Final Report

Guidelines on certain aspects of the MiFID II suitability requirements

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1 Executive Summary

Reasons for publication

The assessment of suitability is one of the most important requirements for investor protection in the MiFID II framework. It applies to the provision of any type of investment advice (whether independent or not) and portfolio management. In accordance with the obligations set out in Article 25(2) of Directive 2014/65/EU on Markets in Financial Instruments (MiFID II) and Articles 54 and 55 of the Commission Delegated Regulation (EU) 2017/565 (MiFID II Delegated Regulation), investment firms providing investment advice or portfolio management have to provide suitable personal recommendations to their clients or have to make suitable investment decisions on behalf of their clients.

This Final Report builds on the text of the 2018 ESMA guidelines[1], which have now been reviewed following the adoption by the European Commission of the changes to the MiFID II Delegated Regulation[2] to integrate sustainability factors, risk and preferences into certain organisational requirements and operating conditions for investment firms. In addition, the review of the guidelines takes into account the results of the 2020 Common Supervisory Action (CSA)[3] conducted by national competent authorities (NCAs) on the application of the MiFID II suitability requirements, complementing the existing guidelines with the good and poor practices observed and providing some practical guidance to firms in the areas where lack of convergence still seems to persist. Lastly, the review also considers the amendments introduced through the Capital Markets Recovery Package[4] to Article 25(2) of MiFID II.

On 27 January 2022, in accordance with Article 16(2) of the ESMA Regulation, ESMA published a Consultation Paper (CP) with proposed draft guidelines on certain aspects of the MiFID II suitability requirements. The consultation period closed on 27 April 2022. ESMA received 90 responses, 10 of which confidential. ESMA also sought the advice of the Securities and Markets Stakeholders Group (SMSG). The responses received are available on ESMA's website unless respondents requested otherwise. This paper summarises the responses to the CP and explains how the responses have been taken into account. ESMA recommends reading this report together with the CP published on 27 January 2022 to have a complete view of the rationale for the guidelines.

By pursuing the objective of ensuring a consistent and harmonised application of the requirements in the area of suitability, including on the topic of sustainability, the guidelines will contribute to the achievement of the objectives of MiFID II. ESMA believes that the implementation of these guidelines will strengthen investor protection – a key objective for ESMA.

Contents

Section 2 gives an overview of the Final Report. Section 3 contains the Annexes: Annex I contains the cost-benefit analysis; Annex II summarises the opinion of the SMSG; Annex III contains the feedback statement; Annex IV contains the full text of the final guidelines; and Annex V contains a list of good and poor practices observed from the supervision of the MiFID II requirements on suitability.

Next Steps

The Guidelines in Annex IV will be translated in the official EU languages and published on ESMA's website. The publication of the translations in all official languages of the EU will trigger a two-month period during which NCAs must notify ESMA whether they comply or intend to comply with the Guidelines.

[1] ESMA35-43-869
[2] Commission Delegated Regulation (EU) 2021/1253 amending Delegated Regulation (EU) 2017/565
[3] ESMA35-43-2748
[4] Directive (EU) 2021/338 amending Directive 2014/65/EU

2 Background

2.1 Overview

Background

1. The assessment of suitability is one of the most important obligations for investor protection. It applies to the provision of any type of investment advice (whether independent or not) and portfolio management. In accordance with the obligations set out in Article 25(2) of MiFID II and Articles 54 and 55 of the MiFID II Delegated Regulation, investment firms providing investment advice or portfolio management have to provide suitable personal recommendations to their clients or have to make suitable investment decisions on behalf of their clients. Suitability has to be assessed against clients' knowledge and experience, financial situation and investment objectives. To achieve this, investment firms have to obtain the necessary information from clients.

2. In July 2012, ESMA published the first set of guidelines on certain aspects of the MiFID suitability requirements. The purpose of these guidelines was to clarify the application of certain aspects of the MiFID suitability requirements in order to ensure the common, uniform and consistent application of the relevant requirements under MiFID I[5] and to promote greater convergence in the interpretation of, and supervisory approaches to, the MiFID suitability requirements, by emphasising a number of important issues, and thereby enhancing the effectiveness of existing standards. The guidelines cover a number of areas concerning, inter alia, client information, record keeping, arrangements necessary for investment firms and staff qualification.

3. In May 2018, following the adoption of MiFID II, ESMA has published revised guidelines on suitability. In particular, the 2012 guidelines have been largely confirmed and broadened in order to:

    - consider technological developments of the advisory market notably the increasing use of automated or semi-automated systems for the provision of investment advice or portfolio management (robo-advice);
    - build on NCAs' supervisory experience on the application of suitability requirements;
    - take into account the outcome of studies in the area of behavioural finance; and
    - provide additional details on some aspects that were already covered under the 2012 guidelines.

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[5] Article 19(4) of MiFID and of Articles 35 and 37 of the MiFID Implementing Directive.

4. The 2018 version of the suitability guidelines also included a good practice for firms in the area of sustainability (considering that, at the time, sustainability had not yet been integrated in the MiFID II delegated acts).[6]

5. In March 2018 the Commission published its Action Plan 'Financing Sustainable Growth'[7], setting up an ambitious and comprehensive strategy on sustainable finance. As part of the Action Plan, the Commission announced the intention to incorporate sustainability when providing financial advice and to clarify the integration of sustainability in so-called fiduciary duties in sectoral legislation.

6. Following the publication of the Commission's Action Plan, the MiFID II Delegated Regulation has been updated[8] to integrate sustainability factors, risk and preferences into certain organisational requirements and operating conditions for investment firms. The amendments have been published in the Official Journal of the European Union on 2 August 2021 and apply from 2 August 2022. They are part of a broader Commission initiative on sustainable development and lay the foundation for a EU framework which puts sustainability considerations at the heart of the financial system to support transforming Europe's economy into a greener, more resilient and circular system in line with the European Green Deal[9] objectives.

7. The introduction of amendments to the MiFID II Delegated Regulation has subsequently triggered the further review and update of the existing 2018 guidelines[10]. Moreover, other relevant factors have been considered as part of the review of the guidelines such as:

   - the integration of the good and poor practices[11] emerged from the 2020 Common Supervisory Action (CSA) to complement the current guidelines. These good and poor practices will help give some practical guidance to firms in the areas where lack of convergence still seems to persist and should also be a helpful tool for firms when applying the MiFID requirements and the ESMA guidelines;

   - the finalisation of the ESMA guidelines on certain aspects of the MiFID II appropriateness and execution-only requirements that gives the opportunity to ensure alignment between the two sets of guidelines when touching on similar requirements; and

[6] While the 2018 guidelines noted that it would be a good practice for firms to collect information about the client's or potential client's ESG preferences, ESMA's CSA showed that, in 2020, the vast majority of firms in the CSA sample did not yet incorporate the collection and analysis of such information into their suitability policies and procedures.
[7] COM(2018) 97 final
[8] Commission Delegated Regulation (EU) 2021/1253
[9] COM(2019)640 final
[10] It should be noted that, as part of this review, ESMA has also considered responses that were provided by stakeholders to the Consultation Paper on the review of the 2018 guidelines in the area of sustainability.
[11] It should be noted that some of the poor practices listed in the annex can be configured (depending on the specific context) as violations of the MiFID II requirements.

- the amendments introduced through the Capital Markets Recovery Package to Article 25(2) of MiFID II[12].

8. It should be noted that the final guidelines do not address all issues arising from the suitability requirements. Clarity on further aspects of the suitability requirements has been and will be provided by ESMA through the publication of ad hoc Q&As[13]. Moreover, ESMA acknowledges the complexity of the sustainable finance topic and the constant evolution of the market and expects to keep working on supervisory convergence in this area with various tools at its disposal.

9. When updating these guidelines, ESMA has striven to ensure consistency with all other relevant EU legislation on this topic (such as the Taxonomy Regulation (TR)[14], the Sustainable Finance Disclosure Regulation (SFDR)[15] and their implementing measures). ESMA has also closely liaised with EIOPA in order to ensure consistency across sectors.

Public consultation

10. On 27 January 2022, ESMA published a Consultation Paper (CP)[16] on the draft guidelines on certain aspects of the MiFID II suitability requirements in order to explain its rationale and gather input from stakeholders. The consultation period closed on 27 April 2022.

11. ESMA received 90 responses, 10 of which confidential. The answers received are available on ESMA's website unless respondents requested otherwise. ESMA also sought the advice of the Securities and Markets Stakeholder Group's (SMSG).

Final report

12. This Final Report summarises and analyses the responses to the CP and explains how the responses, together with the SMSG advice, have been taken into account. ESMA recommends reading this report together with the CP published 27 January 2022 to have a complete view of the rationale for the guidelines.

[12] Under the Capital Markets Recovery Package, a new subparagraph has been added to Article 25(2) of MiFID II that adds a disclosure obligation for firms (i.e., to inform the clients) on the results of the analysis performed on the costs and benefits of switching investments when providing investment advice. A slight wording amendment has been introduced in the text of guideline 10 to align the guideline with Article 25(2) of MiFID II.
[13] ESMA35-43-349 and ESMA Q&A tool available at - [Questions and Answers (europa.eu)](#).
[14] Regulation (EU) 2020/852.
[15] Regulation (EU) 2019/2088.
[16] ESMA35-43-2998.

3 Annexes

3.1 Annex I - Cost-benefit analysis

1. The suitability requirements are an essential element of the regulatory toolkit on the distribution of financial instruments to retail investors and it is important to observe that the quality of the advice delivered to the client plays a critical role in ensuring the consistency of the transaction with the client's profile.

2. These guidelines aim to ensure a common, uniform and consistent implementation of the MiFID II requirements as recently amended in order to (i) integrate client's preferences in terms of sustainability as a top up to the suitability assessment; and (ii) integrate sustainability risks into the organisational requirements.

3. By providing clarification of the relevant MiFID suitability requirements, and specifically on the new requirements on sustainability, ESMA is helping firms to improve their implementation of these requirements and play a role in ensuring an efficient implementation of EU framework which puts sustainability considerations at the heart of the financial system to support transforming Europe's economy into a greener, more resilient and circular system in line with the European Green Deal objectives. The guidelines also aim to ensure a convergent approach in the supervision of the suitability requirements. Greater convergence leads to improved investor protection (consumer outcomes), which is a key ESMA objective.

The impacts of the ESMA guidelines

4. In light of the main objectives of these guidelines (extensively illustrated in the background), the following preliminary assessment aims at explaining the benefits and costs of the key policy choices that are presented for consultation.

5. It should be preliminary observed that since the requirements on the suitability assessment are provided under the MiFID II and the relevant Delegated Regulation, the impact of the proposed guidelines should be considered having in mind those legal provisions that they support. While market participants will likely incur certain costs for implementing these guidelines, they will also benefit from the increased legal certainty and the harmonised application of the requirements across Member States. Investors would in turn benefit from an improved compatibility between investment products and the needs and characteristics of clients. The proposed guidelines should also facilitate competent authorities' efforts to improve the overall compliance with MiFID requirements increasing the investor confidence in the financial markets, which is considered necessary for the establishment of a genuine single capital market.

6. Finally, it is important to remind that those existing 2018 guidelines which are confirmed should not imply any additional impacts/costs for both firms and NCAs.

Benefits

7. It is possible to illustrate the main benefits linked to the guidelines as follows:

   - reduction of the mis-selling risk and its related financial consequences. This is a major benefit for investors and for the financial markets as whole. In particular, firms will benefit from the reduction of complaints, costs of appeals and legal expenditure for tribunal cases, damage to reputation, fines, etc.

   - avoid greenwashing in the distribution of investment products with sustainability features;

   - reduction of risks linked to regulatory or supervisory arbitrage due to an increased degree of harmonisation and more consistent supervisory convergence;

   - positive effects from improved harmonisation and standardisation of the processes that firms have to put in place when implementing the MiFID II suitability framework; and

   - positive effects from improved harmonisation and standardisation for competent authorities on the costs and activities needed to implement the new supervisory processes related to the assessment of suitability.

Costs

8. With reference to the costs, it should be firstly remembered that the key aspects of the suitability assessment and of these guidelines have remained unchanged.

9. In light of what has been said, it can be reasonably expected that those firms having already in place a complete set of arrangements to comply with the existing MiFID II provisions will presumably incur less overall costs when implementing the updated framework and these guidelines.

10. ESMA considers that potential and incremental costs that firms will face when implementing the overall suitability framework under the MiFID II regime (including but not limited to these guidelines) might be both of one-off and ongoing nature, arguably linked to:

    - (direct) costs linked to the update/review of the existing procedural and organisational arrangements to the new sustainability requirements (e.g., the review and/or the update of the MiFID questionnaires, suitability assessment, suitability report, repapering of pre-contractual information, etc);

    - (direct) cost linked to the process of collecting sustainability preferences from clients (e.g., providing advisors and portfolio managers with the necessary tools to recommend/select a suitable financial instrument, review/update of the algorithms/models used to match the client’s profile with suitable financial instruments, etc.);

- (direct) initial and ongoing IT costs;
- (direct) relevant organisational and HR costs linked to the implementation of the guidelines providing clarifications on the qualification of firm staff (in particular staff providing relevant investment services and compliance function staff);
- (direct) costs connected to ESG data sourcing (i.e., to obtain ESG information from products manufacturers) and to obtain ESG data licences from data providers.

11. ESMA believes that the proposed options in this area provide the most cost-efficient solution to achieving the general objectives of these guidelines.

Conclusions

12. In light of what has been illustrated above, ESMA believes that the overall (compliance) costs associated with implementation of the new regime on the suitability assessment (which includes the proposed guidelines) will be fully compensated by the benefits from the improved effectiveness of the suitability assessment.

13. ESMA also considers that the proposed guidelines are able to achieve an increased level of harmonisation in the interpretation and application of the suitability requirements across Member States, minimising the potential adverse impact on firms linked to compliance costs and will have a key role in the broader Commission's initiative on sustainable development. These benefits will outweigh all associated costs in respect of these guidelines.

14. Finally, ESMA believes that the adoption of guidelines is the best tool to achieve the explained objectives since this topic is already covered by existing guidelines. Furthermore, the adoption of guidelines further reduces the risk of diverging interpretations that might lead to discrepancies in the application and supervision of the relevant regulation and requirements across Member States (determining a risk of regulatory arbitrage and circumvention of rules).

3.2 Annex II - Advice of the Securities and Markets Stakeholder Group

1. As provided by Article 16(2) of the ESMA Regulation, ESMA also sought the advice of the Securities and Markets Stakeholder Group's (SMSG).[17]

2. The SMSG's made the following general remarks:

   "The legislation will be implemented in a context where several pieces of the puzzle are still missing. In particular, lack of data on investee companies will make the alignment of sustainability preferences and investment products difficult. In this context, it will be almost impossible for financial institutions to go beyond a 'best effort' compliance. This is neither appropriate nor desirable, but in the present context firms cannot be charged beyond best efforts with (i) the responsibility to make investors understand such a complex set of issues and (ii) completing the lack of regulation and data.

   The lack of data makes it difficult for distributors and manufacturers to have investment products on offer with elevated proportions of Taxonomy alignment or sustainable investments or which consider Principal Adverse Impacts by using quantitative indicators. Clients are not aware of these problems. Hence, a mismatch between expectations of clients and the availability of products is likely and must be taken into account.

   Even when data are available, their reliability is still questionable. The approval of the Corporate Sustainability Reporting Directive, its implementation, the proceedings of EFRAG are all crucial for reliable quantitative indicators.

   The assessment of sustainability preferences is constrained by the Commission Delegated Regulation defining sustainability preferences. If guidelines were written from a blank sheet, the outcome would probably be different. Despite these constraints, the SMSG considers it useful that ESMA investigates alternatives ways to assess sustainability preferences, also taking into account insights from behavioral finance. (This is not only relevant for sustainability preferences, but for suitability assessment in general.)

   The assessment of sustainability preferences entails some complex concepts and adds to the time required to answer a questionnaire. The underlying concepts, like the a, b, c options are not familiar themes for clients. There is no link with existing steps taken by funds in the field of sustainable finance, like the rules of a label or national -defined criteria. Neither the investor's ability to understand complex issues like this, nor the investor's willingness to spend time to a questionnaire is unlimited. As an overarching principle, rules should be focused on what is best for and of value to clients. It is important that information provided to clients can be understood, especially by retail

[17] The SMSG response has been published on the ESMA website (Ref: ESMA22-106-4032).

clients, and that we avoid information overload. More flexibility could be accepted vis-à-vis professional clients.

