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Research paper

Profiling investors with the MiFID: current practice and future prospects

Abstract

With the introduction of the MiFID, the European Regulator has formalized the need for financial firms to *get to know their customers*. To do this, the Directive requires financial operators to assess the suitability and appropriateness of any financial service or product that is proposed to a client. Depending on the result of the suitability and appropriateness questionnaire, investors can be provided with different services and products according to their needs. Unfortunately, the Directive only dictates general rules and each financial firm makes use of its own questionnaire that is likely to be different from its competitors'.

Our analysis focuses on the differences that characterize the MiFID questionnaire across financial firms with both a *descriptive approach* and an *empirical approach*. In the *descriptive approach*, we examine the content of 14 Italian questionnaires in order to highlight the main divergences and similarities in the contents of the questionnaires. The business model of the financial firm but also the competence of the front-office employees and the conduct of the compliance function are possible explanations for the different structure of the questionnaires. In the *empirical approach*, we investigate how reliable MiFID questionnaires are, in terms of the consistency of profiles that come out when they are filled up by the same person. In brief, three different questionnaires are sent to 100 potential investors (who are requested to fill all of them up) to verify the consistency of the profiles that are obtained. Our results show that, depending on the questionnaire that is used, at least for some subjects, the profiles obtained by the same person across the three financial firms vary. This is likely to derive from the differences in the contents and scoring methods of the three questionnaires as highlighted in the descriptive analysis.

Introduction: the profile determination under MiFID

The approach financial firms follow to sell financial products and services is crucial for consumer confidence in financial markets and subsequently has implications for financial system stability as well as investor protection. For years, financial firms have been considering the preferences and needs of their clients before selling any financial product or service to them. In fact, the information that is obtained from the customer is crucial in every step of the contract:

a) *Before* the financial service or product is subscribed, in order to meet the preferences and needs of the investors;
b) *During* the contract, in order to acquire any changes in the needs and preferences of the investor;

c) *After* the end of the contract, in order to protect the intermediary against any complaint that the client could make with reference to a loss that he or she did not expect but is physiological according to the level of risk that characterizes the investment.

Generally, information about clients is collected by the use of a questionnaire, whose function is to reveal the client's needs and preferences. In this perspective, the questionnaire is a mean to better know one's customers but also it is a tool to reduce the possible misunderstandings and to protect financial firms against possible complaints in the case of an unexpected loss.

With the introduction of the Market in Financial Instruments Directive (MiFID, henceforth), this practice has became *compulsory* for financial firms providing investment services[1]; specifically, the MiFID requires financial operators to investigate the *suitability* and *appropriateness* of a product or service to a client, by submitting him or her with a corresponding questionnaire. In particular, the *suitability* is a wider concept which may be defined as[2]: 'the degree to which the product or service offered by the intermediary matches the client's financial situation, investment objectives, level of risk tolerance, financial need, knowledge and experience'. The application of MiFID rules in terms of suitability varies according to a number of conditions that are summarized in table 1.

Table 1 Modulation of MiFID suitability obligations

Influence of the financial firm upon the client's investment decision	Non advised services (reception and transmission of orders, execution of orders, dealing on own account, placing of financial instruments)	• Less protection to the client • Smaller information exchange • No risk tolerance assessment
	Advised services (portfolio management, investment advice)	• Greater protection to the client • Wider information exchange • Risk tolerance assessment
Client's classification	Professional client	• Lower level of protection • Less information • Risk tolerance assessment
	Retail client	• Higher level of protection • More information • Risk tolerance assessment
Type of financial intermediary	Insurance sector	Partial application
	Banking and securities sector	Full application

Firstly, the need for a deeper knowledge of the client depends upon the kind of investment service that is provided. In this perspective, investment services may be divided into two groups:

- a first group of services that entails an element of recommendation on the part of the firm upon the final investment decision of the client, as the firm advises some products or receives an explicit mandate from the client to manage his or her assets ('advised services', that are investment advice and portfolio management);
- a second group of services that do not imply a recommendation by the financial intermediary, resulting in a mere execution of transactions autonomously decided by the client ('non advised services', such as reception and transmission of orders, execution of orders, dealing on own account, placing of financial instruments).

[1] Investment services and activities are defined in art. 4 of MiFID Level 1 Directive 2004/39/EC and refer in particular to a list of activities in MiFID Annex I-A (reception and transmission of orders, execution of orders, dealing on own account, portfolio management, investment advice, underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis, placing of financial instruments without a firm commitment basis, operation of Multilateral Trading Facilities) related to financial instruments listed in MiFID Annex I-C.

[2] See Bank for International Settlement (2008).

As we will outline below, the amount of information that is required to provide the first group of services is greater, according to the MiFID prescriptions.
Secondly, the MiFID suitability obligations vary according to the type of customer the service is provided to. In this sense, the MiFID sets apart 'retail customers' and 'professional clients'. In general, the term 'retail customer' is not defined. Instead, anyone who is not a 'professional' investor (for example, financial intermediaries authorized to operate in the financial markets, companies meeting specific size requirements, some public organizations and, on request, private individual investors meeting certain minimum net worth levels or experience standards) is generally treated as a retail customer[3]. Suitability requirements apply to both, but differently: for retail clients the sources of information are more numerous, while for professional clients the data requirements are more essential.
Finally, even if the notion of suitability is recognized in the regulatory requirements across all financial services sectors (banking, securities and insurance), there are some differences in its application in each sector. In particular, the application of MiFID suitability requirements is only partially mandatory among insurance intermediaries providing investment services, whereas they fully apply to banks and financial firms[4].
The *appropriateness* is a sub-case of the *suitability*; it may be defined as: 'the degree to which the product or service offered by the intermediary matches the retail client's knowledge and experience'[5]. Both suitability and appropriateness have to be assessed through the use of questionnaires but they differ regarding three main points:

