EUROPEAN ASSOCIATION OF CO-OPERATIVE BANKS
The Co-operative Difference: Sustainability, Proximity, Governance

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EACB answer to the ESMA consultation on Guidelines on certain aspects of the MiFID II suitability requirements

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Introduction

The EACB welcomes the opportunity to participate in the ESMA's public consultation (ESMA35-43-2998) on guidelines on certain aspects of the MiFID II suitability requirements. This is because we believe that such guidance can serve as a necessary accompaniment to the upcoming Delegated Act (EU) 2021/1253 amending Delegated Regulation (EU) 2017/565 ("ESG DA amending MiFID II"), which introduces ESG elements into MiFID II. However, we would like to purvey some important messages before providing our answers to the questions in the consultation:

- **Legal and sequencing issues:** Our members have identified some shortcomings in the proposed guidelines (which we explain in further detail in this paper) that make it difficult to implement them in practice. In addition, the granularity of the guidelines will also be another obstacle considering that the Level 2 regulations under the EU Taxonomy Regulation and the Sustainable Finance Disclosures Regulation (SFDR) remain 'works-in-progress'; there are still some issues regarding the interpretation of SFDR itself; and inconsistencies remain in the ESG DA amending MiFID II. These issues will make it especially difficult to properly implement not just the guidelines but also the ESG DA amending MiFID II as from the application date of 2 August 2022. We understand that ESMA has no mandate to change neither the content of the Level 2 regulations under SFDR and the Taxonomy, nor their respective application dates, on which the ESG DA amending MiFID II is dependent. We also understand that ESMA cannot mandate a deferred application date of the ESG DA amending MiFID II. However, in the absence of legal and practical clarity we urge ESMA to: i) postpone publication of the ESMA guidelines; and ii) make legislators more aware that the Level 2 Regulation and Guidelines will only be as efficient and effective as the Level 1 text of the Regulations themselves, and thus the application of the ESG DA amending MiFID II should be on a 'reasonable best efforts basis' without any supporting Guidelines until all relevant legal matters are clarified. Furthermore, we expect supervisors to take proportionality into account in their supervisory practice: without guidelines or legal certainty sustainability preferences could be requested from retail clients, for which there is no answer, and thsus, banks will have to find a proportionate and flexible solution. Besides guideline specific comments which we provide in this paper, please note our other general legal issues below:-
    - In the ESG DA amending MiFID II, the amended Article 2(7)(a) makes it clear that the clients' sustainability preferences should reflect a certain alignment with the Taxonomy Regulation. Article 2(7)(b) – a direct reference to SFDR –states that a minimum proportion of 'sustainable investments' should be reflected in customers' sustainability preferences and Article 2(7)(c) mentions Principle Adverse Impacts (PAIs), without clearly defining what these PAIs are (e.g. whether they are the SFDR PAIs listed in the Annex to the SFDR RTS, or any general PAIs);
    - The ESG DA amending MiFID II also defines the "sustainability preferences" bbut using this definition for practical implementation, has limited use;
    - In relation to Article 2(7)(a) as highlighted above, banks wonder what the effectiveness and usefulness of requesting Taxonomy preferences from retail clients is, if the information to make a well-informed decision will only be available to a very limited extent between 2 August 2022 and 2023. Also, the Taxonomy has become applicable only on a few environmental goals (climate mitigation & adaptation). Information on Taxonomy alignment and full SFDR-disclosures (including Taxonomy-eligibility and alignment) from investment funds, will also, in line with SFDR RTS postponement, become available only from 2024 and onwards. We wonder why banks should ask a retail client something such specific information as referred if the information the firm receives cannot lead to a specific outcome.

- In relation to Article 2(7)(b) of ESG DA amending MiFID II, the SFDR Article 2(17) gives a very broad definition of 'sustainable investments'.[1] This is because 'environmental objectives', 'social objectives' and 'good governance practices' are not further defined. The definition in Article 2(17) also states that "these investments do not seriously undermine these objectives", better known as the principle of Do Not Significantly Harm (or 'DNSH'). The content and presentation of information on 'sustainable investments' must be consistent with the content, methods and presentation of the sustainability indicators related to the adverse effects referred to in Article 4(6) and (7) of SFDR.[2] The SFDR RTS which are needed to comply with the above, have recently been postponed up until (at least) 2023. This in effect means that a PAI is impossible to define, and without a PAI, the DNSH cannot be determined. Not regarding DNSH means it is impossible to comply with SFDR Article 2(17) 'sustainable investments'. As for Article 2(7)(a) of the ESG DA amending MiFID II, the information received from the customer can, legally, not sort any effect on the asset allocation. We therefore wonder why banks should ask this question in the first place.
- In relation to Article 2(7)(c) of the ESG DA amending MiFID II, it is unclear to Financial Market Participants (in SFDR terms dubbed 'FMPs') whether these PAIs as described in the MiFID text are the same as those described in the SFDR, or whether they constitute something (completely) different. Indeed, there is no specific reference in the Delegated Act to MiFID that could lead to a further specific definition of these PAIs. If the PAI's mentioned in the Delegated Act are linked to Article 2(a) SFDR, then the above holds as well. That is, with no SFDR RTS nothing can be said nor done with regards to these PAIs . Furthermore, the data related to PAIs will mostly be dependent on reporting under CSRD, of which data cannot be expected before January 2025. It would thus be helpful if the guidelines would indicate that the mandatory PAIs as laid down in SFDR RTS, do not need to be considered.

- **Negative effects on consumers:** The EACB is skeptical about the usefulness of some of the proposed guidelines to retail investors:-
  - It will prove to be very difficult to educate clients on sustainability preferences as mentioned in the ESG DA amending MIFID II, as these complex concepts are currently moving targets;
  - There could be an 'offering-gap' as there will be a mismatch in customer demand/preferences and available products, especially during 2022 and 2023;
  - Technical jargon and complex language will limit the effectiveness of the ESG DA amending MiFID II and the proposed Guidelines. A non-mandatory common consumer dictionary that translates the technocratic language into understandable elements for consumers, as an Annex to the Guidelines, could help. We also request ESMA to go into more detail on how behavioral insights have played a role in the construction of the Guidelines;
  - Our members have identified varying numbers of sustainability questions that have to be additionally asked to customers in the suitability process. This 'question overload' might further decrease the attractiveness of distribution channels that

[1] SFDR art. 2(17): " 'sustainable investment' means an investment in an economic activity that contributes to an environmental objective, as measured, for example, by key resource efficiency indicators on the use of energy, renewable energy, raw materials, water and land, on the production of waste, and greenhouse gas emissions, or on its impact on biodiversity and the circular economy, or an investment in an economic activity that contributes to a social objective, in particular an investment that contributes to tackling inequality or that fosters social cohesion, social integration and labor relations, or an investment in human capital or economically or socially disadvantaged communities, provided that such investments do not significantly harm any of those objectives and that the investee companies follow good governance practices, in particular with respect to sound management structures, employee relations, remuneration of staff and tax compliance".

[2] Article 2(a), as inserted by Article 25 Taxonomy

offer relatively high levels of investor protection (investment advice and portfolio management) and might incentivize customers to distribution channels where they are less bothered but also less protected (execution only).

