fecif the European Federation of Financial Advisers and Financial Intermediaries

ESMA CONSULTATION PAPER

Guidelines on certain aspects of the MiFID II suitability requirements

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.

Yes, we share ESMA's approach regarding the importance of the disclosure that must be provided to the investor for the purpose of the suitability assessment.

In addition, we understand that the contribution of financial advisors at the present time to clients' understanding of sustainability preferences is a good measure, notwithstanding the technical complexity of the legal definition. Financial advisors are requested to express in a nutshell the complex definition of sustainability preferences stated in the Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 (according to Commission Delegated Regulation (EU) 2021/1253 of 21 April 2021). To better fulfil this task, ESMA should approve templates to be used by advisors. This would provide advisors with a safe harbour in this delicate task of making the complex clear. In any case, advisors' knowledge and competence on sustainability preferences should be reinforced through professional certifications.

Moreover, the adequacy evaluation and information on clients (objectives, risk and investment horizon) must take into account financial and non-financial criteria, taking into account certain aspects of the MiFID suitability requirements in order to be aligned to the fact that the economic system needs to evolve towards a more sustainable and greener economy.

Then yes it would be appropriate to adapt and integrate the sustainability factors, risks and sustainability preferences of investors when assessing suitability performed by the advisor or asset manager.

However, the advisor must inform their clients in a clear, simple manner and in the best interest of the client regarding what sustainable means.

It also appears clear that the solution of 2 levels of information (risk/knowledge and after sustainability) looks to be an easier option.

In order to help clients understand the concept of sustainability, advisors must provide them with a definition of terms and products that meet the sustainability requirements. Advisors shall not use technical language to ensure the client's understanding. Nevertheless, technical terms were defined in order to be the right ones. Then a clear and simple explanation may not mean "poor" wording. Financial education of citizens must be considered.

Advisors should also explain what environmental, social and governance issues mean, especially to non-professional clients. It would be advisable to pay attention to the automated procedures. But digitalisation appears able to tackle this objective quite easily.

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.

Delegated Regulation (EU) 2021/1253 of 21 April 2021, the provisions of which will come into force on the next 2 August, lays down that investors should indicate their "sustainability preferences", choosing whether *or not to integrate, and if so to what extent, in their investment one or more sustainable financial instruments according to the Taxonomy Regulation, the SDFR Regulation or taking into account the main negative effects of the investment on sustainability factors in qualitative or quantitative terms. Such a decision requires an in-depth knowledge of the investor's possible sustainability preferences and risks, as well as an assessment by the client of the extent of his portfolio that he intends to invest in sustainability.*

It is well known that European citizens are not very financially literate and it is difficult to imagine that they are able not only to determine the essential elements of an investment, such as the time horizon or their risk tolerance, but now also to specifically decide which sustainable instruments they want and to what extent they should be included in their portfolio. It is clear that this choice can only be supported by a financial advisor who can transparently and clearly indicate to the client how it is possible to integrate sustainability factors, risks and preferences into their investments. The professionalism and competence of the financial advisor are also fundamental to the role of financial educator, that the advisor habitually performs, not only with regard to all the typical elements of an investment, but also with regard to sustainability. We believe it is out of the question that the client can make these choices independently, for example by using automated platforms. We also believe that it will be particularly complex, at least in an initial phase, to make the client understand the specific features provided by the reference legislation, with the risk that the client will be discouraged and renounce sustainable investments, if she/he is not supported.

The indication of the minimum percentage of sustainability preferences is also particularly complex, considering that there are still few financial instruments available on the market at the moment that can be considered compliant with the provisions of the Taxonomy and SDFR regulations, especially since these regulations have not been fully implemented yet. Only through the support of an advisor can it be expected that investors will acquire a discrete financial culture, including on sustainable investments, sufficient for informed choices in the near future. It is also necessary to assess how onerous these integrations may be socially, financially and structurally, and therefore how much they may impact in terms of system-wide cost.

In addition, it is interesting to extend the obligation of information on sustainability requirements. However, Advisors must be qualified and have sufficient knowledge to fulfil this obligation.
Preservation of resources, professional equality, fight against global warming, etc ... are all societal issues that have gradually become responsible practices expected by investors or claimed to be of paramount interest by many professionals.
It would therefore be important to consider sustainability preferences to better meet the goals and needs of clients seeking greener and more responsible investments.
The requirement of sustainability will lead to a lot of reforms and regulatory adjustments that would probably be burdensome for most SMEs, which are the majority of advisory firms.
Anyway, the "guideline" is probably too precise and 28 pages looks actually too much despite the fact it is well structured and the idea of closed answered (yes/no) looks the best way to manage some aspects.

