Response to ESMA consultation on guidelines on sustainability aspects of the MiFID II suitability requirements

27 April 2022

The Association for Financial Markets in Europe (AFME) and the International Swaps and Derivatives Association (ISDA), (together the "Associations") welcome the opportunity to comment on the draft ESMA guidelines on sustainability aspects of the MiFID II suitability requirements.

The changes to the MiFID II Delegated Regulation renew the need for guidance to ensure a consistent and harmonised application of the new requirements and, in turn, to strengthen investor protection.

Updated ESMA guidelines on the collection of information from clients and the assessment their preferences can help retail investors set realistic expectations and make more informed sustainable investment decisions.

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.

AFME welcomes the opportunity to comment on the draft ESMA guidelines on sustainability aspects of the MiFID II suitability requirements. The changes to the MiFID II Delegated Regulation introduce the need for practical guidance to ensure a consistent and harmonised application of the new requirements and, in turn, to strengthen investor protection. Updated ESMA guidelines on the collection of information from clients and the assessment their preferences can help retail investors make more informed sustainable investment decisions.

According to the amendments in the MiFID II Delegated Regulation, suitable products will have to be identified via one or more of three different approaches based on the investment screening made under the Taxonomy's criteria, or the definition of sustainable investment in Article 2(17) of the SFDR, or against material PAI indicators.

As a result, the assessment will involve, for financial advisors, a screening of the products' features and clients' sustainability preferences based on different approaches and definitions, some of which are still open to interpretation. Distributors thus face the challenge of describing the different approaches, inquiring about sustainability preferences and presenting suitable options in a clear and effective manner, while retail investors may be asked seemingly redundant questions or presented with an overload of complex information and documentation, they may find difficult to navigate. The guidelines should aim at simplifying this exchange of information, ensuring that clients understand these different approaches in an accessible and effective manner.

Indeed, providing for instance information to clients explicitly on the definition in Art. 2.7 might be difficult and rather technical, due to the nature of the definition of the three categories of financial instruments insofar as references i) to various regulatory sources and ii) to qualitative and quantitative parameters are included and these cannot be illustrated to the client in a simple and understandable way.

It is also worth underlining that MiFID II general principles require investment firms – when providing information - to make sure "clients or potential clients are reasonably able to understand the nature and risks of the investment service and of the specific type of financial instrument that is being offered and, consequently, to take investment decisions on an informed basis". However, the recent investor protection framework revisions on sustainability preferences are deemed to be overly complex and technical and will not allow an average client to fully understand all sustainability concepts.

Within this backdrop, investment firms would face an objective difficulty should they be required to i) guarantee their clients or potential clients have a deep understanding of all technical sustainability elements and aspects and ii) illustrate those aspects in a manner that it is so granular and detailed that the final result is ultimately too complex and may lead to an incorrect representation of sustainability preferences provided by the client.

Guidelines should also be more flexible in order to let the distributor adapt information that it provides depending on the client's profile and investment appetite. Some clients will be in need of in-depth information, while others will be more knowledgeable or not interested in sustainable investments. ESMA should take into consideration also the possibility that clients are provided with information on the concept of "sustainability preferences" not bound to the three letters a) to c), nor to possible sub-combinations of the three letters.

Indeed, the Consultation Paper, within the new Supporting Guideline No. 26, allows for the possibility that clients may express "generic" sustainability preferences, thereby pointing to ESMA awareness that it may be extremely difficult for an average client to understand and subsequently provide technical information about their sustainability ambitions. Whenever investment firms make use of this possibility the client shall be duly provided with a specific disclosure whereby firms "inform the client about their choice and the level of the sustainability-related expectation of the product and document in the suitability report the client's choice not to further specify the sustainability preferences" (see Supporting Guideline 26).

The market for sustainable investment products is growing rapidly in response to the climate emergency, but it still has a long road ahead to reach maturity. Thus, today's availability of Taxonomy-eligible investments or products with a significant proportion of sustainable investment remains limited, also due to the limited availability of investable projects in the economy and reliable data provided by companies. In this context, the guidelines must provide clarity and flexibility to help both firms and clients set realistic expectations.

ESMA's proposed approach requires to ask clients about their sustainability preferences without taking into consideration the market reality of available sustainable investment products. Clients may display high ESG ambitions and aim for a significant proportion of their savings to be invested in sustainable investments but, in the initial phase of application, there will be very few products with substantial level of taxonomy-alignment. Hence firms might be required to collect information on clients' sustainability preferences in the absence of matching sustainable products which may lead to significant clients' frustration.