Sustainable finance cannot be restricted to the use of mere exclusion criteria or the setting of minimum proportions. Other approaches, like a strong engagement, also in sectors or companies with a high adverse impact, best in class, and in general transition approaches have their merit. Due to the highly quantitative approach, for example with regard to Principal Adverse Impact, there is a risk that the potential role of engagement is disregarded.

As a general remark it is also important that guidelines that ESMA publishes are drafted in such a way that they help firms and clients, at the stage of the process they are at, even if that means that the guidelines may have to be updated at regular intervals. This would further help manage end-investors' expectations in terms of product availability.

The SMSG is aware that the implementation date of the Commission Delegated Regulation defining sustainability preferences (2 August 2022) is something that cannot be decided on by ESMA. Nevertheless, it wants to voice its concern that the timespan for implementation is too short, also taking into account the inconsistencies that still exist in the legislation (see Annex). Also, the SMSG seriously questions whether now is the right time for these changes to MiFID, taking into account that a broader revision of suitability and appropriateness procedures is being envisaged."

The SMSG had also specific remarks on the guidelines that are summarised and addressed in the Feedback Statement section of this Final Report.

3.3 Annex III - Feedback on the consultation paper

1. The respondents to the Consultation Paper and the SMSG in its advice to ESMA raised some general points on the draft ESMA guidelines some of which are linked to broader issues related to the sustainable finance framework. The main ones are listed below:

   - Lack of ESG data - Various respondents, including the SMSG, stated that a lack of data makes it difficult for distributors and manufacturers to have investment products on offer with elevated proportions of Taxonomy alignment or sustainable investments or which consider Principal Adverse Impacts by using quantitative indicators. These respondents noted that even when ESG data is available, its reliability is still questionable and makes it complex to correctly integrate sustainability with advisory services.

     ESMA is aware that it may not be straightforward to calculate quantitative sustainability indicators due to the lack of reported data, or due to limits to the reliability of the necessary data. Nevertheless, ESMA is convinced that the situation is improving, as evidenced by the growing share of ESG data provided by data providers.

   - Timing issues - Various respondents noted the complexity of the legal framework on sustainable finance and underlined that the misaligned timing of the different pieces of the EU's sustainable finance framework has been most unhelpful to the financial industry in implementing the new requirements. Respondents noted that this puts a significant legal and operational burden on firms and asked the Commission to postpone the implementation of MiFID II delegated act until 2 August 2023 or alternatively asked ESMA to foresee a 12-month transition period for implementation of the final guidelines in the supervisory practice following their publication.

     ESMA firstly notes that the date of application of the new MIFID II requirements on suitability is set out in the Commission Delegated Regulation 2021/1253 and cannot be amended by ESMA. Nonetheless, ESMA is aware of the challenges firms are facing to implement the EU sustainability legal framework. In light of this, ESMA has decided to set the date of application of these guidelines to six months after the publication of the translation of the guidelines, rather than two months as originally set out in the Consultation Paper. It is important however to underline that, notwithstanding the choice made by ESMA on this set of guidelines, firms are required to fully comply with the legal requirements set out in the MiFID II Delegated Regulation from 2 August 2022.

   - Engagement with industry - The SMSG highlighted that ESMA should organise an early Call for Evidence on how sustainability preferences are assessed and on possible alternative approaches following the publication of the guidelines.

     ESMA agrees with the SMSG on the importance of a continuous engagement with industry on this important topic and commits to using its available tools in order to keep gathering evidence on the evolution of the market and on how firms are applying the legal requirements. ESMA also notes that it will continue its supervisory convergence efforts in this important area.

- Financial education - Respondents, including the consumer associations, highlighted that investment products are by nature very complex products that consumers find difficult to understand and that on the path to a greener and more sustainable economy, consumers face an additional challenge: the risk of greenwashing when their investments are directed to activities that are not aligned with their interests and values. Respondents noted that for the success of the sustainable finance phenomenon it is important that investors properly understand the different ESG concepts and products. Respondents noted that banks/investment firms should be willing to contribute their fair share to investor education but the public sector and NCA's also have an important role to play to contribute to investor education.

  ESMA agrees with this comment and, while noting the topic of financial education goes beyond the scope of this set of guidelines, confirms that – together with the other ESAs – it plans to continue working to coordinate NCA activities in this area. In this respect ESMA notes that the ESAs are carrying out work to fulfil their mandate on Financial Education (FE) through the Joint Committee, with several outputs that have already been delivered such as: i) the Joint ESAs high-level conference on financial education in Q1 2022[18] and ii) the thematic repository on financial education and digitalisation initiatives[19]. The work is ongoing and will take into consideration any sectorial development and growing challenges impacting consumers. Furthermore, as stated in its Sustainable Finance Roadmap 2022-2024[20], ESMA supports efforts to develop EU-wide labels, including the EU Green Bond Standard, and in the future ESG labels for financial instruments (e.g., sustainability-linked bonds) and investment products.

- Green bleaching - The SMSG noted that while avoiding greenwashing is a necessity, there could also be a reverse problem: green-bleaching, meaning fund managers that invest in sustainable activities but refrain from claiming so to avoid the data problems arising from the disclosure obligations. While the SMSG does not have a comprehensive overview, anecdotical evidence suggests that this may be the case for example in private equity funds that have a fund of fund structure. These funds depend on the data disclosure of all the underlying funds. As these data are often not yet available, the fund itself cannot make sustainability disclosure and hence prefers not to make any sustainability claims. If green bleaching is a more pervasive trend than anecdotical evidence indicates, that would make the current legislation partly irrelevant. For this reason, the SMSG suggests that ESMA tries to collect information on this, as part of an evaluation of the legislation.

  More broadly, ESMA would like to take the opportunity to reiterate that the European Commission's Action Plan on Financing Sustainable Growth states that sustainability and the transition to a low-carbon, more resource-efficient and circular economy are key in ensuring the long-term competitiveness of the EU economy. ESMA has a key role in supporting this transition as outlined in its Strategic Orientation 2020-2022. The financial markets are at a point of change as it can be observed that investor

[18] https://www.esma.europa.eu/esas-high-level-conference-financial-education-and-literacy
[19] https://www.esma.europa.eu/press-news/esma-news/esas-publish-thematic-repository-financial-education-and-digitalisation
[20] ESMA30-379-1051.

preferences are shifting towards an interest in financial products that incorporate environmental, social and governance (ESG) factors, which have increased rapidly over the last few years. Moreover, sustainability factors are increasingly affecting the risks, returns and value of investments. This changing environment has implications for ESMA's mission to enhance investor protection and promote stable and orderly financial markets. ESMA understands the challenges faced by firms in the implementation of the various new legal requirements and – building on its 2020 Strategy on Sustainable Finance[21] – has recently published a detailed Roadmap[22] to ensure the coordinated implementation of ESMA's sustainable finance mandate over the next three years.

Q1. Do you agree with the suggested approach on the information to clients about the purpose of the suitability assessment and its scope? Please also state the reasons for your answer.

Q2. Do you agree with the new supporting guideline in relation to the information to clients on the concept of sustainability preference or do you believe that the information requirement should be expanded further? Please also state the reasons for your answer.

2. While the majority of respondents agree that it is appropriate to inform the clients on the different elements of sustainability preferences and their underlying concepts, they also highlighted the complexity of the definition of sustainability preferences introduced in the updated MiFID II Delegated Regulation. In particular, respondents noted the inability to explain, without using technical language, the distinction between the different elements mentioned under the points (a) to (c) of Article 2(7) of the MiFID II Delegated Regulation. Respondents highlighted the need to keep the advisory process simple in order to avoid overwhelming clients with information they may not be interested in and they may not be able to understand. In this context, some diverging comments and approaches were noted:

- Some respondents suggested to limit the explanation provided to clients in terms of sustainability to an explanation of the general differences between products with sustainability features in general and products without such sustainability features;
- Some respondents noted the need for the explanations provided by distributors to not encompass all ESG product features present in the market, stressing that mandatory explanations should only focus on environmental and social aspects in the first place (as governance aspects are not suitable as distinct sustainability objectives under TR or SFDR);
- Others requested the requirement to provide explanations on E, S and G aspects to be amended to a non-mandatory requirement (i.e. with the use of "could");

[21] ESMA22-105-1052.
[22] ESMA30-379-1051.

- Many respondents proposed to allow firms, before to proceed with the detailed assessment of client's sustainability preferences, to provide a general warning to clients i) on the state of maturity of the market of ESG products, and ii) on the specific risks potentially attached to the formulation of very ambitious ESG expectations (e.g., such as concentration or liquidity risk or potential higher costs compared to products with non-sustainable features);

- In contrast to the above, some respondents, including consumer associations, noted that, besides an explanation of what ESG objectives mean, there should also be an explanation of the level of ambition of the sustainability aspects a product can have as consumers need to be able to understand the consequences emerging from their sustainability preferences and the impact they could have on the environment and society with the choice of financial instruments. It was highlighted that the information provided to consumers should include wider concepts such as environmental considerations (e.g., climate mitigation and adaptation concepts) or social considerations (e.g., human rights, inclusiveness).

3. ESMA takes note of the comments and, on a general note, agrees that it is important to avoid information overload and to overwhelm clients with information they may not be able to understand. ESMA also notes that – as set out in Recital 6 of the Commission Delegated Regulation 2021/1253 – "*Financial instruments with various degrees of sustainability-related ambition have been developed so far. To enable clients or potential clients to understand those different degrees of sustainability and take informed investment decisions in terms of sustainability, investment firms […] should explain the distinction between, on the one hand, financial instruments that pursue, fully or in part, sustainable investments in economic activities that qualify as environmentally sustainable […], and financial instruments that consider principal adverse impacts on sustainability factors that might be eligible for recommendation as meeting individual sustainability preferences of clients, and, on the other hand, other financial instruments without those specific features that should not be eligible for recommendation to the clients or potential clients that have individual sustainability preferences*".

4. ESMA's guidelines do not prescribe specific ways in which information on sustainability characteristics should be provided to clients but ESMA reminds firms that, in line with legal requirements, all provision of information should be done in a fair, clear and not misleading manner.

5. Furthermore, some respondents requested ESMA to provide more guidance on certain areas, in particular:

   - Some respondents noted that it would be beneficial if ESMA could add to the Guidelines some non-mandatory examples of how the concept of sustainability preferences and the distinction between the different elements mentioned under points (a) to (c) of Article 2(7) of the MiFID II Delegated Regulation could be explained without using technical language. Other respondents also suggested ESMA to produce some standard information material to explain in plain language the key concepts and the various categories of products that could be used by firms when dealing with the client;

- Some respondents also suggested ESMA to clarify the concrete meaning of the three categories outlined under points (a), (b), and (c) of Article 2(7) at product level;

- Others requested ESMA to provide guidance on the possible operational approaches that could be adopted by firms in fulfilling the requirement to inform clients, for example whether the information should be provided in written or oral form or whether the use of educational brochures would satisfy the requirements set out in the MiFID II Delegated Regulation, suggesting the endorsement of brochures/templates by ESMA and/or NCAs;

6. A few consumer associations highlighted that the ESMA guidelines should provide further detail and guidance on how to articulate the different components of what constitutes an adequate explanation of sustainability preferences to the client, not only focusing on the regulatory terminology but considering wider sustainability concepts.

7. Similar concerns were raised by the SMSG, noting the complexity of the concepts to be expressed to investors. Moreover, the SMSG acknowledged the current lack of data and limited availability of financial instruments with sustainability features, an issue that was also raised by many respondents as part of their responses. The SMSG therefore discussed whether it was desirable to inform the investors beforehand about the lack of data. The pros outlined by the SMSG included the fact that informing the client beforehand with complete, clear and transparent information requires presenting all relevant elements of the context, including the lack of data and could also reduce the misalignment of expectations vs availability of products. Cons referred to the fact that informing the client beforehand about the lack of data could influence him/her towards lowering his/her preferences and could increase the acceptance of the current product range of the financial institution and remove the incentive of product's distributors to increase the range of sustainable products in their product offer. The SMSG did not express a preference in this regard but provided a recommendation, regarding the requirement to adapt clients' preferences (guideline 8) noting that, the less the client is aware of the lack of data, the higher is the probability that clients' preferences will need to be adapted.

8. ESMA has carefully considered the above comments but believes the guidelines are already detailed enough on this area and should not be more prescriptive and granular. ESMA agrees the development of further practical examples and explanations can be beneficial but can be developed later on, through different tools (such as Q&As) based on practical implementation of the requirements by firms and practical supervisory experience by competent authorities. ESMA confirms, once again, that it will continue its supervisory convergence efforts in this area even after the publication of the guidelines and using the various convergence tools it has available.

9. A number of comments were also submitted with regards to the requirements applying to retails vs professional clients and the importance to differentiate between categories of clients. In this regard, respondents stressed the importance for the information requirement

to apply to retail investors only as professional investors should be deemed familiar with the concepts and definitions of sustainability preferences. More generally, these respondents noted that the guidelines should make clear that firms can adopt proportionate approaches (and language) depending on the level of "sustainability knowledge" of the client.

10. ESMA has considered the comments received and acknowledges that the needs of professional clients can be significantly different from those of retail clients. This is valid with regard to clients' sustainability preferences but more broadly on the various aspects of the services of investment advice and portfolio management. In this respect, ESMA notes that the guidelines already clearly set out (see paragraph 3) that they "principally address situations where services are provided to retail clients" and they would apply to professional only "to the extent they are relevant". ESMA notes that issues related to the application of the MiFID II suitability requirements to professional clients might be quite specific and therefore notes that it believes it will be more efficient to develop specific Q&As in response to practical issues emerging rather than developing a new section of the guidelines.

11. Lastly, some respondents, including consumer associations, highlighted the need to introduce more safeguards to prevent investment firms from influencing how clients understand and express their sustainability preferences and wider sustainability motivations when informing the client regarding the concept of sustainability.

12. ESMA has carefully considered the above comments but believes the guidelines are already detailed enough in this area. However, as previously noted, ESMA will closely monitor the implementation of the regulatory requirements in the market in the sustainable finance area using its available tools. In doing this, ESMA will keep gathering evidence on the evolution of the market and on how firms are applying the legal requirements.

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.

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

13. Even though many respondents agreed on the general approach outlined under guideline 2 of the consulted guidelines with regard to the collection of clients' sustainability preferences outlined under paragraph 25 and welcomed the example provided under paragraph 26, many comments and potential alternative approaches were included in the responses to the CP. Respondents, sustainability concepts being still rather new and evolving, suggested ESMA to take as far as possible a pragmatic and gradual approach.

14. With regard to the granularity of the information to be collected from clients, some respondents, including the SMSG, noted that investors that have expressed sustainability preferences (by answering "Yes" on the starting question), should be offered the opportunity not to indicate specific preferences (a, b, c) they have, let alone indicate minimum proportions or approaches to PAI.

15. In terms of the procedures to be followed and how to operationalise the approach of collection of client information outlined in the guidelines, the need to ensure flexibility of approaches was noted by most participants. The following was reported by respondents:

    - Some respondents requested more guidance from ESMA, for example through a decision tree to clarify the process to be followed by market participants when asking clients about their sustainability preferences;

    - It was noted that further flexibility is necessary in terms of processes to ensure that the firms advising end clients have the necessary information about their clients' sustainability preferences and it was also noted that, rather than prescribing the sequence, paragraph 26 should focus more on the elements of the process rather than its sequencing. Furthermore, in the case where paragraph 26 will be kept in the final guidelines, it was suggested that it should be made very clear that the approach outlined is to be seen only as an example of good practice and that the actual supporting guideline is confined to paragraph 25;

    - Moreover, respondents suggested to be granted the possibility to use open-ended questions to accelerate the exploration process (e.g. being allowed to ask the client whether he/she has specific sustainability preferences) which will help to collect client's sustainability preferences as efficiently and naturally as possible, taking into account the type of client and the range of available products;

    - Lastly, some respondents, including consumer associations, highlighted the need to introduce more safeguards to prevent investment firms from influencing clients in the assessment process and noted that the requirement to carry out the assessment in a neutral way should be more prominent in the guidelines and cover the whole process (i.e. not referred to only in the third step under guideline 2, paragraph 26 of the consulted guidelines).

