**ESMA Consultation – Guidelines on certain aspects of the MiFID II suitability requirements.**

Febelfin fully supports the Union’s ambition to transit to a low-carbon, more sustainable, resource-efficient and circular economy in line with the UN Sustainable Development Goals. As a financial institution we want to contribute to the reorientation of capital flows towards sustainable investments to achieve sustainable and inclusive growth, both in our capacity as credit institution as well as financial adviser.

Therefore, we endorse the objectives of the MIFD/IDD Delegated Acts as regards the integration of sustainability risks and sustainability preferences in our conduct of business and are willing to assist our clients on their path to more sustainable investing.

We fear however that the delegated acts, as further developed by the draft ESMA guidelines will miss their objectives and have unintended negative impact because the regulation is overly complex for investors to understand. Moreover, at this stage there is no reliable and exhaustive data available, preventing the manufacturing of and advice on sustainable products without the risk of being accused of green washing afterwards.

In our view the better option would be to have a more phased-in inclusion of sustainability preferences, taking into account (i) final ESMA and EIOPA guidelines (which are on today’s date not aligned), and (ii) 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). This way clients could be accompanied whilst 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.

Guideline 1 – information to clients about the purpose of the suitability assessment and its scope.

*16. In order to help clients understand the concept of “sustainability preferences” and the choices to be made in this context, firms should explain the term and the distinction between the different elements of the definition of sustainability preferences under a) to c) and also between these products and products without such sustainability features in a clear manner, avoiding technical language. Firms should also explain what environmental, social and governance aspects mean.*

**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 assume that when reference is made to the purpose of the suitability assessment, the inclusion of sustainability preferences in such suitability assessment is envisaged.

We share the view that we should accompany our clients in their journey towards more sustainable investing. We want however to share some attention points:

1. **Overall complexity – too granular.**

We believe that the granularity in which we need to inquire and hence inform our clients, is overly complexfor a client to understand: a client needs to understand how taxonomy works (its scope, substantially contribution, transition, minimum social safeguards); the difference between “environmentally sustainable investments as defined in the Taxonomy Regulation” and “sustainable investments as defined in SFDR”; the double layer of percentages (‘to which extent’ and ‘minimum proportion’), what ‘principal adverse impacts’ are, and how those can be taken into account and how those sustainability preferences can (not) be applied to the different types of financial instruments and hence what the impact of the inclusion of sustainability preferences will be on his or her investment universe (limited universe).

1. **Lack of common - worldwide – methodology**

There is no single, standardized methodology to determine the positive/negative impacts of a company's activities and on how to understand sustainable investments, which may lead to different ESG ratings and to incomparable financial products which is contrary to the outset of a harmonized, genuine single capital market.

Further, the way the definition of sustainability preferences is drafted seems to have a focus on funds (that are in scope of the Sustainable Finance Disclosure Regulation - SFDR) but do not give any guidance on how to apply this to the broad range of financial instruments.

In addition, where there are increasing ESG disclosure requirements at company level, and a harmonized classification system is being developed within the EU, there is no guarantee that in the near future the same (or at least comparable) regulatory framework will be integrated in other jurisdictions, leaving the EU financial sector to assess activities of non-EU companies without there being any (comparable) data available.

1. **Evolving nature**

As also acknowledged by ESMA[[1]](#footnote-2), not only is the sustainable finance topic complex, the market is also constantly evolving. This is not only due to (i) the nature of the taxonomy classification system (not only will it be extended (upcoming RTS on other environmental topics, but also social taxonomy), it will also continue to evolve by taking into account future technical and scientifical developments and insights), (ii) the further finetuning and, probably convergence towards a more standardized approach on sustainable investments as defined in SFDR, but also to the fact that the market is not mature, and it can be expected that, over time, when more (reliable) data will be flowing in, new financial instruments will be manufactured. We fail to see how to explain a client in a plain language, avoiding technical jargon, the complexity of evolving classification and methodology.

1. **Lack of reliable, sufficiently granular data**

Not only is sustainability (and consequently sustainable finance) by nature evolving, during a significant period of time, manufacturers and distributors will – even for the EU(!) – lack the necessary ánd reliable ESG related data. By August 2022 disclosures pursuant to article 8 Taxonomy Regulation will not yet be available and processed and, in first instance, only information on taxonomy eligibility of economic activities will be available, and no ‘hard’ data, CSRD still needs to be published and become applicable. Only as of 2024 a vast flow of ESG related data can be expected, which leaves a transition period of , at least, one year and a half. For non-EU jurisdictions, the availability of reliable and comparable data is even less certain.

If the application date of the ESG MiFID Delegated Act is not brought in line with the data disclosure flow, the financial sector will be obliged to rely on estimates, taxonomy eligibility etc if not, no financial instruments meeting sustainability preferences will be available.