- We fear that the number of questions asked on sustainability preferences are not in balance and proportionate with the number of questions asked regarding the 'traditional' suitability concepts like financial position, ability to bear losses and risk aversion.
- To help market participants, avoid greenwashing and ensure consistency, we believe it might be useful if ESMA provides non-mandatory example-questions on how to ask for sustainability preferences.

- **Other issues:**

  Derivatives: Derivatives contracts are in most cases financial instruments as meant in MIFID. Therefore, the suitability requirements apply in case investment advice or portfolio management is provided. However, derivatives contracts are not the funding of investments in economic activities like with shares, bonds, and participation rights in investment funds. Derivatives hedge specific risks in the portfolio of a clients like interest rate risk, FS risk, credit risk or commodity risks. Or are used to profit from price movements in the underlying value (e.g., shares or basket of shares). This specific character of derivatives justifies a different approach. In general, in cases that the derivatives are offered for the purposes as mentioned above, there is no reason to determine possible sustainability preferences of the client as these preferences relate to investments in economic activities. The assumption could be that there are no sustainability preferences of the client regarding these derivatives. For transparency reasons we think this assumption should be disclosed to the client. In specific cases derivatives could be seen as sustainable. For example, when the derivative hedges risks on sustainable underlying values like sustainable improvement loans or green bonds. This provided that the sustainable character of the underlying value has consequences for the derivative. E.g. a discount for the client on the derivative when certain pre agreed sustainability metrics on a loan are met.

  - ***Costs and benefits***: ESMA has included a cost-benefit analysis. We do not agree with this rather favorable analysis conducted by ESMA, although it is impossible for us to state how much implementation of these guidelines would cost for our member banks. We believe assessing sustainability is something completely different than testing the current financial risk/return parameters. We therefore do not support the assumption ESMA makes about overall costs.Please see our answer to Q21.

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

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.

A clear explanation of the investment product to the retail client is already required under the current suitability assessment regime, and without a doubt, would also be required when

assessing the suitability of the ESG product based on the client's sustainability preferences. However, the EACB believes that the approach being suggested by ESMA is challenging because:-

- Whilst an explanation of the meaning of environmental, social and governance is expected, we deem it very difficult to explain, without using technical language, the distinction between the different elements mentioned under a) to c) of Delegated Act (EU) 2021/1253 amending article 2(7) of Delegated Regulation (EU) 2017/565.
- There is a lack of investor education in this area, which ESMA has also been addressed in the Sustainable Finance Roadmap 2022-2024 dated 10 February 2022 (ESMA30-379-1051) p. 12: *"….. Investor education also plays a role in making sure that product offerings related to ESG investing can be properly understood, for example in relation to the sustainability impact of different investment strategies put in place to integrate ESG factors. It is worth noting that investor education is important also beyond investment services, for example in asset management too".*

There is no flexibility is given depending on the client's needs and profile. Some clients are in great need of in-depth ESG information while others are not (already knowledgeable, not interested in sustainability, looking for very specific product not related to sustainability). At this stage, guidelines are too stringent. Distributors should therefore have more flexibility to adapt information to provide depending on client's profile and desires.

We agree with the above statement by ESMA but as part of educating (potential) clients, firms should be allowed to explain to the client what a reasonable expectation of sustainability preferences is based on the availability of products in the market, without risking being liable for having steered client preferences. The request in paragraph 16 of the Guidelines to avoid technical terms ("technical language") needs to be qualified. Due to the different objectives of SFDR, Taxonomy Regulation and Delegated Regulation (EU) 2017/565, it may be mandatory to use technical terms in order to provide a sufficiently clear description. According to the principle of certainty, it must be possible to assume that statutory requirements are sufficiently clear and comprehensible in themselves, so that it must be possible to fall back on the statutory terminology when explaining them to the client. It cannot be the task of the investment services company to resolve any ambiguities in the law vis-à-vis the client. Therefore, the statement on the avoidance of technical terms should be limited to those situations where it is possible to do so, and the investment services firm must have discretion.

This explanation could be supported with data. It is important that prior to collecting information from (potential) clients (investment advice or portfolio management) regarding their sustainability preferences, clients understand why banks/investment firms are collecting information that is relevant in relation to the sustainability preferences of the (potential) client and the choices to be made in this context. Meanwhile, we encourage the roles undertaken by ESMA and the NCAs to contribute towards investor education because educating retail clients in this regard cannot be in the hands of service providers alone.

Simultaneously, we could also envisage a narrower ESG explanation to be provided to those clients who do not express an interest in sustainability preferences (by neutrality or answering 'no' to whether they have sustainability preferences). This will address the complexity of using technical language with retail clients. We further address this point in our answer to Q3.

<u>Suggested wording</u>

"In order to help clients understand the concept of "sustainability preferences" and the choices to be made in this context, firms could 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. Firms could also explain what environmental, social and governance aspects mean."

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.

The EACB does not support further expansion of this information requirement. However, we do believe it would be helpful for ESMA to provide in this guideline one or more non -mandatory examples of how the concept of sustainability preferences and especially the distinction between the different elements mentioned under a) to c) of Delegated Act (EU) 2021/1253 amending article 2 sub 7 of Delegated Regulation (EU) 2017/565 could be explained without using technical language.

We would also like to highlight that part of the investor education we refer to in our answer to Q1 would likely include information related to the state of financial markets and existing sustainable products. At this stage, the actual economy does not allow for developing financial products strongly aligned with ESG criteria. For instance, main equity indexes representing a diversity of large companies (i.e. CAC 40, MSCI World) fail to align to more than 5% with taxonomy criteria. In addition, the current lack of ESG data does not help to qualify potential sustainable products. In order to make sure that information is sufficiently exhaustive and neutral, we would like to propose that ESMA works on a paper explaining the state of financial markets when it comes to sustainable investments. This would help to prevent never-ending updates of preferences due to mismatch between clients' profile and products.

Guideline 2 – arrangements necessary to understand clients

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.

The EACB seeks clarification and makes its own proposals regarding some of the proposed approaches:-

- **Paragraph 25 (first bullet point):** We are of the understanding that if a client says "no" to sustainability preferences in general, as explained in paragraph 25 of the proposed guidelines, then the firm is not required to assess sustainability preferences, no minimum proportion (a) and (b) is necessary, and no quantitative and qualitative aspects are considered. Indeed, such waterfall approach is supported by our members but should be made clearer by ESMA in the guidelines. Moreover, it should be made clearer as well whether the client has sustainability preferences with respect to (a) to (c) of the MiFID delegated act, because there is no legal basis to ask about sustainability preferences in general. This means that a client might respond "yes" in general, but might not have specific sustainability preferences for Taxonomy alignment, sustainable investments under SFDR or PAIs. Therefore, it might make more sense to start the suitability test from paragraph 25 (second bullet point) and introduce a follow up question asking whether or not the client has specific preferences. This would ease the process for clients having ESG preferences, but not specific ones as per (a) to (c). Investment firms should be free to

provide "no indication/no preference" instead of "no" in the initial question. The consultation paper also treats the two cases "sustainabilty-neutral" and "no" in the same way, as can be seen from point 83.