16. ESMA notes that many of the aspects concerning the topic of “collecting information from clients” that are outlined in the guidelines are aligned with the amendments that have been introduced to the MiFID II Delegated Regulation. In particular, ESMA would like to highlight that the guidelines already introduce some degrees of flexibility by intentionally setting out many parts of these guidelines as practical examples in which the requirements can be implemented. This is the case, for example, when introducing a particular requirement by a “could” or when allowing firms to collect clients’ preferences in terms of the “minimum proportion” through a particular percentage. With specific reference to paragraph 27 of the final guidelines, ESMA would like to clarify that the paragraph outlines a potential approach that firms could adopt to collect clients’ preferences but leaves flexibility to firms to identify

solutions (in line with the new requirements) that consider and might adapt to the specific business models and suitability processes in place.

17. The majority of respondents highlighted concerns related to the limited availability of financial instruments with sustainability features and stressed the importance of being able to communicate to the clients information regarding the current state of the market. In particular, respondents noted that client profiles should be in line with market realities and the key request common to the majority of respondents was to introduce more flexibility in the guidelines and to allow firms to inform clients on the range of products currently available in the market and in the firm's product range. Some of the proposed potential solutions suggested by respondents are reported below:

    - Some respondents suggested that, as part of educating (potential) clients, firms should be allowed to explain to the client what is the current availability of sustainable products on the market, for example indicating the average level of taxonomy alignment in each product class and the implications for financial risk and liquidity.

    - Another suggested approach was that firms could be given the possibility to provide the client with the overview of the firm's available products with sustainability features, taking a proportionate approach to 'granularity' by using ranges and grouping principal adverse impact indicators (PAIs) by category. In essence, this approach would allow a firm to adapt the client exploration phase in a way that ensures that clients are provided with recommendable products with sustainability features. Respondents had different views on when to provide clients with this information, either before or after having collected clients' preferences. Respondents also proposed different operational approaches (e.g. either presenting a sort of "menu" of available products to clients or adopting a "matrix" driven approach where firms would collect a client's preferences and then present the client with a matrix that identified available products).

    - In relation to the point raised in the previous bullet point, consumer associations highlighted instead the need to specify that the assessment of client sustainability preferences should come before any presentation of the financial products to which an investment firm has access to avoid influencing clients' expression of sustainability preferences.

18. ESMA, regarding the availability of products with sustainability features, takes note of the SMSG concern regarding a potential mismatch with investor expectations. However, ESMA would like to highlight that a number of EU asset managers are already making available SFDR Article 8 and SFDR Article 9 funds, resulting in sustainability-related information being available for a large number of investment funds (recent estimates put the share of these funds in the total assets managed by UCITS investment funds available for sale in the EU at 50%, with this share still growing). In particular, Article 8 SFDR products may, partly, invest in sustainable investments as defined in Article 2(17) of the SFDR, in taxonomy-aligned investments compliant with the taxonomy regulation, or also consider PAI of investment decisions, so they could fall under any of the three points (a) to (c) of Article 2(7) of MiFID II Delegated Regulation) defining sustainability preferences. So-

called Article 9 products tend to have their entire portfolio invested in sustainable investments as defined in Article 2(17) of the SFDR, which is aligned with the definition used in Article 2(7) of the MiFID II Delegated Regulation regarding the minimum proportion of sustainable investments determined by the client.

19. Furthermore, ESMA has considered carefully the above comments and proposals and has introduced under guideline 8 the possibility for firms to disclose to the client information about its offer of products with sustainability features, which can be done after, and not before, the client decides to adapt its preferences.

20. One additional area of focus by respondents concerns the use of ranges and the collection of clients' sustainability preferences not in terms of a particular percentage but by ranges or sizes, as included under guideline 2 of the consulted guidelines, paragraph 26. The majority of respondents supported ESMA's proposal to allow for ranges and many comments were submitted on how to practically implement the use of ranges in the firms' processes. In particular:

- The majority of respondents highlighted the importance that these ranges should not be fixed (i.e. they can evolve over time) and should keep in consideration the current limited availability of financial instruments with sustainability features. It was noted that while a "high" range would not match a high taxonomy-aligned percentage in the first years, these percentages will change over time as data becomes available, as financial instruments with sustainability features evolve and as the market moves in a greener direction.

- One consumer association also highlighted the need not to allow for a maximum proportion of sustainable investment when defining ranges (and to require that solely a minimum proportion is defined);

21. ESMA, having taken into consideration comments provided by respondents, would like to confirm the possibility for firms to obtain information on the customer's preferences in terms of the 'minimum proportion' as set out in points (a) and (b) through the use of a particular "range" or "size". It should be noted that the terminology used in this guideline has been amended to further align the text of the guideline with the relevant text of the EIOPA Guidance on the integration of sustainability preferences in the suitability assessment under the Insurance Distribution Directive (IDD). Moreover, the guidelines have been complemented by a practical example on how firms could operationalise the legal requirement by approximating the minimum proportion by using standardised minimum proportions, such as "minimum 20%, minimum 25%, minimum 30%, etc.".

22. Some respondents also suggested the use of indicators such as ratings as a potential way to inform clients about the different layers of sustainability and to support the assessment process.

23. Furthermore, some respondents highlighted the need for further guidance to clarify how firms should assess clients' sustainability preferences in connection with derivatives contracts. It was noted that derivatives contracts are not the funding of investments in

economic activities like with shares, bonds, and participation rights in investment funds as they are mostly used for hedging purposes or to profit from price movements in the underlying value. For this reason, due to their nature, respondents noted that sustainability factors would not be relevant for the scope of the advice and sustainability preferences should not be integrated as part of the suitability assessment.

24. Moreover, in the context of PAI, the following was noted:

- Many respondents noted the misalignment of the draft guidelines with the MiFID II Delegated Regulation with regards to point (c) of Article 2(7) concerning PAI. In particular, the MiFID II Delegated Regulation states, in referring to option (c) the following: "…where qualitative OR quantitative elements demonstrating that consideration…" while guideline 2, paragraph 25 of the consulted guidelines states that: "…quantitative AND qualitative criteria demonstrating that consideration." It was therefore suggested to align the guidelines with the MiFID II Delegated Regulation and use the word 'OR';

- Clarifications were required on whether: i) there is a minimum number of PAIs that has to be considered; and ii) PAIs indicators other than the SFDR indicators could be taken into account.

25. Lastly, some minor comments were provided with regards to the terminology used in the guidelines, as follows:

- It was noted by some respondents that the last bullet point of paragraph 26 of the consulted guidelines only refers to "client-facing staff" and it may be useful to complement this paragraph by considering that these rules should also apply in the case of robo-advice services;

- Clarity was required regarding the use of the term "sustainability-related expectations" and how this relates to the definition of "sustainability preferences";

26. ESMA has considered the request to provide further clarifications on how a client's sustainability preferences should be considered in connection with derivatives contracts. In this respect, ESMA confirms that a suitability assessment (including the consideration of "sustainability preferences") should always be performed when providing investment advice or portfolio management services, and this includes transactions on derivatives (i.e. there is no "exemption" from asking clients about their sustainability preferences when dealing with specific types/categories of financial instruments). That said, ESMA notes that clients will potentially have different objectives and needs (including hedging needs) and it will be the responsibility of the adviser/portfolio manager to identify the various investment product(s) to be offered to the client to fulfil those needs/objectives (i.e. in the clients' portfolios, for example, a derivative might be used to hedge the interest rate or currency risks while other instruments, such as funds or green bonds can be used to ensure the clients' sustainability preferences are met).

27. ESMA has also considered the feedback received in relation to the requirement to collect information from clients on which Principle Adverse Impact (PAI) should be considered and the elements and indicators to be taken into account in this context. In particular, amendments have been made to the guideline in order to align the text with the Commission Delegated Regulation, confirming that it is possible to either take into account quantitative “OR” qualitative criteria to demonstrate that PAI have been considered when assessing clients’ sustainability preferences. Furthermore, ESMA would like to confirm that, while considering it is a good practice, firms are not bound by the use of SFDR PAI indicators and there is no minimum number of PAIs indicators that has be considered when collecting clients’ sustainability preferences.

28. ESMA has also considered the comments received with regards to the terminology used in the Guidelines, introducing minor amendments in the text and taking into consideration the use by firms of automated or semi-automated systems for the provision of investment advice or portfolio management (robo-advice).

29. Lastly, ESMA can confirm that – as set out in the final guidelines under guideline 2, paragraph 28 – firms can indeed provide investment advice and portfolio management services to a client who, with regard to the “sustainability preferences”, has chosen only to indicate that he/has sustainability preferences but has chosen not to provide further, more detailed, indications. As stated in the guideline, firms should have policies and instructions in place for their staff to address this specific situation.

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?

30. The majority of respondents shared concerns regarding ESMA's suggestion that firms should assess a client's preference with regard to combinations of a, b and c. This concern was shared by the SMSG, which warned that this can potentially result in such a wide range of alternatives that could confuse the client. The SMSG noted that such a 'combination assessment' will at the very least necessitate measures to simplify the process for clients, for instance by means of default options or a table with products corresponding to each preference.

31. An additional point raised by respondents and highlighted by the SMSG concerns the question on how clients' answers will be interpreted when multiple options are selected and in particular on whether preferences are intended to be alternative or cumulative. For example, in the case where a client states to have preferences for points (a), (b) and (c) of Article 2(7), guidance is required from ESMA on whether the product that will be advised has to be aligned with all these options ((a) and (b) and (c)) or advising to invest in a product that is aligned with one of the points only ((a) or (b) or (c)) would meet the regulatory requirements. It was noted by the SMSG the slight preference for the "or" option.

32. With regards to the question on whether to request the client to prioritise preferences, respondents noted that the guidelines should not require firms to consult the client with regard to a prioritisation of the categories as this would unnecessarily complicate the process and, furthermore, it must be considered that clients for whom prioritisation is important will indicate this element autonomously. In practice, it was suggested that the guidelines should specify that the client is expected to provide a prioritisation in case of simultaneous/overlapping preferences but, in the case where no prioritisation is given, advisors could make such assessment in the client's best interest.

33. Lastly, it was also noted, in this context, the difficulty in collecting granular information when the advice is provided online without overburdening the customer.

34. ESMA has carefully considered the feedback received and – to simplify the process of collection of client information – has modified the relevant guidelines accordingly, by removing the reference to the collection of clients' preferences regarding a combination of any of the points (a), (b) or (c) under Article 2(7) MiFID II Delegated Regulation.

35. ESMA would nonetheless like to clarify that, should multiple options between point (a), (b) or (c) of Article 2(7) be expressed by clients without a clear preference, firms can interpret these options as alternative, unless specifically expressed by the client. Similarly, ESMA notes that, while clients are expected to provide a prioritisation in case of simultaneous/overlapping sustainability preferences, in the case where no prioritisation is given, advisors should make such assessment in the client's best interest.

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.

36. The majority of respondents supported how the guidelines deal with the concept of "portfolio approach" but raised some specific comments:

- For example, some respondents noted the need to allow for greater flexibility regarding the way to interpret the words "to what extent" provided for by Article 2 (7), of the MiFID II Delegated Regulation in the context of portfolio approach and to allow firms to set the "measure" or "degree" of the sustainability of investments in relation to the client's preferences as: (i) the "sustainable" portion of the portfolio invested in one or more instruments with certain characteristics, or alternatively (ii) the level of sustainability of the entire portfolio. Consumers should be informed on the way the level of sustainability of the portfolio is calculated.

- As noted as part of the responses to the previous set of questions, respondents noted that it should be reflected in the guidelines that it is possible to divide the clients into pre-set categories for sustainability preferences, e.g. low preference, medium preference and high preference, when recommending portfolios as it would be impossible for an investment firm to have model portfolios for every combination of the points (a) to (c) defined in Article 2(7) of the MiFID II Delegated Regulation.

- With regard to the case of portfolio advice (investment advice with regard to the portfolio), it was stressed that the investment firms should not have to relate the question to the entire portfolio, but could also ask the client - in contrast to portfolio management - about the sustainability preferences in every investment advice session. In view of the low range of sustainable products on offer at the outset, the regular query would have the advantage from the client's point of view that more products will likely be available in subsequent advice.

- Moreover, respondents also highlighted a possible misalignment between paragraph 27 of the consulted guidelines and the existing paragraphs 74 and 86 as the granularity of information being collected depends on the type of client and the type of products being offered and therefore the final guidelines need to provide sufficient flexibility for all client types and products.

37. ESMA has carefully considered the feedback received and – to simplify the process of collection of client information – has modified the relevant guidelines accordingly, by removing the reference to the collection of clients' preferences regarding "to what extent" the client has sustainability preferences, as a quantitative indication of clients' sustainability preferences will be collected by firms when gathering information on the "minimum proportion" to be invested in sustainable instruments and when collecting information on which PAI should be considered. Hence, this quantitative indication of the client's preferences in terms of a minimum proportion of investments with sustainability features in his/her portfolio should be used when applying a portfolio approach to the suitability assessment, in line with the additional guidance provided in guideline 8. When adopting a portfolio approach, firms should also decide to ask which part of the portfolio (if any) the client wants to be invested in products meeting the client's sustainability preferences.

38. With regard to the possibility to use a "portfolio approach", ESMA has now clarified in guideline 8 that, when considering a client's "sustainability preferences", the suitability assessment could be done following different approaches. More specifically, guideline 8 now states that when a firm conducts a suitability assessment based on the consideration of the client's portfolio as a whole it could assess suitability as regards the sustainability preferences, for example, by applying those preferences (including the minimum proportion that shall be invested in investments with sustainability features) on average at the level of the portfolio as a whole or at the level of the part/percentage of the portfolio the client wants to be invested in products with sustainability features.

39. ESMA notes that firms should remain free to identify practical operational solutions that take into account the specificities of their business models (while respecting legal requirements). ESMA and NCAs will monitor the evolution of the market and remain ready to address specific firm approaches, emerging from supervisory experience and queries from stakeholders, through Q&As and other supervisory convergence tools.

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

40. Respondents provided the following comments in relation to the new paragraph concerning the update of client information, as follows:

- The SMSG noted the draft guideline which states that, for ongoing relationships, the information on sustainability preferences should be updated at the next regular update of client information. However, the SMSG asks ESMA to be more precise around the definition of "the next regular update" as updating client information can be required for all kinds of purposes, including the "know your customer" requirements and it is not realistic to require that the first such instance should be accompanied by a complete renewed suitability assessment. Therefore, to avoid misunderstandings, the SMSG suggests reformulating the guideline so that sustainability preferences are not to be assessed at the first update of client information, but at the first investment advice meeting. Similar comments were made by respondents, asking ESMA to clarify that the current wording refers only to meetings that take place in the context of the provision of financial advice or portfolio management and that the update of client information concerns the update of the suitability profile of the client.

- A respondent suggested to not specify as to when this information should be updated but instead offer flexibility to firms to decide when this update should occur depending on the service provided and type of client, as long as the update is done within a reasonable timeframe (e.g., 12 months) from the guidelines coming into effect.

41. ESMA would like to clarify that firms are required by the MiFID II Delegated Regulation to have the new client questionnaires ready at the date of application of the new requirements on 2 August 2022. This will allow any new client or any existing client that wishes to update their profile to do it from that date. That said, ESMA would also like to clarify that, in line with Recital 4 of the Delegated Regulation (EU) 2021/1253, firms could also decide to collect the client's individual sustainability preferences at the "next regular update" of the client profile review. However, in this respect and in consideration of the importance of the topic and the operational complexities that a complete update of client profiles can entail, ESMA would expect firms to launch the campaign to proactively invite clients to update their profiles with regard to sustainability preferences (unless they have already done so) no later than 12 months after the entry into application of the rules. ESMA further clarifies that, until the firm acquires information on the client's sustainability preferences, the client will be considered as "sustainability-neutral" and therefore, in line with paragraphs 57 and 85 of the final guidelines, the client could be recommended products both with and without sustainability-related features.

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.

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.

42. Respondents referenced the current lack of data with respect to financial instruments' sustainability characteristics and suggested, considering the existing difficulties in obtaining ESG data and the type of information that can be purchased from information providers (e.g., sustainability rating), that the guideline should take into account ESG features and ratings and not the financial instruments' classification under points (a) to (c) of Article 2(7) of the MiFID II Delegated Regulation.

