Pérez-Llorca

Legal Briefing

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NEW CNMV TECHNICAL GUIDE FOR THE ASSESSMENT OF SUITABILITY

1. Introduction

Recently, the CNMV approved the Technical Guide 2/2022 for the assessment of suitability (the "**Technical Guide**"). The Technical Guide, which will apply to entities that provide investment services involving financial instruments and the marketing of structured deposits, establishes the criteria, practices, methodologies and procedures that the CNMV considers appropriate for compliance with the applicable regulations in the assessment of suitability, as well as the criteria it will follow in the exercise of its supervisory function.

The Technical Guide updates and replaces the criteria contained in the Performance Guide for the Analysis of Suitability and Appropriateness of 17 June 2010 (the "**2010 Guide**") regarding the assessment of the suitability of clients when investment services other than discretionary portfolio management or investment advice are provided, where such services relate to either (i) complex financial instruments; (ii) or non-complex financial instruments if the initiative has been taken by the institution providing the service.

Among other new features, the technical guide addresses the following issues:

(i) The importance that entities should attach to information on the client's financial literacy and the need to collect this information. Thus, when assessing the appropriateness of complex instruments, specific questions on the nature, characteristics and main risks of the instruments should be included.

(ii) In the case of the assessment of complex instruments, it is generally not prudent to presume suitability based solely on the positive assessment of financial knowledge. A minimum level of client education, prior investment experience, or a combination of both, should also be required, with higher requirements the more complex the product (although justified exceptions based on objective data may be accepted).

In parallel, the CNMV has adopted the ESMA Guidelines on certain aspects of MiFID II suitability and execution-only requirements (the "**Guidelines**"). The Guidelines aim to enhance clarity and improve harmonisation in the application of certain aspects of the suitability and execution-only requirements, following the MiFID II amendments in this area.

With these new features, the CNMV will carry out its supervisory functions by verifying compliance with the obligations concerning the assessment of suitability by applying the criteria set out in the Technical Guide, as well as those of the Guidelines once they become applicable (i.e. 6 months from the publication of the translation of the Guidelines into the official languages of the EU, which took place on 16 April).

It should be noted that, although the Technical Guide replaces the 2010 Guide, as far as the suitability assessment is concerned, the recommendations in the 2010 Guide's suitability assessment should be considered valid, insofar as they do not conflict with subsequent regulatory developments or ESMA Guidelines, or the recommendations in the Technical Guide.

This legal briefing analyses the main aspects of the Technical Guide.

2. Analysis of the Technical Guide and obligations of entities

(i) **Situations where no assessment of suitability is required ("execution-only" regime):** Entities should have procedures in place to detect situations where it is generally unlikely that the initiative is client-driven so that they can verify that the execution-only regime is not being applied incorrectly.

(ii) **Requirement to act in the best interests of the client concerning suitability:** Entities should ensure that products which they consider *a priori* unsuitable for certain investors are not actively marketed to those investors, especially in the case of complex products, by avoiding contacting and offering them to clients. In any case, commercial communications addressed to the general public shall not, in themselves, be considered active marketing of a product.

(iii) **Source of data used in the assessment of suitability:** In analysing suitability, an institution may rely on information already available to it or ask the client when such information is not available. If obtained through questionnaires or suitability tests, the information provided by clients should be considered together so that the outcome of the assessment is consistent, with the client's actual level of financial literacy being crucial, particularly for products of particular complexity. In general, a client who does not adequately answer the relevant questions posed to him will not be considered eligible to purchase relevant products.

(iv) **Client familiarity with financial products, their features and risks:** The mechanisms used to obtain information relating to this criterion should always be robust and seek to prevent the risk of overestimating the actual level of a client's financial literacy. Entities should not presume suitability without first verifying with sufficient accuracy that the client has an appropriate level of financial literacy. in the case of complex products, it will not be prudent to presume suitability based solely on the positive assessment of this criterion. The institution must obtain information on the client's knowledge of the nature, features and main risks of the products or product families being assessed. It is not sufficient to simply assess the client's general financial literacy. The more complex the product in relation to which the assessment is made, the more in-depth the information must be. In this regard, the Technical Guide includes several guidelines that are considered appropriate when asking questions about the client's general financial literacy.

