

Finance Watch response to the ESMA consultation on guidelines on certain aspects of the MiFID II suitability requirements

27 April 2022

Summary

Properly integrating sustainability preferences into suitability assessment is essential in the context of the EU sustainable finance agenda and regulatory framework. These guidelines need to ensure that advisors are able and required to guide clients towards the right products for them and their objectives. Sustainability preferences must be part of suitability assessment on an equal footing with its other components.

In our response, we provide feedback aimed at improving the draft guidelines and we point out several level 1 issues which have strong implications for the integration of sustainability considerations in the suitability test. ESMA could use the opportunity of collecting feedback and drafting guidance to raise these issues with the European Commission, European Parliament and the Council of the EU.

Our key recommendations are:

- Allow the definition of sustainability preferences to cover a wider range of sustainability-related options and strategies especially in light of the current limitations of the EU Taxonomy and SFDR-related product categories and concepts. The aim is to enable clients to express their preference for specific type of investments, e.g. focused on impact or to exclude some investments due to environmental, social or ethical concerns;
- Ensure that the definition of sustainability preferences recognises the different capacity of financial instruments to effectively fund sustainable economic activities (equities or bonds vs synthetic ETFs or derivatives);
- Require a sustainable by default basic product offer;
- Ensure advisors receive comprehensive professional training on sustainability requirements and requiring certification;
- Develop a new Q&A on sustainability preferences and key sustainability-related terms;
- Establish the minimum criteria for sustainable investments and products with ESG criteria under SFDR (see the attached joint NGOs' [briefing](#) for details);
- Properly deal with the issue of conflicts of interest that arise where advisors receive inducements to distribute certain products and prevent it under MiFID II.

General remarks

There are two key parts to integrating sustainability in the suitability requirements: ensuring investors receive the right information and understand it and crucially assessing how far the sustainability of a product impacts its suitability for an investor.

To ensure that the information provided to investors is adequate there needs to be sufficient advice on how to present different EU sustainable finance concepts in a correct, understandable and user-friendly way. A key role for suitability testing moving forward will be to ensure that the information linked to the SFDR and Taxonomy Regulation requirements is meaningful for investors.

A new Q&A specifically covering sustainability preferences and key sustainability-related terms would help to ensure that key concepts like taxonomy-aligned, sustainable investments under SFDR and principle adverse impact indicators (PAIs) are explained in a user-friendly, yet correct and consistent way. A Q&A would promote a more uniform application of the measures and be helpful to smaller firms in particular in the implementation of the new rules.

Advisors must also be required to upgrade their sustainable investment knowledge and competences, so that investors can rely on their explanations and advice. Otherwise, it can be questionable whether advisors would be able to explain different sustainability-related concepts in a correct and clear way.

ESMA could also use the opportunity of collecting feedback and drafting guidance to raise issues with the Markets in Financial Instruments Directive (MiFID II), and the regulation on sustainability-related disclosure in the financial services sector (SFDR) with the EU co-legislators. Three key issues to raise are: 1) the continued existence of conflicts of interest arising from inducements for advisors and distributors of investment products (MiFID II level 1 text), 2) too narrow definition of suitability preferences introduced in the recently adopted changes to the Delegated Acts¹ introducing sustainability considerations in the MiFID II framework, and 3) the need² for minimum criteria for sustainable investments (Article 9 products) and products with ESG characteristics (Article 8 products).

Given that the EU sustainable finance framework is still under construction it is essential to closely monitor and assess the implementation of the guidelines, to check whether they deliver on their objectives.

A final key point is that given the risk-reducing potential of sustainable investments, default product offers should always integrate sustainability risks. While this has been recognised in Article 6 of SFDR and adjustments to UCITS and AIFMD delegated regulations which introduced a requirement to consider sustainability-risks for all financial products, climate-related financial risks are increasing and not yet effectively dealt with in EU risk management frameworks for financial institutions. An investment that duly integrates sustainability risks will automatically have a lower exposure to transition risk. This makes them more suitable for a default product offer, particularly taking a longer-term perspective. A majority of respondents

¹ <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32021R1253&qid=1644938787610>

² <https://www.finance-watch.org/wp-content/uploads/2022/02/2022.02.21-Joint-NGOs-and-consumer-recommendations-for-minimum-criteria-for-Art.-8-9-products.pdf>

(68%) to the Commission's consultation on the renewed sustainable finance strategy supported the idea to require advisors to offer at least one sustainable product by default.