43. Respondents agree that sustainability factors should be considered when analysing the characteristics, nature and features of investment products but requested more guidance on the frequency of update of the product analysis in relation to sustainability factors. It was also noted that the approach set out by ESMA only suggests to classify products based on points (a), (b) and (c) of Article 2(7) of the MiFID II Delegated Regulation and does not consider a product's alignment or degree of alignment to environmental, social or governance or any other thematic/sectoral bias.

44. Lastly, it was noted that paragraph 71 of the consulted guidelines refers to a firm's own product range (i.e., "their product range") and it was pointed out that, since some firms may only advise on third-party products, it would be preferable to refer to "financial instruments included in the range of products they offer".

45. ESMA has carefully considered the feedback received and has introduced some minor amendments to guideline 7, which however do not introduce any substantial change to the content of the guideline. In particular, and as suggested by respondents, ESMA has introduced a reference to the environmental, social and governance aspects in the context of the firms' processes implemented to understand the characteristics, nature and features of investment products.

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.

46. The majority of respondents agreed with ESMA's proposal to sequentially address sustainability preferences once all other criteria have been assessed and even asked ESMA to clearly state that the client's financial and risk profile should prevail over the sustainability preferences as the contrary would have the drawback of potentially distorting the client's investment profile.

47. It was however highlighted that a two-step process - if it separates out the assessment of sustainability preferences from the rest of the assessment of suitability - risks creating a tick-the-box exercise that would undermine the credibility of the suitability assessment. Moreover, it was noted that a two-step approach may significantly narrow down the availability of sustainable products.

48. A few respondents however stated that firms should be allowed to collect all information from the client (including sustainability preferences) at the same time and assess and identify viable suitable products based on this information. Both approaches will yield the

same result: the product will either meet or fail to meet all of the criteria. The query's order isn't important.

49. ESMA notes that the Commission had already clarified in the explanatory memorandum that presented the new requirements that "sustainability factors should not take precedence over a client's personal investment objective. Therefore, the sustainability preferences should only be addressed within the suitability process once the client's investment objective has been identified". ESMA has drafted the guidelines in line with the above principle and has therefore decided not to amend them after the public consultation. ESMA disagrees with the statement that the above approach will limit the availability products and/or will undermine the credibility of the suitability assessment. ESMA also takes the opportunity to clarify that the guidelines do not state that firms cannot use one unique questionnaire to collect information from clients (as long as questions on "sustainability preferences" are not given precedence over questions on the client's investment objective(s)).

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.

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.

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)?

50. Concerns were raised by firms and trade associations with the suggested ESMA proposal to restrict a firm's ability to recommend a product that does not meet a client's sustainability preferences to instances where the client has subsequently adapted his or her individual preferences having learned that there are no products available matching these preferences.

51. Various of these respondents stated that:

- The suggested ESMA approach is not consistent with Recital 8 and Article 54(10) of the MiFID II Delegated Regulation that state that a client should have the "possibility" to adapt (and not "must adapt") his or her sustainability preferences. In other words, the adaptation is a possibility, but not an obligation.

- From the operational point of view, a client should not need to change (permanently) his or her sustainability preferences expressed in the original MiFID questionnaire but should simply be informed through the suitability report of whether the advice complies or not with the sustainability preferences expressed.

- Clients should always be able to adapt their preferences. These respondents noted that clients' sustainability preferences will be sought for the first time following the introduction of the MiFID II Delegated Regulation. These respondents consider therefore that the reference to the firm being allowed to adapt sustainability preferences "not being standard procedure" is unhelpful and should be removed from the guidelines.

- They are critical of the fact that an adjustment should only apply to the advice in question, i.e., not to subsequent advice. In their opinion, this contradicts the MiFID II Delegated Regulation and the respective client interest (where applicable). It appears that adapted sustainability preferences are being treated as "second-class client information".

- 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.

52. Similar concerns were raised by the SMSG that noted:

- It is likely that adapting client preferences will need to happen more often than not at this stage;

- Without information, the client will have no clue which products best proxy his/her initial preferences. An endless iterative adapting of sustainability preferences, which would be discouraging to the client, needs to be avoided;

- There is a risk that the absence of products that match a client's sustainability preferences, results in a prevalence of sustainability preferences over other suitability elements (such as risk profile), if the client does not adapt his/her sustainability preferences. In such a situation, the client would be left without receiving advice. Such a situation is to be avoided.

53. The respondents that disagreed with ESMA's proposed approach suggested that in the situation in which a firm cannot recommend a product that meets the client's preferences it should:

- clearly inform that the client (through the suitability report) that the products it has on offer do not have sustainability characteristics that match the preferences of the client.

- should inform the client (during its regular exchanges with the client) whether products that fulfil the initial sustainability preferences have become available or not.

- should be allowed to provide advice/portfolio management services on financial instruments that match the client's higher initial sustainability preferences without having to re-do the suitability assessment (if the product is suitable).

- allow the client the possibility to adapt his/her sustainability preferences for future investments (emphasis added).

54. On the other hand, consumer associations replying to the public consultation supported the approach suggested by ESMA and noted that firms recommending a product not matching the sustainability preferences as they have been duly assessed, may at all times only be the exception.

55. Consumer associations also noted that the adaptation of sustainability preferences should be limited and that clients should not be 'incited' to adapt their sustainability preferences. Consumer associations noted their concern that firms might try to push their own products by influencing the clients' sustainability preferences and by suggesting a non-availability of products that match the clients' preferences. In this respect, also the SMSG noted that it would be reasonable to expect to witness an inverse correlation between the incidence of amended sustainability preferences on the one hand, and the number and variety of products with sustainability features on offer in the market on the other hand.

56. ESMA has carefully considered the comments received and the diverging views between consumer associations and firms on the content of guideline 8. ESMA, having carefully reviewed the legal requirements set out in the MiFID II Delegated Regulation and having liaised with the Commission, confirms that a firm cannot recommend a product that does not match the client's sustainability preferences, unless the customer adapts his/her preferences and reminds firms that the possibility to adapt clients' preferences only refers to the sustainability preferences and that with regard to the other criteria of the suitability assessment, the product has to meet the client profile and otherwise shall not be recommended.

57. ESMA has also clarified through the guidelines that, after a client decides to adapt its preferences, and not before, the firm could disclose to the client, information about their offering of products with sustainability features. ESMA believes that a presentation by the firm of its product offering at an earlier stage would not be allowed as it could highly influence the clients' answers. ESMA also notes that the flexible portfolio approach allowed for firms using a "portfolio approach" (see paragraph 88 of the final guidelines) will mitigate the risk of frequent adaptations by the client, since the recommendation of products with different degrees of sustainability could more easily meet a client's sustainability preferences.

58. ESMA also notes that for those situations in which a firm assesses that a specific financial instrument is unsuitable for a client, but the client wishes to proceed with the transaction

nonetheless, firms should refer to the guidance provided in the ESMA's Q&A 6 on Suitability.[23]

59. ESMA also notes that the approach set out in the guidelines for the adaptation of client sustainability preferences has been designed having in mind the novelty of the regime. ESMA together with the national competent authorities plans therefore to monitor its application by firms and will consider updating such approach - likely aligning it to the general rules on updating of client information - during the next review of the guidelines.

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.

60. The great majority of respondents, including the SMSG, agreed with ESMA's proposed approach and stated that no additional guidance is necessary for clients that do not indicate sustainability preferences.

61. However, a few respondents noted that firms should not be expected to provide explanations on the products/portfolio's sustainability features to clients that either do not answer the question on sustainability preferences or even declare specifically no interest in sustainability.

62. ESMA agrees with the above comment and has amended the guideline accordingly.

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.

63. A large part of respondents agreed with the explanations set out in paragraph 82 of consulted guidelines on the possibility for clients to adapt their sustainability preferences in the case of portfolio approach. Some of these asked to make it clear that the same approach should be used when firms are providing portfolio management and when providing investment advice on a portfolio level.

64. Many respondents however also cross-referred to their responses to questions 11 to 13 and their practical concerns relating to changes to client preferences (see above for more details).

65. A few respondents, including some consumer associations, disagreed and stated that - where a firm cannot match the sustainability preferences of a client - it should be required to inform the client that there are suitable products matching the client's initial sustainability preferences outside of its own offer within the broader market, rather than pushing the

[23] ESMA35-43-349 – Chapter 2.

client to weaken his/her sustainability preferences and finally recommending a product that doesn't match the client's preferences, or matches them poorly.

66. ESMA points to the replies it provided above on the topic of the changes to client preferences and the use of the portfolio approach.

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?

67. A lower number of responses were received on this question. Of these responses, some noted that the ESMA indication on regular monitor procedures would be helpful at the moment. These respondents noted their belief that the main reason for adapting sustainability preferences will be due to clients' expectations being too different from reality. In this respect, these respondents noted that they would consider it is unnecessary and overly burdensome to impose right away a close monitoring on these cases. However, some of these same respondents noted that, in order to avoid opportunistic re-profiling, clients shall be duly provided with full disclosure - in the suitability report - about the financial instrument offered / the service provided without being asked to update/change their sustainability preferences.

68. Some respondents even noted that such monitoring process has neither legal, nor factual basis and therefore did not agree with such guideline.

69. Conversely, the consumer associations replying to this question noted that they attach importance to firms monitoring where there is a significant occurrence of adaptations of sustainability preferences and also suggested a general reporting obligation to national competent authorities and the public on significant occurrences.

70. ESMA believes the monitoring of situations where there is a significant occurrence of clients adapting their profiles and preferences is an important control for the protection of investors and is fully in line with existing legal requirements. ESMA has therefore decided to confirm the guidelines. ESMA also notes the further flexibility introduced on the portfolio approach and in guideline 8 should make the need for client profile adaptations less frequent.

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

71. The majority of respondents agreed with ESMA's change to guideline 10, although some of them noted that they believe the change was not necessary as the guidelines were already clear and detailed enough.

72. The SMSG queried whether the guideline implied that those specific quantitative calculations must be made by firms. The SMSG also noted that non-quantitative elements may be relevant as well in the assessment.

73. With regard to the SMSG comment, ESMA notes that - as set out in paragraph 97 of the final guidelines - both monetary and non-monetary factors of costs and benefits could be relevant in the analysis of costs and benefits. ESMA however takes the opportunity to clarify that even non-monetary elements (such as diversification and changes in risk) should, whenever possible, be quantified by firms and not simply considered in a qualitative way. This would allow firms to be able to more objectively demonstrate that indeed benefits are superior to costs.

74. Some respondents stated that guideline 10 should not include a reference to the timing of when the suitability report must be provided to the client as - these respondents noted - it should be possible to provide the suitability statement to the client following the transaction (and not before the transaction is made).

75. On the other hand, some respondents asked ESMA to clarify if (in light of the recent change to Article 25(2) MIFID II) it is possible or not for firms to recommend the "switch" also in situations in which costs are greater than benefits. In this regard, ESMA would like to note that the requirement on switching investments under Article 54(11) of the MiFID II Delegated Regulation remains applicable. Hence, firms are still required to "undertake an analysis of the costs and benefits of the switch, such that *they are reasonably able to demonstrate that the benefits of switching are greater than the costs*" (emphasis added). In practice, the following situations could occur: i) where a recommendation is intended to sell an instrument any buy another one and the benefits are greater than the related costs (i.e. the outcome of the analysis is positive), this would lead to the conclusion that the recommendation should be made, accompanied by a disclosure to the client; ii) where benefits are not greater than costs, the client would be informed of the negative outcome of the analysis, which would result in a recommendation not to switch from an instrument to another one.[24]

76. Finally, the consumer associations answering this question agreed with the guideline and noted that switching of financial products can be quite expensive for consumers.

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.

77. The majority of respondents, including the SMSG, agreed with the proposed guidance and some suggested that this guidance on qualification of firms' staff should also be included in the ESMA guidelines for the assessment of knowledge and competence.

78. A few respondents noted that, considering the complexity of the topic, firms should be given sufficient time for the training of relevant staff and some noted that firms should have flexibility in the way they implement their staff training plans.

[24] This approach is also consistent with Recital 7 of MiFID II Delegate Regulation where it is clarified that "Investment firms should undertake a suitability assessment not only in relation to [when] recommendations to buy a financial instrument are made but for all decisions whether to trade including whether or not to buy, hold or sell an investment"

79. Consumer associations also agreed on the importance of staff qualifications and noted that in such complex markets, the preparation of the staff that will provide investment advice to clients is essential (not only knowledge about the specific financial instruments but also the implications of the client's sustainability preferences).

80. ESMA takes note of the general support for the guideline and has therefore not introduced amendments. ESMA also understands that training of staff can indeed be a task that requires time to perform, but reminds firms that the legal requirements have entered into application on 2 August 2022 and it is important that staff providing investment advice possess the necessary knowledge and competence to fulfil their obligations under Article 24 and Article 25 of MiFID II. ESMA also notes that it will consider the topic of sustainability when reviewing its guidelines for the assessment of knowledge and competence.

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

81. The majority of respondents, including the SMSG and the consumer associations, agreed with guidance provided by ESMA on the topic of record keeping. Respondents agreed that record keeping is mandatory on any investment service provided to allow investment firms to have efficient internal control framework and to be able to demonstrate that they comply with their regulatory obligations.

82. Few respondents provided detailed comments, although some noted that record keeping requires technical adjustments which might be challenging to implement as early as August 2022.

83. ESMA believes that, in light of the very few comments received on this topic, no changes are needed to the guidelines.

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.

84. Significantly divergent responses were received on this question. The majority of respondents, including the SMSG, supported the alignment of the two sets of guidelines - where common provisions exist in the regulations for the assessment of suitability and appropriateness - in order to ensure consistent application of the MiFID provisions by firms and an appropriate level of investor protection.

85. Some respondents, however, opposed the alignment of the two sets of guidelines as there are differences in these two processes because of the differences between advisory and non-advisory services that need to be taken into consideration. These respondents noted that harmonising the two sets of guidelines would diminish the distinctions between the various services, which would be inappropriate and therefore, even if they address some of the same issues, the two guidelines should not be overly harmonised.

86. Many also noted that the recently finalised guidelines on appropriateness do not contain references to sustainable preferences and this should not be changed. These respondents, although they saw merit in adding sustainability factors to the appropriateness assessment in the future, believe it is highly premature at this point in time to require firms to assess the client's knowledge and experience with respect to investment products' sustainability factors and risks when execution-only services are rendered.

87. ESMA decided to make only minor adjustments to suitability guidelines to ensure alignment with the guidelines on appropriateness. More specifically, some drafting changes were introduced in guidelines 1, 2 and 4. ESMA does not consider the changes material as they only intended to align the texts when they refer to the same legal requirements.

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

88. The responses to this question were summarised together with the general comments set out at the beginning of this feedback statement.

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

89. Few comments were received on the good and poor practices annexed to the guidelines. The main comment raised by respondents, including the SMSG, was that, to avoid legal uncertainty and divergence between NCAs, it is important that ESMA clarifies what status the examples of good and poor practices have, as compared to other 'soft rules' (such as: Q&A's, opinions).

90. Some detailed more technical comments were also submitted. For example:

- A consumer association noted that 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. They stated that 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.

  ESMA notes that this good practice is intended to highlight controls performed by firms to assess the quality of advice given by investment advisers, and levels of inducement are not a direct indicator for such matter. ESMA also notes that issuer related to the requirements on remuneration of staff are set out in ESMA’s guidelines on certain aspects of the MiFID II remuneration requirements[25].

[25] ESMA35-36-2537

- A few respondents stated that the poor practice on bail-in mechanisms is disproportionate and should be removed.

  ESMA disagrees and notes that the content is in line with the ESMA Statement on 'MiFID practices for firms selling financial instruments subject to the BRRD resolution regime'[26] and has therefore not amended this practice.

- On "Cost/ complexity of equivalent products" and the bad practice stating "On the cost-complexity of products, comparing only products issued by one single-entity (or by entities of the same group)" it was noted that such recommendation runs against § 91 of the draft guidelines and the 2018 version of these guidelines which acknowledges that in such a case the assessment would be limited and therefore requires investment service providers to make clients fully aware of the restricted range of products offered.