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.

We believe that the guidelines are unclear and difficult to interpret in some respects. Investors are not able to undertake a self-assessment that allows her/him to determine her/his sustainability preferences and expectations; she/he does not know how to deal with quality and quantity, and therefore financial advisor support is absolutely essential. Over the next few years, as the reference standards are finalized and implemented, we will gradually come to consider sustainability as a starting point, not an end point. The goal *is that future investments will become more sustainable in the near future and clients more knowledgeable. This can only be achieved through client education by advisors.*

Moreover, the approach suggested for gathering information from clients on their sustainability preferences is substantially based on self-assessment. This is different from the approach that firms are expected to adopt when collecting information on the 'traditional' parameters of suitability assessment.
Although this approach is understandable, it should be anticipated to create misunderstanding, both for advisors and clients.
The client's sustainability preferences should be assessed in a second step once the suitability of the product has been evaluated according to the criteria of knowledge, experience and investment objectives.
This approach makes sense, however, it should be clear when presented to a non-professional client, who is less likely to understand.
Despite it making sense to us, in the case of interest for sustainability, asking a client details on what item / criteria for each "chapter" of ESG could become too much and too long, even for a client that is interested in it.

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

No, we believe that the Guidelines need to be clearer and more understandable, this is an ongoing issue.

Except where used for institutional clients (basically, professional clients), it is much too heavy and off-putting for non-professional clients (basically, private clients).
We recommend "lighter" procedures for non-professional and retail clients (who are often very unfamiliar with SRI/ESG) compared to professional clients. This could lead to two types of ESG questionnaire: one for professional clients and one for non-professional clients.
At one point, ESMA talks about a "bespoke mandate" but there is no granularity of the procedure according to the ESG knowledge of the final client. It will miss its target and its objectives.

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?

Financial advisors need to provide content-based, comprehensible and tailor-made answers to their clients. Sustainability is a factor that is still far from being known to clients, expect in general terms. At this stage, we do not believe that further detailed rules are needed.

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.

As indicated above, sustainability is not a fully acquired factor yet. Recently, the European Commission has proposed to integrate the suitability assessment in order to include a personalized asset allocation strategy. This is an activity usually carried out by financial advisors as part of the advisory service, which permits him/her to have a well-defined picture of the investor's situation in order to draw up a personalized investment plan linked to her/his life cycle. Integrating the asset allocation strategy would also be useful in assessing sustainability preferences.

In addition, transparency rules for green bonds will need to be strengthened, with clarification of the disclosure requirements in the prospectus. The availability of quality ESG data and the development of more robust methodologies are essential for the assessment and management of ESG risks. The deployment of new *tools such as taxonomy as well as the evaluation of practices are also major challenges in light of the climate emergency. In this respect, asset management companies will have to identify financial products that are favourable or unfavourable to environmental objectives.*

The new challenges of digital and sustainable finance highlight several strong trends:
- A rise in new demands from investors, who are opening up to extra-financial considerations.
- Changes in investor practices: some investors want to be direct players who do not hesitate to use technological innovations to disintermediate financial channels and players: the result is the rise of crowdfunding and crypto-currency fundraising.
- A new major model for advice and intermediation: a combined human / machine solution.
Those options mean that authorities must accept polymorphic compliance, regarding investment focused on green or sustainable dimension.

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

Updating the client's information about her or his sustainability preferences should be an addendum to the suitability assessment; all other elements included in the assessment should not be reviewed unless there are significant changes in the investor's personal situation or goals. In fact, it is necessary to empower the client and also transmit, through the advisory service, financial education, so that the client becomes aware of the importance of communicating to his or her advisor any major changes in their personal situation or goals. Integrating the suitability assessment with sustainability preferences also allows the investor to emphasize the relevance of these elements.

It is interesting to update both financial and non-financial information. Sustainability preferences become standards for investors, so if these standards change, the client should be informed and any advisor must take these into account.
The updating of this information will allow answering of customers needs and respect their preferences as regards durability.
The updating of this information is important, because in practice for the time being, the availability of financial instruments with sustainability features may be limited and the introduction of these financial instruments into the company's product range may be gradual.

