

# ESMA Consultation on Guidelines on certain aspects of the MiFID II suitability requirements

## Response by Schroders Investment Management (Europe)

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**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 generally agree with the suggested approach on the information to clients about the purpose of the suitability assessment and its scope. We note the proposed guidance for appropriate training referred to in paragraph 104, which will support the guidance proposed in paragraph 16.

**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.**

We appreciate the approach to explaining the three concepts in non-technical terms (both in paragraph 16 and paragraph 104). It is particularly important that firms have the flexibility to phrase the explanation as it fits their client base. For instance, a firm only providing portfolio management to professional clients will have a different approach than a firm offering investment advice to retail clients. It may be useful, for example, for the final report to stress what these guidelines principally address, i.e. the feedback statement should highlight the contents of paragraph 3, that these guidelines are aimed at services provided to retail clients and that professional clients will naturally be able to be treated in a different way.

Where the guidelines propose that “Firms **should** also explain what environmental, social and governance aspects mean” during the discussions around an investor’s sustainability preferences, this depends on a client’s knowledge, as some (more sophisticated) investors, may already have a good understanding of environmental, social and governance aspects. The last sentence of Guidelines 2/para. 16 might better be drafted:

*“Where relevant, firms may also wish to explain what environmental, social and governance aspects mean. This may happen as part of the discussions around sustainability preferences or may take place in addition to these discussions.”*

**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.**

While we explicitly support the reference to "ranges" in GL2 (e.g. para. 26), we do not agree with the overall approach. As an overarching structural point, General guideline 2 is structured as "arrangements necessary to understand clients" yet the proposed guidance mixes this issue with "matching clients preferences to products", which should be provided under guideline 8.

Currently the proposed wording mixes the two key parts that we believe the guidelines need to address.

- First, the fact that clients will not have the same understanding of what sustainability means compared to the technical nature of the sustainability preferences definition. So the general guideline 2 needs to address how firms can interpret and map a client's own understanding of ESG or sustainability generally, to the technical definition, as well as taking into consideration that parts of the definition (have yet to be completed. Namely, in regards to the taxonomy, its current scope only covers environmental objectives and only two out of the six objectives have further detailed rules. Moreover, significant interpretation differences, e.g. on "sustainable investments" persist.
- Secondly, the guidelines need to help firms match client preferences in the way that they express them to the products that would best meet their needs. This is a separate but important aspect and in part depends on whether clients have unrealistic expectations of e.g. the level of sustainable investments as defined by the taxonomy. Managing these expectations is an important part of the process.

We consider that the current guidelines, first sentence of paragraph 25, correctly identify that the client needs to be informed of the "sustainability preferences" definition given the requirements of Level 2. However, the second part of that sentence then talks about matching to financial instruments. This is not relevant to guideline 2. Also, paragraph 23 and 26 introduce the term "sustainability related expectation", maybe to describe the minimum proportion of e.g. sustainable investments. We believe it's unhelpful to create new and unclear terminology which provides no added value to the terms used in the MiFID DA.

To clearly separate the process of "collecting information" from matching products according to sustainability preferences, we would suggest paragraph 25 and 26 of the guideline should focus on helping firms to interpret and match possible client understanding of sustainability to the definition ("collection of information"). We

suggest this is done by some inclusions of examples of process in the text. For example the guideline could be restructured in a more focused, step-by-step way as follows:

*“25. Information on the sustainability preferences of the client should include all aspects mentioned in the definition of “sustainability preferences” according to Article 2(7) of the MiFID II Delegated Regulation (“the definition”). Firms should seek to understand their client’s views and understanding of sustainability generally and then explain how this fits into the regulatory definition (and ultimately investment choices as per section VII). Where the client has expressed a wish to invest in a sustainable way, firms must take reasonable steps to match their wishes to each aspect, a) to c), of the definition, explain clearly to the client how they have achieved this and record this in their suitability report. The information must be granular enough to identify:*

