

MEMO# 34055

March 2, 2022

EU ESG: ESMA consults on MiFID II suitability guidelines relating to sustainability preferences

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TO: ICI Members

ICI Global Members

ESG Task Force

EU ESG Disclosure Regulation Working Group SUBJECTS: ESG

International/Global RE: EU ESG: ESMA consults on MiFID II suitability guidelines relating to sustainability preferences

On 27 January 2022, the European Securities and Markets Authority (ESMA) published a consultation paper^[1] with proposed revisions to its current guidelines on suitability requirements^[2] under the Markets in Financial Instruments Directive (MiFID II), to reflect the upcoming sustainability-related amendments^[3] to MiFID II Delegated Regulation.^[4] The consultation is open until 27 April 2022.

As background, the MiFID II Delegated Regulation has been updated to integrate sustainability factors, risks and preferences into certain organizational requirements and operating conditions for investment firms. Starting from 2 August 2022, firms providing investment advice and portfolio management will be required to obtain clients' sustainability preferences and consider them as part of the clients' suitability assessment.

This has subsequently triggered the further review and update of the 2018 Guidelines. ESMA sets out in the consultation paper additional guidelines on how firms should incorporate clients' sustainability preferences in their processes and procedures concerning the suitability assessment. It also took the opportunity to consider other relevant factors in the review of the 2018 Guidelines, including the integration of the good and poor practices resulting from the 2020 Common Supervisory Action,^[5] alignment with ESMA Guidelines on appropriateness and execution-only,^[6] and amendments introduced through the Capital Markets Recovery Package to Article 25(2) of MiFID II.

This memorandum summarizes the major guidelines proposed in relation to incorporating sustainability preferences into the suitability process, with a full list of consultation questions in Appendix A.

1. Providing information to clients on the concept of sustainability preferences

By way of recap, "sustainability preferences" refers to a preference expressed by the client for financial instruments that: (i) have a minimum proportion invested in activities that qualify as environmentally sustainable under the EU Taxonomy Regulation, (ii) have a minimum proportion of sustainable investments as defined in the EU Sustainable Finance Disclosure Regulation (SFDR), and/or (iii) consider principal adverse impacts (PAI) on sustainability factors.[\[7\]](#)

ESMA proposes that firms should help clients understand the concept of sustainability preferences and the features and choices to be made in this context. To do so, firms should explain, in non-technical language, the term and the distinction between the different elements of the definition of sustainability preferences, and the differences between products included under sustainability preferences and products without sustainability features. Firms should also explain to clients what environmental, social and governance factors mean.

2. Gathering information on clients' sustainability preferences

ESMA considers that the information collected from clients on sustainability preferences should include all aspects mentioned in the definition of sustainability preferences. Such information should also be sufficiently granular to allow for: (i) a matching of the client's sustainability preferences with the sustainability-related features of financial instruments, and (ii) a combination of the three aspects included under the definition of sustainability preferences. When providing portfolio management or investment advice with a portfolio approach, firms should ensure the same level of granularity of information is collected on the client's sustainability preferences. The following information should be collected 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 any of the three aspects under the definition of sustainability preferences, and if the client has a preference for, where relevant, a combination of one or more of the three aspects.
- Where clients indicate preferences in financial instruments that invest in activities qualified as environmentally sustainable under the Taxonomy Regulation, and/or make sustainable investments as defined in the SFDR, the minimum proportion of these in which the instruments should invest.
- Where clients indicate preferences in financial instruments that consider PAI, the specific PAI that the instruments should consider and the qualitative and quantitative criteria demonstrating that consideration.

In contrast to the approach that firms are expected to adopt when collecting information on the "traditional" parameters of suitability assessment, the approach suggested for gathering information on client's sustainability preferences[\[8\]](#) is substantially based on self-assessment. ESMA reminds firms that the existing 2018 Guidelines focusing on the measures to be adopted to limit the risks of self-assessment remain in place and are not in any way impacted by the new guidance on collecting information on clients' sustainability preferences.

3. Updating clients' sustainability preferences

ESMA proposes that, for ongoing relationships, information regarding the sustainability

preferences of a client should be updated through the next regular update of client information or during the first meeting with the client/first investment advice following the entry-into-application of the MiFID II Amending Delegated Regulation (i.e., 2 August 2022).

4. Understanding sustainability factors of investment products

The existing guidelines on understanding investment products will be updated to ensure that the policies and procedures implemented by firms to understand the characteristics, nature and features of investment products take into consideration the investment products' sustainability factors.

