, some respondents expressed the view that there should not be a mandatory regular update since it can be expected that knowledge and experience will increase over time. Moreover, some respondents considered that firms should not be required to proactively contact clients to update their information or request clients to confirm previously provided information. Some respondents noted that client information should be updated only when entering a new transaction since clients may not enter new investments on a frequent basis, for example in closed-ended venture capital or private equity funds. This view corresponds with that of the SMSG which noted that some clients using non-advised services may not have a long-term relationship with the firm. Hence, periodic updates of client information may not be relevant in the context of non-advised services. In this regard, as also clarified in the CP, ESMA agrees that the issue of periodically updating the information about a client has a different nature for the appropriateness assessment compared with the suitability assessment. Still, when a client intends to enter into a new transaction, firms will need to ensure that the information they have about the client's level of knowledge and experience remains up to date. In this context, ESMA has amended Guideline 5 to clarify where firms rely on previously collected information for the purposes of the appropriateness assessment, they should establish procedures defining the frequency of updating.

36. Some respondents expressed concerns in relation to ESMA's statement that particular attention should be given to the update of information for more vulnerable clients, such as older clients. According to these respondents, such a statement causes undue discrimination to those clients who would not be considered as "more vulnerable". These respondents considered that such an approach has no basis in the regulatory framework.

Further, such respondents expressed the view that the guideline is unclear on how firms should define vulnerable clients. On this point, the SMSG suggested to change the last sentence of paragraph 45 as follows: "Firms should develop a policy to assess knowledge and experience of groups that are deemed more vulnerable on a more regular basis". ESMA agrees with the points made and has amended paragraph 45 of the guidelines taking into account the SMSG's suggestion.

37. According to some respondents, requiring a firm to have arrangements to ensure an update of client information in case of "unusual transactions" being registered on a client's account, as included in the previous text of paragraph 46 of the guidelines, is burdensome, costly, and unnecessary as it would require firms to continuously monitor client accounts. Therefore, few respondents proposed to delete the sentence. ESMA understands the points made and has removed this specific example.

38. Some respondents believed that there is a conflict between paragraph 48 of the guidelines and principle of trust provided for in Article 55(3) of the MiFID II Delegated Regulation. Paragraph 48 of the guidelines relates to firms adopting measures to mitigate the risk of inducing clients to update their knowledge and experience so as to make a certain investment product appear appropriate. Some respondents expressed concerns in relation to the insinuation that a too frequently updated client profile suggests that a profile is updated to allow for financial instruments being assessed as appropriate that would otherwise be inappropriate for the client. In this regard, the SMSG considered that since clients execute transactions with varying frequency, the following change to the paragraph could be introduced: "*An example of a good practice to address this type of risk is that a firm could adopt procedures to verify, before and after transactions are made*, *whether, given clients' transactions, anomalous updates (i.e., too frequent and/or too close after a previous update) took place."*

39. ESMA does not take the view that paragraph 48 of the guidelines goes against the principle of trust as provided for in Article 55(3) of the MiFID II Delegated Regulation. After all, too frequent updates, or updates only after a short period of time from the last modification should be considered potentially leading to inaccurate information collected from the client as such updates might indicate that the information is updated with the purpose of making a certain investment product appear appropriate that would otherwise be inappropriate for the client. Therefore, ESMA deems that no changes are necessary to this paragraph.

40. To most respondents, the requirement of having two staff members being involved in assessing an update which results in a higher level of knowledge or experience seems unnecessarily burdensome, disproportionate, prescriptive or does not seem to reduce the risk that clients exaggerate their statements. Some respondents believed staff members should have sufficient knowledge and competence to independently review and approve updates made by clients. Moreover, having two staff members in the review and approval of an update involved may delay a transaction against the client's wishes. ESMA wishes to clarify that this measure was provided by way of an example and that firms may decide to make use of other measures to limit the risk that a client is induced to update his level of knowledge and experience so as to make a certain investment

product appear appropriate that would otherwise be inappropriate for him. However, ESMA understands that naming a number of staff members can be considered disproportionate in certain cases and has therefore removed this reference altogether from the current paragraph 49 of the guidelines.

41. With regard to situations in which there is a heightened risk of conflicts of interests as mentioned in paragraph 49, some respondents noted that such a consideration is irrelevant in the case of execution-only transactions. ESMA would like to clarify that even when it concerns an execution-only transaction there can be a conflict of interest, since, for example, own products of the firm can be pushed or presented more prominently to the clients or potential clients.

Q7: Do you agree with the suggested approach on client information for legal entities or groups? Please also state the reasons for your answer.

42. More respondents disapproved than approved the suggested approach on client information for legal entities or groups. Some respondents considered that the proposed approach is more adjusted to the suitability test than the appropriateness assessment. Moreover, few respondents noted that the guideline seems to focus on face-to-face selling when in practice trading commonly takes place online. ESMA is of the view that these Guidelines do not focus on face-to-face selling but are drafted in technological neutral manner. ESMA has therefore not amended the Guidelines based on this feedback.

43. Few respondents expressed concerns that the issue addressed in the present guideline is clearly regulated in Article 54(6) second subparagraph, second sentence of MiFID II Delegated Regulation which also applies to the appropriateness assessment. The legal provisions of the MiFID II Delegated Regulation set out that the assessment of knowledge and experience needs to be based on the representative of the natural person or the person authorised to carry out transactions on behalf of the client. ESMA agrees with the fact that Article 54(6) second subparagraph, second sentence of MiFID II Delegated Regulation addresses the matter, however considering this article does not apply to the appropriateness assessment ESMA has decided to offer this guidance through these Guidelines. Therefore, ESMA has decided not to make any amendments based on this input.

44. With regard to the most prudent approach that firms should adopt, as referred to in paragraph 53 of the guidelines, some respondents considered that the approach should not be based on the person with the least knowledge and experience. Rather, it should be based on the person who will actually make the transaction on behalf of the entity or group. Few respondents mentioned that particularly in an online trading tool the designated representative of a company is set through a power of attorney or the company's articles of association. ESMA would like to underline that the prudent approach described in paragraph 53 is only relevant in situations in which the group cannot decide from whom the knowledge and experience should be collected, whereas the feedback provided by the respondents seem to refer to the situation in which it is

clear from whom the information should be collected. ESMA has therefore not reflected this input in this paragraph.

45. For front-line staff dealing with clients over the telephone, some respondents noted that the choice of the representative should be covered by an internal conduct of business instruction rather than a dedicated policy. ESMA notes that in Guideline 6 and the supporting paragraph 51 reference is made to the fact that this Guideline and subsequent paragraphs focus on the situation in which there is no representative foreseen, and a policy should be drafted on how to handle these situations. Firms can of course draft internal conduct of business instructions for their staff based on their dedicated policy, Guideline 6 does not prevent firms from doing so.

Q8: Do you agree with the suggested approach on the arrangements necessary to understand investment products? Please also state the reasons for your answer.

46. A near majority of respondents disapproved of the suggested approach on the arrangements necessary to understand investment products. In particular, some respondents noted that the guideline appears to introduce product governance elements into the assessment or that the proposed requirements overlap with product governance rules. Some respondents also opposed this guideline because of, inter alia, their objection to a more granular approach with regard to more complex products. ESMA wishes to underline that there is a logical interaction between the product governance and appropriateness requirements. This was already reflected in the previous text of now paragraph 56 of the guidelines, which stated that, in the context of considering the different characteristics and relevant risk factors for the purposes of the appropriateness assessment, firms should take the analysis conducted for the purposes of the product governance requirements into account. Nevertheless, ESMA understands the comments made about introducing product governance elements into the appropriateness requirements, which can be confusing for firms. Therefore, ESMA decided to delete the last two sentences relating to defining ex-ante limits.