(v) **Nature, volume and frequency of the client's transactions in financial products and the period over which they have been carried out:** When assessing the client's investment experience, only experience that may have influenced the client's ability to understand the nature and risks of financial products should be considered. The CNMV notes that its supervisory experience indicates that it is common to observe clients with investment experience in certain financial products who at the same time state that they do not have sufficient knowledge of these products to understand their features and risks. Consequently, presuming suitability based solely on the existence of prior investment experience, without gathering information and analysing other factors that should be considered when assessing suitability (level of financial knowledge, level of education and professional experience) will not be appropriate.

(vi) **Level of education and professional background:** Where the transaction to be assessed relates to complex products, the financial knowledge of the client should not generally be presumed to be appropriate without the client having a minimum level of academic education to do so, in addition to the relevant precise level of financial literacy and, where appropriate, adequate prior investment experience. As an exception, the suitability of financial professionals may be presumed even in the case of complex products, solely based on their professional experience and without seeking other information, but only where the institution is satisfied that the client has appropriate professional experience directly related to the securities markets, their products and their risks.

(vii) **Delivery to the client of a copy of the assessment document carried out:** The document should detail the questions asked and the answers given by the client. In the event that the assessment carried out concerns different products or product families, the result of the assessment for each of the product families assessed must be clearly communicated to the client.

(viii) **Records of suitability assessments carried out:** They must (i) allow for their electronic use and include all the information necessary to be able to reproduce the assessment performed and the result obtained, including the answers given by the clients; and (ii) identify the suitability assessments carried out on clients who did not end up executing the assessed transaction.

(ix) **Analysis of the information collected and consistency checks:** Entities should take reasonable steps and actions to verify that the information provided by clients is reliable, accurate and generally consistent. These measures shall include appropriate procedures to detect *a priori* atypical situations at the time the information is collected. These measures will also include a periodic ex-post assessment (which may be annual) of the overall or aggregate reasonableness of the information used in assessing suitability.

(x) **Period of validity of previous suitability analyses**: Although the institution must assess each transaction processed within the scope of suitability, this does not imply that a full assessment must be made for each transaction processed, but rather that a transaction may be considered suitable based on an analysis carried out previously: in general, for non-complex products, the CNMV considers a period not exceeding 5 years to be reasonable, while for complex products a period not exceeding 3 years will be reasonable.

(xi) **Warnings regarding the inappropriateness, absence or insufficiency of data to carry out the assessment, or the non-obligation to carry out the assessment:** The following model warning is considered appropriate: "*We inform you that the institution is not obliged to assess the suitability of (the operation to be carried out by the client must be specified) given that the product that you are going to purchase is non-complex and that the transaction is carried out on your initiative and not that of the institution. In the absence of such an assessment, we are unable to form an opinion as to whether or not this transaction is in your best interest and, therefore, if the transaction is not in your best interest, we cannot advise you*". In exceptional circumstances, in the case of clients who trade listed shares frequently, it will not be necessary to warn them about "execution-only" transactions for each transaction they undertake.

(xii) **Assessment of jointly trading clients:** despite the great diversity of cases that may arise concerning joint ownership, authorised persons, representatives, types of power of attorney, etc., each institution must decide the best way to resolve the different possible situations depending on different variables. The CNMV establishes that in general:

- In the event that a natural or legal person appoints a proxy/legal representative, the CNMV considers it reasonable that, for the purposes of the suitability test, the knowledge and experience of the proxy/legal representative should be taken into account when it is the proxy/legal representative who trades.

- In the case of the designation of joint holders or joint and several authorised persons, it is considered reasonable that the assessment of suitability should be made on the basis of the holder/authorised person agreed by the clients. In the absence of client agreement, under the ESMA Guidelines, a prudent approach should be applied and consideration should be given to the knowledge and experience of the holder/authorised person with the least experience and knowledge.

- In the case of the designation of joint holders and joint and several authorised persons, it is considered reasonable that, in the absence of a more specific agreement by the clients, the assessment should be made on the basis of the knowledge and experience of the principal holder/authorised person, since it is that client who is acting on behalf of the others in such a transaction.

(xiii) **Annex:** The Technical Guide includes an annex which, in the form of a Q&A document, resolves a number of questions on the practical application of the criteria included in the guide.

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