Also, it should be clarified that new MiFID II requirements should not be applicable when a client is pursuing hedging purposes via OTC Derivatives, and therefore investment firms should be allowed to adjust information provided to the clients and questions asked for the suitability assessment, when investment advice is limited to hedging needs through ESG-linked OTC Derivatives, because it is not clear if these types of instruments could really be aligned with products' categories (i.e. a, b and c) as described by new MiFID II requirements.

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.

As indicated in our answer to Question 1, the information to be provided is excessively broad and complex for its intended users.

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.

For the reasons stated above, the approach proposed by ESMA for gathering information from clients on their sustainability preferences, based on self-assessment, would not be appropriate at this stage. A more generic approach should be allowed in order to explain the new concept of sustainability preferences in a more holistic way to clients. Likewise, it would be good to allow for the possibility to explore clients' sustainability preferences at a high level in order to prevent clients' frustration if they have to go through a long conversation on their sustainability preferences with their financial adviser in the absence of matching sustainable products.

In addition, given that SFDR is a closed list and does not comprise all existing typologies of financial instruments, and that the definition of "sustainability preferences" only covers investment in environmentally sustainable investments under the Taxonomy regulation and, currently, there are no taxonomy rules on social or governance aspects, the range of products meeting the client's sustainability preferences will be restricted, with the result that the client may be exposed to higher liquidity, concentration or other risks or may have to bear higher costs in their investment due to the observance of their sustainability preferences, which may be contrary to their interests and to the policy objectives.

Furthermore, such circumstances may compromise the provision of the advisory service, overweighting recommendations on product types for which information on sustainability attributes is available to the detriment of other product types that may be suitable for the client.

As an alternative, the guidelines could adopt a two-phased approach. In a first, initial, phase, clients should be allowed to indicate whether they have or not preference in including in their investments also aspects related to sustainability. Should clients have expressed positive sustainability preferences, investment firms could ask them, in a second, subsequent phase, to indicate the level / degree of these preferences (e.g. low-medium-high or, in alternative, the minimum weight) in relation to their investments. This could be referred to the whole group of sustainable financial instruments and therefore without splitting the indications for the three types listed under letters a) to c). In this sense, the requirement "to what extent" provided for by Article 2, point 7, could be referred to the degree of client's sustainability-related ambitions (multilevel approach of the entire portfolio, for example high-medium-low) or to the portion / minimum percentage of the portfolio the clients wants to be invested in financial instruments meeting his sustainability preferences.

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

The same assessment should not apply across all categories of investors. ESMA should clarify that simplified guidelines apply to professional clients as they demonstrate already well-defined sustainability preferences and do not need the same level of protection as retail clients. The guidelines should clarify how the assessment of sustainability preferences should be carried out for professional investors.

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?

Additional guidance should be provided to clarify the following;

- Combining clients' preferences is not a requirement at transaction level and does only apply at portfolio level, where applicable.
- A combination should be proposed to the client only if the latter has explicitly asked for such combination. If not, distributors should have the possibility to offer a product matching with one of the preferences. 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 3 products:

  a. An equity instrument with 25% environmental taxonomy alignment issued by an international corporate, that is not rated according to SFDR social definition,
  b. A social bond 100% aligned with SFDR definition issued by an international corporate, which turnover is overall 10% aligned with the environmental taxonomy,
  c. 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 3 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.

- While level 2 asks for collecting PAI qualitative **and/or** quantitative elements, the revised guidelines require to collect qualitative **and** quantitative elements. We would be in favour of sticking to the level 2 wording as it provides important flexibilities for both clients and investment firms. 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.

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 proposed approach to the assessment of ESG preferences in the case of portfolio approach is too granular and should be simplified. Intermediaries with a portfolio approach shouldn't be required to submit to their clients a double set of questions (at product and portfolio level) in order to avoid making it hard for the clients to answer too many questions on the same issue. We therefore ask ESMA to re-evaluate the model for the portfolio approach in order to simplify the requirement keeping into consideration what is mentioned above.

Under guideline 2, point 27, when portfolio management or investment advisory services are provided on a portfolio approach, where appropriate, the decision to obtain information from the client f which part of the portfolio should be invested in products that observe its sustainability preferences should be optionalBy default, sustainability preferences should be considered by the institution for the entire managed or advised portfolio.