47. Few respondents expressed the view that the proposed approach to consider relevant risk factors (such as credit risk, market risk, liquidity risk), as included in paragraph 56 of the guidelines, goes beyond the relevant MiFID II provisions. In this respect, few respondents noted that the proposed guideline reflects ESMA's suitability guidelines which require to classify investment products also according to their risks. However, few respondents considered that this approach is not adapted to the appropriateness requirements. ESMA wishes to stress that it views considering relevant risk factors of the investment products offered or demanded as essential to understanding investment products and to ensuring that the information collected on a client's knowledge and experience is relevant for the specific type of product offered or demanded. Indeed, in assessing appropriateness, firms should assess whether a client understands the risks involved in relation to the specific type of product offered or demanded, meaning that considering risk factors is also essential for the appropriateness assessment. Therefore, ESMA has not made any changes to paragraph 56 of the guidelines.

48. In paragraph 57 of the guidelines, as regards more complex investment products with particular features, ESMA proposes that firms should not rely on only one data provider and should compare data by multiple sources of information. Some respondents opposed this approach because they considered that this would be costly, time-consuming and would not bring much additional value to investor protection. Moreover, few respondents noted that as many data providers have the same sources of information, it would bring no use to compare data provided by them. ESMA agrees with the comments made and has deleted the relevant sentence in paragraph 57 of the guidelines.

49. With regard to the examples provided in paragraph 59 of the guidelines, few respondents including the SMSG considered these to be too detailed or too far going. One respondent noted that, for example, when categorising investment products for the purpose of the appropriateness assessment, firms should be able to freely choose what level of granularity they use to assess. The SMSG suggested that a different classification in line with product complexity would be more effective. ESMA wishes to clarify that paragraph 59 of the guidelines does not prescribe a certain level of granularity but stipulates that firms should use a sufficient level of granularity to ensure that only investment products with sufficiently comparable characteristics and risk features are grouped together. Moreover, the multiple key factors to be considered for the categorisation are included as examples and it is up to firms to determine which factors are relevant in their situation. In light of this, no changes have been deemed necessary to paragraph 59 of the guidelines.

Q9: Do you agree with the suggested approach on the arrangements necessary to assess the appropriateness of an investment or else issue a meaningful warning? Please also state the reasons for your answer.

50. Most respondents generally agreed with the suggested approach on the arrangements necessary to assess the appropriateness of an investment or else issue a meaningful warning. Of those respondents who did not agree with the suggested approach, few respondents noted that the guideline is too prescriptive and would only be appropriate when automated tools are used to conduct the appropriateness assessment. Although the guideline indeed includes more detailed guidance on the use of automated tools in the appropriateness assessment, ESMA wishes to stress that the more general aspects of the guideline, such as those included in Guideline 8 and paragraphs 64-67, are relevant for all firms conducting an appropriateness assessment.

51. With regard to the requirement related to issue a meaningful warning as included in the previous text of Guideline 8 of the guidelines, some respondents questioned whether such a requirement is consistent with the second subparagraph of Article 25(3) MiFID II which provides that warnings related to the appropriateness assessment may be provided in a standardised format. Moreover, few respondents sought clarification on what such a meaningful warning should look like. ESMA acknowledges that the use of the term “meaningful” in Guideline 8, without further specification, might cause confusion for firms. Importantly, the use of this term was not intended to provide guidance on issuing warnings other than that already included in Guideline 9. Therefore, ESMA has

decided to use the term "clear and not misleading", as used in Guideline 9, instead of "meaningful" in Guideline 8.

52. Few respondents noted that paragraph 67 of the guidelines appears not to sufficiently consider smaller firms which do not have the same human and other resources as larger firms. ESMA wishes to clarify that firms that make use algorithms in the course of the appropriateness assessment, should ensure a sufficient level of investor protection to clients, no matter whether the firm is relatively small or big. In ESMA's view, the points included in paragraph 67 are minimally required to ensure a sufficient level of investor protection. Therefore, it has decided not to make any changes in this respect.

53. The SMSG suggested including additional considerations to reflect the fact that the use of automated software tools using "machine-learning" algorithms is expected to increase in the financial sector. The SMSG therefore believed that these tools should be a) properly documented and explained so as to allow regular reviews by third parties, including supervisors and b) regularly tested. Moreover, the SMSG advised to add an additional paragraph 63a obliging firms to:

- Inform clients ex-ante that automated tools are being used in the appropriateness assessment;
- Make arrangements so that clients may, upon request, have access to a qualified member of staff to obtain an explanation of how the assessment has been made; and
- Allow the client to request a review of the outcome of the assessment by a qualified member of staff.

54. ESMA questions whether the additional paragraph suggested by the SMSG might be too burdensome and considers there is insufficient legal basis to incorporate these points. ESMA has therefore decided to not make any changes.

Q10: Do you agree with the suggested approach on the effectiveness of warnings? Please also state the reasons for your answer.

55. Guideline 9 received mixed feedback. While some respondents agreed with the suggested approach or parts of it, on the effectiveness of warnings, others disapproved of it.

56. Some respondents suggested deleting the proposed requirement in Guideline 9 of the guidelines that firms should take reasonable steps to make sure the warnings they issue to clients are correctly received "*and understood*". These respondents considered that the latter requirement would result in additional questions being asked to the client. Similarly, some respondents noted that asking the client on the telephone whether he/she has understood the warning may be patronising. Therefore, these respondents expressed the view that warning the customer and ensuring the client has received the warning is sufficient. ESMA wishes to clarify that the use of the term "understood" in

paragraph 69 of the guidelines should be read in light of ensuring the effectiveness of warnings and is not intended to require firms to ask additional questions to clients. Moreover, in relation to telephone orders, ESMA has amended paragraph 69 of the guidelines to clarify that rather than asking clients whether they have understood the warning on the phone, firms should ensure that staff explain the warning and its impact to the client and answer any questions from the client to ensure that the client has correctly received and understood the warning.

57. Few respondents considered that it does not seem to bring much additional value to state the reason for warning the client, i.e., whether insufficient information was provided or because the transaction is deemed inappropriate for the client in light of the information provided. ESMA considers explaining the reasons for using the warning as an important element in ensuring that the client has correctly received and understood the warning. Therefore, ESMA has decided not to amend Guideline 9 in this respect.

58. The SMSG believed that warnings need to be fairly concise and not ambiguous but that they should nonetheless be fairly generic. The SMSG also recommended ESMA to add a guideline for the warnings to be prominent. ESMA agrees with the points made by the SMSG and has amended Guideline 9 accordingly.

59. A majority of respondents opposed ESMA's proposal, included in paragraph 75 of the guidelines, arguing that introducing such policies or procedures would result in preventing or restricting clients to invest in certain financial products despite wishing to do so, after having received a warning. These respondents considered that such a requirement is not foreseen in Article 25(3) MiFID II nor Article 56 MiFID II Delegated Regulation. Some respondents expressed the view that firms should not have to make ex-post evaluation in non-advised services and that a firm's liability should not continue after a clear warning has been provided.

