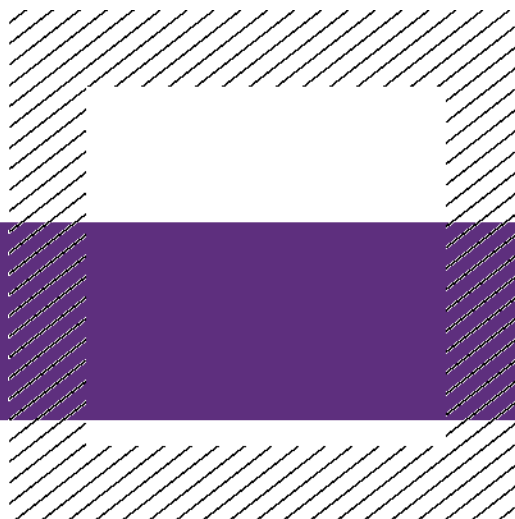




OCTOBER 2018

**SUMMARY OF SPOT INSPECTIONS ON
MIFID I/MIFID II CLIENTS' KNOWLEDGE
AND EXPERIENCE**



INTRODUCTION

As part of its new #Supervision2022 strategy, at the beginning of the year the AMF announced its intention to conduct more brief and thematic inspections known as “SPOT” (*Supervision des Pratiques Opérationnelle et Thématique* - operational and thematic supervision of practices) as well as its desire to share the lessons learned from these exercises. This report contains the summary of the brief inspections carried out during the first half of 2018 on the gathering of information relating to retail banking clients’ investment knowledge and experience. These missions focused both on the application of the rules imposed by the European directive 2004/39/EC of 21 April 2004 concerning Markets in Financial Instruments, which entered into force on 1 November 2007 (hereinafter “MiFID I”), and on the changes introduced by the European directive 2014/65/EU of 15 May 2014, which entered into force on 3 January 2018, and Commission delegated regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU (hereinafter “MiFID II”).

These inspections should be viewed in the light of, on the one hand, the summary published on 10 July 2018 on the marketing of financial instruments, and on the other hand, the entry into force of MiFID II.

1 SCOPE AND METHOD OF THE INSPECTIONS CARRIED OUT IN 2018

These inspections on clients’ investment knowledge and experience were carried out simultaneously in five firms.

The inspections looked in particular at:

- ☐ The firms’ new business relationship and marketing procedures;
- ☐ The procedures for gathering and updating information relating to clients’ investment knowledge and experience;
- ☐ The questionnaire forms used to gather this information.

The investigations focused on the firms’ compliance with MiFID I obligations. Changes introduced due to the entry into force of MiFID II (particularly relating to the changes in questionnaires used to gather information on clients’ investment knowledge and experience) were also analysed this time.

The selected subscriptions (numbering 20 per entity¹) were made by individual investors during 2017 (during the validity period of MiFID I) and related to the financial instruments that were most heavily marketed by the five firms in question, i.e. shares and units in undertakings for collective investment in transferable securities (UCITS).

¹ For these 100 selected subscriptions, the investment service provided to the client was order reception/transmission (48 cases), investment advice (30 cases) and discretionary management (22 cases).

2 KEY LESSONS LEARNED FROM THE INSPECTIONS

SUMMARY

- With regard to the gathering of information relating to **clients' knowledge**, the exclusive use of self-assessment, which was widely used under MiFID I in the firms inspected, has disappeared with the entry into force of MiFID II. Some firms have even taken the opportunity to establish very detailed questionnaires, adapted to different categories of financial instrument².
- All the firms inspected have established either **additional questionnaires** dedicated to complex or risky products, or a **document summarising the risks** associated with the product in order to ensure that the client is fully aware thereof (which constitutes good practice as already specified in the summary published in June 2018³ and is all the more remarkable if it existed before the entry into force of MiFID II).
- With regard to the gathering of information relating to **clients' experience**, the situation is more contrasted: only one firm asked the client to specify the number and average amount of orders by category of financial instrument, having observed that MiFID II made no changes on this point.
- Since MiFID II entered into force, all the firms inspected have now implemented **client profiling**. Note that clients who refused to respond to the client knowledge and experience questionnaire are clearly identified, in order not to confuse them with "beginner" profiles that are likely to receive investment advice⁴.
- In terms of **updates to the questionnaire**, all the firms inspected have now defined the minimum frequency for updates.

At the time of the inspections, and particularly during the analysis of the client knowledge and experience questionnaires used by these firms, the following points were also raised:

- With regard to the **client's financial position**, the types of information collected are appropriately detailed in all the firms inspected. Note that where a client refuses to identify their assets⁵ or liabilities with other firms, the firms inspected do not refrain from providing that client with investment advice, and, as the case may be, they warn the client that the advice provided may not be optimal for their situation.
- With regard to the gathering of information on the **client's investment plan**, the types of long-term investment horizon tend to be more fine-tuned with the entry into force of MiFID II (three of the five firms have added a long-term investment horizon).

² Conversely, one of the firms inspected has integrated an element of self-assessment that did not exist before (not validating the client's knowledge and only asking them questions if they have in the past declared a high level of knowledge) and simplified its previous questionnaire, which was, however, of a good standard with respect to MiFID I.