In addition, with regard to the portfolio management service, it should be noted that the managed portfolios are considered as "Financial Product" under SFDR, having a configuration for sustainability purposes in accordance with the provisions of SFDR. Where applicable, the managed portfolio, like any other "Financial Product", must be adjusted to the client's sustainability preferences.

The specific instructions that the client may give within the framework of the portfolio management service should be assessed according to the client's sustainability preferences and, in any case, would need to be in line with the sustainability configuration adopted under the SFDR managed portfolio provisions.

See also our answer to question 15.

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

We support guidelines clarifying that, for existing clients, the sustainability preferences of a client can be updated as part of the regular update following the entry-into-application of the amendments to the MiFID II Delegated Regulation as consistent with Recital 4 of Delegated Regulation (EU) 2021/1253, according to which "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." . We would however suggest deleting the reference to "the first meeting with the client", in order to make the guidelines consistent with the Delegated Regulation as well as the existing guidelines. The term of "meeting" could also be confusing as it could cover any potential interaction between the client and its advisor.

For additional recommendations on simplifying the operational aspects of updating client information, see also the answer to questions 11 and 13.

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.

When determining the sustainability factors considered for matching financial instruments with the client's sustainability preferences, it would be advisable for investment firms and advisors to be able to take into consideration aspects other than those listed under point 71, guideline 7. For example, the percentage of investments in activities selected in application of the policies or measures established for the promotion of environmental and/or social characteristics.

It would be necessary to be able to establish other sustainability factors relating to sustainability-related attributes that cannot be verified exclusively in accordance with the aforementioned SFDR and Taxonomy regulations, provided that this does not result in Greenwashing.

Furthermore, in view of the state of development of sustainability regulations, ESMA's proposed revised guidelines should consider the possibility that certain information on the sustainability factors listed in draft supporting guideline 7 (paragraphs 70-71) may not be available or at least, to allow using an estimate or an assumption (internal criteria) that we can be deduced based on public information.

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 welcome the emphasis given to the possibility to use other material KPIs in alternative to the PAIs listed in the RTS under SFDR, alongside narrative disclosures. This would help identify products that fulfil the client's objectives where no suitable products reach a significant minimum proportion of sustainable investment, as well as enable advisors to respond to specific preferences from the clients.

ESMA could also refer to the European ESG Template (EET) implemented by the European Working Group (now FinDatEx). Under the EET, firms can identify products' target market according to a wide range of mandatory as well as optional indicators including investments in companies emitting ozone depleting substances, chemical production or involved in deforestation, and further social indicators such as lacking policies on human trafficking, child labour or discrimination.

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 proposed revised guidelines do not appear conducive to a smooth and simple process for clients. According to paragraph 81, if preferences do not match with existing products, clients would have to adapt their preferences without having the knowledge of what the market is currently providing. This could lead to several adaptation attempts before finding a suitable product, especially in a context where sustainability products are lacking due to both a lack of green projects and missing ESG data.

We would therefore suggest the following approach:

- The update should 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 to systematically submit a new questionnaire if the product is not an exact match.
- 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 of the MIFID II

Delegated Regulation does not specify whether adaptation should occur before or after products recommendation.

- At portfolio level, in case initial preferences are based on a combination between a), b) and c), the advisor can prioritise one of these criteria and base its product recommendation on one of the aspects of this combination (either a), b) or c)).

Accordingly, the new wording would be: *§81 – 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.***

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.

In our view, this approach needs to be simplified in case of investment advice on single products and we suggest its redrafting in accordance with the applicable regulation.

Recital 8 of Delegated Regulation (EU) 2021/1253 determines as the only requirement for issuing recommendations on products/investments that are not in line with the client's sustainability preferences, that such products/investments are not presented as being in line with the sustainability preferences: "(...) investment firms may continue to recommend financial instruments that cannot be considered suitable to meet individual sustainability preferences, provided that they do not present them as being in line with such preferences (...)"

The new wording of Art. 54.10 of Delegated Regulation (EU) 2017/565 (as amended by Delegated Regulation (EU) 2021/1253) is configured in the same sense: "(...) The investment firm shall refrain from recommending or deciding to trade financial instruments AS instruments that meet the sustainability preferences of a client or potential client where those financial instruments do not comply with those preferences. (...)"

Furthermore, the same recital 8 of Delegated Regulation (EU) 2021/1253 states: "(...) In order to enable new recommendations to be made to clients or potential clients, where financial instruments do not meet a client's sustainability preferences, the client must have the possibility to adapt the information on those preferences (...)".