Question 8. 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 understand that these arrangements, necessary to understand investment products, should be accompanied by measures to strengthen the knowledge and competence of employees. ESMA should ensure the implementation and high-level harmonisation of these knowledge and competence requirements in all Member States.

In addition, we would prefer a simple solution based on a pan-European report for any investment product. But, anyway, obtaining guidelines is always of interest.

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.

We do not believe further guidelines are needed. Most firms have begun a process of transitioning to include sustainability factors in investment products as part of their policies and procedures. Certainly, it will be *critical to outline the rules through the implementation of the taxonomy, once defined. Firms that do not adapt will be automatically excluded from the market.*

Moreover, procedures should be simplified and made less complex and burdensome.
Obtaining and allowing the use of some scoring solutions or "labels" would be better.

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.

The additional guidelines are in accordance with the MiFID II Directive. At the moment, clients are asked whether they are interested in investing in sustainable products and what their preferences are with respect to ESG elements, that are social, environmental or governance aspects. This assessment has no impact on the portfolio. We believe it would be useful in the future to integrate the suitability assessment with a personalized asset allocation strategy to take into account the client's sustainability preferences.

We strongly agree with the two-step model of first assessing financial suitability and then sustainability preferences. Besides, simple questions on sustainability would allow the client's financial profile (first step) to be integrated with the client's sustainability profile (second step).

In addition, it is absolutely necessary to know the client's preferences in terms of sustainability, in order to be able to adapt the advice given to the client as much as possible.

However, simple questions linked to the KYC concerning sustainability looks the right way to go. This would make it possible to establish the client's risk profile and needs and to advise him/her on the appropriate products, whether in terms of sustainability or for other reason in a single analysis.

This would follow the procedure set out in Article 54(10) of the MIFID Delegated Regulation.

The solution of a "neutral" position in case of "no answer" is adequate regarding what we are targeting.

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.

No, we do not believe the guideline should be more detailed. As stated earlier we believe there should be an asset allocation strategy to ensure portfolio efficiency.

It must be reminded that the advisor must act in a neutral manner and not influence the client's sustainability preferences.

When proposing a product that is not adapted to the client's sustainability preference, it is important to explain to the client why this product would be more interesting for him or her.

This possibility should be offered as part of the investment advice referred to in recital 8 of the MIFID Delegated Regulation so that the client can understand and adapt his sustainability preferences.

It is necessary that changes in sustainability preferences were documented in the suitability report in order to keep track of the client's changing sustainability preferences and to justify how the advice is adapted to the client's new preferences. But the suitability report may just be a single paragraph in the adequacy report.

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.

We believe it is accurate that there can be areas of adaptability in the professional relationship between financial advisor and client in both risk assessment and sustainability.

In addition, when the client adapts his preferences, it does not affect his or her risk profile, which does not change, nor the other products advised, which are adapted to the risk profile. But considering that suitability actually becomes a part of what make the decision of investing or not, yes, those cases must be monitored through an "add on" to the report or recommendation made by advisors.

Indeed, if this concerns the whole standard procedure, it will create unnecessary duplication. This results in more cumbersome procedures, which is counterproductive and does not allow for clear, fair and non-misleading information for the client. A clear and simple registered doc and/or explanation from the advisors, would be the most sufficient form.

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)?

Firms generally have a wide range of products from different providers available, in order to diversify their offering. If the firm does not have sustainable instruments available it will be excluded from the market.

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.

Obviously, the client has the option of not expressing a preference for sustainability, but this does not preclude firms from including sustainable products in the client's portfolio. It is up to the financial advisor to explain to the client why certain products have been offered and to educate the investor on sustainability issues as well.

We have to distinguish two situations:

- If the person has no preference for sustainability because he/she does not know what sustainable investment is, then yes, I agree with the approach stated, we should offer him/her all types of financial instruments, including sustainable financial instruments, and explain them to him/her.

- On the other hand, if the person does not want to have a sustainable investment because it does not interest him/her, then why offer it to him/her.

Also, in view of the possible doubt about the "no" answer on whether the client has sustainability preferences, it would be relevant to split the question into two points.