- **Paragraph 25 (second bullet point):** Insofar as a combination of the aspects under letters a) and b) and c) of Article 2 (7) of Delegated Regulation (EU) 2017/565, being necessary to consider in the client survey: A necessity to actively ask clients about this would increase the complexity of the client survey and the cases that clients cannot be offered products according to their stated sustainability preferences. There should therefore be no active obligation to have to consider the aspects cumulatively.
- **Paragraph 25 (third bullet point):** The questioning of clients about the desired minimum proportion in the cases of letters a) and b): In our opinion, the law does not require such a questioning. It only requires that the clients determine that the products have a minimum proportion (see Article 2 (7) letters a) and b) Delegated Regulation (EU) 2017/565 "a financial instrument for which the client or potential client determines that a minimum proportion shall be invested in ..." [emphasis added by drafter]). In particular, however, a question about the desired minimum proportion would be misleading. Clients would associate such a questioning with the justified expectation that the share cannot be fallen short of later (see wording "minimum proportion") and that the published shares in the products are comparable with each other. However, neither of these is the case: only actual values are consistently available for the relevant products. These are related to the reporting date and can later be exceeded, but also fallen short of. The published proportions are not comparable because the basis/calculation basis for their determination may differ. This applies first of all to the individual types of financial instruments (such as funds, bonds and certificates, shares). However, it also applies within a type of financial instrument or in comparison of product manufacturers (e.g. funds, there e.g. due to different strategies). In the case of products under a), the Commission's planned differentiation in the degree of sustainability is also likely to stand in the way of comparability of proportions. Finally, we see the danger that such a questioning could promote an overbidding competition of product manufacturers with regard to quotas and thus greenwashing. The possibility of clustering would not change anything in terms of misleading the client about the differing information content or the limited informative value of the quotas. As long as the published values are not minimum ratios and lack comparability, there should therefore be no need to ask the client for the desired minimum ratio. Instead, there should be the option to inform clients about the published ratios in the suitability report. This would also provide the opportunity to inform clients about their limited informative value, including any lack of comparability.

- **Paragraph 25 (fourth bullet point):** We also note that ESMA's guidelines are not in line with Article 2(7)(c) of Delegated Regulation 2021/1253. Paragraph 25 of the ESMA Guideline states as follows: "*For aspect c), which principal adverse impacts (PAI) should be considered including quantitative <u>AND</u> qualitative criteria demonstrating that consideration*" whilst Article 2(7)(c) of the delegated regulation states "*quantitative <u>OR</u> qualitative criteria*". Systematically introducing quantitative elements would make the matching process longer and more difficult to be successful, notably due to a lack of PAI quantitative data before the full implementation of the CSRD. Therefore, ESMA should update the correct wording to *"or"* instead of *"and"* when referring to the criteria. The explanations in paragraph 25 should be supplemented by the reference contained in Article 54 (5) Delegated Regulation (EU) 2017/565 that the information should only be collected "insofar as it is relevant". This restriction by the legislator shows that a certain degree of flexibility should be left to the distributors, which should also be reflected in the guidelines.

- **Paragraph 26 (bullet point 4):** Paragraph 26 of ESMA's guidelines also reads as follows: *"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)."* The word "and" should be replaced by the word "or" as explained for paragraph 25 above. In addition, the service provider should be free to decide whether it is possible for the client to make a more accurate qualitative exclusion of PAI meters. The operating models and product ranges of service providers are so different that one model should not be extended to all actors, but how and at what level the survey should be carried out should be decided on service provider-by-service provider basis.

- **Paragraph 26 (bullet point 4):** According to this bullet point, information to be collected from clients should include all aspects mentioned in the definition of "sustainability preferences". Furthermore, in case the client wishes to include a financial instrument that considers principal adverse impacts "PAI", the information collected should cover the PAI and qualitative and quantitative elements. The wording proposed for the guidelines goes further than the legal requirement in Article 2(7)c "qualitative **or** quantitative criteria". The guidelines refer to qualitative **and** quantitative criteria. The final guidelines need to be amended here to reflect the legal wording, also in order not to further increase the complexity of the questions about sustainability preferences. Currently, there is no definition of quantitative options and criteria the market can use, neither from product manufacturers nor distributors. The available PAIs are provided in 64 specifications according to the Disclosure-Regulation RTS. However, these 64 specifications (e.g. percentage of hazardous waste) cannot be discussed with clients, therefore we see a lack of practicability in the application of the Draft Guidelines. In addition to these application problems, we wanted to raise the point that various of the 64 specifications currently lack a common definition in the EU-Taxonomy on sustainable economic activities. We therefore would at least call to collect from the client and report to him only the specifications for which a definition in the Taxonomy is in place. E.g. the presented example "waste" is not included in the two Taxonomy Delegated Regulations which are applicable, but will be included in a subsequent Delegated Regulation. Therefore, this specification should not be part of the collection of information on the sustainability preferences of the client. We also believe to ask clients about certain aspects which may be important for them but are not defined, could disincentivize the future sustainable investment willingness of the client. Where no definition is in place, no product will be available.

- Suggested wording:

  "*In case the client wishes to include a financial instrument that considers PAI, the information collected should cover the PAI and qualitative and* ***OR*** *quantitative elements mentioned under c)****, provided a definition for the PAI according to a Delegated Regulation supplementing Regulation (EU) 2020/852 of the European Parliament and of the Council by establishing the technical screening criteria*** **applies**. *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*, **provided a definition for the PAI applies**."

- **Paragraph 26:** In our view, a further query according to E, S and G goes beyond the legal requirements, so that this cannot be provided for in the concretizing guidelines. In addition, querying for G would make little sense, since the SFDR provides for active pursuit of an E or S goal. G, on the other hand, is a necessary prerequisite for all

sustainable products and is precisely not intended as an actively pursued goal. Accordingly, it is not likely that there will be products that focus on G.

- **Paragraph 26:** The paragraph states that: *"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."* We believe this Guideline could be overly prescriptive. The 'combination-effect' is highly burdensome for both client and undertaking. We believe it is better to delete or amend this passage. Please also see our answer to Q5.

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

Objectively, we would not propose any further guidance at this stage given the absence of clear Level 1 (Taxonomy) and Level 2 (SFDR RTS) regulation. However, we wish to highlight that the legal uncertainty does pose issues on how exactly sustainability preferences can be proposed to clients and how to explain E, S, and G, thus leading to different interpretations across actors. For example, "sustainable investments" defined under SFDR Article 2(17) for the purposes of setting sustainability preferences is not further defined in any other legislation. Indeed, some market actors may define varying degrees of Article 8 SFDR products under the term "sustainable investments".

Clients' sustainability preferences will initially most likely be limited to a manageable number of financial instruments.

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?

According to ESMA, firms should investigate (a) to (c) of sustainability preferences, in a granular and detailed manner. In this way, firms should be enabled to apply them cumulatively or in different combinations when selecting / recommending financial instruments. We would like to refer to our comments on question 3 regarding the combination of aspects under letters (a) to (c) of article 2 (7) Delegated Regulation (EU) 2017/565. There is also no legal requirement for prioritization on the part of clients or advisors regarding product categories. For this reason alone, it would have to be rejected that the client, who specifies several categories according to a) to c), would have to be questioned regarding a prioritization with regard to the categories. This would unnecessarily complicate the process. Furthermore, it must be considered that the client to whom prioritization is important will indicate this autonomously.

