

# Suitability and Appropriateness



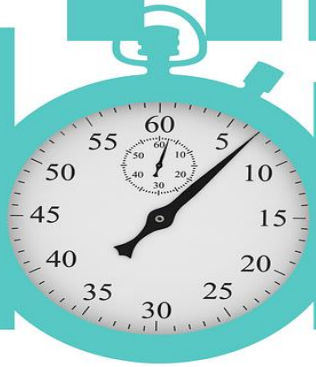
Presented by Peter Haines  
29<sup>th</sup> February 2024



# Contents

- When do they apply?
- Four different types of suitability
- Practical challenges – subjectivity and recordkeeping
- The broader context
- The FCA's view

# Time is Money



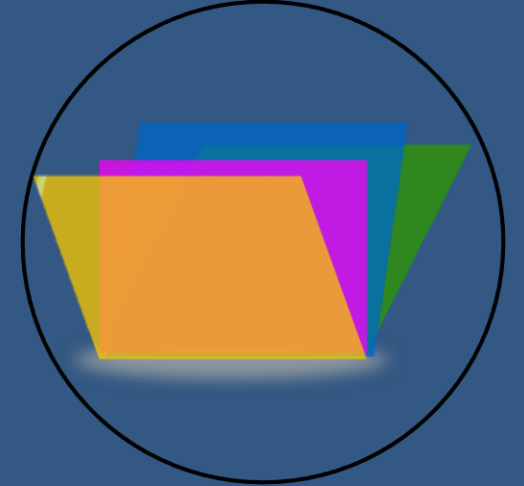
I have twenty clients to call!



**Suitability – it's  
not rocket  
science!**



**It's about  
looking after  
the client's  
interests**



**It's also about  
making  
suitability  
demonstrable**





Investment objectives  
Risk appetite  
Investment horizon  
Affordability

Oh, I mustn't forget to record it!

## Four Different Types of Suitability

Transaction Suitability

Portfolio Suitability

Product Suitability

Implied or Contractual Suitability

## Suitability – Two Steps

Step One:  
Get the client classification right

Step Two:  
Either apply the suitability requirements  
or ensure that they do not apply

## Investment Advice - Definition

- “The provision of **personal recommendations** to a client, either upon the client’s request or at the initiative of the firm, in respect of one or more transactions relating to designated investments.”

A recommendation:

- a) made to a person in their capacity as an **investor or potential investor**, or in their capacity as agent for an investor or a potential investor;
- b) which constitutes a recommendation to them to **[buy or sell] a particular investment ...;**
- c) that is:
  - I. **presented as suitable** for the person to whom it is made; or
  - II. based on a consideration of the **circumstances of that person;** and
  - III. that is not issued exclusively to the **public.**

