26 April 2022

# EBF RESPONSE TO ESMA CONSULTATION ON THE REVIEW OF MIFID II SUITABILITY GUIDELINES

## General Comments

The EBF welcomes the regulator's objective of ensuring a consistent and harmonized application of the suitability requirements as these are important elements of investor protection rules; thus, we welcome the opportunity to provide our views on the different issues included in the Consultation Paper published by ESMA.

While we welcome the ultimate objective of the European legislators and supervisors of promoting sustainable development, as a general remark, we would like to stress that the new regulation gives rise to a number of inconsistencies, concerns and doubts which we believe will hinder its implementation.

In this regard, we would like to take the opportunity to point out some of these inconsistencies and doubts, especially those where clarifications of the authorities would be welcome in order to ensure a smooth and harmonised implementation of the new regulation in Europe.

## I.- Convenience of aligning the application timelines of different ESG rules

In the first place, we understand that it would be desirable that the integration of sustainability preferences, both in the product governance and advisory processes, was made at the same time. In this regard, given that both Delegated Regulation 2021/1253 and Delegated Directive 2021/1269 pursue the objective of incorporating sustainability factors, preferences and risks into the MIFID 2 framework, we understand that what would make sense is that they apply/are required to apply from the exact same date.

Furthermore, taking into account that: **(i)** the definition of sustainability preferences incorporated in MIFID 2 for the purposes of the suitability assessment refers to Regulation 2020/852, of 18 June, on the establishment of a framework to facilitate sustainable investment (the "**Taxonomy Regulation**") and Regulation 2019/2088, of 27 November, on sustainability-related disclosures in the financial services sector (the "**SFDR Regulation**"); **(ii)** the regulatory technical standards developing SFDR Regulation have been delayed (what also impacts in the Taxonomy framework) and (iii) the PAI integration is only to be launched by end 2022,we understand that it would make sense to postpone the implementation of the sustainability preferences. Otherwise, the misalignment of the application timelines of the aforementioned rules will create great legal uncertainty for investment firms and a huge confusion for their clients. All elements together create a real burden on the implementation with a risk of unintentional green-washing and acting against the interest of the investor. We therefore fully support the European joint industry proposal to postpone the implementation of MiFID II delegated act until 1 July 2023.[1] If this would not be agreeable by the EC, we would like to raise the question of the timing of the guidelines. The implementation has already started while the level 3 is still in progress. In this context, we would also call for more flexibility from the NCA regarding supervision of implementation

In addition, with respect to ESMA's guidelines, we would like to stress that firms will need sufficient time and clarity to adapt their processes to the final set of guidance adopted. Therefore, we believe that ESMA should allow for a sufficient broad implementation period following the publication of the final guidelines or -a more phased-in inclusion of sustainability preferences, taking into account the expected data flow (disclosures in the framework of article 8 Taxonomy Regulation, upcoming CSRD, SFDR RTS) and with a focus on information rather than on very granularly defined sustainability preferences.

This way clients would become more aware and educated on ESG (both positive impact as well as adverse impacts), become familiar with the evolving offer of sustainable products (due to increase in reliable data, finetuning of methodologies and manufacturing of products around principal adverse impacts). Clients could be accompanied during the time that the market is being further developed, without driving them away by directly asking him complicated, granular questions, without there being a sufficiently developed offer behind.

**II.- Lack of clarity with respect to certain requirements**

Delegated Regulation 2021/1253 seems to adopt a "one-size fits all" approach and, therefore, does not take into account the different nature and characteristics of certain financial instruments which are not under the scope of SFDR and Taxonomy Regulations. In its consultation paper ESMA recognises the different product scope of MiFID II, the SFDR and the Taxonomy Regulation, however it states that *the definition of "sustainability preferences" "ensures that financial instruments with sustainability-related features are eligible for recommendation to the clients or potential clients who express sustainability preferences*".

We do not share ESMA's view in this regard: we believe that since the scope of both aforementioned regulations is different to MIFID's scope ("*financial products"* vs. "*financial instruments*"), it becomes highly difficult or even impossible to meet the definition of sustainable investment (which is relevant for determining the client's sustainability preferences) in respect to certain MIFID 2 financial instruments. For example, amongst others, this would be the case of derivative instruments concluded for hedging purposes. It is not clear how these instruments would fit within the new regulation as, due to its particular features, **(1)** in practice it would be difficult to meet the definition of sustainability preferences (the definition of sustainability preferences would generally require investing in some way in sustainable activities; a requirement that would be difficult to meet in most of financial derivatives); and **(2)** when the client's main objective is to hedge its financial risks,

[1] Actions to support the transition of the financial sector and deferral of the MiFID II and IDD DAs.pdf

sustainable preferences would, in principle, have little relevance considering also that they cannot be measured. In order to create legal certainty, hedging derivatives should be explicitly excluded from the scope. Other examples are represented by: i) green bonds as they are not currently aligned with environmentally sustainable investments as defined in Article 2, point (1), of Regulation (EU) 2020/852 being required to apply different technical criteria set by Climate Bonds Initiative and ICMA; ii) government bonds as they are excluded from the Taxonomy; iii) equities as currently only large companies are required to provide the NFR during 2023 and, in this context, to provide the portion of their activities which are Taxonomy-aligned. Finally, the regulation on the preferences foresees a flexibility (ability to change the preference at transactional level) that is unknown as such in MiFIDII. However, based on a consolidated reading of the new texts, not-answering the preference question could lead to not render a service to the client (see article 54, §8 Del Reg 2017/565).

### III Greater flexibility

In addition, regarding ESMA's Consultation Paper, **we believe that ESMA's suggested approach is excessively complex**. As explained above, Delegated Regulation 1253/2021 already introduces great complexity in order to integrate sustainability preferences in the advisory process (complex legal definitions cross-referenced to Taxonomy and SFDR concepts; lack of clarity in respect of certain types of financial instruments, problems of data availability on the expected implementation timeline, etc.). With this background in mind, we believe that ESMA's approach should try to simplify a regime that is too complex in origin, especially from an investor/client perspective and to allow for more flexibility.