That is, the recommendation on the product/investment that does not meet the sustainability preferences should be able to be issued without having to adjust, in advance, the sustainability preferences. In any case, once the recommendation has been issued, the client should be given the option to adjust the sustainability preferences, so that new recommendations can be made.

It can be concluded that it should be possible to issue the recommendation that does not conform to their sustainability preferences, provided that:

- The recommended product/investment is suitable for the client's knowledge, experience, financial situation and investment objectives; and
- There is no suitable product/investment available that matches the client's investment preferences (in the case of portfolio approach advice, matching sustainability preferences should be considered on a portfolio-wide basis); and
- The client is informed that the product/investment does not meet the client's sustainability preferences; and
- The client is offered the possibility of adapting its sustainability preferences for future investments.

It is necessary to point out that, in the case of portfolio-based advice, the recommendation should be understood to be in line with the client's sustainability preferences if the proposed investment, considered in the context of the portfolio as a whole, is in line with these preferences, even if the recommendation includes specific products that, individually, do not comply with the sustainability preferences.

In such a case, it is not necessary to inform the client that the recommendation is not adapted to his or her sustainability preferences, nor is it necessary to offer the client the possibility of adapting his or her sustainability preferences for future investments.

On the other hand, in the event that a product/investment is recommended that is not adapted to the client's sustainability preferences, it is not appropriate to state in the recommendation the client's decision to adapt his sustainability preferences and his reasons for doing so.

In such cases, the recommendation should inform the client that the product/investment does not meet the client's suitability preferences and the client should be offered the possibility to adapt his/her sustainability preferences for future investments.

In the event that the client decides to adapt their sustainability preferences, it should be within the process whereby such adaptation takes place that the client's decision to adapt their sustainability preferences and their reasons for doing so are recorded.

Finally, as regards the provision of information to professional clients (per se and upon request) on the lack of suitability of the recommended instruments to their sustainability preferences or, as the case may be, on the possibility of adapting their sustainability preferences, it should be borne in mind that, in accordance with the new art. 29a(2) of Directive 2014/65/EU (as amended by Directive (EU) 2021/338), the obligations to provide a suitability statement (recommendation) specifying the advice provided and how this advice matches the client's preferences, objectives and other characteristics, would NOT apply in case of professional clients (both per se, and upon request): "The requirements set out in the third subparagraph of Article 25(2) and in Article 25(6) shall not apply to services provided to professional clients unless they inform the investment firm in electronic or paper format that they wish to benefit from the rights provided for in those provisions."

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.

In addition to the concerns highlighted in the response to Question 11, we notenote that where the provision of the advice service is carried out considering the totality of the client's positions, the approach set out in this proposed supporting guideline 8 may impair the provision of the service, as a different client suitability profile may be derived for each specific recommendation or transaction. It may also prejudice the periodic review processes of the suitability of client investments. Under the criteria set out in this guideline, the question may arise as to which client profile to take for suitability review – whether the "general" profile or the profile that may have been established by the customer for a particular transaction or recommendation. Depending on whether the client makes use of this possibility to identify suitable products for a particular transaction or to update the general profile, the guidelines should clarify that the advisor has discretion to review the transaction-specific profile or the general profile.

Moreover, according to guideline 8 (paragraph 75): "Firms are reminded that the suitability assessment is not limited to recommendations to buy a financial instrument. Every recommendation must be suitable, whether it is, for example, a recommendation to buy, hold or sell an instrument, or not to do so". In this respect, it should be clarified whether the possibility to tailor sustainability preferences should also be offered to the client on the occasion of the issuance of other types of proposals where there is no recommendation to buy or invest in a financial instrument.

Managed portfolios are considered a "Financial Product" for the purposes of SFDR. Where applicable, the managed portfolio, like any other "Financial Product", must be aligned with the client's sustainability preferences. However, it is not appropriate to adapt what has been agreed in respect of the management mandate to the client's sustainability preferences, as this could lead to a change in the rating of such managed portfolio under SFDR or Taxonomy regulations. This may require an adaptation of the appropriate sustainability disclosures in the pre-contractual and post-contractual documentation of the managed portfolio, as well as, where applicable, of the sustainability disclosures of the managed portfolio to be published on the website.