1. **Greenwashing - misselling**

Given (i) the evolving nature of sustainability and sustainable finance and (ii) the lack of the reliable ESG data, the (reputational) risk that the financial sector will be accused of green washing and even misselling is significant. There is a real risk that financial instruments which have been advised as meeting an client’s sustainability preferences at the time of the initial advice could potentially no longer meet such preferences due to such evolvements and/or input of data both of which are completely out of the distributors’ control.

1. **Potential constraints related to sustainability preferences.**

In the interests of our clients (investor protection) as well as in light of the broader perspective (*i.e.* reorienting capital flows towards initiatives supporting the UN development goals), we are of the view that we should be allowed to discuss – in a neutral way – any restraints of sustainable products, e.g. category a and b financial instruments that are primarily focused on corporate debt and equities and hence less suitable for conservative profiles; an increased concentration risk especially for clients that desire to invest significantly in category a financial instruments, given the limited number of companies that have taxonomy aligned activities (certainly at a first stage) and the fact that government debt cannot be taxonomy aligned.

We should avoid to raise ESG expectations that can not be fulfilled and will only drive a client away from sustainable investing.

1. **Products not ESG eligible by nature**

Clients should realize that some products will never meet sustainability preferences as defined in MIFD. In such case – so not to unnecessarily confuse clients and absent any added value for the latter, clients should not be inquired on their sustainability preferences.

A typical example are hedging products, which can never meet ‘sustainability preferences’ as currently defined in the MiFID amendment. But the same applies in case a client is seeking an advice on a specific product.

**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.**

See sub Q1.

Referring to the points already set out sub Q1, we would like to specifically highlight the lack of any guidance on the ESG assessment of financial instruments that are not financial products under SFDR.

In subsidiary order, we are also confronted with the assessment of non-EU financial instruments and the uncertainty caused by future developments.

Guideline 2 – arrangements necessary to understand clients.

*25.The 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 and should be sufficiently granular to allow for a matching of the client’s sustainability preferences with the sustainability-related features of financial instruments. Granularity of information should also allow for a combination of the different aspects mentioned in Article 2(7). Firms should collect the following information from clients:*

* *Whether the client has any sustainability preferences (yes/no).*
* *Whether – and if so, to what extent - the client has sustainability preferences with regard to aspect a), b) or c) of the definition according to Article 2(7) MiFID II Delegated Regulation and if the client has a preference for, where relevant, a combination of one or more of the three aspects.*
* *For aspects a) and b), the minimum proportion.*
* *For aspect c), which principal adverse impacts (PAI) should be considered including quantitative and qualitative criteria demonstrating that consideration.*

*Throughout the process, firms should adopt a neutral and unbiased approach as to not influence clients’ answers.*

*26. To achieve this, firms could choose the following approach:*

* *First, firms could collect information on the degrees of sustainability related expectation of the client which would refer to one or more of the aspects expressed through a) to c) of Article 2(7) of the MiFID II Delegated Regulation (“qualitative aspect of sustainability preferences”).*

*When doing so, firms could also assess whether the client would only prefer one certain degree of sustainability-related expectation or whether more or all of them should be part of its preferences. This aspect could be assessed through closedended yes/no-questions. Where the client wishes to include more or all of the aspects mentioned under a) to c) of Article 2(7) of the MiFID Delegated Regulation, this could be either assessed and matched on portfolio level or on the level of the financial instrument, depending on the service provided.*

*When providing portfolio management or investment advice (with or without portfolio approach) the firm could also ask the client to what extent financial instruments according to a) to c) should be included in client's investment/portfolio.*

* *Firms could, as a second step, also collect information on whether the client’s sustainability preferences with regard to b) and c), if any, 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.*
* *As a third step, firms could collect information on the client’s preferences in terms of the “minimum proportion” as mentioned in a) and b) if the client requested to include these financial instruments in the investment. Where a firm decides to collect this information not in terms of particular percentage but by ranges or sizes, these ranges should be presented in neutral way to the client and should be sufficiently granular*
* *In case the client wishes to include a financial instrument that considers PAI, the information collected should cover the PAI and qualitative and quantitative elements mentioned under c). Firms could test the client’s preferences and appetite for PAI integration with regard to the families of PAI indicators as whole, based on a possible focus of the client on environmental, social or governance aspects, using the categories presented in the SFDR RTS (instead of an approach based on each PAI indicator) such as emissions, energy performance, water & waste, etc.*

*A qualitative evaluation could then be initiated for each category that is important/key for the client or not. This qualitative evaluation could be based on the approaches in which products consider PAI (e.g. exclusion strategies / controversies policies / voting and engagement policies).*

* *Firms should have policies and instructions for their client-facing staff in place for situations where clients answer that they do have sustainability preferences but do not state a preference with regard to any of the specific aspects mentioned under a) to c) or with regard to a minimum proportion. For example, the firm could consider any of the aspects under a) to c) or a combination thereof and could consider that it is not bound by any minimum proportion of sustainability-related expectation for the purpose of conducting the suitability assessment. Where firms make use of this possibility, they should inform the client about their choice and the level of the sustainability-related expectation of the product and document in the suitability report the client’s choice not to further specify the sustainability preferences.*

