

25 September 2023

Dear Chief Executive Officer,

Dear Compliance Officer,

## **Mystery Shopping Exercise into client onboarding practices and corresponding investor experience**

You are receiving this letter as the Chief Executive Officer and Compliance Officer of an investment firm supervised by the Malta Financial Services Authority (referred to herein as the 'MFSA' or the 'Authority').

### **BACKGROUND**

The MFSA endeavours to stimulate compliance with applicable rules governing investment services licensed entities for a fair, honest and transparent financial market, which in turn strengthens confidence within same market, with the ultimate aim of protecting investors accordingly. To this end, the Authority's supervisory activities are aimed at attaining high compliance standards within the supervised licensed entities through the use of diversified tools encompassing investigations, off-site work, on-site inspections as well as through mystery shopping exercises.

In view of the fact that mystery shopping is seen as a form of research to support and enhance current market practises, the Conduct Supervision Function within the Authority has chosen to conduct part of its supervisory assessment through the use of this tool. A mystery shopping exercise has been undertaken in 2022, where face-to-face interactions, as well as testing of online portals were done to mainly assess the account opening process for retail clients, undertaken by investment service licence holders (also referred to herein as 'Regulated persons' or 'licenced entities' or 'firms'). This letter contains the results of this mystery shopping exercise, which was carried out between the months of July and September 2022. The fieldwork for the mystery shopping exercise was conducted on behalf of the MFSA by an outsourced independent external provider, whilst the assessment of the outcome was undertaken by the Conduct Supervision Function within the MFSA.

This letter provides an insight of the identified observations and highlights good and bad practices observed in the market.

### **METHODOLOGY**

The Maltese Financial Market is supervised by the MFSA at a national level, whilst the European Securities Market Authority ('ESMA') supervises the financial market at EU level. The

aim of ESMA is to adopt a common supervisory approach and methodology across all of its mandates.

The MFSA has in 2022 committed to participate in ESMA's Common Supervisory Action ('CSA') coordinated mystery shopping exercise. By doing so, the MFSA has been mandated to follow the methodology as set by ESMA, including mystery shopping scenarios and the formulation of a simulated profile of a retail prospect client. All mystery shoppers participating in the mystery shopping exercise did not have any existing relationship with the entity being assessed.

The MFSA completed an assessment of the Maltese market and a sample of eight (8) investment service licensed entities were selected, as a suitable representation of the local market.

During the first half of 2022, the MFSA has planned, prepared and trained the mystery shoppers to achieve a successful outcome.

In total, five (5) mystery shopping exercises have been done in a physical manner to four (4) investment service licensed firms. Another six (6) online mystery shopping exercises to five (5) investment service licensed firms were also carried out. The online exercises included interaction by the mystery shoppers through the use of websites or mobile applications.

All mystery shopping sessions were limited to one introductory meeting. For the majority, the interaction between the advisor and the shoppers was preliminary in nature and in no instance did such meeting result in a product or specific recommendation. Nevertheless, mystery shoppers were able to record sufficient information about their experiences allowing for results to be evaluated for the purposes of research and compliance.

In addition to undertaking a deep thorough assessment of the outcomes included herein, we also encourage you to refer to the circular issued to the industry and dated 26<sup>th</sup> September 2023, titled "*ESMA publishes the main findings from the Common Supervisory Action (CSA) for the year 2022 and the Mystery Shopping exercise on information on costs and charges emanating from MiFID II requirements*", which includes reference to [ESMA's publication](#) on this same mystery shopping coordinated exercise mandated by ESMA itself, and covers the outcome of the mystery shopping exercises. The publication includes results emanating from the participation of ten (10) National Competent Authorities ('NCAs'), one of which was the MFSA.

## **KEY FINDINGS**

### ***A. Collection of Personal Information / Circumstances***

Collecting information about prospective/existing clients and their personal circumstances is central to enable licensed entities to fulfil their obligations in the provision of the relevant or appropriate services. The level of collation of information is highly dependent on the service being provided.