³ Summary of inspections carried out on the marketing of financial instruments in June 2018, published on the AMF website in July 2018.

⁴ When MiFID II entered into force, one of the firms inspected opted to no longer open securities accounts for clients who refused to respond to the investment knowledge and experience questionnaire.

⁵ This observation follows on from the previous summary of inspections carried out on the marketing of financial instruments in June 2018, which was published on the AMF website in July 2018.

2.1 GATHERING INFORMATION ON CLIENT KNOWLEDGE

Overview: As a result of the entry into force of MiFID II, the new wording of points I and II of article L.533-13 of the French Monetary and Financial Code expressly provides for the gathering of information concerning *“the investment knowledge and experience of their clients [...] in relation to the specific type of financial instrument or service [...]”*

In three of the firms inspected, the information on the client's investment knowledge and experience was gathered exclusively from self-assessments before the entry into force of MiFID II.

These firms had determined four categories of financial instrument (*“money market products”, “bond products”, “equities and diversified products”, “venture capital, deferred settlement and equity derivatives”*).

Clients declared whether or not they were familiar with these different categories (response: yes or no) without adding any detail on their level of knowledge. Moreover, the firms did not ask any additional questions in order to validate the real level of the clients' knowledge.

Clients were able to declare that they were familiar with and would like to subscribe for all the categories of financial instrument. Across a sample of 60 subscriptions, the inspections identified:

- 26 subscriptions realised by clients who had declared they were familiar with and interested in the four categories of financial instrument;
- 17 subscriptions realised by clients who had declared they were familiar with and interested in three of the four categories of financial instrument.

Since the entry into force of MiFID II, these three firms have ceased to use client self-assessment, adopting questions that correspond to six categories of product (*“members' shares”, “undertakings for collective investment”, “shares and equity securities”, “bonds and debt instruments”, “derivative products”, “structured products”*). These questions, numbering three or four per product category, validate the client's level of knowledge in the form of a quiz.

In the fourth firm inspected, the two types of questionnaire used were based on self-assessment:

- one for “Retail Banking” clients, which asked a single question (*“Generally speaking, describe your knowledge of the financial markets: poor/medium/good”*);

- and another for “Private Banking” clients, which identified 11 categories of so-called “complex” products⁶, which the client declared that they were familiar with or not (response: yes or no).

Besides the exclusive use of self-assessment in the two questionnaires, that intended for “Retail Banking” clients asked a generic question that neither made any distinction between the types of financial instrument available, nor allowed for the possibility that the client has no knowledge whatsoever of the financial markets.

Since the entry into force of MiFID II, this firm has made the following improvements:

- the questionnaire for “Retail Banking” clients includes four questions intended to validate the client's knowledge of the financial markets⁷; and
- the questionnaire for “Private Banking” clients includes two questions based on self-assessment⁸, then eight questions intended to validate the client's knowledge of the financial markets⁹.

In the fifth firm inspected, the questionnaire is not based on any form of self-assessment by the client. It asks the client four distinct questions, depending on the type of capital protection attached to the product (*“investments with capital protection at all times”, “investments with capital protection on maturity”, “investments presenting a limited risk of capital loss”, “investments presenting a medium to high risk of capital loss”*)¹⁰.

⁶ Product categories known as “complex”: “structured products with capital protection on maturity”, “structured products with no capital protection on maturity”, “bonds convertible into shares or share purchase warrants (excluding UCIs)”, “direct investments in unlisted securities or venture capital funds (FCPR, FCPI) and shares traded on an unregulated market”, “real estate investment products (SCPI, OPCI)”, “ETFs/index tracker funds (listed index UCIs excluding UCITS)”, “certificates and securities structured around transferable securities, commodities, indices and baskets of securities”, “alternative investment funds”, “funds of alternative funds”, “forward foreign exchange contracts”, “derivative products”).

⁷ “The prospect of high performance implies a risk of capital loss: yes/no/I don't know”; “In stock market terms, volatility represents: the scale of the variation in the price of a financial asset/the ability to quickly sell or buy an asset without there being a significant impact on the price/an indicator that measures the surplus profitability of a security compared with its benchmark/I don't know”; “With respect to your savings invested in the financial markets, it is possible to reduce risk by diversifying your assets: true/false/I don't know”; “The performance of a European equity derivative product depends primarily on: variations in property prices/the valuation of the underlying asset/variations in high yield bond prices/I don't know”.

⁸ “What is your level of knowledge of the financial markets? Low/intermediate/advanced”; “What is the source of your knowledge of the financial markets? Professional experience with respect to the financial markets/financial institutions/investment experience/financial qualification (diploma, certificate, CFA)/reading financial and economic news/other”.

⁹ “Please put the following financial assets in order of their level of risk: bond fund (UCI) in €, CAC 40 share, money market fund (UCI) in €”; “A share is: a part of capital stock/a loan”; “The change in the price of a share over the medium/long term can be linked to the results of a company: yes/no”; “A bond is: a share of capital stock/a loan”; “Does a bond rated AAA present more risk for the investor than a bond rated BBB? Yes/no”; “Which of the following indices is a benchmark index for US equities? Nikkei 225/Dow Jones/EURO STOXX 50”; “The use of a UCI (SICAV/FCP) in your portfolio instead of an equity security does the following: diversifies risk/concentrates risk”; “In stock market terms, volatility represents: the scale of the variation in the price of a financial asset/the ability to quickly sell or buy an asset without there being a significant impact on the price/an indicator that measures the surplus profitability of a security compared with its benchmark”.

