MiFID Connect

GUIDELINE ON THE APPLICATION OF THE SUITABILITY AND APPROPRIATENESS REQUIREMENTS UNDER THE FSA RULES IMPLEMENTING MIFID IN THE UK

This Guideline does not purport to be a definitive guide, but is instead a non-exhaustive statement of the measures that firms subject to MiFID (including UK branches of third country firms in respect of MiFID-scope business carried on in or from the UK) may adopt in complying with the requirements as to suitability and appropriateness under the FSA Rules implementing MiFID in the UK as from 1 November 2007. This Guideline focuses only on the UK's implementation of MiFID requirements relating to suitability and appropriateness.

The FSA's suitability and appropriateness requirements relating to non-MiFID business and requirements that are not derived from MiFID have not been considered in detail here. The Guideline is therefore not primarily intended to cover particular issues for non-MiFID scope firms such as insurance companies or IFAs not caught by MiFID and non-MiFID scope investment products such as life products or pensions.

This Guideline (including the extracts from the FSA Handbook, MiFID and the Implementing Directive) is up to date as at the date of issue. It may be revised from time to time in the light of any relevant changes to the FSA Handbook. If you intend to place significant reliance on it, it would be sensible to check whether there have been any such changes to the FSA Handbook or other material.

This Guideline has taken account of "FSA Confirmation of Industry Guidance"(DP 06/5).

This Guideline does not alter the meaning of any relevant FSA Rule, nor should it be interpreted as doing so.

The FSA has reviewed this Guideline and has confirmed that it will take it into account when exercising its regulatory functions. This Guideline is not mandatory and is not FSA guidance. This FSA view cannot affect the rights of third parties.

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SECTION ONE

1. INTRODUCTION TO OBLIGATIONS

This section provides a summary of the changes introduced by the FSA Rules implementing the suitability and appropriateness requirements of MiFID (the "**Implementing Rules**"). These changes are considered further in the course of the Guideline.

Suitability under the Implementing Rules

Under the pre-MiFID FSA Rules (i.e. those applicable pre-1 November 2007), a firm had to perform suitability assessments when providing investment advisory or discretionary portfolio management services to a private customer. An assessment of suitability was required in respect of intermediate customers and market counterparties only in an extremely limited range of circumstances. As required by MiFID, the Implementing Rules extend the application of suitability requirements by requiring firms providing investment advisory services (in the sense of giving "personal recommendations") or discretionary portfolio management services to assess suitability for all professional clients in respect of MiFID business (including those clients who in relation to the provision of other services would be classified as eligible counterparties), as well as for retail clients. The result is that MiFID firms now have an obligation to assess suitability for all clients when providing such investment advisory or discretionary portfolio management services (the "**Suitability Obligation**").

In order to make an assessment of suitability, a firm needs to obtain the necessary information in relation to the client to assess: (i) his investment objectives; (ii) his financial situation; and (iii) his knowledge and experience. Knowledge and experience can be assumed for products, services or transactions in respect of which a client has been classified as professional. It cannot be assumed for retail clients. Similarly, it can be assumed that a per se professional client has the ability to financially bear any related investment risks consistent with his investment objectives if the service provided is investment advice (in the form of personal recommendations). This cannot be assumed for retail clients or for "opted-up" professional clients or when providing discretionary portfolio management services to any type of client.

Under both the pre-MiFID FSA Rules and the Implementing Rules, if a firm does not obtain the necessary information to assess suitability, it cannot make a personal recommendation to the client or take a decision to trade for him. But, under both the pre-MiFID FSA Rules and the Implementing Rules, the regime accommodates a range of advice. As long as it is consistent with the client's objectives (and the client understands the scope of the service) it is possible for a firm to focus the scope of the advisory service provided to fit with the information the client is prepared to disclose, e.g. a personal recommendation could be given in relation to just part of a client's portfolio if that is want the client wants or agrees, and if sufficient information has been provided in order for suitability to be assessed in relation to that part of the portfolio.

Under the pre-MiFID FSA Rules, if a financial instrument was found to be unsuitable for the client, a firm could not provide investment advisory or discretionary portfolio management services in respect of that instrument. However, the firm could proceed on a non-advised, execution only basis in relation to that instrument if the client wished to do so and had confirmed this in writing, and that doing so was consistent with the firm's obligation to act in the client's best interests. The position under the Implementing Rules is the same except that the firm will need to check if there is an obligation to test appropriateness when providing the non-advised service. In some cases, there may be no obligation to test appropriateness if the instrument is a non-complex instrument (see below).

Where suitability was required to be assessed under the pre-MiFID FSA Rules, firms should have obtained information that was "sufficient" to assess suitability. Under the Implementing Rules,

firms will be required to obtain information that is "necessary" to assess suitability. This difference in wording does not, however, significantly change the standard, in practice, as to the type and level of detail of information required to test suitability.

Appropriateness under the Implementing Rules

The Implementing Rules introduce a new requirement to test appropriateness where a firm provides investment services other than investment advice (in the form of personal recommendations) or discretionary portfolio management. For such services, a firm must ask the client to provide information about his knowledge and experience in the investment field relevant to the specific type of product or service offered or demanded so as to enable the firm to assess whether the product or service envisaged is appropriate for the client (in the sense that the client has the necessary experience and knowledge in order to understand the risks involved in relation to the product or service). Where the test applies, firms must either offer to a client or transact for him only those products that are appropriate or, if the client demands a product that is assessed as inappropriate for him, give the client a warning (which can be in standard form if the firm wishes) that the product is inappropriate to the client's circumstances in terms of the test. If a client is provided with a warning but still wishes to proceed, the firm should consider whether to do so having regard to the circumstances. If the client does not, or cannot provide sufficient information to allow the firm to judge appropriateness but the client still wishes to do business with the firm, the firm must warn the client that it is unable to judge appropriateness before considering whether to proceed (the "**Appropriateness Obligation**").

A firm is entitled to assume that a professional client has the necessary knowledge and experience in order to understand the risks involved in relation to the particular products or services for which he has been classified as a professional client. The Implementing Rules also set out various other circumstances in which assumptions may be made about a client's knowledge and experience to understand the risks.

The Appropriateness Obligation is disapplied in respect of certain types of financial instruments ("non-complex" instruments) provided that certain conditions are met.

Major changes

The Implementing Rules therefore introduce the following major changes compared to the pre-MiFID FSA regime:

(a) when providing MiFID investment advisory or discretionary portfolio management services, suitability should be tested for professional clients as well as for retail clients;

(b) for services covered by MiFID, other than investment advice and discretionary portfolio management, firms must consider whether appropriateness will need to be tested.

FSA requirements additional to MiFID under its rules for suitability and appropriateness

Although MiFID does not expressly require firms who have to assess suitability to provide the client with a suitability report, it does require the provision of adequate reports on the service provided. As well as reflecting this general principle, FSA Rules require a suitability report to be made to the client if the client is a retail client and certain types of investments are involved (including holdings in regulated collective investment schemes).

FSA Rules also adopt the MiFID formulation as the basis for the requirement to test suitability when providing investment advisory or discretionary portfolio management services for non-MiFID investment business in respect of retail clients.

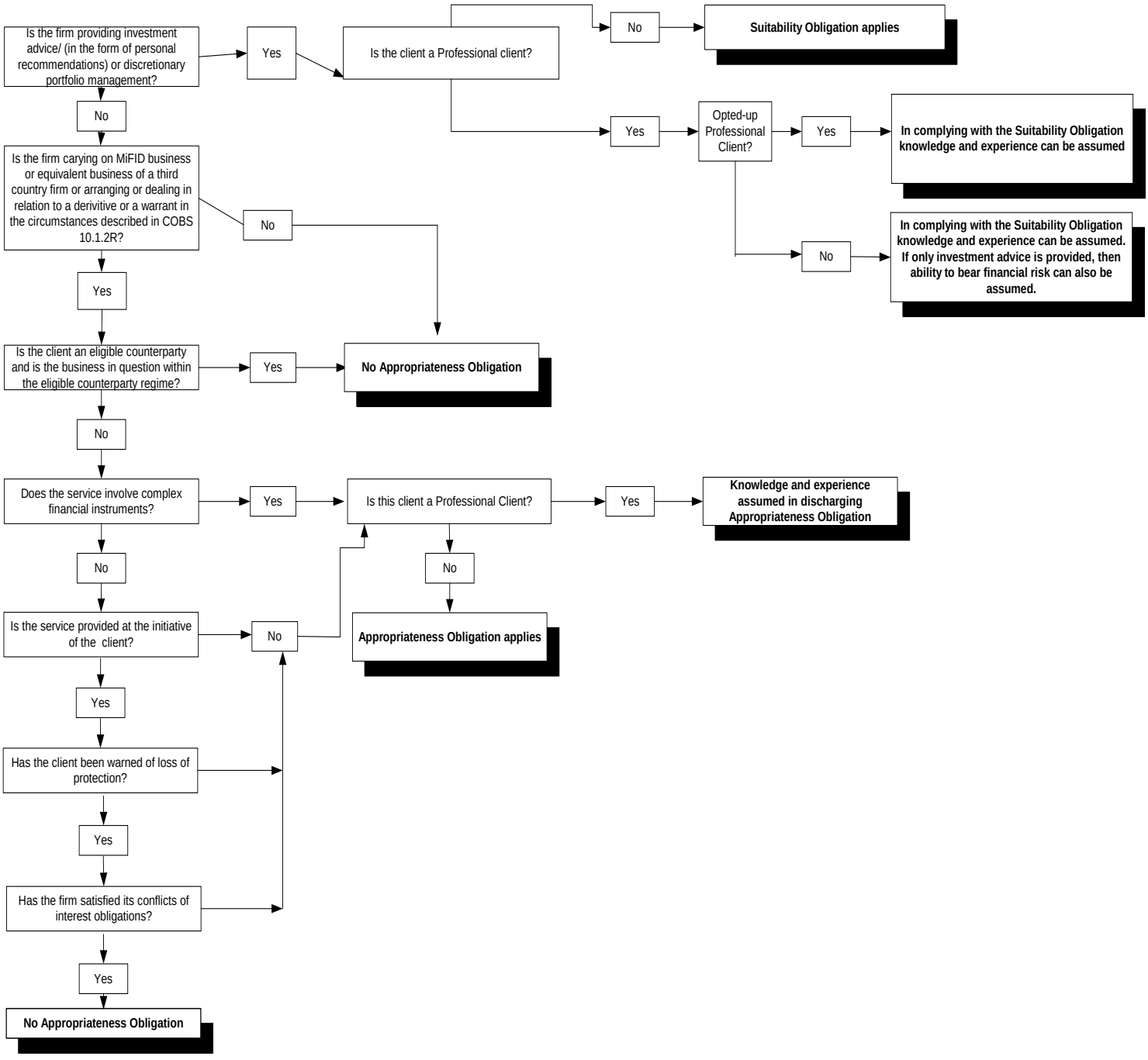
FSA Rules extend the requirement to test appropriateness to certain types of non-MiFID business (both in terms of products and firms).

SECTION TWO

2. APPLICATION OF THE SUITABILITY OR APPROPRIATENESS OBLIGATION UNDER THE IMPLEMENTING RULES

The flowchart below summarises the process for determining whether a firm is subject to the Suitability Obligation or the Appropriateness Obligation under the Implementing Rules. Each step of this process is explained in more detail in the guidelines below.

Figure 1: Scope of Suitability or Appropriateness Obligation



2.1 ***Reliance on a suitability assessment or appropriateness assessment performed by another investment firm***

COBS 2.4.3 R

(1) If a *firm* (F) is aware that a *person* (C1) with or for whom it is providing services is acting as agent for another *person* (C2) in relation to those services, C1, and not C2, is the *client* of F in respect of that business.

(2) Paragraph (1) does not apply if:

(a) F has agreed with C1 in writing to treat C2 as its *client*; or

(b) C1 is neither a *firm* nor an *overseas financial institution* and the main purpose of the arrangements between the parties is the avoidance of duties that F would otherwise owe to C2.

If this is the case, C2 is the *client* of F in respect of that business and C1 is not.

…

COBS 2.4.4R

(1) This *rule* applies if a *firm* (F1), in the course of performing *MiFID or equivalent third country business*, receives an instruction to perform an *investment or ancillary service* on behalf of a *client* (C) through another *firm* (F2), if F2 is:

(a) a *MiFID investment firm* or a *third country investment firm*; or

(b) an *investment firm* that is:

(i) a *firm* or authorised in another *EEA State*; and

(ii) subject to equivalent relevant requirements.

(2) F1 may rely upon:

(a) any information about C transmitted to it by F2; and

(b) any recommendations in respect of the service or transaction that have been provided to C by F2.