As part of the exercise, mystery shoppers were asked to indicate to the Authority what kind of information, as well as the extent of information, the respective licensed entity requested from each mystery shopper. We assessed both the face-to-face as well as the non-face-to-face interactions in terms of the information when it comes to personal and financial circumstances of the mystery shopper. In the face-to-face interactions the mystery shoppers requested investment advisory services from the licensed entities and an assessment was done on the firm's onboarding procedure and provision of information. With respect to online interactions, an assessment was done on the onboarding process with a view to understand whether licensed entities carry out an appropriateness test assessment when it comes to complex financial instruments.

We therefore looked into the mystery shoppers' discussions with advisors and also at the information requested by licensed investment entities through online means. Moreover, we also assessed whether the licensed entity provided an explanation as to why the information gathering process is important for the particular service being provided.

#### **[i] Suitability / Appropriateness Self-Assessment by Clients**

- Face-to-Face Interaction

From the assessment undertaken, it can be concluded that the majority of the face-to-face interactions use the initial meeting as an introductory meeting where some advisors also discuss a number of products and offerings without obtaining full and adequate information on the circumstances of the prospective client.

From the face-to-face interactions it transpired that a number of licenced entities are adopting the approach of asking the prospective clients to fill in the client fact finding documentation themselves at home, rather than obtaining the know your client information, during the face-to-face meeting held between the advisor and the mystery shopper. The completion of the client fact finding document at home, without the assistance of an advisor, leads to the client undertaking a level of self-assessment during completion.

- Online Interaction

When it comes to the collation of information from retail customers through the online platforms, at the know your client stage, it was noted that one website is generating questions to clients which commenced with the statement "Do you understand...." or similar statements. Such questions request the client to make a determination of his understanding with respect to certain financial instruments and their characteristics, which leads to the mystery shopper undertaking a level of self-assessment.

#### Regulatory Requirements and Guidelines

When it comes to collecting client information, Guideline 2.7 and Guideline 2.8 within Appendix 6 of the [Conduct of Business Rulebook](#) requires licensed entities to avoid using yes or no questions and, or a tick-the-box self-assessment approach, when asking clients whether they have sufficient knowledge about the main characteristics and risks of specific types of

investment products and on whether they feel sufficiently experienced to invest in certain products.

Moreover, reference is also being made to Rule R.4.4.31 which states that Regulated Persons shall take reasonable steps and have appropriate tools to ensure that the information collected is reliable and consistent, without undue reliance on clients' self-assessment.

This shall include, but shall not be limited to the following:

- a) ensuring that Clients are aware of the importance of providing accurate and up to date information;
- b) ensuring questions used in the process are likely to be understood by clients, capture an accurate reflection of the client's objectives and needs, and the information necessary to undertake the suitability assessment; and
- c) taking steps, as appropriate, to ensure the consistency of client information. This includes, considering whether there are obvious inaccuracies in the information provided by clients;
- d) Ensuring that no undue reliance is made on any clients' self-assessment in relation to knowledge, experience and financial situation.

Moreover Guideline G.4.4.45 within the Conduct of Business Rulebook talks about the importance of the adoption of mechanisms to avoid self-assessment and ensure the consistency of the answers provided by the client for the correct assessment of the client's knowledge and experience. This is reinforced by G.4.4.46 which specifies that self-assessment questions should be counterbalanced by objective criteria.

In this context, reference should also be made to R.4.1.8(k) of the Conduct of Business Rulebook which specifically prohibits investment firms from requesting clients to sign declarations to the effect that that have understood and accept certain features of the product and that they are relying on their own skill, judgement and expertise in order to purchase products when it is the obligation of the Regulated Person to assess the suitability or appropriateness of such products vis-à-vis clients. In this respect, the Regulated Person should avoid stating, or giving the impression that it is the Client who decides on the suitability of the Product or that it is the Client who establishes which Products fit his own risk profile.

#### Identified Bad Practice

It has been noted that some companies are requesting clients to confirm that the products to be transacted in (where complex products are concerned) are suitable as part of the user's portfolio objectives and attitude towards risk. Such disclaimers are not allowed especially when a non-advisory service is being provided in relation to complex instruments. Companies should move away from putting the onus on the client by asking them to make certain declarations when indeed it is the entity's obligation to undertake the relative assessment depending on the service being provided by the entity.