As a general remark, we would like to express our concern that some of the measures and examples included in the draft guidelines go beyond their initial purpose (i.e., to enhance clarity in the application of certain aspects of the suitability requirements and, in particular, in the integration of sustainability preferences) and introduce new requirements on firms. For example, on PASI criteria, the Guidelines refers on „qualitative AND quantitative "criteria while in the Regulation, it is „OR ".

Finally, the new rules on sustainability preferences will have a big impact not only on investment firms subject to MiFID, but also on manufacturers of financial instruments (e.g. companies and asset managers) that will need to provide large amount of data that is needed in order for investment firms to fulfil their requirements. EBF welcomes European-wide industry initiatives such as FinDatEx EET template[2] which we hope will facilitate transfer of necessary data between certain types of producers and distributors across EU.

**Q1. Do you agree with the suggested approach on the information to clients about the purpose of the suitability assessment and its scope? Please also state the reasons for your answer.**

We agree in principle with the proposed approach of bringing the concept of sustainability preferences closer to the investor in an understandable way.
However, precisely with a view to promoting the greatest possible clarity in communications to clients, we do not agree with the approach proposed by the draft guideline 1, paragraph 16, according to which investment firms are required to explain to the client the concept of "sustainability preferences" necessarily referring to the three types of financial instruments (letters a, b and c) listed in Article 2, point 7, of the Delegated Regulation (EU) 2017/565.
This is because:

- the definition of the three categories of financial instruments is strictly technical and contains references to various regulatory sources and to qualitative and quantitative parameters that cannot be illustrated to the client in a simple and understandable way;
- it is currently impossible for investment firms to correctly identify many of the financial instruments falling into the three categories

We therefore ask to ESMA to take into consideration also the possibility to provide clients with more generic information on the concept of “sustainability preferences” not bound to the three letters a) to c).
In any case, the request to avoid technical terms ("technical language") requires a restriction. Due to the different objectives of the SFDR, the Taxonomy Regulation and the DVO 2017/565, it may be necessary to use technical terms in order to provide a sufficiently clear description. Therefore, the statement on the avoidance of technical terms which is also implicit in the draft guideline 11, paragraph 104, regarding the qualifications of firm’s staff (see Q.18 below), should be limited to those situations where this is possible.

In the Sustainable Finance Roadmap 2022-2024 dated 10 February 2022[3] ESMA has stated: “….. Investor education also plays a role in making sure that product offerings related to ESG investing can be properly understood, for example in relation to the sustainability impact of different investment strategies put in place to integrate ESG factors. It is worth noting that investor education is important also beyond investment services, for example in the area of asset management too. We agree with this statement by ESMA and think that banks/investment firms should be willing to contribute their fair share to investor education. However, it is important to realize that it is also being part of the role and responsibilities of the public sector and the NCA’s to contribute to investor education.
As part of educating (potential) clients, firms should be allowed to explain to the client what a reasonable expectation of sustainability preferences is based on the availability of products in the market, without risking being liable for having steered client preferences. For example, firms could indicate what the average level of taxonomy alignment is in each product class

[3] ESMA30-379-1051, p. 12 sub b,

and the implications for financial risk and liquidity. This explanation could be supported with data.

**Q2. Do you agree with the new supporting guideline in relation to the information to clients on the concept of sustainability preference or do you believe that the information requirement should be expanded further? Please also state the reasons for your answer.**

First of all, we would like to point out that we welcome the marginal number 26, fifth bullet but we think that it should be extended taking into account digital flow (non client-facing situations). However, in our opinion, the information to be provided is excessively broad and complex. We question whether clients are actually willing to receive all such information. In fact, regular clients will not be familiar with the Taxonomy and SFDR regulations and they may just be willing to express their preferences for sustainable investments more generally.

In addition, requiring firms to explain the term and distinction of the different elements of the definition of sustainability preferences would mean, in practice, that firms are obliged to explain concepts which are still unclear (clarification of important aspects related therewith, such as “sustainable investments”, “taxonomy” or “principal adverse impacts”, is still pending) and without necessarily being able to offer products that fit within each of the categories a) to c) of the definition of sustainability preferences. In this regard, paragraph 34 of the Consultation Paper recognizes that firms may not have any financial instruments included in their product range that would meet the definition of sustainability preferences, thus, it could also happen that firms have financial instruments that only fit in one of the categories of paragraphs a) to c) of the definition of sustainability preferences. In these cases, we understand that informing the client about the different concepts and categories within the definition of sustainability preferences would not make much sense: it would be more useful for clients to be informed from the very beginning about the unavailability of products that may meet their sustainability preferences or to focus the explanations only in the category/categories for which the firm has products.

We therefore believe that the survey on the client’s sustainability preferences could be conducted in a simple and easily understandable way, using a qualitative logic, leaving to the pre-contractual information the task to provide the client with information on the sustainable characteristics of the recommended financial instrument.

Finally, in line with the proportionality principle that guides MIFID 2, we believe it is essential to differentiate between categories of clients and adapt any information requirements, as professional clients may already have more knowledge (or at least better access to knowledge) about sustainable finance than retail clients.

In view of the above, we believe that with the new proposals, the suitability assessment could become excessively complicated and burdensome without a clear benefit for clients. If the suggested approach was finally implemented as it currently is, we suggest including this issue as a "best practice" and not as a guideline.. Institutions will be obliged to train clients, which goes beyond the regulatory obligations of establishments, but they can only do so with a phased in approach.