*27. Firms should ensure the same level of granularity of information is collected on the client’s sustainability preferences when providing portfolio management or investment advice with a portfolio approach. The client's sustainability preferences should be collected with regard to the portfolio (whereas the possibility of specific individual instructions remains, e.g. if a client asks for specific ESG-related products in the portfolio). Firms should therefore ask the client which part of the portfolio (if any) the client wants to be invested in products meeting the client's sustainability preferences. Where firms work with model portfolios that combine some or all of the criteria listed under paragraph 25 above, these model portfolios should allow for a granular assessment of the client’s preferences and should not be translated into a questionnaire that pushes the client into a certain combination of the criteria that would not meet the client’s sustainability preferences (i.e. all preferences need to be asked for and matched with the sustainability-related features of the model portfolio).*

**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.**

1. **High complexity and lack of data in general**

Investment advisors should collect information on all aspects of ‘sustainability preferences’. However these aspects are very complicated for a client to understand. Higher we already referred to the very technical concept of taxonomy alignment and the evolution of classification, as well as the lack of standard methodologies to assess sustainable investments. To this, we could add the ‘minimum proportion’ combined with the extent of the portfolio *e.g.* a client should understand that in case he or she indicates a preference for category A financial instruments, with a minimum of 10% invested in taxonomy-aligned environmentally sustainable investments applied to 40% of his/her portfolio, his/her entire portfolio may only consist of 4% taxonomy aligned environmentally sustainable investments. Therefore it should be possible for a financial institution to request a client to define one single percentage that is applied to his portfolio as a whole (e.g. 10% of his portfolio must be invested in environmental sustainable investments/activities), this would make it more understandable for a client and is also more in line with other suitability dimensions at the level of a portfolio (like risk, horizon,…)

1. **How to explain and apply “Principal adverse impacts”**

*Complexity of principal adverse impacts*

The concept of “principal adverse impacts on sustainability factors” as well as “quantitative or qualitative elements demonstrating that consideration” are extremely difficult for a client to understand, even more if we are not allowed to link it – upfront – to specific products.

Further, the market of sustainable products is far from mature: which PAI will be taken into account by manufacturers and how will those – in practice – be considered? How to anticipate these market developments in the information/education of the client as well as in the questionnaire?

On the ‘which’, the draft Guidelines suggest to test a client’s preferences and appetite for PAI integration with regard to the families of PAI indicators as whole, using the categories presented in the SFDR RTS such as emissions , energy performance, water & waste etc. However, PAI are not defined in MIFD and, as explicitly stated in the explanatory memorandum, are not limited to the indicators in accordance with SFDR RTS. Further, the PAI as listed in Annex to the draft SFDR RTS are drafted from a reporting perspective. Some indicators are not that meaningful from the perspective of client that wants to limit the adverse impacts of his/her investments.

On the “how” side, *i.e.* the qualitative or quantitative elements that demonstrate the PAI consideration – in this respect we understand that the “and” in the guidelines is an error and should read “or” in line with the text of the MiFID Delegated Regulation – the draft guidelines only indicate that “this qualitative evaluation could be based on the approaches in which products consider PAI (e.g. exclusion strategies/controversies policies / voting and engagement policies”. Again, this allows for manufacturers to create the coming years different kinds of sustainability products, with a different degree and/or ESG focus. The development of such a wide range of financial instruments with various degrees of sustainability-related ambition has also been recognized by the European Commission[[2]](#footnote-3).

*Conclusion and suggested approach on PAI*

The above complexity and variety within a still developing market and the need for a client to understand the sustainability-related features of financial instruments, leads us to believe that the better approach is, at least in the first phase of application of the rules in 2022 as there is no or only limited data available (cfr. Intro Q1 remark iv), to only determine at a general, higher, level a client’s appetite for sustainable products taking into consideration PAI (*e.g.* on E, S or G), without the need – at the time of the questionnaire - to enter into details on any specific indicators and the qualitative or quantitative elements that are used to demonstrate such PAI consideration.

Once the range of suitable products has been determined any sustainability-related elements at product level can then in more detail (specific PAI, qualitative/quantitative elements) be discussed with the client based upon the precontractual information. By doing so, the client will still ultimately decide on the specific PAI (and the qualitative or quantitative elements that are relevant to him or her), in a more customer friendly, educational way.

In general, we would appreciate to receive guidance on how to apply PAI to financial instruments that are not Financial Products under SFDR.

1. **Punctual remarks**

Note that in marginal 26, second bullet, the draft ESMA guidelines suggest that a firm could collect information on whether the client’s sustainability preferences with regard to b and c), if any have a focus on either environmental, social or governance criteria […]. The definition of sustainable investments in SFDR however only refers to social and environmental objectives, no reference to governance.