Given how difficult it is to get information or data on any one of the three types of sustainability preferences, we expect many firms will struggle to apply these preferences cumulatively or in combination. As explained in our answer to question 2, the current economy is also not mature enough yet to provide a wide diversity of ESG financial products. Therefore, the more clients ask for a combination, the riskier products will be as such products will not be diversified enough. In this context, we believe that ESMA could elaborate on the legal basis of the combination requirements in the Guidelines:-

- We would like to first of all clarify with ESMA what is meant in paragraph 26 by "*firms could also assess whether the client would only prefer <u>one certain degree of sustainability-related expectation or whether more or all of them should be part of its preferences</u>.* We wonder if there is a distinction between an expectation and a preference, and if so, this should be clarified.
- Our understanding is that in a portfolio management situation, a product including a combination is required to be recommended only if the client has expressed preferences in favour of such combination. If not, we would then be allowed to recommend a product taking into account only one of the client's preferences. We thus suggest splitting the second bullet point of paragraph 25 into two, introducing a question dedicated to potential combinations.
- We believe that ESMA shoul specify in the guidelines that combining "a", "b", and "c" preferences is not a requirement at transaction level, but only at portfolio level, where applicable. Indeed, where the suitability test is conducted at transaction level, and a client expresses ESG preferences for categories "a", "b" and "c", the financial institutions can propose to the client the following types of products: (i) any product that respects the clients' minimum "a" proportion (i.e. taxonomy alignment), irrespective of the other categories, (ii) any product that respects the clients' minimum "b" proportion (SFDR alignment), irrespective of the other categories, (iii) any product that respects the clients "c" preference (PAI), irrespective of the other categories, and, of course, (iv) any product that respects a combination of client's preferences, if possible. If financial institutions were constrained to only sell to the client products that represent a combination of the three preferences (a, b and c), the eligible product universe would be extremely reduced, and hence the commercial process would be overly burdensome and counterproductive, as illustrated in the following example.

  A client expresses three preferences:
  a) *20% environmental taxonomy alignment,*
  b) *30% social SFDR alignment,*
  c) *PAI on Average income inequality score (for sovereigns).*

  The financial institutions can propose three products:
  i. *An equity instrument with 25% environmental taxonomy alignment issued by an international corporate, that is not rated according to SFDR social definition,*
  ii. *A social bond 100% aligned with SFDR definition issued by an international corporate, which turnover is overall 10% aligned with the environmental taxonomy,*
  iii. *A sovereign bond that respects the PAI on average income inequality.*

  According to our interpretation of MIFID ESG texts, the financial institution is able to propose all three products to the client and respects the suitability test in doing so, while explaining to the client which product corresponds to which preference (respectively "A" product to "a" preference, "B" product to "b" preference, and "C" product to "c" preference).

  Otherwise, if the financial institutions were bound to respect all the three types of preferences within the suitability test of each product, then none of the financial products would be sold. In order to be allowed to sell these products to the client, the financial institution would need to ask the client to re-express the same ESG preferences, but one by one, selling one product at a time. This would be excessive for the client, who should be allowed to express all three types of MIFID ESG

preferences, without them being required to be bundled by default into a combination.

Indeed, for the client's preferences in the above example, no real product could respond to all three preferences, as the PAI concerns a sovereign issuer (preference c) and the other two preferences cannot apply to a sovereign issuer by design (e.g. the taxonomy does not apply to sovereigns). It is not feasible to require clients to fill-in as many ESG MIFID questionnaire as different preferences, some inherently incompatible for one transaction.

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.

In paragraph 27, ESMA states that *"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".* This needs to be clarified, because there appears to be a contradiction between portfolio approach and the possibility to target ESG preferences to a certain part of the portfolio. Although we in general support this possibility, it should be noted that in certain services or client groups it should be possible for the investment service provider to restrict the possibility to divide the portfolio based on the different clients' specific ESG preferences. The client can be offered a model portfolio, where it is not possible to divide clients' portfolios in different parts. Model portfolios are identical portfolios which can be used for large groups of clients. Therefore, in model portfolios it is usually not possible to divide portfolios in parts where clients' individual ESG preferences apply and do not apply, and this should be stated clearly in ESMA's guidelines.

Guideline 5 – updating client information

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

If the interpretation is correct, then we do agree that the sustainability preferences can be updated during the next update of the profile of the client and not during a regular contact moment while rebalancing. Updating one's profile takes time to prepare, while a rebalance can happen at any moment and often requires swift action to place an order.

However, we suggest deleting the reference to "the first meeting with the client", in order to make it consistent with the delegated regulation (recital 4) and the existing guidelines. The term of "meeting" could also be confusing as it could cover any potential interaction between the client and its advisor. We also strongly believe that the word "meeting" as the current wording states refers only to meetings which focus on investment advice, e.g. a meeting during which the client wishes to discuss their account or a loan, and that this must not lead to a mandatory update of the information on sustainability preferences. Please see the suggested edit below:-

"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."

Guideline 7 – arrangements necessary to understand investment products

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 generally agree with the approach but note some impracticalities that may impact it:-

- The ranking and grouping of financial instruments should not take into account all the clients' answers in (a) (b) and (c) (if, for example, there are several sub-questions on each topic). For example, in PAI categories, such a breakdown cannot in practice go into such detail because there would be too many product categories. ESMA's proposed guidelines should be able to simplify the matter for the client, not complicate it. A simple explanation of the matter to the client balanced with a fairly accurate inquiry of different kinds information could be clarified by ESMA.
- There are certain inconsistencies between different parts of ESMA's guidelines. For example, guidelines 70 and 71 mention the link with product governance obligations, which only come into practice later this year.
- We do not agree with the statement in paragraph 70 that the level of complexity of the products should be aligned with the information provided by the clients (especially in terms of their knowledge and experience) because we disagree with the assumption that a higher level of complexity would require more knowledge and experience of the client. For this reason, this statement should be deleted.
- The lack of available reliable data increases the chances of incorrect ranking and grouping, resulting in possible miss-selling and unintended greenwashing. This is a valid argument towards considering deferral of application of the MiFID Delegated Regulation (EU) 2021/1253 to a later point in time.

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 believe that no further guidance is needed here from ESMA, but also refer to our answer to question 8.

Guideline 8 – arrangements necessary to understand the suitability of an investment

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 EACB seeks clarification and proposes different wording with respect to some elements of guideline 8:

- **Paragraph 79:** Whilst the proposed order of conducting the traditional suitability test first and then followed by the sustainability preferences criteria, does simplify the approach, there are other factors than the objectives mentioned in paragraph 79 that can play an important role for a client. For example, preferences in certain sectors or geographical areas can prevail or have the same level of importance to the client than sustainability factors. Therefore, service providers should have flexibility to either use the proposed order as mentioned above, or else to interview the client in detail (all criteria of the suitability test, including sustainability preferences) and then use this as a basis for product selection. Both approaches will lead to the same result: Either the product fits in all queried criteria or it does not. The order of the query is irrelevant. This applies in particular to the extent that a system-based check is carried out to determine which products can be recommended to a client on the basis of all client details.

