16 June 2023
ESMA35-43-3599

Call for evidence

On the integration of sustainability preferences in the suitability assessment and product governance arrangements

Responding to this paper

ESMA invites comments on all matters in this paper and in particular on the specific questions summarised in Annex 1. Comments are most helpful if they:

1. respond to the question stated;

2. indicate the specific question to which the comment relates;

3. contain a clear rationale; and

4. describe any alternatives ESMA should consider.

ESMA will consider all comments received by **15 September 2023.**

All contributions should be submitted online at www.esma.europa.eu under the heading 'Your input - Consultations'.

Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESMA's rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESMA's Board of Appeal and the European Ombudsman.

Data protection

Information on data protection can be found at www.esma.europa.eu under the heading 'Data protection'.

Who should read this paper?

This paper is primarily of interest to competent authorities, firms that are subject to Directive 2014/65/EU on Markets in Financial Instruments (MiFID II) and their clients. Due to its focus on investor protection issues, this paper is therefore addressed to investors and consumer organisations; to investment firms and credit institutions providing investment advice or discretionary portfolio management services; to UCITS management companies and external Alternative Investment Fund Managers (AIFMs) when providing the investment services of investment advice or individual portfolio management; and to any relevant trade association.

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1 Executive Summary

Reasons for publication

As part of a broader Commission initiative on sustainable development, the MiFID II framework has been updated to integrate sustainability-related requirements for investment firms. ESMA has subsequently updated its Guidelines on suitability and product governance requirements. In light of the importance of a continuous engagement with industry, ESMA is launching a Call for evidence on the evolution of the market and on how firms are applying the new legal requirements.

Contents

Section 2 provides background information concerning the ESMA Call for evidence. Section 3 sets out the various topics included in the ESMA Call for evidence and respective questions.

Annex I lists all the questions set out in the ESMA Call for evidence.

Next Steps

ESMA, together with the national competent authorities, will assess the replies to this Call for evidence and will continue monitoring the application by firms of the MiFID II requirements on the topics of suitability and product governance and the related ESMA guidelines to ensure supervisory convergence on this important topic.

2 Background

1. The assessment of suitability is one of the most important obligations 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.

2. As part of a broader Commission initiative on sustainable development, the MiFID II Delegated Regulation has been updated[1] to integrate sustainability factors, risk and preferences into certain organisational requirements and operating conditions for investment firms. The amendments entered into application on 2 August 2022.

3. The introduction of amendments to the MiFID II Delegated Regulation triggered the review and update of the 2018 ESMA guidelines on suitability. On 27 January 2022, ESMA published a Consultation Paper (CP)[2] on the draft guidelines on certain aspects of the MiFID II suitability requirements in order to explain the rationale of the proposed changes and gather input from stakeholders. ESMA received 90 responses, including the advice of the Securities and Markets Stakeholder Group (SMSG).

4. The Final Report[3] on the guidelines on certain aspects of the MiFID II suitability requirements (henceforth referred to as "suitability guidelines") was published on 23 September 2022. It included an analysis of the responses to the CP and explained how the responses, together with the SMSG advice, were taken into account. The ESMA guidelines will apply as from 3 October 2023[4].

5. As mentioned in the Final Report[5], the SMSG highlighted that ESMA should organise an early Call for Evidence (CfE) on how sustainability preferences are assessed and on possible alternative approaches following the publication of the guidelines.

[1] Commission Delegated Regulation (EU) 2021/1253
[2] ESMA35-43-2998.
[3] ESMA35-43-3172.
[4] The date corresponds to six months from the date of publication of the suitability guidelines on ESMA's website in all EU official languages https://www.esma.europa.eu/document/guidelines-certain-aspects-mifid-ii-suitability-requirements-1
[5] See Annex 3 paragraph 1 of the Final Report.

6. ESMA agrees with the SMSG on the importance of a continuous engagement with industry on this important topic and has decided to launch a CfE to gather evidence on the evolution of the market and on how firms are applying the legal requirements.

7. This CfE represents a good opportunity for further interactions with stakeholders also in relation to the new MiFID II sustainability-related requirements on product governance. The MiFID II Delegated Directive was amended[6] to integrate sustainability factors in product governance obligations, amendments which entered into application on 22 November 2022. These amendments were also one of the triggering factors for the review of the ESMA 2017 guidelines on product governance, which was completed on 27 March 2023 with the publication of the Final Report on the topic[7].