(3) F2 will remain responsible for:

(a) the completeness and accuracy of any information about C transmitted by it to F1; and

(b) the appropriateness for C of any advice or recommendations provided to C.

(4) F1 will remain responsible for concluding the services or transaction based on any such information or recommendations in accordance with the applicable requirements under the *regulatory system*.

[Note: article 20 of *MiFID*]

COBS 2.4.5G

(1) If F1 is required to perform a suitability assessment or an appropriateness assessment under

COBS 9 or *COBS* 10, it may rely upon a suitability assessment performed by F2, if F2 was subject to the requirements for assessing suitability in *COBS* 9 (excluding the *basic advice rules*) or equivalent requirements in another *EEA State* in performing that assessment.

(2) If F1 is required to perform an appropriateness assessment under *COBS* 10, it may rely upon an appropriateness assessment performed by F2, if F2 was subject to the requirements for assessing appropriateness in *COBS* 10.2 or equivalent requirements in another *EEA State* in performing that assessment.

COBS 2.4.8G

It will generally be reasonable (in accordance with *COBS* 2.4.6R(2)) for a *firm* to rely on information provided to it in writing by an unconnected *authorised person* or a *professional firm*, unless it is aware or ought reasonably to be aware of any fact that would give reasonable grounds to question the accuracy of that information.

COBS 10.1.3R

This chapter applies to a *firm* which assesses appropriateness on behalf of another *MiFID investment firm* so that the other *firm* may rely on the assessment under *COBS* 2.4.4R (Reliance on other investment firms: MiFID and equivalent business).

Under COBS 2.4.4R, a firm which receives an instruction from a non-MiFID investment firm, such as an IFA, to execute an order for a client may not be required to seek information separately from that client in order to assess the appropriateness of the order but would instead be able to rely on the referring firm having carried out such an assessment (if the referring firm complies with the requirement to assess appropriateness). This would similarly be the case where a broker receives an order from a portfolio manager.

Also, as per COBS 2.4.8G, where a professional firm (such as a law firm, accountancy firm or actuarial consultant) refers a client to a firm for discretionary portfolio management services and the professional firm has instructed the firm to follow a particular strategy for the portfolio (e.g. invest in bonds), as being consistent with the client's investment objectives (e.g. achieve income), it will generally be reasonable for the discretionary portfolio management firm to manage the portfolio in accordance with the instructions without being obliged to reassess whether the proposed strategy is suitable for the client. Instructions received from the professional firm might also cover desirable restrictions, such as to hold only AAA-rated bonds. But if a firm still has to exercise its discretion in relation to strategies to be followed (including any restrictions) or the client's investment objectives, it will need to ensure that its decisions are suitable for the client.

Similarly where, for example, in the case of a pension fund client, that fund employs consultants whose remit is to retain portfolio managers, it will generally be reasonable for a discretionary portfolio management firm that is retained through such a consultant to rely on information provided by the consultant relating to the fund without being obliged to verify this with the fund.

Some firms may also be interested in the position of 'transfer agents' in the market. The activities of an operator or depositary of a fund in handling subscriptions and redemptions, managing the box and distributing fund units are outside the scope of MiFID. A service provider which operates a fund register on behalf of a depositary or operator, and which is not actively distributing or marketing fund units or otherwise providing investment services to clients, is not performing the investment service of reception and transmission of orders and is unlikely to be carrying on MiFID business. This will have a bearing on whether there is any need for such a service provider to rely on another firm's assessment of suitability or appropriateness, since the obligations may not apply to

the activities in question. However, even if a firm's activities are outside the scope of MiFID, the firm should still consider whether it has responsibilities under the Implementing Rules in relation to non-MiFID scope business.

SECTION THREE

3. THE NATURE OF THE SUITABILITY OBLIGATION

3.1 *Introduction*

COBS 9.1.1R

This chapter applies to a firm which makes a *personal recommendation* in relation to a *designated investment*.

COBS 9.1.3R

This chapter applies to a *firm* which *manages investments*.

COBS 9.2.1R

(1) A *firm* must take reasonable steps to ensure that a *personal recommendation*, or a decision to trade, is suitable for its *client*.

(2) When making the *personal recommendation* or *managing* his *investments*, the *firm* must obtain the necessary information regarding the *client's*:

(a) knowledge and experience in the investment field relevant to the specific type of *designated investment* or service;

(b) financial situation; and

(c) investment objectives;

so as to enable the *firm* to make the recommendation, or take the decision, which is suitable for him.

[Note: article 19(4) of *MiFID*, article 12(2) of the *Insurance Mediation Directive*]

COBS 9.2.2R

(1) A *firm* must obtain from the *client* such information as is necessary for the *firm* to understand the essential facts about him and have a reasonable basis for believing, giving due consideration to the nature and extent of the service provided, that the specific transaction to be recommended, or entered into in the course of managing:

(a) meets his investment objectives;

(b) is such that he is able financially to bear any related investment risks consistent with his investment objectives; and

(c) is such that he has the necessary experience and knowledge in order to understand the risks involved in the transaction or in the management of his portfolio.

(2) The information regarding the investment objectives of a *client* must include, where relevant, information on the length of time for which he wishes to hold the investment, his preferences regarding risk taking, his risk profile, and the purposes of the investment.

(3) The information regarding the financial situation of a *client* must include, where relevant, information on the source and extent of his regular income, his assets, including liquid assets, investments and real property, and his regular financial commitments.

[Note: articles 35(1), (3) and (4) of the *MiFID implementing Directive*]

COBS 9.3.1G

(1) A transaction may be unsuitable for a *client* because of the risks of the *designated investments* involved, the type of transaction, the characteristics of the order or the frequency of the trading.

(2) In the case of *managing investments*, a transaction might also be unsuitable if it would result in an unsuitable portfolio.

[Note: recital 57 to the *MiFID implementing Directive*]

COBS 9.3.2G

(1) A series of transactions that are each suitable when viewed in isolation may be unsuitable if the recommendation or the decisions to trade are made with a frequency that is not in the best interests of the *client*.

(2) *A firm* should have regard to the *client's* agreed investment strategy in determining the frequency of transactions. This would include, for example, the need to switch a *client* within or between *packaged products*.

[Note: recital 57 to the *MiFID implementing Directive*]

The nature of the Suitability Obligation and the range and level of detail of information required from clients will depend on the type of service being provided and the nature of the client. Firms will therefore have flexibility in meeting the objectives of the rules on suitability, taking into account the nature and extent of the service being provided and the client. This flexibility may be particularly important in the wholesale markets (to the extent that suitability obligations do apply) given that the range of services provided is typically more varied than in retail markets.

The information required is that which is "necessary" to test suitability. As there are several types of services which are subject to the Suitability Obligation, the range and depth of information that may be considered "necessary" will vary from one service to another. The following are some examples of broad categories of services for this purpose:

3.1.1 *Ad-hoc advice*

This includes a range of situations which could require very different levels of detail relating to the client's circumstances to be taken into account. For example, a request to a firm to carry out an ad-hoc review of a client's entire portfolio may require the firm to effect a detailed review of the client's overall investment objectives, knowledge and financial situation. However, where a client instructs a firm only to give personal recommendations relating to an identified portion of his/her assets or in relation to the desirability of investing in a specific investment, without reviewing the client's entire portfolio, the suitability assessment could involve a narrower review, focusing on the client's objectives, financial situation and knowledge in relation to that particular portion of assets or specific investment.

3.1.2 *On-going advisory services*

This includes various forms of on-going advisory service where there is no exercise of discretion by the firm in relation to particular investments. For example, the firm advises the client on an on-going basis in relation to the balance of the portfolio but leaves it to the client to decide on specific investments to be made. As in the case of 3.1.1 above, the level of detail required for an assessment of suitability in these situations may potentially vary considerably depending on whether the ongoing investment advice relates to: (a) the entirety of a customer's portfolio of investments as opposed to a small subset of total assets; and (b) whether the firm is advising the client on his/her investment strategy or only advising within the constraints and parameters of a strategy set by the client.

3.1.3 *Discretionary portfolio management*

This includes all forms of discretionary management of the whole or part of a client's portfolio. The firm manages the portfolio without seeking the client's approval for each investment decision. It receives a mandate from the client and then exercises its own discretion in managing the portfolio within the terms of the mandate. The detail of the suitability assessment is likely to reflect whether the mandate relates to the whole of the client's portfolio or only a portion of the whole, and whether the firm sets the investment strategy or this is dictated by the client.

3.2 ***'Know Your Customer' - Required information***

See COBS 9.2.1R and 9.2.2R above.

Under COBS 9.2.1R and 9.2.2R, the test of suitability requires a firm to have obtained "necessary" information about a client's knowledge and experience, his financial situation and his investment objectives, to assess suitability. What is "necessary" will vary from case to case and as such the firm must decide in each case what is necessary under the Implementing Rules. The scope and detail of the information required to have been obtained may vary enormously depending upon the client, the product and the service concerned.

Firms will need to consider how best to obtain the necessary information relating to clients. For example, depending on the type of service and the complexity of the product, firms may require clients to complete a standardised questionnaire, a tailored questionnaire or a combination of both. Firms can also use publicly available information for this purpose, or even non-publicly available information if this would not breach information barriers or confidentiality obligations. It might be appropriate to obtain the information in a meeting with the client, or a telephone conversation or other means of communication such as e-mail interchange may suffice. In wholesale markets, where contact between firms and their clients in relation to some products or services is particularly regular or even constant, firms will need to determine how the necessary information can most efficiently be obtained and at what point (perhaps including, for example, through the firm's ordinary course of dealing with the client). For more structured products or transactions, it is likely that the necessary information would be obtained in the course of negotiations and discussions with the client about the product or transaction.

There is no stipulation under the Implementing Rules as to when the information must be obtained prior to the provision of a service. Firms must therefore judge this for themselves. The information could be obtained a day or a month or even a year before a service is provided. However, if information has been obtained significantly in advance of provision of the relevant service, firms will need to consider issues relating to updating of client information (see section 3.2.7).

3.2.1 *Knowledge and experience*

COBS 9.2.3R

The information regarding a *client's* knowledge and experience in the investment field includes, to the extent appropriate to the nature of the *client*, the nature and extent of the service to be provided and the type of product or transaction envisaged, including their complexity and the risks involved, information on:

(1) the types of service, transaction and *designated investment* with which the client is familiar;

(2) the nature, volume, frequency of the *client's* transactions in *designated investments* and the period over which they have been carried out;

(3) the level of education, profession or relevant former profession of the *client*.

[Note: article 37(1) of the *MiFID implementing Directive*]

COBS 9.2.8R

(1) If a *firm* makes a *personal recommendation* or *manages investments* for a *professional client* in the course of *MiFID or equivalent third country business*, it is entitled to assume that, in relation to the products, transactions and services for which the *professional client* is so classified, the *client* has the necessary level of experience and knowledge for the purposes of *COBS* 9.2.2R(1)(c)).

….

[Note: article 35(2) of the *MiFID implementing Directive*]

One of the factors that might contribute to a client having appropriate knowledge is if the firm has provided information to the client about the nature of the product or service and the risks that it entails, and has a reasonable basis for believing that the client has read and understood it.

In deciding as to the level of detail of information to obtain from clients, firms could take into account, for example, as relevant:

- the nature of the product and the professional/retail nature of the client. For further guidance please refer to section 3.2.5;
- when dealing with corporate customers (who are classified as retail clients), a firm may determine the level of knowledge and experience within the corporate either by considering the past investment history of the corporate client or the knowledge and experience of the people in that corporate with whom it deals on a regular basis and to whom any recommendations are to be made. The firm can take into account the knowledge and experience of individuals authorised to make investment decisions on behalf of the corporate as a whole. As a result, a firm may also combine together the past investing experience of the corporate with the knowledge and experience of individuals currently working within the corporate with whom it deals to determine the overall level of knowledge and experience of the corporate. It should not, however, rely on a conclusion that is manifestly wrong; for example, if the relevant knowledge and experience resided in individuals who are no longer working for the corporate client;
- the level of education, profession or former profession of the client in order to help the firm to satisfy itself that the client's level of knowledge may have a particular relevance for more complex products such as derivatives and structured products - for example,

individuals who have a finance related professional background or qualifications are more likely to understand the risks in complex products than individuals who do not have such a background. Conversely, firms should also pay due care and attention during the sales process to whether a client is illiterate or has some other incapacity which could prevent or impact on understanding - for example, when product documentation is in a language that is not the client's first language.