- i. The extent the client’s understanding of sustainability can reasonably map across and be matched to one or more of each aspect of the definition;*
- ii. For aspects a) and b) obtain from the client the minimum proportion of financial instruments mentioned in the definition; and*
- iii. For aspect c) which principal adverse impacts (PAI) the client wishes to address via their investment.*

*26. To achieve this, the following examples could help firms translate client preferences to the definition:*

*In respect of 25 i. (matching to one or more aspect of the definition) information may be obtained through closed-ended Yes/No questions. For example, following such an exercise, this might result in identifying that the client is only interested in an exclusion strategy in which case this will map to aspect c) only of the definition . Another result might identify that a client wishes to make a positive impact on the environment, which could be interpreted as falling within a) or b).*

- In respect of 25 ii. (minimum proportion), a firm may collect this information by ranges or sizes and not only in terms of a particular percentage. When doing so the firm should highlight the current low percentage of taxonomy-compliant investments because of the very recent introduction of the taxonomy, its incomplete nature until 20XX when the detailed requirements will have been finalised, and lack of data available. Over time, as companies provide data in their reporting (at the earliest [2024]) and set out plans, if any, to transition to a more sustainable operation, percentages are likely to improve meaning ranges and expectations will change over time. Firms will need to explain this to clients and highlight that the advisor will return to this topic as part of the regular review process.*
- In respect of 25 iii. firms may test the client’s preferences for PAI integration with regard to the families of PAI indicators as a whole, based on a possible focus of the client on environmental, social or governance aspects using the categories presented in the SFDR RTS such as greenhouse gas emissions, waste, water etc. Alternatively firms may use an approach based on each PAI indicator. A qualitative evaluation could then be carried out for each category that is important or not to the client (e.g. exclusion strategies, controversies policies, engagement & voting policies).*

*Firms should have policies and instructions in place when clients have sustainable preferences but do not provide enough granular information to enable the firm to match their general preference to the specific aspects of a) to c) of the definition including with regard to identifying a minimum proportion. When this occurs a firm can make a reasonable assumption of each of the aspects a) to c)*

*of the definition and may consider it not bound to any minimum proportion for the purposes of complying with the sustainability requirements of the suitability assessment. Where a firm makes use of this possibility they should inform the clients about the assumptions they have used and document in the suitability report the client's choice not to further specify their sustainability preferences."*

The parts of proposed paragraph 25 and 26 referring to matching preferences to products needs to be introduced in guideline 8.

The last sentence of paragraph 25 ("Throughout the process, firms should adopt a neutral and unbiased approach [so] as to not influence clients' answers" is one of three references in the proposed guidelines which seeks to address potential bias in the sales process - the other two being the second part of the last sentence of the third indent of paragraph 26 "these ranges should be presented in a neutral way" and last sentence of paragraph 27 "pushes clients into a certain combination"). This is not only a sustainability point but one which is a conflict of interest point that should be made more generally in the suitability guidelines, probably under General guideline 1. Alternatively it may be that this is not necessary, since the last indent of existing paragraph 78 refers to conflicts generally ("any conflict of interest are prevented from adversely affecting the quality of the suitability assessment").

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

Yes, we think the guidance of how firms assess client's sustainability preferences need to give examples as highlighted in our response to question 3 above. Importantly, the guidance should highlight the newness of the sustainability preferences requirements and the incomplete nature of the taxonomy, as well as what is likely to happen over time. ESMA has the power to revisit these guidelines to ensure they remain relevant as the market in sustainable investments and specifically corporate reporting improves and matures.

**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?**

We do not think additional guidance is required. Portfolio managers and advisers will be taking the client's understanding of sustainability and interpreting and guiding clients around how their wishes map to the preferences described in Art. 2(7) MiFID DA. There are currently products that span/overlap the definition and it will be the portfolio manager's and adviser's job to suggest solutions to meet those wishes dependent on the product range that the firm offers. It is in this area where the industry is already seeking solutions to highlight the sustainability aspects of the products available via the European ESG Template.