For example: are you interested in sustainable investments? if so, do you have any sustainability preferences?

But in case of "no" let's stay on a neutral basis.

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, this seems necessary in order to be able to offer the most suitable products to the client, but this will considerably increase the workload of financial investment advisors and management companies.

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?

Suitability assessments should be revised by incorporating clients' sustainability preferences. Moreover, new products or interest appear frequently. It's only a question of time: authorities must let a couple of years pass so that advisors can adapt portfolios or situations to the shifted investment paradigm.

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

Yes, this guideline is already in place. It should be considered that the decision to make a switch is not motivated only by an assessment of costs/returns, but may arise from the changing needs of the client, identified by the financial advisor, who knows the investor well.

In addition, this could appear necessary to allow the client to have clear, accurate and non-misleading information on their investments or, in this case, on a change of investment.

On the other hand, migration to a new investment world is not defined as a greater profit universe. Then it could lead to a result that is not what our Governments and authorities are seeking.

But, regarding transparency rules, we need to do something.

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 integration.

We agree that staff should have the necessary knowledge and competence regarding the criteria of the sustainability preferences according to Article 2(7) of the MiFID II Delegated Regulation and be able to explain to clients the different aspects in non-technical terms.

Consequently, this amendment should also entail the amendment of ESMA Guidelines on the assessment of knowledge and competence, so that they require knowledge and skills on assessment of sustainability risks and factors for providing advice and giving information and explaining to clients the different aspects of sustainability preferences in non-technical terms. According to the criteria stated in ESMA Guidelines on the assessment of knowledge and competence, and this new Guideline on certain aspects of the MiFID II suitability requirements, firms should ensure that staff possess appropriate knowledge and competence on sustainability preferences. To that end, firms should require a relevant certificate (according to NCA's Technical Guides implementing ESMA Guidelines on the assessment of knowledge and competence) and eventually enable appropriate staff training.

These requirements on qualification of firms' staff should be complemented by a consumer education campaign on sustainable finance. This would facilitate the dialogue necessary for the assessment of sustainability preferences.

Finally, this point is extremely important.

We don't need further details yet. Please let our local authorities exchange with local advisors until a pan-European standard appears.

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

The documentation should only be recorded if the process is for a specific investment. If simulations are conducted that do not result in an investment, they should not be recorded.

It is a good measure. We believe that the record keeping criteria on financial and sustainability issues should be aligned as far as possible.

Finally, any solution on a durable support may be accepted and especially the report.

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.

Yes, we appreciate that there is provision for alignment between the two guidelines.

Aligning the two sets of guidelines will avoid duplication and therefore problems of understanding due to the overlapping of the two texts.

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

No. It's detailed enough and probably too much.

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

Firms have systems in place to identify some of the factors that may detect the need for an update of the client's portfolio, but it is also necessary to empower the investor and make it clear to him/her that he/she must point out to the adviser significant changes in his/her needs and expectations that may lead to adjustments in his/her portfolio.

In the annual statements, evidence is given of the cases in which the bail-in mechanism is applied; this mechanism is rarely explained to clients in the profiling phase.

In addition, we agree on the desirability of maintaining an annex 4 on sustainability - good and poor practices. However, these are criteria that should be generalised both for the assessment of financial and sustainability preferences.

Finally, the list is understandable but, in some cases, clients find what it leads to is burdensome.

We are generally talking about clients having asked for an advisor because of their poor interest in finance. For those clients, the simplest is the best.

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.

They will probably be very high.

New skills but also compliance resources and time spending for small and big firms; hours of 1 or more employees or for SMEs managers. Then thousands of Euros.

IT costs probably hundreds of Euros per advisor – not only for the tool but also increasing storage solutions. Depending on the system but not less than 5€ per client (storage) + 200 to 500€ each year for the central tool except wherein case IT producers may accept to consider it as a normal part of their IT (probably not because of the programming time and space needed)

Staff costs: new skills, new time spent then … new money. How much will depend mainly on the time consumed but it will depend on the job/role and also the firm itself.

Training will be quite clear: at least 1 day each 3 years (comparable to other focused skills) and an initial one of 20 to 30 hours. Therefore, probably 300 to 1000€ in the first year and 200 to 500€ each year for each producer or employee concerned.

Big firms may pay less than SMEs per individual employed because of their capacity to buy training and IT in volume.