60. ESMA wishes to clarify that the aim of the policies and procedures included in paragraph 75 of the guidelines is not to prevent or restrict clients' access to certain investment products. Rather, the proposed paragraph aims to ensure that warnings provided to clients are effective. Furthermore, ESMA would like to underline that article 56(2) b) and c) MiFID II Delegated Regulation envisages the possibility for firms to accept or not to accept a client's request to proceed after a warning. However, while ESMA wishes to stress that firms should have certain controls on the effectiveness of warnings, as also clarified in paragraph 96 of the guidelines, it has decided that paragraph 75 of the guidelines, on having ex-ante procedures, should be considered as a good practice.

61. Some respondents considered that it appears unnecessary to differentiate between own issues and third-party issues and that the conflict of interest mentioned with regard to own products is non-existent (as it is a non-advised service). ESMA would like to clarify that even when it concerns an execution-only transaction there can be a conflict of interest, since the own products of the firm can be pushed or presented more prominently to the clients or potential clients.

Q11: Do you agree with the suggested approach on the qualifications of firm staff? Please also state the reasons for your answer.

62. The Guideline received divergent responses. While some respondents partially agreed with the suggested approach on the qualifications of firm staff, almost as many disapproved of it.

63. Some respondents expressed concerns relating to the Guideline possibly going beyond Level 1 requirements, specifically Article 25(1) MiFID II. Further, few respondents suggested a proper coordination of the proposed guideline with the ESMA Guidelines for the assessment of knowledge and competence (ESMA/2015/1886). Some respondents considered that the guideline brings no value as MiFID II already provides a basis for qualification of staff and client-facing staff should already be complying with the aforementioned ESMA Guidelines. Few respondents considered that the proposed requirements should only apply to firm staff providing information to or advising clients on financial instruments, investment services or ancillary services. Conversely, such requirements should not apply to other staff members such as non-client-facing staff or staff developing automatised tools.

64. ESMA wishes to note that Guideline 10 provides guidance on the qualifications of firm staff involved in the appropriateness assessment, so both client-facing and non-client-facing staff. For client-facing staff, Guideline 10 clearly refers to the ESMA Guidelines for the assessment of knowledge and competence. According ESMA, both client-facing and non-client-facing staff should have adequate qualifications to ensure an adequate appropriateness assessment. Amongst others, Article 21(1)(d) of MiFID II provides a clear legal basis for this approach.

Q12: Do you agree with the suggested approach on record-keeping? Please also state the reasons for your answer.

65. Most respondents appeared to agree with the general principles relating to record-keeping. However, those who did not agree considered that there is no need for additional requirements on record-keeping since existing rules are sufficient. Moreover, few respondents noted that record-keeping requirements should be high-level and not be too prescriptive. Few respondents suggested that there should be a limited duration for record-keeping, for example three years. In ESMA's view, firms will benefit from the additional guidance on record-keeping when complying with the record-keeping requirements of Article 56 of the MiFID II Delegated Regulation. It has therefore decided to retain the guidance included in Guideline 11.

Q13: Do you see any specific difficulties attached to the requirement to keep records of any warnings issued and any corresponding transactions made by clients?

66. A majority of respondents generally agreed with the proposal. Few respondents noted that record-keeping should be regulated on a high-level basis and not be too prescriptive by ESMA.

Q14: Do you agree with the suggested approach on determining situations where the appropriateness assessment is needed? Please also state the reasons for your answer.

67. A majority of respondents generally agreed with the suggested approach on determining situations where the appropriateness assessment is needed.

68. Few respondents noted that the guidelines should clarify that some alternative investment funds could also fulfil the criteria of Article 57 of MiFID II Delegated Regulation and could hence be considered as non-complex. ESMA wishes to refer to ESMA Q&A 10.1, which clarifies that shares in AIFs cannot be assessed against the criteria set out in Article 57 of the MiFID II Delegated Regulation.

69. The SMSG considered that ESMA is confusing two different matters in this guideline. On the one hand, there is the question of the differentiation between advised and non-advised transactions. On the other hand, there is the question concerning the identification of when a service consists of an execution-only transaction and hence does not require an appropriateness assessment. The SMSG therefore advised ESMA to split these two matters into different guidelines. ESMA indeed agrees that Guideline 12 covers these two elements. However, both elements are directly related to the subject of this guideline, which is determining situations in which the appropriateness assessment is required. For this, both the distinction with advised services on the one hand, and the execution-only exemption on the other hand, are important. Therefore, ESMA has not made any amendments to Guideline 12.

70. Furthermore, the SMSG believed that ESMA should underline how to differentiate between a personalised communication and a personalised recommendation which is subject to a suitability assessment. For this purpose, the SMSG advised ESMA to reconsider and if necessary, update CESR (2010) Q&As on “Understanding the definition of advice under MIFID”. ESMA has taken note of this suggestion and will reflect on the need to review those Q&As.

71. Regarding paragraph 86 of the guidelines, few respondents sought further clarification as to the types of interactions that would give rise to record-keeping obligations apart from performing an appropriateness test and obtaining information from clients. Furthermore, with reference to paragraph 86, some respondents noted that in situations where a client initiates transaction through pure self-service channels, it should always be considered that such transactions are made on the client’s initiative (unless, for example, the client has received personalised marketing communications from the firm). Some respondents suggested that when transactions are conducted in hand-held situations, firms should have internal instructions which determine the situations in which transactions fall and do not fall within the execution-only regime.

72. Moreover, few respondents expressed that ESMA should ensure that the guidelines are technology neutral rules and sufficiently take into account the specificities of execution-only services which usually take place in an online environment. These respondents considered that in online trading situations, it should always be deemed that the

transaction is made at the client's initiative. ESMA agrees with the fact that the guidelines are technological neutral and believes that they are currently drafted in such a manner. Furthermore, ESMA considers that in an online environment, transactions should not by default be considered to be made on the client's own initiative. Subsequently, ESMA has not amended the guidelines on this point.

73. Some respondents considered that requiring firms to trace whether a client has submitted his/her order in response to a personalised communication from or on behalf of a firm, as included in paragraph 90 of the guidelines, would not be proportionate. ESMA would like to underline that firms should be able to adequately identify whether or not a transaction can be qualified as an execution-only transaction and must, therefore, take the necessary measures to trace this. ESMA has thus not made changes to paragraph 90.

Q15: Do you agree with the suggested approach on controls? Please also state the reasons for your answer.

74. A majority of respondents agreed to ESMA's suggested approach on controls.

75. Few respondents suggested that paragraph 92 of the guidelines be deleted as it is too suspicious of firm staff. To alleviate such concerns ESMA has deleted the reference 'by sales staff'. ESMA wishes to underline the importance that automated controls should not be circumventable and that firms should periodically monitor their functioning.

76. Few respondents noted that requirements relating to minutes of face-to-face meetings as included in paragraph 95 of the guidelines are already found in Article 16(7) of MiFID II and limited to the cases stipulated therein. Therefore, these respondents believed that no new requirements should be introduced. ESMA agrees that Article 16(7) of MiFID II stipulates what falls under 'record', however, in order to comply with Article 16(6) of MiFID II it is necessary to keep minutes of face-to-face meetings because otherwise the competent authority is not able to assess whether these meetings comply with applicable obligations.

77. Few respondents expressed the view that paragraph 95 of the guidelines should be deleted as it cannot be reconciled with the appropriateness assessment. ESMA has decided to delete the last sentence of paragraph 95.

Q16: When providing non-advised services, should a firm also assess the client's knowledge and experience with respect to the envisaged investment product's sustainability factors and risks? If so, how should such sustainability factors and risks be taken into account in the appropriateness assessment? Please also state the reasons for your answer.

