

Consultation response on the ESMA review of the MiFID Suitability Guidelines

info@dufas.nl
www.dufas.nl

To ESMA
From Dutch Fund and Asset Management Association (DUFAS)

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Subject **ESMA Consultation Paper Guidelines on certain aspects of the MiFID II suitability requirements**

Contact details Randy Pattiselanno, Manager strategy & regulatory affairs, rp@dufas.nl

DUFAS (the Dutch Fund and Asset Management Association) welcomes the opportunity to respond to the ESMA Consultation Paper Guidelines on certain aspects of the MiFID II suitability requirements, as published by ESMA on 27 January 2022.

Timing

- In terms of timing, needless to say is that the expected publication of the ESMA final guidelines in Q3 2022 does not match the timing of the entering into force of the MiFID Commission Delegated Act (EU) 2021/1253 of 21 April 2021 ("MiFID DA"). As such, investment firms will not be able to comply with these guidelines when implementing the MiFID DA, whilst these are essential for a proper implementation. Moreover and more importantly, proper and effective implementation of the MiFID DA will also be hindered by the absence of data stemming from the taxonomy and SFDR level 2 disclosures in particular. We hope and expect NCAs (national competent authorities) to take this into consideration in their supervision.

Distinction retail versus professional clients

- In general, we believe that the guidelines should make a clear distinction between retail clients and professional clients. This should be reflected in the way the concept of sustainability preferences and ESG is being explained to clients, and in the granularity of the intake of sustainability preferences. This may vary and strongly depend on the type of client.

Unavailability sufficient products

- One of the main challenges of an investment firm in obtaining sustainability preferences from the client through the suitability assessment is that there may not be products available or not sufficiently available to match these preferences as from 2 August onwards and in the near future. The guidelines should reflect and acknowledge that matching products may not be readily available, and hence possibilities should exist to manage the expectations of the client.

Flexibility & proportionality

- Flexibility and proportionality in explaining and the intake of sustainability preferences is key. As such, the guidelines should reflect that a firm should not be obliged to run through the three sustainability preferences categories of products as suggested. Instead, the investment firm should be able to ask the client for options and combinations of grouping of products as they deem fit and proper, provided of course the groups of products should be matched with the sustainable preferences matched products under MiFID. Furthermore, the intake and obtaining preferences should take place on a 'phase in approach'. Original expressed sustainability preferences may not always be met in first instance by the investment firm, but may be matched as soon more products that corresponds with the MiFID sustainability preferences become available.

Guidelines on certain aspects of the MiFID suitability requirements

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.

In general, we agree with ESMA's suggested approach subject to the comments set forth in our answer to Q2. As a general observation, we advise ESMA for the application of the suitability requirements clearly to distinguish between retail clients and professional clients.

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.

DUFAS supports the guideline that the firm needs to explain clients the concept of "sustainability preferences".

First of all, one of the main challenges of an investment firm in obtaining through the suitability assessment sustainability preferences from the client is that there may not be products available or not sufficiently available to match these preferences. This could practically mean that investment firms are obliged to ask clients whether they have an interest in certain products matching the concept of sustainability preferences under MiFID without being able to offer such products. Investment firms will be forced to explain taxonomy aligned investments to clients whilst at the same time they may have to acknowledge these products are not available, at least not in the near future. Given that fact, we recommend to include a supporting guideline to the effect acknowledging that matching products may not be readily available, but will be in the long run. As a result of this the firm should be allowed to adapt the suitability assessment towards sustainability preferences at the start of the entry of into force of these changes. It is crucial that the investment firm is able to manage expectations in advance. Hence, this should also be reflected in the manner sustainability preferences need to be asked. For example, a firm that provides an (retail) investor upfront with information on the new rules on sustainability preferences, accompanied by an explanation on ESG, while through such information manages expectations on the availability of products matching the preferences under MiFID, this should suffice to comply with guideline 1.

Secondly, we do believe that the manner and extent of explaining the concept of "sustainability preferences" should be proportionate depending on the type of client, retail or professional. Surely, avoiding technical terms is advisable when dealing with mass retail clients, but this is not necessarily the case with professional clients or eligible counterparties. Particularly, where a professional client itself is subject to the EU sustainable finance regulations, such as the SFDR, it is clearly not needed to avoid technical terms. On the contrary. In addition, in such case, explaining ESG and the concept of "sustainability preferences" could be very limited. Flexibility and proportionality is key in this respect. We recommend ESMA to amend the guideline to this effect.