MiFID II general principles require investment firms – when providing information - to make sure "clients or potential clients are reasonably able to understand the nature and risks of the investment service and of the specific type of financial instrument that is being offered and, consequently, to take investment decisions on an informed basis". However, the recent investor protection framework revisions on sustainability preferences (see Delegated Regulation (UE) 2021/1253, Delegated Directive (UE) 2021/1269 and Delegated Regulation 2021/1257 as well as these draft ESMA Guidelines) are deemed to be overly complex and technical to allow an average client to fully understand all sustainability concepts.

**Q3. Do you agree with the suggested approach on the arrangements necessary to understand clients and specifically with how the guideline has been updated to take into account of the clients' sustainability preferences? Please also state the reasons for your answer. Are there other alternative approaches, beyond the one suggested in guideline 2, that you consider compliant with the MiFID II requirements and that ESMA should consider? Please provide examples and details.**

According to draft Guideline 2, paragraph 25, the identification of client's sustainability preferences shall be made at a "sufficiently granular" level for all investment advice and portfolio management. However, it should be noted that when the delegated regulation starts to apply there will be a very limited number of available financial instruments that match any of the three categories of preferences. The draft Guidelines suggest that firms nevertheless need to explain the different categories and ask clients if they are interested in such products without having any products to offer.

In fact, even in the future where we hope that more data regarding financial instruments will be available, it must be recognized that product ranges of investment firms can still be limited and it will probably not be uncommon that only one product will be suitable to be recommended to the client after the first part of the suitability assessment has been made (i.e., knowledge and experience, financial situation, and investment objectives position).

It should be noted that for some investment services, it is clear from the outstart that sustainability considerations are not relevant at all. For example, when a client receives advice on investments in FX or interest rate derivatives for hedging purposes. For such products, it is not reasonable to require that the investment firm and client may go through the whole process of providing and collecting detailed information on sustainability preferences. Instead, a simplified procedure should allow the firm to inform the client beforehand that sustainability considerations are not relevant for the type of service in question.

As mentioned in Q 2, the Guidelines should allow firms flexibility as regards differentiating between different types of clients when providing the information as retail clients typically have other needs than professional investors such as pension funds and asset managers.

**Q4. Do you believe that further guidance is needed to clarify how firms should assess clients' sustainability preferences?**

At this stage, further guidance is not necessary. The sustainability preferences of the clients will initially very likely encounter a limited range of financial instruments.

Under draft guideline 2, paragraph 25, given that: (a) the financial products subject to Regulation (EU) 2019/2088 ("SFDR") does not comprise all existing typologies of financial instruments; (b) the definition of "sustainability preferences" only covers investment in environmentally sustainable investments under Regulation (EU) 2020/852 ("Taxonomy") and, currently, there are no taxonomy rules on social aspects nor technical criteria for all environmental objectives have been published;, this may overly restrict the range of products that may observe the client's sustainability preferences. This could imply that the client may be exposed to higher liquidity, concentration or other risks or may have to bear higher costs in their investment due to the observance of their sustainability preferences, which may be contrary to their interests.

Furthermore, such circumstances may compromise the provision of the advisory service, overweighting recommendations on product types for which information on sustainability attributes is available to the detriment of other product types that may be suitable for the client.
In our view, the date of application of MiFID II DVO 2017/565 on 2 August 2022 is a cause for concern. At this point in time, much information, in particular that of the SFDR DVO (RTS), will not yet be available, so implementation will only be based on the interpretations of the SFDR. In addition, the technical implementation needs a corresponding lead time. We therefore welcome the initiative at European level to postpone the date of application to 01.07.2023.

Under draft Guideline 2, paragraph 26, second bullet, it is stated that firms could collect information on whether the client's sustainability preferences with regard to b) and c) have a focus on either environmental, social or governance criteria or a combination of them. Sustainable investments under 2(17) SFDR is however defined as either an investment contributing to an environmental objective or a social objective. Good governance is a prerequisite for being a sustainable investment but is not an objective in itself. For the avoidance of doubt, this should be confirmed by ESMA in the final report. Moreover, as governance is "built-in "into Taxonomy-alignment and Sustainable instruments, questions about governance have no real added value and can be misleading for an investor.

Therefore, we do not agree with the proposal that distributor should also collect information on whether the client's sustainability preferences with regard to b) and c) have a focus on either environmental, social or governance criteria or a combination of them or whether the client does not have such a focus. Taking into account the nature of ESG factors it needs to underlined that those factors are interconnected and dividing them into separated categories could be impossible and pointless.

Under draft Guideline 2, paragraph 26, fourth bullet, it is stated that when collecting client's preferences linked to alternative c) PAI, information shall be collected regarding qualitative **and** quantitative elements. However, article 2(7) c Delegated Regulation (EU) 2017/565 states that information must be collected regarding qualitative **or** quantitative elements. The EBF proposes that the guidelines are aligned with text of the delegated regulation.

We also note in the same bullet point, there is a reference to draft SFDR RTS as regards PAI. We do not oppose this per se. However, since there is no reference to SFDR in article 2(7) c, also other ways could be used to demonstrate PAI. For the avoidance of doubt this should be confirmed by ESMA in the final report.

**Q5. Where clients have expressed preference for more than one of the three categories of products referred to in letters a), b) or c) of the definition of Article 2(7) of the MiFID II Delegated Regulation, do you think that the Guidelines should provide additional guidance about what is precisely expected from advisors when investigating and prioritizing these simultaneous / overlapping preferences?**

No, we are of the opinion that the previous instructions are sufficient.

Only a clarification would be desirable: this is that the query of the preferences according to a) to c) is a so-called "or" link, i.e. the client who defines and selects several preferences as sustainable can be offered financial instruments that fulfil only one of the selected preferences (see also the wording of Art. 2 para. 7 MiFID II Regulation 2017/565 - "[...] to what extent, one or more of the following financial instruments shall be integrated into his or her investment").
In particular, it should be rejected that the client, who specifies several categories, has to be consulted with regard to a prioritisation of the categories. This would unnecessarily complicate the process.