### Conclusion

The Authority does not consider as appropriate the approach adopted by some licenced entities where the clients compile the client fact find questionnaire on their own and not during the face-to-face meeting held with the financial advisor. Licenced entities, engaging such approach are therefore expected to revisit this process accordingly.

In line with the above applicable provisions, licensed entities are requested to assess the questions forming part of the collation of client information database as well as any disclaimers which clients are required to sign and ensure that the provisions within the Conduct of Business Rulebook, especially when it comes to self-assessment, are being adequately satisfied.

#### **[ii] Adequate collation of client information**

- Face-to-Face Interaction

The majority of the licensed entities did not provide an explanatory background of the lifecycle of the advisory process which includes the collection of information (and the importance of the provision by clients of the correct and full information) as well as the suitability assessment.

It has been noted that from first impressions and without collecting adequate information from the mystery shoppers, certain advisors have immediately requested the mystery shoppers to think about upcoming local bond issues and report back to the licensed entity if interested in such issues.

It was further observed that during the initial face-to-face interaction, advisors representing licensed entities holding multiple licenses, have also proceeded to propose products that do not fall within the investment services licence, such as asking the mystery shopper to consider a pension plan, at first instance without having commenced the client fact finding process.

#### Regulatory Requirements

Rule R.4.4.21 of the Conduct of Business Rulebook specifies that Regulated Persons shall clearly explain that it is the Regulated Person's responsibility to conduct the assessment, so that clients understand the reason why they are asked to provide certain information and the importance that such information is up-to-date, accurate and complete, as this enables the Regulated Person to act in the clients' best interest. Such information may be provided in standardised format.

Additionally, as mandated under Rule R.4.4.24, when providing Advice or Portfolio Management Services to a Client, the Regulated Person must first obtain the necessary information regarding the client's:

- a) knowledge and experience in the investment field relative to the specific type of the product or service;
- b) financial situation including his ability to bear losses; and

- c) investment objectives including risk tolerance, so as to enable the Regulated Person to recommend to the client, products which are suitable for him/her and, in particular, are in accordance with his/her risk tolerance and ability to bear losses.

Regulated Persons are not to create any ambiguity or confusion about their responsibilities in the process when assessing the suitability of Financial Instruments or Services in accordance with R.4.4.24. Furthermore, when undertaking the suitability assessment, the firm is required to inform Clients or potential Clients, clearly and simply, that the reason for assessing suitability is to enable the firm to act in the Client's best interest, as stipulated in Rule R.4.4.19.

#### Identified Good Practises

- i) All face-to-face mystery shopping exercises did not exhibit any particular trend when it comes to the recommendation of financial instruments. It can be clearly stated that no licensed entity forced any shopper to invest in a specific product.
- ii) Whilst shoppers' feedback on communication by advisors was subjective, gathering their impressions of the communication style used during the mystery shopping was essential, given how important good communication is for establishing and maintaining a constructive relationship. In this respect, overall, all of the staff attending to the mystery Shoppers were responsive to the mystery shopper's questions, providing the requested information.

#### Identified Bad Practises

- i) One of the licensed entities exhibited lack of interest in the mystery shopper because of the low amount available for investment. It is important that smaller retail clients are not directly or indirectly excluded from the provision of services solely on the basis of their amount available for investment.
- ii) It is worth pointing out that only one mystery shopper highlighted that the advisor was putting forward a lot of information without keeping in mind that the person had minimal experience on investments. Some prospective clients may feel overwhelmed by the information being communicated and so it is important that no jargon is used and all technical terms are duly explained in simple terms, facilitating the understanding of the person in front of the advisor and keeping in mind that certain individuals have minimal experience on investments. Good communication is an essential part of the relationship between the advisor and the prospective/existing client. Unless information is provided in a clear, plain language format, it can be difficult for investors to understand what they are going to buy or sell and how the product contributes to the clients' investment objectives.

#### Conclusion

Advisors are required to follow the above- mentioned Rules and clearly explain the advisory service life cycle to clients and prospective clients.