Thirdly, we have to bear in mind that asking clients for their sustainability preferences is not new, at least not for a lot of firms. What is new is the definition and the matching products. A supporting guideline may need to be added as to explain to clients what this means for their existing portfolio which is subject to previously identified and agreed sustainability preferences. Flexibility in the manner an investment firm explains these changes is key.

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.

Guideline 2.25 seems to suggest that if a client expresses sustainability preferences, the firm need to ask the client if and to what extent he or she wishes to invest in the three categories matching products as outlined in Article 2(7) MiFID Commission DA (EU) 2021/1253 of 21 April 2021.

No obligation to ask clients for preferences along the lines of the 3 categories

First of all, the MiFID sustainability categories seems to suggest that these are mutually exclusive. This is however not the case. We believe therefore that firms should have flexibility in the manner they collect information about sustainability preferences from clients, as long as the sustainability preferences match the required products. This means that a firm should not be obliged to run through the three categories as suggested, but could conduct this in alternative ways.

Combination or categories of products

Instead, the firm should be able to ask the client for options and combinations of grouping of products, along the lines of guideline 7.71, provided of course the groups of products should be matched with the sustainable preferences matched products under MiFID. For example, a firm may have bucketed their sustainable products in e.g. (i) group of products that are taxonomy aligned. i.e. e.g. products aimed at reducing CO2 emissions, (ii) group products that have 'high', 'medium' and 'low' proportions of sustainable investments, (iii) group of products that consider E and S, (iv) groups of products that consider a wide range of principle adverse impact indicators, or (v) groups of products that are focused on specific sustainable themes. Essentially, the firm should be able to offer a comprehensible set of options to a client to consider their sustainability preferences against. This is more likely to be understood by the client then solely asking for preferences along the lines of the three categories. The possibility of providing multiple combinations of options is key for the entire investment intake process, as long (i) the outcome at the end of the day matches with the three categories under MiFID and provided (ii) that within the intake process avoiding bias is ensured.

Information on principal adverse impacts

The guidelines currently suggest that principal adverse impacts should be considered, and then goes on to say that this should include quantitative and qualitative criteria demonstrating this consideration. It is currently unclear how best to interpret this. If this refers to any quantitative PAI data that should be available on all investments, it is unclear how this information will become available to the investment firm (for instance when investing in a collective investment scheme), given such information is not part of the current templates as released by the European Commission. Separately, we question to what extent (non-professional) clients are able to understand and clarify which families of PAI indicators they would prefer, and what would be a suitable and acceptable level for their portfolio. A slightly different approach could be to ask clients to what extent the PAI indicators should be less than a benchmark or another objectively measurable index, and to then ask clients to express their preference for specific (families) of PAIs.

Phase in approach

Given the lack of matching products at the start of entering into force of the MiFID II Delegated Act, the guideline should also allow the following approach. As a first step, a firm can obtain clients' sustainability preferences through open and unbiased questions. These original preferences will be stored by the firm in the client's profile. However, because of the lack of matching products the firm should be allowed, taking

into account these original preferences, to recommend the client with currently alternative available sustainable products. For example, a client wishes to have a taxonomy aligned investment, which may not be available. But instead a firm should for example be allowed to offer a product that is aimed at CO2 emission reduction, whilst not fully complying with the EU taxonomy. Where products matching the original or part of the original preferences may become available, the firm should include this in the regular update of the suitability assessment. This approach is a 'phase in model'. A firm at the long run may be able to match the original sustainability preferences expressed by the client, where it cannot fulfil such preferences at the start of the entering into force of the MiFID Delegated Act. With such phase in model biasness is also avoided.

No sustainability preferences

If a client has indicated that it has no sustainability preferences, we recommend that the guideline explicitly – for the avoidance of the doubt- provides that in such case there is no need to ask for preferences along the lines of the three categories or any matter as the case may be. Provided that the firm has already informed the client on the entire concept of sustainability preferences under guideline 1. Furthermore, we agree therefore with guideline 8.83. that in such case a firm may consider this client as "sustainability-neutral" and recommend products both with and without sustainability-related features. This is also consistent with the product governance provision under MiFID that a client that has no sustainability preferences may still be offers sustainable products as long these are suitable for the client. Clients with no sustainability preferences are not falling within the negative target market.