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

1. **Guidance on methodology**

In addition to what has been explained sub Q3, we want to bring the following two points under the attention:

1. There is no common understanding on how to interpret and assess ‘sustainable investments’ as defined in SFDR.
2. Further, it remains unclear how to consider sustainability preferences in respect of financial instruments that are not financial products under SFDR.
3. **General ESG preferences**

In accordance with bullet 5 of marginal 26 of the draft ESMA guidelines, financial institutions “should have policies and instructions for their client-facing staff in place for situations where clients answer that they do have sustainability preference but do not state a preference with regard to any of the specific aspects mentioned under a) to c) or with regard to a minimum proportion”.

We support this approach and are of the view that this option should also be available in case of a digital flow, if not, clients with an appetite for sustainability risk to be driven towards a ‘no’, to avoid more detailed questions. Hence the outcome would be opposite to the intention of the 2018 EU action plan on sustainable finance.

**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 combination at the level of a specific financial instrument required.**

According to the definition of sustainability preferences in the MiFID Delegated Act, financial institutions should inquire their clients on the category (or categories) of sustainable instruments they are interested in, where three categories of financial instruments should be distinguished:

1. Financial instruments with a minimum proportion invested in taxonomy aligned environmentally sustainable investments (category a); and/or
2. Financial instruments with a minimum proportion invested in sustainable investments as defined in SFDR (category b); and/or
3. Financial instruments that consider principal adverse impacts (category c).

Clients can have a preference for one or more of such categories of financial instruments.

Marginal 25 is to our understanding a reflection of the above principle (cfr the explicit reference to the MiFID Delegated Act) whereby ‘aspect(s)’ can be read as ‘categories’. Hence, financial institutions should request their clients if they are interested in (i) A financial instruments, and/or (ii) B financial instruments and/or (iii) C financial instruments.

On top thereof firms could, depending on the service, inquire their clients on a preference for any combination of the “qualitative aspects of sustainability preferences” or sustainability features that characterize each such category of financial instruments, i.e. minimum investment in taxonomy aligned environmentally sustainable investments (A), minimum investment in sustainable investments (B), consideration of certain PAI.

**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 understand that, also in case of a portfolio approach, the client must be inquired on his or her sustainability preferences in a neutral, unbiased way, however:

1. **Alignment of MiFiD Sustainability Preferences and SFDR)**

We believe that – in the interest of the client – financial institutions should be allowed to bring MiFID ESG preferences and disclosures under SFDR in line. Pursuant to SFDR a portfolio managed under ‘discretionary portfolio management’ is considered a Financial Product. Hence portfolio managers will be required to make precontractual and periodic disclosures on, amongst others, the (minimum) percentage of sustainable investments with an environmental objective (whether or not taxonomy aligned) and the (minimum) percentage of sustainable investments with a social objective, and not on the percentage of financial instruments with a (minimum) proportion of such (taxonomy aligned) sustainable investments. Consequently, the disclosure requirements under SFDR (one step: (minimum) proportion of (taxonomy aligned) sustainable investments) are not in line with the sustainability preferences as literally described in MiFID ESG Delegated Act (two step reasoning: “the extent of the ESG portfolio” and “the minimum proportion at the level of an individual financial instrument”). To remain consistent and not to confuse clients, we are of the view that we can inquire our clients on their sustainability preferences by asking them about their desired minimum proportion of (taxonomy) aligned sustainable investments (in line with SFDR disclosures).

1. **Portfolio advice to be treated as portfolio management (at the option of the investment adviser – to be determined at service level)**

Given the enhanced transparency on commitments at the level of the portfolio (only one layer: e.g. 10% commitment on sustainable investments at the level of the portfolio) instead of a commitment (“minimum proportion”) at the level of a specific instrument, which is a part of a subportfolio (“to what extent”) (resulting in the fact that a client with an ESG subportfolio of 40% consisting of category b products with a minimum commitment of 10%, will end up with a portfolio of which the total commitments on sustainable investments only amounts to 4%), we are of the view that a financial adviser should have this option not only in case of portfolio management, but also in case of investment advice with a portfolio approach.

Guideline 5 – updating client information.

*55. With regard to the sustainability preferences of a client, this information should be updated – for ongoing relationships – through the next regular update of client information or during the first meeting with the client/the first investment advice following the entry into-application of Commission Delegated Regulation 2021/1253.*

**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 that not all existing client profiles need to be updated instantly and agree that the next regular update of client information or the next client meeting is a good opportunity to talk about the integration of sustainability preferences. Nevertheless we are of the view that the **next general update of the client profile** would be the **better approach** for the actual update of the profile– which has also been confirmed at the ESMA hearing of Friday 18 March 2022 - because:

1. **Contrary to recital 4 of the Commission Delegated Regulation (EU) 2021/1253**

In accordance with the explanatory memorandum, as confirmed in the aforementioned recital 4 “for existing clients, for whom a suitability assessment has already been undertaken, investment firms should have the possibility to identify the client’s individual sustainability preferences at the next regular update of the existing suitability assessment.”.

1. **Not technically possible – first investment advice**

Referring to the first investment advice ignores the reality of increased automation and digitization of investment services. We therefore request to drop in any event the reference to “first investment advice”.