- field of application
- content
- operational effect

With reference to the field of application, portfolio management and investment advice ('advised services') need the suitability questionnaire, whereas services other that portfolio management and investment advice ('non advised services') require an appropriateness questionnaire[6]. There are two further distinctions between the suitability and appropriateness questionnaires, even more relevant from an operational point of view (see table 2).
The first one relates to the different set of information to be asked to the client. The MiFID dictates that the suitability questionnaire should be deeper and organized in three sections containing different information about the client. The first section is addressed to the investment objectives of the client; in this section, the client has to express his or her preferences about the time horizon and the risk profile of the investment he or

[3] For a complete definition of 'professional client', see MiFID Level 1 Directive 2004/39/EC, Annex II.
[4] In the original MiFID prescription, nothing is specified as far as insurance companies providing investment products are concerned. As a consequence, each Member State is free to design a specific regime for the insurance sector, provided that the regime is compliant with the Directive 2002/92/EC of the European Parliament and of the Council of 9 December 2002 on Insurance Mediation (IMD, henceforth). For example, in Italy the CONSOB Regulation n. 16190 of the 29 October 2007 (Reg. 16190/2007, henceforth) extends the suitability and appropriateness obligations to the so called Subjects Qualified to the Insurance Intermediation (SQII, henceforth) (art. 85), such as Italian and European investment firms, Italian and European banks, financial intermediaries belonging to the list ex art. 107 of the Legislative Decree n. 385 of 1 September 1993 and Poste Italiane. Moreover, this prescription is extended to insurance firms that directly sell financial insurance products to the client, while no mention is made about insurance distributors, such as brokers and insurance agents, that continue to follow the general prescriptions dictated by ISVAP, which is the Italian Supervisory Authority for insurance sector ('Code of private insurance', Legislative Decree n. 209 of 7 September 2005 and ISVAP Regulation n. 5 of the 16 October 2006) e by the IMD cited above.
[5] See Bank for International Settlement (2008).
[6] Under MiFID, in the case of execution only services (but in non complex products only) the appropriateness test is not applied, provided that the service is offered at the initiative of the client, that the client has been clearly informed that the firm is not required to assess the appropriateness of the instrument or service offered and accordingly that the client will not have the benefits that would otherwise be provided by appropriateness determinations; the investment firm also has to comply with its conflict of interests obligations.

she is going to make, in order to identify those investment products that matches his or her preferences about risk, return and length of time.

Table 2 Suitability questionnaire and Appropriateness questionnaire: a comparison

	Suitability	Appropriateness
Application field	• Portfolio management • Investment advice	Investment services other than portfolio management and investment advice. No test is required for execution only service.
Set of information	Three sections: • investment objectives; • financial capacity; • experience and knowledge.	One section: • experience and knowledge.
Operational effects	Compulsory questionnaire: if the questionnaire is not filled up by the client, portfolio management and investment advice services cannot be provided.	Non compulsory questionnaire: if the client refuses to give some information, the service may be provided all the same, but under a disclosure obligation by the firm.

The second section is focused on the financial capacity of the client; it relates to the client's financial ability to incur risk and is a function of some economic information, such as the amount and stability of his or her income, the amount of expenses relative to income, the diversification of assets, the amount, time frame and structure of liabilities. The third section aims to investigate the experience and financial knowledge of the client, as clients who comprehend risk are more likely to make financial planning decisions consistent with accomplishment of their goals; typically, the types of service, transaction and financial instrument with which the client is familiar or that the client has used in the past are investigated. With regard to the appropriateness questionnaire, the amount of information asked for from the client is lower; as far as 'non advised services' are concerned, it follows that the only section to be assessed is the necessary experience and knowledge of the client, in order to understand if the client is able to recognize the risks involved in the product or investment service offered or demanded[7].

Moreover, the suitability and appropriateness questionnaires differ with regard to the compulsoriness (or not) of their need to be filled out, resulting in different operational implications for the investment firm. The suitability questionnaire is compulsory: the firm cannot provide the advice or management service if the client has not completed the test and provided all the required information; this means that the suitability questionnaire is a preliminary test of knowledge the firm cannot do without, as it works as a stopping step for the service provision. On the contrary, in cases where the client does not provide the information needed to perform the appropriateness questionnaire, or provides insufficient information, firms are required to warn

[7] 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 he or she is so classified, the client has the necessary level of experience and knowledge; moreover, where that investment service consists in the provision of investment advice, the investment firm shall be entitled to assume also that the professional client is able financially to bear any related investment risks consistent with his or her investment objectives. This means that for professional clients the suitability questionnaire is reduced into two sections ('investment objectives' and 'financial capacity'), when providing portfolio management, and even into one section ('investment objectives'), when providing financial advice, as the other information may be implicitly assumed by the firm. In contrast, the appropriateness has no more need to be assessed, as the only set of information required for appropriateness ('financial experience and knowledge' of the client) is implicitly supposed to exist.

the client that the firm does not have sufficient information to determine whether the service or product envisaged is appropriate; nevertheless, the service or product may be provided. Therefore, the appropriateness questionnaire is not a stopping step for the service provision, but it simply causes the rise of a disclosure obligation for the providing firm[8].

A part from the above indications about when and how a suitability determination must be made, the Directive does not dictate any other rule, for instance, as far as the content of the questionnaire is concerned; thus, each financial firm makes use of its own questionnaire that is likely to be different from the ones used by its competitors'. Starting from this consideration, our analysis focuses on the differences that characterize the MiFID questionnaire across financial firms with both a *descriptive* and an *empirical approach*. In the *descriptive approach*, we examine the content of each questionnaire in order to highlight the main divergences and similarities among them; in the *empirical approach*, we investigate how reliable MiFID questionnaires are, in terms of the consistency of profiles that come out when different questionnaires are filled up by the same person.