**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 question why there is reference in paragraph 26 to the treatment of ESG preferences in the case of a portfolio approach. We consider that the existing guidelines in paragraph 86 are sufficiently clear on the point and could be tweaked to refer to sustainability preferences. Specifically:

*"86. When conducting a suitability assessment.....On the other hand with regard to the client's financial situation, ~~and~~ investment objectives and sustainable preferences, the suitability assessment....."*

*Where a firm conducts a suitability assessment.....On the other hand, with regard to the client's financial situation, ~~and~~ investment objectives and sustainability preferences, the suitability assessment about the impact of the product and transaction can be done at the level of the client's portfolio. The firm should monitor whether those objectives and preferences are still met or not at portfolio level and issue appropriate recommendations as the case may be."*

Whilst we appreciate the flexibility paragraph 27 provides in terms of portfolio approach (allowing both sustainability preferences to be met systematically by the whole portfolio, as well as specific parts of the portfolio, we again question the structure proposed. Specifically:

- the first two sentences of paragraph 27 relate to the collection of information from the client. Existing guideline 3 headed "Extend to information to be collected from clients (proportionality)" would seem to be the best place to provide this guidance – perhaps by an amendment to paragraphs 37 and 38.
- The last sentence relates to model portfolios and potential conflicts of interest. Please see our comments in response to Q3 on conflicts management. This sentence is about matching a client's preferences to products offered and so should be moved to Guideline 8 – specifically paragraph 76 (which already states that tools such as model portfolios should be fit for purpose and produce satisfactory results).

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

We appreciate the level 2 Delegated Regulation applies from 1 August 2022 but welcome confirmation of the fact that for existing clients the requirements will apply at the first review after this date, in line with recital 4 of the MiFID DA.

**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 suggest GL 7/paragraph 71 should be amended to clarify that the product range offered may not be their own but those of a 3<sup>rd</sup> party manufacturer. Specifically, the wording “included in their product range” should be amended to say “included in the range of products they offer”.

In a context where the taxonomy is still being worked out, reference to “rank” might create excessive expectations with regards to the capacity of the market to align to this taxonomy. We would therefore suggest removing the word “rank” from the proposed wording:

*“71. When considering the sustainability factors of products in view of the subsequent matching with the client’s sustainability preferences, firms could, for example, group the financial instruments included in the range of product they offer in terms of: i) the proportion invested in economic activities that qualify as environmentally sustainable (as defined in Article 2, point (1), of Taxonomy Regulation), through appropriate ranges; ii) the proportion of sustainable investments (as defined in Article 2, point (17), of SFDR) through appropriate ranges; iii) the consideration of principal adverse impacts, by family of PAI indicators or individual indicators. Such grouping should also be consistent with the firm’s analysis conducted for the purposes of product governance obligations. Firms are reminded that a grouping of financial instruments for the purpose of the suitability assessment cannot replace the collection of information from clients as described in paragraphs 25 and 26 above.”*

**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

**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.**

Please see our comments in question 3. We consider certain aspects of the guidance in paragraph 25 and 26 should be addressed here since it refers to matching a client’s preferences to products. This could first be addressed in a general way by amending the existing guidance in the following ways:

*“General guidance 8*

*74. In order to match clients with suitable investments, firms should establish policies and procedures to ensure they consistently take into account:*

- All available information about the client necessary to assess whether an investment is suitable, including the client’s current portfolio of investment (and asset allocation within that portfolio)*
- All material characteristics of the investments considered in the suitability assessment, including all relevant risks, sustainability preferences, and any direct or indirect costs to the client.*

.....

78. A firm should establish policies and procedures which enable it to ensure, inter alia that:

- *The advice and portfolio management services provided to the client take account of an appropriate degree of risk diversification and the client's sustainability preferences;*
- *The client has....."*

**Q.11 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.**

Yes, we note the content of recital 5 of the delegated regulation supporting the proposed approach and that paragraph 80 highlights the requirements stated in Article 54(10) of the MiFID Delegated Regulation (and recital 8).