It should be considered that, in the event that the managed portfolio that the client wishes to contract does not match his sustainability preferences, he should be offered the possibility of adapting his sustainability preferences, as indicated in the comments to Guideline 8 (Points 80 and 81).

On the other hand, as regards the provision of portfolio advice, it should be clarified that the recommendation should be considered to be in line with the client's sustainability preferences if the proposed investment, taken as part of the portfolio as a whole, is in line with these preferences, even if the recommendation includes specific products which individually do not meet the client's sustainability preferences. In such a case, it is not appropriate to inform the client of the lack of adaptation of the recommendation to his sustainability preferences, nor is it necessary to offer him the possibility to adapt his sustainability preferences for future investments

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)?

As discussed above, we see this as an important challenge and highly likely to occur. From an operational standpoint, financial advisors/investment firms should be able to update clients' general profile and not be limited to each particular transaction. This possibility should be limited to situations where no products meet the client's sustainability preferences and the client wishes to adapt such preferences. The firm's explanation and the client's decision should be documented in the suitability report.

It should be clarified that, where appropriate, the client should be informed of this circumstance when he is informed of the outcome of his suitability assessment (when he is informed of his suitability profile) and not in specific investment recommendations or proposals.

In any case, the firm should be able to issue recommendations on products that do not match the client's sustainability preferences by informing the client that the recommended product does not match his preferences and offering the client the possibility to adapt his sustainability preferences for future recommendations.

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.

As provided for in the new wording of Art. 54.10 of Delegated Regulation (EU) 2017/565 (as amended by Delegated Regulation (EU) 2021/1253), the firm must inform the client when the recommended product does not meet its sustainability preferences, or, when it refrains from making a recommendation because there are no products that meet its sustainability preferences: "(. ...) The investment firm shall refrain from recommending or deciding to trade financial instruments as instruments that meet the sustainability preferences of a client or potential client when such financial instruments do not meet those preferences. The investment firm shall explain to the client or potential client the reasons for abstaining and shall keep a record of those reasons."

On the other hand, in accordance with the new wording of Art. 54. 12 of Delegated Regulation (EU) 2017/565 (as amended by Delegated Regulation (EU) 2021/1253), the firm must inform the client when the recommended product is not in line with the client's sustainability preferences: "When providing investment advice, investment firms shall provide the retail client with a report that includes a summary of the advice provided and explains the reasons why the recommendation is suitable for that client, including how the recommendation meets the client's investment objectives and personal circumstances with reference to the investment time horizon required, the client's knowledge and experience, attitude to risk, ability to bear losses and sustainability preferences (. ..)".

If the recommendation is in line with the client's sustainability preferences because the client does not have sustainability preferences, the applicable regulation only requires that the client be informed of how the recommendation meets his preferences but does not require information on the sustainability features of the products.

In this sense, it should be sufficient to make available to the customer the corresponding pre-contractual information of the recommended products, which contains the appropriate information on sustainability required by the applicable regulations. We also suggests to change “offer” by “recommendation” in the second sentence. This would make clear that obligations related to information and documentation do relate to the recommended product and not the whole investment firm’s range of products.

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 proposed approach to the assessment of ESG preferences in the case of portfolio approach is too granular and should be simplified. For the investment advice we don't think that a rebalancing of the portfolio should be automatically triggered; the client will receive the periodical suitability assessment and will be invited to contact his/her client manager/branch in order to discuss a portfolio review.

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?

Firstly, we understand that, in accordance with the MIFID II Delegated Regulation, firms can recommend financial products that do not meet the client's individual sustainability preferences, provided this is clearly stated, with no need for a mandatory adaptation of the client's preferences.

In any case, regarding potential adaptations of sustainability preferences, we understand that as long as the firm is transparent with the client and provides the necessary information in a clear manner, the fact that clients adapt their sustainability preferences in a relatively frequent manner should not be considered problematic. Thus, we believe that this will be quite common, especially in the short term, as the availability of financial instruments with sustainability features may be initially limited and the introduction of these financial instruments in the firm's product scope might be gradual (as ESMA recognised in paragraph 34 of the Consultation Paper), as well as the evolution of the client's knowledge of the sustainability product universe. A significant occurrence of clients adapting their sustainability preferences will become more likely once disclosures begin to be made available under CSRD, when both clients and their advisors will be able to perform a more accurate assessment. Until then, a continuous monitoring of the evolution of clients' sustainability preferences would prove too cumbersome. However, we find that holding an ad-hoc update meeting with the client after the first cycle of CSRD reporting to review, revisit and, where needed, amend the sustainability preferences would represent a good practice.