8. It is important to note that this CfE is not intended as a new consultation on the content of the suitability guidelines or of the guidelines on product governance. ESMA, together with the national competent authorities, plans to monitor the application of the guidelines on suitability and on product governance by firms and will consider complementing them with Q&As and/or will make any necessary changes during the next review of the guidelines. The CfE is not aimed at proposing any specific changes to the guidelines but is instead aimed at helping ESMA to i) gain a better understanding of how the MiFID II requirements are being implemented and applied by firms across the Union and the challenges firms are facing in their application; (ii) gain a better understanding of investor experiences and reactions to the incorporating of sustainability factors within the services of investment advice and portfolio management; (iii) collect information, views and data on main trends on aspects related to the provision of sustainable investment products and services to (retail) clients.

9. This CfE is intended to complement and not to overlap with other ESMA initiatives and consultations on sustainable finance, such as the ESAs Call for evidence on greenwashing launched in November 2022[8], which sought input on potential greenwashing practices in the whole EU financial sector, including banking, insurance and financial markets. The consultation closed in January 2023. A progress report was published on 1 June 2023.

[6] Commission Delegated Directive (EU) 2021/1269
[7] ESMA35-43-3448 Final report on MiFID II guidelines on product governance (europa.eu)
[8] https://www.esma.europa.eu/sites/default/files/library/esas_call_for_evidence_on_greenwashing.pdf

3 Call for evidence

3.1 Sustainable finance and financial education

10. A definition of "sustainability preferences" is included in Article 2(7) of the MiFID II Delegated Regulation. The new definition, which cross refers to the Taxonomy Regulation[9] and SFDR[10], is meant to ensure that (potential) clients are recommended a broad spectrum of financial instruments with sustainability-related features that meet their sustainability preferences.

11. In the suitability guidelines, ESMA has clarified that "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".

12. During the public consultation ESMA conducted on the suitability guidelines, respondents - including the consumer associations - highlighted that investment products may by nature be complex and that for the success of EU initiatives in the area of sustainable finance 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 that the public sector and national competent authorities (NCAs) also have an important role to play to contribute to investor education.

13. ESMA agrees on the importance of financial education, in particular on sustainable finance, and notes that ESMA, EBA and EIOPA (the ESAs) are carrying out work to fulfil their mandate on financial education through the Joint Committee and that in 2023[11], the work will also seek to incorporate environmental, social and governance (ESG) dimensions in the promotion of financial education by the ESAs and NCAs. Furthermore, as stated in its Sustainable Finance Roadmap 2022-2024, ESMA supports efforts to develop EU-wide labels, including the EU Green Bond Standard, and in the future ESG labels for financial instruments.

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[9] Regulation (EU) 2020/852 of the European Parliament and of the Council
[10] Regulation (EU) 2019/2088 of the European Parliament and of the Council
[11] See 2023 Work Programme of the Joint Committee of the European Supervisory Authorities [Ref: JC 2022 28] – Link: https://www.esma.europa.eu/sites/default/files/library/joint_committee_work_programme_2023.pdf

14. In April 2022, the European Commission invited the ESAs to jointly submit draft regulatory standards amending the provisions laid down in the SFDR Delegated Regulation[12] [13]. As part of their work on the final report, under consultation[14], the ESAs suggest simplifying the language in the pre-contractual and periodic product disclosures and enhance the comprehensibility for retail investors. In particular, the ESAs are consulting on the inclusion of a 'dashboard' containing the key information to complement the more detailed information of the pre-contractual and periodic disclosure. The objective of the dashboard is to attract the reader's attention to the most vital information and alleviate issues of information overload. The simplification of the templates through the dashboard is complemented by the use of plainer language. The ESAs are asking stakeholders for further suggestions to simplify and enhance the legibility of the current SFDR templates.

15. ESMA wants to take the opportunity of this CfE to gather input and views on consumer needs, industry initiatives and challenges in this area.