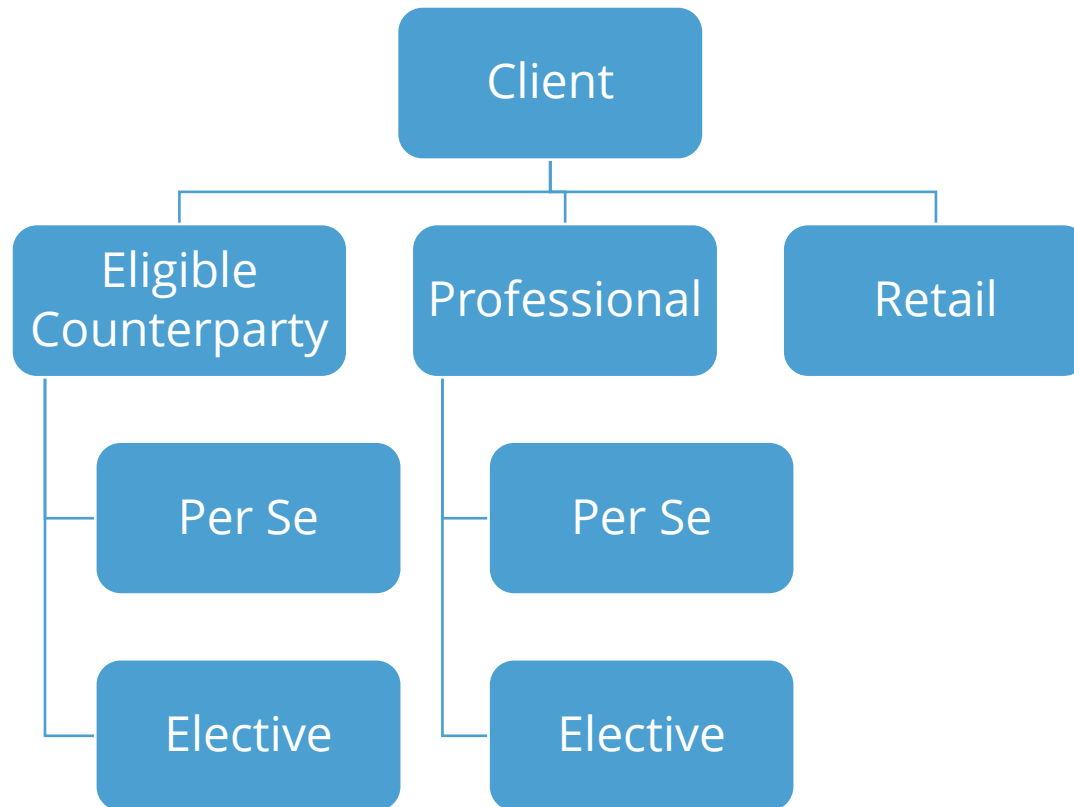


# Suitability

- Always applies where giving “Investment Advice”
- Your firm cannot contract out of this duty
- No firm big/ugly enough for this to be disappplied

# Client Categorisation

- The three categories of client are retail, professional and eligible counterparty



*N.B. Eligible counterparty is effectively a subset of professional client for investment advice*

# Suitability – High Level

## FCA Principles for Businesses (PRIN)

- Twelve **high level principles** that apply to authorised firms

### *Principle 9:*

*A firm must take reasonable care to ensure the **suitability** of its advice and discretionary decisions for any customer who is entitled to rely upon its judgement.*

## Suitability - The Obligation

When providing **investment advice** or portfolio management a firm must:

- 1) obtain the **necessary information** regarding the client's:
  - a) **knowledge and experience** in the investment field relevant to the specific type of financial instrument, insurance-based investment product or service;
  - b) financial situation including his ability to **bear losses**; and
  - c) investment **objectives** including his **risk tolerance**,
    - so as to comply with 2)
- 2) only recommend investment services, financial instruments and insurance-based investment products, as applicable, or take decisions to trade, which are **suitable** for the client and, in particular, in accordance with the client's **risk tolerance** and ability to **bear losses**.

## Suitability – Information

- “Where a client is a **legal person** or a group of two or more natural persons or where one or more natural persons are represented by another natural person, the investment firm shall establish and implement **policy as to who should be subject to the suitability assessment and how this assessment** will be done in practice, including from whom information about knowledge and experience, financial situation and investment objectives should be collected.
- The investment firm shall **record this policy.**”



## Suitability - Information

- *Investment firms shall determine the **extent of the information** to be collected from clients in light of all the features of the investment advice ... to be provided to those clients.*
- *Investment firms shall 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 determining, giving due consideration to the nature and extent of the service provided, that the specific transaction to be recommended ... satisfies the following criteria:*
  - a) it meets the **investment objectives** of the client in question, including client's **risk tolerance**;*
  - 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...*

## Suitability - Information

N.B. A firm can assume that a **professional** client has the necessary level of **experience and knowledge** and can bear any related **investment risks** consistent with their investment **objectives**

### Investment Objectives

- Time horizon
- Risk profile
- Purpose of investment

### Financial Situation

- Source and extent of regular income
- Assets, including liquid assets
- Regular financial commitments

### Knowledge and Experience

- Types of service, transaction and investment the client is familiar with
- Nature, volume and frequency of trading
- Level of education, profession or former profession