**Q6. Do you agree with the proposed approach with regard to the assessment of ESG preferences in the case of portfolio approach? Are there alternative approaches that ESMA should consider? Please provide possible examples.**

We believe that it is necessary to adjust paragraph 27 of the draft Guidelines in order to allow for:

- Greater flexibility regarding the way in which to consider and refer to the client's portfolio. Referring to Article 2, point (7), of the Delegated EU Regulation 2017/565, it should be possible to set the "measure" or "degree" of the sustainability of investments in relation to the client's preferences as: (i) the "sustainable" portion of the portfolio invested in one or more instruments with certain characteristics, or alternatively; (ii) the level of sustainability of the entire portfolio;
- A suitability assessment performed at the portfolio level, carried out taking into account the impact that the single"ESG scorings / ratings" of the financial instrument (ESG financial instrument score) produce on the overall value of the ESG portfolio scoringse (ESG portfolio scoringse) or of its sustainable portion, set as the weighted

average of all ESG scoring / rating values of the financial instruments making up the portfolio / or its sustainable portion.

- Considering paragraph 27 (properly adjusted according to our request) as an alternative to the previous paragraphs 25 and 26.

We also believe that, in order to identify the financial instruments capable of satisfying the sustainability preferences expressed by clients, investment firms can measure the level of sustainability of all financial instruments by adopting an "ESG rating / scoring" provided by the main info-providers / rating agencies or based on proprietary metrics. In this regard, it is in fact important to bear in mind that:

- The "ESG scorings/ratings" represent from the methodology point of view the best practice in use by financial industry (primarily asset manager, issuers, banks distributors…) on the ESG topics;
- The "ESG scorings / ratings" provided by the main info-providers are currently the only tools available for investment firms to map both the degree of sustainability-related ambitions / expectation of the financial products falling within the SFDR / Taxonomy scope, and the other financial instruments falling within the scope of MiFID II (e.g. shares, bonds, certificates etc ...) that must be classified according to the sustainability factors, as explicitly required by the amendments to the Delegated Regulation (EU) 2017/565 and recalled by point 15 of the Background section of the ESMA consultation paper;
- Investment firms are already using "ESG ratings / scorings" provided by the main info-providers or are developing proprietary metrics based on the use of one or more of the aforementioned "ESG rating / scoring" and on their possible integration with internal methodologies and / or provided by specialized companies in order to take into additional information (for example those provided by issuers on the sustainable characteristics of the products they issue, which reflect the specific metrics adopted by individual issuers), whose final outcome also reflects and takes into account the characteristics and aspects of sustainability as defined by the new Article 2, point 7, of the Delegated Regulation (EU) 2017/565;
- Sustainability factors are dynamic quantities that change over time and that require a numerical and granular valuation approach, in order to intercept the lesser or greater sensitivity of an issuer, and the related financial instruments issued, the management of these factors with respect to the issue of sustainability, as it is already the case today for other risk factors (such as market risk, typically measured using VaR methods; credit risk, typically measured using expected / unexpected loss methods; liquidity risk); At the level of the guidelines, we would also like to highlight the issue of risk, as investments based on ESG criteria involve additional risks (e.g. limited portfolio diversification). This topic should be presented to the clients, apart from the undoubted advantages and features of these forms of investing. This issue could also be raised in the text of the guidelines.

**Q7. Do you agree with the suggested approach on the topic of 'updating client information'? Please also state the reasons for your answer.**

We agree with the proposal to adopt a gradual approach by proceeding with the acquisition of "ESG preferences" during the periodic re-profiling of the clients and according to the internal rules that each investment firm has adopted. It properly leaves room for a transitional period in order to collect the new information. This is aligned with Recital 4 of the Delegated Regulation 2021/1253.

It is less clear the reason why ESMA has introduced an additional moment (**or during the first meeting with the client/the first investment advice following the entry into-application** of Commission Delegated Regulation 2021/1253.") and whichever comes first. In that case ESMA would introduce a requirement that can't be based upon MiFID and will be additionally burdensome for investment firms.
It is also unclear what the "first meeting" with a client is. Financial institutions could be in contact with their clients for several reasons, which are not necessarily related to a client's investment profile. Further, the guidelines do not seem to take into account that an advisory contract could have several account holders that are not necessarily all present at the moment of the advice/first meeting.
Referring to the first investment, advice is technically complicated in case of a digitalized flow. Moreover, as the first meeting with the client or the next advice may already take place on August 3, it would be appropriate to provide for a "transit period" as such of 1 year and to align it with the regulatory text to link it at the next annual update.

**Q8. Do you agree with the suggested approach with regards to the arrangements necessary to understand investment products? Please also state the reasons for your answer.**

We support the proposed approach.
The additions in subparagraphs 70 and 71 are appropriate, as the existing system of product governance is retained and the possibility of forming groups of financial instruments is also created for investment preferences.

In general, we do agree with the suggested approach, however the mismatch in the timing of the regulation is also an issue. Draft guideline 7, paragraphs 70 and 71 mention the link with product governance obligations, which will only come into practice later this year.

While we agree with the approach of ranking and grouping the financial instruments, we do want to point out again that because of the lack of available reliable data the chances of incorrect ranking and grouping are actually quite high, resulting in possible misselling and unintended greenwashing. Therefore, ESMA's guidelines should consider the possibility that certain information on the sustainability factors listed in this Supplementary Guideline may not be available or should at least allow to work using an estimate or an assumption (internal criteria) that can be deduced based on public information. This is another argument to consider delaying the introduction of the MiFID II amendments to a later point in time.

In addition, we propose that the ranking of the products can be made through the "ESG scoring/rating" of each financial instrument assigned by the main data-providers, as better explained in our previous Q6 answer.