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.

Although further detail on suitability preferences is included throughout the guidelines later on, the new paragraph added to guideline 1 is very limited. Further requirements to give context to the products that the advisor is able to offer the client should be added to guideline 1. This should include references to assessment of suitability preferences throughout paragraphs 11 to 15. The provisions on suitability assessment in general and the scope of how firms inform clients of the assessment is also relevant to how they inform clients about sustainability preferences. Firms should also make it clear that their advice is based on their experience and product offer, giving context to their sustainability offer and track record with comparisons to other offers on the market.

As a more general comment, paragraph 11 of the guidelines should also include a description of the level of processing of the data, referred to as 'information'. Investors should be informed that the data will only be used for the purpose of conducting the suitability, including sustainability preferences, assessment, or if additional consent for further processing or storage is required this should be explicitly outlined and recorded.

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.

Yes, we do believe that the new supporting guideline in relation to the information to clients on the concept of sustainability preference should be expanded further.

We would like to point out the limitations of the definition of sustainability preferences in MiFID II delegated regulation, which is very restrictive, confining the sustainability-related choices only to taxonomy-aligned investments, sustainable investments defined under SFDR and principle adverse impact indicators (PAIs). This is particularly problematic given:

- Challenges with regards to the EU Taxonomy, which on one hand is still being developed while on the other hand its integrity is challenged in light of the Complementary Delegated Acts introducing gas and nuclear energy;
- Lax rules for sustainable investments (Article 9 products) under SFRD. Please see a [joint NGOs briefing](#) further elaborating on this as well making recommendations to remedy this issue. It is also noteworthy that the sustainability preferences definition under MiFID II does not even offer a choice of investing in the newly created categories

of products with ESG characteristics (Art. 8 products). While this is understandable given the absence of a definition of what constitutes ESG characteristics and even more relaxed rules regarding this product category, it also results in restricting investors' choice.

- Issues with the principal adverse impact indicators, which do not contain any thresholds and merely need to be “considered”, hence it can be questioned whether they constitute an appropriate tool for the “do no significant harm” assessment.

One of the issues with the current rules around Article 8 and Article 9 products under SFDR is that neither category properly captures **investment for impact**. Meanwhile, **one of the key considerations of the advisor** assessing suitability of financial products should be whether an investor is interested in sustainability considerations because of the **sustainability risks that may have a financial impact on their investment or because of their intention to make a positive impact on the environment or society with their investment, or both**.

What the suitability preferences definition currently disregards is also that there are **different types of financial instruments** available on the market and that they differ in their **capacity to effectively fund sustainable economic activities**. While the financing capacity of bonds (especially project bonds) is rather straightforward, it can be questioned to what extent synthetic ETFs, money market funds, structured products or derivatives have this ability. This aspect is also linked with the impact-related considerations in the paragraph above.

It is hoped that with time and further development of the sustainable finance regulatory agenda, supply of reliable taxonomy-aligned products or products qualifying as sustainable investments under SFDR will increase. However, for the time being it may be also questioned how many reliable products qualifying for the aforementioned categories will be available on the market. First disclosures of the principal adverse impact considerations will only commence as of June 2022; however, we understand this will not necessarily translate into product-level disclosures which are commonly interpreted as not being mandatory.

The above-mentioned considerations create a major challenge to make MiFID II sustainability-related suitability assessment work in practice. A recommendation to allow adaptation of sustainability preferences and modification of suitability assessment in case no product meets the investor's sustainability preferences has the potential to further deteriorate the situation by channelling finance to unsuitable investments, by using the insufficient supply of the products that would qualify as a justification.