- **Paragraphs 80 and 81:** These paragraphs present some challenges. First of all these paragraphs assume complete availability of all data, which is not a reality at least up until 2024. It also assumes that a complete coverage of products for all preferences, which in practice will not be the case. If preferences do not match with existing products, clients would have to adapt their preferences without knowledge about what the market is currently providing. This could lead to several adaptation attempts before finding an adequate product, especially in a context where sustainability products are lacking due to both a lack of green projects and missing ESG data. Particularly regarding the taxonomy alignment, the realistic minimum percentages of alignment will be very low. According to paragraph 81 such adaptation should not be standard procedure. We thus suggest the following approaches:-
  - The update should first of all occur at transaction level and not at profile level. This means that the general profile of the client remains unchanged, while slightly adapted for the transaction if needed. This would prevent systematically submitting a new questionnaire if the profile does not match. Our understanding of paragraph 81 is that it seems to allow this approach by stating that "this adaptation should only refer to the sustainability assessment/investment advice in question".
  - Investment firms should be allowed to display to clients available offers if initial preferences do not match with existing products. Adaptation of preferences would then be based on the client's choice regarding existing investment firms' products. It should be noted that recital 8 and art.54(10) of the delegated regulation does not specify whether adaptation should occur before or after product recommendation.
  - In case initial preferences are combination-based, a product recommendation could be based on one of the aspects of this combination (either a), b) or c)).
  - In case a client with sustainability preferences decides to choose a product without sustainability characteristics, the adaptation would touch upon the fact that the client's ESG preferences could not be matched with any existing product.
  - Another approach could be to not adjust the sustainability preferences of the client at all whenever there is no availability, but to request client consent on either: (i) to accept that the product that the client is advised on deviates because of the unavailability of that specific product; or (ii) that the client finds the characteristics of another product more appealing and ranks those characteristics of higher importance than sustainability aspects (for example the aforementioned preferences in sector or geographical area).

  <u>Suggested wording (Paragraph 81):</u>

> *"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 financial institution can present its product offer range (not only a specific product) to a client whose initial preferences are outside its offer, in order to allow the client to decide whether he/she wishes to adapt his/her preferences or not****."*

There is no requirement under the Act for documentation in the suitability report. Rather, the law only requires documentation (see article 54(10) Delegated Regulation 2017/565). This can also be internal documentation. If the legislator had considered documentation in the declaration of suitability to be necessary, it would have regulated this in article 54 (12) Delegated Regulation 2017/565. article 54 (12) Delegated Regulation 2017/565 has also been adapted, so that the fact that the legislator has not made any provision in this respect in article 54 (12) Delegated Regulation 2017/565 suggests that a record in the declaration of suitability is not required.

- **Paragraph 82:** Paragraph 82 is challenging and applies in practice only to client-specific portfolios, not to model portfolios offered in a similar way to wider client groups. In our view, such monitoring obligation is not an obligation under Delegated Regulation 2021/1253. Therefore, such a continuous monitoring obligation in portfolios subject to investment advice should be voluntary and this should be turned into a voluntary obligation in ESMA's guidance

- **Paragraph 83:** With respect to paragraph 83, we understand that if a client declares that it does not have sustainability preferences, then those sustainability preferences would not need to be further documented or disclosed to the 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.

We do not believe there is a need for more detailed guidelines in this case, but rather clarification.

Recital 8 states that: *"In order to allow for further recommendations to clients or potential clients, where financial instruments do not meet a client's sustainability preferences, the client should have the possibility to adapt information on his or her sustainability preferences".* Paragraph 80 of ESMA's guidelines uses different terminology: *"it can only do so once the client has adapted his / her Sustainability Preferences".* On the other hand, this possibility is mentioned in paragraph 84 of ESMA's Guidelines in a slightly different way than in Article 54 (10) of the Delegated Regulation. This wording by ESMA may leave it unclear how to deal with client sustainability preferences and sustainable investment products in these situations.

Ideally, we believe that the adaptation of preferences should be based on existing offers rather than being made before the product offer. And if the client would accept the offer made despite not matching with their sustainability preferences, then the following transparency should be recorded properly:-

- A clear explanation that the financially suitable products do not have sustainability characteristics that match the preferences of the client.

- The initial preferences of the client should be documented clearly in the suitability report. During the regular reviews, the firm should inform the client whether products that fulfill the initial sustainability preferences have become available or not.
- The firm is allowed to advise financial instruments that match the client's higher initial sustainability preferences without having to re-do the suitability assessment (if the product is financially suitable).

Please read our answers to questions 10 and 12 for further insight.

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

The EACB understands that ever-adapting sustainability preferences is burdensome and complicated for all, but expects with the current approaches under the ESMA guidelines that these shall be a common occurrence, thus making the section stating that "this should not be a standard process" challenging once the guidelines become applicable. This is not only due to the limited range of products with which sustainability preferences can be met, but also because the more detailed the requirements for the survey on sustainability preferences will be then the harder to match the right product. It should also be borne in mind that clients must be free to change the investment objectives they have given - including their sustainability preferences - at any time and as often as they wish. It is not apparent why this general principle should be deviated from in the present case to the detriment of the client. We thus request that the first sentence in recital 81 be deleted.

We agree that if a client changes its sustainability preferences, this should only apply to an individual investment advice, and this change would not change the client's overall investor profile/suitability assessment. That said, documenting the change in this individual investment recommendation for the investment recommendation report is also challenging and will take time, as there will be so many sustainability preferences in the future and a considerable number of different options to change them. We thus suggest that ESMA's guidance be amended for paragraphs 80 and 81 so that the investment recommendation report only contains information on whether or not client has changed its sustainability preferences in relation to the recommendation.

Furthermore, we are critical of the fact that an adjustment should only apply to the advice in question, i.e. not to subsequent advice. In our opinion, this contradicts the statutory regulation and the respective client interest (where applicable). It appears that adapted sustainability preferences are being treated as "second-class client information" and that returning to the original preferences, especially in asset management and portfolio consulting, would lead to the consequence that the portfolio would have to be restructured. This should not be the case.

Finally, we see references to monitoring of preferences which are hard to understand because what ESMA may have not considered is that adaptation of the sustainability preferences will most likely be triggered often based on the above-mentioned issues. There is a requirement for documentation under the MiFID Delegated Regulation for documentation (see Art. 54(10), (EU) 2017/565) which can also be internal documentation, but not for documentation in the suitability statement. If the legislator had considered documentation in the declaration of suitability to be necessary, it would have regulated this in Art. 54 (12), (EU) 2017/565. This article has also been adapted in that the legislator has not made any provision in this respect suggesting that a record in the declaration of suitability is not required.

We also do not see any obligation for regular monitoring. This is likely to apply in particular if a system-side process is provided for the possibility of adjusting sustainability preferences.

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

Please refer to our answers to questions 10-12.

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

The EACB shares ESMA's approach, considering that the obligation to provide information to clients about recommended products is already done via pre-contractual information documents (KID, prospectus) but suggests changing "offer" to "recommendation" in the second sentence of paragraph 83. This would make clear that obligations related to information and documentation does relate to the recommendation to client and not the whole investment firm's range of products.

Suggested wording:

"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~~ recommendation*** *should be documented and explained to the client with a mention of the products/portfolio's sustainability features."*

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.

Relating to portfolios, two types of portfolios can be distinguished: There are client-specific portfolios that are more typical when the client has more assets to invest. In addition, there are also so-called model portfolios, which can typically be offered to a wider client base. Service providers should be free to decide what type of investments or portfolio services are offered to their various clients and client groups, or if at all. In both portfolio types, the service provider may not always be able to act in accordance with the client's sustainability preferences, or the service provided may not meet the client's sustainability preferences.

The difference is that in customized portfolios, customizing a client's portfolio to meet the client's specific sustainability preferences may be easier than in model portfolios.