It is not acceptable that advisors recommend products/services to their prospective clients without fully understanding the circumstances of the client. Advisors should therefore move away from providing recommendations or considerations before the collation of all the relevant information on the client is complete.

Finally, in line with paragraph 15 of section 2.1 of the *ESMA MiFID II Supervisory Briefing on Suitability*, the Company is required to have arrangements and procedures in place which guide, track and record the interaction between staff and clients in order to ensure the distinction between 'advised' and 'non-advised' services. In line with R.1.3.8 of the Conduct of Business Rulebook, advisors should therefore make it clear to the client as to whether they are providing advisory services or otherwise so as to avoid any misunderstandings.

Whilst the Authority appreciates that advisors look at the client's overall situation in a holistic manner whilst using multiple licences to achieve such an objective, licensed entities must ensure that advisors do not exert undue pressure on the client to invest in multiple products and consequently increase the investment amount initially proposed by the client. Additionally, as referred to within Rule R.4.1.13(a), a Regulated Person shall not persuade or attempt to persuade a Client to surrender or cancel any product or service which such client may have already purchased, if such surrender or cancellation is not in the best interest of the client.

***[iii] Adequate representation of clients' circumstances within Company's documentation***

- *Face-to-Face Interaction*

For face-to-face advisory meetings to be effective, complete, correct and up-to-date client information must be gathered, to determine whether there is sufficient basis to move forward with the provision of advisory or discretionary portfolio management services.

It is common practice amongst firms that collate information about the client during the face-to-face meeting, to ask a number of questions during the meeting and simultaneously compiling the client fact find questionnaire with the provided information. Once the compilation of the client fact find document is complete, the advisor asks the client to sign the document accordingly.

One mystery shopper faced a circumstance where the investment advisor gave a brief overview of what the mystery shopper was signing for, however afterwards at home the mystery shopper noticed that there within the signed client fact find document, there was other information included therein which the mystery shopper was not aware of. In this case it is concerning to note that all sections of the client fact finding document were duly populated by the advisor, however there were certain sections which were not a true reflection of the information or lack of information, provided by the mystery shopper. This shows that the advisor representing the licensed entity, did not obtain a complete picture of the mystery shopper's overall financial situation and did not correctly reflect this within the client fact find.

Regulatory Requirements and Guidelines

As stipulated within Rule R.4.1.5, when providing Products, Services and/or, where appropriate, Ancillary Services to Clients, a Regulated Person shall:

- (a) act honestly, fairly and professionally in accordance with the best interests of its Clients;
- (b) at all times carry out the regulated activities with utmost good faith, integrity, due skill, care and diligence;
- (c) do everything which is reasonably possible to satisfy the needs and requirements of its Clients and shall place the interests of those Clients before all other considerations. Subject to these requirements and interests, a Regulated Person shall have proper regard for others.

In addition, when providing Advice or Portfolio Management, if a Regulated Person does not obtain the information required under R.4.4.24, the Regulated Person shall not recommend Services or Financial Instruments to the Client, as detailed under Rule R.4.4.42.

Reference is also being made to guideline G.4.4.64 which states that whilst clients are expected to provide correct, up-to-date and complete information necessary for the suitability assessment, Regulated Persons need to take reasonable steps to check the reliability, accuracy and consistency of information collected about Clients. Regulated Persons shall remain responsible for ensuring they have the necessary information to conduct a suitability assessment. In this respect, any agreement signed by the Client, or disclosure made by the Regulated Person, which would aim at limiting the responsibility of the Regulated Person with regard to the suitability assessment, would not be considered compliant with the relevant requirements in Chapter 4 of the Conduct of Business Rulebook.

Identified Bad Practises

[i] Where more than one visit was carried out to the same licensed entity, however at different branch locations, the lack of a harmonised approach was apparent in terms of the servicing of clients as well as in the provision of documentation. It is the responsibility of the licensed entity to ensure that a harmonised approach is being adopted across the entity in its entirety.

[ii] It is worrying to note that one mystery shopper felt pressurised to sign off the relevant documentation to open an investment account, without giving the mystery shopper enough time to read through all documentation. The investment advisor gave a brief overview of what the mystery shopper was signing for, but the mystery shopper stated that the advisor did not fully explain the content of the documentation in detail because afterwards, at home, the mystery shopper noticed that there was other information mentioned within the provided documentation that the mystery shopper was not aware of.