Besides as mentioned under general comments, it will take time and resources to get the information out in the organization, make necessary IT-adaptations and educate staff in order for them to handle the information in meetings with clients. Considering that we do not yet have final rules (e.g. SFDR level 2 and ESMA guidelines, product governance rules) and that there still are so many legal uncertainties how the rules should be interpreted, it will be almost impossible to have everything in place by 2 August 2022 and there will be need for additional work and adjustments during the years to come. It is important that both ESMA and NCAs recognise the enormous challenges that industry face implementing these rules and take a flexible approach in their forthcoming supervisory activities.

**Q9. Do you believe that further guidance is needed to clarify how firms should take into consideration the investment products' sustainability factors as part of their policies and procedures? Please also state the reason for your answer.**

No, another detailed guideline is not needed in our view.
As a general comment, implementation will be challenging as the product governance rules will become applicable after the rules on suitability and we do not know which data about financial instruments that will be available.

**Q10. Do you agree with the additional guidance provided regarding the arrangements necessary to ensure the suitability of an investment concerning the client's sustainability preferences? Please also state the reasons for your answer.**

We fully agree with ESMA's proposal in draft guideline 8, paragraph 79 in order to clarify that sustainability preferences should only be addressed once the suitability has been assessed in accordance with the criteria of knowledge and experience, financial situation and other investment objectives (Traditional Criteria). This is fully in line with the spirit of Delegated Regulation 1253/2021, specifically with recital 5 that clarifies that *"investment firms providing investment advice should first assess a client's or potential client's other investment objectives, time horizon and individual circumstances, before asking for his or her potential sustainability preferences*".

Given this two layer approach, we are over the view that the sustainability preferences should not be fully integrated in the suitability assessment process whereby a financial instrument is only suitable when both the 'traditional' criteria as well as the 'sustainability preferences' are met. Financial instruments are 'suitable' for a client once all the traditional criteria are met. Separate reference (in general in the same suitability report) should be made to the sustainability preferences, if any, that are (not) met. This is in line with the explanatory memorandum stating that "financial instruments can still be recommended within the suitability test, but not as financial instruments meeting individual sustainability preferences" and makes the different status (deviation from the profile possible for sustainability preferences vs no deviation possible) clear for a client.

However, we underline that it should also be possible to perform the suitability assessment based on portfolio level (ESG instrument score which is assessed and matched with the average ESG portfolio score or the ESG score of the sustainable portion of the portfolio), as an alternative to the assessment based on the instrument level, as better explained in our previous Q6 answer.

**Q11. Do you agree with the approach outlined with regards to the situation where the firm can recommend a product that does not meet the client's preferences once the client has adapted such preferences? Do you believe that the guideline should be more detailed? Please also state the reasons for your answer.**

We do not agree.

Article 54 (10) and Recital 8 of the Delegated Regulation (EU) 2017/565 state that the client "can" (and not "must") decide to adapt his sustainability preferences. In other words, the adaptation is a possibility, but not an obligation.

In our view it is only important that the firm does not present the financial instrument as meeting the individual sustainability preferences, in order to prevent and avoid a greenwashing practice (as specified also in the Recital 7). And for reaching this objective, it is necessary a specific information in the suitability report to explain this situation, while it is not required a mandatory adaptation of the client's sustainability preferences.

Having said that, we underline that if firms works with a portfolio approach, the client would not find himself in the circumstance of having to adapt his sustainability preferences if a specific instrument does not fall into categories a), b) and c) or it has a low ESG rating/score under the condition that the ESG portfolio scoring/ESG scoring of the sustainable portion of the portfolio remains consistent with the ESG ambition expressed by the client.

In the case of portfolio-based advice, the recommendation should be understood to be in line with the client's sustainability preferences if the proposed investment, considered in the context of the portfolio as a whole, is in line with these preferences, even if the recommendation includes specific products that, individually, do not comply with the sustainability preferences. In such a case, it is not necessary to inform the client that the recommendation is not adapted to his or her sustainability preferences, nor is it necessary to offer the client the possibility of adapting his or her sustainability preferences for future investments.

In our view, this approach needs to be simplified in case of investment advice on single products (and not portfolio approach). In particular firms should be allowed to recommend the product just informing client that the product recommended does not meet client's sustainability preferences, but it is anyway suitable for the investor (see also point 79 stating that "sustainability preferences should be addressed only once that suitability has been assessed with criteria of knowledge and experience, financial situations, and other investment objectives”). After having informed the client, then client can execute the deal on the recommended product or adapt his/her sustainability preferences in order to be recommended with another suitable product. This approach should also be applicable when investment firm - after having assessed the suitability in accordance with knowledge, experience, financial situation, investment objective - does not have any financial instruments included in its product range meeting any sustainability preferences; otherwise, even if client adapts his/her sustainability preferences, no products will be available for recommendation.

Finally, as regards the provision of information to professional clients (per se and upon request) on the lack of suitability of the recommended instruments to their sustainability preferences or, as the case may be, on the possibility of adapting their sustainability preferences, it should be borne in mind that, in accordance with the new art. 29a(2) of Directive 2014/65/EU (as amended by Directive (EU) 2021/338), the obligations to provide a suitability statement (recommendation) specifying the advice provided and how this advice matches the client's preferences, objectives and other characteristics, would NOT apply in case of professional clients (both per se, and upon request): "The requirements set out in the third subparagraph of Article 25(2) and in Article 25(6) shall not apply to services provided to professional clients unless they inform the investment firm in electronic or paper format that they wish to benefit from the rights provided for in those provisions

**Q12. Do you agree with the approach outlined with regards to the situation where the client makes use of the possibility to adapt the sustainability preferences? Please also state the reasons for your answer.**

The question of adaptation cannot be analyzed in isolation but is closely linked to the process of matching available products with the clients’ sustainability preferences (see Q 10 – 11).

