



**1 December 2021**

**Re: Common Supervisory Action on MiFID II Suitability Requirements**

Dear CEO

Throughout 2020, the Central Bank of Ireland (“Central Bank”) undertook a review of Firms’ compliance with the suitability requirements in the European Union’s Markets in Financial Instruments Directive (MiFID II). The review was conducted as part of a Common Supervisory Action (CSA) coordinated by the European Securities and Markets Authority (ESMA). The purpose of the review was to assess Firms’ compliance with the suitability requirements under MiFID II by simultaneously conducting supervisory activities throughout the EU/EEA.

The CSA involved an assessment of MiFID-authorized Firms and Credit Institutions, throughout the EU/EEA, which offer MiFID services requiring an assessment of suitability to be undertaken. Central to the exercise was the formulation of a common methodology and framework, alongside clear supervisory expectations, which allowed National Competent Authorities (NCAs) to assess Firms’ compliance with the suitability requirements in a consistent manner, ensuring a convergent supervisory outcome was achieved. The findings, which are highlighted in ESMA’s recent public statement<sup>1</sup>, incorporate the findings from the Central Bank’s own supervisory analysis, and engagement with other NCA’s.

When providing investment advice and/or portfolio management, Firms are required to take all reasonable steps to ensure that a client’s investments align to their objectives and personal circumstances. This is a key measure to protect investors from the risk of purchasing unsuitable products.

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<sup>1</sup> [ESMA Public statement on the findings from the 2020 CSA on Suitability](#)



In order to complete the review, the Central Bank engaged with all Irish authorised MiFID Firms and Credit Institutions offering MiFID services requiring an assessment of suitability to be undertaken. This included gathering information on the suitability practices within the Firms and obtaining information to identify any concentration of risk. A significant desk-based review then commenced and virtual inspections were undertaken in selected Firms. The sample of Firms utilised in the inspection covered 97% of all suitability assessments undertaken in 2019, which represented 83% of all retail clients. A report detailing the Central Bank's findings was submitted to ESMA in H1 2021.

ESMA's public statement details a number of shortcomings within the suitability process and areas where improvements are required, some of which are specific to the introduction of MiFID II, such as enhanced requirements on suitability reports.

The ESMA public statement, which should be read in conjunction with this letter, reminds all market participants to ensure compliance with all relevant MiFID II requirements at all times. NCAs will continue to engage in follow up actions based on findings within each jurisdiction. In the case of the Central Bank, this has included engaging directly with those Firms where mitigating action is required to improve their investor protection frameworks in the context of all recent conduct findings. This has resulted in the Central Bank issuing thirty six Risk Mitigation Programmes, requiring Firms to take specific action on foot of our findings.

The purpose of this letter is to provide feedback to industry on the findings of this review and to outline the Central Bank's expectations in relation to the application of the MiFID II suitability requirements.

### **Findings**

We have also elaborated below on some of the findings in the ESMA public statement where we wish to highlight areas for attention by Firms authorised in Ireland. As such this letter is to be read in conjunction with the ESMA public statement and does not take from the importance of any aspect of that statement which might not be referred to in this letter.



### ***Firms need to adopt a client-focused approach***

The ESMA public statement noted a number of key investor protection weaknesses which are consistent with the findings of the Central Bank. While our inspection did observe some good practices, examples of which are outlined in **Appendix 1**, our overarching concern is that Firms have failed to establish a risk-based and client-focused approach to suitability that prioritises positive outcomes for clients and puts the necessary safeguards, procedures and controls in place to ensure clients' best interests are protected.

For example, more positive practices were identified where Firms took a personalised and comprehensive approach to advice and suitability that recognised all aspects of a client's situation and circumstances, compared to where Firms only considered information required for the individual transaction at hand. Other positive practices included Firms which considered proposed new products in terms of client focused criteria. Correspondingly, the Central Bank has identified instances where Firms failed to establish tailored suitability frameworks specific to their businesses and the needs and circumstances of their clients. This resulted in inadequate risk assessments of their individual business models, product offerings and internal systems and practices.

The absence of a client-focused approach was also evident in inadequate training frameworks, poor reporting and disclosures to clients, and a failure to establish clear procedures for the identification of potentially vulnerable clients. In some instances, the Central Bank identified Firms where speed and convenience of a transaction was prioritised over conducting a comprehensive suitability assessment. Where a Firm utilises digital channels in the suitability assessment, Firms must meet the same high standards of compliance and investor protection, regardless of the distribution channels or mechanisms used to deliver investment services.

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

A key element of the MiFID II requirements is the need for Firms to collect all necessary information to enable Firms to recommend to the client or potential client the investment services and financial instruments that are suitable.



In line with ESMA findings, it was not always evident how Firms considered all relevant information in their assessment, particularly information relating to clients' financial situation and their capacity to withstand losses, instead relying on the client's risk tolerance despite the two covering different aspects of the suitability assessment<sup>2</sup>. Firms must ensure they have clear procedures for calculating clients' capacity for loss, to ensure clients do not invest in products that are outside their financial capacity.