Clients should be given sufficient time to digest the information provided and should not be pressured to utilise the licensed entity's services.



### Conclusion

We encourage licensed entities to develop guidance to improve the quality of advice and the overall client experience. This includes the development of best practice guidance on the advisory process and involve input from advisors on common problems they face and practical solutions to address them. Guidance must also cover specific topics such the provision of information to customers including transparency and suitability of fees and charges.

Licensed entities should also adequately train advisors to appropriately capture information from client and transposing such information within the suitability assessment documentation. This is in line with Rule R.4.4.7 which specifies that Regulated Persons shall ensure that staff know, understand and apply the Regulated Person's internal policies and procedures designed to ensure compliance with MiFID II.

Licensed entities are also being encouraged to institute a continuing educational requirement for advisors in order to keep their industry knowledge current and maintain a high standard of professionalism. This area is being looked into at European level and follows the proposal put forward by the European Commission, detailed within its Retail Investor Package aimed at preserving high standards of professional qualifications for financial advisors.

Lastly it is important that advisors allow enough time to the prospective client to go through the information included within the client fact finding documentation before requesting the client to sign off the information contained therein.

### ***[iv] Sustainability preferences***

- Face-to-Face Interaction

All entities licenced to provide investment advice and/or portfolio management, and to whom a mystery shopping review was undertaken, did not obtain information about sustainable preferences in their interaction with the mystery shopper.

### Regulatory Requirements and Guidelines

Rule R.4.4.28(e) of the Conduct of Business Rulebook mentions that the information regarding the investment objectives of the Client shall include, where relevant, information about sustainability preferences.

Guideline G.4.4.26 highlights that it is considered good practice for Regulated Persons to consider non-financial elements when gathering information on the Client's investment objectives, as well as information on Client's suitability preferences on environmental, social and governance factors.

### Conclusion

It is imperative that licensed entities offering investment advice and/or discretionary portfolio management service, adopt the requirements and provisions surrounding sustainability preferences. In this regard, investment service licenced entities are required to evaluate the official letter dated 5<sup>th</sup> October 2022 issued by the Authority entitled “*Re: Publication of the ESMA Final Report on Guidelines on Certain Aspects of the MiFID II Suitability Requirements – Implications on Investment Firms’ existing Procedural and Organisational arrangements relating to the Client Suitability Assessment processes following Commission Delegated Regulation (EU) 2021/1253 and the incorporation of sustainability elements in the revised guidelines.*”

### **B. Assessments attributed to the provision of non-advisory service**

Undertaking an Appropriateness Test when the licensed entity is providing non-advisory services, is central to enable the licensed entity to fully understand whether the client requesting to buy or sell a complex financial instrument, without requiring investment advice or portfolio management services, has the appropriate level of knowledge and experience in the type of product to be invested in. The test aims to protect those who may not understand or be aware of the implications and level of risk involved in a transaction, particularly where the products are ‘complex’.

As part of the exercise, we have assessed the level of data gathering by licensed entities in order to be in a position to carry out appropriateness testing. We also assessed the warnings which are required to be displayed in the context of this assessment.

#### **[i] Appropriateness Testing**

- Online Interaction

Through the use of websites and mobile application, it was evident that limited information on knowledge and experience is being obtained from prospective investors and mystery shoppers are not being requested to provide adequate information on their knowledge and experience. The focus of the questions asked was mainly on obtaining information in respect to the trading experience of the mystery shopper in terms of frequency of transactions and this does not fully address Rule R.4.4.57. Moreover, the determination of whether an individual is knowledgeable and experienced should be undertaken by the regulated entity and should not be determined by the individual who is subject to the Appropriateness test himself.