When considering the sustainability factors of products in view of the subsequent matching with the client's sustainability preferences, it is suggested that firms should rank and group the financial instruments included in their product range by: (i) the proportion invested in economic activities that qualify as environmentally sustainable as defined under the Taxonomy Regulation; (ii) the proportion of sustainable investment as defined in the SFDR; and (iii) the consideration of PAI. Such group should be consistent with the firms' analysis conducted for the purposes of product governance obligations.

5. Considering sustainability preferences in suitability assessment

In line with the approach set out in Recital 5 of the MiFID II Amending Delegated Regulation, ESMA proposes to add to the 2018 Guidelines that sustainability preferences of the clients should be assessed as a second step, once the suitability of the product has been first assessed in accordance with the criteria of knowledge and experience, financial situation and other investment objectives. Where a client does not express sustainability preferences, the firm may consider this client as "sustainability-neutral" and recommend products both with and without sustainability-related features. Nevertheless, the firm's product offer should be documented and explained to the client with a mention of the product's sustainability features.

ESMA suggests that a firm could only recommend a product that does not meet the initial sustainability preferences of the client once the client has adapted his/her sustainability preferences. The firm's explanation and the client's decision should be documented in the suitability report. It is noted that this possibility only refers to the sustainability preferences and not to the other criteria of the suitability assessment. ESMA further clarifies that the adaptation of the client's sustainability preferences where financial products do not meet such preferences should only refer to the suitability assessment in question/the particular transaction, rather than to the client's profile in general.

ESMA recognizes that the availability of financial instruments with sustainability features are limited at this stage, Firms should still collect all information concerning sustainability preferences from clients, even though it does not have any financial instruments in their product range that would meet the client's sustainability preferences at the time the information is collected. In this situation, the firm should clearly indicate there are currently no products available that would meet those preferences and the client should be given the possibility to adapt the sustainability preferences. Similarly, this should be documented in the suitability report.

6. Next steps

ESMA expects to publish a final report followed by the final guidelines in Q3 2022. It also intends to conduct a separate public consultation on the review of its MiFID II product governance guidelines, following the sustainability-related amendments to the MiFID II

product governance directive.[\[9\]](#)

Appendix A: Complete List of Consultation Questions

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.

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.

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.

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

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?

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.

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

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

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.

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.

Q11. Do you agree with the approach outlined with regard 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.

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

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)?

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.

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.

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?

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

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.

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

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.

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

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

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.

Lisa Cheng
Research Analyst
ICI Global

Elizabeth Lance
Assistant Chief Counsel
ICI Global

Notes

[1] See Consultation Paper Guidelines on certain aspects of the MiFID II suitability requirements (27 January 2022), available at https://www.esma.europa.eu/sites/default/files/library/esma35-43-2998_consultation_paper_on_review_mifid_ii_guidelines_on_suitability.pdf ("Consultation Paper").

[2] See Final Report Guidelines on certain aspects of the MiFID II suitability requirements (28 May 2018), available at https://www.esma.europa.eu/sites/default/files/library/esma35-43-869-fr_on_guidelines_on_suitability.pdf ("2018 Guidelines").

[3] See Commission Delegated Regulation (EU) 2021/1253 of 21 April 2021 amending Delegated Regulation (EU) 2017/565 as regards the integration of sustainability factors, risks and preferences into certain organisational requirements and operating conditions for investment firms, available at https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv%3AOJ.L_.2021.277.01.0001.01.ENG&toc=OJ%3AL%3A2021%3A277%3ATOC ("MiFID II Amending Delegated Regulation").

[4] See Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive, available at <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32017R0565> ("MiFID II Delegated Regulation").

[5] See Public Statement summarizing the results of the 2020 Common Supervisory Action on MiFID II suitability requirements (21 July 2021), available at https://www.esma.europa.eu/sites/default/files/library/esma35-43-2748_public_statement_on_2020_csa_on_suitability.pdf.

[6] See Final Report Guidelines on certain aspects of the MiFID II appropriateness and execution-only requirements (3 January 2022), available at https://www.esma.europa.eu/sites/default/files/library/esma35-43-2938_gls_appropriateness_ex-only.pdf.

[7] See MiFID II Amending Delegated Regulation, *supra* note 3, at Article 1(1).

[8] See Consultation Paper, *supra* note 1, at Annex III, paragraph 26-27, p.28-30.

[9] The European Commission introduced amendments to the MiFID II product governance directive to integrate sustainability factors into the product governance obligations. These amendments will be effective from 22 November 2022. See Commission Delegated Directive (EU) 2021/1269 of 21 April 2021 amending Delegated Directive (EU) 2017/593 as regards the integration of sustainability factors into the product governance obligations, available at <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32021L1269>.

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