1. **What is “the first meeting” with a client”? What in case of several holders of the advisory contract?**

It is 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.

1. **Right of postponement**

In any event, , clients should have the right to postpone the discussion on the integration of sustainability preferences into their profile to a later date.

Forcing a client to express her or his sustainability preferences (especially given the complexity thereof cfr. questions above) – especially on what might be considered a – for the client – inconvenient moment will only drive clients to a negative answer.

We would therefore suggest to bring the text of the guidelines in line with the feedback received during the aforementioned ESMA hearing.

Guideline 7 – arrangements necessary to understand investment products

*70. Firms should adopt robust and objective procedures, methodologies and tools that allow them to appropriately consider the different characteristics, including sustainability factors, and relevant risk factors (such as credit risk, market risk, liquidity risk, …) of each investment product they may recommend or invest in on behalf of clients. This should include taking into consideration the firm’s analysis conducted for the purposes of product governance obligations [...]*

*71. When considering the sustainability factors of products in view of the subsequent matching with the client’s sustainability preferences, firms could, for example, rank and group the financial instruments included in their product range 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); ii) the proportion of sustainable investments (as defined in Article 2, point (17), of SFDR); iii) the consideration of principal adverse impacts. 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.*

**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 do not have specific issues with the principles set out in these guidelines. We are however awaiting the consultation on the announced guidelines on the integration of sustainability factors in product governance.

In anticipation to this consultation we already want to bring to your attention the following observations:

1. According to the Delegated Directive “the target market should be set at a sufficient granular level”. Also the sustainability factors should be presented “in a transparent manner and provide distributers with the relevant information to duly consider any sustainability related objectives of the (potential) client”. However, given the timeline and the granularity in which we should inquire our clients, we have difficulties in anticipating in our questionnaire what we will receive from manufactures. For now, the only information in the European MiFID Template (EMT) under C5 is “Is this product suitable for sustainability preferences? Y/N”.
2. Because it is a directive and not a regulation, we fear that a (slightly different) implementation in the EU jurisdictions, combined with the interpretation of the local supervisory authorities, might render the matching of the target market/information on the sustainability factors with the granular definition of sustainability preferences more complicated.

In any event, it would be more logic that the date of application of the ESG MiFID Delegated Regulation would follow the application date of the ESG MiFID Delegated Directive on product governance.

**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**

See sub Q8.

Guideline 8 – arrangements necessary to ensure the suitability of an investment.

*79. 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. Once the range of suitable products has been identified following this assessment, in a second step the product or, with regard to portfolio management or investment advice with a portfolio approach, investment strategy that fulfils the client’s sustainability preferences should be identified.*

*80. Where a firm intends to recommend a product that does not meet the initial sustainability preferences of the client in the context of investment advice as referred to in Recital 8 of the MiFID II Delegated Regulation, it can only do so once the client has adapted his/her sustainability preferences. The firm’s explanation regarding the reason to resort to such possibility as well as the client’s decision should be documented in the suitability report. Firms are reminded that this possibility only refers to the sustainability preferences and that with regard to the other criteria of the suitability assessment, the product has to meet the client profile and otherwise shall not be recommended as stated in Article 54(10) of the MiFID II Delegated Regulation.*

*81. With regards to the possibility for the client to adapt the sustainability preferences referred in Article 54(10) of the MiFID II Delegated Regulation, firms are reminded that this possibility should not be the standard procedure. Where a client adapts the sustainability preferences, this adaption should only refer to the suitability assessment/investment advice in question and not to the client’s profile in general. In case of investment advice, it should also be documented in the suitability report and be subject to the regular monitoring procedures.*

*82. In case of portfolio management, the client's sustainability preferences, including the minimum proportion that shall be invested in sustainable investments, need to be collected and assessed when agreeing on the mandate and the investment strategy. If the firm cannot meet those preferences, it should discuss this with the client when agreeing on the mandate in which the investment strategy is defined and ask the client to adapt his/her preferences. The decision of the client should be documented.*

*When providing ongoing investment advice with a portfolio approach, firms should assess the client’s sustainability preferences including the minimum proportion when conducting the initial suitability assessment. Then the firm should monitor whether those preferences are still met or not at portfolio level and issue appropriate recommendations as the case may be.*

*In case of portfolio management or ongoing investment advice with a portfolio approach, if the client adapts the sustainability preferences after the initial suitability assessment, firms should evaluate the impact of this change and whether this triggers a rebalancing of the portfolio.*

*83. Where a client does not answer the question whether it has sustainability preferences or answers “no”, the firm may consider this client as “sustainability-neutral” and recommend products both with and without sustainability-related features. The firm’s product offer should be documented and explained to the client with a mention of the products/portfolio’s sustainability features.*

*84. If the client states that he/she has sustainability preferences, and the firm does not have any products with sustainability related factors available, this should also be documented in the suitability report.*

**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 agree that indeed 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”).