#### Regulatory Requirement

Rule R.4.4.57 of the Conduct of Business Rulebook, states that when providing the Service other than Advice or Portfolio Management, a Regulated Person shall ask the Client to provide information regarding his knowledge and experience in the field relevant to the specific type of Financial Instrument or Service offered or demanded so as to enable the Regulated Person

to assess whether the Service or Product envisaged is appropriate for the Client. In carrying out the appropriateness assessment, the Regulated Person shall, when providing non-advised services, comply with all the applicable requirements contained in Chapter 4 of the Conduct of Business Rulebook, as well as with Appendix 6 to this Chapter which implements the ESMA Guidelines on certain aspects of the MIFID II appropriateness and execution requirements.

It is important that questionnaires completed through online modules, including websites and mobile applications, are designed in such a way so as to enable the Regulated Person to gather the necessary information about its client. Furthermore, Regulated Persons should adopt mechanisms to address the risk that clients may tend to overestimate their knowledge and experience, for example by including questions that would help Regulated Persons actually assess the overall Clients' understanding about the characteristics and the risks of the different types of financial instruments. The risk of overestimation by clients of their knowledge and experience may result higher when they provide information through an automated (or semiautomated) system, especially in situations where very limited or no human interaction at all between clients and the Regulated Person's employees is foreseen.

Going forward, the retail investor package proposed by the European Commission touches upon the Appropriateness test and proposals are being put forward for firms to also assess the capacity of the client to bear full or partial losses and the client's risk tolerance when assessing appropriateness. In case of a negative appropriateness assessment, the firm will only be allowed to proceed with the transaction at the clients' explicit request.

### Conclusion

In view that certain appropriateness tests utilised by licensed entities were based solely on understanding the trading frequency experience of the user and did not fully address the above-mentioned requirements within the Conduct of Business Rule Book, licensed entities are requested to re-assess their tests and ensure that such assessments adequately satisfy the relevant requirements.

### ***[ii] Failure of Appropriateness Test Warning***

- Online Interaction

During the course of the mystery shopping exercises, a number of mystery shoppers have come across a warning displayed by the respective licensed entity, informing the mystery shopper that they did not pass the entity's appropriateness assessment in the context of the instrument being considered by the client.

It was noted that all sampled licensed entities accepted the clients who failed the Appropriateness Test on the basis that such users make a request to proceed with the account opening, subsequent to the notification of failure of the appropriateness test.

### Regulatory Requirement

In line with the requirement set out in paragraph 9.6 in Appendix 6 of the Conduct of Business Rulebook (implementing the 'ESMA Guidelines on certain aspects of the MIFID II appropriateness and execution requirements'), where the Regulated Person's policies and procedures provide for the possibility to accept its clients' requests to proceed with the transaction after a warning has been issued, the Regulated Person should evaluate the overall effectiveness of the warnings issued on an ex-post basis (for instance, by assessing the ratio of warnings that were followed by a transaction to the total of all warnings issued) and should make adjustments to its relevant policies and procedures where necessary.

Additionally in line with the requirement set in paragraph 9.7 in Appendix 6, by way of good practice, the Regulated Person should consider setting out policies and procedures identifying any conditions and criteria under which a client's request to proceed with a transaction after having received a warning may be accepted or not. For instance, a Regulated Person may take into account situations where there is a heightened risk of conflicts of interest because the Regulated Person is selling its own investment products (or investment products issued by entities of the same group), or actively marketing investment products from within the Regulated Person's range. Another factor that may be considered by the Regulated Person is a high level of complexity or risk of products offered or demanded.

### Conclusion

Licensed entities are required to ensure that the aforementioned provisions are being effectively implemented.

### **C. Disclosure of Information**

Through the interaction with the licensed entities, investors should have a clear understanding of the product/s being discussed and all applicable fees and charges (including how such are calculated), for the clients to make an informed decision.

As part of the exercise, we have looked at the level of disclosure, including preliminary dissemination of documentation and the explanation thereof.

#### ***[i] provision of information /documentation by the licensed entity***

- Face-to-Face Interaction

During the face-to-face meetings, advisors did provide an overview of the licensed entity, however the level of detail varies from one firm to another.

The level of documentation provided to clients during the first meeting also varied across the sampled entities, wherein certain entities did not provide any documentation to the mystery shoppers and others that provided documentation including instrument related information papers, cost and charges schedule and a copy of the completed client fact find form, amongst others.

- Online Interaction

It was noted that the mobile application of one licensed entity did not contain information about the licenced entity for the user to read about.

