

If the client does not provide the information on the MiFID questionnaire, the bank must refrain from providing investment advice

Before providing investment advice, a bank must gather the requisite information from its client about his or her knowledge, experience, financial situation and goals. Failure to do so can have serious consequences for the bank. This month's case offered me an opportunity to reiterate these principles as well as the rules applicable in such circumstances.

The facts

In 2009, Mrs X entered into an advisory management agreement (dynamic management option) covering an equity savings plan and securities account held with Bank A. Clients who sign this agreement receive recommendations to buy or sell specific financial instruments, either at their own request or at the initiative of Bank A.

Mrs X said that in Q1 2011, her advisor manager recommended buying a large quantity of B securities, which accounted for over half her portfolio.

The price of these securities then plummeted, causing heavy losses.

Mrs X claims that she has no knowledge of financial markets and that her advisor manager never recommended selling the securities to limit her losses. She accused Bank A of failing in its duty to provide advice.

She turned to me with a claim for damages equal to the capital losses on her portfolio.

The analysis

I asked Bank A whether it had complied with its duty to provide advice¹ to Mrs X.

The bank told me that under the advisory management agreement, the advisor manager was not required to sell Mrs X's securities to limit her losses. According to the bank, since the agreement signed by Mrs X was not a management mandate², the bank was under no obligation to monitor Mrs X's portfolio and step in to reduce her capital losses.

After reviewing the file, I found that the agreement signed by Mrs X was indeed not a management mandate. However, I saw that in an email to Mrs X her manager had, after providing some general market information, recommended buying and then "*holding*" the B securities. This constituted investment advice from Bank A to Mrs X within the meaning of Article 314-43 of the AMF General Regulation³ as applicable at the time of the events.

¹ Article L.533-13 I of the Monetary and Financial Code: "*With a view to providing an investment consultancy service or a portfolio management service on behalf of third parties, investment service providers shall make enquiries of their clients, including their potential clients, concerning their knowledge of, and experience in, investment matters, as well as their financial situation and their investment objectives, so as to enable them to recommend suitable financial instruments to them or to manage their portfolio in a manner appropriate to their situation*".

² A management mandate is an agreement whereby a client authorises a manager (representative) to manage a portfolio comprising one or more financial instruments, such as equities, bonds and investment funds, according to the client's goals, experience and situation. The manager must first ask the client about his or her goals, experience and situation. The client agrees to refrain from giving any instructions during the term of the mandate.

³ Article 314-43 of the AMF General Regulation, "*a recommendation shall be personalised if it is addressed to a person in his capacity as an investor or a potential investor, or in his capacity as a representative of an investor or a potential investor. The recommendation must be presented as adapted for that person or based on an examination of the specific circumstances of that person. [...]*"

Under Article 314-43 of the AMF General Regulation, investment advice is defined as the provision of personalised recommendations to a client, either at the request of that client or at the initiative of the account-keeper, in relation to one or more transactions involving financial instruments.

Accordingly, I went back to Bank A with my analysis and asked it to send me the documentation that must be obtained before investment advice is provided.

Bank A said that it was unable to locate the MiFID Know Your Customer (KYC) questionnaire, even though this questionnaire must be completed before investment advice can be provided.

The recommendation

I felt in this case that by not being able to produce Mrs X's KYC questionnaire, Bank A could not prove that it had made sure that the recommended transactions, namely the buying and holding of B securities, were suited to its client's financial situation, needs, goals and experience.

Based on all the information and the patent underdiversification of Mrs X's portfolio, I recommended to Bank A that it should pay compensation in the amount of the capital losses sustained by Mrs X on her securities.

The bank agreed to review its position and follow my suggestion.

Lesson to be learned

Two lessons can be learned from this case.

First, since there was no management mandate, it was necessary to show that Mrs X had indeed been provided with investment advice. As regards this point, the whole idea of an advisory management agreement, which is the subject of specific remuneration, is to provide investment advice.

Beware of confusing discretionary management mandates with advisory management agreements: while the terms are relatively similar and easy to confuse, the investment service provided by the financial institution is very different.

A client who signs a management mandate leaves the financial institution to manage the portfolio and agrees not to interfere in management. Under an advisory management agreement, however, the financial institution merely provides the client with investment advice. The client is supported by the financial institution but remains in charge of investment decisions.

Second, before providing the remunerated service of investment advice, account-keepers must gather essential client information to ensure that they are legally entitled to recommend suitable financial instruments. If clients, and especially potential clients, do not provide the information required in the MiFID questionnaire, service providers must refrain⁴ from recommending financial instruments to them. If a bank feels that it has not provided advice or is merely receiving/transmitting orders, the obligations to which it is subject are set out expressly in Art L. 533-13 II and III of the Monetary and Financial Code.

I would be remiss if I failed to mention the new requirements arising from MiFID 2, which came into effect barely a month ago and which steps up the obligations on ISPs in terms of assessing suitability. I will surely have an opportunity to revisit these requirements in the future when dealing with a case that is subject to the new provisions.

⁴ Article L533-13 of the Monetary and Financial Code