78. Most respondents and the SMSG opposed the proposal that a firm should, when providing non-advised services, also assess the client's knowledge and experience with respect to the envisaged investment product's sustainability factors and risks.

79. Some respondents who opposed such suggestion expressed that questions in relation to a product's sustainability factors and risks should only be asked to clients in the context of the suitability assessment as part of the questions on the client's investment goals and preferences. Few respondents noted that introducing sustainability factors and risks in the appropriateness assessment would result in the distinction between investment advice and non-advised services being blurred. Moreover, the client may be confused as to whether the service being provided is advisory or non-advisory.

80. Moreover, some respondents noted that it was generally premature to introduce sustainability in the appropriateness assessment. Notably, sustainable finance aspects are currently being further developed within the EU Sustainable Finance Plan.

81. Some respondents expressed the view that including specific product characteristics into the appropriateness assessment is already required by Article 25(3) MiFID II and addressed in Guidelines 7 and 8.

82. Furthermore, some respondents underlined that knowledge and experience regarding sustainability factors and risks should not be a separate element or requirement to be assessed by firms. Also, some respondents expressed the view that sustainability risks should not be described as a separate type of risk.

83. ESMA takes note of the input received and considers that no amendments are necessary at this stage.

Annex VI

Guidelines on certain aspects of the MiFID II appropriateness and execution-only requirements

I. Scope

Who?

1. These guidelines apply to:

   a. competent authorities; and

   b. firms.

What?

2. These guidelines apply in relation to Article 25(3) and (4) of MiFID II and Articles 55 to 57 of the Delegated Regulation. These guidelines also apply in relation to the organisational requirements of Article 16(2), (5) to (7) MiFID II and Article 21, 72 and 76 of the Delegated Regulation, as well as Articles 24(1), (4) and (5) and 25(1), (5) and (6) of MiFID II, insofar as they relate to the appropriateness assessment.

When?

3. These guidelines apply from six months of the date of publication of the guidelines on ESMA's website in all EU official languages.

II. Legislative references and definitions

Legislative references

ESMA Regulation	Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC[7]
MiFID II	Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU[8]
Delegated Regulation	Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive[9]

Definitions

investment product	a financial instrument (within the meaning of Article 4(1)(15) of MiFID II) or a structured deposit (within the meaning of Article 4(1)(43) of MiFID II).
firms	investment firms (as defined in Article 4(1)(1) of MiFID II) and credit institutions (as defined in Article 4(1)(27) of MIFID II) when providing non-advised services, and external alternative investment fund managers (AIFMs) (as defined in Article 5(1)(a) of the AIFMD[10]) when providing the non-core service referred to in Article 6(4)(b)(iii) of the AIFMD).
non-advised services	(i) investment services (within the meaning of Article 4(1)(2) of MiFID II) other than investment advice and portfolio management; and (ii) the selling of structured deposits.

III. Purpose

4. These guidelines are based on Article 16(1) of the ESMA Regulation. The purpose of these guidelines is to clarify the application of certain aspects of the MiFID II

[7] OJ L 331, 15.12.2010, p. 84.
[8] OJ L 173, 12.6. 2014, p. 349.
[9] OJ L 87, 31.3.2017, p. 1.
[10] Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 (OJ L 174, 1.7.2011, p. 1).

appropriateness and execution-only requirements in order to ensure the common, uniform, and consistent application of, respectively, Article 25(3) of MiFID II and of Articles 55 and 56 of the MiFID II Delegated Regulation as well as of Article 25(4) of MiFID II and of Article 57 of the MiFID II Delegated Regulation.

5. ESMA expects these guidelines to promote greater convergence in the application of, and supervisory approaches to, the MiFID II appropriateness and execution-only requirements, by emphasising a number of important issues, and thereby enhancing the value of existing standards. By helping to ensure that firms comply with regulatory standards, ESMA anticipates a corresponding strengthening of investor protection.

IV. Compliance and reporting obligations

Status of the guidelines

6. In accordance with Article 16(3) of the ESMA Regulation, competent authorities and financial market participants must make every effort to comply with these guidelines.

7. Competent authorities to which these guidelines apply should comply by incorporating them into their national legal and/or supervisory frameworks as appropriate, including where particular guidelines are directed primarily at financial market participants. In this case, competent authorities should ensure through their supervision that firms comply with the guidelines.

Reporting requirements

8. Within two months of the date of publication of the guidelines on ESMA's website in all EU official languages, competent authorities to which these guidelines apply must notify ESMA whether they (i) comply, (ii) do not comply but intend to comply, or (iii) do not comply and do not intend to comply with the guidelines.

9. In case of non-compliance, competent authorities must also notify ESMA within two months of the date of publication of the guidelines on ESMA's website in all EU official languages of their reasons for not complying with the guidelines.

10. A template for notification is available on ESMA's website. Once the template has been filled in, it shall be transmitted to ESMA.

11. Firms are not required to report whether they comply with these guidelines.

V. Guidelines on certain aspects of the MiFID appropriateness requirements

INFORMATION TO CLIENTS ABOUT THE PURPOSE OF THE APPROPRIATENESS ASSESSMENT AND ABOUT EXECUTION-ONLY

(Article 24(1), 24(4), 24(5), 25(3) and 25(4) of MiFID II)

Guideline 1

12. **Firms should, in good time before the provision of non-advised services, inform their clients, by using clear and simple language, about the appropriateness assessment and its purpose which is to enable the firm to act in the client's best interest.**

13. ESMA considers that this should include the following:

    - A clear explanation that it is the firm's responsibility to conduct the assessment, so that clients understand the reason why they are asked by the firm to provide certain information and the importance of providing information that is up-to-date, accurate and complete;

    - A reminder that it is in the client's interest to provide accurate and complete answers to the questions asked by the firm for the purpose of the appropriateness assessment;

    - Information regarding the situations where no assessment will be done (i.e., where the client does not provide the information requested or such information is not sufficient to conduct the appropriateness assessment or where services are provided under the execution-only exemption[11]) and the consequences thereof. However, such information should not give the impression that as a default option the client could refrain from submitting his/her information[12];

    - A short explanation of the main differences between advised and non-advised investment services taking into account the applicable requirements, to avoid any confusion between the two.

14. In case of an ongoing relationship with the client, firms should not provide the abovementioned information before the provision of each non-advised service. In such a case, this information could be provided before the provision of the initial non-advised service and, with respect to the information under the first two bullet points of paragraph 13, whenever the client is requested to update the information on his/her level of knowledge and experience.

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[11] Investment services that only consist of execution or reception and transmission of client orders relating to investment products defined under MiFID II as being 'non-complex'.

[12] See also paragraph 28.

15. It is up to the firms to decide how they will inform their clients about the appropriateness assessment. The format used to inform clients should however enable firms to keep records of the information provided[13].

16. Firms should avoid stating, or giving the impression, that it is the client who decides on the appropriateness of the investment service or product, or who establishes which service or product fits his own knowledge and experience. In general, firms should not make any misleading statements to clients in relation to the firms' obligation to carry out the appropriateness assessment.

17. Provided that all the information given to clients complies with the relevant provisions (including obligations on the provision of information in durable medium), firms 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). For firms providing online services in particular this may include:

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

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

KNOW YOUR CLIENT AND KNOW YOUR PRODUCT

Arrangements necessary to understand clients

(Articles 16(2) and 25(3) of MiFID II and Article 55 of the Delegated Regulation)

Guideline 2

18. **Firms' policies and procedures should aim to enable firms to collect all information necessary to conduct the appropriateness assessment in relation to the specific product types offered or demanded[14].**

19. Firms shall establish, implement, and maintain adequate policies and procedures (including appropriate tools) to ask the client or potential client to provide information regarding that person's knowledge and experience in the investment field relevant to the specific type of investment service or product offered or demanded and including, as appropriate, the elements listed in Article 55(1) of the Delegated Regulation.