3.2.2 *Financial Situation*

> ***See COBS 9.2.2R(1) and (3) above.***
>
> ***COBS 9.2.8R***
>
> ….
>
> (2) If the service consists of making a *personal recommendation* to a *per se professional client*, the *firm* is entitled to assume that the *client* is able financially to bear any related investment risks consistent with his investment objectives for the purposes of *COBS* 9.2.2R(1)(b)).
>
> [Note: article 35(2) of the *MiFID implementing Directive*]

Firms will need to consider how much information is necessary and relevant in relation to a client's financial situation, taking into account the type of product, service or transaction to be recommended or entered into, and the nature of the client, as described in Section 3.1 above. The amount of information required may also vary depending upon the size of the proposed investment and the range of financial products in respect of which the firm intends to advise or provide discretionary portfolio management services. Therefore, where the client only seeks personal recommendations on investments in very low risk and non-complex products (for example, gilts) and is investing a relatively small amount, the amount of information the firm may consider necessary in respect of his financial situation may be much less than the amount of information required if he were interested in more complex commodity derivatives and he is investing a large amount. Also, if a client first approaches a firm with the intention to seek a personal recommendation regarding gilts but a year later decides that he would like personal recommendations on OTC derivatives, the firm should consider whether the information initially obtained is sufficient to test suitability in the new circumstances.

The level of detail of information on the client's financial situation that a firm may consider to be necessary and relevant may also depend on the nature and sophistication of the client. And note that in the case of personal recommendations the requirement to obtain information about a professional client's financial situation applies only where the client is an 'elective' professional client and not a 'per se' professional client.

In the case of discretionary portfolio management services, the requirement to obtain information about a client's financial situation applies in relation to both retail and professional clients.

Under COBS 9.2.2R, where information relating to the client's financial situation is necessary, a firm needs to obtain the necessary information to understand the essential facts about the client to enable the firm to offer the service required. Therefore, if a client seeks ad-hoc investment advice (in the form of a personal recommendation) on the timing of the sale of an existing investment, detailed information about his financial circumstances is unlikely to be necessary since the investment advice provided is of a very focused nature

(unless the reason for the sale was directly related to the client's financial circumstances). However, where a client wishes to invest money regularly in derivatives or seeks ongoing investment advice from the firm as to such investments, the amount of information required regarding his financial circumstances may be much greater.

3.2.3 *Investment Objectives*

See COBS 9.2.2R above.

COBS 9.2.2R requires that a firm obtain from both professional clients and retail clients information about their investment objectives. The amount of information that is necessary from the relevant client will vary depending upon the circumstances.

Firms will wish to consider whether information under all of the heads in COBS 9.2.2R(2) is relevant in each case (and, if so, how much information is relevant) as the amount of information required will vary depending upon the nature of the product and service and the nature of the client.

Some institutional investors have pre-determined investment strategies - sometimes as required by law (e.g. pension funds) or by contract (e.g. collective investment schemes). Where reasonable, firms may rely on statements of such strategies and instructions to follow such strategies provided by the client or by its agent (e.g. professional firm or pension consultant) as the basis of such a client's investment objectives, unless it is aware or ought reasonably be aware of any fact that would give reasonable grounds to question the accuracy of that information.

When seeking information in relation to the client's investment objectives, the types of information the firm may wish to obtain could include information as to whether the client wishes to:

- invest for income or growth (with liquidity or not); or
- keep his/her capital safe and avoid any risk; or
- accept a low risk so as to aim to achieve some level of a profit; or
- hedge; or
- accept an appropriately higher level of risk because he has a higher profit expectation.

A client should also be asked to provide details regarding the investment horizon he prefers - e.g. a short, intermediate or long term time horizon.

3.2.4 *Client Assessments*

See COBS 9.2.1R and COBS 9.2.2R(1)(a), (b) and (c) above.

Under COBS 9.2.2R, the firm may conclude that a transaction is suitable for the client if the firm has a reasonable basis for believing that the transaction satisfies the following criteria (to the extent relevant):

- ***it meets the investment objectives of the client (COBS 9.2.2R(1)(a));***

  Firms should satisfy themselves that the transaction recommended or entered into is likely to meet those investment objectives - although, in the context of an ongoing mandate, the firm may need to consider the combined effect of its investment advice overall and not just in relation to an individual transaction. For example, for a client with an intermediate risk profile, it may be appropriate to have a proportion of high risk

instruments in his portfolio so long as the overall risk profile of the portfolio remains in accordance with an intermediate risk profile;

- ***it is such that the client is able financially to bear any related investment risks consistent with his investment objectives (COBS 9.2.2R(1)(b));***

  Firms should have a reasonable basis for believing that the transaction recommended or entered into is such that the client would be able to financially bear the risk, if the transaction recommended or entered into carries with it a financial risk (e.g. an investment that could fall in value over time or which involves the possibility of losses in excess of the amount invested). In considering this issue, firms may also, where relevant, take into account, for example, the scale of the relevant investment/investment strategy in the context of the client's overall portfolio, the nature of the client and the nature of their mandate.

  Firms should, where relevant, assess what the impact of a reasonably foreseeable loss relating to recommended investments would be. Where relevant, firms should consider the risks of extreme market movements (even if relatively unlikely), particularly in the case of contingent liability investments. For example, if a firm proposes to recommend that a client invests in OTC currency or commodity derivatives that are highly volatile and the risk of loss goes beyond the initial investment and is open-ended, the firm should satisfy itself that the client has the financial resources necessary to bear the loss consistent with his investment objectives.

- ***it is such that the client has the necessary knowledge and experience to understand the risks involved in the transaction or in the management of the portfolio (COBS 9.2.2R(1)(c));***

  Having obtained information on the knowledge and experience of the client, firms will be better placed to ensure that they have sufficient information to assess the client's understanding of the nature of risks involved in a proposed transaction or in the management of his portfolio. Giving a client a product risk warning, provided that it is understood, may supplement the existing knowledge of the client. This, combined with the client's experience may, in some cases, result in an overall assessment that the client has sufficient knowledge and experience for the purposes of the suitability assessment. In some instances, for example in relation to very simple products, a risk warning may be sufficient to ensure that the client has sufficient knowledge relating to the risk of an investment service or financial instrument, as long as the firm has a reasonable basis for believing that the client has read and understood it. In an advisory relationship, there will be additional ways in which a firm may establish the client's level of knowledge and experience so that a suitable recommendation can be made.

Where a firm provides discretionary portfolio management services, a mandate can be agreed between the firm and the client and the firm can follow this mandate unless the mandate is changed or if the client subsequently informs the firm that the information supplied is inaccurate. If the firm discovers that the information accompanying the mandate is inaccurate, the firm should consider seeking a fresh mandate from the client. (Please also see section 3.2.7 regarding updating the mandate).

The Suitability Obligation applies to all decisions to trade taken by a firm pursuant to a mandate. However, the Suitability Obligation does not apply to the agreement of, or routine changes to, a mandate, unless in the process the firm, in effect, provides a personal recommendation. So, for example, a suggestion by a firm that a mandate should be amended to allow for investment in a broader range of securities should not be subject to the Suitability

Obligation. In contrast, a suggestion by a firm that a mandate be amended solely to allow investment in a specific security, would in effect be a personal recommendation and the Suitability Obligation would apply.

3.2.5 *Nature and complexity of product, sophistication of client*

See COBS 9.2.2R and COBS 9.2.3R above.

When considering the scope and detail of the information to be sought, firms are entitled, under COBS 9.2.2R and COBS 9.2.3R, to take into account the nature of the client and the nature and extent of the service or type of product or transaction:

(i) *The nature of the client*

As per COBS 9.2.2R and COBS 9.2.3R, a firm may be able to test suitability by obtaining information about a more limited range of matters when dealing with a professional client than when dealing with a retail client. For instance, in relation to a professional client a firm can assume knowledge and experience for the product, service or transaction for which the client has been classified as professional.

In addition, if the client is a per se professional client receiving personal recommendations, the firm can also assume that the client is able to financially bear the risks in respect of any such products or transactions recommended by the firm.

Wholesale investment firms may consider stipulating in their standard terms of business to be entered into with professional clients that no investment advice (in the form of personal recommendations) will be provided to such clients unless agreed otherwise in writing on a transaction-by-transaction basis. As a result wholesale investment firms may not have to obtain from these clients investment objectives when there is no actual need to do so. This approach is consistent with historic market practice but simply stating that no investment advice will be provided will not be enough - it must be the case as a matter of fact that no investment advice is actually given. If as a matter of fact personal recommendations are given, regardless of what the standard terms of business say, suitability will have to be considered.

As indicated earlier, firms who provide personal recommendations to professional clients should not need to have to re-establish a client's investment objectives in relation to each routine trading recommendation the firm makes in relation to plain vanilla instruments, provided that the client's commercial objectives are clear (e.g. to realise a profit, avoid a loss etc) and the particular transaction does not raise additional considerations. So, for example, firms who provide such 'routine' personal recommendations to professional clients might consider addressing their suitability obligations by including in their client documentation a statement to the effect that if the firm provides a personal recommendation to the client in the course of its routine trading services, and the client's objectives are clear, it will seek to ensure that such recommendations are consistent with its understanding of the client's investment objectives, unless otherwise agreed between the parties in relation to a particular transaction.

In addition, a firm is likely to need to obtain less information from existing clients than it would need to obtain from new clients provided that the firm has obtained the information already. Firms can, therefore, have a flexible approach in terms of the

amount of information required from clients depending upon the nature of the client and the extent of the relationship with the client. Where a client has had a long-standing relationship with the firm, the amount of new information required to test suitability may be minimal, unless the client's circumstances or investment choices change.

There is no eligible counterparty classification for investment advisory and discretionary portfolio management services. A client that would otherwise be classified as an eligible counterparty will be treated as a professional client for these services. However, within the scope of the Implementing Rules, when dealing with such clients a firm may be able to conclude that the level of detail of information required to assess suitability is more limited because of the size and sophistication of the client.

(ii) *Nature and extent of the service or type of product or transaction*

As COBS 9.2.2R refers to information which is necessary given the nature and extent of the service to be provided and the transaction to be recommended, the more complex and high risk the product, the higher the threshold of required information. For example, a higher degree of information would be required when dealing in a highly structured OTC product for an individual, than would be the case for relatively straight forward derivatives being offered to experienced institutional investors. Likewise, the level of detail of information required from a client prior to the sale of UK FTSE stocks may typically be less than that required prior to the sale of equities in small-cap Japanese entities, because the latter will involve more complex risks (e.g. foreign exchange risk and liquidity risk) than the former.

As already suggested, the level of detail of information required may be more limited when providing an ad-hoc personal recommendation on a single investment in respect of which a client has sought advice than in the case of a recommendation relating to or discretionary management of the client's whole portfolio. Where a client seeks very limited ad hoc investment advice on whether to invest in a particular equity or debt instrument, and the firm is not advising on the size of the transaction, detailed information about the client's overall financial position may not be necessary, provided that the firm is satisfied that the client can bear the financial risks. However, where a firm provides personal recommendations on an ongoing basis, more information may become necessary to determine suitability. Similarly, where a firm takes on a role to advise upon, or a discretionary investment mandate relating to, all or a substantial proportion of the client's portfolio, the firm is likely to have to obtain a much more extensive set of information to be able to "understand the essential facts about the client".

(iii) *The nature of advice in the context of corporate finance activities*

The key element of "investment advice" under the Implementing Rules is that it involves a "personal recommendation". In order for a recommendation to be personal it must be presented as suitable for the person in question or based on a consideration of the circumstances of the person. The recommendation must include an express or implied recommendation to act in a particular way in relation to a designated investment.

Some corporate finance advice (in the sense of advice relating to the capital structure of a corporate and advice relating to mergers and acquisitions) will not fall within the ambit of a "personal recommendation" under the Implementing Rules and will, therefore, not be subject to the Suitability Obligation. For example, expressing opinions or providing generic recommendations or general factual information to clients such as indicating a general preference to equities over bonds, producing league tables showing the performance of designated investments against published benchmarks or providing general debt raising and restructuring advice (i.e. advising the corporate to issue securities) is likely to fall outside the scope of the definition of investment advice.

However, it is possible that certain corporate finance advisory services could constitute the making of a personal recommendation as defined under the Implementing Rules and could therefore trigger the application of the Suitability Obligation. On this basis, for example, advising senior management to sell their shares in the target company in the context of a takeover will be a personal recommendation, as the relevant individuals will be acting in the capacity of an investor or potential investor.

Firms will be subject to less onerous requirements when making personal recommendations to corporates automatically classified as professional clients as the level of experience and knowledge and the ability to bear financial loss may be assumed. Note that the ability to bear financial loss cannot be assumed for opted-up professional clients and firms must therefore obtain further information as to these client's financial circumstances. For retail clients that are provided with corporate finance related services, no assumptions as to experience and knowledge or ability to bear financial loss can be made.