We are concerned with the statement in draft guideline 8, paragraph 81 stating that the possibility to adapt “*should not be standard procedure”.*

Although we have sympathy for the policy objective of this statement (which we understand to be avoidance of mis-selling and greenwashing) it is important to consider the practical reality: **there will be a very limited number of sustainable financial instruments available on the market, in particular that meet article 2(7) a and b.** This will not only be the case between 2 August 2022 and 1 January 2023 but probably for a few years to come. If a client is not able to amend its preferences to fit with this the market situation and the investment firms offering, he or she will not be able to invest in any financial instruments. Of course, this is not a desirable outcome.

Moreover, we would like to underline that it is the client that takes the decision to adapt or not and that since the level 2 rules allow this, firms are not in the position to refuse - even if it should happen often. The need to adapt will depend on the market situation and investment firms’ product offering which will be develop over time.

Furthermore, it should be borne in mind that for DPM/advice with a portfolio approach, the client will define the preferences before signing the contract. If the outcome thereof does not match the offering, institutions should be able to open the dialogue with the client in order to align preferences and the offering (logged and based on transparent information).

Based on the above, we propose that the statement in point 81 is deleted. The requirement of documentation in the suitability report of a client's adaptation should however be kept.

Moreover, it should be clarified in the Guidelines that advice given on products which deviate from the originally expressed sustainability preferences must of course be suitable for the client in accordance with stage 1 and is only a possibility not an obligation.

**Q13. Could you share views on operational approaches a firm could use when it does not have any financial instruments included in its product range that would meet the client's sustainability preferences (i.e. for the adaptation of client's preferences with respect to the suitability assessment in question/to the particular transaction and to inform the client of such situation in the suitability report)?**

Please also note that for some investment services, it is clear from the outstart that sustainability considerations are not relevant at all. For example, when a professional client receives advice on investments in FX or interest rate derivatives for hedging purposes. For such services, it is not reasonable to require that the investment firm and client go through the whole process of providing and collecting detailed information on sustainability preferences. Instead, a simplified procedure should allow the firm to inform the client beforehand that sustainability considerations are not relevant for the type of service in question.

Please also see our response to Q10 to Q13.

**Q14. Do you agree with the proposed approach for firms to be adopted in the case where a client does not express sustainability preferences, or do you believe that the supporting guideline should be more prescriptive? Please also state the reasons for your answer.**

We welcome the approach of being able to recommend sustainable products to customers without a sustainability preference. We do not consider any further explanation necessary.

Having said that, in accordance with the new wording of Art. 54. 12 of Delegated Regulation (EU) 2017/565 (as amended by Delegated Regulation (EU) 2021/1253), the institution must inform the client when the recommended product is not in line with the client's sustainability preferences: "When providing investment advice, investment firms shall provide the retail client with a report that includes a summary of the advice provided and explains the reasons why the recommendation is suitable for that client, including how the recommendation meets the client's investment objectives and personal circumstances with reference to the investment time horizon required, the client's knowledge and experience, attitude to risk, ability to bear losses and sustainability preferences (. ..)".

If the recommendation is in line with the client's sustainability preferences because the client does not have sustainability preferences, the applicable regulation only requires that the client should be informed of how the recommendation meets his preferences, but does not require information on the sustainability features of the products, as it seems to be required in draft guideline 8, paragraph 83.

In this sense, it should be sufficient to make available to the customer the corresponding pre-contractual information of the recommended products, which contains the appropriate information on sustainability required by the applicable regulations.

**Q15. Do you agree with the proposed approach with regard to the possibility for clients to adapt their sustainability preferences in the case of portfolio approach? Do you envisage any other feasible alternative approaches? Please provide some possible examples.**

When investment firms adopt a portfolio approach the client would not find himself having to adapt the sustainability preferences on the occasion of each single transaction / proposal See our previous Q11, Q13 and Q14 answers.

**Q16. What measures do you believe that firms should implement to monitor situations where there is a significant occurrence of clients adapting their sustainability preferences? What type of initiatives do you envisage could be undertaken to address any issues detected as a result of this monitoring activity?**

Regarding potential adaptations of sustainability preferences, we understand that as long as the firm is transparent with the client and provides the necessary information in a clear manner, the fact that clients adapt their sustainability preferences in a relatively frequent manner should not be considered problematic. Thus, we believe that this will be quite common, especially in the short term, as the availability of financial instruments with sustainability features may be initially limited and the introduction of these financial instruments in the firm's product scope might be gradual (as ESMA recognised in paragraph 34 of the Consultation Paper), as well as the evolution of the client's knowledge in the sustainability universe (See Q 12).

In order to avoid opportunistic re-profiling, clients – as mentioned before – shall be duly provided with full disclosure about the financial instrument offered / the service provided without being asked to update/change his/her/their sustainability preferences. In particular, within the suitability report it may be defined a new section in which the client is informed of the result of the suitability assessment in reference to his/her/their sustainability preferences.

**Q17. Do you agree with the proposed amendment to supporting guideline 10? Please also state the reasons for your answer.**

While Article 25(2) of MiFID II mentions that "*when providing investment advice, investment firms shall inform the client whether or not the benefits of the switching of financial instruments are greater than the costs involved in such switching*", Article 54 (11) of the Delegated Regulation 2017/565, still refers that investment firms shall "*be able to demonstrate that the benefits of switching are greater than the costs*".

However, general guideline 10 (paragraph 94), which mentions that the investment firms should be able to demonstrate that the benefits of switching are greater than the costs, is not aligned with the supporting guideline (paragraph 97) which mentions a "*clear explanation of wether or not the benefits of the **recomended** swich are greater than its costs (...)*".
In our view, it should be clear if there is (or not) the possibility of recomending the "switch" also in situations in which costs are greater than benefits.

Moreover, the reference to the time at which the declaration of suitability must be handed over should be omitted. This reference unnecessarily creates uncertainty as to whether the declaration cannot be included in the declaration of suitability if it is sent following the transaction.