[13] While taking into account Guideline 11.
[14] While taking into account Guideline 3.

20. To that end, firms' policies and procedures should ensure that they do not abstain from asking information or discourage clients or potential clients in any way from providing information on their knowledge and experience.

21. It is up to firms to determine the means for asking the client to provide information on his knowledge and experience. They could use questionnaires (also in a digital format) completed by their clients or information collected during discussions with them to conduct the appropriateness assessment. In such cases, firms should ensure that the questions they ask their clients are specific enough and are likely to be understood correctly and that any other method used to collect information, such as the use of transaction data on certain types of products from an existing client to assess his experience, is designed to obtain the necessary information about the client's level of knowledge and experience. This is particularly important when firms are collecting the information through an online channel without any human interaction.

22. When designing the questionnaires aiming at collecting information about their clients for the purpose of an appropriateness assessment firms should be aware and consider the most common reasons why investors could fail to answer questionnaires correctly. In particular:

- Attention should be given to the clarity, exhaustiveness, and comprehensibility of the questionnaire, avoiding misleading, confusing, imprecise, and excessively technical language (e.g., abbreviations);

- Firms should give careful consideration to the layout and format of questionnaires and should avoid orienting investors' choices (e.g., font, line spacing…);

- Collecting information on a series of items through a single question should be avoided;

- Firms should carefully consider the order in which they ask questions in order to collect information in an effective manner;

- In order to prevent a client from guessing and thus providing unreliable information, the client should be able to reply that s/he does not know how to answer the question.

23. Firms should have procedures and mechanisms in place to limit the risk of circumventing the requirements, making sure that the information collected adequately reflects the client's level of knowledge and experience. For example, firms could: consider limiting the number of times clients can answer the questionnaire(s) within a certain period of time, work with different sets of questionnaires when a client requests to retake the questionnaire and/or use a cooling-off period. Where such measures are imposed, a client could still be allowed to proceed with the transaction, provided that a warning is issued in case of transactions in relation to which the client does not have sufficient

knowledge and experience[15]. Firms could also implement other controls to ensure that a client cannot repeat the questionnaire several times to "test" what kind of answers are needed to get the desired outcome.

24. As it is the responsibility of the firm to aim for collecting the relevant information from clients, firms should take all reasonable steps to sufficiently assess their clients' understanding of the main characteristics and the risks related to the specific types of investment products offered by the firm or at least to the product types in which the client has an interest. This includes an understanding of the relationship between risk and return on investments, for example by using questionnaires with multiple choice questions aimed at assessing the client's real knowledge about the specific types of investment products.

25. In assessing the knowledge of the client, firms should put in place mechanisms to ensure clients are not being asked to complete a self-assessment. Addressing the risk that clients may tend to overestimate their knowledge and ensuring the consistency of the answers provided by the client[16] are particularly important for the correct assessment of the client's knowledge. Firms should, in particular, avoid using yes or no questions and/or a tick-the-box self-assessment approach when asking the client whether s/he has sufficient knowledge about the main characteristics and risks of specific types of investment products (for example, firms should avoid submitting a list of investment products to the client and asking him to indicate which products s/he understands). Self-assessment should be counterbalanced by objective criteria. For example:

- Instead of asking whether a client understands the notions of risk-return trade-off of specific types of investment products, the firm should for instance question clients on some practical examples of situations that may occur in practice, for example by means of graphs or through positive and negative scenarios which are based on reasonable assumptions;

- Instead of asking a client whether s/he has sufficient knowledge about the main characteristics and risks of specific types of investment products, the firm should for instance ask questions aimed at assessing the client's real knowledge about the specific types of investment products, for example by asking the client multiple choice questions to which the client should provide the right answer;

26. In assessing a client's experience, a firm should also avoid using overly broad questions with a yes/no type of answer and or a very broad tick-the-box approach. Instead of asking a client whether s/he feels sufficiently experienced to invest in certain products, the firm should for instance ask the client what specific types of investment products the client is familiar with and how recent and frequent his/her trading experience with them is.

[15] See guideline 9.
[16] See guideline 4.

27. In case of online services, firms should design their questionnaires taking into account factors such as:

   - Whether the questions 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/support (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 suggesting they reconsider such responses; or implementing systems to automatically flag apparently inconsistent information provided by a client for review or follow-up by the firm).

28. Firms should refrain from providing the client with a warning that they are not in a position to determine whether the envisaged investment service or product is appropriate for them without previously asking the client for information about his/her knowledge and experience. Firms should also abstain from emphasising that the client could proceed without such an assessment. In these situations, such a warning should only be issued when the outcome of the appropriateness assessment cannot be determined because the client has not responded to all or part of the questions.[17]

29. Where firms pre-fill answers based on the client's transactions history with that firm (e.g., through another investment service), they should ensure that only fully objective, pertinent, and reliable information is used and that the client is given the opportunity to review and, if necessary, correct and/or complete each of the pre-filled answers to ensure the accuracy of any pre-populated information. Firms should also refrain from predicting clients' experience based on assumptions.

30. For the purpose of the appropriateness assessment, firms should only take into account the information on the client's knowledge and experience. Firms should avoid giving the perception to clients that information collected other than that which relates to a client's knowledge and experience, in particular with regard to the client's financial situation and investment objectives that may be collected for other purposes (e.g., in the context of product governance or in the context of advised services to the same client), is taken into account when conducting the appropriateness assessment.

Extent of information to be collected from clients (proportionality)

(Article 25(3) of MiFID II and Article 55 of the Delegated Regulation)

Guideline 3

[17] While taking into account guideline 9.

31. **In determining the extent of the information to be asked about the client's or potential client's knowledge and experience, firms should take into account the type and characteristics of the investment products or services to be considered (i.e., the level of complexity and risk of the investment products or services) and the nature of the client.**

32. In accordance with Article 25(3) of MiFID II, before providing non-advised services for which an appropriateness assessment is required, firms shall ask the client or potential client to provide information regarding their knowledge and experience in the investment field relevant to the specific type of investment service or product offered or demanded so as to enable the firm to assess whether the investment service or product envisaged is appropriate for the client.

33. Firms should ensure that they ask for information that takes into account the type and characteristics of the investment products or services that are considered (i.e., level of complexity and risk of the investment products or services) and the nature of the client.

34. In particular, in order to ensure that they are able to carry out the appropriateness assessment to the same standard regardless of the investment product or investment service considered, when providing access to more complex or risky investment products, firms should carefully consider whether they need to ask more in-depth information about the client's knowledge and experience than they would ask when less complex or risky investment products are at stake. This should enable firms to, on the basis of the answers provided, assess the client's capacity to understand the risks associated with such instruments. For such investment products with a high level of complexity or risk (for example, derivatives or leveraged products), firms should carry out, on the basis of the answers provided, a reliable assessment of the client's knowledge and experience, including, for example, his/her ability to understand the mechanisms which make the investment product "more complex or risky", whether the client has already traded in such products, the length of time s/he has been trading them for, etc.

35. Depending on the level of complexity of the investment products involved, the firm should assess the client's knowledge and experience more specifically than solely on the basis of the type to which the product belongs (e.g., subordinated debt instead of bonds in general).