¹⁰ Investments with capital protection at all times: “The valuation of a life insurance policy vehicle in € is dependent on fluctuations in the financial markets: true/false/I don't know”; Investments with capital protection on maturity: “For bonds, it is possible to lose all or part of the initial investment, particularly in the event of resale before maturity or the bankruptcy of the issuer: true/false/I don't know”; Investments presenting a limited risk of capital loss: “The prospect of high returns from an investment is often associated with a risk of capital loss: true/false/I don't know”; Investments presenting a medium to high risk of capital loss: “The value of a share is dependent on fluctuations in the financial markets (upwards as well as downwards); therefore it is possible to lose all or part of the capital invested: true/false/I don't know”.

Since the entry into force of MiFID II, this firm has introduced an element of self-assessment into the initial question posed to the client (*“Would you qualify your current knowledge of financial investment as: High - you have a good knowledge of financial instruments, you are able to estimate the risk and the prospect of return on the main types of financial investments/Partial - you know that different types of financial investments exist, with different levels of risk, but you are not aware of all their different features/Limited - you know nothing at all about financial investments”*). Clients declaring that they have “partial” or “limited” knowledge are classed, based solely on this self-assessment, as “Beginners”. Only clients who state that they have a “high” level of knowledge need to answer the questions intended to validate their knowledge. Besides the fact that they have been reduced to three in number, these questions are no longer specific enough in terms of the distinctions made between the different types of financial instrument¹¹.

Although the exclusive use of self-assessment by the client of their investment knowledge was still very common under MiFID I, the analysis of the procedures as revised with the entry into force of MiFID II shows that this practice has disappeared in the firms inspected.

Bad practices

- Exclusive use of self-assessment by the client of their own investment knowledge (with no validation by the service provider of the level of knowledge declared by the client).
- Very general questions, which do not distinguish between categories of investment or financial instrument (e.g. question that relates only to the financial markets in general). This practice is no longer acceptable under MiFID II.
- Choice of responses that does not provide for the client having no investment knowledge at all (e.g. Poor/Average/Good);

Good practices

- Questions that can be used to validate the client's knowledge (in the form of multiple choice questions).
- Questions that differentiate the category of financial instrument (by distinguishing between equity products, bonds, money market products, derivatives, and structured products, for example). This good practice under MiFID I, which was not much in evidence in these inspections, has become an obligation with the entry into force of MiFID II and is now integrated into the procedures of the inspected firms.

¹¹ *“The value of an investment in the financial markets: is guaranteed at all times/may change upwards as well as downwards/I don't know”;
“The value of a fixed-rate bond: may fall in the event of a rise in interest rates/cannot fall in the case of resale before maturity/I don't know”;
“The return on a life insurance policy invested in a € fund: may change every year/is indexed each year/I don't know”.*

2.2 USE OF ADDITIONAL QUESTIONNAIRES

Three firms among those inspected had established additional questionnaires intended for the client, for the following financial instruments:

- in the first firm, one additional questionnaire for trading floor products relating to interest rate and foreign exchange transactions. This questionnaire includes the following statement, signed by the client: *“These transactions are realised for hedging purposes. They are intended to reduce or manage interest rate risk or foreign exchange risk and are considered to be matched against an asset or economic liability that constitutes the underlying instrument. I am aware that hedge transactions may be used to reduce or manage risks with the aim of limiting loss of earnings or financial losses but that these risks can never be totally removed. I am fully aware, in the absence or in the event of changes to the underlying instrument, that these transactions may give rise to loss of earnings or additional financial losses”*.

With the entry into force of MiFID II, this questionnaire was replaced by another, which includes detailed questions on the different types of financial instruments (see above in paragraph on client knowledge);

- in the second firm, four additional questionnaires (to be dated and signed by the client) relating respectively to real estate investment companies (SCPIs), retail venture capital funds (FCPIs), companies that provide funding for the film and audiovisual sector (SOFICAs), and structured products, and summarising how these products operate and the risks associated with each of them;
- in the third firm, one additional questionnaire for SCPIs (to be completed and signed by the client), which summarised the characteristics of the product and principal risks associated with it, as well as a summary form for private equity funds (to be signed by the client), which listed the associated risks.

In the fourth firm inspected, additional questionnaires (to be dated and signed by the client) had been established for specific financial instruments, including SCPIs and structured products. They set out the specific features, benefits and disadvantages of the products in question, and if applicable asked questions intended to validate the client's knowledge.

In the fifth firm inspected, a document template was in place (in the form of a “compendium of information for a good understanding”), which listed the risks attached to the financial instrument that the client wished to invest in.

This document, dated and signed by the client, was issued to them for the most risky products that had been identified in advance on being brought to market.

Best practices

- The provision of a questionnaire to the client that validates their knowledge about the complex product being offered to them.
- Sending the client a document summarising how a complex or risky financial product works and the risks associated with it;

2.3 GATHERING INFORMATION ON CLIENT EXPERIENCE

Reminder: As a result of the entry into force of MiFID II, the new wording of points I and II of article L.533-13 of the French Monetary and Financial Code expressly provides for the gathering of information concerning *“the investment knowledge and experience of their clients [...] in relation to the specific type of financial instrument or service [...]”*.