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 and preamble of the MiFID Delegated Act 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.

**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.**

1. **Market conditions**

We understand that in first instance clients should be inquired on their sustainability preferences in a neutral way, which we understand as market conditions as opposed to own offer approach.

If financial institutions are not allowed to apply market conditions, unrealistic ESG expectations will be raised leading to client frustration.

1. **No prior adaptation of sustainability preferences**

However, in a second stage a financial institution should be able not only to discuss its offer, but also to render – in all transparency – a suitable, but not meeting a client’s sustainability preferences, investment advice – without the client having to review priorly her or his sustainability preferences. By acting upon the advice, the client confirms whether or not (s)he is willing to drop or revise his/her sustainability preferences. This is particularly important in a more automated, digitalized environment. But also in a client facing situation, it should be possible for an adviser to discuss immediately any alternatives.

An alternative approach to the adaptation of sustainability preferences could consist of the following. When the client is questioned on his sustainability preferences in a neutral way (as indicated by ESMA), but his/her preferences are too ambitious taking into account the available offer of the investment firm (leading to no or a very limited offer), the investment firm explains this to the client and gives him/her the option to adapt at that moment. Adaptation could then take place to the highest possible level where there is still a reasonable advisory offer, taking into account the client’s other preferences related to suitability. Both the initial and modified preferences are recorded. Applying this procedure provides clarity and transparency for the client on what he/she can expect and avoids the cumbersome and less transparent process of deviation of the client’s preferences at transaction level. Once the advisory offer of the investment firm evolves, it could proactively rediscuss ambition levels of these clients’ sustainability preferences.

1. **Adaptation of the sustainability preferences at service/contract level**

We understand that as a starting point, a client’s sustainability preferences should remain as they are and adaptations are to be done at the level of the specific transaction. The draft guidelines recognize that this is not feasible for portfolio management where the client agrees on an investment strategy. Hence, discussions are held at the level of the specific service/contract and not at the level of the individual transactions in execution of such service.

In our view, this same approach should be possible in case of advisory services, depending on the set-up of such service. If the client agrees to a certain model/certain investment strategy, also the sustainability preferences should be agreed upon at that same contract/service level and not at the level of each separate transaction. If such approach would not be allowed, matters will become overly complicated and risk leading towards an impoverishment of the investment services offer for certain types of clientele. This is confirmed in marginal 79 stating that “*once the range of suitable products has been identified following this assessment, in a second step the product or, with regard to portfolio management or investment advice with a portfolio approach, investment strategy that fulfils the client’s sustainability preferences.*”

**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 answer sub Q.11.

**How to deal with adaptations at the transaction level going forward?**

In addition it is not clear how to deal with adaptations at the transaction level going forward.

At the time of the transaction, a statement stating that a certain transaction is suitable, but not meeting a client’s sustainability preferences is feasible, but then how are firms supposed to deal with this transaction specific deviation in for instance the following cases:

* Advice with portfolio approach going forward: as the transaction is not in line with the sustainability preferences of the client at general level, but an adaptation was accepted at transaction level, how to deal with this at the occasion of the next investment advice? According to the general profile it should not be part of the ESG subportfolio, but at transaction level the client nevertheless accepted the lesser ESG features of the financial instrument. Logically this product should continue to be part of the ESG portfolio (given the specific adaptation), rendering this subportfolio however “less ESG” than required on the basis of the general profile.

It will be a challenge to continuously track all this and have it reflected in the continuous suitability reporting.

**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)**

See sub. Q11.

**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.**

Yes.

**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 examples.**

See Q11

**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?**

Note that s*ince it is very likely that, as a first step, investment firms’ offers will be less ambitious than client’s expectations, it is also very likely that the use of the possibility for the clients to adapt their sustainability preferences will be frequent.*

*Therefore, we consider it is unnecessary and overly burdensome to impose right away a close monitoring on these cases.*

Guideline 10 - costs and benefits of switching investments

*97. When providing investment advice, a clear explanation of whether or not the benefits of the recommended switch are greater than its costs should be included in the suitability report the firm has to provide to the retail client before the transaction is made.*

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

I. Has there been a proper assessment of the need to reformulate the General Guideline N°10 and/or more generally, the level 2 Delegated Regulation on which it is based, in light of the new wording of the MiFID Quickfix ?

*MiFID Quickfix* is introducing changes to the Level 1 provisions. General Guideline n°10 (a level 3 rule) seems to result principally from Article 54§11 of Delegated Regulation 2017/565 (level 2 rule). This could mean that a firm may be required under ‘§94’ to demonstrate *whether or not* the expected benefits of such a switch are greater than the costs.

II. The alignment with the new Article 25(2) of MiFID II does not as such materially change the supporting guideline. However, 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. This makes it difficult to assess the manner in which suitability requirements on switches can be applied in practice.

1) The legal definition of a switch in the MiFID Quickfix directive was not further clarified in the Guidelines itself although one of the main findings of the CSA in 2020 was that there does not seem to be a common interpretation of what circumstances could be considered as a ‘switch’.