The changed wording does not fully align with the new subparagraph of Article 25(2) of MiFID II. It remains difficult to assess how suitability requirements on switches can be applied in practice. We do not think the change in the Supporting Guideline 97 adds clarity, but is rather confusing and unclear. It does not seem logical that an investment firm would provide details on its assessment that a benefit would not be greater than the cost if it recommends a switch. The MiFID Quickfix provision in the 3rd subparagraph of Article 25 (2) actually provides greater clarity because it allows an investment firm to inform the end investor that the benefits are not greater of an envisaged switch at the initiative of the client, regardless of whether the switch is recommended or not.

The new supporting guideline N°97 remains unclear and/or inconsistent and confusing, particularly when read in conjunction with other supporting guidelines or the General Guideline n°10.We also believe that it is a missed opportunity: the draft Guidelines do not really tackle one of the main findings of the CSA in 2020, which concluded that there does not seem to be a common interpretation of what circumstances could be considered as a 'switch'. A good rule of thumb could be to consider that it applies specifically when position changes are advised in the same asset class, since supporting guideline N°101 would suggest that additional verifications would be better suited to support strategic changes (e.g. from equity focused investments towards fixed-income investments).

**Q18. Do you agree with the additional guidance regarding to the qualification of firms' staff or do you believe that further guidance on this aspect should be needed? Please also state the reasons for your answer.**

The reference to the expected staff's ability to explain to clients the different aspects of the criteria of the sustainable preferences in non-technical terms should be limited to the extent possible (see also Q1 above).

As mentioned under General Comments, implementing the new rules on suitability preferences requires investment firms to make substantive investments in IT solutions and staff training. However, in the absence of final rules (e.g. SFDR level 2 and ESMA guidelines), many important implementation decisions have to be based on draft rules and consultation papers. Therefore, although investment firms are doing their best efforts to be ready by 2 August 2022, there will be need for additional work and adjustments during the years to come. It is important that both ESMA and NCAs recognise the enormous challenges that industry face when implementing these rules and take a flexible approach in their forthcoming supervisory activities.

Regarding point 94 and 95, draft guideline 10, It should be noted that, according to the new Art. 29a(2) of Directive 2014/65/EU (as amended by Directive (EU) 2021/338), the obligations to analyze the costs and benefits of changing financial instruments and, where applicable, to inform the client about such analysis, would not apply in case of professional clients (both per se and on request) unless they inform the institution that they wish to benefit from such rights: "The requirements set out in the third subparagraph of Article 25(2) and in Article 25(6) shall not apply to services provided to professional clients unless they inform the investment firm in electronic or paper format that they wish to benefit from the rights provided for in those provisions."

Point 96, draft guideline 10: The benefits to the client's portfolio from the change to be considered should include the client's sustainability preferences.

**Q19. Do you agree on the guidance provided on record keeping? Please also state the reasons for your answer.**

In principle, we agree with the record presented. In our opinion, this corresponds to the process already in place. Only transaction-related changes must be recorded in the future, e.g. in the declaration of suitability.

**Q20. Do you agree on the alignment of the two sets of guidelines (where common provisions exist for the assessment of suitability and appropriateness)? Please also state the reasons for your answer.**

In principle, we agree with an alignment of both guidelines. In particular, identical wording would be desirable. Only the regulation of sustainability should be treated differently, as it plays no role in "appropriateness/execution only".

However, generally speaking, we do not support a "copy paste" approach since there can be differences between advisory and non-advisory services that needs to be taken into consideration as well as the technological environment. Each guideline needs to be analyzed from the perspective of whether it works well in the context of suitability or appropriateness (respectively).

Where the provisions are identical, e.g. knowledge and competence, we see no reason that the guidelines differ.

**Q21. Do you have any further comment or input on the draft guidelines?**

We don't agree with the statement that the draft guidelines in their current form provide benefit in the form of legal certainty and harmonized application of the requirements across the Member States (paragraph 52, page 19 of the consultation paper). The issue is that the guidelines can't change MiFID, such as the definition of sustainability preferences. It is that definition that is unclear and causes so much legal uncertainty. That uncertainty cannot be fixed by ESMA's guidelines. As a result of these uncertainties, investment firms may be forced to "double implementation" leading to additional cost.

We would like to note that the guidelines not only don't clarify what is unclear, but even increase uncertainty.

For example, regarding paragraph 52 of the consultation paper: "It should be preliminary observed that since the requirements on the suitability assessment are provided under the MiFID II and the relevant Delegated Regulation, the impact of the proposed guidelines should be considered having in mind those legal provisions that they support. While market participants will likely incur certain costs for implementing these guidelines, they will also benefit from the increased legal certainty and the harmonized application of the requirements across Member States." In our introduction we have thoroughly explained that there is no legal certainty whatsoever, and that harmonized application will not be reached in the coming years. To present the guidelines as beneficial to firms, is therefore misleading.

Regarding paragraph 55 of the consultation paper: "With reference to the costs, it should be firstly reminded that the key aspects of the suitability assessment and of these guidelines have remained unchanged." In our introduction we have outlined that testing sustainability preferences could become a major part of the suitability assessment; In that sense one could state that the suitability assessment will radically change.

Regarding paragraph 56: "In light of what has been said, it can be reasonably expected that those firms having already in place a complete set of arrangements to comply with the existing MiFID II provisions will presumably incur in less overall costs when implementing the updated framework and these guidelines." We believe assessing sustainability is something completely different than testing the current financial risk/return parameters. We therefore do not support the assumption ESMA makes about overall costs.

We would also like to take the opportunity to insist on one of our main concerns regarding the integration of sustainability preferences within the advisory process already described in the general comments section.