In three of the firms inspected, the gathering of information relating to the client's investment experience was based on three questions relating to:

- the securities account(s) held (ordinary share accounts/share savings accounts), specifying the length of time held (*“more than 5 years”, “less than 5 years”*) and the firm where the accounts are held (*“our firm”, “another firm”*);
- the number of orders passed each month, on all financial instruments combined (*“< 3”, “between 3 and 10”, “> 10”*) and the average amount per order (*“< €1,000”, “between €1,000 and €10,000”, “> €10,000”*); and
- the methods of investment already used (*“direct investments”, “collective management products”, “discretionary management”*).

Since the entry into force of MiFID II, these firms only ask about the number of orders passed each month and the average amount per order. However, one question has been added, asking the client to indicate whether they have experience (response *“yes”* or *“no”*) in the following five products: *“members’ shares”, “UCI/undertakings for collective investment”, “shares and equity securities”, “bonds and other debt instruments”* and *“structured products”*.

In the fourth firm inspected, “Retail Banking” clients were asked two questions:

- one about the composition of their financial wealth: *“Is your financial wealth composed primarily of: you have not yet built any financial wealth as such/secure investments (money market, bank savings, etc.)/mostly conservative investments (equity share < 30%)/mostly balanced investments (equity share between 30% and 60%)/mostly dynamic investments (equity share greater than 60%)”*;

- the other on order placing (response “yes” or “no”): “Have you previously placed orders on any of the following: index-linked UCITS/complex financial products/shares using the Deferred Payment Service?”

“Retail Banking” clients were asked the following questions:

- on the investment services that they have already used within the firm: “Which of the following services have you used previously: reception/transmission or execution of orders on financial instruments/advisory management services/discretionary management services?”;
- on so-called “complex” products that they have declared knowledge of (see above in paragraph relating to client knowledge) and their level of experience in these products (“up to 3 investments in the following complex products”, “more than 3 investments in the following complex products”).

Since the entry into force of MiFID II, this firm has made the following changes:

- for “Retail Banking” clients, the questions on the products held are on transactions realised have been expanded¹²;
- for “Private Banking” clients, there is now a detailed table showing investment experience over the last five years for five categories of simple product and seven categories of complex product¹³ (the client must indicate their usual frequency of investment¹⁴).

In the fifth firm inspected, the client previously had to indicate, for each of four product categories (see above paragraph on gathering information on the client's knowledge¹⁵) whether they had “realised one or more transactions on these products during the last 24 months for a total amount invested of at least €1,500”.

¹² “From among the following products, check those that you hold or that you have held in the past: current and savings accounts/life insurance or endowment policies/securities accounts”; “How do you manage your financial investments?” Independently or with the help of your family, but with no help from a financial advisor/With the help of your bank manager or financial advisor/Not applicable as I have no financial investments”; “Indicate the number of transactions that you have realised on the following investments during the last 36 months: euro funds, money market UCIs/UCIs (equities, bonds, diversified)/structured products (debt instruments, formula-based funds)/private equity (FCPIs, FCPRs, unlisted securities)/real estate funds (SCPIs, OPCIs)/direct holdings in listed securities (equities, bonds)/derivative products (warrants, certificates, options)” -> 3 responses possible: “none”, “1 to 5”, “more than 5”; “Have you previously been in a situation where your financial investments have realised losses: yes/no”; “If yes, how did you react to this situation?” You sold your positions immediately/you increased your positions/you maintained your positions”.

¹³ This firm identified five categories of simple product (“direct investments in shares”, “investment grade bonds”, “bonds ranked as less than investment grade”, “UCITS”, “ETFs/tracker funds on market indices”) and seven categories of complex product (“structured products”, “bonds convertible into shares or share purchase warrants, excluding UCIs”, “ETFs/tracker funds with leverage or inverse leverage schemes”, “funds of alternative funds/alternative investment funds”, “unlisted securities and direct investments in OTC securities or private equity funds”, “real estate investment products”, “derivative products”).

¹⁴ For each product category, the client must indicate whether their frequency of investment is occasional (less than 3 transactions per year) or frequent (more than 3 transactions per year) or whether they have no experience at all.

¹⁵ Reminder of the four product categories identified by this firm: “investments with capital protection at all times”, “investments with capital protection on maturity”, “investments presenting a limited risk of capital loss”, “investments presenting a medium to high risk of capital loss”.

Since the entry into force of MiFID II, this firm has reduced the number of questions to three, and made them more general¹⁶, no longer distinguishing between product categories. This degrades the quality of the information obtained and contravenes the provisions of article L.533-13 of the French Monetary and Financial Code as amended following the entry into force of MiFID II.

With regard to gathering information relating to client experience, the situation observed is more contrasted compared with that relating to information on client knowledge. This is due in part to the differences in the content of the questions posed by the firms and also to the modifications made by the firms to their questionnaires, after the entry into force of MiFID II. The AMF reminds firms that the client's level of experience must be assessed with questions that provide precise information, which must in particular include details of the number and average amount of the transactions realised, and that since the entry into force of MiFID II, this information must also differentiate between the types of financial instrument.