Since firms usually obtain detailed information about their clients as a key part of the process of providing corporate finance advice, it is unlikely that they would be required to change their existing processes significantly to satisfy the new requirements under the Implementing Rules.

3.2.6 *Failure to obtain information*

COBS 9.2.6R

If a *firm* does not obtain the necessary information to assess suitability, it must not make a *personal recommendation* to the *client* or take a decision to trade for him.

[Note: article 35(5) of the *MiFID implementing Directive*]

COBS 9.2.7G

Although a *firm* may not be permitted to make a *personal recommendation* or take a decision to trade because it does not have the necessary information, its *client* may still ask the *firm* to provide another service such as, for example, to arrange a deal or to deal as agent for the *client*. If this happens, the *firm* should ensure that it receives written confirmation of the instructions. The *firm* should also bear in mind the *clients' best interests rule* and any obligation it may have under the *rules* relating to appropriateness when providing the different service (see *COBS* 10, Appropriateness (for non-advised services)).

If a firm is unable to obtain the information necessary to assess suitability in a particular circumstance, COBS 9.2.6R provides that it must not make a personal recommendation or decision to trade. However, as per COBS 9.2.7G, a firm's inability to obtain the necessary

information should not automatically mean that a firm must simply refuse to provide any service to the client.

There is an irreducible minimum level of information without which it is not possible to make a personal recommendation. However, as long as it is consistent with the client's interests and investment objectives, there may be circumstances in which a firm can propose an alternative service or transaction tailored to the level of detail of information that the client has been willing to provide, for example a client may accept an advisory service relating to a portion of his portfolio, based on less information than would be required to provide a discretionary management service in relation to the client's total portfolio. However, even if a more limited service is offered or provided, any recommendation or decision to trade must still be suitable for the client (including being consistent with the client's investment objectives) and the scope of the service agreed and understood by the client.

When a firm has not been able to obtain sufficient information in order to be able to provide a particular service, it may need to enter into discussions with the client to redefine the service such that information that the firm has obtained is sufficient to be able to provide the redefined service. When recommending a different product or transaction, a firm should have regard to its obligation to act fairly and professionally in accordance with the best interests of the client.

3.2.7 *Updating client information*

COBS 9.2.4R

A *firm* must not encourage a *client* not to provide information for the purposes of its assessment of suitability.

[Note: article 37(2) of the *MiFID implementing Directive*]

COBS 9.2.5R

A *firm* is entitled to rely on the information provided by its *clients* unless it is aware that the information is manifestly out of date, inaccurate or incomplete.

[Note: article 37(3) of the *MiFID implementing Directive*]

COBS 9.2.5R makes clear that a firm may rely on information provided by its clients unless it is aware that the material is "manifestly out of date, inaccurate or incomplete". However, firms will, bearing this rule in mind, want to consider when and in what circumstances to update client information. The frequency with which updating of client information may need to be done will vary from client to client depending on the client's individual circumstances, his level of sophistication and the types of products in respect of which he receives investment advisory or discretionary portfolio management services. Firms should consider the frequency with which information updates need to be obtained. In doing so firms may take into account the type of relationships they have with their clients.

For example, where the information is the basis of an ongoing advisory relationship for a retail client, a firm is likely to want to review the information regularly. Where a firm has a discretionary portfolio management client with a high risk profile the firm is likely to need to update their information on the client more regularly than where the firm has an ongoing advisory mandate and the client has invested in a range of UK equities-based funds. When providing services to professional clients, firms may include a provision within the account opening documentation that requires the client to update the firm when the client's circumstances change. Where a firm relies on a third party for information e.g. pension fund's consultant, the firm may also feel able to rely on the consultant to update information.

COBS 9.2.5R provides that while a firm may rely on the information provided by its clients, it should not do so if it is aware that the information is manifestly inaccurate, incomplete or out of date. 'Awareness' in this context means that one ought to be able to infer from the facts and circumstances that information is out of date, inaccurate or incomplete. Firms will not be expected routinely to second-guess the accuracy of information or whether it is out of date. Firms will only be expected to infer inaccuracy, incompleteness or staleness of information if it is reasonable to conclude that the information is out of date, incomplete or inaccurate.

For example, if a firm has a particular client who can only provide accounts that are over, for example, two years old, the firm might conclude that in the circumstances the information cannot be relied upon because it is out of date. Similarly, it might be a couple of years since a client provided up to date accounts or account statements. Again, a firm might conclude that in the circumstances the information cannot be relied upon. Likewise, if a client provides information relating to his income that seems to be contradicted by account statements provided around the same time, a firm should make further enquiries, as it is reasonable to conclude that there is a discrepancy.

The updating of the information will usually relate only to some elements of the information initially obtained. For example, the information as to knowledge and experience and financial situation may change in a fairly short period of time (e.g. a Retail Client changes employers which results in a significant increase in income). However, it is unlikely that information as to investment objectives would need to be updated so often unless the client informs the firm that his investment objectives have changed. In addition, firms will only be required to update the information that is necessary for the provision of investment advisory or discretionary portfolio management services.

3.3 ***Consequences of the Suitability Test***

As already indicated, firms cannot recommend a product or service that they have assessed as unsuitable for the client. However, where a particular product or service is found to be unsuitable for a client, it may be possible for other products or services to be provided. For example, the firm could proceed on a non-advised basis in relation to that instrument if the client wishes to do so and has agreed to this. In these circumstances the firm will need to consider whether the client understands the risks involved in the product/service and whether any additional warnings need to be given to the client in accordance with the Appropriateness Obligation (see section 4). As already stressed, firms must also consider their overarching duty to act in the best interests of their clients.

3.4 ***Grandfathering***

The Implementing Rules do not provide explicitly for grandfathering clients for the purpose of suitability (although note that there is an express provision for the grandfathering of customers for the purposes of the appropriateness test).

If a firm obtained information from a client under the pre-MiFID FSA Rules, it should be able to rely on that information under the Implementing Rules if the client's individual circumstances or the range of services offered have not changed in a way that would require suitability to be tested afresh. Under the Implementing Rules, the assessment of suitability must still be done on an ongoing basis where there is an ongoing service. But this also means that, in relation to an ongoing portfolio management relationship, the Implementing Rules should not require more than is expected of a firm under its pre-MiFID review obligations.

Even if a firm did not have to test suitability under the pre-MiFID FSA Rules for certain clients (because it was not under an obligation to, such as, in the case of market counterparties and intermediate customers), there may be a requirement under the Implementing Rules to test suitability for those clients. However, from a practical perspective, a firm may already have or know the

information regarding its existing clients necessary to assess suitability. As a result, it may simply be a case of firms ensuring that the information already held is appropriately recorded and taken into account.

3.5 ***Record keeping***

COBS 9.5.1G

For its *MiFID business*, a *firm* is required to keep orderly records of its business and internal organisation (see *SYSC* 9, General rules on record-keeping). For other business, a *firm* is required to take reasonable care to establish and maintain such systems and controls as are appropriate to its business (see *SYSC* 3, Systems and controls). The records may be expected to reflect the different effect of the *rules* in this chapter depending on whether the *client* is a *retail client* or a *professional client*: for example, in respect of the information about the *client* which the *firm* must obtain and whether the *firm* is required to provide a *suitability report*.

COBS 9.5.2R

The *firm* must retain its records relating to suitability for a minimum of the following periods:

(1) if relating to a *pension transfer*, *pension opt-out* or *FSAVC*, indefinitely;

(2) if relating to a *life policy*, *pension contract* or *stakeholder pension scheme*, five years;

(3) if relating to *MiFID or equivalent third country business*, five years; and

(4) in any other case, three years.

COBS 19.5.3R

A *firm* need not retain its records relating to suitability if:

(1) the *client* does not proceed with the recommendation; and

(2) it is neither *MiFID or equivalent third country business*.

The records needed to evidence the suitability assessment for investment advisory clients will differ from those required for discretionary investment management services. Firms will therefore need to consider their record-keeping policies bearing in mind the services provided to the client, the type of clients they deal with and the documentation they normally ask for from a client when commencing a client relationship.

The types and extent of records that different firms keep to evidence suitability will vary from firm to firm and from client to client (including whether the client is a retail client or a professional client), and will relate to those elements/pieces of information required in the context of the nature of the client, the nature and extent of the relevant service and the type of product or transaction envisaged.

Firms should have record-keeping policies and procedures in place and must take measures to ensure that they follow such policies in practice. In the context of suitability assessments for retail clients, firms should at least ensure that a record of the information collected in order to establish suitability is maintained along with a record of the advice that was given. Where a suitability report is required, this should also be retained.

As indicated above, the types and extent of records that firms keep to evidence compliance with the Suitability Obligation will vary depending on the circumstances and taking into account the nature of the service and the client in question. This flexibility is particularly relevant in the context of services provided to professional clients in wholesale markets.

In addition, controls may also involve the introduction and use of policies, processes and training. These may have a particular role in markets where firms' communications with clients will not

necessarily constitute personal recommendations, and where firms choose not to provide such recommendations.

SECTION FOUR

4. THE PROVISION OF INVESTMENT SERVICES OTHER THAN INVESTMENT ADVICE AND DISCRETIONARY PORTFOLIO MANAGEMENT

4.1 *Introduction*

COBS 10.1.1R

This chapter applies to a *firm* which provides *investment services* in the course of *MiFID or equivalent third country business* other than making a *personal recommendation* and *managing investments*.

COBS 10.1.2R

This chapter applies to a *firm* which *arranges* or *deals* in relation to a *derivative* or a *warrant* with or for a *retail client* and the *firm* is aware, or ought reasonably to be aware, that the application or order is in response to a *financial promotion*.

COBS 10.1.3R

This chapter applies to a *firm* which assesses appropriateness on behalf of another *MiFID investment firm* so that the other *firm* may rely on the assessment under *COBS* 2.4.4R (Reliance on other investment firms: MiFID and equivalent business).

COBS 10.4.1R

(1) A *firm* is not required to ask its *client* to provide information or assess appropriateness if:

(a) the service only consists of execution and/or the reception and transmission of *client* orders, with or without *ancillary services*, it relates to particular *financial instruments* and is provided at the initiative of the *client*;

(b) the *client* has been clearly informed (whether the warning is given in a standardised format or not) that in the provision of this service the *firm* is not required to assess the suitability of the instrument or service provided or offered and that therefore he does not benefit from the protection of the *rules* on assessing suitability; and

(c) the *firm* complies with its obligations in relation to conflicts of interest.

(2) The *financial instruments* are:

(a) shares admitted to trading on a *regulated market* or an equivalent third country market (that is, one which is included in the list which is published by the European Commission and updated periodically); or

(b) money market instruments, bonds or other forms of securitised debt (excluding those bonds or securitised debt that embed a *derivative*); or

(c) *units* in a *scheme* authorised under the *UCITS directive*; or

(d) other non-complex *financial instruments*.

(3) A *financial instrument* is non-complex if it satisfies the following criteria:

(a) it is not a *derivative* or other security giving the right to acquire or sell a *transferable security* or giving rise to a cash settlement determined by reference to transferable securities, currencies, interest rates or yields, commodities or other indices or measures;

(b) there are frequent opportunities to dispose of, redeem, or otherwise realise the instrument at prices that are publicly available to the market participants and that are either market prices or prices made available, or validated, by valuation systems independent of the issuer;

(c) it does not involve any actual or potential liability for the *client* that exceeds the cost of acquiring the instrument; and

(d) adequately comprehensive information on its characteristics is publicly available and is likely to be readily understood so as to enable the average *retail client* to make an informed judgment as to whether to enter into a transaction in that instrument.

[Note: article 19(6) of *MiFID* and article 38 of the *MiFID implementing Directive*]

COBS 10.5.1G

A service should be considered to be provided at the initiative of a *client* (see *COBS* 10.4.1R(1)(b)) unless the *client* demands it in response to a personalised communication from or on behalf of the *firm* to that particular *client* which contains an invitation or is intended to influence the *client* in respect of a specific *financial instrument* or specific transaction.

[Note: recital 30 of *MiFID*]

COBS 10.5.2G

A service can be considered to be provided at the initiative of a *client* notwithstanding that the *client* demands it on the basis of any communication containing a promotion or offer of *financial instruments* made by any means that by its very nature is general and addressed to the public or a larger group or category of *clients*.

[Note: recital 30 of *MiFID*]

COBS 10.5.3G

(1) Communications to the world at large, such as those in newspapers or on billboards, are likely to be by their very nature general and therefore not personalised communications.

(2) Communications addressed to a *client* (such as, for example, an email, a telephone call or a letter), may or may not be personalised depending on the content.

(3) A communication is not personalised solely because it contains the name and address of the *client* or because a mailing list has been filtered.

