



SUPERVISORY AND REGULATORY PAPER: GUIDELINE ON SUITABILITY OF CLIENTS' SECURITIES TRANSACTIONS

**APPLICABLE LEGISLATION: SECURITIES INDUSTRY ACT, 2011
SECURITIES INDUSTRY REGULATIONS, 2012**

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GUIDELINE ON THE DUTY OF REGISTRANTS FOR ASSESSING SUITABILITY OF CLIENTS' SECURITIES TRANSACTIONS PURSUANT TO REGULATION 69 OF THE SECURITIES INDUSTRY REGULATIONS, 2012

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SUITABILITY OBLIGATIONS

1. INTRODUCTION

1.1 The Securities Commission of the Bahamas (the Commission”) is responsible for the administration of the Securities Industry Act, 2011 (“SIA”) and the Securities Industry Regulations, 2012 (“SIR”). The Commission supervises and regulates the activities of the securities and capital markets, investment funds and investment fund administrators.

1.2 Pursuant to s. 154 of the SIA, the Commission is empowered to publish guidelines regarding the application of securities laws or of any regulations or rules made pursuant to securities laws.

1.3 Regulation 69 of the SIR requires a registrant to **“take reasonable steps to ensure that before it makes a recommendation to, or accepts instructions from a client or makes a discretionary purchase or sale of a security on behalf of a client, the proposed purchase or sale is suitable for the client given the client’s financial circumstances, risk tolerance, investment knowledge and investment needs and objectives.”**

1.4 The SIR makes no distinction between categories of clients or the types of services that may be rendered to clients, and therefore would seem to require registrants to apply the same level of assessment in all circumstances. Notwithstanding the generality of Regulation 69, however, the Commission recognises that registrants may have categories of clients who require less protection than others. It is also recognised that the level of investor protection necessary may vary, depending on the services being provided by the registrant. The obligation to assess suitability is general, these guidelines set out what steps a registrant is reasonably expected to take when considering the nature of the client as well as the services being rendered.

2. PURPOSE

Regulation 69 requires a registrant to assess its clients’ investment risk profile by taking into account each clients’ financial circumstances, risk tolerance, investment knowledge, and investment needs and objectives. The purpose of these guidelines is to provide guidance to

registrants for taking reasonable steps, through a risk based approach, to assess suitability of their clients' securities transactions.

3. APPLICABILITY

These guidelines apply to persons registered to carry on securities business pursuant to Part VI of the Securities Industry Act, 2011.

4. DUE DILIGENCE

4.1 Upon opening a new client relationship and thereafter on a periodic basis, or upon a triggering event, registrants must ensure, for the purpose of assessing suitability, that they obtain details pertaining to the financial circumstances, risk tolerance, investment knowledge as well as investment needs and objectives of the client.

4.2 Registrants must adopt policies and procedures to ensure that detailed due diligence as prescribed in 4.1 is collected for each client it services.

4.3 Examples of triggering events include changes in family or financial circumstances, job loss or retirement, inheritance, large purchase or sale of an asset, etc.

5. CLASSIFICATIONS OF CLIENTS

5.1 For the purpose of applying suitability assessment, a registrant may distinguish and classify clients in various categories and thereafter, apply differing standards of assessment for each client category. Acceptable classifications of clients include:

5.1.1 Professional Investors

Clients that fall into the following categories and which are subject to licensing or regulation in The Bahamas or another jurisdiction may be regarded as Professional Investors for the purposes of these guidelines:

- Institutions defined in Regulation 2(1)(a) – (e) of the SIR;
- Pension funds; and
- Other institutional investors which are subject to licensing or regulation in The Bahamas or in another jurisdiction in order to operate in the financial markets.

Registrants seeking to classify a client as a Professional Investor for purposes of these guidelines should obtain evidence that the client is licensed or regulated in The Bahamas or in another jurisdiction to operate in financial markets.

5.1.2 Sophisticated Investors

Non-Professional Investors may be, sophisticated investors for the purposes of these guidelines in that –

- (i) they meet the criteria established in the definition of an “**accredited investor**” in Regulation 2 of the SIR; and
- (ii) they have sufficient knowledge and experience of financial products so as to understand the risks involved in investing in such products.

Registrants seeking to classify a client as a Sophisticated Investor for purposes of these guidelines should obtain written representation or declaration from the client as to –

1. the client’s knowledge and experience in securities and his/her understanding of specific securities and ability to bear the financial risks associated with such products;
2. the client’s being an accredited investor as defined in Regulation 2 of the SIR;
3. the client’s understanding that the effect of his/her designation as a Sophisticated Investor is to waive his/her entitlement to have the suitability of his/her securities transactions assessed in certain circumstances.

Sophisticated Investors should have the opportunity and option to be re-classified as Retail Investors at any time, upon their request to the registrant.

5.1.3 Retail Investors

Clients who do not qualify as either Professional or Sophisticated Investors are regarded as Retail Investors for purposes of these guidelines.

6. CONSIDERATIONS FOR ASSESSMENT OF SUITABILITY

6.1 Discretionary Management

Registrants who offer discretionary management services to clients, whereby the client authorises the registrant to manage his/her securities portfolio based on an investment profile agreed to by the client, will normally make the decisions regarding securities transactions without consultation with the client. In such cases, registrants must thoroughly assess, discuss and agree with the client, all components of suitability, prior to recommending an investment strategy and prior to the client's execution of a discretionary mandate based on an investment strategy agreed to with the registrant.

The registrant must conduct periodic reviews, at a minimum on an annual basis, to ensure that the client's discretionary portfolio is managed in line with the discretionary mandate executed by the client and as such, matches the suitability assessment of the client.