Bad practices

- Very general questions, which do not differentiate between investment categories or financial instruments (e.g. one question on financial investments realised in general).
- Questions that do not result in precise enough information on the number and average amount of transactions realised.

Good practices

- Questions that differentiate the category of financial instrument (by distinguishing between simple products and complex products, for example).
- Questions about the number and average amount of transactions realised.
- Questions on the composition of the portfolio and the breakdown by type of product (distinguishing between conservative, balanced and dynamic investments, for example).

2.4 DETERMINING THE CLIENT'S INVESTOR PROFILE

In three of the firms inspected, there was no investor profile established: the client was only identified by the category or categories of financial instrument that they declare knowledge of and in which they wish to invest (see above paragraphs on gathering information on the client's knowledge and experience).

¹⁶ "Does the client have financial investments [held with the firm] (except for company savings schemes) amounting to more than €1,500? yes/no", "Have you made one or more financial investments for an amount greater than €1,500 outside our bank? yes/no", "For the most part, in your investment decisions: you are independent/you seek help from a professional; and in realising transactions: you do so yourself/you delegate transactions to a professional".

Since the entry into force of MiFID II, these three firms have implemented client profiling according to six categories (*"secure"*¹⁷, *"conservative"*, *"moderate"*, *"balanced"*, *"dynamic"*, *"aggressive"*), calculated automatically based on the client's age, their property situation (owner or tenant), their knowledge of the different categories of financial instrument, their investment objectives, and their risk tolerance.

The assessment of risk tolerance, which was also implemented as a result of the entry into force of MiFID II, is based on four questions¹⁸, the answers to which are entered in the questionnaire on the client's knowledge and experience.

In the fourth firm inspected, "Retail Banking" clients were profiled using an approach known as "psychometric" testing, under which the client was asked to answer 16 questions. The questionnaire about knowledge and experience, which recorded the client's responses, provided the following information:

- *"Please respond to each question spontaneously - there are no right or wrong answers. If any question could be interpreted in different ways, please give the most intuitive response possible. "*
- *The response "Neither agree nor disagree" should not be used to answer "I don't know" or "Neutral". If you answer the entire questionnaire with "Neither agree nor disagree", the overall rating for tolerance of financial risk will be 3 (moderate)".*

The responses provided by the client determined their "risk profile", from one of the following six categories: *"0 - none", "1 - very low", "2 - low", "3 - moderate", "4 - high", "5 - very high".*

For "Retail Banking" clients, the client profile categories were identical, but the client themselves chose the most appropriate response for them (by checking the corresponding box in the knowledge and experience questionnaire). This therefore constituted self-assessment of the client's profile.

This firm did not make any changes after the entry into force of MiFID II, either for "Retail Banking" or "Private Banking" clients.

¹⁷ The "secure" profile only relates to cash savings held at the bank in passbook accounts.

¹⁸ Questions relating to the client's risk tolerance: *"Rank the following from 1 to 3, in order of how important they are to you (1 being most important): security of your capital/profitability of your investments/availability of your money"; "Below are some statements. Please tell us which corresponds best to you: In terms of financial risk ... For you, the security of your capital is of paramount importance at all times, even if profitability is low/you seek a moderate return with the least possible risk/you primarily seek a high level of return over the long term, and are willing to tolerate fluctuations in the market/you seek a very high return, and are willing to tolerate the risk of capital loss"; "If your portfolio were to lose 10% as a result of a market downturn, what would you do? You would sell your portfolio/You would wait for the markets to recover in order to sell your portfolio/You would remain patient without panicking/You would maintain your investments and increase if opportunities presented themselves"; "Imagine that you want to invest on the financial markets. Which methods would you choose? You would delegate the management of your investment to a professional/You would act independently but take advice from your financial advisor/You would act independently, basing your decisions on your own knowledge".*

In the fifth firm inspected, the client profile was determined by the answers they provided to the questions concerning their investment knowledge and experience (see above paragraphs on the gathering of information on the client's knowledge and experience). There were four profile categories:

- X: refused to answer the questions;
- A: no experience (no knowledge/experience at all, or no knowledge/experience of products with capital protection);
- B: conservative (some knowledge/experience of products with a limited risk of capital loss);
- C: aware (knowledge/experience of products with an average-to-high risk of capital loss).

Since the entry into force of MiFID II, the headings for these profile categories have been changed (A: beginner; B: informed; C: aware). Moreover, the category X, previously used for clients who refused to fill in the questionnaire assessing their investment knowledge and experience, has been removed as this firm has decided that henceforth it will no longer agree to open a securities account for clients who refuse to answer these questions.

Bad practice

- Allowing the client to select their own profile via self-assessment of their investment knowledge and experience.

Good practices

- Determining the profile of the client according to their responses to questions on their investment knowledge and experience, and their reaction in certain situations such as high volatility on their investment (“psychometric” testing).
- Distinguishing between clients who refuse to answer the questions on their knowledge and experience and clients who are attributed a “beginner” profile after having answered the questions (so that an investment advisory service is not provided to clients who refused to answer).

In this regard, the AMF reminds firms that they must ensure that the algorithms used to assess the client's knowledge and experience are tools used for investment advisory services. They must not lead to certain profiles being over-represented. With respect to their duty to provide advice, firms must ensure that they offer clients a suitable level of diversification of their investments¹⁹.