In the *descriptive approach*, we collect a sample of 14 MiFID suitability questionnaires belonging to the major Italian financial firms and addressed to retail clients. We analyze each questionnaire by comparing its level of completeness and compliancy to the MiFID requirements and reveal the main differences among them as well as possible explanations for the divergences. In the *empirical approach,* we make use of 3 questionnaires belonging to Italian banks[9] and we submit them to a sample of 100 potential investors. This way, each person in the sample is requested to fulfill all of the 3 questionnaires in order to verify the consistency of the 3 profiles obtained (so we collect 300 questionnaires as a whole). We find that, depending on the bank questionnaire that is used, at least for some subjects, the profiles obtained vary. This means that, in the extreme case, the same subject could be classified by a bank as risk averse and by another bank as risk seeker. Possible explanations for this result are strictly connected to the differences in the questionnaires contents, as deeper illustrated in the descriptive analysis. In turn, such differences in the questionnaires can be motivated by the business models of the financial firm one is considering but also by the competence of the front-office employees as well as the conduct of the compliance function.

Data and methodology for the descriptive analysis

A key part of the analysis is to understand how firms actually do to meet their MiFID suitability obligations in order to obtain the profile of their clients. We analyze 14 suitability questionnaires provided by the first 14 Italian financial groups in terms of promoted assets[10] in the area of portfolio management; all together, these groups share 90 per cent of the total market. Our analysis deals only with questionnaires in respect to *retail* customers and products with a significant *investment* component that require a suitability determination[11]. It is worthy to point out that the Italian regulatory authority for financial markets (CONSOB) has recently implemented the 'Level 3' (L3, henceforth) of MiFID, in order to homogenize the practices for fairness and transparency followed by Italian intermediaries towards retail clients, with a specific concern for illiquid and

[8] This means that even if the MiFID Level 2 Commission Directive 2006/73/EC, art. 35 (5) does not allow intermediaries to recommend investment services or financial instruments to the client when the investment firm does not obtain the information needed, it could be possible for the investment firm to give other investment services which are subject only to the appropriateness test.

[9] These questionnaires are different from those we employ in the descriptive analysis and are the only ones for which we were able to collect the scoring method that is used to calculate the profiles.

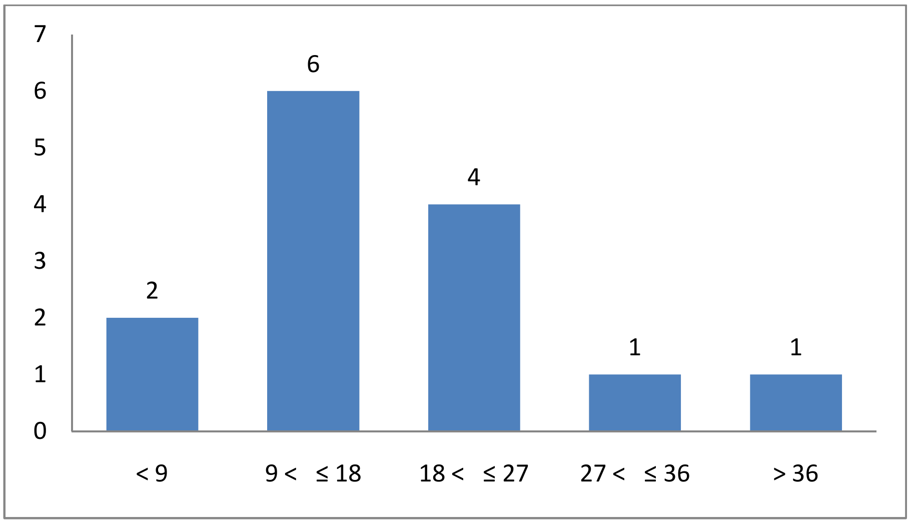
[10] See Assogestioni, 2009.

[11] Questionnaires for institutional investors and those addressed to the provision of services that require only an appropriateness evaluation are not part of this survey, as they may be considered a portion of the wider suitability questionnaire.

complex financial products[12]. In this perspective, CONSOB dictates further obligations that financial intermediaries have to follow when assessing the suitability/appropriateness of their customers. Specifically, CONSOB requires that in order to assess the suitability/appropriateness of a product, financial firms have to implement a set of controls, regarding the coherence between the complexity, the risk profile, the liquidity of the product and the characteristics of the client as derived from the suitability/appropriateness questionnaire. These obligations have led some Italian intermediaries to make adjustments to their suitability questionnaires and, most of all, in their algorithms for assessing the risk profile in order to be fully compliant to L3. For example, better specifications of illiquid and complex products inside the questionnaire have been sometimes needed, as well as some further specifications about the investment objectives and the time horizon desired. We collected suitability questionnaires from the 14 Italian financial groups after these regulatory adjustments.

At first glance, the 14 suitability questionnaires provided by the major Italian financial groups appear to be largely different. Some of them are very analytical, whereas some of the others are very short and essential. The number of questions asked to the client is a first proxy for the comparison: there are questionnaires where the maximum number of questions equals 37 and others with a minimum of 8; in our sample, the average number of questions asked to the client is approximately 19. Indeed, in our sample the range between the maximum and the minimum number of questions is quite high and also the dispersion around the average is not negligible, with a convergence towards the left side of the frequency distribution (see figure 1).

Figure 1 Number of questions in the suitability questionnaires*



**(sample: the first 14 Italian financial groups in terms of promoted assets)*

In order to develop a deeper analysis of our sample of questionnaires and to derive a coherent basis for comparisons, we decided to use the information categories suggested by MiFID as an objective parameter. More specifically, MiFID asks firms to provide a suitability questionnaire made up of three sections, respectively in regards to: ‘financial objectives’, ‘financial capacity’, ‘financial experience and knowledge’. These sections are compulsory and must be necessarily covered by each financial firm through the suitability assessment of its clients. At the same time, MiFID suggests a set of items that ‘should’ be included in each

[12] We refer to the CONSOB Communication n. 9019104 of the 2 March 2009. This communication has been followed by interassociative guidelines for the application of L3 measures promoted by the category associations in 14 July 2009.

section, without formulating a legislative obligation for them directly[13]. This means that, even though MiFID stipulates some advisable questions to be included in the questionnaire, each financial firm is free to define the specific questions of its own suitability questionnaire, provided that the three main sections are covered. The set of items suggested by MiFID are summarized in table 3 and we decided to use them as a 'benchmark' to compare the completeness of various questionnaires provided by our sample of Italian financial firms.