Additional examples and clarifications and, to the extent possible, a more precise definition would be welcomed :

a) A clearer definition of the switch perimeter could be:

A switch occurs when it is the intention to combine multiple identified transactions at a given point in time or within a short timeframe. At the time the initial sale transaction is being decided or proposed, a sufficient link should exist between the sale and the purchase. For instance when they are simultaneously instructed. A purchase order should only be regarded if it is sufficiently connected to (a previous or envisaged) sale transaction, notably when the investment firm knows or cannot be reasonably ignorant about the purpose of the sale, which is a reinvestment of the proceeds in an identified financial instrument, at the time of the sale.

b) Examples should clarify, amongst others:

B.1. if and to what extent firms can make a marginal control on the fact that the benefits are greater than the costs when they recommend a switch.

A marginal control has the benefit of taking into account the market uncertainties that are inherent to investments.

B.2 if and to what extent any qualitative appreciation of suitability, as mentioned in supporting guideline §96, can be invoked and be appreciated in light of the costs of the switch.

* How should the benefit of diversification, for instance in a portfolio approach or compared to a model portfolio, be compared with costs and charges, if the expected benefit cannot be quantified?
* What about a change in client circumstances, its financial situation, its knowledge and experience, its investment appetite, its investment horizon and, not the neglected, its sustainability preferences. The introduction of the latter will in the years to come trigger (important) rebalancing of portfolios.
* Is it possible to justify a switch only for the purpose of hedging a particular risk and how would the cost-benefit in that case be applied ?
* Is it possible that the cost-benefit analysis should be applied only to investments within the same asset class?

The strategic planning of asset allocation between different asset classes could for instance be justified on an assessment of the evolution in the financial markets, relevant indicators or benchmarks, statistical circumstances or a commercial approach and/or relate to a change in the investor profiling of the customer base.

* Is it possible to justify switches at the time of termination of the portfolio management agreement on the mere basis that existing products are not suited for positions in execution only?

B.3. if and to what extent any practical guidance can be provided

* Do you agree that a switch is normally not envisaged if the client is holding sufficient amount of cash on its investor account, as the purchase advice would be more related to the allocation of the cash than on the reinvestment of the sale proceeds?
* Are switches only or primarily focused on the full reinvestment of the net proceeds of the sale transaction?
* Do we understand the new Supporting Guideline §97 correctly if we consider that it only applies when the firm recommends the switch, which does not seem to apply to one or more reactive investment advices that do not endorse the switch or that do not request advice on a switch itself?
* We think the new Supporting Guideline should not apply to any ad hoc investment advice on a sale transaction, unless this (initial) sale advice already envisages the actual selection of an alternative reinvestment?
* A suitability report is a client-facing document that should highlight material aspects of the suitability considerations of the proposed transaction(s). It is not clear how all the assumptions underpinning an investment advice can be rendered sufficiently transparent and to what extent they affect the .
* If the suitability report envisages the entire reallocation of a client portfolio or a combination of multiple buy and sell orders at the same time, it is difficult to consider on an individual basis whether each sale transaction is individually linked to another purchase transaction. Can this mean that the justification of the costs and benefits are formulated from a “portfolio’ point of view ?

2) Should the new Supporting Guideline N°97 not be further aligned with the wording in the General Guideline n°10?

The reasonableness of the assessment and the potentiality of the benefits of the switch in the Supporting Guideline are currently not referenced in the Supporting Guideline n°97 and should in our view even be emphasized. Given the fact that the ‘expected’ benefits may not be guaranteed, it should be clear that reasonable assumptions and/or their outcome may be affected by external factors or uncertainty and that an actual comparison with the costs of the switch may be difficult to demonstrate, let alone to clarify in any client document.

Guideline 11- qualifications of staff

*104. Staff giving investment advice or information about financial instruments, structured deposits, investment services or ancillary services to clients on behalf of the firm (including when providing portfolio management) must possess the necessary knowledge and competence required under Article 25(1) of MiFID II (and specified further in ESMA Guidelines for the assessment of knowledge and competence), including with regard to the suitability assessment. Staff should also have the necessary knowledge and competence with regard to the criteria of the sustainability preferences as specified in Article 2(7) of the MiFID II Delegated Regulation and be able to explain to clients the different aspects in non-technical terms. To that effect, firms should give staff appropriate trainings.*

**Q18. Do you agree with the proposed amendment to supporting guideline 10? Please also state the reasons for your answer.**

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Guideline 12 – record-keeping

*109. Therefore, a firm is required to record all relevant information about the suitability assessment, such as information about the client (including how that information is used and interpreted to define the client’s risk profile), and information about financial instruments recommended to the client or purchased on the client’s behalf, as well as the suitability report provided to clients. Those records should include:*

* *any changes made by the firm regarding the suitability assessment, in particular any change to the client’s investment risk profile;*
* *the types of financial instruments that fit that profile and the rationale for such an assessment, as well as any changes and the reasons for them.*
* *The situations where a client’s sustainability preferences are adapted in accordance with Article 54(10) of the MiFID II Delegated Regulation, including a clear explanation of the reasons for such adaption. (own underlining)*

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

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**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 actual effectiveness and necessity of any additional changes to the existing suitability guidelines should be assessed on a case by case basis.