2.5 FREQUENCY OF UPDATES TO THE CLIENT KNOWLEDGE AND EXPERIENCE QUESTIONNAIRE

The AMF observed different situations with regard to how frequently clients' knowledge and experience questionnaires were updated. Across a sample of 100 investment files inspected, an average of 25% of the client questionnaires were more than two years old at the time of subscription²⁰.

In three of the firms inspected, the procedure intended for the network of the group to which these firms belong mentioned that the knowledge and experience questionnaire should be updated regularly, but did not indicate a required frequency²¹. These firms explained that they preferred an “event-based” approach to managing the information, primarily when a significant change in the behaviour of the client was observed (e.g. change in types of order placed, reactivation of a dormant securities account, etc.).

Since the entry into force of MiFID II, these three firms have decided that the maximum age of a questionnaire when an order is placed can be one year. All questionnaires are now given a status: “active” or “obsolete” (i.e. less than or more than one year old). If the status is “obsolete”, the account manager must contact the client.

¹⁹ Source: b) of point 7 of article 54 of Commission Delegated Regulation 2017/565 of 25 April 2016 (“all tools, such as those used in the suitability assessment process to evaluate risk profiles or to determine the client's knowledge and experience, are adapted and designed to be used with their clients, with their limitations properly identified and mitigated as far as possible during the suitability assessment process”).

²⁰ The actual number of questionnaires that were more than two years old ranged from 9/20 for the worst-performing firm, to 0/20 for the best.

Conversely, it was noted that when a client placed an order online that did not fall within the scope of their profile (order reception/transmission), their category was automatically updated:

- without the client being informed clearly of this change in category and its consequences;
- and without them being required to undergo another assessment of their investment knowledge, so that they did not receive an alert in the event of subsequent similar transactions.

These procedures are still in force.

In the fourth firm inspected, the maximum age of the questionnaire when an order was placed was three years, both for “Retail Banking” and “Private Banking” clients.

Since the entry into force of MiFID II, the maximum age of a questionnaire when an order is placed has been dropped to two years (beyond that, the questionnaire is given a status of “*expired*”, and the client must be contacted).

In the fifth firm inspected, the maximum age of the questionnaire at the time an order is placed was two years.

This firm did not make any changes after the entry into force of MiFID II.

Non-compliance with regulations

The AMF reminds firms that the provisions of article L.533-13 of the French Monetary and Financial Code, in its versions applicable after the entry into force of MiFID I and MiFID II respectively, provide that the information gathered relating to clients’ investment knowledge and experience is intended to verify whether the financial instrument or service recommended for the client is suitable for their needs (advisory services or portfolio management) or appropriate (other investment services).

Consequently, in order to comply with these provisions, client profiles may not be modified automatically as a result of the client confirming an order placed online after having received an alert, unless firstly the client's information relating to their investment knowledge and experience has been updated, and secondly, the client has been informed of the consequences of this change.

Bad practice

- Failure to define a frequency for updates to the client knowledge and experience questionnaire. The AMF notes that this bad practice, which was observed under MiFID I, has disappeared since the entry into force of MiFID II, as all the firms inspected have specified a frequency for updates to the client questionnaires.

Good practice

- Definition of a frequency for updates to the client knowledge and experience questionnaire.

²¹ “Regulations stipulate that the information relating to the client's knowledge, objectives and financial position must be updated on a regular basis” (source: Group network procedure).

2.6 ADDITIONAL INFORMATION GATHERED BY THE INSPECTION

2.6.1 GATHERING OF INFORMATION RELATING TO THE CLIENT'S FINANCIAL POSITION

Reminder: article 54 of Commission Delegated Regulation 2017/565 of 25 April 2016 - which is almost identical to the provisions of the previous article 314-46 of the AMF General Regulation - specifies in point 4 that *“Information concerning the financial position of the client or potential client should include, where applicable, information on the source and size of their normal income, their assets, including cash, their investments and property assets, and their normal financial liabilities. ”*

In three of the firms inspected, the information gathered relating to the client's financial position included the following information:

- income and wealth (differentiating between the client's principal residence, other properties owned, and other assets);
- assets (differentiating between bank savings, financial savings, and life insurance);
- debts (differentiating between outstanding loans and other liabilities).

With regard to assets and liabilities, distinction is made between the assets and liabilities in the firm providing the service, and those held in other firms.

Since the entry into force of MiFID II, this firm has revised the categories used (adding expenses, and separating wealth):

- income and expenses;
- wealth (differentiating between the client's principal residence, other properties owned, and other assets);
- assets (differentiating between bank savings, financial savings, and life insurance);
- debts (differentiating between outstanding loans and other liabilities).

Moreover, if the client does not wish to communicate the amount of their assets held in other firms or the amount of their other liabilities, they will henceforth be informed that the investment advice provided may not be optimal²².