(4) If a *firm* is satisfied that a communication does not contain any personalised content, it may wish to make clear that it does not intend the communication to be personalised and that the personal circumstances of the recipient have not been taken into account.

COBS 10.5.5G

The circumstances in which valuation systems will be independent of the issuer (see *COBS* 10.4.1R(3)(b)) include where they are overseen by a depositary that is regulated as a provider of depositary services in a *EEA State*.

[Note: recital 61 to the *MiFID implementing Directive*]

COBS 10.6.1G

A *firm* need not assess appropriateness if it is receiving or transmitting an order in relation to which it has assessed suitability under *COBS* 9 (Suitability (including basic advice)).

COBS 10.6.2G

A *firm* may not need to assess appropriateness if it is able to rely on a recommendation made by an *investment firm* (see *COBS* 2.4.5G (Reliance on other investment firms: MiFID and equivalent business).

A firm may assume that a professional client has the necessary knowledge and experience in order to understand the risks involved in relation to those products, transactions and services for which it is classified as a professional client.

Consequently, and unlike the situation with a retail client, provided that a firm has categorised a professional client in accordance with the applicable requirements, a firm should not generally need to obtain additional information from the client for the purposes of the appropriateness assessment for those products and services for which they have been classified as a professional client.

As with suitability, it is possible that a firm may already assess appropriateness as a matter of commercial prudence in any case. The extent to which the new requirements will have an impact on how firms currently provide services and products to clients will vary, therefore, from firm to firm.

The approach to the appropriateness assessment may be graduated according to the complexity of an instrument (either complex or non-complex). For example, where a complex product (including MiFID-scope derivatives) conforms to all or most of the qualitative criteria at COBS 10.4.1R(3) for determining that it would otherwise be a non-complex instrument (for example an exchange-traded structured note with no contingent liability), the intensity of the determination of appropriateness may be less - unless the nature of the client dictates otherwise. Conversely, where the complex instrument conforms to few or none of the criteria (e.g. a highly structured or leveraged OTC product), then the corresponding obligation will need to be much more exacting in determining appropriateness. Accordingly, depending on the degree of the non-complex criteria that are satisfied, it may be reasonable for a firm to adopt a gradation in the intensity of its assessment (high, intermediate and low).

Similarly, the intensity of the Appropriateness Obligation in terms of the due diligence required may differ as between a complex product offered to a client known to be an experienced investor and, on the other hand, the same product offered to a client known to be less experienced. If a product is not particularly complex, there may be fewer risks attached to it and the fewer the risks related to the product, the less many clients are likely to need by way of knowledge and experience in order to understand the risks.

4.2 ***The Appropriateness Obligation***

COBS 10.2.1R

(1) When providing a service to which this chapter applies, a *firm* must ask the *client* to provide information regarding his knowledge and experience in the investment field relevant to the specific type of product or service offered or demanded so as to enable the *firm* to assess whether the service or product envisaged is appropriate for the *client*.

(2) When assessing appropriateness, a *firm*:

(a) must determine whether the *client* has the necessary experience and knowledge in order to understand the risks involved in relation to the product or service offered or demanded;

(b) may 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 product, for which the *client* is classified as a *professional client*.

[Note: article 19(5) of *MiFID* and article 36 of the *MiFID implementing Directive*]

COBS 10.2.2R

The information regarding a *client's* knowledge and experience in the investment field includes, to the extent appropriate to the nature of the *client*, the nature and extent of the service to be provided and the

type of product or transaction envisaged, including their complexity and the risks involved, information on:

(1) the types of service, transaction and *designated investment* with which the *client* is familiar;

(2) the nature, volume, frequency of the *client's* transactions in *designated investments* and the period over which they have been carried out;

(3) the level of education, profession or relevant former profession of the *client.*

[Note: article 37(1) of the *MiFID implementing Directive*]

COBS 10.2.3R

A *firm* must not encourage a *client* not to provide information required for the purposes of its assessment of appropriateness.

[Note: article 37(2) of the *MiFID implementing Directive*]

COBS 10.2.4R

A *firm* is entitled to rely on the information provided by a *client* unless it is aware that the information is manifestly out of date, inaccurate or incomplete.

[Note: article 37(3) of the *MiFID implementing Directive*]

COBS 10.2.5G

When assessing appropriateness, a *firm* may use information it already has in its possession.

COBS 10.2.6G

Depending on the circumstances, a *firm* may be satisfied that the *client's* knowledge alone is sufficient for him to understand the risks involved in a product or service. Where reasonable, a *firm* may infer knowledge from experience.

COBS 10.2.7G

If, before assessing appropriateness, a *firm* seeks to increase the *client's* level of understanding of a service or product by providing information to him, relevant considerations are likely to include the nature and complexity of the information and the *client's* existing level of understanding.

COBS 10.2.8G

If a *firm* is satisfied that the *client* has the necessary experience and knowledge in order to understand the risks involved in relation to the product or service, there is no duty to communicate this to the *client*. If the *firm* does so, it must not do so in a way that amounts to making a *personal recommendation* unless it complies with the *rules* in *COBS* 9 on suitability.

COBS 10.4.2R

If a *client* engages in a course of dealings involving a specific type of product or service through the services of a *firm*, the *firm* is not required to make a new assessment on the occasion of each separate transaction. A *firm* complies with the *rules* in this chapter provided that it makes the necessary appropriateness assessment before beginning that service.

[Note: recital 59 of the *MiFID implementing Directive*]

Firms will need to consider how they seek the necessary information from clients in order to assess appropriateness. For example, to comply with COBS 10.2.2R, depending on the type of service and the complexity of the product, firms could require clients to complete a standardised questionnaire, a tailored questionnaire or a combination of both. Alternatively, firms could simply ask a short set of

targeted questions to test a client's knowledge of the principal risks in a product or service. It might be appropriate to obtain the information in a meeting with the client, or a telephone conversation or other means of communication such as e-mail interchange may suffice.

There is no stipulation under Implementing Rules as to when the information must be sought prior to the provision of a service. Firms must therefore judge this for themselves. The information could be sought a day or a month or even a year before a service is provided. However, if information has been obtained significantly in advance of provision of the relevant service, firms will need to consider issues relating to updating of client information

COBS 10.2.4R states that a firm may rely on the information provided by its clients, unless it is aware that the information is manifestly out of date, inaccurate or incomplete. This does not mean that firms be expected routinely to second-guess the accuracy of all information or whether it is out of date or incomplete. (See also section 3.2.7 above).

4.3 ***Knowledge and Experience***

See COBS 10 above.

COBS 10.4.3R

A *client* who has engaged in a course of dealings involving a specific type of product or service beginning before 1 November 2007 is presumed to have the necessary experience and knowledge in order to understand the risks involved in relation to that specific type of product or service.

[Note: recital 59 of the *MiFID implementing Directive*]

One of the factors that might contribute to a client having appropriate knowledge and experience in order to understand the risks is if the firm has provided information to the client about the nature of the product or service and the risks that it entails, provided the firm does not have grounds for believing that the client has misunderstood the information given to them.

As per COBS 10.2.2R, in determining the level of detail of information to seek from clients, firms may take into account among other factors:

- the status and nature of the client. For example, a firm may need to seek less information from existing clients than it would need to obtain from new clients provided that the firm has a record of the relevant information already received (please also see section 4.7 on grandfathering clients for appropriateness). Within the terms of the Implementing Rules, firms can, therefore, have a flexible approach in terms of the amount of information required from clients depending upon the nature of the client and the extent of the relationship with the client. Where a client has had a long-standing relationship with the firm, the amount of new information required to test appropriateness may be minimal;
- the type of the product. The more complex and high risk the product, the higher the threshold of required information and knowledge and experience to understand the risks. For example, the level of detail of information required from a client prior to an investment in a unit of a UCITS (if the appropriateness test is triggered) may typically be less than that required prior to the trading of futures, because the latter will involve more complex risks (e.g. potential contingent liability) than the former. One of the ways in which a firm may be able to ensure that the client has appropriate information in respect of the risks associated with a particular product is by providing the client with information/risk warnings so long as these are clear, fair and not misleading and provided the firm does not have grounds for believing that the client has misunderstood the information given to them.

- when dealing with corporate customers (who are classified as retail clients), a firm may determine the level of knowledge and experience within the corporate either by considering the past investment history of the corporate client or the knowledge and experience of the people in that corporate with whom it deals on a regular basis and to whom any recommendations are to be made. The firm can take into account the knowledge and experience of individuals authorised to make investment decisions on behalf of the corporate as a whole. As a result, a firm may also combine together the past investing experience of the corporate with the knowledge and experience of individuals currently employed within the corporate with whom it deals to determine the overall level of knowledge and experience of the corporate.
- the level of education, profession or former profession of the client may help the firm to satisfy itself that the client's level of knowledge and experience is appropriate for more complex products such as derivatives and structured products - for example, individuals who have a finance related professional background or qualifications are more likely to understand the risks in complex products than individuals who do not have such a background. Conversely, firms should also pay due care and attention during the sales process to whether a client is illiterate or has some other incapacity which could prevent or impact on understanding - for example, when product documentation is in a language that is not the client's first language.

4.4 ***Basis of obligation***

See COBS 10.2.1R above.

Whereas the Suitability Obligation applies to a "specific transaction" as per COBS 9.2.2R(1), the Appropriateness Obligation applies to the "specific type" of "product or service" offered or demanded as per COBS 10.2.1R(1).

In complying with the Appropriateness Obligation, where it applies, a firm will need to establish the appropriateness of a "specific type" of "product or service" before the transaction is entered into or the service provided. The Implementing Rules do not specify any particular point at which the assessment must be made before the transaction is entered into or service provided; a firm needs to consider when to do this in the light of the interests of the client, its business model, communication channels, the type of products involved, etc. In some cases, the assessment might be made in stages over a period of time leading up to the transaction. If so, and if market conditions meant that the risks associated with a specific type of product changed shortly before a transaction was to be concluded, a firm should check whether its earlier assessment is still valid.

It may suit some firms' business models to aim to assess the appropriateness of a product or service before it is offered to a client. In practice, this could mean, for example, that the client is asked for sufficient information about their experience and knowledge at the beginning of a relationship in order to allow the firm subsequently to establish whether products or services offered or requested may be appropriate. Some firms may similarly want to build up a profile of information on existing clients' experience and knowledge in order to be able to consider appropriateness before a product is offered. In all cases this information would need to be kept under review to ensure that it was not out of date. A firm should then ensure that products and/or services it offered are appropriate for the client on the basis of the information obtained.

Such an approach could, in practice, also accommodate firms classifying certain product types as "appropriate" for certain clients (on the basis of those clients' experience and knowledge), which could simplify the assessment process for individual offerings. For example, a firm might wish to contact a number of retail clients who have recently been regular investors in a particular type of fund in order to invite them to invest in a new fund of the same type. As long as the controls around it are adequate, such an approach could facilitate the integration of the appropriateness test into some business models.

Other options as to when the determination is made include, for example, assessing the appropriateness of the product or service through an on-line or telephone process, through application documentation, once a client has returned a product application form, or at the point of execution.

4.5 ***Risk disclosures*** (see Appendix 1)

COBS 10.3.1R

(1) If a *firm* considers, on the basis of the information received to enable it to assess appropriateness, that the product or service is not appropriate to the *client*, the *firm* must warn the *client*.

(2) This warning may be provided in a standardised format.

[Note: article 19(5) of *MiFID*]

COBS 10.3.2R

(1) If the *client* elects not to provide the information to enable the *firm* to assess appropriateness, or if he provides insufficient information regarding his knowledge and experience, the *firm* must warn the *client* that such a decision will not allow the *firm* to determine whether the service or product envisaged is appropriate for him.

(2) This warning may be provided in a standardised format.

[Note: article 19(5) of *MiFID*]

COBS 10.3.3G

If a *client* asks a *firm* to go ahead with a transaction, despite being given a warning by the *firm*, it is for the *firm* to consider whether to do so having regard to the circumstances.

Both COBS 10.3.1R and COBS 10.3.2R envisage the provision of 'risk warnings' to clients in certain circumstances - specimen risk warnings are attached at Appendix 1. (Firms should note that these are not the same as risk warnings that may be necessary under COBS 14).

4.6 ***Grandfathering***

See COBS 10.4.3R.

As noted above, under the Implementing Rules, a firm can presume that a client who has engaged in a course of dealings involving a specific type of product or service before 1 November 2007 (with any firm) has the necessary experience and knowledge in order to understand the risks involved in relation to that type of product or investment service. This equates to a form of grandfathering for such clients.