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

We recommend that ESMA clarifies the guideline 10 further, including how the amendment relates with the Delegated Regulation 565/2017, according to which the firm can recommend a switch only when the benefits are greater than the costs.

Under Article 25 paragraph 2 of MiFID II investment firms are required to communicate to the client "whether or not the benefits of the switching of financial instruments are greater than the costs involved in such switching". Under Article 54 paragraph 11 of the Delegated Regulation (EU) 2017/565, investment firms are required to "demonstrate that the benefits of the switching are greater than the costs" and this is considered an essential element for the positive outcome of the suitability assessment. The above-mentioned provision of the Delegated Regulation is therefore stricter than the above-mentioned provision included in MiFID II.

In order to better clarify the issue, according to the Delegated Regulation:

- the suitability assessment procedures adopted by most investment firms should provide for a blocking check with reference to the outcome of cost-benefit analysis, so as that the recommendation can be provided only if this outcome is positive;

- in the suitability report, where such assessment is conducted, an indication should be provided in this regard only in the event of a positive outcome, since in the event of a negative outcome the recommendation is not provided.

In light of the above and in order to avoid potential misunderstandings and problems with clients, ESMA should clarify whether the new Article 25 paragraph 2 i)has or has not intended to modify (and not only integrate) the requirements on cost-benefit analysis of switching investment, previously regulated only by Delegated Regulation (EU) 2017/565 and ii) whether the new article makes it possible - in the case of investment advice - to recommend the switch even if the deriving benefits are lower than the costs.

We also note that, according to the new Art. 29a(2) of Directive 2014/65/EU (as amended by Directive (EU) 2021/338), the obligations to analyse the costs and benefits of switching financial instruments and, where applicable, to inform the client about such analysis, not necessarily apply in case of professional clients (both per se and on request) unless they inform the investment firm that they wish to benefit from such rights: "The requirements set out in the third subparagraph of Article 25(2) and in Article 25(6) shall not apply to services provided to professional clients unless they inform the investment firm in electronic or paper format that they wish to benefit from the rights provided for in those provisions."

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.

We agree.

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

We agree.

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.

We agree.

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

The guidelines could add clarity on the following points:

- Regarding Guideline 3 (para 32): ESMA should clarify how the principle of proportionality is applied in terms of the scope of information to be collected on the client's sustainability preferences. This clarification should in particular, take into account the particularities that may affect financial instruments for which information on their sustainability attributes is not available, or products with sustainability-related attributes that cannot be verified under the SFDR and Taxonomy regulation.
- Regarding Guideline 9 (para 93): Additional criteria that may be considered to justify the choice or recommendation of an equivalent product with higher costs or greater complexity should include the client's sustainability preferences. It should be considered that adherence to the client's sustainability

preferences may result in the client being exposed to higher liquidity, concentration or other risks, or bearing higher investment costs.

The guidelines can also help address the issues emerging from the overlap of MiFID II with the SFDR and the Taxonomy Regulation related to the sequencing of the requirements' implementation. The amendments to the MiFID II Delegated Regulation will take effect on 2 August 2022 and make the suitability assessment reliant on the sustainability information disclosed under the SFDR and Taxonomy Regulation, intended to "provide distributers with the relevant information to duly consider any sustainability related objectives of the client or potential client."

In SFDR, pre-contractual disclosures on the Taxonomy-alignment of sustainable investment products have been delayed to 2023, and pre-contractual disclosures on the consideration of adverse sustainability impacts at financial product level only apply as of 30 December 2022. As for the Taxonomy Regulation, Taxonomy-alignment disclosures made under Article 8 will not be available before January 2023 for non-financial undertakings and January 2024 for financial undertakings, respectively, referencing reporting periods 2022 and 2023.

As a result, without clarification from regulators and supervisors, distributors will not be able to carry out a suitability assessment based on either the consideration of quantitative PAI indicators determined by the client, or a minimum proportion of sustainable investment aligned with SFDR or the Taxonomy. In this context, we support ESMA's effort to set realistic expectations and provide flexibility in the suitability assessment during this initial period.

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

We do not have additional comments.

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

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About AFME

AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.[1]

About ISDA

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 970 member institutions from 77 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org. Follow us on Twitter, LinkedIn, Facebook and YouTube.

[1] AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia. AFME is registered on the EU Transparency Register, registration number 65110063986-76.