In the fourth firm inspected, the financial position of “Retail Banking” clients was not assessed using the knowledge and experience questionnaire, but rather during the sales discussion (when the information was entered into the IT tool used by the account manager, primarily in the “Wealth Budget” tab). The fields filled in that did not distinguish between the assets held within the firm or outside the firm were as follows:

²² The following statement(s) appear in the questionnaire template that is now used since the entry into force of MiFID II: *“As the client does not wish to communicate details of their assets held in other firms, they have been informed that the investment advice provided to them will be based only on the information known by our firm. This situation is likely to mean that the investment advice provided is not optimal for the client”; “As the client does not wish to communicate details of their debts with respect to other firms, they have*

- annual income²³ ;
- assets²⁴ ;
- annual expenses²⁵ ;
- liabilities²⁶ .

For “Private Banking” clients, their financial position was assessed using the knowledge and experience questionnaire, by means of the following four questions:

- *“What is your estimated net worth/net assets? ”;*
- *“What is the estimated breakdown of your wealth between real estate assets and property/equipment? ”;*
- *“What is the estimated amount of your total annual income? ”;*
- *“How much do you plan to invest [in our firm]? ”*

Since the entry into force of MiFID II, this firm has not made any changes to the questionnaire used for “Retail Banking” clients. However, for “Private Banking” clients, their financial position is now assessed with more specific questions:

- *“What is the estimated amount of your total wealth? Less than €5M/€5M to €10M/€10M to €30M/More than €30M”;*
- *“What is the estimated breakdown of your wealth?”* The client must indicate what percentage of their financial wealth²⁷ is represented by real estate assets, financial assets, and professional assets, and other assets (works of art, collections, etc.);
- *“What is the usual breakdown of your financial assets?”* The client must indicate what percentage of their financial assets²⁸ is represented by equities, bonds, money market funds and equivalent investments (general funds, deposit accounts, etc.) and other assets;
- *“What is the estimated amount of your total annual income? Less than €100K/€100K to €500K/More than €500K”.*

In the fifth firm inspected, the client's financial position was not assessed using the knowledge and experience questionnaire, but rather in the report resulting from the sales discussion.

been informed that the investment advice provided to them will be based only on the information known by our firm. This situation is likely to mean that the investment advice provided is not optimal for the client”.

²³ Wages, operating income, non-commercial income, income from real estate, income from securities, pensions, family allowances, other income.

²⁴ Properties (principal residence, secondary residence, real estate investments), professional assets (business assets, commercial premises), savings (current accounts, liquid savings, term investments, securities, life insurance, other investments). For securities and life insurance, the following sub-categories are entered: diversified funds/securities, funds: money market securities, guaranteed funds, bond funds/securities, equity funds/securities.

²⁵ Property loans, other loans, rental payments, pension payments, taxes, other expenses.

²⁶ Outstanding property loans (principal residence, secondary residence, real estate investment), cash loans, consumer loans, business loans, commitments given, other personal loans.

²⁷ Less than 25%/25% to 50%/50% to 75%/More than 75%.

²⁸ Less than 25%/25% to 50%/50% to 75%/more than 75%.

The information gathered was as follows:

- real estate assets (differentiating between the value of the assets, property loans outstanding in the firm, and property loans outstanding in other firms);
- financial assets (under the following six categories: “cash savings”, “term savings”, “life insurance and endowment policies”, “securities and stock market investments”, “real estate savings”, “pensions and company savings schemes”), differentiating between assets held in the firm providing the service and those held in other firms; and
- income and expenses, including monthly income (professional, real estate, securities and other income) and monthly expenses (rental payments, loans, taxes, monthly savings, insurance premiums, and other expenses).

This firm did not make any changes after the entry into force of MiFID II.

Point to note

In the summary note published in July 2018 on inspections relating to the marketing of financial instruments, the AMF indicated that: *“subject to the scope of the advice requested by the client, if institutions, in spite of their requests, are unable to collect precise information about the financial **assets** held by their client at other institutions, the provision of advice is possible only if all the other required elements of information have been collected. Institutions are required to document the client’s refusal and to warn him, in a traceable manner, that the suitability of the advice will be assessed solely in relation to the information disclosed.”*

On this subject, it was noted that, in cases where the client did not wish to communicate the amount of their assets held in other firms, three of the five firms inspected included in the knowledge and experience questionnaire the following statement: *“As the client does not wish to communicate details of their assets held in other firms, they have been informed that the investment advice provided to them will be based only on the information known by our firm. This situation is likely to mean that the investment advice provided is not optimal for the client.”*

This practice is consistent with the reminder above.

With regard to the client's debts held with other firms, the three firms have adopted the same practice, i.e. the addition of a warning, as follows: *“As the client does not wish to communicate details of their debts with respect to other firms, they have been informed that the investment advice provided to them will be based only on the information known by our firm. This situation is likely to mean that the investment advice provided is not optimal for the client.”*

In its *Guidelines* 2012/387 dated 25 June 2012²⁹ and its *Questions and Answers* 35-43-349³⁰ ESMA requests the firm to determine the necessity of collecting information on all the client's commitments if the investment advice involves illiquid or risky products.

The AMF considers this type of warning as a good practice, as long as the investment service provider:

- ensures that the financial instrument proposed is neither illiquid nor risky;
- collects all the other information required to provide an investment advisory service; and
- documents the client's refusal to provide information on the amounts of their debts with respect to other firms.