  ESMA disagrees and notes that the guidelines make reference to "firms recommending one type of product" while this poor practice refers to firms only comparing products issued by one single-entity (or by entities of the same group).

- On Indicators/monitoring/control functions it was noted that the reference to the diversification of risks in funds is not useful because funds are often diversified to mitigate the risks of individual assets. Furthermore, some respondents also disagreed with the reference internal audit for the conduct of continuous monitoring .

  ESMA agrees with the point and has amended the good practice accordingly.

91. ESMA finally takes the opportunity to underline that the good and poor practices set out in the annex are not part of the guidelines and are not subject to the "comply or explain process" by national competent authorities. While these practices are only illustrative examples, ESMA believes they are a useful way to provide firms with a benchmark and the additional comfort of knowing whether ESMA and national competent authorities encourage (good practices) or discourage (poor practices) particular instances of firm behaviour.

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.

92. Not all respondents to the Consultation Paper provided commentary in relation to the level of resources that would be required to implement and comply with the guidelines. However, many of the responses received to this question included additional information regarding the costs that firms would incur to implement and comply with the guidelines and with the overall sustainability framework.

[26] ESMA/2016/902

93. Many respondents noted that firms will need to go through many internal changes to implement and comply with the amended ESMA suitability guidelines and provided an indication of the main one-off and ongoing costs firms will have to incur.

94. Respondents identified, inter alia, the following one-off costs:

- Costs connected to the need to adapt the internal procedures and processes to the new sustainability requirements (e.g., MiFID questionnaire, suitability assessment, suitability report, product governance process, repapering of pre-contractual information, etc.)

- Costs connected to the process of collecting sustainability preferences from clients (e.g., staff training, providing advisors and portfolio managers with the necessary tools to recommend a suitable financial instrument/select a suitable financial instrument)

95. Respondents also indicated that firms would be required to go through, inter alia, the following ongoing costs:

- Costs connected to the need to hold longer advisory sessions (i.e., to explain and collect sustainability preferences from clients)

- Increased costs connected to ESG data sourcing (e.g., to obtain ESG information from products manufacturers) and to obtain ESG data licences from data providers.

96. In addition to the above, many of the respondents noted that firms are incurring ongoing costs due to the need to adjust the IT systems due to the overall changes in the sustainability framework.

97. ESMA notes that while many of the above-mentioned cost elements are linked to the implementation of the MiFID II requirements rather than the ESMA guidelines, ESMA has nonetheless considered all responses when finalising the cost and benefit analysis that is included under Annex I of this Final Report.

3.4 Annex IV - Guidelines

I. Scope

Who?

1. These guidelines apply to:

   a. Competent Authorities and

   b. Firms

What?

2. These guidelines apply in relation to Article 25(2) of MiFID II and Articles 54 and 55 of MiFID II Delegated Regulation and apply to the provision of the following investment services listed in Section A of Annex I of MiFID II:

   - investment advice;
   - portfolio management.

3. These guidelines principally address situations where services are provided to retail clients. They should also apply, to the extent they are relevant, when services are provided to professional clients, taking into account the provisions under Article 54(3) of the MiFID II Delegated Regulation and Annex II of MiFID II.

When?

4. These guidelines apply as from six months from the date of publication of the guidelines on ESMA's website in all EU official languages.

   The previous ESMA guidelines issued under MiFID II[27] will cease to apply on the same date.

II. Legislative references, abbreviations and definitions

Legislative references

ESMA Regulation	Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC.[28]

[27] ESMA35-43-1163 - - Guidelines on certain aspects of the MiFID II suitability requirements.
[28] OJ L 331, 15.12.2010, p. 84.

MiFID II	Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU.[29]
MiFID II Delegated regulation	Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive.[30]
Commission Delegated Regulation 2021/1253	Commission Delegated Regulation (EU) 2021/1253 of 21 April 2021 amending Delegated Regulation (EU) 2017/565 as regards the integration of sustainability factors, risks and preferences into certain organisational requirements and operating conditions for investment firms.[31]

Definitions

Investment product	A financial instrument (within the meaning of Article 4(1)(15) of MiFID II) or a structured deposit (within the meaning of Article 4(1)(43) of MiFID II).
Firms	Investment firms (as defined in Article 4(1)(1) of MiFID II) and credit institutions (as defined in Article 4(1)(27) of MIFID II) when providing the investment services of investment advice and portfolio management listed in Section A of Annex I of MiFID II, investment firms and credit institutions (when selling or advising clients in relation to structured deposits), UCITS management companies (as defined in Article 2(1)(b) of UCITS Directive[32]) and external Alternative Investment Fund Managers (AIFMs) (as defined in Article 5(1)(a) of the AIFMD[33] when providing the investment services of individual portfolio management or non-core services (within the meaning of Article 6(3)(a) and (b)(i) of UCITS Directive and Article 6(4)(a) and (b)(i) of the AIFMD).
Suitability assessment	The whole process of collecting information about a client and the subsequent assessment by the firm that a given investment product is suitable for him, based also on the firm's solid understanding of the products that it can recommend or invest into on behalf of the client.

[29] OJ L 173, 12.06.2014, p. 349.
[30] OJ L 87, 31.3.2017, p. 1.
[31] OJ L 277, 2.8.2021, p. 1.
[32] Directive 2009/65/EC
[33] Directive 2011/61/EU

Robo-advice	The provision of investment advice or portfolio management services (in whole or in part) through an automated or semi-automated system used as a client-facing tool.

II. Purpose

5. The purpose of these guidelines is to clarify the application of certain aspects of the MiFID II suitability requirements in order to ensure the common, uniform and consistent application of Article 25(2) of MiFID II and of Articles 54 and 55 of the MiFID II Delegated Regulation.

6. ESMA expects these guidelines to promote greater convergence in the interpretation of, and supervisory approaches to, the MiFID II suitability requirements, by emphasising a number of important issues, and thereby enhancing the value of existing standards. By helping to ensure that firms comply with regulatory standards, ESMA anticipates a corresponding strengthening of investor protection.

III. Compliance and reporting obligations

Status of the guidelines

7. This document contains guidelines issued under Article 16 of the ESMA Regulation.[34] In accordance with Article 16(3) of the ESMA Regulation, competent authorities and financial market participants shall make every effort to comply with guidelines.

8. Competent authorities to whom these guidelines apply should comply by incorporating them into their national legal and/or supervisory frameworks as appropriate, including where particular guidelines are directed primarily at financial market participants. In this case, competent authorities should ensure through their supervision that financial market participants comply with the guidelines.

Reporting requirements

9. Competent authorities to which these guidelines apply must notify ESMA whether they comply or intend to comply with the guidelines as appropriate, stating their reasons for non-compliance where they do not comply or do not intend to comply, within two months of the date of publication of the guidelines on ESMA's website in all official languages of the EU.

10. Firms are not required to report whether they comply with these guidelines.

[34] Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC.

IV. Guidelines on certain aspects of the MiFID suitability requirements

V. INFORMATION TO CLIENTS ABOUT THE PURPOSE OF THE SUITABILITY ASSESSMENT AND ITS SCOPE

Relevant legislation: Article 24(1), 24(4) and 24(5) of MiFID II and Article 54(1), of the MiFID II Delegated Regulation.

General guideline 1

11. Firms should inform their clients clearly and simply about the suitability assessment and its purpose which is to enable the firm to act in the client's best interest. This should include a clear explanation that it is the firm's responsibility to conduct the assessment, so that clients understand the reason why they are asked to provide certain information and the importance that such information is up-to-date, accurate and complete. Such information may be provided in a standardised format.

Supporting guidelines

12. Information about the suitability assessment should help clients understand the purpose of the requirements. It should encourage them to provide up-to-date, accurate and sufficient information about their knowledge, experience, financial situation (including their ability to bear losses), and investment objectives (including their risk tolerance). Firms should highlight to their clients that it is important to gather complete and accurate information so that the firm can recommend suitable products or services to the client. Without this information, firms cannot provide investment advice and portfolio management services to clients.

13. It is up to the firms to decide how they will inform their clients about the suitability assessment. The format used should however enable controls to check if the information was provided.

14. Firms should avoid stating, or giving the impression, that it is the client who decides on the suitability of the investment, or that it is the client who establishes which financial instruments fit his own risk profile. For example, firms should avoid indicating to the client that a certain financial instrument is the one that the client chose as being suitable, or requiring the client to confirm that an instrument or service is suitable.

15. Any disclaimers (or other similar types of statements) aimed at limiting the firm's responsibility for the suitability assessment would not in any way impact the characterisation of the service provided in practice to clients nor the assessment of the firm's compliance to the corresponding requirements. For example, when collecting clients' information required to conduct a suitability assessment (such as their investment horizon/holding period or information related to risk tolerance), firms should not claim that they do not assess the suitability.

16. In order to help clients understanding the concept of "sustainability preferences" introduced under Article 2(7) of the MiFID II Delegated Regulation and the choices to be

made in this context, firms should explain the terms and the distinctions between the different elements of the definition of sustainability preferences outlined under points (a) to (c) of Article 2(7) and also between these products and products without such sustainability features in a clear manner, avoiding technical language. Firms should also explain terms and concepts used when referring to environmental, social and governance aspects.

17. In order to address potential gaps in clients' understanding of the services provided through robo-advice, firms should inform clients, in addition to other required information, on the following:

- a very clear explanation of the exact degree and extent of human involvement and if and how the client can ask for human interaction;
- an explanation that the answers clients provide will have a direct impact in determining the suitability of the investment decisions recommended or undertaken on their behalf;
- a description of the sources of information used to generate an investment advice or to provide the portfolio management service (e.g., if an online questionnaire is used, firms should explain that the responses to the questionnaire may be the sole basis for the robo-advice or whether the firm has access to other client information or accounts);
- an explanation of how and when the client's information will be updated with regard to his situation, personal circumstances, etc.

18. Provided that all the information and reports given to clients shall comply with the relevant provisions (including obligations on the provision of information in durable medium), firms should also carefully consider whether their written disclosures are designed to be effective (e.g., the disclosures are made available directly to clients and are not hidden or incomprehensible). For firms providing robo-advice this may in particular include:

- Emphasising the relevant information (e.g., through the use of design features such as pop-up boxes);
- Considering whether some information should be accompanied by interactive text (e.g., through the use of design features such as tooltips) or other means to provide additional details to clients who are seeking further information (e.g., through F.A.Q. section).

V.I KNOW YOUR CLIENT AND KNOW YOUR PRODUCT

Arrangements necessary to understand clients

Relevant legislation: Articles 16(2) and 25(2) of MiFID II, and Articles 54(2) to 54(5) and Article 55 of the MiFID II Delegated Regulation.

General guideline 2

19. Firms must establish, implement and maintain adequate policies and procedures (including appropriate tools) to enable them to understand the essential facts and characteristics about their clients. Firms should ensure that the assessment of information collected about their clients is done in a consistent way irrespective of the means used to collect such information.

Supporting guidelines

20. Firms' policies and procedures shall enable them to collect and assess all information necessary to conduct a suitability assessment for each client, while taking into account the elements developed in guideline 3.

21. For example, firms could use questionnaires (also in a digital format) completed by their clients or information collected during discussions with them. Firms should ensure that the questions they ask their clients are specific enough, are likely to be understood correctly and that any other method used to collect information is designed to get the information required for a suitability assessment.

22. When designing the questionnaires aiming at collecting information about their clients for the purpose of a suitability assessment firms should be aware and consider the most common reasons why investors could fail to answer questionnaires correctly. In particular:

    - Attention should be given to the clarity, exhaustiveness and comprehensibility of the questionnaire, avoiding misleading, confusing, imprecise and excessively technical language;

    - The layout should be carefully elaborated and should avoid orienting investors' choices (font, line spacing…);

    - Presenting questions in batteries (collecting information on a series of items through a single question, particularly when assessing knowledge and experience and the risk tolerance) should be avoided;

    - Firms should carefully consider the order in which they ask questions in order to collect information in an effective manner;

- In order to be able to ensure necessary information is collected, the possibility not to reply should generally not be available in questionnaires (particularly when collecting information on the investor's financial situation).

23. Firms should also take reasonable steps to assess the client's understanding of investment risk as well as the relationship between risk and return on investments, as this is key to enable firms to act in accordance with the client's best interest when conducting the suitability assessment. When presenting questions in this regard, firms should explain clearly and simply that the purpose of answering them is to help assess clients' attitude to risk (risk profile), and therefore the types of financial instruments (and risks attached to them) that are suitable for them.

24. Information necessary to conduct a suitability assessment includes different elements that may affect, for example, the analysis of the client's financial situation (including his ability to bear losses) or investment objectives (including his risk tolerance). Examples of such elements are the client's:

    - marital status (especially the client's legal capacity to commit assets that may belong also to his partner);

    - family situation (changes in the family situation of a client may impact his financial situation e.g. a new child or a child of an age to start university);

    - age (which is mostly important to ensure a correct assessment of the investment objectives, and in particular the level of financial risk that the investor is willing to take, as well as the holding period/investment horizon, which indicates the willingness to hold an investment for a certain period of time);

    - employment situation (the degree of job security or that fact the client is close to retirement may impact his financial situation or his investment objectives);

    - need for liquidity in certain relevant investments or need to fund a future financial commitment (e.g. property purchase, education fees).

25. When determining what information is necessary, firms should keep in mind the impact that any significant change regarding that information could have concerning the suitability assessment.

26. The information on the sustainability preferences of the client should include all aspects mentioned in the definition of "sustainability preferences" according to Article 2(7) of the MiFID II Delegated Regulation and should be sufficiently granular to allow for a matching of the client's sustainability preferences with the sustainability-related features of financial instruments. Firms should collect the following information from clients:

    - Whether the client has any sustainability preferences (yes/no).

- If the client answers "yes" to the previous question, whether the client has sustainability preferences with regard to one or more of points (a), (b) or (c) of the definition according to Article 2(7) MiFID II Delegated Regulation.

- For aspects (a) and (b), the minimum proportion.

- For aspect (c), which principal adverse impacts (PAI) should be considered including quantitative or qualitative criteria demonstrating that consideration.

Throughout the process, firms should adopt a neutral and unbiased approach as to not influence clients' answers.

27. To achieve this, firms could choose the following approach:

- Firms could collect information on the sustainability preferences of the client which would refer to one or more of the aspects expressed through points (a) to (c) of Article 2(7) of the MiFID II Delegated Regulation. This aspect could be assessed through closed-ended yes/no-questions.

- Firms could also collect information on whether the client's sustainability preferences with regard to points (b) and (c), if any, have a focus on either environmental, social or governance sustainability factors or a combination of them or whether the client does not have such a focus.

- Where the client expresses preferences in terms of the "minimum proportion" as mentioned in points (a) and (b), firms could collect this information not in terms of an exact percentage but by minimum percentages. These percentages should be presented in a neutral way to the client and should be sufficiently granular. Firms could, for example, assist the customer to identify the minimum proportion by approximating the minimum proportion by standardised minimum proportions, such as "minimum 20%, minimum 25%, minimum 30%, etc.".

- In case the client wishes to include a financial instrument that considers PAI, the information collected should cover the qualitative or quantitative elements of PAI mentioned under c). Firms could test the client's preferences and appetite for PAI integration with regard to the families of PAI indicators as whole, based on a possible focus of the client on environmental, social or governance aspects, using the categories presented in the SFDR RTS[35] (instead of an approach based on each PAI indicator) such as emissions, energy performance, water & waste, etc.

  An evaluation could then be initiated for each category that is important/key for the client or not. This qualitative evaluation could be based on the approaches in

[35] COMMISSION DELEGATED REGULATION (EU) 2022/1288

which products consider PAI (e.g., exclusion strategies / controversies policies / voting and engagement policies).

In case the client wishes to include a financial instrument that considers PAI, firms could also ask the client if there are specific economic activities that, on the basis of relevant PAIs, it wishes to exclude from its investments (for example, specific economic activities that are considered as significantly harmful under the EU taxonomy framework and/or that are opposed to the environmental and ethical views held by the client and that are linked to certain principal adverse impacts on sustainability factors).