4.7 ***Record Keeping***

COBS 10.7.1G

For its *MiFID business*, a *firm* is required to keep orderly records of its business and internal organisation (see *SYSC* 9, General rules on record-keeping). For other business, a *firm* is required to take reasonable care to establish and maintain such systems and controls as are appropriate to its business (see *SYSC* 3, Systems and controls). The records may be expected to include the *client* information a *firm* obtains to assess appropriateness and should be adequate to indicate what the assessment was.

COBS 10.7.2R

The *firm* must retain its records relating to appropriateness for a minimum of five years.

….

Firms will need to consider their record keeping policies bearing in mind the services provided to the client, the type of clients they deal with and the documentation they normally ask for from a client when commencing a client relationship.

The types of records that different firms keep to document appropriateness will vary from firm to firm and within each firm from client to client but a firm only need record those elements/pieces of information required in the context of the nature of the relevant service and/or nature of the relevant client.

Firms should have record keeping policies and procedures in place and they take measures to ensure that they follow such policies in practice. In the context of appropriateness, firms should at least ensure that a record of the information collected in order to establish appropriateness is maintained but firms may not always feel it necessary to create a separate stand-alone document recording appropriateness on a transaction-by-transaction basis if they can satisfy the obligation in other ways.

Appendix 1

SPECIMEN DISCLOSURE AND RISK WARNING STATEMENTS

These disclosure statements provide examples for meeting the regulatory obligation on firms to provide risk warnings to clients where relevant to the firm's obligation to assess appropriateness. Firms will need to be satisfied that using one of these examples is appropriate in the circumstances.

1. **Warning to a client that a product or service is not appropriate**

   The first warning that must be given to a client is where a firm determines, on the basis of information supplied to it, that an investment product or service is not appropriate for a particular client. As this will occur on a case-by-case basis, this warning should be tailored to the circumstances of the individual case.

   On the basis of the information that you have previously supplied to us in relation to your knowledge and experience, we consider that [ ] is not an appropriate [product/service] for you.

   [Where a firm feels it reasonable to do so it may also wish to add*:*

   If you still wish us to proceed on your behalf, we may still [purchase/sell/deal in/invest in] [product]/[with the proposed service], but you should note that it may not be appropriate for you and that you may be exposing yourself to risks that fall outside your knowledge and experience and/or which you may not have the knowledge or experience properly to assess and/or control by way of mitigating their consequences for you.]

2. **Warning to a client that fails to provide sufficient information**

   The second warning that must be given to a client is where the client fails to provide sufficient information to enable the firm to assess appropriateness or insufficient information regarding knowledge or experience. A firm should provide this warning once it has established that it has not received sufficient information in order to assess appropriateness.

   In providing our [products and services] to you, we are required to obtain information from you in order to assess whether a given product or service is appropriate for you.

   If you fail to provide sufficient information in this regard (or fail to provide any information), there is a strong risk that we will not be able to assess whether you have the necessary knowledge and experience to understand the risks involved.

   If you still wish us to proceed on your behalf, we may do so, but you must note that we may not be able to determine whether the [product/ service] is appropriate for you.

   Consequently, we strongly advise you to provide us with any requested information which we believe to be necessary for the purpose of enabling us to assess the appropriateness of the [products/service] for you.

3. **Warning to a client in relation to non-complex instruments**

   In the case of business that is to be undertaken in non-complex instruments at the initiative of the client, a firm is not required to assess appropriateness if (among other things) it has clearly informed its clients that it is not required to assess the suitability of the instrument or service provided.

   In providing [describe service(s)] to you in relation to the following non-complex instruments: [e.g. shares and bonds traded on regulated markets, units in regulated collective investment schemes], we

are not required to assess the suitability of the instrument or the service provided or offered to you and, as a result, you will not benefit from the protection of the FSA rules on assessing suitability. Therefore, we will not assess whether:

(i) *the relevant product or service meets your investment objectives;*

(ii) *you would be able financially to bear the risk of any loss that the product or service may cause; or*

(iii) *you have the necessary knowledge and experience to understand the risks involved.*

Appendix 2

SOME PRACTICAL POINTS TO CONSIDER

[*Below is a set of practical points for firms to consider when preparing themselves for compliance with suitability and appropriateness requirements and preparing their suitability/appropriateness policy/process.*]

- Have you established a process for assessing suitability? Have staff been trained in the process?
- Have you established a process for assessing appropriateness? Have staff been trained in the process?
- Do you have a mechanism in place to keep the information on which assessments are made updated regularly?
- Do you have a mechanism in place for reviewing suitability in the event of a material change in the circumstances of the client or product?
- Do you have a mechanism in place for reviewing appropriateness in the event of a material change in the relevant information?
- Do you have systems in place for recording relevant client information and any relevant correspondence with clients?
- Do you have record keeping mechanisms in place that adequately record the manner in which suitability and appropriateness have been assessed for each client?
- Have you confirmed that the suitability obligation applies to the transactions under consideration? If not, have you confirmed that the appropriateness obligation applies to the transactions under consideration?

Appendix 3

SUITABILITY AND APPROPRIATENESS UNDER MiFID - LEVEL 1 AND LEVEL 2 TEXT

MiFID

Recital 30

A service should be considered to be provided at the initiative of a client unless the client demands it in response to a personalised communication from or on behalf of the firm to that particular client, which contains an invitation or is intended to influence the client in respect of a specific financial instrument or specific transaction. A service can be considered to be provided at the initiative of the client notwithstanding that the client demands it on the basis of any communication containing a promotion or offer of financial instruments made by any means that by its very nature is general and addressed to the public or a larger group or category of clients or potential clients.

Article 19(4)

When providing investment advice or portfolio management the investment firm shall obtain the necessary information regarding the client's or potential client's knowledge and experience in the investment field relevant to the specific type of product or service, his financial situation and his investment objectives so as to enable the firm to recommend to the client or potential client the investment services and financial instruments that are suitable for him.

Article 19(5)

Member States shall ensure that investment firms, when providing investment services other than those referred to in paragraph 4, ask the client or potential client to provide information regarding his knowledge and experience in the investment field relevant to the specific type of product or service offered or demanded so as to enable the investment firm to assess whether the investment service or product envisaged is appropriate for the client.

In case the investment firm considers, on the basis of the information received under the previous subparagraph, that the product or service is not appropriate to the client or potential client, the investment firm shall warn the client or potential client. This warning may be provided in a standardised format.

In cases where the client or potential client elects not to provide the information referred to under the first subparagraph, or where he provides insufficient information regarding his knowledge and experience, the investment firm shall warn the client or potential client that such a decision will not allow the firm to determine whether the service or product envisaged is appropriate for him. This warning may be provided in a standardised format.

Article 19(6)

Member States shall allow investment firms when providing investment services that only consist of execution and/or the reception and transmission of client orders with or without ancillary services to provide those investment services to their clients without the need to obtain the information or make the determination provided for in paragraph 5 where all the following conditions are met:

- the above services relate to shares admitted to trading on a regulated market or in an equivalent third country market, money market instruments, bonds or other forms of securitised debt (excluding those bonds or securitised debt that embed a derivative), UCITS and other non-complex financial instruments. A third country market shall be considered as equivalent to a regulated market if it complies with equivalent requirements to those established under Title III. The Commission shall publish a list of those markets that are to be considered

as equivalent. This list shall be updated periodically,

- the service is provided at the initiative of the client or potential client,

- the client or potential client has been clearly informed that in the provision of this service the investment firm is not required to assess the suitability of the instrument or service provided or offered and that therefore he does not benefit from the corresponding protection of the relevant conduct of business rules; this warning may be provided in a standardised format,

- the investment firm complies with its obligations under Article 18.

MiFID implementing Directive

Recital 56

It is necessary to make different provision for the application of the suitability test in Article 19(4) of Directive 2004/39/EC and the appropriateness test in Article 19(5) of that Directive. These tests have different scope with regards to the investment services to which they relate, and have different functions and characteristics.

Recital 57

For the purposes of Article 19(4) of Directive 2004/39/EC, a transaction may be unsuitable for the client or potential client because of the risks of the financial instruments involved, the type of transaction, the characteristics of the order or the frequency of the trading. A series of transactions that are each suitable when viewed in isolation may be unsuitable if the recommendation or the decisions to trade are made with a frequency that is not in the best interests of the client. In the case of portfolio management, a transaction might also be unsuitable if it would result in an unsuitable portfolio.

Recital 58

In accordance with Article 19(4) of Directive 2004/39/EC, a firm is required to assess the suitability of investment services and financial instruments to a client only when it is providing investment advice or portfolio management to that client. In the case of other investment services, the firm is required by Article 19(5) of that Directive 2004/39/EC to assess the appropriateness of an investment service or product for a client, and then only if the product is not offered on an execution-only basis under Article 19(6) of that Directive (which applies to non-complex products).

Recital 59

For the purposes of the provisions of this Directive requiring investment firms to assess the appropriateness of investment services or products offered or demanded, a client who has engaged in a course of dealings involving a specific type of product or service beginning before the date of application of Directive 2004/39/EC should be presumed to have the necessary experience and knowledge in order to understand the risks involved in relation to that product or investment service. Where a client engages in a course of dealings of that kind through the services of an investment firm, beginning after the date of application of that Directive, the firm is not required to make a new assessment on the occasion of each separate transaction. It complies with its duty under Article 19(5) of that Directive provided that it makes the necessary assessment of appropriateness before beginning that service.

Recital 60

A recommendation or request made, or advice given, by a portfolio manager to a client to the effect that the client should give or alter a mandate to the portfolio manager that defines the limits of the portfolio manager's discretion should be considered a recommendation within the meaning of Article 19(4) of Directive 2004/39/EC.

Recital 61

For the purposes of determining whether a unit in a collective investment undertaking which does not comply with the requirements of the Directive 85/611/EC, that has been authorised for marketing to the public, should be considered as non-complex, the circumstances in which valuation systems will be independent of the issuer should include where they are overseen by a depositary that is regulated as a provider of depositary services in a Member State.

Recital 62

Nothing in this Directive requires competent authorities to approve the content of the basic agreement between an investment firm and its retail clients. However, neither does it prevent them from doing so, insofar as any such approval is based only on the firm's compliance with its obligations under Directive 2004/39/EC to act honestly, fairly and professionally in accordance with the best interests of its clients, and to establish a record that sets out the rights and obligations of investment firms and their clients, and the other terms on which firms will provide services to their clients.

Article 35(1)

Member States shall ensure that investment firms obtain from clients or potential clients such information as is necessary for the firm to understand the essential facts about the client and to have a reasonable basis for believing, giving due consideration to the nature and extent of the service provided, that the specific transaction to be recommended, or entered into in the course of providing a portfolio management service, satisfies the following criteria:

(a) it meets the investment objectives of the client in question;

(b) it is such that the client is able financially to bear any related investment risks consistent with his investment objectives;

(c) it is such that the client has the necessary experience and knowledge in order to understand the risks involved in the transaction or in the management of his portfolio.

Article 35(2)

Where an investment firm provides an investment service to a professional client it shall be entitled to assume that, in relation to the products, transactions and services for which it is so classified, the client has the necessary level of experience and knowledge for the purposes of paragraph 1(c).

Where that investment service consists in the provision of investment advice to a professional client covered by Section 1 of Annex II to Directive 2004/39/EC, the investment firm shall be entitled to assume for the purposes of paragraph 1(b) that the client is able financially to bear any related investment risks consistent with the investment objectives of that client.

Article 35(3)

The information regarding the financial situation of the client or potential client shall include, where relevant, information on the source and extent of his regular income, his assets, including liquid assets, investments and real property, and his regular financial commitments.

Article 35(4)

The information regarding the investment objectives of the client or potential client shall include, where relevant, information on the length of time for which the client wishes to hold the investment, his preferences regarding risk taking, his risk profile, and the purposes of the investment.

Article 35(5)

Where, when providing the investment service of investment advice or portfolio management, an investment firm does not obtain the information required under Article 19(4) of Directive 2004/39/EC, the firm shall not

recommend investment services or financial instruments to the client or potential client.

Article 36

Member States shall require investment firms, when assessing whether an investment service as referred to in Article 19(5) of Directive 2004/39/EC is appropriate for a client, to determine whether that client has the necessary experience and knowledge in order to understand the risks involved in relation to the product or investment service offered or demanded.

For those purposes, an investment 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 product, for which the client is classified as a professional client.

Article 37(1)

Member States shall ensure that the information regarding a client's or potential client's knowledge and experience in the investment field includes the following, to the extent appropriate to the nature of the client, the nature and extent of the service to be provided and the type of product or transaction envisaged, including their complexity and the risks involved:

(a) the types of service, transaction and financial instrument with which the client is familiar;

(b) the nature, volume, frequency of the client's transactions in financial instruments and the period over which they have been carried out;

(c) the level of education, profession or relevant former profession of the client or potential client.