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

Please see our response to Q3.

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?

As said in our answer to Q3, DUFAS believes that the guidelines should provide flexibility in how a firm arrives at receiving all the necessary clients' information as to the sustainability preferences. At the end of the day, the investment firm needs to be able to match the preferences with the three category products, but flexibility and proportionality is key. As such we do not think that additional guidance about what is precisely expected from investment firms when investigating and prioritizing these simultaneous overlapping preferences is needed.

Q6. Do you agree with the proposed approach with regard to the assessment of ESG preferences in the case of portfolio approach? Are there alternative approaches that ESMA should consider? Please provide possible examples.

We do agree in general with the portfolio approach. We support that firms should 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 acknowledges that a client should determine the allocation between sustainability preferences matching products and the part which is not.

However we do strongly object to guideline 2.27 which indicates that *"firms should ensure the same level of granularity of information is collected on the client's sustainability preferences when providing portfolio management or investment advice with a portfolio approach."* Firms should have flexibility depending on the type of service and type of client. The collection of information on sustainability preferences could be much more granular with e.g. a pension fund in comparison to a mass retail client. Although the guideline seems to aim at the type of investment service, this has indirect implications for the type of client. In practice you would like to vary in the granularity of the collection of information because of the type of client and/or products offered. Even within a group of clients, say retail clients, firms should have flexibility as product offering may vary from mass retail clients to private banking clients or high net worth clients. But also vary on the scale of knowledge and experience of clients. Needless to say, notwithstanding any flexibility and proportionality, any biasness in the intake should be avoided.

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.

Recital 4 of the MiFID Commission DA (EU) 2021/1253 of 21 April 2021 provides that *"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 believe that this level 1 recital should be reflected into guideline 5.55. This means that after entry into force of the MiFID DA (EU) 2021/1253, the firm is required for *existing* clients and provided the advisory and portfolio managements relationship are ongoing relationships to obtain the sustainability preferences in accordance with MiFID with the *next* suitability assessment. Not necessarily the next contact with the client. In practice this means for advisory services, that sustainability preferences may need to be obtained with the first advice following entry into force MiFID DA. For portfolio management, these sustainability preferences needs to be obtained with the suitability assessment, which is in practice the annual review or earlier if the firm conducts reviews more frequently. Needless to say, where an update of client information according to the firm necessitates to a new suitability assessment, this sustainability preferences intake is also triggered. Although the guideline 5.55 reflects most part of this, the guideline could be more specific with regard to portfolio management services. Furthermore, firms should be allowed to approach an existing client where they provide an overview of its current portfolio, and assessment of the current classification of sustainable products and indicate that the firm will contact the client at a later date to assess the actual sustainability preferences in accordance with the new rules. The framework should also allow an initial mapping of portfolios with the preferences without triggering a new suitability assessment. We recommend ESMA to include such approach in the revised guidelines.

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.

In general, we agree with the amendments in guideline 7, although the majority relate to product governance obligations. Although, we appreciate ESMA's statement in guideline 7.71 that *'Firms are reminded that a grouping of financial instruments for the purpose of the suitability assessment cannot replace the collection of information from clients as described [...] above'*, we refer to our suggestions that grouping of

products could be instrumental in the client intake and helping (retail) clients to understand what is possible, available and what is not. Here again, the ability of grouping of ESG products and offering various options as outcome of the intake is key.

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.

Please see our response to Q8.

GUIDELINE 8: ARRANGEMENTS NECESSARY TO ENSURE 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.

DUFAS appreciates that the two step approach regarding sustainability preferences is reflected in recital 5 of the MiFID DA (EU) 2021/1253, which reads "In order to avoid such practices or misrepresentations, investment firms providing investment advice should first assess a client's or potential client's other investment objectives, time horizon and individual circumstances, before asking for his or her potential sustainability preferences". However, we do think that in some occasions, in practice combining suitability preferences with the suitability assessment should be allowed. For example where the client's already indicates that he or she want to invests in sustainable products as part of the investment objective. Some sort of flexibility should be allowed where justified and logical.

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.