Regulatory Requirement

In line with Rule R1.4.17 a Regulated Person shall in good time and prior to the conclusion of a contract, provide to the prospective client adequate disclosures. All information required to be disclosed must be presented to the prospective clients in a clear and transparent manner and must also be easily accessible in case of online dissemination of information.

Additionally, Rule R.1.3.6 of the Conduct of Business Rulebook states that a Regulated Person shall in good time, prior to the conclusion of any contract, or if there is a material change after the conclusion of a contract for the provision of a Service or Product, make the following disclosures to Clients:

- a. its name and address and the Product or Service which is being provided or carried out which, shall include the address of the head office of the Regulated Person (including where applicable, the name of the Member State or Third Country where such head office is situated) and, where appropriate, the address of the agent or branch concluding the contract (including where applicable, the name of the Member State or Third Country where such branch is situated). Where the Regulated Person is a Third Country Insurance undertaking, such Regulated Person shall provide the address of the Maltese branch;
- b. a statement of the fact that the Regulated Person is licensed by the MFSA, together with the address of the MFSA. Where applicable, a Regulated Person shall also disclose to the Client the Register in which the Regulated Person has been included and the means for verifying that it has been registered or notified;
- c. information relating to the procedures allowing Clients or other interested persons to register complaints about the Regulated Person;
- d. information about any compensation which may be available to the Client under any compensation scheme which may be applicable.

Conclusion

Entities should ensure that they provide all the necessary information about the entity, including the services and products offered, to enable the client to make an informed decision. Training must be provided to advisors when it comes to face-to-face meetings so that information is properly disseminated to the client. In relation to online servicing, websites and mobile applications must contain sections which give an overview of the Company's business model and the group structure (if applicable). This information should be provided in a user-friendly manner which is easily accessed (e.g. through layering).

It is very important that the licenced entity has the relevant controls, processes and procedures in place to ensure that the relevant and important documentation that needs to be

provided to the client in respect to the service and product being offered by the entity, is provided in good time before the transaction is concluded.

***[ii] explanation of type of advisory service being provided***

- Face-to-Face Interaction

None of the sampled investment entities provided an oral explanation of the terms 'independent' or 'non-independent' advice, during the face-to-face meetings held with the mystery shoppers. It was however noted that only one licensed entity omitted to explain these terms within its documentation provided to the client.

Regulatory Requirement

Rule R.1.4.19 stipulates that Regulated Persons shall inform clients about the nature and type of the advice provided to them. Regulated Persons should explain in a clear and concise way, whether and why investment advice qualifies as independent or non-independent and the type and nature of the restrictions that apply, including the prohibition to receive and retain inducements (if applicable).

Conclusion

The lack of disclosure to clients with regards to the type of advisory service being provided, seems to be a practice adopted by all sampled entities. Such practise is not in line with Rule R.1.4.19. Licensed entities are therefore required to assess their current processes with a view to ensure that these are in line with the abovementioned regulatory requirements.

***[iii] Explanation of fee structures***

- Face-to-Face Interaction

When it comes to information on costs and charges, the discussion varied widely from one entity to another, with some advisors providing ample information and others much less. Some shoppers received information on fees associated with purchasing different asset classes, including a breakdown of such fees, whilst other shoppers only received information covering a limited number of fees.

Furthermore, in the majority of cases, information on costs was not voluntarily provided by the firm staff but provided upon explicit request of the mystery shopper. Following such request however, the majority of the sampled licensed entities provided the mystery shoppers with written material containing fee information, such as a fee schedule, for their consideration.

Identified Bad practises

It is noted that during the meetings with the prospective client, there is a tendency for advisors to focus more on the products and services offered and discuss how these satisfy the investment goals and objectives of that prospective client and less importance is given to the

provision of information relating to fees and costs, as well as the relationship between risk and return. It is important that all relevant information is provided to clients in good time and before a transaction is concluded.

#### Regulatory Requirement

Rule R.1.4.27 requires that Regulated Persons shall, in good time, prior to providing a product or a service to a client, disclose to such client information relating to all costs and associated charges related to a product or service and its Distributor, which must include the cost of advice, where relevant, and the cost of the product recommended or marketed to the client (also encompassing any third-party payments). The Regulated Person should also specify how the client may pay such costs.