Table 3 Set of items suggested by MiFID for the suitability questionnaire

Section	Should include
Investment objectives	◆ Information on the length of time for which the client wishes to hold the investment ◆ The investor's preferences regarding risk taking ◆ His or her risk profile ◆ The purpose of the investment
Financial capacity	◆ Source and extent of his or her regular income ◆ His or her assets (including liquid assets) ◆ Investment and real property ◆ His or her regular financial commitments
Experience and knowledge	◆ Types of service, transaction and financial instrument with which the client is familiar ◆ The nature, volume and frequency of the client's transactions in financial instruments ◆ The period over which the client's transactions have been carried out ◆ The level of education of the client ◆ Profession or relevant former profession of the client

The 'benchmark' questionnaire suggested by MiFID comprizes 13 items, equally portioned among the three sections. All the items suggested by MiFID are clearly understandable; the only item that needs a specification is the one related to the risk assessment of the client. In this sense, MiFID makes a distinction between the preferences regarding risk taking and the client's risk profile; provided that the legislation does not explicit the specific meaning of each of them, we associated the 'preferences regarding risk taking' item with all the questions related to the risk and return characteristics of the investments the client is willing to undergo (objective risk), while we interpreted the 'risk profile' item as the one aimed to know the behavior of the client in situations of riskiness and uncertainty (subjective risk)[14]. This way, we are able to make a distinction between the assessment of the objective risk and the evaluation of the subjective aspect of risk.

Results for the descriptive analysis

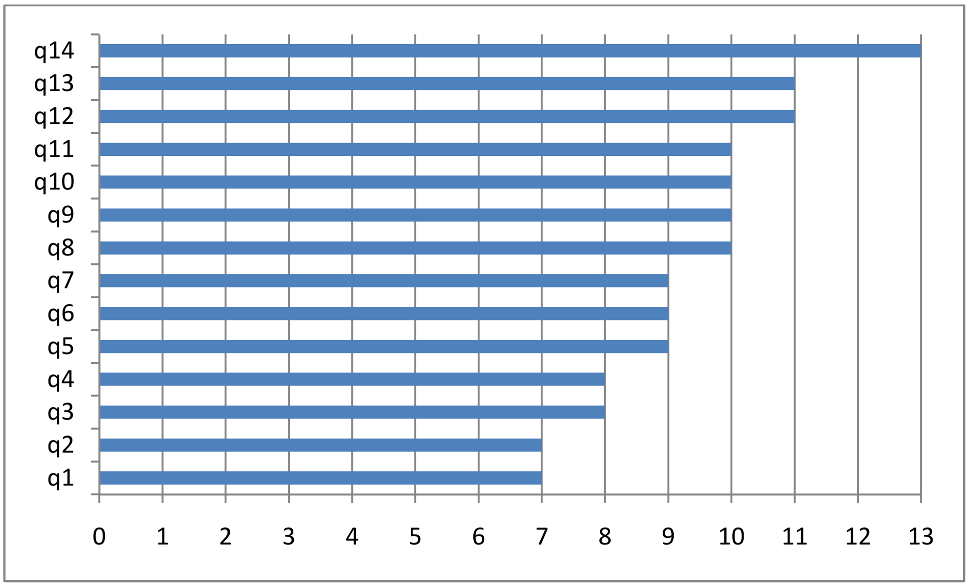
With these premises, we try to analyze how much the 14 questionnaires under study verge on this 'benchmark' suggested by law and if the divergence among questionnaires is significant or not. A first synthesis of our findings is summarized in figure 2.

[13] See the MiFID Level 2 Commission Directive 2006/73/EC, art. 35 and 37.

[14] For the purpose of clarity, we classified questions of the form: *'Which of the following investment results fits better your preferences regarding risk taking? A- A low expected return with a low risk of loss; B- A medium expected return with a limited risk of loss; C- A high expected return accepting a high risk of loss'* as belonging to the 'preferences regarding risk taking' item, whereas questions like *'Suppose that you have made an investment in a long term stock fund. A month after your investment, the value of your fund drops by 15 per cent. What is your reaction? A- I sell my investment in order to avoid further panic if the market continues to go down; B- I try to keep a cool head and I wait until when my investment recoups its value over the planned time horizon; C- I buy some more in order to take advantage of low prices'* as belonging to the 'risk profile' item.

If we evaluate the completeness of the suitability questionnaires in terms of how much they cover the set of items indicated by MiFID, only one questionnaire is complete, as the other ones leave one or even more suggested items uncovered. The largest element of our sample (ten questionnaires) includes a number of items between eight and ten. On the basis of this evidence, it is interesting to further identify what are the items generally covered in our sample and, conversely, what are the areas of questions generally overlooked. From the first point of view, the items covered by all the 14 questionnaires are those related to: the length of time for which the client wishes to hold the investment, preferences regarding risk taking, types of service, transaction and financial instrument with which the client is familiar, the nature, volume and frequency of the client's transactions in financial instruments[15].