We do not believe the guidance should be more detailed. In fact we question whether the reference to documenting decisions in this section is needed (see end of paragraphs 80, 81, 82 first paragraph, 83 second sentence) given the proposed new supporting guideline on record keeping (paragraph 109) and the existing general guideline at paragraph 107.

**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.**

See our comment above on paragraph 80 (question 11). Paragraph 81 seems to reflect the requirement set out in the Delegated Regulation.

Unless GL 2 is redrafted (see our suggestions under question 3), taking into account current market realities and acknowledging that the legal definitions of sustainability preferences will not resonate with "normal" clients, reference to the firm being allowed to adapt sustainability preferences "not being standard procedure" is unhelpful. Firms will clearly need to ensure their advisors are trained appropriately in such circumstances and, at least initially, the need to follow this procedure may well be a common occurrence for two reasons. First, the unfinished nature of the Taxonomy Regulation has results in low percentage scores and the significant existing data gaps. Second, clients' sustainability preferences are sought for the first time following the introduction of the Delegated Regulation. Hence, adapting sustainability preferences is going to be necessary. The wording "not being standard procedure" may become relevant in the future once company reporting (and the subsequent fund reporting) has improved.

**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)?**

No. As a product provider to distributors we have no practical examples, we would however point to our response to Q3 and Q12 and highlight that market realities need to be taken into account.

**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.**

The first sentence of paragraph 83 is appropriate. We question whether the second sentence is required given the proposed new guidance in record keeping (paragraph 109, second indent). We see no need for more prescription.

**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.**

Yes, although we point out that the existing guidance contains in paragraph 74 (chapeau and first indent) essentially means the third paragraph of proposed guidance 82 in not necessary. If a firm has policies in place “to consistently take into account all available information about the client and the client’s current portfolio” then firms will “evaluate the impact of this [sustainability preferences] change” and whether the portfolio needs rebalancing. As an alternative to the third paragraph, reference to “sustainability preferences “ could be added to the first indent of paragraph 74.

**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?**

Initially, if the guidelines are explicit in allowing firms to explain to their customers the issues arising with the Taxonomy Regulation, its incomplete nature and lack of data from companies and the industry generally, then the instances of clients having to adapt their sustainable preferences will be less than if the guidance does not refer to discussing such market realities with clients. It will set a client’s expectations accordingly and as a client’s suitability is reassessed during the required regular reviews, firms will be able to update and adapt their advice/portfolio as necessary.

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

We have no comment

**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.**

Yes we agree with the proposed guidelines. It will be essential for firms to be able to translate the client's understanding of ESG/sustainability into the regulatory definition in order to ensure that the client understands why the firm has chosen the course of action agreed upon in the suitability report.

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

Yes, although see our previous responses to many of the questions asked above, particularly on when suitability preferences are amended. There is no need to repeat the need for decisions to be documented throughout the guidance given the amendments here.

**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.**

The proposed approach would seem sensible.

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

We note that the numbering/layout of the sections starting with "V" (which is underlined) then two "VI" (not underlined) and then VII (not underlined) needs to be corrected.

We suggest there needs to be a legislative reference in section II to the SFDR RTS mentioned in proposed paragraph 26 indent 4.

We highlight an error in the original suitability guideline paragraph 86 which incorrectly cross-refers to paragraph 36(b) of the guidelines which does not exist (it appeared in the 2017 consultation paper). We believe the correct reference should be to paragraph 37, second indent/bullet.

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

No.

**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.**

We will have some cost in implementing this as we will be required to collect information on the sustainability preferences of our EU institutional clients. However, the most substantial cost of implementation is connected to our efforts to collate the information

that distributors will need. This involves a project team, an RFP process for a data provider, contributing to the FinDatEx work, delivering the EET etc. Notably, the delivery of the EET needs to take place well in advance of the introduction of the MiFID changes in August.

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