#### Conclusion

It is important that information on costs and charges is provided voluntarily rather than upon the explicit request of the prospect/existing client. Moreover, advisors must adopt a process of explaining what documentation is being provided, including where applicable, the explanation that a document covers the applicable costs and charges. Clients must be handed the cost and charges disclosure sheet so that this can be analysed further, before a decision to proceed is taken. It is deemed best practice that advisors go through the documentation provided and explain the contents of the documents being handed out.

- Online Interaction

With respect to the costs and charges disclosure within the online sphere, although all mystery shoppers managed to locate the costs and charges schedule within the website/ mobile application, mystery shoppers stated that accessibility to certain important information, including the costs and charges disclosure sheet, is not straightforward. For certain users it proved difficult and time consuming to identify the section where such important documentation can be accessed and viewed.

#### Regulatory Requirement

Reference is being made to Rule R.1.1.7 which states that if a Regulated Person is permitted to disclose Information to a client by means of a website, and where that Information is not addressed personally to the client, the client shall be notified electronically of the address of the website, and the place on the website where the information may be accessed.

#### Identified Good Practises

- i) The implementation of a chat facility within the online sphere is deemed as a good channel to assist users in any difficulties or questions they may have. It has been noted that the chat icon is always available across the browsing experience, some even providing instant messaging service and also the option for the user to call a representative of the entity was also made available. Some entities also provide users the possibility to access Frequently Asked Questions which provide further assistance to the user.

- ii) Some firms offered, via their websites, online access to interactive cost calculation tools.

#### Conclusion

Entities with an online presence or offering mobile applications must ensure easy accessibility to information.

#### ***[iv] Prominent display of certain financial instruments over others***

- Online interaction

In terms of product display within the licensed entities' respective website/ mobile application, it was noted that the majority of licensed entities which were subject to this exercise, displayed certain products in a more prominent manner when compared to other products offered by the same entity.

#### Conclusion

It is our view that giving one product more prominence over another, may entice customers to favour such financial instrument. The Authority highly recommends that licensed entities do not provide information that might give the impression that certain products are better than others.

#### ***[v] Explanation of potential financial instruments for investment***

- Face-to-Face Interaction

Some licensed entities provided explanatory supporting documentation on specific products discussed during the meeting, where such documentation would include the main characteristics of the product. As an example, mystery shoppers were provided with the KIID pertaining to the Fund being discussed.

An explanation of the characteristics of the instrument being considered was provided however in one case, a mystery shopper highlighted that the level of knowledge possessed by the financial advisor varied across the instruments being discussed.

#### Regulatory Requirement

In line with Rule R.2.104, Distributors shall ensure that relevant staff possess the necessary expertise to understand the characteristics and risks of the Products that they intend to offer or recommend, and the services provided as well as the needs, characteristics and objectives of the Identified target market.



### Conclusion

As highlighted earlier, training of client facing staff is critical in order to ensure that the entity observes the best interest of the client at all times.

### **OUR EXPECTATIONS ON FIRMS**

The observations and findings arising from this exercise are being highlighted in this letter with a view to sharing experiences, learning valuable lessons, and identifying good practices for the benefit of the financial market and the end consumer.

The firm's Board or Executive Committee is to consider which of the risks and observations indicated in this letter are applicable to your business. To this end, your firm is expected to carry out a gap analysis with respect to the practices and processes of your firm and then to take prompt action to address any identified shortcomings accordingly.

Kindly note that the Authority will be continuously monitoring compliance by investment services licence holders with the applicable regulatory requirements and may engage with particular investment firms on the matters forming the subject of this letter.

Should you require any clarification on the above, please do not hesitate to contact the Authority's Conduct Supervision Function on [csuinvestments@mfsa.mt](mailto:csuinvestments@mfsa.mt).

Yours faithfully,

**Malta Financial Services Authority**

**Dr Christopher P. Buttigieg**  
Chief Supervision Officer

**Dr Sarah Pulis**  
Head Conduct Supervision

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