Figure 2 Completeness of the suitability questionnaires: number of MiFID suggested items covered*



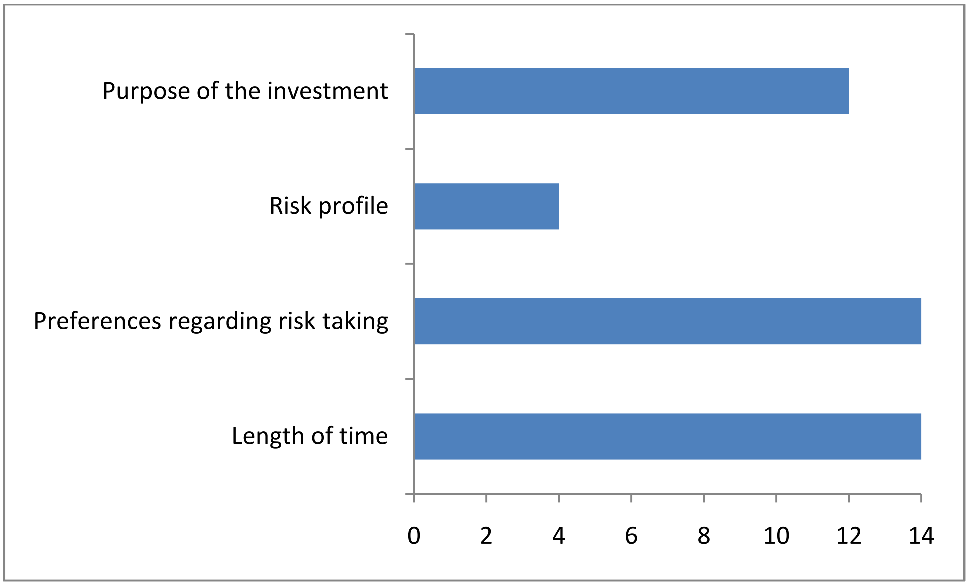
* *(sample: the first 14 Italian financial groups in terms of promoted assets)*

On the contrary, the less investigated areas are those regarding: regular financial commitments (seven questionnaires), the asset composition (six questionnaires), the risk profile (four questionnaires), the period over which past investments have been carried out (one questionnaire). Some intermediaries provide 'extra' questions, not included in the 'benchmark' scheme suggested by MiFID. Nevertheless, generally these questions are introduced for insurance products, in order to be ISVAP compliant, or to acquire information useful for the firm providing the service rather than for the suitability assessment of the client[16]. The only 'extra' question, not suggested by MiFID, but useful to improve the knowledge of the client is the one related to the frequency to which the client brings himself or herself up to date about financial situation; in our sample, two financial firms include this question in their suitability questionnaires.
Shifting the analysis from the general scheme to the single compulsory sections of the questionnaire, we may provide a deeper insight about the specific questions asked and the different approaches followed by each intermediary. In this sense, as regards to the 'investment objectives' section, the approach generally followed by our sample of Italian intermediaries is quite homogeneous (see figure 3).

[15] This finding is coherent with the implementation of L3 that requires a set of controls for the complexity, the risk profile and the liquidity of the products.
[16] For example, some questions are used to discover if all the financial assets of the client are deposited in that financial firm or not.

All the 14 suitability questionnaires under analysis include questions about the time horizon of investments and preferences regarding risk taking; moreover, the majority of questionnaires (85 per cent) ask the client to specify the purpose of the investment he or she is going to realize, in terms of capital conservation, capital growth, or strong capital growth. On the contrary, a generalized behavior in our sample is to disregard questions about the risk profile of the client, as only four questionnaires include this item among the ones investigated. When the risk profile of the client is assessed, the firm asks the client to place himself or herself in a situation of financial risk or of a more common daily uncertainty and to choose the alternative that fits better his or her hypothetical behavior in presence of that risk or uncertainty.

Figure 3 Investment objectives: coverage of MiFID suggested items*

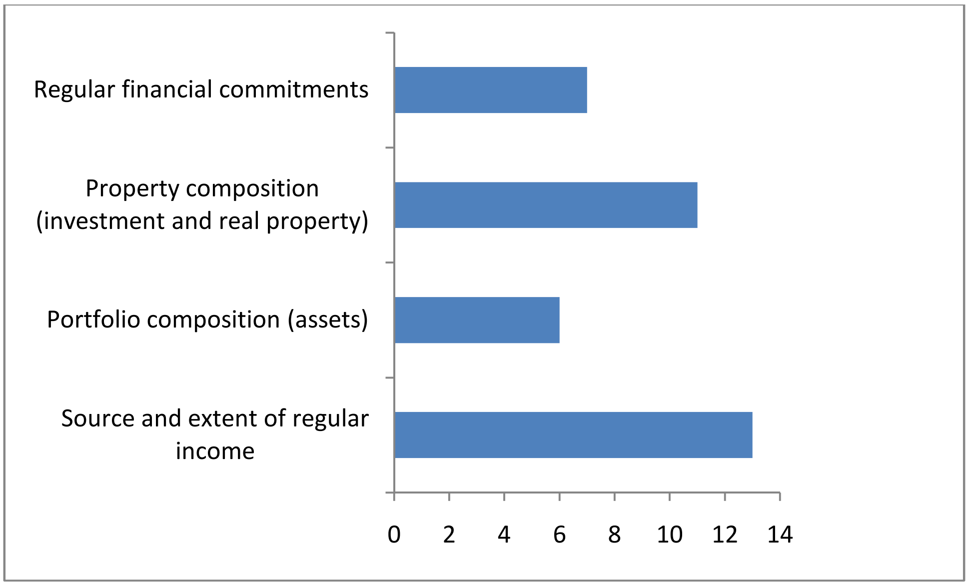


* *(sample: the first 14 Italian financial groups in terms of promoted assets)*

From the perspective of our analysis, this is a critical point: our sample of Italian financial groups seems to take great care on the assessment of the objective financial risk, while less attention is given to the evaluation of the subjective component of risk. In other words, the client is always asked about his or her preferences in respect of the financial risk-return combination of future investments; conversely, the attitude of the client towards a general situation of riskiness or uncertainty is rarely comprised.
Further investigation of the 'financial capacity' section of the suitability questionnaire reveals that more diversified choices are observed among Italian financial groups (see figure 4). There is not an item, among those suggested by MiFID for this section that is covered by all the questionnaires. Nevertheless, the most frequent group of questions is the one related to the source and extent of regular income (13 questionnaires), followed by those questions regarding the overall property composition (11 questionnaires). The items concerning the evaluation of regular financial commitments and the financial portfolio composition are less investigated (respectively, only seven and six questionnaires). From the perspective of our study, this is another point worthy of note: on the one hand, regular financial commitments are a proxy of the risk capacity of an individual (that is how much risk he or she affords to take), as the presence of financial dependents reduces the client's ability to assume risk. On the other hand, the actual financial portfolio composition is another important proxy of the client's risk taking behavior in real life, as it gives information about the

financial decisions assumed in the past by the client. As a consequence, neglecting these two items means also that two important pieces of information in the general assessment of risk are overlooked[17].