6.2 Advisory Services

An advisory client is one who has contracted the services of the registrant and obtains advice and recommendations from the registrant with respect to specific securities transactions. The registrant may solicit and/or influence the client, in this instance, for the purpose of buying or selling securities.

6.2.1 Advisory Services for Professional and Sophisticated Investors

Given the knowledge and experience of the Professional and Sophisticated Investor and their understanding of the risks associated with securities, registrants are not expected to assess every component of suitability when making a recommendation. When providing advice or recommendations to these categories of clients, registrants are only expected to give consideration to the clients' investment needs and objectives. The status of a client's profile should be reviewed and monitored on a regular basis. The required regularity for monitoring a client's profile should be based on the full assessments of the client's investment knowledge, needs and objective.

6.2.2 Advisory Services for Retail Clients

Registrants providing advisory services to Retail Investors must carry out a complete suitability assessment of the product being recommended, unless there is a reasonable explanation for not conducting the suitability assessment in relation to a specific transaction i.e. the registrant has conducted a like transaction on behalf of the client and there has been no change to the client's profile since the previous transaction was conducted.

6.3 Execution Only Services

An execution only client does not obtain any advice or recommendations from the registrant but has contracted with the registrant solely for brokerage and/or custodial services. Any securities transaction entered into by such clients are purely at the clients' own risk and upon their written or verbal instructions. The clients' instructions with respect to securities transactions are in no way solicited or influenced by the registrant.

Due to the time-sensitive nature of securities transactions and given that a client may not always be contactable, it is accepted that the registrant may not always be able to confirm "unsuitable" instructions prior to the execution of a trade. The registrant, however, must report to the client in a timely fashion, execution of instructions which are not suitable based on the client's investment profile.

6.3.1 Execution-Only Services for Professional and Sophisticated Investors

Given the knowledge and experience of the Professional and Sophisticated Investors and their understanding of the risks associated with securities, a suitability assessment in respect of execution-only services is not expected. Should a registrant have exceptional concerns about an execution only order, the matter should be discussed with the client in a timely manner, but without jeopardizing the execution of the order, and the registrant should satisfy itself of the client's understanding of the order and potential risks.

6.3.2 Execution-Only Services for Retail Investors

When providing execution-only services to Retail Investors, registrants are not generally expected to consider the client's financial circumstances, risk tolerance or investment needs and objectives when assessing suitability. The registrant is, however, expected to consider the Retail Investor's

knowledge and experience of the type of product involved. The timing of this assessment should not jeopardise the execution of the order, provided that additional due diligence requirements, as explained below, have been conducted and a general written warning issued to the client prior to account opening.

6.3.3 Additional Due Diligence Requirements for Execution Only Services

If during the account opening process, while or after conducting the aforementioned suitability due diligence (ref: 4.1), the registrant has some concern about the new client's ability to operate an execution only account and/or to make reasonable investment decisions, the registrant is to take reasonable steps, and must document in writing that they have done so, to warn the client that the execution only service is not suitable for the new client. This written warning, if needed, must take place prior to the opening of the execution only account. The written warning should specify that by engaging execution only services, the new client may lose some protections afforded to him/her under the regulations.

Where the warning is provided but the new client decides to proceed with the execution only service, the account should be opened and subsequent orders accepted upon receipt of the client's validated instructions.

6.4 Clients Managed by External Asset Managers

It is recognised that a registrant may act only as custodian where the discretionary management services are provided by External Asset Managers ("EAM") who are licensed, in The Bahamas or in other jurisdictions, to provide such services professionally. In certain jurisdictions, there may not be a local requirement for an EAM to be licensed in order to provide professional discretionary management services. In such circumstances, the registrant should satisfy itself that the EAM is suitably qualified to provide professional discretionary management services.

Where an agreement exists between the registrant and the client authorizing an EAM to manage the client's portfolio on a discretionary basis, the registrant is not expected to assess suitability on behalf of the client, but may regard the relationship in the same way as execution only services for professional/sophisticated investors.

It would be prudent for the registrant to ensure that adequate contractual terms exist between the registrant and the client releasing the registrant from any duty to advise, explain or warn the client with regard to the management of the assets by the EAM.

6.5 General Considerations to be made by Registrants

A guide to the general considerations to be made by registrants is summarised in the chart below.

	Advisory Services			Execution-only Services		
	Retail Investor	Sophisticated Investor	Professional Investor	Retail Investor	Sophisticated Investor	Professional Investor
Financial circumstances	Yes	No	No	No	No	No
Risk tolerance	Yes	No	No	No	No	No
Investment Knowledge and Experience	Yes	No	No	Yes	No	No
Investment needs and objectives	Yes	Yes	Yes	No	No	No

7. **POLICIES, PROCEDURES, INTERNAL CONTROLS AND REPORTING**

Registrants should have adequate policies, procedures and internal controls to ensure that the minimum standards established by these guidelines are adhered to. These measures include clearly written policies and procedures for the effective gathering of information relating to its clients' financial circumstances, risk tolerance, investment knowledge and investment needs and objectives, where necessary.

Registrants' policies and processes should include provisions for assessing the suitability of proposed securities transactions prior to making a recommendation or executing an instruction from its clients, subject to the considerations provided for in these guidelines.

The policies and procedures should include a system for reporting to clients, on a periodic basis, the suitability of the client's investment activity given the stated investment profile of the client.

Registrants should be capable of clearly explaining to their clients the methodology used in assessing the suitability of clients' securities transactions. Records of suitability assessments, including supporting information, should be kept on each clients' file.

The Commission will, through its on-site inspections programme, consider these guidelines when examining compliance by a registrant with the suitability requirements contained in Securities Laws.