Article 37(2)

An investment firm shall not encourage a client or potential client not to provide information required for the purposes of Article 19(4) and (5) of Directive 2004/39/EC.

Article 37(3)

An investment firm shall be entitled to rely on the information provided by its clients or potential clients unless it is aware or ought to be aware that the information is manifestly out of date, inaccurate or incomplete.

Appendix 4

FINANCIAL INSTRUMENTS UNDER MIFID
Annex 1, Section C of MiFID

1. Transferable securities;

2. Money-market instruments;

3. Units in collective investment undertakings;

4. Options, futures, swaps, forward rate agreements and any other derivative contracts relating to securities, currencies, interest rates or yields, or other derivatives instruments, financial indices or financial measures which may be settled physically or in cash;

5. Options, futures, swaps, forward rate agreements and any other derivative contracts relating to commodities that must be settled in cash or may be settled in cash at the option of one of the parties (otherwise than by reason of a default or other termination event);

6. Options, futures, swaps, and any other derivative contract relating to commodities that can be physically settled provided that they are traded on a regulated market and/or a multi-lateral trading facility ("**MTF**");

7. Options, futures, swaps, forwards and any other derivative contracts relating to commodities, that can be physically settled not otherwise mentioned in C.6 and not being for commercial purposes, which have the characteristics of other derivative financial instruments, having regard to whether, inter alia, they are cleared and settled through recognised clearing houses or are subject to regular margin calls;

8. Derivative instruments for the transfer of credit risk;

9. Financial contracts for differences.

10. Options, futures, swaps, forward rate agreements and any other derivative contracts relating to climatic variables, freight rates, emission allowances or inflation rates or other official economic statistics that must be settled in cash or may be settled in cash at the option of one of the parties (otherwise than by reason of a default or other termination event), as well as any other derivative contracts relating to assets, rights, obligations, indices and measures not otherwise mentioned in this Section, which have the characteristics of other derivative financial instruments, having regard to whether, inter alia, they are traded on a regulated market or an MTF, are cleared and settled through recognised clearing houses or are subject to regular margin calls.

Appendix 5

GLOSSARY

Ancillary Service: means any of the services listed in Section B of Annex I to MiFID, that is: (a) safekeeping and administration of financial instruments for the account of clients, including custodianship and related services such as cash/collateral management; (b) granting credits or loans to an investor to allow him to carry out a transaction in one or more financial instruments, where the firm granting the credit or loan is involved in the transaction; (c) advice to undertakings on capital structure, industrial strategy and related matters and advice and services relating to mergers and the purchase of undertakings; (d) foreign exchange services where these are connected to the provision of investment services; (e) investment research and financial analysis or other forms of general recommendation relating to transactions in financial instruments; (f) services related to underwriting; and (g) investment services and activities as well as ancillary services within (a) to (f), above, related to the underlying of the derivatives included under Section C - 5, 6, 7 and 10, that is (in accordance with that Annex and Recital 21 to, and Article 39 of, the MiFID Regulation): (i) commodities; (ii) climatic variables; (iii) freight rates; (iv) emission allowances; (v) inflation rates or other official economic statistics; (vi) telecommunications bandwidth; (vii) commodity storage capacity; (viii) transmission or transportation capacity relating to commodities, where cable, pipeline or other means; (ix) an allowance, credit, permit, right or similar asset which is directly linked to the supply, distribution or consumption of energy derived from renewable resources; (x) a geological, environmental or other physical variable; (xi) any other asset or right of a fungible nature, other than a right to receive a service, that is capable of being transferred; (xii) an index or measure related to the price or value of, or volume of transactions in any asset, right, service or obligation; where these are connected to the provision of investment services or ancillary services. [Note: article 4(1)(3) of MiFID]

Arranging: means (a) (except in relation to a home finance transaction) arranging (bringing about) deals in investments, making arrangements with a view to transactions in investments or agreeing to carry on either of those regulated activities; (b) (in relation to a regulated mortgage contract) arranging (bringing about) regulated mortgage contracts, making arrangements with a view to regulated mortgage contracts or agreeing to carry on either of those regulated activities; (c) (in relation to a home purchase plan) arranging (bringing about) a home purchase plan, making arrangements with a view to a home purchase plan or agreeing to carry on either of those regulated activities; (d) (in relation to a home reversion plan) arranging (bringing about) a home reversion plan, making arrangements with a view to a home reversion plan or agreeing to carry on either of those regulated activities.

Authorised person: means (in accordance with section 31 of the Financial Services and Markets Act 2000 (Authorised persons)) one of the following: (a) a person who has a Part IV permission to carry on one or more regulated activities; (b) an incoming EEA firm; (c) an incoming Treaty firm; (d) a UCITS qualifier; (e) an ICVC; (f) the Society of Lloyd's. (see also GEN 2.2.18 R for the position of an authorised partnership or unincorporated association which is dissolved.)

Client: means (1) (except in PROF, in relation to a home finance transaction) has the meaning given in COBS 3.2, that is (in summary and without prejudice to the detailed effect of COBS 3.2) a person to whom a firm provides, intends to provide or has provided a service in the course of carrying on a regulated activity, or in the case of MiFID or equivalent third country business, an ancillary service; (a) every client is a customer or a market counterparty; (b) "client" includes: (i) a potential client; (ii) a client of an appointed representative of a firm with or for whom the appointed representative acts or intends to act in the course of business for which the firm has accepted responsibility under section 39 of the Financial Services and Markets Act 2000 (Exemption of appointed representatives); (iii) a collective investment scheme even if it does not have separate legal personality; (iv) if a person ("C1"), with or for whom the firm is conducting or intends to conduct designated investment business, is acting as agent for another person ("C2"), either C1 or C2 in accordance with COB 4.1.5 R (Agent as client); (v) for a firm that is establishing, operating or winding up a personal pension scheme, a member or beneficiary of that scheme; (c) "client" does not include: (i) a trust beneficiary not in (b)(v); (ii) a

corporate finance contact; (iii) a venture capital contact. (2) [deleted] (3) (in PROF) (as defined in section 328(8) of the Financial Services and Markets Act 2000 (Directions in relation to the general prohibition)) (in relation to members of a profession providing financial services under Part XX of the Financial Services and Markets Act 2000 (Provision of Financial Services by Members of the Professions)): (a) a person who uses, has used or may be contemplating using, any of the services provided by the member of a profession in the course of carrying on exempt regulated activities (including, where the member of the profession is acting in his capacity as a trustee, a person who is, has been or may be a beneficiary of the trust); or (b) a person who has rights or interests which are derived from, or otherwise attributable to, the use of any such services by other persons; or (c) a person who has rights or interests which may be adversely affected by the use of any such services by persons acting on his behalf or in a fiduciary capacity in relation to him. (4) (in relation to a regulated mortgage contract, except in PROF) the individual or trustee who is the borrower or potential borrower under that contract. (5) (in relation to a home purchase plan, except in PROF) the home purchaser or potential home purchaser. (6) (in relation to a home reversion plan, except in PROF): (a) the reversion occupier or potential reversion occupier; or (b) an individual who is an unauthorised reversion provider and who is not, or would not, be required to have permission to enter into a home reversion plan.

Client's best interests rule: COBS 2.1.1R.

COBS: means the Conduct of Business sourcebook from 1 November 2007.

Controlled activity: means (in accordance with section 21(9) of the Financial Services and Markets Act 2000 (The classes of activity and investment)) any of the following activities specified in Part 1 of Schedule 1 to the Financial Promotions Order (Controlled Activities): (a) accepting deposits (paragraph 1); (b) effecting contracts of insurance (paragraph 2(1)); (c) carrying out contracts of insurance (paragraph 2(2)); (d) dealing in securities and contractually based investments as principal or agent (paragraph 3(1)); (e) arranging (bringing about) deals in investments (paragraph 4(1)); (f) making arrangements with a view to transactions in investments (paragraph 4(2)); (fa) operating a multilateral trading facility (paragraph 4A); (g) managing investments (paragraph 5); (h) safeguarding and administering investments (paragraph 6); (i) advising on investments (paragraph 7); (j) advising on syndicate participation at Lloyd's (paragraph 8); (k) providing funeral plan contracts (paragraph 9); (l) providing qualifying credit (paragraph 10); (m) arranging qualifying credit etc (paragraph 10A); (n) advising on qualifying credit etc (paragraph 10B); (o) entering into a home purchase plan (paragraph 10C); (p) making arrangements with a view to a home purchase plan (paragraph 10D); (q) advising on a home purchase plan (paragraph 10E); (r) entering into a home reversion plan (paragraph 10F); (s) making arrangements with a view to a home reversion plan (paragraph 10G); (t) advising on a home reversion plan (paragraph 10H);or (u) agreeing to carry on specified kinds of activity (paragraph 11) which are specified in paragraphs 3 to 10H (other than paragraph 4A) of Part 1 of Schedule 1 to the Financial Promotion Order.

Controlled Investment: means (in accordance with section 21(10) of the Financial Services and Markets Act 2000 (Restrictions on financial promotion) and article 4 of the Financial Promotion Order (Definitions of controlled activities and controlled investments)) an investment specified in Part II of Schedule 1 to the Financial Promotion Order (Controlled investments).

Deals: means a dealing transaction.

Dealing: means (1) (other than in MAR 1 (The Code of Market Conduct)) (in accordance with paragraph 2 of Schedule 2 to the Financial Services and Markets Act 2000 (Regulated activities) buying, selling, subscribing for or underwriting investments or offering or agreeing to do so, either as a principal or as an agent, including, in the case of an investment which is a contract of insurance, carrying out the contract. (2) (in MAR 1) (as defined as in section 130A(3) of the Financial Services and Markets Act 2000), in relation to an investment, means acquiring or disposing of the investment whether as principal or agent or directly or indirectly, and includes agreeing to acquire or dispose of the investment, and entering into and bringing to an end a contract creating it.

Derivatives: means a contract for differences, a future or an option.

Designated Investment: means a security or a contractually-based investment (other than a funeral plan contract and a right to or interest in a funeral plan contract), that is, any of the following investments, specified in Part III of the Regulated Activities Order (Specified Investments), and a long-term care insurance contract which is a pure protection contract: (a) life policy (subset of article 75 (Contracts of insurance)); (b) share (article 76); (c) debenture (article 77); (d) government and public security (article 78); (e) warrant (article 79); (f) certificate representing certain securities (article 80); (g) unit (article 81); (h) stakeholder pension scheme (article 82); (ha) personal pension scheme (article 82(2)); (i) option (article 83); for the purposes of the permission regime, this is sub-divided into: (i) option (excluding a commodity option and an option on a commodity future); (ii) commodity option and option on a commodity future; (j) future (article 84); for the purposes of the permission regime, this is sub-divided into: (i) future (excluding a commodity future and a rolling spot forex contract); (ii) commodity future; (iii) rolling spot forex contract; (k) contract for differences (article 85); for the purposes of the permission regime, this is sub-divided into: (i) contract for differences (excluding a spread bet and a rolling spot forex contract); (ii) spread bet; (iii) rolling spot forex contract; (l) rights to or interests in investments in (a) to (k) (article 89) but not including rights to or interests in rights under a long-term care insurance contract which is a pure protection contract.

EEA State: means (in accordance with Schedule 1 to the Interpretation Act 1978), in relation to any time (a) a state which at that time is a member State; or (b) any other state which is at that time a party to the EEA agreement. [Note: Current non-member State parties to the EEA agreement are Norway, Iceland and Lichtenstein. Where the context requires, references to an EEA State include references to Gibraltar as appropriate].

Eligible counterparty: (in accordance with COBS 3.6.1R) a client that is either a per se eligible counterparty or an elective eligible counterparty.

Equivalent business of a third country investment firm: means the business of a third country investment firm carried on from an establishment in the United Kingdom that would be MiFID business if that firm were a MiFID investment firm.