Figure 4 Financial capacity: coverage of MiFID suggested items*



* *(sample: the first 14 Italian financial groups in terms of promoted assets)*

Finally, in respect to the 'financial experience and knowledge' section, all the sample collects information about the type of service/products with which the client is familiar and the nature, volume and frequency of the client's transactions in financial instruments (see figure 5).

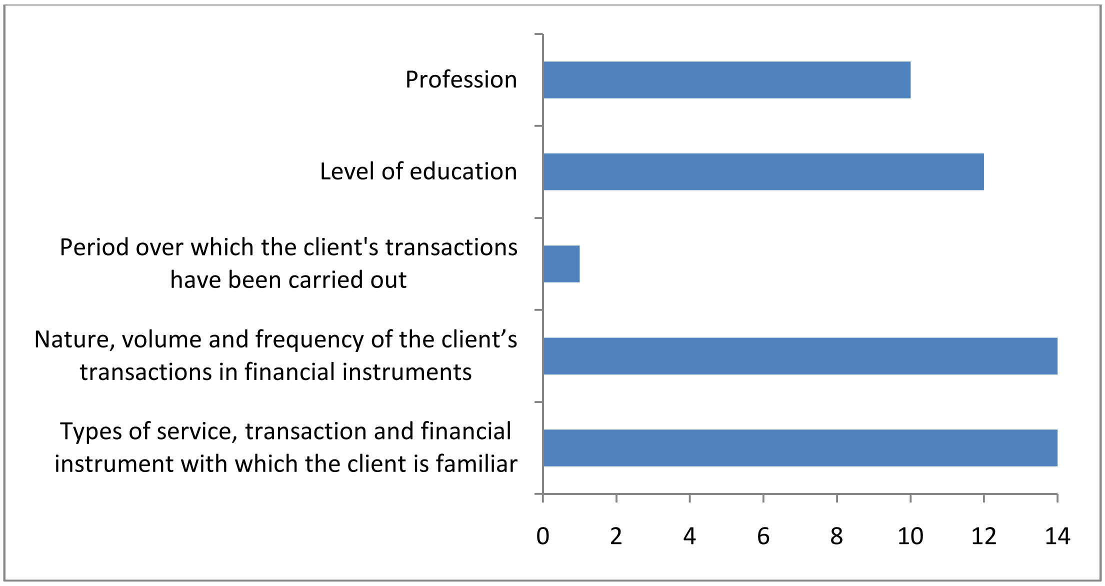
In contrast, almost none of the firms take the period over which past investments are carried out into account (only one questionnaire); respectively 12 and 10 questionnaires include the level of education and the profession among the set of questions to be filled up.

The 14 suitability questionnaires are very different not only with regard to the number of items globally asked and the adherence upon the MiFID 'benchmark', but also concerning the degree of investigation within each item. For example, even though the items of the length of time, preferences regarding risk taking, types of service/instrument with which the client is familiar, the nature/volume/frequency of the client's financial transactions are assessed by all the 14 questionnaires, the number of questions included in each of them varies consistently from one questionnaire to another: some questionnaires provide just one question for investigating each item, whereas other questionnaires are much more analytical and use more than five questions to analyze the same aspect.

In summary, a key finding of our descriptive analysis is that the implementation of the suitability assessment, even though it is recognized as a common MiFID regulatory requirement, is applied in a highly variable manner by our sample of Italian financial firms. The differences that do exist may stem from the fact that supervisors give only general rules for the development of the suitability questionnaire without providing a unique and shared form, in adherence to a prudential regulation approach.

[17] One may observe that each intermediary is able to know the portfolio composition of the client, without explicitly asking him or her, looking at their internal source of information and databases. Nevertheless, if this is true for the assets held at that intermediary, this is not possible for the part of the financial portfolio managed by other intermediaries. As a consequence, an explicit question is needed.

Figure 5 Financial experience and knowledge: coverage of MiFID suggested items*



* *(sample: the first 14 Italian financial groups in terms of promoted assets)*

As a consequence, each intermediary may develop its own suitability questions according to the:

- business model: the propensity to ask some information may vary depending on the kind of business that characterizes each intermediary; the orientation toward a model of commercial banking or a prevalence of the investment business within the financial group, the penetration level in the market of investment services, the development of specific financial services, the diversification and sophistication in the offer of financial products, the characteristics of their prevalent client are all elements that may exert an influence;
- compliance function: the specific questions included in the questionnaire may also depend upon how the compliance function of the firm interprets the regulatory recommendations and the relevance accorded to specific aspects in the application of the law;
- competence level of front-offices: as front-offices are the bridge between the firm and the customer in the implementation of the suitability questionnaire, a different approach in the development of the questions may also depend upon the specific competence of the front-offices in terms of technical advice, ability to built a relationship, and commercial approach to the client;
- a random component, that does not depend upon a strategic or rational motivation by the firm, but just upon erratic occurrences or behavioural biases in the people designed to the development of the questionnaire itself.

However, in spite of different constructions of the questionnaire, some common behaviors amongst our sample of Italian financial groups may be depicted. Specifically, the majority of our sample seems to derive the risk tolerance assessment of the client in a partial way, as recently maintained also by Pan and Statman (2010): while the desirable objective risk-return characteristics of future investments are constantly investigated, the subjective risk profile of the client, as well as his or her past financial investments (risk taken in the real life) and his or her current financial constraints (risk capacity) are elements less frequently requested, even though they all exert an influence upon the suitability of suggested services/products and may work as a control for the chosen risk-return combination. Indeed, it seems that the suitability questionnaire provided by our sample of Italian intermediaries is drawn mainly with the aim of deriving objective parameters for the implementation of traditional asset allocation strategies (such as time horizon, purpose of investment, preferences regarding the objective risk) rather than with the purpose of making a deeper analysis of the subjective characteristics of the clients.