Model portfolios on the other hand are a standard product offered by the service provider and cannot typically be customised according to client-specific sustainability preferences. In these cases, the client could be presented with the most available asset manager model portfolio according to the client's sustainability preferences. Following this presentation, the client could

be asked if the client is willing to customize its sustainability preferences. If the client adjusts its sustainability preferences according to the nearest model portfolio available, this model portfolio could be offered to the client as fully suitable for the client.

Therefore, whilst we see it as necessary in investment advice (paragraph 81) that the client can make an adjustment to their sustainability preferences, we generally support the contrasting approach under paragraph 82 (portfolio management) where the adaptation is discussed with the client, and note that ESMA should clearly distinguish the different services to which these two paragraphs apply.

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

Regarding monitoring, we already address some aspects in our answer to question 12. However, we elaborate further below.

First of all, due to the issue of lack of ESG product availability, we can expect many recurring cases of adaptation which are not ideal. This is because if the goal of the sustainable finance regulations is to increase sustainable financing, then there should remain a market signal or a way of monitoring whether the consumer demand for sustainable financial products is being met in a realistic way. The client lowering their sustainability preferences in their adaptation could thus reduce the transparency in the availability of sustainable products. This is also why we make recommendations on how to adjust the adaptation approach in our answers to previous questions.

Furthermore, for government bonds it is harder to determine whether they can be counted as sustainable investments or not. For taxonomy alignment this is acknowledged, but not for sustainable investments as defined in article 2(17) SFDR. This could lead to clients having to adapt/accept a product with less sustainable instruments/alignment whenever their situation calls for a change in their risk profile. We do not think that this is the intention of what the regulation tries to achieve, and we would like to point this out.

In this context, controls and restrictions in the form of monitoring should only be introduced if they have a targeted effect and remedy grievances. As long as no suitable products are available, the firms will in many cases have no choice but to inform the clients that no suitable product is available in the desired specification and, if necessary, to point out to them the possibility of changing their preferences or to disclose to them the deviation from their sustainability preferences. Against the background of the limited product spectrum, no consideration should be given to only restrictively permitting deviations from the (initial) sustainability preferences. In addition, we consider further restrictions to be counterproductive, as clients might be inclined to completely deselect the topic of sustainability if they could only change their preferences to a limited extent.

Monitoring would eventually make sense when all conditions are gathered, thus entering into force once all data required to build ESG products are available (first reporting under CSRD).

Guideline 10 – costs and benefits of switching investments

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

We understand the reasoning that a switch should be possible based on the best interests of the client, but we have some remarks regarding the wording in paragraph 97:

- **This amendment is not in line with level 1 and 2 provisions** – While MiFID (Article 5(2)) and the MiFID delegated regulation 2017/565 (Article 54(11)) require to provide a costs/benefits analysis to clients before the recommended switch is made, there is no obligation to introduce such analysis within the suitability report. According to article 54(11) DR 2017/565 investment firms *"(…) shall undertake an analysis of the costs and benefits of the switch, such that they are reasonably able to demonstrate that the benefits of switching are greater than the costs."* Neither this clause, nor article 54(12) Delegated Regulation 2017/565, requires an investment firm to include this information in a suitability report. The requirement "able to demonstrate" relates to the firm's policy and procedures. See guideline 10 and also "MiFID II Supervisory briefing, Suitability" 13 November 2018 | ESMA35-43-1206:
  "What are the firm's policy and procedures to ensure that, when the firm recommends switching an investment, an analysis of the costs and benefits of the switch is conducted and part of the suitability assessment so that the firm is reasonably able to demonstrate that the expected benefits of switching are greater than the costs?".

  Whilst the members of the EACB wish to provide this information to clients, we wish some flexibility on the medium to use.

- **Introducing ESG factors into a cost/benefit analysis seems impossible to make** – As written, the recommended amendment could suggest that sustainability factors can be introduced into the analysis. This would be very problematic as it looks very difficult to define objective criteria to determine whether a switch can be detrimental or beneficial in terms of sustainability. For example, a client asks to switch from an instrument A to an instrument B. The first one is 20% taxonomy aligned, while the second includes a coal extraction exclusion (PAI). On which criteria the cost/benefit analysis can be defined? On this basis, the EACB suggests that ESMA makes it clear that sustainability criteria does not need to be introduced into the analysis.

Guideline 11 – qualifications of firm staff

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.

If our understanding is correct, that paragraph 104 leaves it to the service provider to determine how in-depth training should be provided to staff then we generally support this approach by ESMA. We believe that each service provider should be able to define this depth of training for themselves and this is well suited to the fact that the services and products offered by the different actors vary a lot. We thus do not see the need for further guidance but would like to highlight our concern that the current uncertainties regarding the definition of sustainability preferences as specified in Article 2(7) of the MiFID II Delegated Regulation, the components of that definition (Taxonomy, Sustainable Investments, DNSH, PAIs) and the lack of data (Taxonomy) make it difficult, if not impossible to understand what sustainability preferences are, let alone that it can

be explained to clients in non-technical terms. Persisting in these requirements, without providing any form of relief causes legal uncertainty and stress in the organizations of investment firms and for its employees. It is possible if not likely that interpretations will change and leave employees in confusion. We refer to our approaches under Question 1 when tackling the issue of addressing retail clients in technical terms.

We advocate to delete the wording "in non-technical terms" as this is not possible due to the rather complex definitions.

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 competence54), 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~~ on best effort basis****. To that effect, firms should give staff appropriate trainings*."

Guideline 12 – record-keeping

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

The EACB believes that the additional bullet point regarding to the adaptation of sustainability preferences is superfluous and covered by the first bullet point ("any changes made"). It thus should be removed, especially since the underlying reason for changes is not relevant. It does not have to be based upon Article 54(10) of Delegated Regulation.

Planned alignment with ESMA guidelines on appropriateness and execution only

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 EACB does not support the alignment of the suitability and appropriateness assessment guidelines, even though these intersect when it comes to the criteria of "knowledge" and "experience" because:

- The appropriateness assessment is constructed, as per the Level 1 legislation, as a narrower obligation focusing on the knowledge and experience of the client and the complexity of the product based for non-advised execution-only services. If a client is offered discretionary portfolio management and the service provider makes investment

decisions on behalf of the client after the suitability assessment, the client's understanding relating to investment product does not need to be as in-depth as when the client makes the investment decision himself after the appropriateness test. This is the spirit of the law intended by the legislator.

- Although we see merit in adding sustainability factors to the appropriateness assessment in the future, we believe it is highly premature at this point in time to require firms to assess the client’s knowledge and experience with respect to investment products’ sustainability factors and risks when execution-only services are rendered. The main argument to refrain assessing clients’ knowledge and experience on sustainability factors is that sustainability definitions are still evolving in the regulatory ESG-landscape. We suggest that after evaluating SFDR (that at this moment clearly is not applicable on execution-only services) pre-contractual and periodic disclosures and MiFID II ESG amendments (i.e., to Product Governance and Suitability) ESMA could look into amending the appropriateness guidelines. Firms should not confuse clients in the present with testing appropriateness when the relevant knowledge and experience that needs to be assessed is evolving significantly.
- One of the first consumer tests on periodic- and pre-contractual information in SFDR points out that even well informed, highly (financially) educated clients have problems understanding ESG factors. Many found the SFDR templates for example complicated and hard to read. Another, quite large, portion of the respondents to the consumer test were not interested or simply did not know. As stated above, the ESAs should research how ESG-information is processed by retail investors by means of evaluating SFDR pre-contractual and periodic information with regard to ESG information in advised investment services before turning its attention to non-advised services.
- Furthermore, as knowledge and experience in non-advised services are only tested with regards to complex financial instruments, most relevant sustainable products (for example UCITS) will fall out of scope of the appropriateness process. Therefore, testing knowledge and experience will prove to be difficult when checking client appropriateness for such products.