Execution venue: means for the purposes of the provisions relating to best execution in COBS 11.2, execution venue means a regulated market, an MTF, a systematic internaliser, or a market maker or other liquidity provider or an entity that performs a similar function in a third country to the functions performed by any of the foregoing. [Note: article 44(1) of MiFID implementing Directive]

Financial instrument: means (1) (other than in (2)) instruments specified in Section C of Annex I of MiFID, that is: (a) transferable securities; (b) money-market instruments; (c) units in collective investment undertakings; (d) options, futures, swaps, forward rate agreements and any other derivative contracts relating to securities, currencies, interest rates or yields, or other derivative instruments, financial indices or financial measures which may be settled physically or in cash; (e) options, futures, swaps, forward rate agreements and any other derivative contracts relating to commodities that must be settled in cash or may be settled in cash at the option of one of the parties (otherwise than by reason of a default or other termination event); (f) options, futures, swaps, and any other derivative contract relating to commodities that can be physically settled provided that they are traded on a regulated market and/or an MTF; (g) options, futures, swaps, forwards and any other derivative contracts relating to commodities, that can be physically settled not otherwise mentioned in (f) and not being for commercial purposes, which have the characteristics of other derivative financial instruments, having regard to whether, inter alia, they are cleared and settled through recognised clearing houses or are subject to regular margin calls (see articles 38(1), (2) and (4) of the MiFID Regulation); (h) derivative instruments for the transfer of credit risk; (i) financial contracts for differences; and (j) options, futures, swaps, forward rate agreements and any other derivative contracts relating to (i) climatic variables; (ii) freight rates; (iii) emission allowances; (iv) inflation rates or other official economic statistics; (v) telecommunications bandwidth; (vi) commodity storage capacity; (vii) transmission or transportation capacity

relating to commodities, whether cable, pipeline or other means; (viii) an allowance, credit, permit, right or similar asset which is directly linked to the supply, distribution or consumption of energy derived from renewable resources; (ix) a geological, environmental or other physical variable; (x) any other asset or right of a fungible nature, other than a right to receive a service, that is capable of being transferred; (xi) an index or measure related to the price or value of, or volume of transactions in any asset, right, service or obligation; where the conditions in Articles 38(3) and (4) of the MiFID Regulation are met…(2) ...

[Note: article 4(1)(17) and section C of Annex I to MiFID and articles 38 and 39 of the MiFID Regulation]

Financial promotion: means (1) an invitation or inducement to engage in investment activity that is communicated in the course of business [Note: section 21 of the Financial Services and Markets Act 2000 (Restrictions on financial promotion]; (2) (in relation to COBS 3.2.1R(3), COBS 4.3.1R, COBS 4.5.8R and COBS 4.7.1R) (in addition to (1)) a marketing communication within the meaning of MiFID made by a firm in connection with its MiFID or equivalent third country business.

Firm: means an authorised person, but not a professional firm unless it is an authorised professional firm.(see also GEN 2.2.18 R for the position of an authorised partnership or unincorporated association which is dissolved.)

FSAVC: means free-standing additional voluntary contribution.

Insurance Mediation Directive: means the European Parliament and Council Directive of 9 December 2002 on insurance mediation (No 2002/92/EC).

Investment: means (in accordance with sections 22(4) (The classes of activity and categories of investments) and 397(13) (Miscellaneous offences) of the Financial Services and Markets Act 2000) any investment, including any asset, right or interest.

Investment firm: means any person whose regular occupation or business is the provision of one or more investment services to third parties and/or the performance of one or more investment activities on a professional basis. [Note: article 4(1)(1) of MiFID]

Investment service: means any of the following involving the provision of a service in relation to a financial instrument: (a) reception and transmission of orders in relation to one or more financial instruments; (b) execution of orders on behalf of clients; (c) dealing on own account; (d) portfolio management; (e) the making of a personal recommendation; (f) underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis; (g) placing of financial instruments without a firm commitment basis; (h) operation of multilateral trading facilities. [Note: article 4(1)(2) of, and section A of Annex 1 to, MiFID]

Investment services and activities: means any of the services and activities listed in Section A of Annex I to MiFID relating to any financial instrument, that is: (a) reception and transmission of orders in relation to one or more financial instruments; (b) execution of orders on behalf of clients; (c) dealing on own account; (d) portfolio management; (e) the making of a personal recommendation; (f) underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis; (g) placing of financial instruments without a firm commitment basis; (h) operation of multilateral trading facilities. [Note: article 4(1)(2) of, and section A of Annex 1 to, MiFID]

Life Policy: means (1) (in accordance with the definition of "qualifying contract of insurance" in article 3(1) of the Regulated Activities Order) a long-term insurance contract (other than a reinsurance contract and a pure protection contract); and (a) a long-term care insurance contract; and (b) (in COBS) a pension policy; unless (2) or (3) apply. (2) In PERG (other than in relation to a firm's permission – see Note 5B to Table 1 in Annex 2, PERG 2) and for the purposes of the financial promotion rules in COBS 4, life policy does not include a long-term care insurance contract. (3) In relation to a firm's permission: (a) (in accordance with the definition of "qualifying contract of insurance" in article 3(1) of the Regulated Activities Order) a long-term insurance contract (other than a reinsurance contract and a pure protection contract); (b) a long-term care insurance contract which is a pure protection contract; and (c) a pension term assurance policy.

Managing Investments: means the regulated activity, specified in article 37 of the Regulated Activities Order (Managing investments), which is in summary: managing assets belonging to another person in circumstances which involve the exercise of discretion, if: (a) the assets consist of or include any security or contractually based investment (that is, any designated investment, funeral plan contract or right to or interest in a funeral plan contract); or (b) the arrangements for their management are such that the assets may consist of or include such investments, and either the assets have at any time since 29 April 1988 done so, or the arrangements have at any time (whether before or after that date) been held out as arrangements under which the assets would do so.

MiFID: means the European Parliament and Council Directive on markets in financial instruments (No. 2004/39/EC). See also MiFID Regulation and MiFID implementing Directive.

MiFID business: means investment services and activities and, where relevant, ancillary services carried on by a MiFID investment firm.

MiFID implementing Directive: means Commission Directive No. 2006/73/EC implementing Directive 2004/39/EC 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.

MiFID Investment firm: means a firm which is: (1) an investment firm with its head office in the EEA (or, if it has a registered office, that office); (2) a BCD credit institution (only when providing an investment service or activity in relation to the rules implementing the Articles referred to in Article 1(2) of MiFID); (3) a UCITS investment firm (only when providing the services referred to in Article 5(3) of the UCITS Directive in relation to the rules implementing the articles of MiFID referred to in Article 5(4) of that Directive); unless, and to the extent that, MiFID does not apply to it as a result of Article 2 (Exemptions) or Article 3 (Optional exemptions) of MiFID.

MiFID or equivalent third country business: means MiFID business or the equivalent business of a third country investment firm.

Packaged product: means (a) a life policy; (b) a unit in a regulated collective investment scheme; (c) an interest in an investment trust savings scheme; (d) a stakeholder pension scheme; (e) a personal pension scheme; whether or not (in the case of (a), (b) or (c)) held within a PEP, an ISA or a CTF and whether or not the packaged product is also a stakeholder product.

Pension contract: means a contract under which rights to benefits are obtained by the making of contributions to an occupational pension scheme or to a personal pension scheme, where the contributions are paid to a regulated collective investment scheme.

Pension opt-out: means a transaction, resulting from the decision of a retail client who is an individual, to: (a) opt out of an occupational pension scheme of which he is a member; or (b) decline to become a member of an occupational pension scheme which he is eligible to join, or will be eligible to join at the end of a waiting period, in favour of a stakeholder pension scheme or personal pension scheme.

Pension transfer: means a transaction, resulting from the decision of a retail client who is an individual, to transfer deferred benefits from: (a) an occupational pension scheme; (b) an individual pension contract providing fixed or guaranteed benefits that replaced similar benefits under a defined benefits pension scheme; or (c) (in the cancellation rules (COBS 15)) a stakeholder pension scheme or personal pension scheme, to: (d) a stakeholder pension scheme; (e) a personal pension scheme; or (f) a deferred annuity policy where the eventual benefits depend on investment performance in the period up to the intended retirement date.

Per se professional client: means a client categorised as a per se professional client in accordance with COBS 3.5.

Person: means (in accordance with the Interpretation Act 1978) any person, including a body of persons corporate or unincorporate (that is, a natural person, a legal person and, for example, a partnership).

Personal recommendation: means a recommendation that is advice on investments and is presented as suitable for the person to whom it is made, or is based on a consideration of the circumstances of that person. A recommendation is not a personal recommendation if it is issued exclusively through distribution channels or to the public. [Note: article 52 of the MiFID implementing Directive]

Portfolio management: means managing portfolios in accordance with mandates given by clients on a discretionary client-by-client basis where such portfolios include one or more financial instruments. [Note: article 4 (1)(9) of MiFID]

Professional client: means a client that it either a per se professional client or an elective professional client (see COBS 3.5.1R). [Note: article 4(1)(12) of MiFID].

Professional firm: means a person which is: (a) an individual who is entitled to practise a profession regulated by a designated professional body and, in practising it, is subject to its rules, whether or not he is a member of that body; or (b) a person (not being an individual) which is controlled and managed by one or more such individuals.

Regulated market: means a multilateral system operated and/or managed by a market operator, which brings together or facilitates the bringing together of multiple third-party buying and selling interests in financial instruments – in the system and in accordance with its non-discretionary rules – in a way that results in a contract, in respect of the financial instruments admitted to trading under its rules and/or systems, and which is authorised and functions regularly and in accordance with the provisions of Title III of MiFID. [Note: article 4(1)(14) of MiFID]

Regulatory system: means the arrangements for regulating a firm or other person in or under the Financial Services and Markets Act 2000, including the threshold conditions, the Principles and other rules, the Statements of Principle, codes and guidance and including any relevant directly applicable provisions of a Directive or Regulation such as those contained in the MiFID implementing Directive and the MiFID implementing Regulation.

Retail client: means (1) (other than in relation to the provision of basic advice on stakeholder products) in accordance with COBS 3.4.1R, a client who is neither a professional client or an eligible counterparty [Note: article 4(1)(12) of MiFID]; or (2) (in relation to the provision of basic advice on a stakeholder product and in accordance with article 52B of the RAO) any person who is advised by a firm on the merits of opening or buying a stakeholder product where the advice is given in the course of a business carried on by that firm and it is received by a person not acting in the course of a business carried on by him.

Rule: means (in accordance with section 417(1) of the Financial Services and Markets Act 2000 (Definitions)) a rule made by the FSA under the Financial Services and Markets Act 2000, including: (a) a Principle; and (b) an evidential provision.

Scheme: means (1) (except in COBS, CASS and SUP) a collective investment scheme. (2) (in COBS, CASS and SUP) (a) a regulated collective investment scheme; (b) an investment trust where the relevant shares have been or are to be acquired through an investment trust savings scheme; (c) an investment trust where the relevant shares are to be held within an ISA or PEP which promotes one or more specific investment trusts; (d) (in COB 10) in addition to (a), (b) and (c), an unregulated collective investment scheme.

Stakeholder pension scheme: means a scheme that meets the conditions in section 1 of the Welfare Reform and Pensions Act 1999 or article 3 of the Welfare Reform and Pensions (Northern Ireland) Order 1999.

Suitability report: means a report which a firm must provide to its client under COBS 9.4 (Suitability reports) which, among other things, explains why the firm has concluded that a recommended transaction is suitable for the client.

Third country investment firm: means a firm which would be a MiFID investment firm if it had its head office in the EEA.

Transferable security: means (1) (in PR and LR) (as defined in section 102A of the Financial Services and Markets Act 2000) anything which is a transferable security for the purposes of MiFID, other than money-market instruments for the purposes of that directive which have a maturity of less than 12 months. (2) (in COLL and CIS) an investment within COLL 5.2.7 R (transferable securities), CIS 5.2.9 R (Transferable securities) or, as the case may be, CIS 5A.2.9 R (Transferable securities) in relation to schemes falling under COLL 5, CIS 5 or CIS 5A respectively. (3) those classes of securities which are negotiable on the capital market, with the exception of instruments of payment, such as: (a) shares in companies and other securities equivalent to shares in companies, partnerships or other entities, and depositary receipts in respect of shares; (b) bonds or other forms of securitised debt, including depositary receipts in respect of such securities; and (c) any other securities giving the right to acquire or sell any such transferable securities or giving rise to a cash settlement determined by reference to transferable securities, currencies, interest rates or yields, commodities or other indices or measures. [Note: article 4(1)(18) of MiFID]

UCITS Directive: means the Council Directive of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (No 85/611/EEC), as amended.

Unit: means the investment, specified in article 81 of the Regulated Activities Order (Units in a collective investment scheme) and defined in section 237(2) of the Financial Services and Markets Act 2000 (Other definitions)), which is the right or interest (however described) of the participants in a collective investment scheme; this includes: (a) (in relation to an AUT) a unit representing the rights or interests of the unitholders in the AUT; (b) (in relation to an ICVC) a share in the ICVC.

Warrants: means (1) (except in COLL) the investment, specified in article 79 of the Regulated Activities Order (Instruments giving entitlements to investments), which is in summary: a warrant or other instrument entitling the holder to subscribe for a share, debenture or government and public security. (2) (in COLL) an investment in (1) and any other transferable security (not being a nil paid or partly paid security) which is: (i) listed on an eligible securities market; and (ii) akin to an investment within (1) in that it involves a down payment by the then holder and a right later to surrender the instrument and to pay more money in return for a further transferable security.