36. When the firm intends to provide a non-advised service that has specific features, the firm should also, before such service is provided, conduct an appropriateness assessment relating to such specific features. This would for instance be relevant where a bundle of services or products is envisaged, for which, as required per Article 25(3) of MiFID II, the firm shall consider whether the overall bundled package is appropriate. For example, if a firm intends to provide both execution services and the ancillary service of granting loans allowing the client to carry out the transaction, this bundle of services will have different risks than each of the components considered in isolation. To take these differences into account when conducting the appropriateness assessment, it should not only relate to the envisaged investment products, but also to the ancillary service of

granting loans and to the risks resulting from the combination of both. Another example would be a firm that enables clients to open a short position by selling an investment product. In this context, the firm should specifically assess whether the client has the necessary knowledge and experience to understand the risks involved in short positions.

37. It is reminded that according to Article 56(1), second subparagraph of the MiFID II Delegated Regulation, a firm shall be entitled to assume that a professional client has the necessary experience and knowledge in order to understand the risks involved in relation to those particular investment services or transactions, or types of transaction or investment product, for which the client is classified as a professional client.

Reliability of client information

(Article 25(3) of MiFID II and Article 55(3) of the Delegated Regulation)

Guideline 4

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

39. If the information collected is not sufficiently reliable and consistent, this would amount to not having received sufficient information to conduct the appropriateness assessment and firms shall issue a warning to the client in accordance with the third subparagraph of Article 25(3) of MiFID II.

40. Firms should take reasonable steps to check the reliability, accuracy and consistency of information collected about clients and not merely rely on the fact that clients are expected to provide correct, up-to-date, and complete information as is necessary for the appropriateness assessment. Such steps could, for example, include asking the client for further clarification where the information collected on his/her knowledge and experience shows that s/he has more knowledge about complex bonds than about plain vanilla bonds.

41. Firms' policies and procedures should aim at assessing the quality and effectiveness of the means used to collect information on the knowledge and experience of clients or potential clients. Where firms rely on tools to be used by clients as part of the appropriateness process (such as online questionnaires or software assessing whether an investment product is appropriate or if a warning should instead be issued, i.e., "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. Firms should include consistency controls on the replies provided by clients in questionnaires in order to highlight contradictions between different pieces of information collected.

42. 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 in order to resolve any relevant potential

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inconsistencies or inaccuracies. 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.

Relying on up-to-date client information

(Articles 16(2) and 25(3) of MiFID II and Article 55(3) of the MiFID II Delegated Regulation)

Guideline 5

43. **When firms rely on previously collected information on clients' knowledge and experience, firms should establish procedures defining the frequency of updating such information in order to ensure that the information remains up to date and is accurate and complete for the purpose of the appropriateness assessment.**

44. For the purposes of the appropriateness assessment, firms could either collect information on a client's knowledge and experience each time before an investment product is offered or demanded (in case of one-off transactions) or rely on previously collected information, provided that it is up to date.

45. ESMA acknowledges that the issue of updating information in the context of the appropriateness assessment has a different nature than for the suitability assessment, because the information on a client's knowledge and experience will tend to be less volatile than other elements of the suitability assessment, and knowledge and experience generally increases overtime. Therefore, the frequency for updating information on clients could be lower under the appropriateness regime than under the suitability regime. Firms should develop a policy to assess knowledge and experience on a more regular basis with regard to groups of clients that are deemed more vulnerable.

46. The appropriateness assessment should be performed on the basis of reliable information about the client's knowledge and experience. Firms should implement procedures aimed at having at their disposal up-to-date information about the client's knowledge and experience anytime a product is offered or demanded, for example by asking clients with whom the firm has an ongoing relationship to inform the firm regularly of any change or update regarding the information originally provided. Firms should also have adequate procedures to deal with situations where the client does not answer to their questions regarding changes or updates of the information provided initially.

47. Information could be updated, for example, by sending a questionnaire to clients or providing clients with the client information available to the firm and requesting confirmation that it remains accurate, complete, and up to date. If in such a questionnaire, firms use pre-filled answers based on the client's transactions history with that firm, firms should ensure that only fully objective, pertinent, and reliable information is used to pre-fill those answers and that the client has the possibility to review and, if necessary, correct each of the pre-filled answers and complete them. Relevant actions following updating might include changing the client's level of knowledge and experience based on the updated information collected.

48. In order to avoid relying on client information that is incomplete, inaccurate, or out of date, firms should have arrangements in place to ensure that they ask the client to update the information on his/her knowledge and/or experience upon becoming aware of a relevant change that could affect his/her level of knowledge and/or experience.

49. Firms should adopt measures to mitigate the risk of inducing the client to update his/her level of knowledge or experience so as to make a certain investment product appear appropriate that would otherwise be inappropriate for him, without there being a real modification in the client's level of knowledge and experience. An example of a good practice to address this type of risk is the adoption of procedures to verify, before or after transactions are made, whether a client's profile has been updated too frequently or only after a short period of time from the last modification. Such situations would therefore be escalated or reported to the relevant control function. These policies and procedures are particularly important in situations where there is a heightened conflict of interest risk, e.g., in self-placement situations or where the firm receives inducements for the distribution of an investment product. Another relevant factor to consider in this context is the type of interaction that occurs with the client (e.g., face-to-face or through automated assessment).

Client information for legal entities or groups

(Articles 16(2) and 25(3) of MiFID II)

Guideline 6

50. **Firms should have a policy defining on an ex-ante basis how to conduct the appropriateness 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. Such a policy should be drafted in accordance with the general guideline 6 and supporting guidelines enshrined in ESMA Guidelines on certain aspects of the MiFID II suitability requirements[18].**

51. This implies, amongst others, that such a 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, and it should focus on this latter situation. Where the policy allows clients to agree to designate a representative, they should be made aware clearly and in written form about the effects that such agreements may have regarding the protection of their respective interests. Steps taken by the firm in accordance with its policy should be appropriately documented to enable ex-post controls.

52. Where a representative is foreseen under applicable national law or is designated, information about knowledge and experience should be collected from that

[18] ESMA Guidelines on certain aspects of the MiFID II suitability requirements (Ref: ESMA35-43-1163).

representative and the appropriateness assessment should be done with regards to that representative.

53. If the group of two or more natural persons involved have difficulties in deciding the person(s) with regard to whom the information on knowledge and experience should be assessed, the firm should adopt the most prudent approach by taking into account the information on the person with the least knowledge and experience. Firms should in such cases at least be prudent whenever there is a significant difference in the level of knowledge and experience of the different clients part of the group, or when the intended transaction may include leveraged investment products or contingent liability transactions that pose a risk of significant losses that could exceed the initial investment of the group of clients and should clearly document the approach chosen.

54. When a firm decides to ask information to assess the appropriateness for each individual client part of the group, the firm's policy should clearly specify how it will deal with those situations where there are significant differences between the level of knowledge and/or experience of those individual clients. Here again, the firm should adopt the most prudent approach by taking into account the information on the client part of the group with the least knowledge and experience. Alternatively, the firm's policy may also specify that it will not be able to assess the appropriateness in such a situation. In this context, it should be noted that collecting information on all the clients part of the group and considering, for the purposes of the assessment, an average profile of the level of knowledge and experience of all of them, would unlikely be compliant with the MiFID II overarching principle of acting in the clients' best interests.