Establishing a level playing field in this context is necessary, but only to the extent that common provisions apply for both the assessment of suitability and appropriateness. For instance when an alignment is established regarding the general principles related to the information requirements and reliability of information, the manner in which questions are formulated, the use of design features or the manner in which inconsistencies should be detected, staff training and record keeping.

The information to be collected about the elements mentioned in article 55 (1) of the Delegated Regulation (EU) 2017/565 may nevertheless differ, taking into account, when relevant, the nature of the client, the nature and extent of the service to be provided and the type of product or transaction envisaged, including their complexity and the risks involved. This is for instance relevant for the extent of information collected about the client’s knowledge and experience (e.g. for portfolio management), the relevance and frequency of updating client information or the reliance on the product analysis conducted for the purpose of product governance requirements.

Rules applicable to the effectiveness of warnings or the matching of appropriate products may differ from the approach applied to the suitability context. A tendency for overregulation should be avoided.

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

We understand that a client’s sustainability preferences only need to be updated at the occasion of the update of the general MiFID profile.

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

We believe the examples of good and bad practices are not sufficiently detailed, when it comes to examples or clarifications of how the suitability requirements for switches should be applied.

1) The practice to identify the expected (excess) return for a switch, is overly emphasizing the quantitative impact of the switch compared to its underlying assumptions and uncertainties. Supporting Guideline N°96 demonstrates that the benefits are not necessarily quantifiable, numeric or at least they cannot be easily or immediately quantified or compared with the switching costs. Only a limited number of circumstances can be identified in which the 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. How can you reasonably compare the transaction costs with a change in a client’s financial situation, risk appetite or ESG preferences, and/or with the preferred liquidity percentage in a portfolio approach or the estimated or recent changes in product and/or market volatility?

2) Poor practices that include references such as ‘excessive’ are not quite clear.

3) The poor practice for identifying post factum any circumvention of the suitability guidelines related to switches should be reformulated, for the following reasons:

* A poor practice could be inadequate training on or monitoring of staff’s compliance with internal instructions and procedures applicable to switches or lack of review of complaints in that respect.

* 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. This puts a larger burden on certain types of (larger) firms, taking into account their internal organization, its nature and complexity.

* 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.

If the investment firm or advisor is not informed, at the time of the initial sell advice, about the intention to reinvest the proceeds of the proposed sell transaction, on the one hand, and about the actual financial instrument in which a reinvestment is envisaged, on the other hand, it remains unlikely that any cost-benefit analysis could have been contemplated. No information would be available on the comparison between the switch the costs and the/or reasonably expected return or any other benefit of the reinvestment, on the one hand, and maintening a position in the already sold financial instrument on the other hand.

* Subsequent controls as formulated by the poor practice could be overly burdensome
  + Details about the motives of the reinvestment may simply not be available or may not have been recorded.
  + What is, objectively spoken, a short time frame for these controls?
  + 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.
  + Retail investors may be triggered by inflation risk, in order to reinvest the proceeds of a previous transaction within a reasonable timeframe.

4) equivalent products

*Amended DR article 54.9. “Investment firms shall have in place, and be able to demonstrate that they have in place, adequate policies and procedures to ensure that they understand the nature features, including costs and risks of investment services and financial instruments selected for their clients, including any sustainability factors, and that they assess, while taking into account cost and complexity, whether equivalent investment services or financial instruments can meet their client’s profile.”*

In the public statement [esma35-43-2748\_public\_statement\_on\_2020\_csa\_on\_suitability.pdf (europa.eu)](https://www.esma.europa.eu/sites/default/files/library/esma35-43-2748_public_statement_on_2020_csa_on_suitability.pdf) , ESMA also noticed some shortcomings in this area (main finding 9.), but no specific guideline or clarification is foreseen.

It remains difficult today to have a common understanding of what are exactly “equivalent products”.

**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:

* Extra time to explain & gather sustaianbility preferences
* Integrate sustainability preferences for existing clients
* Cost new questionnaire in all services
* Cost new suitability test in all services;
* Develop internal trainings (commercial and non-commercial staff)
* New information packages for clients (education client)
* Cost (ongoing) suitability report
* Cost control preferences changes ect.
* Align DPM with SFDR + ongoing reportings SFDR
* Other elements (risk; organisation ect.?)
* Cost of storage
* Rebalancing; monitoring ESG subportfolio
* Cost of implementing changing laws (social taxonomy, potential impact on ‘sustainability preferences definition’ and SFDR RTS);

1. Marginal 8, section 2.1 ESMA consultation. [↑](#footnote-ref-2)
2. Preamble (6) MiFID ESG Delegated Act. [↑](#footnote-ref-3)