28. Firms should have policies and instructions for their client-facing staff in place for situations where clients answer that they do have sustainability preferences but do not state a preference with regard to any of the specific aspects mentioned under points (a) to (c) of Article 2(7) of the MiFID II Delegated Regulation or with regard to a minimum proportion. For example, the firm could consider any of the aspects under points (a) to (c) of Article 2(7) of the Delegated Regulation. Where firms make use of this approach, they should explain it and inform the client about the sustainability features of the investment product(s) recommended or on which the firm will invest on behalf of the client and document in the suitability report[36] the client's choice not to further specify the sustainability preferences. Firms should ensure that similar arrangements are in place when firms provide robo-advice services given the limited human interaction.

29. When providing portfolio management or investment advice with a portfolio approach firms should collect information on the client's sustainability preferences with the same granularity as set out in paragraphs 26 and 27 above. Firms should also ask the client which part/percentage of the portfolio (if any) the client wants to be invested in products meeting the client's sustainability preferences. Where firms work with model portfolios that combine some or all of the criteria listed under paragraph 26 above, these model portfolios should allow for a granular assessment of the client's preferences and should not be translated into a questionnaire that pushes the client into a certain combination of the criteria that would not meet the client's sustainability preferences.[37]

30. Firms should take all reasonable steps to sufficiently assess the understanding by their clients of the main characteristics and the risks related to the product types in the offer of the firm. The adoption by firms of mechanisms to avoid self-assessment and ensure the consistency of the answers provided by the client[38] is particularly important for the correct assessment of the client's knowledge and experience. Information collected by firms about a client's knowledge and experience should be considered altogether for the overall appraisal of his understanding of the products and of the risks involved in the transactions recommended or in the management of his portfolio.

[36] "Suitability report is the "statement of suitability" referred to in Article 25 of MIFID II".
[37] This paragraph should be read in conjunction with paragraph. 87 of the guidelines.
[38] See guideline 4.

31. It is also important that firms appraise the client's understanding of basic financial notions such as investment risk (including concentration risk) and risk-return trade off. To this end, firms should consider using indicative, comprehensible examples of the levels of loss/return that may arise depending on the level of risk taken and should assess the client's response to such scenarios.

32. Firms should design their questionnaires so that they are able to gather the necessary information about their client. This may be particularly relevant for firms providing robo-advice services given the limited human interaction. In order to ensure their compliance with the requirements concerning that assessment, firms should take into account factors such as:

- Whether the information collected through the online questionnaire allows the firm to conclude that the advice provided is suitable for their clients on the basis of their knowledge and experience, their financial situation and their investment objectives and needs;

- Whether the questions in the questionnaire are sufficiently clear and/or whether the questionnaire is designed to provide additional clarification or examples to clients when necessary (e.g., through the use of design features, such as tool-tips or pop-up boxes);

- Whether some human interaction (including remote interaction via emails or mobile phones) is available to clients when responding to the online questionnaire;

- Whether steps have been taken to address inconsistent client responses (such as incorporating in the questionnaire design features to alert clients when their responses appear internally inconsistent and suggest them to reconsider such responses; or implementing systems to automatically flag apparently inconsistent information provided by a client for review or follow-up by the firm).

Extent of information to be collected from clients (proportionality)

Relevant legislation: Article 25(2) of MiFID II, and Articles 54(2) to 54(5) and Article 55 of the MiFID II Delegated Regulation.

General guideline 3

33. Before providing investment advice or portfolio management services, firms need to collect all 'necessary information'[39] about the client's knowledge and experience, financial situation and investment objectives. The extent of 'necessary' information may vary and has to take into account the features of the investment advice or portfolio

[39] 'Necessary information' should be understood as meaning the information that firms must collect to comply with the suitability requirements under MiFID II.

management services to be provided, the type and characteristics of the investment products to be considered and the characteristics of the clients.

Supporting guidelines

34. In determining what information is 'necessary' firms should consider, in relation to a client's knowledge and experience, financial situation and investment objectives:

- the type of the financial instrument or transaction that the firm may recommend or enter into (including the complexity and level of risk);
- the nature and extent of the service that the firm may provide;
- the needs and circumstances of the client;
- the type of client.

35. While the extent of the information to be collected may vary, the standard for ensuring that a recommendation or an investment made on the client's behalf is suitable for the client will always remain the same. MiFID allows firms to collect the level of information proportionate to the products and services they offer, or on which the client requests specific investment advice or portfolio management services. It does not allow firms to lower the level of protection due to clients.

36. For example, when providing access to complex[40] or risky[41] financial instruments, firms should carefully consider whether they need to collect more in-depth information about the client than they would collect when less complex or risky instruments are at stake. This is so that firms can assess the client's capacity to understand, and financially bear, the risks associated with such instruments.[42] For such complex products ESMA expects firms to carry out a robust assessment amongst others of the client's knowledge and experience, including, for example, his ability to understand the mechanisms which make the investment product "complex", whether the client has already traded in such products (for example, derivatives or leverage products), the length of time he has been trading them for, etc.

37. For illiquid financial instruments[43], the 'necessary information' to be gathered will include information on the length of time for which the client is prepared to hold the investment. As information about a client's financial situation will always need to be collected, the extent of information to be collected may depend on the type of financial instruments to be recommended or entered into. For example, for illiquid or risky financial instruments,

[40] As defined in MiFID II and taking into account the criteria identified in guideline 7.
[41] It is up to each firm to define *a priori* the level of risk of the financial instruments included in its offer to investors taking into account, where available, possible guidelines issued by competent authorities supervising the firm.
[42] In any case, to ensure clients understand the investment risk and potential losses they may bear, the firm should, as far as possible, present these risks in a clear and understandable way, potentially using illustrative examples of the extent of losses in the event of an investment performing poorly.
[43] It is up to each firm to define *a priori* which of the financial instruments included in its offer to investors it considers as being illiquid, taking into account, where available, possible guidelines issued by competent authorities supervising the firm.

‘necessary information’ to be collected may include all of the following elements as necessary to ensure whether the client’s financial situation allows him to invest or be invested in such instruments:

- the extent of the client’s regular income and total income, whether the income is earned on a permanent or temporary basis, and the source of this income (for example, from employment, retirement income, investment income, rental yields, etc.);

- the client’s assets, including liquid assets, investments and real property, which would include what financial investments, personal and investment property, pension funds and any cash deposits, etc. the client may have. The firm should, where relevant, also gather information about conditions, terms, access, loans, guarantees and other restrictions, if applicable, to the above assets that may exist.

- the client’s regular financial commitments, which would include what financial commitments the client has made or is planning to make (client’s debits, total amount of indebtedness and other periodic commitments, etc.).

38. In determining the information to be collected, firms should also take into account the nature of the service to be provided. Practically, this means that:

- when investment advice is to be provided, firms should collect sufficient information in order to be able to assess the ability of the client to understand the risks and nature of each of the financial instruments that the firm envisages recommending to that client;

- when portfolio management is to be provided, as investment decisions are to be made by the firm on behalf of the client, the level of knowledge and experience needed by the client with regard to all the financial instruments that can potentially make up the portfolio may be less detailed than the level that the client should have when an investment advice service is to be provided. Nevertheless, even in such situations, the client should at least understand the overall risks of the portfolio and possess a general understanding of the risks linked to each type of financial instrument that can be included in the portfolio. Firms should gain a very clear understanding and knowledge of the investment profile of the client.

39. Similarly, the extent of the service requested by the client may also impact the level of detail of information collected about the client. For example, firms should collect more information about clients asking for investment advice covering their entire financial portfolio than about clients asking for specific advice on how to invest a given amount of money that represents a relatively small part of their overall portfolio.

40. Firms should also take into account the nature of the client when determining the information to be collected. For example, more in-depth information would usually need to be collected for potentially vulnerable clients (such as older clients could be) or inexperienced ones asking for investment advice or portfolio management services for

the first time. Where a firm provides investment advice or portfolio management services to a professional client (who has been correctly classified as such), it is entitled to assume that the client has the necessary level of experience and knowledge, and therefore is not required to obtain information on these aspects.

41. Similarly, where the investment service consists of the provision of investment advice to a 'per se professional client'[44] the firm is entitled to assume that the client is able to financially bear any related investment risks consistent with the investment objectives of that client and therefore is not generally required to obtain information on the financial situation of the client. Such information should be obtained, however, where the client's investment objectives demand it. For example, where the client is seeking to hedge a risk, the firm will need to have detailed information on that risk in order to be able to propose an effective hedging instrument.

42. Information to be collected will also depend on the needs and circumstances of the client. For example, a firm is likely to need more detailed information about the client's financial situation where the client's investment objectives are multiple and/or long-term, than when the client seeks a short-term secure investment. [45]

43. Information about a client's financial situation includes information regarding his investments. This implies that firms are expected to possess information about the client's financial investments he holds with the firm on an instrument-by-instrument basis. Depending on the scope of advice provided, firms should also encourage clients to disclose details on financial investments they hold with other firms, if possible also on an instrument-by-instrument basis.

Reliability of client information

Relevant legislation: Article 25(2) of MiFID II, and Articles 54(7), first subparagraph of the MiFID II Delegated Regulation.

General guideline 4

44. Firms should take reasonable steps and have appropriate tools to ensure that the information collected about their clients is reliable and consistent, without unduly relying on clients' self-assessment.

Supporting guidelines

45. Clients are expected to provide correct, up-to-date and complete information necessary for the suitability assessment. However, firms need to take reasonable steps to check the reliability, accuracy and consistency of information collected about clients[46]. Firms

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[44] As set out in Section I of Annex II of MiFID II ('Categories of client who are considered to be professionals').
[45] There may be situations where the client is unwilling to disclose his full financial situation. For this particular question see Q&As on MiFID II investor protection topics (ESMA35-43-349)
[46] When dealing with professional clients, firms should take into account the proportionality principles as referred to in guideline 3, in line with Article 54 (3) of MiFID II Delegated Regulation.

remain responsible for ensuring they have the necessary information to conduct a suitability assessment. In this respect, any agreement signed by the client, or disclosure made by the firm, that would aim at limiting the responsibility of the firm with regard to the suitability assessment, would not be considered compliant with the relevant requirements in MiFID II and related Delegated Regulation.

46. Self-assessment should be counterbalanced by objective criteria. For example:

- instead of asking whether a client understands the notions of risk-return trade-off and risk diversification, the firm should present some practical examples of situations that may occur in practice, for example by means of graphs or through positive and negative scenarios which are based on reasonable assumptions;

- Instead of asking whether a client has sufficient knowledge about the main characteristics and risks of specific types of investment products, the firm should for instance ask questions aimed at assessing the client's real knowledge about the specific types of investment products, for example by asking the client multiple choice questions to which the client should provide the right answer;

- instead of asking a client whether he feels sufficiently experienced to invest in certain products, the firm should ask the client what types of products the client is familiar with and how recent and frequent his trading experience with them is;

- instead of asking whether clients believe they have sufficient funds to invest, the firm should ask clients to provide factual information about their financial situation, e.g. the regular source of income and whether outstanding liabilities exist (such as bank loans or other debts, which may significantly impact the assessment of the client's ability to financially bear any risks and losses related to the investment);

- instead of asking whether a client feels comfortable with taking risk, the firm should ask what level of loss over a given time period the client would be willing to accept, either on the individual investment or on the overall portfolio.

47. In assessing a client's knowledge and experience, a firm should also avoid using overly broad questions with a yes/no type of answer and or a very broad tick-the-box self-assessment approach (for example, firms should avoid submitting a list of investment products to the client and asking him/her to indicate which products s/he understands). Where firms pre-fill answers based on the client's transactions history with that firm (e.g., through another investment service), they should ensure that only fully objective, pertinent, and reliable information is used and that the client is given the opportunity to review and, if necessary, correct and/or complete each of the pre-filled answers to ensure the accuracy of any pre-populated information. Firms should also refrain from predicting clients' experience based on assumptions.

48. When assessing the risk tolerance of their clients through a questionnaire, firms should not only investigate the desirable risk-return characteristics of future investments but they should also take into account the client's risk perception. To this end, whilst self-

assessment for the risk tolerance should be avoided, explicit questions on the clients' personal choices in case of risk uncertainty could be presented. Furthermore, firms could for example make use of graphs, specific percentages or concrete figures when asking the client how he would react when the value of his portfolio decreases.

49. Where firms rely on tools to be used by clients as part of the suitability process (such as questionnaires or risk-profiling software), they should ensure that they have appropriate systems and controls to ensure that the tools are fit for purpose and produce satisfactory results. For example, risk-profiling software could include some controls of coherence of the replies provided by clients in order to highlight contradictions between different pieces of information collected.

50. Firms should also take reasonable steps to mitigate potential risks associated with the use of such tools. For example, potential risks may arise if clients were encouraged to provide certain answers in order to get access to financial instruments that may not be suitable for them (without correctly reflecting the clients' real circumstances and needs)[47].

51. In order to ensure the consistency of client information, firms should view the information collected as a whole. Firms should be alert to any relevant contradictions between different pieces of information collected, and contact the client in order to resolve any material potential inconsistencies or inaccuracies. Examples of such contradictions are clients who have little knowledge or experience and an aggressive attitude to risk, or who have a prudent risk profile and ambitious investment objectives.

52. Firms should adopt mechanisms to address the risk that clients may tend to overestimate their knowledge and experience, for example by including questions that would help firms assess the overall clients' understanding about the characteristics and the risks of the different types of financial instruments. Such measures may be particularly important in the case of robo-advice, since the risk of overestimation by clients may result higher when they provide information through an automated (or semi-automated) system, especially in situations where very limited or no human interaction at all between clients and the firm's employees is foreseen.

[47] In this regard, see also paragraph 54 of Guideline 5, which addresses the risk of clients being influenced by firms to change answers previously provided by them, without there being any real modification in their situation.

Updating client information

Relevant legislation: Article 25(2) of MiFID II, subparagraph 2 of Article 54(7), and Article 55(3) of the MiFID II Delegated Regulation.

General guideline 5

53. Where a firm has an ongoing relationship with the client (such as by providing ongoing advice or portfolio management services), in order to be able to perform the suitability assessment, it should adopt procedures defining:

    (a) what part of the client information collected should be subject to updating and at which frequency;

    (b) how the updating should be done and what action should be undertaken by the firm when additional or updated information is received or when the client fails to provide the information requested.

Supporting guidelines

54. Firms should regularly review client information to ensure that it does not become manifestly out of date, inaccurate or incomplete. To this end, firms should implement procedures to encourage clients to update the information originally provided where significant changes occur.

55. Frequency of update might vary depending on, for example, clients' risk profiles and taking into account the type of financial instrument recommended. Based on the information collected about a client under the suitability requirements, a firm will determine the client's investment risk profile, i.e. what type of investment services or financial instruments can in general be suitable for him taking into account his knowledge and experience, his financial situation (including his ability to bear losses) and his investment objectives (including his risk tolerance). For example, a risk profile giving to the client access to a wider range of riskier products is an element that is likely to require more frequent updating. Certain events might also trigger an updating process; this could be so, for example, for clients reaching the age of retirement.

56. Updating could, for example, be carried out during periodic meetings with clients or by sending an updating questionnaire to clients. Relevant actions might include changing the client's profile based on the updated information collected.

57. With regard to the sustainability preferences of a client, this information should be updated - for ongoing relationships – at the latest through the next regular update of client information following the entry-into-application of Commission Delegated Regulation 2021/1253. Clients should be provided the opportunity to have their profile updated immediately if they wish so. Where the client does not request the immediate update of its profile, and during the period preceding the acquisition from the firm of the information on the client's sustainability preferences, the client will be considered as

"sustainability-neutral" and therefore, in line with paragraph 85, the client could be recommended products both with and without sustainability-related features".

58. It is also important that firms adopt measures to mitigate the risk of inducing the client to update his own profile so as to make appear as suitable a certain investment product that would otherwise be unsuitable for him, without there being a real modification in the client's situation[48]. As an example of a good practice to address this type of risk, firms could adopt procedures to verify, before or after transactions are made, whether a client's profile has been updated too frequently or only after a short period from last modification (especially if this change has occurred in the immediate days preceding a recommended investment). Such situations would therefore be escalated or reported to the relevant control function. These policies and procedures are particularly important in situations where there is a heightened risk that the interest of the firm may come into conflict with the best interests of its clients, e.g. in self-placement situations or where the firm receives inducements for the distribution of a product. Another relevant factor to consider in this context is also the type of interaction that occurs with the client (e.g. face-to-face vs through an automated system) [49].