A solution for the way forward would be to:

- Adjust the definition of sustainability preferences to:
 - incorporate Article 8 products (provided that the Commission puts forward a proposal for minimum requirements for Article 8 products to strengthen this currently lax category);

- investments outside the categories of MiFID II sustainability preferences definition at least in the interim period. This would allow firms to offer products that do not qualify as sustainable under the EU taxonomy or SFDR for certain legal reasons, however do follow robust and reliable methodologies and investment strategies qualifying as sustainable under the existing rules;
 - ensure that clients can specify any exclusion they wish to apply (the investments they do not wish to finance). This could include nuclear or gas (which is particularly important in the context of the Complementary Delegated Act including gas and nuclear into the green taxonomy), weapons, tobacco, pornography and any controversial or other economic activities that are considered as significantly harmful under the EU taxonomy framework;
 - enable an analysis of the client's preference regarding generating impact as opposed to sustainability risks, which should be considered as part of the client's risk tolerance assessment.
- Develop the minimum criteria for Art. 8 and Art. 9 products under SFDR in line with the recommendations of the [NGO briefing](#) as a matter of priority. This would ensure that the sustainable finance framework becomes more robust and coherent and recognise and incorporate different sustainable investment strategies including impact investing.

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 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 guidance is consistent with the definition of sustainability preferences in the MiFID II Delegated Regulation. However, as explained in the response to Q2, the aforementioned definition is very restrictive, which is problematic especially given the ongoing evolution of the sustainable finance framework and the current limitations of the EU taxonomy and SFDR. Requirements on checking sustainability preferences need to be further adapted to ensure that they are effective. Conclusions should also be drawn from the assessment of these preferences and used as part of the suitability assessment.

In addition to what is suggested in para 25 and 26, clients should be asked for their preferences on whether they are interested in impact investment, investments that do no significant harm or simply in products integrating sustainability risk considerations due to their potential impact on financial returns.

While the definition of Article 9 is well suited to accommodate impact investments, currently it is too lax (no minimum threshold of the EU taxonomy alignment and in the absence of the social taxonomy nothing to verify social objectives). Also, current rules on Article 9 products do not consider the essential tool used in impact investment, which is engagement

(stewardship). Moreover, the type of the financial instrument is also not considered. Meanwhile, not all financial products have the capacity to effectively fund sustainable economic activities.

While we strongly advise to remedy that by creating minimum criteria for Article 9 products (please refer to a joint NGO [briefing](#) for more details), for the time being, clients should be specifically asked for their preferences with regards to the above-mentioned considerations.

It should be noted that the principal adverse impacts (PAIs), referred to in Article 2(7)(c) do not really qualify as proper “do no significant harm” criteria, despite the approach taken by the ESAs in the SFDR RTS. PAIs do not contain any thresholds, which are necessary to avoid harm. Moreover, SFDR wording leaves a lot of flexibility to firms with regards to consideration of PAIs.

We acknowledge there are serious challenges with regards to Article 8 products given the absence of the definition of what constitutes ESG characteristics as well as relatively lax rules around this product category all together. However, it can be questioned why this newly created product category would not be offered to the clients. Instead of removing it from the clients’ selection, it would be advisable to beef it up with proper minimum criteria for Article 8 products as a matter of priority. Once again, please refer to a joint NGO [briefing](#) for more details.

We welcome the reference in para 26 of the guidance to asking clients whether they have any specific preference for either environmental or social criteria. However, we would suggest that this is not only set as an example, but rather as a straightforward recommendation. Even the SFDR RTS recognise that products can qualify as sustainable by pursuing either environmental or social objectives and not necessarily both at the same time. There may be people with a preference for one of them or both and this should be recognised.

While it is important to distinguish between E, S and G criteria, governance is the basis of even pure financial performance. Hence, it may be time to move away from this old-fashioned distinction between the E, S and G, to ensure that clients are always offered products where the underlying companies meet the minimum good governance criteria.

Given the risk-reducing potential of sustainable investments, default product offers should always integrate sustainability risks. While this has been recognised in Article 6 of SFDR and adjustments to UCITS and AIFMD delegated regulations which introduced a requirement to consider sustainability-risks for all financial products, climate-related financial risks are increasing and not yet effectively dealt with in risk management frameworks. A more sustainable investment that duly integrates sustainability risks will automatically have lower exposure to transition risk. This makes them more suitable for a default product offer, particularly taking a longer-term perspective. A majority of respondents (68%) to the Commission’s consultation on the renewed sustainable finance strategy supported the idea to require advisors to offer at least one sustainable product by default.

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

Please see our responses to questions 2 and 3.

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?

Yes, additional guidance about what is precisely expected from advisors when investigating and prioritising these simultaneous / overlapping preferences would be helpful especially in the context where there is still a scarcity of independent advice and where conflicts of interest are prevalent.