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

First of all, we kindly draw ESMA’s attention to the introduction starting on page 2 of this paper for further input. In our introduction we highlight that in general:-

- The regulatory requirements already burden the investment advisory process with a level of detail that is unnecessary for achieving sustainability goals. The client will again receive a great deal of information through these guidelines, so there is a risk of information overload. In addition, on the basis of the legal requirements, the client is already to be questioned to an extent (number of questions) and a degree of detail that has not been the case with any other client information to date. Ultimately, the specifications must be designed in such a way that the sustainability preference query is also understandable for clients who use robo-advice. This includes in particular that the differences between the product groups are clear (and not blurred by too detailed questions), and that the time required to answer the questions is reasonable, so that there are no negative consequences as described above, which would not be in the client's interest.
- ESMA guidelines should not add to the complexity that already exists. This would not be in the client's interest. Due to the legal requirements to take sustainability preferences into account, the lack of coordination of these requirements with the other European requirements on sustainability in terms of content and timing, this already presents a challenge.
- In practice, it is also difficult that the ESMA interpretations are to be available only shortly before or with applicability of the regulatory requirements. This will lead to expensive

adjustments at the investment firms, which will have to be implemented downstream. In future, the legislator should ensure that the implementation period also takes into account the issuance of guidelines and is correspondingly longer so that the IT systems only have to be adapted once. However, this is a demand that is primarily directed at the legislator. However, we would welcome ESMA to support this aspect.

- There are a large number of regulatory requirements on sustainability that are continuously being developed. This means that investment firms must be given sufficient leeway to respond to these developments. For this reason, mandatory requirements in the guidelines that go beyond the statutory requirements should be avoided.
- It should be taken into account in this context that at the present time there are very few products that precisely cover all specific ESG objectives. An unnecessarily detailed query process would have to be established, for whose client preferences there is no sustainable instrument in accordance with Art. 2 (7) Delegated Regulation (EU) 2017/565 in case of doubt.
- Ultimately, our call remains that the ESMA guidelines should be delayed in terms of application until at least the legal clarity on SFDR and Taxonomy Level 2 regulations is achieved, and that the application of the ESG DA amending MiFID II is applied as from 2 August 2022 on a 'reasonable best efforts basis'.

Regarding other specific paragraphs in the consultation paper itself, please note our remarks:

- **Paragraph 52 (p.19): "***It should be preliminary observed that since the requirements on the suitability assessment are provided under the MiFID II and the relevant Delegated Regulation, the impact of the proposed guidelines should be considered having in mind those legal provisions that they support. While market participants will likely incur certain costs for implementing these guidelines, they will also benefit from the increased legal certainty and the harmonized application of the requirements across Member States."*
- We don't agree with the statement that the guidelines in their current form provide benefit in the form of legal certainty and harmonized application of the requirements across the Member States. The issue is that the guidelines can't change MiFID, such as the definition of sustainability preferences. It is that definition that is unclear and causes so much legal uncertainty. That uncertainty cannot be fixed by ESMA's guidelines. As a result of these uncertainties, investment firms may be forced to "double implementation" leading to additional costs. We also note that the guidelines not only fail to clarify, but in contrast, they even increase uncertainty. For example, one could argue on the basis of recital 4 of the ESG DA amending MiFID II, that the sustainability preferences should be assessed during the next regular update of the suitability assessment ("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"). This usually would be an annual update. In the supporting guidelines with guideline 5 however another moment in time is introduced: "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." (Paragraph 55, page 37). Why does ESMA introduce this additional moment in time? Is it meant; whichever comes first? In that case ESMA would introduce a requirement that can't be based upon MiFID and will be additionally burdensome for investment firms.
- **Paragraph 55:** *"With reference to the costs, it should be firstly reminded that the key aspects of the suitability assessment and of these guidelines have remained unchanged."* Testing sustainability preferences could now become a major part of the suitability assessment; in that sense one could state that the suitability assessment will radically change unlike the statement made in paragraph 55.

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

Good and bad practices

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

Good practices

- **Client profiling.**

"The implementation of automated controls to identify inconsistencies in clients' answers. The effect is that the client directly (if the questionnaire is completed online), or the firm's staff (in case of face-to face interaction) is alerted that some clarification from the client is necessary before she can continue to fill in the questionnaire. Advisors seek clarification where the interaction occurs face-to-face." The EACB agrees that it is indeed possible that clients' answers are contradictory e.g., 'no risk and high yield'. Automated or not, firms should capture any inconsistency, to the extent reasonably practicable.

"Identifying ad hoc event-driven indicators that may suggest the opportunity of updating client information for suitability assessment (e.g., retirement, access to financing, etc.). At the occurrence of any such event, the clients would be contacted for a meeting to verify whether a review of the profile might be necessary, keeping a record of such interaction." We agree that this could be a good practice. It should however not become a requirement. It should be sufficient if the client is informed that it should contact the investment firm in certain events to ask if the suitability assessment needs to be updated. The risk of not doing so, should remain for the account of the client. We believe that the update of the client information in principle should be limited to the next regular client review.

"Use of complementary questions aimed to more effectively assess the ability of clients to understand products (especially the more complex ones) and their related risk profile to avoid relying on self-assessment. For example, questions dedicated to one or more of the following aspects: relationship between risk and return; mechanisms/actions that may reduce the risk of investments; impact of risk diversification on investments returns related to investments in foreign currencies and related risks; liquidity risk; key features of structured products; financial leverage and its effect on investments; key features and related risks of derivative instruments and instruments with embedded derivatives." We wish to highlight that clients receive before entering into an investment, the agreement information with regard to financial instruments and products offered. We believe that the client should have a global understanding of financial product especially on the risks involved and that he accepts the risks. We are not of the opinion that the suitability assessment should be an exam to test clients' understanding in detail of financial instruments. There is a reason the client enters into an advisory – of discretionary mandate as he may not be confident to take investment decisions on his own.

- **Costs and benefits of switching investments**

"When identifying the perimeter of switches subject to cost/benefit analysis, adopting mechanisms to limit the risk of keeping separate the two parts of a switch transaction (i.e., the sale and subsequent connected purchase) as a means to circumvent the rule. For example, limiting the possibility of "splitting up" purchase and sale recommendations in different days."

"On the cost/benefit analysis of the switch, the provision of a simple and clear overview of the portfolio before and after the recommended transaction, which includes the expected (excess) return and costs related to the switch. By doing so, a client will understand what the effect of the switch would be on the expected return of his portfolio."