## Suitability – Fact-Finding

- Among investment advisers, the term '**fact-finding**' is commonly used to describe the process of gathering, and recording, the required information about the client
- The **rules** do not use this term, nor do they specify exactly what information is required (firms are expected to determine this themselves)
- However, the FCA refers to the importance of the fact-finding process





## Suitability – Fact-Finding

In a speech in 2019, Debbie Gupta, the FCA's Director of Financial Advice Supervision gave the following advice:

- *“Don't see fact finding as just a **regulatory requirement**. It is essential to **demonstrating suitability** and the best way to demonstrate you fully understand your client. It also provides you with cover for your recommendations and advice.*
- *Don't rely on the **same fact-find** you have used for years. Times change and your fact finding should change with it.*
- *Don't rely on '**I just know my client**' as a reason not to record key information. One of the most effective safeguards in the event of a file review/complaint is a robust file. This is a file which captures all the client information and can clearly demonstrate why the recommendation meets the client's needs and objectives.”*

## Suitability - Switching

- “When providing investment advice or portfolio management services that involve **switching** investments, either by selling an instrument and buying another or by exercising a right to make a change in regard to an existing instrument, investment firms shall **collect the necessary information** on the client’s existing investments and the recommended new investments and shall **undertake an analysis of the costs and benefits of the switch**, such that they are reasonably able to demonstrate that **the benefits of switching are greater than the costs.**”



## Suitability Reports

- “When providing **investment advice**, investment firms shall provide a **report** to the **retail client** that includes an **outline** of the advice given and how the recommendation provided is **suitable** for the retail client, including how it meets the **client’s objectives** and **personal circumstances** with reference to the **investment term** required, client’s **knowledge and experience** and client’s **attitude to risk** and **capacity for loss**.
- Investment firms shall draw clients’ attention to and shall include in the suitability report information on whether the recommended services or instruments are likely to require the retail client to seek a **periodic review** of their arrangements.”

# Consequences of Non-Compliance

- Suitability is a rule in the FCA rulebook
- Likely sanctions:
  - Censure
  - Private
  - Public
  - Fine
- *Civil action*

If in doubt:

- Complete a written record
- **Ensure “demonstrable suitability”**

**NB: the “smart lawyer test”**

# Time Horizon

- Why do so many wealth and asset managers forget this??
- Is it only important for private clients?
- If so, why?



# Suitability Challenges

- Portfolio Suitability
- Higher risk “Special Situations” Fund
- “It’s high risk, so deal with it”
- What if it means unusual sector concentration?
- Diversification of high risk investments is potentially damaged by concentration

# Suitability Challenges

- Product choice – does suitability apply here?
- Final salary transfer to high risk investment fund?

# Appropriateness

- COBS 10: For non-advised services (i.e. other than making a personal recommendation and managing investments)
- A firm must ask the client to provide information regarding their knowledge and experience in the investment field relevant to the specific type of product or service offered or demanded
- The firm must assess whether the service or product envisaged is appropriate for the client
- 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.
- Does not apply to non-complex products



# Appropriateness

- An assessment of appropriateness is not required for:
  - Shares traded on a regulated market
  - Money market instruments and bonds
  - Units in UCITS funds
  - Other 'non-complex' financial instruments
- An instrument is non-complex if:
  - It is not a derivative
  - It is sufficiently liquid
  - It does not involve a liability exceeding the initial investment
  - Comprehensive information is publicly available

# Appropriateness

- If the firm cannot obtain sufficient information, it must warn the client
- If the firm considers the transaction in be inappropriate, it must warn the client
- If the client wishes to proceed, the firm must consider whether to do so, having regard to the circumstances



What if the  
regulator  
calls?



# The Broader Context

- Implied or contractual suitability/appropriateness
- How about selling credit derivatives to a private bank?
  
- Poll:
- If you are selling credit derivatives to a private bank, do you have a suitability or appropriateness obligation?

# Conclusions and Questions

- Perform a review of suitability/appropriateness before the FCA does
- Make sure that you include them in your annual training plan
- So much of this is about discipline and recording
- Suitability v Demonstrable Suitability

Any Questions?

[peter.haines@peterhaines.co.uk](mailto:peter.haines@peterhaines.co.uk)