Arrangements necessary to understand investment products

(Articles 16(2) and 25(3) of MiFID II)

Guideline 7

55. **Firms should ensure that policies and procedures are implemented to understand the characteristics, nature, and features of investment products in order to allow them to assess if such products are appropriate to their clients.**

56. For that purpose, firms should adopt reliable and objective procedures and tools that allow them to appropriately and in a proportionate manner consider the different characteristics and relevant risk factors (such as credit risk, market risk, liquidity risk) of the investment products offered or demanded. This should include taking into consideration the firm's analysis conducted for the purposes of product governance obligations[19]. In this context, firms should carefully assess how certain investment products could behave under different circumstances (e.g., convertible bonds which may, for example, change their nature into shares).

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

57. Considering the level of ‘complexity’ of products is particularly important, and this should be matched with the client’s information on knowledge and experience. Although complexity is a relative term, which depends on several factors, firms should – further to the assessment of products as complex or non-complex as required for the distinction between services that require an appropriateness assessment and those that do not - also take into account the criteria and principles identified in MiFID II, when defining and appropriately graduating the level of complexity to be attributed to investment products for the purposes of the appropriateness assessment.

58. Firms should adopt procedures to ensure that the information used to correctly classify investment products included in their product offer is sufficiently reliable, accurate, consistent, and up to date. Such procedures should take into account the different characteristics and nature of the investment products considered. In addition, firms should review the information used so as to be able to reflect any relevant changes that may impact the investment product’s classification. This is particularly important taking into account the continuing evolution and growing speed of financial markets.

59. When categorising investment products for the purpose of the appropriateness assessment, firms should use a sufficient level of granularity to ensure that only investment products with sufficiently comparable characteristics and risk features are grouped together and client’s experience and knowledge is being assessed on such characteristics and risks. Firms should consider multiple key factors for the categorisation (such as, for instance, optionality elements (in case of derivatives, or products with embedded derivatives); financial leverage; eligibility to bail-in; subordination clauses; observability of the underlying (e.g. the use of unfamiliar or opaque indices); guarantees of principal repayment or capital protection clauses; liquidity of the product (i.e. tradability on trading venues, bid-ask spread, selling restrictions, exit charges); and the currency denomination of the investment product).

MATCHING CLIENTS WITH APPROPRIATE PRODUCTS

Arrangements necessary to ensure a consistent appropriateness assessment

(Articles 16(2) and 25(3) of MiFID II and Articles 21 and 56(1) of the Delegated Regulation)

Guideline 8

60. **In order to assess whether an investment service or product envisaged is appropriate for the client, firms should establish policies and procedures to ensure that they consistently take into account:**

- **all information obtained about the client’s knowledge and experience necessary to assess whether an investment product is appropriate;**

- **all relevant characteristics and risks of the investment products considered in the appropriateness assessment.**

Firms should establish policies and procedures enabling them to issue a clear and not misleading warning in case they consider that the investment service or product is not appropriate for the client or potential client.

61. A sale of an investment product that amounts to a disinvestment by the client should not trigger the necessity for firms to conduct an appropriateness assessment.

62. Firms that rely on automated tools when conducting an appropriateness assessment should have appropriate systems and controls to ensure that the tools are fit for purpose and produce satisfactory results when matching the client's and investment product's characteristics.

63. 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 (according to their level of knowledge and experience) or investment products too broadly would not be fit for purpose.

64. Firms should clearly define and document the applicable methodology used to determine the outcome of the appropriateness assessment. Where a firm uses a defined scoring system to grade and assess appropriateness, the methodology, metrics, and formula used should be clear, unambiguous, and documented.

65. When assessing – in the course of conducting an appropriateness assessment – a client's understanding of the main characteristics and risks of the specific types of investment products offered or demanded, a firm should consider the information that it has collected about the client's knowledge and experience altogether for the overall appraisal of his/her understanding of the investment products and of the risks involved in the envisaged transactions.

66. Relevant staff should have sufficient and unambiguous guidelines as to how to perform the appropriateness assessment, to ensure they do not have undue discretion when performing this assessment and to be in a capacity to justify their decision ex-post. Firms should ensure that tools and procedures adopted for the appropriateness assessment are designed in such a way that a client would not match with types of investment products for which the client's experience and/or knowledge has not been assessed or for which the client has not shown a sufficient level of knowledge and/or experience, and that a proper warning is issued accordingly.

67. In order to ensure the consistency of the appropriateness assessment conducted through automated tools (even if the interaction with clients does not occur through automated systems), algorithms that determine the appropriateness of investment products offered or demanded should be properly documented and regularly monitored and tested. When defining such algorithms, firms should take into account the nature and characteristics of the investment 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 services if that error is likely to result in an inappropriate transaction 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 services provided; and

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

Effectiveness of warnings

(Article 25(3) of MiFID II and Article 56(2) of the Delegated Regulation)

Guideline 9

68. **To ensure its effectiveness, the warning issued by firms in case no or insufficient information is provided by the client on his/her knowledge or experience, or in case the assessment of such information shows that the investment service or product offered or demanded is not appropriate for the client, must be prominent, clear, and not misleading.**

69. Firms should take reasonable steps to make sure the warnings they issue to clients are correctly received and understood as such. To this end, warnings should be prominent. This could be done for example by using a different colour for the warning message from the rest of the information provided or, if the order is placed over the telephone, by explaining the warning and its impact to the client while answering any questions from the client to ensure that the client has correctly received and understood the warning.

70. The warnings issued by firms should clearly state the reason for warning the client: either that no information was provided by the client or that the information collected is insufficient and that the firm therefore is not in a position to determine the appropriateness of the envisaged transaction, or that the assessment of the information provided by the client shows that the envisaged transaction is inappropriate for the client. For example, ambiguous messages stating that the product is appropriate for "basic/intermediate/expert clients" should be avoided. Similarly, firms should avoid issuing warnings containing imprecise language (e.g., stating that the product or service "may not be appropriate" for the client), as they are unlikely to make the client sufficiently aware of the risks of proceeding with the transaction. Firms should also avoid overly long warnings that obscure the key message that the client does not have or did not demonstrate having the necessary knowledge and experience for the investment service or product.

71. Firms should not downplay the importance of warnings and should not encourage the client to ignore them (e.g., during telephone conversations or in language used in the warning).

72. Firms should avoid the use of messages in the warnings that could encourage the client to proceed with the transaction, to re-take the appropriateness assessment or to request an upgrade to professional client. For example, firms could implement a process that the client needs to confirm that s/he is aware of the information provided in the warning before s/he can proceed with the transaction.

73. If a client who does not have the necessary knowledge and experience is offered educational tools, webinars, or 'demo' trading platforms with the aim of improving his/her knowledge, the firm should, subsequently, determine that the client has the necessary knowledge regarding the envisaged investment service or product by conducting another appropriateness assessment focused on his/her level of knowledge. Such educational tools should not be structured in such a way that they specifically aim to improve the client's ability to provide correct answers to a predefined set of questions as this may lead to a circumvention of the firm's obligation to assess the client's knowledge and experience of the investment products offered or demanded.

74. Where firms' policies and procedures provide for the possibility to accept their clients' requests to proceed with the transaction after a warning has been issued, firms should evaluate the overall effectiveness of the warnings issued on an ex-post basis, for instance, by assessing the ratio of warnings that were followed by a transaction to the total of all warnings issued and should make adjustments to their relevant policies and procedures where necessary.

75. Additionally, by way of good practice, firms could have policies and procedures identifying any conditions and criteria under which a client's request to proceed with a transaction after having received a warning could be accepted or not. For example, a firm could take into account situations where there is a heightened risk of conflicts of interest because the firm is selling its own investment products (or investment products issued by entities of the same group) or actively marketing investment products from

within the firm's range. Another factor that could be considered is a high level of complexity or risk of products offered or demanded.