Realistically most clients are unlikely to indicate a sustainability preference that is as specific or restrictive as the categories in letters a) to c) under Article 2(7) of the Delegated Regulation. Most clients will likely indicate general sustainability preferences with a high level of expectation of what this would mean in terms of the ESG impact of the investment. A key role for the advisor must therefore be to manage expectations and enable client understanding of what are the differences between sustainable investments under SFDR and products which are EU taxonomy-aligned and PAI considerations and give some context as to what the higher and lower thresholds for percentage of taxonomy alignment and sustainability are on the market.

As mentioned in response to Q2 and Q3, given the current limitations and the evolutionary nature of the sustainable finance framework, clients should also be asked for their preferences beyond the definition of MiFID II sustainability preferences, including whether they are interested in impact investment, investments that do no significant harm or simply in products integrating sustainability risk considerations due to their impact on financial returns.

The approach outlined in paragraphs 25 and 26 does introduce useful guidance around creating 'ranges or sizes' to give context to the minimum proportion requirement. These ranges should be based on real market data, not theoretical suggestions. The logic should be extended to the PAI requirements being grouped into families, which again could be a useful approach to facilitate client-understanding.

To avoid that the suitability test becomes a complicated tick-the-box exercise, the first step of the information collection on sustainability preferences should be to explain what these preferences are and give examples and context of sustainability in the product category(s) that the client is being advised on. The overall focus should help to manage the expectations and increase the understanding of clients over how far products and portfolios are actually likely to have an impact in line with their sustainability preferences.

Aside from additional guidance over how to prioritise overlapping and simultaneous preferences, a new Q&A with much more detailed guidance on assessing sustainability

preferences is needed. The Q&A could include a template questionnaire and suggested outcomes and implications from likely responses. This could include specific questions related to exclusion preferences for nuclear, gas in particular, given the recent work on the Complementary Delegated Acts for the EU Taxonomy (see our response to question 2). It should also cover overlapping and simultaneous preferences comprehensively.

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.*

The requirements for assessment of ESG preferences under paragraph 27 for portfolio assessment rightly aim to ensure that the level of assessment is not reduced for clients in these cases. A missing element is to ensure that clients are given an explanation of how their specific sustainability preferences will be applied to the whole portfolio.

This should extend beyond an explanation of which part of the portfolio if any is in line with the clients' preferences and cover the sustainability/ alignment of each part of the portfolio with these preferences. This is to avoid that the portfolio as a whole is presented as being aligned with a clients' sustainability preferences, as even a majority of the portfolio might be, but that the remaining part is not at all aligned. Lack of alignment of a part of the portfolio could undermine the alignment of another part, effectively negating the intentions of the client in expressing sustainability preferences.

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

The addition to guideline 5 follows the existing logic already present in the guidelines. One of the most important moments to include information on sustainability would rightly be as part of the periodic reporting to clients (annually for example). This should remain one of the key interaction and disclosure opportunities. However, given the evolving nature of regulatory requirements on sustainability reporting the guideline would benefit from more precision, to ensure that further updates to regulatory requirements trigger a client update where they impact product information.

The reliance on meetings with clients as key moments to update should also be reconsidered. The different measures introduced in response to the COVID pandemic have reduced meetings and led firms to develop alternative ways of interacting with many clients. The guidelines could reflect this and ensure they capture clients that obtain advice through the diverse media that are available to them. This should still leave the option of updates through meetings for clients that prefer and keep them.

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.

Firstly, it is crucial to emphasise that firms should **consider sustainability risks as part of the regular risk management for the investment products they offer**, in line with the requirements in Art. 6 in SFDR and later reinforced in Article 18 para 5 of Delegated Regulation (EU) No 231/2013 (AIFMD) introduced by the Commission [Delegated Regulation](#) (EU) 2021/1255 of 21 April 2021 and Article 5a of the Commission [Delegated Directive](#) (EU) 2021/1270 of 21 April 2021 amending Directive 2010/43/EU as regards the sustainability risks and sustainability factors to be taken into account for Undertakings for Collective Investment in Transferable Securities (UCITS) .