It is critical that Firms conduct a holistic assessment of all client circumstances to make a fair and balanced recommendation, and this must be clearly evidenced in Firms' records and files. In some cases it appeared Firms heavily prioritised the assessment of one or two aspects of a client's circumstances, at the expense of others. Shortcomings were also evident in poor record-keeping<sup>3</sup>, with a failure to evidence how the suitability assessment was conducted and how information gathered was used to inform the recommendation.

The review did witness positive practises where Firms updated client information more frequently depending on the risk profile of the client. Firms must ensure they have mechanisms in place to regularly update client information, as the overall findings of the CSA across Europe highlighted significant variances in the frequency of updates.

### ***Suitability Reports need to be sufficiently detailed and personalised***

Transparency and effective disclosure is key to enabling investors to make informed decisions. The suitability report, which was introduced under MiFID II, should be a personalised document that enables the investor to understand how and why a product has been deemed suitable for them, based on their individual circumstances.

The CSA identified instances where suitability reports were not sufficiently detailed or personalised, instead relying on automated templates and standardised wording that provides little value to clients. Information on the client's financial situation was sometimes missing or limited, and the report failed to illustrate why the recommendation was consistent with the client's circumstances.

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<sup>2</sup> [ESMA Public statement on the findings from the 2020 CSA on Suitability](#)

<sup>3</sup> Suitability General Guideline 12



As outlined in the ESMA findings, Firms must reassess their suitability report to ensure they are avoiding a generic, ‘tick-box’ approach<sup>4</sup> to disclosure and are complying with all relevant requirements, as set out under MIFID II. They must ensure the document is specific to their own business model and product offering, is up to date and acts as a bespoke, valuable communication in the context of the individual client’s needs, objectives and circumstances.

### ***Controls on ‘Exception’ Processes need to be stricter***

The Central Bank is particularly concerned at the quality of oversight of ‘exception’ processes, whereby a client insists on proceeding with the transaction at their own initiative<sup>5</sup>, against the Firm’s suitability advice. In such a case, the client should be clearly informed that the transaction is not considered by the Firm to be suitable, including a clear explanation of the potential risks involved by proceeding to trade. To ensure compliance with MiFID II requirements, Firms must have documented processes in place which demonstrate the transaction was initiated by the client. Firms stated that such practices were permitted only at the exclusive initiative of the client, however there was inadequate rationale or records to support this. We also observed cases where clients could ‘opt-up’ to a higher risk profile than determined by the Firm in order to trade in riskier products, with limited or no management sign off required to proceed to trade. Where exceptions are utilised, they must be subject to stringent oversight and controls.

Firms also failed to demonstrate that they have effective training or oversight procedures in place to ensure sales advisors are not unduly influencing clients to avail of these exceptions and invest in unsuitable products, for example by only emphasising the positive aspects of the product<sup>6</sup>. Disclosures around the practices observed were not sufficiently clear, creating a risk of ambiguity in the nature of the service being provided and level of protection afforded to clients.

We also observed cases where Firms used disclaimers, signed by clients, which could potentially be read to limit the responsibility of the Firm regarding the suitability assessment and its obligations<sup>7</sup>.

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<sup>4</sup> ESMA Investor Protection Q&As on the Suitability Report

<sup>5</sup> [ESMA Investor Protection Q+A](#) - Recital 87 of the MiFID II Delegated Regulation clarifies that a suitability assessment should be undertaken “not only in relation to [when] recommendations to buy a financial instrument are made but for all decisions whether to trade including whether or not to buy, hold or sell an investment”.

<sup>6</sup> ESMA Investor Protection Q&As on suitability and appropriateness, Question 6 p.39

<sup>7</sup> ESMA Suitability General Guidelines 4, point 45 state that any agreement signed by the client, or disclosure made by the Firm, that would aim at limiting the responsibility of the Firm with regard to the suitability



In light of these findings, Firms who permit exceptions to their standard suitability practices must review each of these exceptions to determine whether they are in clients' best interests, are properly controlled and overseen by senior management. This review should include having regard to the MiFID requirement that, when providing the investment service of investment advice or portfolio management, a Firm shall not recommend or decide to trade where none of the services or instruments are suitable for the client<sup>8</sup>.

### **Action Required**

In light of these findings, all Irish authorised MiFID Firms and Credit Institutions, who provide portfolio management and advisory services to retail clients, are required to conduct a thorough review of their individual sales practices and suitability arrangements. This review must be documented and must include details of actions taken to address findings in the ESMA public statement and this letter. This review should be completed and an action plan discussed and approved by the board of each Firm by end of Q1 2022.

Where the Firm participated in the inspection and received formal mitigating actions, the feedback in the ESMA public statement and this letter should be considered in conjunction with those remediation activities.