OTHER RELATED REQUIREMENTS

Qualifications of firm staff

(Articles 16(2) and 25(3) of MiFID II and Article 21(1)(d) of the Delegated Regulation)

Guideline 10

76. **Staff involved in the appropriateness assessment should understand the role they play in this assessment and have an adequate level of skills, knowledge, and expertise, including sufficient knowledge of the relevant regulatory requirements and procedures in order to discharge their responsibilities. To that end, firms should regularly train their staff.**

77. ESMA emphasises that staff giving information about investment products, investment services or ancillary services to clients on behalf of the firm 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[20]), including with regard to the appropriateness assessment.

78. Firms should also ensure that other staff that do not directly face clients but are involved in the appropriateness assessment in any other way should still possess the necessary skills, knowledge and expertise required depending on their particular role in the appropriateness process. This may regard, for example, setting up the questionnaires, defining algorithms governing the assessment or other aspects necessary to conduct the appropriateness assessment and controlling compliance with the appropriateness requirements.

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

    - have an appropriate understanding of the technology and algorithms used to conduct an automated assessment (particularly, staff should be able to understand the rationale, risks and rules behind the algorithms underpinning the automated assessment); and

    - are able to understand and review the automated assessment generated by the algorithms.

[20] ESMA Guidelines for the assessment of knowledge and competence (Ref: ESMA71-1154262120-153 EN (rev)).

Record-keeping

(Articles 16(6), 16(7), 25(5) and 25(6) of MiFID II and Articles 56(2) and 72 and 76 of the Delegated Regulation)

Guideline 11

80. **As part of their obligation to maintain records of the appropriateness assessment referred to in Article 56(2) of the MiFID II Delegated Regulation, firms should at least:**

    - **maintain adequate recording and retention arrangements to ensure orderly and transparent record-keeping regarding the appropriateness assessment, including the collection of information from the client and the non-advised service provided;**

    - **ensure that record-keeping arrangements are designed to enable the detection of failures regarding the appropriateness assessment;**

    - **ensure that records kept are accessible for the relevant persons in the firm and for competent authorities;**

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

81. Record-keeping arrangements adopted by firms should be designed to enable firms to track ex-post:

    - the result of the appropriateness assessment including its rationale, i.e. a clear and straightforward link between the client information gathered and assessed and the outcome of the assessment;

    - any warning issued by the firm where the investment service or product was assessed as potentially inappropriate for the client, or where the client did not provide sufficient information to enable the firm to undertake an appropriateness assessment (irrespective of whether the client asked to proceed with the transaction or not);

    - whether the client asked to proceed with the transaction despite the warning; and

    - whether the firm accepted the client's request to proceed with the transaction in accordance with the related procedures adopted.

82. Therefore, a firm should record all relevant information about the appropriateness assessment, such as information about the client (including how that information is used

and interpreted to define the client's knowledge and experience profile), and information about investment products offered to the client. Those records should include:

- any updates to the information provided in the context of the appropriateness assessment, in particular any change to the client's knowledge and experience profile;

- the types of investment products that fit that profile and the rationale for such an assessment, as well as any changes and the reasons for them.

83. Firms should have in place arrangements enabling them to understand and mitigate the additional risks that could affect the provision of investment services through online or digital tools such as malicious cyber activity.[21]

84. Record-keeping arrangements adopted by firms may vary depending on the distribution channel used to provide non-advised services. For instance, firms should:

- where services are provided online, develop IT tools to track and store the information;

- where services are provided by telephone, adopt appropriate arrangements to ensure that the firm is able to link any warning issued by it with a possible transaction made by the client who decides to proceed despite that warning;

- where services are provided face-to-face, collect and record all relevant forms and documents used in the appropriateness process, in particular those signed by the client and/or the firm's staff.

Determining situations where the appropriateness assessment is required

(Articles 16(2), 25(3) and 25(4) of MiFID II and Article 57 of the Delegated Regulation)

Guideline 12

85. **Firms should adopt appropriate arrangements to ensure that they are able to determine situations where an appropriateness assessment needs to be performed and avoid performing one in situations where a suitability assessment needs to be performed**.

86. Firms should have procedures and controls in place regarding the interaction between sales staff and clients to guide and record[22] the interaction and ensure that there is a clear distinction between advised and non-advised transactions on the one hand, and,

[21] Firms should consider such risks not only in relation to the provisions stated in the guideline, but also as part of a firm's wider obligations under Article 16(4) of MiFID II to take reasonable steps to ensure continuity and regularity in the performance of investment service and activities, and corresponding delegated act requirements linked to this.
[22] While taking into account guideline 11.

on the other, between transactions falling within the execution-only exemption and other non-advised transactions.

87. Firms should have in place policies and procedures to ensure that the conditions provided in Article 25(4) MiFID II for providing an "execution-only service" where an appropriateness assessment is not conducted are being met.[23]

88. Firms should design, implement, and update policies and processes to identify which of their investment products may be regarded as "complex" and "non-complex" for the purposes of the appropriateness requirements. Unless they have been assessed against and have met all the criteria of Article 57 of the MiFID II Delegated Regulation, 'other non-complex financial instruments' as referred to in Article 25(4)(a)(vi) of MiFID II should be categorised as complex.

89. Firms' policies and processes should ensure that the investment products expressly excluded from the list of non-complex instruments of Article 25(4)(a)(i-v) of MiFID II are in any case not assessed against the criteria set out in Article 57 of the MiFID II Delegated Regulation to potentially be categorised as non-complex investment products for the purposes of the appropriateness assessment.

90. Firms should be able to trace whether a client has submitted his/her order in response to a personalised communication from or on behalf of the firm. In such cases, the firm should disqualify the transaction for the purposes of the "execution-only" exemption.

Controls

(Articles 16(2), the second subparagraph of 16(5) and 25(3) of MiFID II and 76 of the Delegated Regulation)

Guideline 13

91. **Firms should have appropriate monitoring arrangements and controls in place to ensure compliance with the appropriateness requirements.**

92. When firms rely on automated systems or tools in the appropriateness assessment process (e.g., client-profiling tools based on knowledge and experience, automatic warnings, or controls on complexity of investment products), these systems or tools should be fit for purpose and should be monitored periodically. Firms should keep records of this monitoring.[24]

93. When making use of automated controls in the context of the appropriateness assessment, firms should ensure that the automated controls cannot be circumvented[25]

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[23] This does not prevent firms from carrying out an appropriateness assessment for all kinds of products, complex and non-complex.
[24] See also guideline 11
[25] Exceptions should be reserved for specific circumstances set in the firm's procedures and with specific hierarchical authorisation.

and should periodically monitor the correct functioning of these automated controls. Firms should have appropriate policies and procedures in place to detect IT issues at an early stage.

94. In the context of the appropriateness assessment, firms should pay particular attention to the complexity of investment products. For example, databases with complexity codes used for the appropriateness assessment tools should be reviewed on a regular basis and should be kept up to date.

95. When the appropriateness assessment is done through face-to-face meetings or by telephone, in which case a human intervention exists, firms should include written records from face-to-face meetings or telephone recordings in their regular control processes to monitor whether sales staff comply with their duties in the context of the appropriateness assessment. Firms should monitor these written records or telephone recordings as part of their control procedures.

96. Firms should monitor matters such as the ratio of warnings that were followed by a transaction to the total of all warnings issued in order to evaluate the overall effectiveness of the warnings issued.