To that end, we would like to suggest a following modification of Para 70 of supporting guidelines:

*“Firms should adopt robust and objective procedures, methodologies and tools that allow them to appropriately consider the different characteristics, including sustainability factors, and relevant risk factors (such as **sustainability risks**, credit risk, market risk, liquidity risk, ...) of each investment product they may recommend or invest in on behalf of clients.”*

With regards to para 71, please refer to our responses to earlier questions, in particular Q2 and Q3. As mentioned, a key issue is a too restrictive definition of sustainability preferences under MiFID II delegated regulation which, combined with the challenges with regards to the EU taxonomy and product categories under SFDR creates a lot of problems.

Until the EU sustainable finance framework is completed and untangled, the definition of sustainability preferences under MiFID II should be broadened and firms and advisors will need additional guidance to ensure that clients are not misled or misinformed about product sustainability. An effective way to achieve this would be to create a Q&A explaining in a correct and comprehensible way different sustainable investment terms, how they interrelate and their impact.

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.

Yes, there is a need for further guidance to clarify how firms should take into consideration the investment products’ sustainability factors as part of their policies and procedures. In particular, firms need guidance on how to incorporate sustainability risks into risk assessment and management processes through the relevant implicated regulation. Please also refer to our response to the previous question.

The additional supporting guidance under general guideline 7 is missing additional requirements to ensure that the part or parts of a portfolio or product that are not at all compliant with any of the categories listed in paragraph 71, subpoints i), ii) and iii) are also described. As outlined in our response to question 6, information on products or portfolios that have a

complete lack of sustainability factors should also be given. This would help avoid negating the intentions of a client that expresses sustainability preferences.

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 approach taken of creating a two-step process that effectively separates out the assessment of sustainability preferences from risks creating a tick-the-box exercise that would undermine the credibility of suitability assessment. Moreover, following a two-step approach may significantly narrow down the availability of sustainable products. We recommend to follow an integrated approach whereby sustainability preferences are addressed at the same time as the criteria of knowledge and experience, financial situation and other investment objectives.

Moreover, we would like to highlight that consideration of sustainability risks should be part of the general risk assessment and hence integrated while evaluating the client's risk appetite and capacity to bear losses.

An additional requirement to assess and explain whether a financial instrument will have any 'real economy impact' should also be included. Some synthetic financial instruments do not actually finance any 'real' economic activity, but simply mirror it. This means that although they may mirror some level of sustainable activity, they would not have any actual positive impact on it. An example would be a synthetic ETF that does not actually hold any underlying assets or securities, but simply mirrors performance of an index. In cases such as these the client should be clearly informed that these financial instruments will not have any actual impact.

Please also note our responses to earlier questions, in particular to Q2 and Q3.

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.

The key issue to be tackled around clients adapting their sustainability preferences is that this does not become a way to shepherd them towards a product sale. After identifying a 'suitable' set of products for a client, an advisor may then see that their product offer is not fully compatible with their suitability preferences. This may then lead them to offer comparisons of expected risk-reward profiles of products to entice the client into adapting their sustainability preferences with their product offer. This could risk becoming a sales-by-insinuation process where sustainability preferences are adapted to allow the sale of products that suit the advisor more than the client. Paragraph 81 under general guideline 8 should be strictly and effectively implemented to this effect.

An additional point is that the suitability assessment should and could be adjusted after the assessment of sustainability preferences. As outlined in the response to question 3 the risk-

reducing potential of sustainable investments must be taken into account and advisors should be on the look-out for misconceptions.

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 guidance on adaptation of sustainability preferences is very limited. The approach rightly limits the adaptation of preferences to the suitability assessment or advice in question.

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)?

This approach both in the guidelines, but also in the line of questioning in this consultation of adapting sustainability preferences to fit product offers is fundamentally flawed. Our response to question 11 outlines the key issues that this approach raises. Firms should not be encouraged to put in place structures to normalise bypassing sustainability preferences. It not only undermines the purpose of introducing a requirement to assess these preferences, but also erases the market-correcting capacity of investors to create supply for more sustainable products through clearly stated demand.

Please also refer to our responses to questions 2 and 3 where we elaborate on the need to broaden the definition of sustainability preferences in MiFID II delegated regulation. This should enable firms to easily offer some sustainable products even if for the moment the sustainable finance framework is still evolving.