Q1: What actions did firms implement within their organisation to take into account the new requirements related to sustainability preferences? Please elaborate especially on the following:

- **What proportion of firms' employees (differentiating between client facing staff and the other staff) have received training on sustainability topics? What did these trainings consisted of? Was any test or exam put in place?**

- **Which conflicts of interest relating to the integration of clients' sustainability preferences did firms identify and which measures did firms take to ensure that these conflicts of interest do not damage the interest of clients?**

Q2: Are there specific aspects of sustainable finance that retail investors struggle to understand? For example:

- **Understanding of general aspects such as why it is important to consider sustainability risks and factors when investing?**

- **Understanding differences between sustainable products and products without sustainability features?**

[12] mandate_to_esas_on_pai_product.pdf (europa.eu)
[13] Commission Delegated Regulation (EU) 2022/1288
[14] https://www.esma.europa.eu/press-news/consultations/joint-consultation-review-sfdr-delegated-regulation

- **Understanding that sustainability characteristics and (expected) return are two separate issues?**

- **Understanding the new legal definition of "sustainability preferences" and its components (e.g., categories a), b) and c), minimum proportion, principal adverse impact indicators (PAIs), etc)?**

Q3: Are there specific financial education initiatives on sustainable finance developed by consumer associations, trade associations or other organisations and that are used by investment firms that you can bring to ESMA's attention? Please accompany your reply with any relevant background information on the initiative and/or with details on its effectiveness/usefulness.

Q4: What is the main way firms currently provide information to retail clients about sustainable finance? For example:

- **Orally during the meetings with clients**

- **Through educational brochures or other (paper) documents**

- **Through dedicated website and apps**

- **A combination of the above**

- **Other**

In your opinion, are these approaches effective? Please provide details. Are retail clients satisfied with the quality of information provided?

3.2 Sustainability preferences

16. According to Article 54 of the MiFID II Delegated Regulation, firms are required to collect clients' sustainability preferences and to consider them as part of the clients' suitability assessment.

17. During the public consultation on the ESMA suitability guidelines, many respondents highlighted the need not to impose on firms excessive rigidities in terms of procedures and operational approaches to be followed for the approach of collection of client information on sustainability preferences. In the Final Report, ESMA highlighted that the guidelines intentionally introduce degrees of flexibility by setting out many parts of these guidelines as practical examples showing how the requirements can be implemented (using the wording "Firms could…").

Firm questionnaires

18. When updating the suitability guidelines ESMA carefully considered the topic of 'Know your client'[15] and specifically how to take into account the clients' sustainability preferences. This resulted in an updated guideline 2 that took into account the many comments received during the public consultation.

19. For example, ESMA, having taken into consideration comments provided by respondents, confirms the possibility for firms to obtain information on the client's preferences by using standardised minimum proportions, such as "minimum 20%, minimum 25%, minimum 30%, etc.", taking into account that such standardised minimum proportion should be "neutral and unbiased" as should be the whole process. In this respect, many stakeholders raised concerns regarding a potential mismatch between investor expectations and the actual availability of financial instruments with sustainability features and "'high' minimum proportions". ESMA is interested to understand if this issue has materialised since the entry into application of the rules.

20. Furthermore, some market participants have asked ESMA to elaborate a non-binding template for a suitability questionnaire (including on sustainability aspects). ESMA believes that a one-size-fits all approach on the suitability questionnaire is a sub-optimal solution as it would not be able to consider the differences in firms' business models, product offerings, type of clients served, etc.

[15] As developed in Part I.II "Know your client and know your product" of Suitability Guidelines.

21. ESMA is interested in better understanding the approaches implemented by firms, in order to disseminate good practices and provide guidance to firms where issues emerge.

Q5: What are clients' experiences/reactions to the new questionnaires including questions on "sustainability preferences"? (e.g. do they require guidance to be able to answer to the questions? Do they show interest in the topic?)

Q6: Are there practical examples of questions used to collect information from clients on their sustainability preferences that you can share with ESMA? (as for other parts of this CfE, respondents can opt for their input to ESMA not to be made public)

Q7: Which of the sustainable investment definitions do clients most often opt for? (EU Taxonomy alignment? Sustainable investment within the meaning of SFDR? Consideration of PAI? All of them?) Please provide any statistics, where available.

Q8: How are firms collecting information from clients on their preferences concerning the minimum proportion? With regards to the use of standardised minimum proportions, which standardised minimum proportions are presented to clients?

Q9: What is approximately the average minimum proportion of sustainable investments requested by clients? Please provide details, where available.

Q10: Are firms currently able to satisfy the sustainability preferences expressed by clients (in particular in relation to the three categories (Taxonomy, SFDR, PAI))? If so, for which categories and/or types of financial instruments do firms find it most difficult to satisfy clients' preferences?