59. Firms should inform the client when the additional information provided results in a change of his profile, whether it becomes more risky (and therefore, potentially, a wider range of riskier and more complex products may result suitable for him, with the potential to incur in higher losses) or *vice-versa* more conservative (and therefore, potentially, a more restricted range of products may as a result be suitable for him).

Client information for legal entities or groups

Relevant legislation: Article 25(2)of MiFID II and Article 54(6) of the MiFID II Delegated Regulation.

General guideline 6

60. Firms must have a policy defining on an *ex ante basis*, how to conduct the suitability assessment in situations where a client is a legal person or a group of two or more natural persons or where one or more natural persons are represented by another natural person. This policy should specify, for each of those situations, the procedure and criteria that should be followed in order to comply with the MiFID II suitability requirements. The firm should, clearly, inform *ex-ante* those of its clients that are legal entities, groups of persons or natural persons represented by another natural person about who should be subject to the suitability assessment, how the suitability assessment will be done in practice and the possible impact this could have for the relevant clients, in accordance with the existing policy.

[48] Also relevant in this context are measures adopted to ensure the reliability of clients' information as detailed under guideline 4, paragraph 44.
[49] In this regard, also see the clarifications already provided by ESMA in the Q&As on MiFID II investor protection topics (Ref: ESMA35-43-349 – Question on 'Transactions on unsuitable products').

Supporting guidelines

61. Firms should consider whether the applicable national legal framework provides specific indications that should be taken into account for the purpose of conducting the suitability assessment (this could be the case, for instance, where the appointment of a legal representative is required by law: e.g. for underage or incapacitated persons or for a legal person).

62. The policy should make a clear distinction between situations where a representative is foreseen under applicable national law, as it can be the case for example for legal persons, and situations where no representative is foreseen, and it should focus on this latter situations. Where the policy foresees agreements between clients, they should be made aware clearly and in written form about the effects that such agreements may have regarding the protection of their respective interests. Steps taken by the firm in accordance with its policy should be appropriately documented to enable *ex-post* controls.

Situations where a representative is foreseen under applicable national law

63. Subparagraph 2 of Article 54(6) of the MiFID II Delegated Regulation defines how the suitability assessment should be done with regard to situations where the client is a natural person represented by another natural person or is a legal person having requested treatment as a professional client. It seems reasonable that the same approach could apply to all legal persons, regardless of the fact that they may have requested to be treated as professionals or not.

64. Firms should ensure that their procedures adequately incorporate this article in their organisation, which would imply amongst others that they verify that the representative is indeed – according to relevant national law – authorised to carry out transactions on behalf of the underlying client.

Situations where no representative is foreseen under applicable national law

65. Where the client is a group of two or more natural persons and no representative is foreseen under applicable national law, the firm's policy should identify from whom necessary information will be collected and how the suitability assessment will be done. Clients should be properly informed about the firm's approach (as decided in the firm's policy) and the impact of this approach on the way the suitability assessment is done in practice.

66. Approaches such as the following could possibly be considered by firms:

    (a) they could choose to invite the group of two or more natural persons to designate a representative; or,

    (b) they could consider collecting information about each individual client and assessing the suitability for each individual client.

Inviting the group of two or more natural persons to designate a representative

67. If the group of two or more natural persons agrees to designate a representative, the same approach as the one described in subparagraph 2 of Article 54(6) of the MiFID II Delegated Regulation could be followed: the knowledge and experience shall be that of the representative, while the financial situation and the investment objectives would be those of the underlying client(s). Such designation should be made in written form as well as according to and in compliance with the applicable national law, and recorded by the relevant firm. The clients - part of the group - should be clearly informed, in written form, about the impact that an agreement amongst clients could have on the protection of their respective interests.

68. The firm's policy could however require the underlying client(s) to agree on their investment objectives.

69. If the parties involved have difficulties in deciding the person/s from whom the information on knowledge and experience should be collected, the basis on which the financial situation should be determined for the purpose of the suitability assessment or on defining their investment objectives, the firm should adopt the most prudent approach by taking into account, accordingly, the information on the person with the least knowledge and experience, the weakest financial situation or the most conservative investment objectives. Alternatively, the firm's policy may also specify that it will not be able to provide investment advice or portfolio management services in such a situation. Firms should at least be prudent whenever there is a significant difference in the level of knowledge and experience or in the financial situation of the different clients part of the group, or when the investment advice or portfolio management services may include leveraged financial instruments or contingent liability transactions that pose a risk of significant losses that could exceed the initial investment of the group of clients and should clearly document the approach chosen.

Collecting information about each individual client and assessing the suitability for each individual client

70. When a firm decides to collect information and assess suitability for each individual client part of the group, if there are significant differences between the characteristics of those individual clients (for example, if the firm would classify them under different investment profiles), the question arises about how to ensure the consistency of the investment advice or portfolio management services provided with regard to the assets or portfolio of that group of clients. In such a situation, a financial instrument may be suitable for one client part of the group but not for another one. The firm's policy should clearly specify how it will deal with such situations. Here again, the firm should adopt the most prudent approach by taking into account the information on the client part of the group with the least knowledge and experience, the weakest financial situation or the most conservative investment objectives. Alternatively, the firm's policy may also specify that it will not be able to provide investment advice or portfolio management services in such a situation. In this context, it should be noted that collecting information on all the clients part of the group and considering, for the purposes of the assessment, an average profile of the

level of knowledge and competence of all of them, would unlikely be compliant with the MiFID II overarching principle of acting in the clients' best interests.

Arrangements necessary to understand investment products

Relevant legislation: Articles 16(2) and 25(2) of MiFID II, and Article 54(9) of the MiFID II Delegated Regulation.

General guideline 7

71. Firms should ensure that the policies and procedures implemented to understand the characteristics, nature and features (including costs and risks) of investment products allow them to recommend suitable investments, or invest into suitable products on behalf of their clients.

Supporting guidelines

72. 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 credit risk, market risk, liquidity risk[50], …) of each investment product they may recommend or invest in on behalf of clients. This should include taking into consideration the firm's analysis conducted for the purposes of product governance obligations[51]. In this context, firms should carefully assess how certain products could behave under certain circumstances (e.g. convertible bonds or other debt instruments subject to the Bank Recovery and Resolution Directive[52] which may, for example, change their nature into shares). Considering the level of 'complexity' of products is particularly important, and this should be matched with a client's information (in particular regarding their knowledge and experience). Although complexity is a relative term, which depends on several factors, firms should also take into account the criteria and principles identified in MiFID II, when defining and appropriately graduating the level of complexity to be attributed to products for the purposes of the assessment of suitability.

73. When considering the sustainability factors of products in view of the subsequent matching with the client's sustainability preferences, firms could, for example, rank and group the financial instruments included in the range of products they offer in terms of: i) the proportion invested in economic activities that qualify as environmentally sustainable (as defined in Article 2, point (1), of Taxonomy Regulation); ii) the proportion of sustainable investments (as defined in Article 2, point (17), of SFDR); iii) the

[50] It is particularly important that the liquidity risk identified is not balanced out with other risk indicators (such as, for example, those adopted for the assessment of credit/counterparty risk and market risk). This is because the liquidity features of products should be compared with information on the client's willingness to hold the investment for a certain length of time, i.e. the so called 'holding period'.

[51] In particular, MiFID II requires firms (under subparagraph 2 of Article 24(2)) to '*understand the financial instruments they offer or recommend*' in order to be able to comply with their obligation to ensure the compatibility between products offered or recommended and the related target market of end clients.

[52] Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012 (OJ L 173, 12.6.2014, p. 190–348).

consideration of principal adverse impacts and other environmental, social and governance sustainability features. Such grouping should also be consistent with the firm's analysis conducted for the purposes of product governance obligations. 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 in paragraphs 26 and 27 above.

74. Firms should adopt procedures to ensure that the information used to understand and correctly classify investment products included in their product offer is reliable, accurate, consistent and up-to-date. When adopting such procedures, firms should take into account the different characteristics and nature of the products considered (for example, more complex products with particular features may require more detailed processes and firms should not solely relying on one data provider in order to understand and classify investment products but should check and challenge such data or compare data provided by multiple sources of information).

75. In addition, firms should review the information used so as to be able to reflect any relevant changes that may impact the product's classification. This is particularly important, taking into account the continuing evolution and growing speed of financial markets.

V.II MATCHING CLIENTS WITH SUITABLE PRODUCTS

Arrangements necessary to ensure the suitability of an investment

Relevant legislation: Article 16(2) and 25(2) of MiFID II and Article 21 of the MiFID II Delegated Regulation.

General guideline 8

76. In order to match clients with suitable investments, firms should establish policies and procedures to ensure that they consistently take into account:

- all available information about the client necessary to assess whether an investment is suitable, including the client's current portfolio of investments (and asset allocation within that portfolio);

- all material characteristics of the investments considered in the suitability assessment, including all relevant risks and any direct or indirect costs to the client.[53]

[53] See Articles 50 and 51 of MiFID II Delegated Regulation regarding the obligation to inform clients about costs.

Supporting guidelines

77. 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[54].

78. Firms that rely on tools in the suitability assessment process (such as model portfolios, asset allocation software or a risk-profiling tool for potential investments), should have appropriate systems and controls to ensure that the tools are fit for purpose and produce satisfactory results.

79. In this regard, the tools should be designed so that they take account of all the relevant specificities of each client or investment product. For example, tools that classify clients or investment products broadly would not be fit for purpose.

80. A firm should establish policies and procedures which enable it to ensure inter alia that:

- the advice and portfolio management services provided to the client take account of an appropriate degree of risk diversification;
- the client has an adequate understanding of the relationship between risk and return, i.e. of the necessarily low remuneration of risk free assets, of the incidence of time horizon on this relationship and of the impact of costs on his investments;
- the financial situation of the client can finance the investments and the client can bear any possible losses resulting from the investments;
- any personal recommendation or transaction entered into in the course of providing an investment advice or portfolio management service, where an illiquid product is involved, takes into account the length of time for which the client is prepared to hold the investment; and
- any conflicts of interest are prevented from adversely affecting the quality of the suitability assessment.

81. Sustainability preferences should only be addressed once the suitability has been assessed in accordance with the criteria of knowledge and experience, financial situation and other investment objectives. Once the range of suitable products has been identified following this assessment, in a second step the product or, with regard to portfolio management or investment advice with a portfolio approach, an investment strategy that fulfils the client's sustainability preferences should be identified.

82. 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

[54] See recital 87 of MiFID II Delegated Regulation as well as paragraph 31 of section IV of CESR, Understanding the definition of advice under MiFID, question and answers, 19 April 2010, CESR/10-293.

Commission Delegated Regulation 2021/1253, it can only do so once the client has adapted his/her sustainability preferences. The firm's explanation regarding the reason to resort to such possibility as well as the client's decision should be documented in the suitability report. Firms are reminded that this possibility only refers to the sustainability preferences and that with regard to the other criteria of the suitability assessment, the product has to meet the client profile and otherwise shall not be recommended as stated in Article 54(10) of the MiFID II Delegated Regulation.

83. Where a client adapts the sustainability preferences, this adaption should only refer to the investment advice in question and not to the client's profile in general. In case of investment advice, the adaptation should also be documented in the suitability report and be subject to the regular monitoring procedures. After the client has expressed the intention to adapt its preferences, and not before, the firm could disclose to the client information about its offering of products with sustainability features.

84. In case of portfolio management, the client's sustainability preferences, including the minimum proportion that shall be invested in investments with sustainability features, need to be collected and assessed when agreeing on the mandate and the investment strategy. If the firm cannot meet those preferences, it should discuss this with the client when agreeing on the mandate in which the investment strategy is defined and ask the client if he/she would like to adapt his/her preferences. The decision of the client should be recorded in the mandate.

When providing investment advice with a portfolio approach, firms should assess the client's sustainability preferences including the minimum proportion when conducting the initial suitability assessment. Then the firm should monitor whether those preferences are still met or not at portfolio level and issue appropriate recommendations as the case may be.

In case of portfolio management or investment advice with a portfolio approach, if the client adapts the sustainability preferences after the initial suitability assessment, firms should evaluate the impact of this change and whether this triggers a rebalancing of the portfolio.

85. Where a client does not answer the question whether it has sustainability preferences or answers "no", the firm may consider this client as "sustainability-neutral" and recommend products both with and without sustainability-related features.

86. When making a decision on the methodology to be adopted to conduct the suitability assessment, the firm should also take into account the type and characteristics of the services provided and, more in general, its business model. For example, where a firm manages a portfolio or advises a client with regard to his portfolio, it should adopt a methodology that would allow it to conduct a suitability assessment based on the consideration of the client's portfolio as a whole.

87. When conducting a suitability assessment, a firm providing the service of portfolio management should, on the one hand, assess - in accordance with the second bullet

point of paragraph 38 of these guidelines - the knowledge and experience of the client regarding each type of financial instrument that could be included in his portfolio, and the types of risks involved in the management of his portfolio. Depending on the level of complexity of the financial instruments involved, the firm should assess the client's knowledge and experience more specifically than solely on the basis of the type to which the instrument belongs (e.g. subordinated debt instead of bonds in general). On the other hand, with regard to the client's financial situation and investment objectives, the suitability assessment about the impact of the instrument(s) and transaction(s) can be done at the level of the client's portfolio as a whole. In practice, if the portfolio management agreement defines in sufficient details the investment strategy that is suitable for the client with regard to the suitability criteria defined by MiFID II and that will be followed by the firm, the assessment of the suitability of the investment decisions could be done against the investment strategy as defined in the portfolio management agreement and the portfolio of the client as a whole should reflect this agreed investment strategy.

When a firm conducts a suitability assessment based on the consideration of the client's portfolio as a whole within the service of investment advice, this means that, on the one hand, the level of knowledge and experience of the client should be assessed regarding each investment product and risks involved in the related transaction. On the other hand, with regard to the client's financial situation and investment objectives, the suitability assessment about the impact of the product and transaction can be done at the level of the client's portfolio.

88. When a firm conducts a suitability assessment based on the consideration of the client's portfolio as a whole it could assess suitability as regards the sustainability preferences, for example, by applying those preferences (including the minimum proportion that shall be invested in investments with sustainability features[55]) on average at the level of the portfolio as a whole or at the level of the part/percentage of the portfolio the client wants to be invested in products with sustainability features[56].

89. When a firm conducts a suitability assessment based on the consideration of the client's portfolio as a whole, it should ensure an appropriate degree of diversification within the client's portfolio, taking into account the client's portfolio exposure to the different financial risks (geographical exposure, currency exposure, asset class exposure, etc.). In cases where, for example, from the firm's perspective, the size of a client's portfolio is too small to allow for an effective diversification in terms of credit risk, the firm could consider directing those clients towards types of investments that are 'secured' or per se diversified (such as, for example, a diversified investment fund).

Firms should be especially prudent regarding credit risk: exposure of the client's portfolio to one single issuer or to issuers part of the same group should be particularly considered. This is because, if a client's portfolio is concentrated in products issued by

[55] See paragraph 26 of the guidelines.
[56] See paragraph 29 of the guidelines.

one single entity (or entities of the same group), in case of default of that entity, the client may lose up to his entire investment. When operating through so called self-placement models, firms are reminded of ESMA's 2016 Statement on BRRD[57] according to which "*they should avoid an excessive concentration of investments in financial instruments subject to the resolution regime issued by the firm itself or by entities of the same group*". Therefore, in addition to the methodologies to be implemented for the assessment of products credit risk (see guideline 7), firms should also adopt *ad hoc* measures and procedures to ensure that concentration with regard to credit risk is effectively identified, controlled and mitigated (for example, the identification of *ex ante* thresholds could be encompassed)[58].