For every switch firms are expected to explain to the client what the effect would be on the expected return of his portfolio. We are of the opinion that firms should explain to the client the reason for the switch e.g. price target has been met or any other valid reason, but not going to the extent of explaining the costs and benefits. Firms are already required to disclose ex ante the costs involved so the client is adequately informed. We note that during a portfolio review there will be mixed sales and purchases of financial instruments that are not related to each other hence, these are not switches. Furthermore, firms that offer an all-in fee do not have any negative incentive for churning by entering into unnecessary switching transactions. The new guideline makes clear that the investment firm has to inform the client whether or not the (expected) benefits of the recommended switch are greater than its cost. It doesn't require the investment firm to clarify this with calculations. Calculations based upon expected returns may provide false certainty of certain returns. In this regard, we refer to the major problems with the PRIIPs KIDs, where it has not yet been possible to develop meaningful performance scenarios, which is why a warning had to be included in the KIDs.

- **Indicators/monitoring/control functions**

"Identifying, within the firm's systems for periodic assessment of suitability, triggering factors that may alert the firm to the need of event-driven updates of the portfolio. For example, relevant market factors (delisting of a stock)." We agree that extreme market events e.g., exchange crashes, should be captured and must be acted upon quickly. Such processes are usually embedded at the Investments / Centralized Portfolio Management departments.

"Frequent and thorough reviews of all aspects of firms' suitability practices (organizational, IT, etc.) by control functions (compliance and internal audit) with formalization, as output, of clearly defined actions to address any issues identified and improve the firm's suitability arrangements." We agree that the policies and procedures should be regularly assessed by the Audit department / Compliance.

"Continuous monitoring by control functions (compliance and internal audit) of advisors' performance to assess advisory activity and behaviors by taking into account client outcomes in the form of qualitative elements (e.g., complaints, satisfaction surveys) and quantitative metrics (e.g. return on investments, level or risk, cost and complexity of products, compatibility of investments with client profile)." We do not agree that the Risk Control functions are able to do this on a continuous basis. However, controls on suitability should be included in the risk control framework of the firm.

"Adopting adequate diversification measures also where the client's portfolio is mostly or entirely invested in funds (especially in non-UCITS funds)." This is just an example for portfolio risks e.g., concentration risk. We believe there are more constraints that should be taken into consideration e.g., segmentation on asset classes, industry sectors, country diversification etc.

Poor practices

- **Client profiling**

"Asking a limited range of knowledge and experience questions that do not cover the key features of the different categories of financial instruments that may be offered to the client.

Not properly investigating the clients' understanding of bail-in mechanism and its potential impact on the investments, e.g., where questionnaire presented to clients do not include questions specifically focused on the potential impacts for investments in a bank bond where the bail-in tool is activated". Informing clients about these risks is required.

Assessing the clients understanding, should depend on the type of debt the client intends to invest in. Yes, in case of common equity tier 1, additional tier 1, and tier 2 capital, but not for other types of debt. In general, the reference to ensuring that a client "understands" the bail-in mechanism seems too far-reaching to us. It is sufficient if the possibility of a bail-in and the associated risks are communicated in the specific advice.

"Defining a client's risk tolerance solely based on the composition of such client's existing portfolio. Not reviewing a client's suitability information for an excessively long period, in case of ongoing relationship with the client. Performing an assessment of the suitability without taking into account all information collected from clients for the purposes of suitability assessment". We agree, as there is already a regulatory requirement to regularly update the clients' documents. Indeed, all relevant information should be taken into consideration. However, one reason for lack of updated review is likely to be a possible lack of timeliness (e.g., in financial circumstances due to unemployment, retirement). Consequently, it is too far-reaching to regard a general failure to check over a longer period of time as "bad practice", especially as this statement would itself be subject to interpretation (ESMA guidelines, paragraphs 51 to 57).

- **Matching**

"Over-reliance on one aspect of the suitability criteria, to the extent that it is unclear how the other suitability information is considered (e.g., where a client fits into a certain risk profile category based on its investment objectives and risk tolerance, however it is not clear how the ability to bear losses is considered)." We believe that all answers of the client should be taken into consideration. It is important that the clients' answers are assessed on consistency. When the clients' answers lead to an aggressive profile it would be inconsistent when the client is not able to bear losses. This should be captured in the suitability assessment.

"Excluding the application of suitability controls below certain predefined thresholds (e.g., excluding monitoring of compliance with concentration risk limits for portfolios under certain amounts)." We agree that these exclusions should be avoided. This may be different in case of tailored-made portfolios.

"Suitability policies and processes which permit exceptions or 'overrides' by sales staff ex-post, without adequate controls measures (e.g., by control functions), including on the documentation stating the reasons for the override." We are of the opinion that any 'override' should be adequately motivated and documented. Furthermore, this should be explicitly approved by the client. Firms may have additional procedures that sales staff is not able to override clients' suitability profile without approval from senior staff or is subject to a 4-eyes controls.

- **Cost/complexity of equivalent products**

"On the cost-complexity of products, comparing only products issued by one single-entity (or by entities of the same group)." This poor practice is true for firms offering independent advice.

"On the cost-complexity of products, grouping of "equivalent products" into an excessively large number of clusters with only a few products each with the effect of making the comparison of products of little effect and therefore circumventing the objective of the assessment required by Article 54(9) of the MiFID II Delegated Regulation."

We agree with this, but the extent to which investment firms offer third-party products is exclusively a competitive issue. The example should therefore be supplemented by the addition that the constellation refers to the fact that the institution also offers products from other providers. If only the products of one manufacturer are offered, only these are also the subject of the examination.

- **Costs and benefits of switching investments**

"Limiting the assessment of cost/benefit analysis over switches only to sale and related purchase provided within the same recommendations, without implementing controls based on possible indicators that may demonstrate that a sale and purchase are linked (e.g., the two transactions are undertaken in a short time span, or the size of the sale and purchase are the same)."

"Excluding the application of the control over switches below certain predefined specific thresholds. For example, where the increase of costs as a result of a switch is below a certain threshold predefined by the firm, independently from the related benefits."

See our previous answers under 'good practices' costs and benefits of switching investments.

Since the examples listed are results of the CSA practiced by individual market participants (but not by all, who have made other arrangements to implement the regulatory requirements), the examples should in no way be binding. The non-binding nature of the examples should also be mentioned in the final guidelines.

Q23.What resources (financial and otherwise) would be required to implement and comply with the guidance (organizational, IT, training, staff costs, etc., distinguishing between one-time and ongoing costs)? When answering this question, please also provide information on the size, internal organization, and nature, scope, and complexity of your institution's activities, if relevant.

One-time costs

From a distributor perspective, there are numerous aspects of the existing process that need to be added:

- Obtaining ESG information from manufacturers
- Product governance processes
- Questionnaire
- Suitability assessment
- Tools to assist advisors in recommending a suitable financial instrument or portfolio managers in selecting a suitable financial instrument
- Suitability declaration, incl. ongoing suitability in asset management
- Reporting: not a legal requirement, but clients may want to understand whether their objectives have been met.

In addition:

- All investment advisors and sales representatives must be trained
- ESG information must be obtained from all clients seeking advice or portfolio management, explanation of client survey in each case, response to client follow-up questions

Ongoing costs

- Advisory process will take more time, especially if client is in a "trade-off situation"
- Costs for (ESG) data retrieval from manufacturer, expanded sustainability reporting (more printing, more postage)
- ESG data licenses
- Ongoing IT adjustments due to future changes in the "sustainability world"

Contact:

The EACB trusts that its comments will be taken into account.

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