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 approach outlined in paragraph 83 is not sufficient and risks undermining the usefulness of the assessment of sustainability preferences. Further follow up should be required to ensure that clients understand what sustainability preferences are and the differences between products that are sustainable and those that are not. If this is not done then clients may have sustainability preferences, but simply not be able to express. The proposed short-cut approach could rather lead companies without sustainable products to push clients to say that they do not have strong preferences and so could be considered sustainability-neutral.

As outlined in our response to question 2, a Q&A is required to provide more detailed and structured guidance in the form of example questions to ensure that the process of identifying

sustainability preferences is effective. Otherwise, the assessment could become a check-the-box exercise for firms, in the best case only creating administrative compliance burden with no benefit to the client and in the worst case creating widespread green-washing.

We suggest that advisors always offer at least one sustainable product by default. A majority of respondents (68%) to the Commission's consultation on the renewed sustainable finance strategy supported this option.

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.

The approach under the first part of paragraph 82 of general guideline 8 is flawed. The effective response and recommendation where a firm cannot match the sustainability preferences of a client should not be to simply adapt the preferences. It undermines the assessment of these preferences in the first place and risks creating a check-the-box exercise, rather than meaningful advice based on expert assessment. The first response should be to provide advice as to whether there are other alternatives on the market that could match the sustainability preferences of the client. The advisor should also make it very clear that the firm cannot meet these preferences in these cases. If a client independently decides to adapt their sustainability preferences, then the advisor should explain the consequences and impact of doing this.

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?

The requirement to document the decision of the client under paragraph 82 is important, but would only be effective if there is context available for national competent authorities (NCAs). To this end suitability assessment and sustainability preferences should be recorded and analysed, including any decisions to adapt preferences. This should include an appropriate level of detail, to detect potential issues around shepherding clients to certain products and cases where adapting preferences has become the standard procedure.

NCAs should conduct mystery shopping exercises to experience the advice being provided where there is an identified significant occurrence of clients adapting their sustainability preferences. Based on this exercise NCAs should then assess whether to intervene and to address issues detected.

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

The amendment to guideline 10 is helpful, but should go further. The information should also explain the impact (if there is any) of the proposed switch on the client's sustainability preferences.

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.

Additional guidance needed to ensure that there is a minimum requirement of professional training in terms of hours, then verification via a competence test to ensure that training has raised the knowledge and competence of the advisor. A continuous training requirement should also be included, to ensure that advisors remain up to date with the latest requirements in this developing field and regulatory environment. The current wording of appropriate training does not provide sufficient clarity, or follow the precedents for professional training for client-facing advisors currently in the EU legislative framework.

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

The record-keeping guidance is a useful upgrade to general guideline 12 and the supporting guidelines. It is worth noting here that a step further should be taken to assess the situations where clients' sustainability preferences have been adapted. Our response to question 16 outlines steps that could be taken to address this.

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 alignment of the two sets of guidelines appears to be a logical approach to avoid overlaps or inconsistencies that could otherwise reduce the value of the guidance provided.

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

There are background issues to this guidance that should be noted and addressed by the EU co-legislators. ESMA could use the opportunity of collecting feedback and drafting guidance to raise these issues with the European Commission, European Parliament and the Council of the EU.

The first issue is that there is no effective ban on inducements for the sale of investment products under MiFID II. This exposes all clients to potential conflict of interests that arise where advisors receive inducements to distribute certain products. This creates a particular problem in the proposed changes to the guidelines around the adaptation of suitability

preferences, as outlined in our response to question 15, but also more generally to ensure that suitability assessment leads to the right outcome for clients.

The second key issue is over the EU sustainable finance framework. Please address responses to questions 2 and 3 for more details.

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

In the good practices section covering indicators, monitoring and control functions the continuous monitoring of control functions of advisors' performance does not cover the level of inducements earned and broken down by products category as part of the quantitative metrics. This is an odd omission and concerning from the point of view of client trust. It is essential information to monitor possible instances of mis-selling. Without this information management and NCAs will have a severely reduced capacity to identify and address mis-selling.

NCAs and ESMA would benefit from conducting further structured analysis of these good and poor practices, supported by mystery shopping exercises. This information should be collected and analysed at regular intervals (potentially yearly) to monitor the effectiveness of the guidelines and legislative requirements on suitability assessment in general. A specific focus should be put on assessment of suitability preferences in the first years after the implementation of the guidelines, to assess their effectiveness and adapt them if needed.

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.*

N/A