90. In order to ensure the consistency of the suitability assessment conducted through automated tools (even if the interaction with clients does not occur through automated systems), firms should regularly monitor and test the algorithms that underpin the suitability of the transactions recommended or undertaken on behalf of clients. When defining such algorithms, firms should take into account the nature and characteristics of the products included in their offer to clients. In particular, firms should at least:

- establish an appropriate system-design documentation that clearly sets out the purpose, scope and design of the algorithms. Decision trees or decision rules should form part of this documentation, where relevant;

- have a documented test strategy that explains the scope of testing of algorithms. This should include test plans, test cases, test results, defect resolution (if relevant), and final test results;

- have in place appropriate policies and procedures for managing any changes to an algorithm, including monitoring and keeping records of any such changes. This includes having security arrangements in place to monitor and prevent unauthorised access to the algorithm;

- review and update algorithms to ensure that they reflect any relevant changes (e.g. market changes and changes in the applicable law) that may affect their effectiveness;

- have in place policies and procedures enabling to detect any error within the algorithm and deal with it appropriately, including, for example, suspending the provision of advice if that error is likely to result in an unsuitable advice and/or a breach of relevant law/regulation;

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[57] See 'MiFID practices for firms selling financial instruments subject to the BRRD resolution regime' (ESMA/2016/902).
[58] To this end, in line with the mentioned ESMA's Statement, firms should also take into account the specific features of the securities offered (including their risk features and the circumstances of the issuer) as well as clients' financial situation, including their ability to bear losses, and their investment objectives, including their risk profile.

* have in place adequate resources, including human and technological resources, to monitor and supervise the performance of algorithms through an adequate and timely review of the advice provided; and

* have in place an appropriate internal sign-off process to ensure that the steps above have been followed.

Costs and complexity of equivalent products

Relevant legislation: Article 25(2) of MiFID II and Article 54(9) of the MiFID II Delegated Regulation.

General guideline 9

91. Suitability policies and procedures should ensure that, before a firm makes a decision on the investment product(s) that will be recommended, or invested in the portfolio managed on behalf of the client, a thorough assessment of the possible investment alternatives is undertaken, taking into account products' cost and complexity.

Supporting guidelines

92. Firms should have a process in place, taking into account the nature of the service, the business model and the kind of products that are provided, to assess products available that are 'equivalent' to each other in terms of ability to meet the client's needs and circumstances, such as financial instruments with similar target markets and similar risk-return profile.

93. When considering the cost factor, firms should take into account all costs and charges covered by the relevant provisions under Article 24(4) of MiFID II and the related MiFID II Delegated Regulation provisions. As for the complexity, firms should refer to the criteria identified in the above guideline 7. For firms with a restricted range of products, or those recommending one type of product, where the assessment of 'equivalent' products could be limited, it is important that clients are made fully aware of such circumstances. In this context, it is particularly important that clients are provided appropriate information on how restricted the range of products offered is, pursuant to Article 24(4)(a)(ii) of MiFID II[59].

94. Where a firm uses common portfolio strategies or model investment propositions that apply to different clients with the same investment profile (as determined by the firm), the assessment of cost and complexity for 'equivalent' products could be done on a higher level, centrally, (for example within an investment committee or any other committee defining common portfolio strategies or model investment propositions) although a firm

[59] In accordance with MiFID II, firms are therefore not expected to consider the whole universe of possible investment options existing in the market in order to comply with the requirement under Article 54(9) of MiFID II Delegated Regulation.

will still need to ensure that the selected investment products are suitable and meet their clients' profile on a client-by-client basis.

95. Firms should be able to justify those situations where a more costly or complex product is chosen or recommended over an equivalent product, taking into account that for the selection process of products in the context of investment advice or portfolio management further criteria can also be considered (for example: the portfolio's diversification, liquidity, or risk level). Firms should document and keep records about these decisions, as these decisions should deserve specific attention from control functions within the firm. The respective documentation should be subject to internal reviews. When providing investment advice firms could, for specific well-defined reasons, also decide to inform the client about the decision to choose the more costly and complex financial instrument.

Costs and benefits of switching investments

Relevant legislation: Articles 16(2) and 25(2) of MiFID II and Article 54(11) and (12) of the MiFID II Delegated Regulation.

General guideline 10

96. Firms should have adequate policies and procedures in place to ensure that an analysis of the costs and benefits of a switch is undertaken such that firms are reasonably able to demonstrate that the expected benefits of switching are greater than the costs. Firms should also establish appropriate controls to avoid any circumvention of the relevant MiFID II requirements.

Supporting guidelines

97. For the purpose of this guideline, investment decisions such as rebalancing a portfolio under management, in the case of a "passive strategy" to replicate an index (as agreed with the client) would normally not be considered as a switch. For the avoidance of doubt, any transaction without maintaining these thresholds would be considered as a switch. For per se professional clients, the cost benefit analysis may be carried out on investment strategy level.

98. Firms should take all necessary information into account, so as to be able to conduct a cost-benefit analysis of the switch, i.e. an assessment of the advantages and disadvantages of the new investment(s) considered. When considering the cost dimension, firms should take into account all costs and charges covered by the relevant provisions under Article 24(4) of MiFID II and the related MiFID II Delegated Regulation provisions. In this context, both monetary and non-monetary factors of costs and benefits could be relevant. These may include, for example:

- the expected net return of the proposed alternative transaction (which also considers any possible up-front cost to be paid by the client(s)) vs the expected net return of the existing investment (that should also consider any exit cost which the client(s) might incur to divest from the product already in his/their portfolio);

- a change in the client's circumstances and needs, which may be the reason for considering the switch, e.g. the need for liquidity in the short term as a consequence of an unexpected and unplanned family event;

- a change in the products' features and/or market circumstances, which may be a reason for considering a switch in the client(s) portfolio(s), e.g. if a product becomes illiquid due to market trends;

- benefits to the client's portfolio stemming from the switch, such as (i) an increase in the portfolio diversification (by geographical area, type of instrument, type of issuer, etc.); (ii) an increased alignment of the portfolio's risk profile with the client's risk objectives; (iii) an increase in the portfolio's liquidity; or (iv) a decrease of the overall credit risk of the portfolio;

99. When providing investment advice, a clear explanation of whether or not the benefits of the recommended switch are greater than its costs should be included in the suitability report the firm has to provide to the retail client before the transaction is made.

100. Firms should also adopt systems and controls to monitor the risk of circumventing the obligation to assess costs and benefits of recommended switch, for example in situations where an advice to sell a product is followed by an advice to buy another product at a later stage (e.g. days later), but the two transactions were in fact strictly related from the beginning.

101. Where a firm uses common portfolio strategies or model investment propositions that apply to different clients with the same investment profile (as determined by the firm), the costs/benefits analysis of a switch could be done on a higher level than at the level of each individual client or each individual transaction. More especially, when a switch is decided centrally, for example within an investment committee or any other committee defining common portfolio strategies or model investment propositions, the costs/benefits analysis could be done at the level of that committee. If such a switch is decided centrally, the costs/benefits analysis done at that level would usually be applicable to all comparable client portfolios without making an assessment for each individual client. In such a situation also, the firm could determine, at the level of the relevant committee, the reason why a switch decided will not be performed for certain clients. Although the costs/benefits analysis could be done at a higher level in such situations, the firm should nevertheless have appropriate controls in place to check that there are no particular characteristics of certain clients that might require a more discrete level of analysis.

102. Where a portfolio manager has agreed a more bespoke mandate and investment strategy with a client due to the client's specific investment needs, a cost-benefit analysis of the switch at client-level should be more appropriate, in contrast to the above.[60]

103. Notwithstanding the above, if a portfolio manager considers that the composition or parameters of a portfolio should be changed in a way that is not permitted by the mandate agreed with the client (e.g. from an equities-focused to a fixed income-focused strategy), the portfolio manager should discuss this with the client and review or conduct a new suitability assessment to agree a new mandate.

V.III OTHER RELATED REQUIREMENTS

Qualifications of firm staff

Relevant legislation: Articles 16(2), 25(1) and 25(9) of MiFID II and Article 21(1)(d) of MiFID II Delegated Regulation.

General guideline 11

104. Firms are required to ensure that staff involved in material aspects of the suitability process have an adequate level of skills, knowledge and expertise.

Supporting guidelines

105. Staff must understand the role they play in the suitability assessment process and possess the skills, knowledge and expertise necessary, including sufficient knowledge of the relevant regulatory requirements and procedures, to discharge their responsibilities.

106. Staff must possess the necessary knowledge and competence required under Article 25(1) of MiFID II (and specified further in ESMA Guidelines for the assessment of knowledge and competence[61]), including with regard to the suitability assessment. Staff should also have the necessary knowledge and competence with regard to the criteria of the sustainability preferences as specified in Article 2(7) of the MiFID II Delegated Regulation and be able to explain to clients the different aspects in non-technical terms. To that effect, firms should give staff appropriate training.

107. Other staff that does not directly face clients but is involved in the suitability assessment in any other way must still possess the necessary skills, knowledge and expertise required depending on their particular role in the suitability process[62]. This may regard, for example, setting up the questionnaires, defining algorithms governing the

[60] For relationships with professional clients see paragraph 89.
[61] Ref: ESMA71-1154262120-153 EN (rev).
[62] ESMA notes that some Member States require certification of staff providing investment advice and/or portfolio management, or equivalent systems, to ensure a proper level of knowledge and expertise of staff involved in material aspects of the suitability process.

assessment of suitability or other aspects necessary to conduct the suitability assessment and controlling compliance with the suitability requirements.

108. Where relevant, when employing automated tools (including hybrid tools), investment firms should ensure that their staff involved in the activities related to the definition of these tools:

(a) have an appropriate understanding of the technology and algorithms used to provide digital advice (particularly they are able to understand the rationale, risks and rules behind the algorithms underpinning the digital advice); and

(b) are able to understand and review the digital/automated advice generated by the algorithms.

Record-keeping

Relevant legislation: Articles 16(6), 25(5) and 25(6) of MiFID II, and Articles 72, 73, 74 and 75 of the MiFID II Delegated Regulation.

General guideline 12

109. Firms should at least:

(a) maintain adequate recording and retention arrangements to ensure orderly and transparent record-keeping regarding the suitability assessment, including the collection of information from the client, any investment advice provided and all investments (and disinvestments) made following the suitability assessment made, and the related suitability reports provided to the client;

(b) ensure that record-keeping arrangements are designed to enable the detection of failures regarding the suitability assessment (such as mis-selling);

(c) ensure that records kept, including the suitability reports provided to clients, are accessible for the relevant persons in the firm, and for competent authorities;

(d) have adequate processes to mitigate any shortcomings or limitations of the record-keeping arrangements.

Supporting guidelines

110. Record-keeping arrangements adopted by firms must be designed to enable firms to track ex-post why an (dis)investment was made and why an investment advice was given even when the advice didn't result in an actual (dis)investment. This could be important in the event of a dispute between a client and the firm. It is also important for control purposes - for example, any failures in record-keeping may hamper a competent authority's assessment of the quality of a firm's suitability process, and may weaken the ability of management to identify risks of mis-selling.

111. Therefore, a firm is required to record all relevant information about the suitability assessment, such as information about the client (including how that information is used and interpreted to define the client's risk profile), and information about financial instruments recommended to the client or purchased on the client's behalf, as well as the suitability report provided to clients. Those records should include:

- any changes made by the firm regarding the suitability assessment, in particular any change to the client's investment risk profile;
- the types of financial instruments that fit that profile and the rationale for such an assessment, as well as any changes and the reasons for them;
- the situations where a client's sustainability preferences are adapted in accordance with Article 54(10) of the MiFID II Delegated Regulation, including a clear explanation of the reasons for such adaptation.

112. Firms should understand the additional risks that could affect the provision of investment services through online/digital tools such as malicious cyber activity and should have in place arrangements able to mitigate those risks.[63]

[63] Firms should consider such risks not only in relation to the provisions stated in the guideline, but also as part of a firm's wider obligations under Article 16(4) of MiFID II to take reasonable steps to ensure continuity and regularity in the performance of investment service and activities, and corresponding delegated act requirements linked to this.

3.5 Annex V - List of good and poor practices observed from the supervision of the MiFID II requirements on suitability

Areas of suitability	*Good practices*
Client profiling	The implementation of automated controls to identify inconsistencies in clients' answers. The effect is that the client directly (if the questionnaire is completed online), or the firm's staff (in case of face-to face interaction) is alerted that some clarification from the client is necessary before s/he can continue to fill in the questionnaire. Advisors seek clarification where the interaction occurs face-to-face.
	Identifying ad hoc event-driven indicators that may suggest the opportunity of updating client information for suitability assessment (e.g., retirement, access to financing, etc.). At the occurrence of any such event, the clients would be contacted for a meeting to verify whether a review of the profile might be necessary, keeping a record of such interaction.
	Use of complementary questions aimed to more effectively assess the ability of clients to understand products (especially the more complex ones) and their related risk profile to avoid relying on self-assessment. For example, questions dedicated to one or more of the following aspects: relationship between risk and return; mechanisms/actions that may reduce the risk of investments; impact of risk diversification on investments; returns related to investments in foreign currencies and related risks; liquidity risk; key features of structured products; financial leverage and its effect on investments; key features and related risks of derivative instruments and instruments with embedded derivatives.
Costs and benefits of switching investments	When identifying the perimeter of switches subject to cost/benefit analysis, adopting mechanisms to limit the risk of keeping separate the two parts of a switch transaction (i.e. the sale and subsequent connected purchase) as a means to circumvent the rule. For example, limiting the possibility of "splitting up" purchase and sale recommendations in different days.

Areas of suitability	*Good practices*
	On the cost/benefit analysis of the switch, the provision of a simple and clear overview of the portfolio before and after the recommended transaction, which includes the expected (excess) return and costs related to the switch. By doing so, a client will understand what the effect of the switch would be on the expected return of his portfolio.
Indicators/monitoring/control functions	Identifying, within the firm's systems for periodic assessment of suitability, triggering factors that may alert the firm to the need of event-driven updates of the portfolio. For example, relevant market factors (delisting of a stock).
	Frequent and thorough reviews of all aspects of firms' suitability practices (organisational, IT, etc) by control functions (compliance) with formalisation, as output, of clearly defined actions to address any issues identified and improve the firm's suitability arrangements.
	Continuous monitoring by control functions (compliance) of advisors' performance to assess advisory activity and behaviours by taking into account client outcomes in the form of qualitative elements (e.g. complaints, satisfaction surveys) and quantitative metrics (e.g. return on investments, level or risk, cost and complexity of products, compatibility of investments with client profile).
	Adopting adequate diversification measures also where the client's portfolio is mostly or entirely invested in funds (especially in non-UCITS funds).

Areas of suitability	*Poor practices*
Client profiling	Asking a limited range of knowledge and experience questions that do not cover the key features of the different categories of financial instruments that may be offered to the client.
	Not properly investigating the clients' understanding of bail-in mechanism and its potential impact on the investments, e.g. where questionnaire presented to clients do not include questions specifically focused on the potential impacts for

Areas of suitability	*Poor practices*
	investments in a bank bond where the bail-in tool is activated.
	Defining a client's risk tolerance solely based on the composition of such client's existing portfolio.
	Not reviewing a client's suitability information for an excessively long period, in case of ongoing relationship with the client.
	Performing an assessment of the suitability without taking into account all information collected from clients for the purposes of suitability assessment.
Product mapping	Allocating products in overly general categories such as, for instance, complex and non-complex products only, or simply in broad asset classes (e.g. bonds, funds…) also for their assessment in terms of risk.
Matching	Over-reliance on one aspect of the suitability criteria, to the extent that it is unclear how the other suitability information is considered (e.g. where a client fits into a certain risk profile category based on its investment objectives and risk tolerance, however it is not clear how the ability to bear losses is considered).
	Excluding the application of suitability controls below certain predefined thresholds (e.g. excluding monitoring of compliance with concentration risk limits for portfolios under certain amounts).
	Suitability policies and processes which permit exceptions or 'overrides' by sales staff ex-post, without adequate controls measures (e.g. by control functions), including on the documentation stating the reasons for the override.
Cost/complexity of equivalent products	On the cost-complexity of products, comparing only products issued by one single-entity (or by entities of the same group).
	On the cost-complexity of products, grouping of "equivalent products" into an excessively large number of clusters with only a few products each with the effect of making the

Areas of suitability	*Poor practices*
	comparison of products of little effect and therefore circumventing the objective of the assessment required by Article 54(9) of the MiFID II Delegated Regulation.
Costs and benefits of switching investments	Limiting the assessment of cost/benefit analysis over switches only to sale and related purchase provided within the same recommendations, without implementing controls based on possible indicators that may demonstrate that a sale and purchase are linked (e.g. the two transactions are undertaken in a short time span, or the size of the sale and purchase are the same).
	Excluding the application of the control over switches below certain predefined specific thresholds. For example, where the increase of costs as a result of a switch is below a certain threshold predefined by the firm, independently from the related benefits.