Data and methodology for the empirical analysis

The aim of this empirical analysis is to investigate how reliable MiFID questionnaires are, in terms of the consistency of profiles that come out when different questionnaires are submitted to the same person. To do this, we collect a sample of MiFID questionnaires belonging to three Italian banks[18]. All the three questionnaires are suitability questionnaire addressed to retail clients. For each of them we also collected the scoring method that is used to calculate the profile of the client that fulfils the questions[19]. The three anonymous questionnaires (hereafter A, B and C) are submitted to a sample of 100 potential investors in order to verify the consistency of their profiles[20]. The sample is chosen according to a totally random criterion; we do not face any sampling problems as each person represents a result by himself or herself through the comparison of the three different profiles.

Because each of the three banks provides a different structure of profiles, we are forced to subjectively match them according to the description of each classification that is offered. This way, before comparing the profiles, we make them comparable. In particular, Bank A classifies clients into conservative, balanced and enterprising; Bank B into safety, income, balanced, increase and dynamic and Bank C distinguishes among cautious, moderate and dynamic. Each of the questionnaires provides a detailed explanation of the characteristics that feature each of the profile as shown in tables 4, 5, and 6. The way the profiles are described changes across the questionnaires; questionnaire A and B provide respectively three and five categories and describe in words the main features that investor must have to be included in each profile. On the contrary, questionnaire C provides three risk profiles that are described in terms of the percentage of the capital that should be allocated among liquidity, bonds and stocks for each profile. This way any attempt of matching the profiles requires a high level of subjectivity. Table 7 illustrates how the different profiles are matched across the three banks in the following analysis.

Table 4 Description of profiles for bank A

Profile	Description of profile
Conservative	The portfolio that is suitable for this profile is addressed at realizing a financial supply, without any expectation of capital increase and whose main goal is to allow the management of small expenses. It does not require any particular expertise in investing and is generally linked to a low risk propensity. Suitable products according to this risk profile are liquid assets, government bonds, and financial insurance products with capital protection.
Balanced	The portfolio that is suitable for this profile is addressed at realizing an increase in the invested capital through the acceptance and management of negative oscillations in the value of the capital. It requires a medium expertise in investing and is generally linked to a medium risk propensity. Suitable products according to this risk profile are diversified bond and stock investments and financial insurance products without capital protection.
Enterprising	The portfolio that is suitable for this profile is addressed at realizing a relevant increase in the invested capital through the acceptance and management of huge negative oscillations in the value of the capital. It requires a good expertise in investing and is generally linked to a high risk propensity. Suitable products according to this risk profile are sector stock investments and high-risk bonds and also derivatives.

[18] Names are not revealed for privacy reasons. The questionnaires we employ in this study are different from those we used in the descriptive analysis.

[19] Obtaining the scoring method was quite difficult because of the opposition of banks to reveal this information. This is the reason why we were able to collect only three questionnaires.

[20] This way we submitted 300 questionnaires as a whole.

Table 5 Description of profiles for bank B

Profile	Description of profile
Safety	Capital conservation in the short term and slight increase in the medium term
Income	Capital conservation in the medium term and slight increase in the long term
Balanced	Increase of capital in the medium-long term
Increase	Relevant increase of the capital in the medium-long term
Dynamic	Relevant increase of the capital in the short-medium term

Table 6 Description of profiles for bank C

Profile	Description of profile
Cautious	35% in liquidity; 54% in bonds; 11% in stocks
Moderate	20% in liquidity; 47% in bonds; 11% in stocks
Dynamic	7% in liquidity; 33% in bonds; 68% in stocks

Table 7 Matching of profiles for banks A, B and C

Questionnaire A	Questionnaire B	Questionnaire C
Conservative	Safety + Income	Cautious
Balanced	Balanced	Moderate
Enterprising	Increase + Dynamic	Dynamic

In the experiment, each of the subjects is requested to fulfill all of the three questionnaires. Once completed this step, the three profiles for each subjects are calculated and compared in order to assess their consistency.

Results for the empirical analysis

Table 8 illustrates the results; in particular, it shows the percentage of cases the profiles of single subjects are consistent throughout the sample[21]. The first column from the left informs that in the 77 per cent of cases, the same subject obtains profiles that are different across the three banks. In particular, in the 14 per cent of the cases, the profiles are totally different as they range from the highest to the lowest profile across the three banks for the same subject. Moreover, in the attempt of understanding if a questionnaire causes the inconsistency of the profiles more than the other two; we provide the percentage of inconsistency of profiles for each couple of questionnaires. The analysis shows that the inconsistency is 51 per cent between questionnaires A and B, 60 per cent between A and C and finally is 53 per cent between B and C.

Table 8 Percentage of consistency of profiles across questionnaires

Across all of the 3 questionnaires	Between questionnaires A and B	Between questionnaires A and C	Between questionnaires B and C
23%	49%	40%	47%

In this sense, we cannot maintain that any of the three questionnaires is ‘bad’ because the couples of questionnaires show almost the same degree of inconsistency. More precisely, we should recognize that the questionnaires are strongly different as far as their structures and scoring methods are concerned. First of all, the range of questions that are asked to the client varies from eight in questionnaire A, to sixteen in questionnaire B and nine in questionnaire C as shown in table 9.

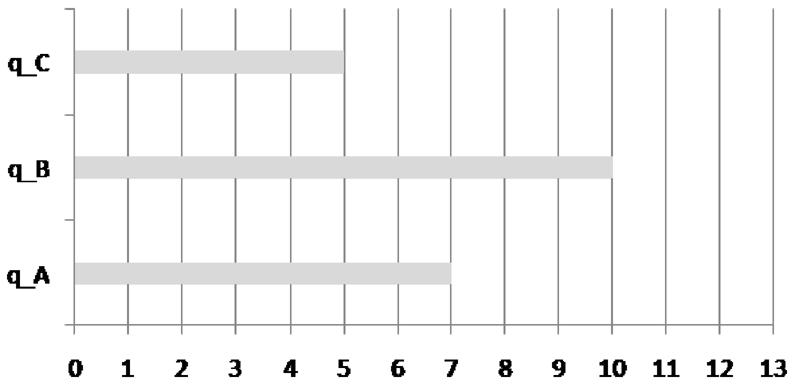
[21] A full description of the results is provided on request.