2.6.2 GATHERING INFORMATION ON THE CLIENT'S INVESTMENT PLAN

In three of the firms inspected, the client's investment plan was defined based on:

- three investment objectives ("*building capital*", "*diversification of assets*", "*providing additional income*");
- the four categories of financial instrument already used to determine the client's knowledge ("*money market products*", "*bond products*", "*equities and diversified products*", "*venture capital, deferred settlement and equity derivatives*"); and
- three investment horizons ("*short term/1 year*", "*medium to long term/1 to 5 years*", "*long term/5 years*").

²⁹ "34. "For illiquid financial instruments, the 'necessary information' to be gathered will obviously include information on the length of time for which the client is prepared to hold the investment." As information relating to the client's financial position must always be collected, the scope of this information may depend on the type of financial instruments being recommended or acquired. For example, for illiquid or risky financial instruments, the "necessary information" that must be collected may include all of the following details, in order to ensure that the client's financial position allows them to invest or be invested in such instruments:
[...]

c) the client's regular financial commitments, including financial commitments that the client has made or that they plan to make (liabilities, total debts, other regular commitments, etc.). "

³⁰ Free translation: "2 Adequacy and appropriate nature - Answer 7 [Last update: 10 October 2016]: It is particularly recommended that, for the most complex and most risky products, as well as illiquid products, the service provider must determine the necessity of collecting additional information, in order to realise the due diligence processes indicated above.

Consequently, it is the responsibility of the service provider to decide on the specific cases in which it can ensure that certain products are suitable for the client without having collected comprehensive information on the client's financial position. This may be the case, for example, if the client declares only some of their assets, but also provides information on all of their debts (such as bank loans, etc.). In that event, the information given by the client on their debts must be complete. The service provider must in a position to ensure, based on the information disclosed by the client, that the client's assets allow them to bear the risks corresponding to the investment, in particular the risk of potential losses. "

Since the entry into force of MiFID II, these three firms have made the following changes:

- adding more investment objectives (six possible choices: *"building capital/increasing savings gradually over time"*, *"earning regular income/having access to additional income"*, *"increasing your wealth/growing your existing wealth and optimising it"*, *"diversifying your assets/making different types of investment: structured products, SCPI, FIP, FICP, etc."*, *"preparing an inheritance and passing on your wealth/simplifying, balancing and optimising your inheritance"*, *"accessing specific financial instruments/hedging foreign exchange, commodities, share allocation plans, etc."*);
- abandoning the identification of investment objectives based on categories of financial instrument; and
- adding more granular investment horizons (five possible choices: *"very short term/< 1 year"*, *"short term/1 to 3 years"*, *"medium term/3 to 5 years"*, *"medium to long term/5 to 8 years"*, *"long term/more than 8 years"*).

In the fourth firm inspected, the investment plans of "Retail Banking" clients did not appear in the knowledge and experience questionnaire, but rather in a specific document (called *"Investment Plan"*), which was completed during the sales discussion. The client was asked to indicate:

- their investment objective (six categories: *"preparing for retirement"*, *"adding to your income/pension"*, *"building and increasing your wealth"*, *"passing on your wealth"*, *"planning for your children's education and future"*, *"other (please specify)"*); and
- their investment horizon (four categories: *"0-2 years"*, *"3-4 years"*, *"5-9 years"*, *"10 years or more"*).

Since the entry into force of MiFID II, this firm has not modified its categories.

The investment plans of "Private Banking" clients appear in the knowledge and experience questionnaire. The client is asked to indicate:

- their investment objective (three categories: *"preservation of wealth"*, *"generating regular income"*, *"increasing your wealth"*); and
- their investment horizon (four categories: *"less than 1 year"*, *"1 to 3 years"*, *"3 to 5 years"*, *"more than 5 years"*).

Since the entry into force of MiFID II, this firm has made the following changes:

- there are now five investment objectives (*"preservation of your assets"*, *"passing on your wealth"*, *"preparation for retirement"*, *"generating regular income"*, *"increasing your wealth"*);
- the investment horizons have been revised (three categories: *"1 to 3 years"*, *"3 to 5 years"*, *"more than 5 years"*).

In the fifth firm, the client's investment plan did not appear in the knowledge and experience questionnaire, but rather in the report resulting from the sales discussion with the account manager (called *"Comprehensive savings and insurance discussion"*). The client was asked to indicate:

- their investment objective (ten categories: *"building capital"*, *"having access to savings at any time"*, *"investing in real estate paper"*, *"pay less tax"*, *"collect immediate income"*, *"prepare for your children's future"*, *"prepare for retirement"*, *"prepare for a property purchase"*, *"pass on capital"*, *"increase your capital"*); and
- their investment horizon (three categories: *"< 1 year:"*, *"1 to 4 years"*, *"> 4 years"*).

This firm did not make any changes after the entry into force of MiFID II.

As indicated in the summary published on 10 July 2018 on the marketing of financial instruments, the gathering of information on the client's investment horizon, which is provided for under MiFID I³¹ and MiFID II³², must be adapted to the types of product that the investment services providers are offering, and especially if these products are illiquid³³ or very long term.

³¹ Former Article 314-47 of the AMF General Regulation.

³² Point 5 of Article 54 of Commission Delegated Regulation (EU) 2017/565 of 25 April 2016.

³³ AMF Position DOC-2012-13 page 6: *"For illiquid financial instruments, the 'necessary information' to be gathered will obviously include information on the length of time for which the client is prepared to hold the investment."*