While sustainability preferences are defined by reference to the Taxonomy and SFDR Regulations, the scope of which is limited to “financial products”[4], Delegated Regulation 1253/2021 extends the consideration of sustainability preferences to “financial instruments” sold under the services of investment advice or portfolio management. This implies a great distortion regarding the application of the regulation as many of the financial instruments that may be sold under investment advice differ substantially (in nature and characteristics) from financial products under the scope of SFDR which are products with a clear investment portfolio approach. A clear example would be derivative instruments concluded for hedging purposes. In order to meet the sustainability preferences’ concept the derivative should invest in sustainable or environmentally sustainable investments or consider principal adverse impacts on sustainability factors. It seems rather difficult or even impossible that a derivative instrument can meet these characteristics.

As already explained in the general comments section, we would like to insist on the fact that firms will need sufficient time and clarity to adapt their processes to the final set of guidance adopted. Therefore, we believe that ESMA should allow for a sufficiently broad implementation period following the publication of the final guidelines.

Finally, we have also some comments regarding the Guidelines that have not been changed:

- Regarding Guideline 3 (parr 32): It would need to be clarified how the principle of proportionality is applied in terms of the scope of information to be collected on the customer's sustainability preferences. In particular, taking into account the particularities that may affect financial instruments for which information on their sustainability attributes is not available, or products with sustainability-related attributes that cannot be verified under the SFDR and Taxonomy regulations
- Regarding Guideline 6 (parr 65): In the scheme envisaged in this Supplementary Guideline, it should be clarified from whom the sustainability preferences are taken. The sustainability preferences of the represented client should be taken into account in the case of a nominee, or the sustainability preferences of the co-owner nominated by the other co-owners in the case of co-ownership.

As a general comment it is important that the Guidelines are technology neutral and work for both digital channels and physical meetings with clients.

[4] Art. 2.12 of SFDR Regulation which includes: (a) a portfolio managed in accordance with point (6) of this Article; (b) an alternative investment fund (AIF); (c) an IBIP; (d) a pension product; (e) a pension scheme; (f) a UCITS; or (g) a PEPP.

**Q22. Do you have any comment on the list of good and poor practices annexed to the guidelines?**

We welcome the fact that ESMA consults on providing clear and practical regulatory guidance in order for firms to better understand or apply the MiFID requirements and the ESMA guidelines. A selection of the good and poor practices or clarifications may certainly help and constitute useful tips and tricks when implementing or strengthening the suitability assessments respectively to identify material flaws to avoid.

Certain aspects in the current list of good or poor practices do not seem to meet this requirement entirely.

1. Switches are not necessarily only based on a mere appreciation of the expected return compared to the costs of the switch. They could be oriented to limit an expected loss, take into account the risk-return profile or benefits may also simply not be quantifiable. The perimeter of the switches should therefore preferably be limited to those circumstances in which the monetary benefits undisputedly outweigh the costs of the switch: when the costs would excessively outweigh the potential benefits or where the probability of an acceptable benefit would be negligible compared to the level of switch costs or the underlying assumptions. In other circumstances, the disclosure of the costs of the switch itself could be a reasonable safeguard in its own right.
2. Poor practices that include references such as 'excessive' do not provideare not quite clear guidance on what this means.
3. Client Profiling: we would like to avoid that alerts have to be formulated to the client prior to the completion of the questionnaire, particularly when inconsistent answers are formulated. This is because the doublecheck of inconsistent information is a means to verify if a client has already the necessary knowledge to understand the main features and risks of the product or not. The only information a client should receive should be the fact that he/she did not pass or that further information on the product is available in the product manual(s) or other client training material(s).
4. Switching investments (good practices): The example, "limiting the possibility of "splitting up" purchase and sale recommendations in different days" is as a good practice not sufficiently precise to enable a practical instruction in the normal course of an ongoing relationship with investment advisory or portfolio management services. It would preferably be deleted.
5. Costs and benefits of Switching investments (poor practices): The wording of the first poor practice should preferably be reformulated or even deleted ( notably the examples between brackets as it overemphasizes the fact that transactions with the same investment amount are necessarily linked and does not identify what a short timespan is):
    a. Whether or not indicators are relied on, such as the size of the transaction or the short timeframe in which transactions have occurred, is less relevant.
    b. The requirement to identify the costs and benefits of a switch is not intended to be carried out after an initial suitability assessment has been done.

c. Subsequent controls as formulated by the poor practice could be overly burdensome
d. Details about the motives of the reinvestment may simply not be available or may not have been recorded.
e. What is, objectively spoken, a short time frame for these controls?
f. Article 25 (2) of MiFID nor the definition of a switch introduced by Directive (EU) 2021/338 states that the size of the subsequent transaction has to be taken into account.
g. Retail investors may be triggered by inflation risk, in order to reinvest the proceeds of a previous transaction within a reasonable timeframe.

**Q23. What level of resources (financial and other) would be required to implement and comply with the guidelines (organisational, IT costs, training costs, staff costs, etc., differentiated between one off and ongoing costs)? When answering this question, please also provide information about the size, internal organisation and the nature, scale and complexity of the activities of your institution, where relevant.**

Some costs are:

- Extra time to explain & gather sustainability preferences
- Integrate sustainability preferences for existing clients
- Cost new questionnaire in all services
- Cost new suitability test in all services; education client
- Cost (ongoing) suitability report
- Cost control preferences changes ect.
- Align DPM with SFDR + ongoing reporting SFDR
- Other elements (risk; organisation ect.?)
- Cost of storage
- Rebalancing; monitoring ESG sub portfolio
- Cost of implementing changing laws (social taxonomy, potential impact on ‘sustainability preferences definition’ and SFDR RTS);

## About EBF

The European Banking Federation is the voice of the European banking sector, bringing together national banking associations from across Europe. The federation is committed to a thriving European economy that is underpinned by a stable, secure, and inclusive financial ecosystem, and to a flourishing society where financing is available to fund the dreams of citizens, businesses and innovators everywhere.

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