Table 9 Number of questions in the questionnaires

Questionnaire	Number of questions
q_A	8
q_B	16
q_C	9

This evidence suggests that questionnaire B could be more precise and articulated that the others. Besides, by following the methodology that we already used in the descriptive approach we briefly analyze the contents of the three questionnaires in order to catch any difference that could help explaining the relevant inconsistency of the profiles that a single person obtains when he or she is analyzed by a bank or another. We first investigate the level of compliance to the MiFID suitability provisions in terms of the number of items that are included into the three questionnaires with respect to the 13 that are suggested in the Directive. Figure 6 shows that none of the three questionnaires is perfectly compliant to the number of items suggested (with B covering ten, A covering seven and C only five out of thirteen items).

Figure 6 Number of MiFID suggested items covered



As far as the similarities, the items that are present in all of the three questionnaires are those related to the purpose of the investment (within the 'investment objectives' section), the source and extent of regular income ('financial capacity' section) and the types of services and products the client is familiar with ('financial experience and knowledge' section). This way, at least one of the items belonging to each of the main three sections is present in all of the questionnaires. As a further similarity, the period over which the investments were carried out is absent in all of the questionnaires, as table 10 shows.

Table 10 Similarities in the three questionnaires

Items <u>included</u> in all the 3 questionnaires	Items <u>absent</u> in all the 3 questionnaires
• Purpose of the investment • Source and extent of regular income • Services and products the investor is familiar with	• Period over which the investment was held

The main differences deal with the risk profile and risk preferences together with the level of education and profession. In fact, only questionnaire C investigates the investor's preferences for risk taking and only A includes a question on the risk profile. Moreover, questionnaire B is the only one interested into the level of education and current profession of the subject. All the other items are included by two banks out of three. Table 11 summarizes the main findings in term of differences among the three questionnaires.

Table 11 Difference in the three questionnaires

Items included in one of the 3 questionnaires	Items included in two of the 3 questionnaires
• Preference for risk taking (q_C) • Risk profile (q_A) • Level of education (q_B) • Profession (q_B)	• Length of time of the investment (q_A and q_B) • Assets (q_A and q_B) • Regular financial commitments (q_B and q_C) • Nature, volume and frequency of transactions (q_A and q_B)

This analysis mainly confirms the results we already obtained in the descriptive analysis. In fact, by observing the information provided in tables 10 and 11, all of the three banks seem to be interested the most into the *objective parameters* (purpose of the investment, source and extent of regular income, services and products the client is familiar with, length of time of the desired investment, regular financial commitments, and so on). On the contrary, very little is asked in term of the level of education, profession, risk profile and also on the preferences of the investor about risk taking, as already maintained in Linciano (2010). At the end of the descriptive analysis we already focused the attention on the possible reasons that could explain the huge differences in the contents of the questionnaires and in the scoring methods. The results of this analysis let us maintain that those differences, together with the little attention to the *subjective characteristics* of the client, seem to provide good explanations for the variety and inconsistency of profiles that an investor can obtain by applying to different banks.

Conclusions

The MiFID has formalized the need for financial firms to acquire information about the features and preferences of their clients before selling investment product or services to them. Many firms were already used to this habit but the MiFID has made it compulsory and has recommended the sections and items to be included into the suitability and appropriateness questionnaires. This general recommendation has led financial firms to comply to this obligation by developing or improving the questionnaires on their own; as a result, a multitude of questionnaires is now available to the public of investors, depending on the financial firm they are clients of.

The aim of this paper is to analyze to what degree the questionnaires diverge from each other and if the differences are able to produce any impact on the profiles that investors obtain. To do this we carry out both a descriptive and an empirical analysis on a sample of 17 questionnaires belonging to Italian financial firms (14 for the descriptive analysis and 3 involved in the empirical approach). In the descriptive analysis we demonstrate that questionnaires largely diverge as far as their structure and contents are concerned. More over, Italian suitability questionnaires seem to be developed mainly with the purpose of deriving objective parameters for the implementation of traditional asset allocation strategies rather than with the aim of making a deeper analysis of the subjective characteristics of clients.

The empirical analysis allow us to demonstrate that the differences in the questionnaires may produce dramatic effects on investors: they could be profiled as ‘cautious’ by one financial firm and ‘dynamic’ by another. The differences that do exist may stem from the fact that supervisors give only general rules for the development of the questionnaire without providing a unique and shared form, in adherence to a prudential regulation approach. As a consequence, each intermediary may develop its own suitability questions according to the business model it holds, the conduct of the compliance function in decoding the MiFID provisions, the competence and relationship skills of the front-office employees and so on.

Therefore, a question remains unsolved as far as the opportunity that the European Regulator may impose a standard questionnaire for all of the intermediaries whom the MiFiD is addressed to. It is not clear, at the moment, if the current regulation is the results of a specific choice of the Regulator or, on the contrary, if it depends on a lack of consciousness as far as its effects upon investors is concerned. In fact, the Regulator may have chosen on purpose to suggest general recommendation on the contents of the questionnaires in order to let it adhere as much as possible to the features and needs of each intermediary. Nevertheless, the choice can also be motivated by the unconsciousness about the effects that this independence can produce upon investors. What is clear, at the moment, is the lack of protection that the questionnaire grants to investors. Their profile, from whom the range of products and services that they are allowed to subscribe depends upon, can largely vary according to the intermediary they are profiled by and also by the method that is used by the front-office employees to ask the questions that are included into the questionnaire. Thus far, an intervention from the European regulator could be appropriate in order to review some of the MiFID provisions that currently seem to fail in granting the maximum level of protection to retail investors.

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