In circumstances of non-compliance by any Firm with any regulatory requirements relevant to the matters raised in this letter, the Central Bank may, in the course of future supervisory engagement, or when exercising its supervisory and/or enforcement powers in respect of such non-compliance, have regard to the consideration given by a Firm to the matters raised in the ESMA public statement and this letter.

Should you have any queries in relation to the contents of this letter, please contact [mifidconductofbusiness@centralbank.ie](mailto:mifidconductofbusiness@centralbank.ie).

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assessment, would not be considered compliant with the relevant requirements in MiFID II and related Delegated Regulation

<sup>8</sup> MiFID II Delegated Regulation 54 (10)



Yours sincerely

A handwritten signature in black ink that reads "Sandra Shanley". The signature is written in a cursive, flowing style.

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Sandra Shanley

Head of Function

Consumer Protection – Investment Firms and Client Assets Division  
Central Bank of Ireland



## Appendix 1

The examples of good and poor practices below relate to areas evaluated during the inspection and are not an exhaustive list of good and poor practices relating to suitability compliance.

Topic	Positive Practices Observed	Weak Practices Observed
<b>Monitoring &amp; Oversight</b>	<ul style="list-style-type: none"><li>• Clear involvement of the third line of defence.</li><li>• High-volume quality assurance and monitoring of client suitability files.</li></ul>	<ul style="list-style-type: none"><li>• Absence of a risk-based monitoring programme that applies additional monitoring or controls to higher-risk practices.</li><li>• No reviews or second checks of assessments, instead relying fully on advisors.</li><li>• Business functions rejecting recommendations arising from control functions.</li></ul>
<b>Training</b>	<ul style="list-style-type: none"><li>• Real-world scenarios that demonstrate how the suitability assessment should be undertaken, and potential risks to clients, e.g. worked examples for assessing capacity for loss.</li><li>• Additional training triggered as required, e.g. by new products or market volatility.</li><li>• Mandatory training required for all staff involved in suitability, escalated in cases of non-completion.</li></ul>	<ul style="list-style-type: none"><li>• Minimal or no consumer-focus.</li><li>• Material is not tailored to Firm's business model, sales strategy or product offering.</li><li>• Failure to ensure all relevant staff involved in suitability (including administrative staff) receive formal suitability training.</li><li>• Over reliance upon staff longevity at the expense of formal and regularly updated suitability training.</li></ul>
<b>Vulnerable Clients</b>	<ul style="list-style-type: none"><li>• Clear policies and procedures for identification of vulnerable clients.</li><li>• Procedures outline clear actions that must be taken.</li></ul>	<ul style="list-style-type: none"><li>• Vague or non-existent policies for defining vulnerabilities.</li><li>• Policies not implemented in practice.</li><li>• Suggested, non-mandatory actions to be taken.</li></ul>





	<ul style="list-style-type: none"> <li>• Vulnerable clients are reviewed more frequently and additional measures undertaken.</li> </ul>	<ul style="list-style-type: none"> <li>• No evidence of formal additional checks/monitoring.</li> </ul>
<b>Disclosures</b>	<ul style="list-style-type: none"> <li>• Clear disclosures within documentation and Terms &amp; Conditions stating responsibility for suitability assessment lies with the Firm.</li> </ul>	<ul style="list-style-type: none"> <li>• Unclear disclosures within Terms &amp; Conditions, limiting Firms' responsibility regarding the assessment of suitability.</li> </ul>
<b>Arrangements to Understand Investment Products<sup>9</sup></b>	<ul style="list-style-type: none"> <li>• Firms assess and consider proposed new products against a list of client-focused criteria, including whether the fees and underlying investment are appropriate.</li> <li>• Investment Committees, with compliance representation, in place to approve and monitor products.</li> <li>• Use of restricted lists of products that are too risky/complex for sale to retail clients.</li> <li>• Regular evaluation of products' performance, with movements triggering reassessment of suitability.</li> </ul>	<ul style="list-style-type: none"> <li>• Lack of formal policies and procedures to ensure Firms understand the investment products selected for their clients, including the complexity and risk of the product. Instead, reliance placed on basic templates containing limited information.</li> </ul>
<b>Updating of Suitability Information</b>	<ul style="list-style-type: none"> <li>• Material changes in client circumstances or market events trigger updating of information.</li> <li>• More frequent updates depending on the risk profile of the client<sup>10</sup>.</li> <li>• Client information checked and updated at every interaction.</li> <li>• Blocks placed on accounts where information is out of date.</li> </ul>	<ul style="list-style-type: none"> <li>• Infrequent minimum update of information.</li> <li>• No risk-based approach to updating information.</li> <li>• Account blocks may be overridden without appropriate approval or sign-offs, rationale unclear.</li> </ul>

<sup>9</sup> ESMA Suitability General Guideline 7

<sup>10</sup> Suitability General Guideline 5 (54)