DUFAS agrees with the guideline 8.80 with regard to the adaption of sustainability preferences. This principle is already reflected in recital 8 MiFID DA (EU) 2021/1253, which reads "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. In order to prevent mis-selling and greenwashing, investment firms should keep records of the client's decision along with the client's explanation supporting the adaptation".

We agree that the client's decision must be documented. However, we advise to clarify that such decision for *retail* clients should be included in the suitability report, whilst for *professional* clients this should be recorded, but not necessarily in a suitability report as the establishment of such suitability report is applicable to retail clients only.

Furthermore, DUFAS has concerns with ESMA's proposal that a client's sustainability preferences may not be adapted as part of a "standard procedure", as set forth in guideline 8.81. The MiFID DA (EU) 2021/1253 does not exclude that this could be a standard procedure, whilst there may be merit in applying this as standard procedure in certain circumstances. We have already indicated that certain products matching the sustainability preferences products may not be available on the market, e.g. taxonomy aligned

products. Where a client e.g. prefers to have taxonomy aligned products, the investment firm must be able to advise other products up until the moment that such products may become available on the market, the so-called phase in model. A firm should be able to standardize this procedure up until that moment. Hence, DUFAS advocates more flexibility in this process, particularly at the beginning of the entry of into force of the MiFID DA. We refer to our suggestion of the phase in model as described in our answer to Q3.

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.

Please see our response to Q11.

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

Firms should be flexible in their approach how to deal with the adaptation of sustainability preferences. As best practice, we envisage that the firm will seek alternative solutions as a second best product. For example, where a client has expressed his preferences for taxonomy aligned products, the firm may seek recommending e.g. climate funds qualifying as a sustainable investment, although not meeting the taxonomy requirements. Please also see our response to Q11.

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.

Yes, DUFAS agrees with guideline 8.83. that in case a client does not express sustainability preferences, the firm may consider this client as "sustainability-neutral" and recommend products both with and without sustainability-related features. It should be clear that in such case, the firm should not be obliged to continue the intake along the lines of the three categories or any other combinations as the case may be, provided of course the firm has explained the concept of sustainability preferences and what is possible and available as set forth in guideline 1.

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.

In general DUFAS agrees with the approach with regard to the possibility for clients to adapt their sustainability preferences in the case of the portfolio approach, subject to our response to Q11.

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?

In principle, we do not believe that there should be an explicit requirement to monitor instances of adapting sustainability preferences. This may be different where the adaption is caused by the absence of products matching the original sustainability preferences from the client.

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.

No comments.

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.

DUFAS supports the need for staff to have the necessary knowledge and competence concerning sustainability preferences. This will be important to answer clients' questions and bridge the gap between clients' expectations and reality. This requirement should also be part of ESMA's knowledge and competence guidelines.

GUIDELINE 12: RECORD-KEEPING

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

DUFAS generally agrees with the guidance on guidelines on record-keeping

QUESTIONS NOT RELATED TO SPECIFIC REVISIONS

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.

No comments.

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

No comments.

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

No 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.

The costs of implementing the new rules are difficult to assess and very much depend on the specific organization. There may be a difference in costs depending on the type of clients the investment firm serves. Contrary to perhaps servicing retail clients, where investment firms serve professional clients only, DUFAS members do not expect to automatize the client intake. The substantial costs will consist of training of staff together with the matching of clients to products.

DUFAS expects that the biggest cost of implementing the changes depends on what data is and needs to be available to match clients to products. Where the information can be obtained from the disclosures and/or investment firms can rely on information from last year (for instance on PAIs to the extent this is reported annually), then the costs may be limited. However, if investment firms may for example need to run separate PAI reports every time they speak to a client, then this would cause a capacity issue.

DUFAS: Dutch Fund and Asset Management Association

Since 2003, DUFAS has been committed to a healthy asset management sector in the Netherlands. DUFAS has more than 50 members: from large asset managers who invest Dutch pension and insurance assets to smaller, specialist asset managers. DUFAS increases awareness of the social relevance of investing, helps to develop sector standards and represents the sector in the implementation of new laws and regulations. In addition, DUFAS is committed to a single European market with equal regulations.

More information

Would you like to respond, or should you have any questions? I would be pleased to hear from you. Please feel welcome to e-mail Randy Pattiselanno, DUFAS manager strategy & regulatory affairs, at rp@dufas.nl.