Adaptation of client sustainability preferences

22. In the suitability guidelines, ESMA clarified that "where a firm intends to recommend a product that does not meet the initial sustainability preferences of the client […] 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."

Q11: How often has the adaptation of clients' sustainability preferences been necessary during these first months of application of the rules (e.g. in terms of percentage considering new clients and existing clients whose profiles have already been updated to include information on sustainability preferences)?

Q12: What kind of operational arrangements have firms put in place to allow clients to adapt their sustainability preferences?

Q13: How were clients informed about the possibility to adapt their preferences?

Q14: Have firms imposed limits on how frequently a client can adapt its sustainability preferences during the investment advice?

Q15: If available: what percentage of those who adapted decided to (1) lower the level of ambition within an option (i.e. reducing the "minimum proportion" or lowering the threshold of sustainable investments in a portfolio), (2) change between the three options (i.e. categories a, b and c) (3) opt for a combination/ for a different combination between the three options (i.e. categories a, b and c) (4) express no sustainability preferences anymore.

Q16: How often did clients refrain from adapting their sustainability preferences, accepting that the firm could not recommend any financial instruments or invest on their behalf?

Updating of client profiles

23. In the suitability guidelines ESMA clarified that firms were required by the MiFID II Delegated Regulation to have the new clients' questionnaires ready at the date of application of the new requirements on 2 August 2022. This would allow any new client or any existing client that wishes to update his or her profile to do it from that date.

24. That said, ESMA also clarified that, in line with Recital 4 of the Delegated Regulation (EU) 2021/1253, firms could also decide to collect the existing clients' individual sustainability preferences at the "next regular update" of the client profile review.

25. ESMA is interested in understanding how this part of the requirements has been implemented by firms and if there are any specific good practices that ESMA should be aware about or, on the contrary, if there are any specific issues that firms and/or investors are facing during the process of collection of client information on sustainability preferences.

Q17: In relation to the update of clients' profiles:

- **Which percentage/average proportion of clients have updated their (MiFID) profiles following the entry into application of the new regime on 2 August 2022?**

- **On average, taking into account the number of clients whose profile has already been updated, what is the proportion of clients who express sustainability preferences in your firm/jurisdiction?**

- **On average, taking into account the number of clients who express sustainability preferences, what is the proportion of clients that have expressed a specific preference for one or more of the three categories (Taxonomy, SFDR, PAI) in your firm/jurisdiction? (How many clients are only expressing whether or not they have sustainability preferences i.e. yes, no?).**

3.3 Assessment of suitability

Portfolio approach

26. ESMA has clarified in guideline 8 of the ESMA guidelines on the MiFID II suitability requirements that, when considering a client's "sustainability preferences", the suitability assessment could be done following different approaches. More specifically, paragraph 88 of the suitability guidelines notes 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*".

27. In practice, this implies that the assessment of suitability as regards the sustainability preferences can be performed at four different levels:

    - at the level of every single financial instrument recommended to/invested on behalf of the client;
    - at the level of every single financial instrument of the part of the portfolio the client wants to be invested in financial instruments with sustainability features; or
    - at the level of the client portfolio as a whole; or
    - at the level of the part of the portfolio the client wants to be invested in financial instruments with sustainability features.

28. For sustainability preferences that are expressed as minimum proportions in accordance with Article 2(7)(a) and (b) of the MiFID II Delegated Regulation, it follows that these minimum proportions could be assessed at the level of every single financial

instrument recommended to the client or invested on behalf of the client; on average at the level of the client portfolio as a whole; or at the level of the part of the portfolio the client wants to have invested in financial instruments with sustainability features; or at the level of every single financial instrument of the part of the portfolio the client wants to be invested in financial instruments with sustainability features.

29. Below are some (simplified) practical examples that set out some of the possible approaches ESMA believes could be used in case of a portfolio approach as described in the guidelines. It is important to note that the list of examples is not intended to be exhaustive or prescriptive but – at this stage – is set out for discussion purposes.

Example 1

Amount to invest: 3000 €
Client sustainability preferences: 1/2 of portfolio invested in products with the following criteria:

- Preference of SFDR instruments Art 2(7)(b)
- "Minimum proportion": 40%

Investment recommendation

- Financial instrument X: 500 € - SFDR Art. 8 fund with a 40% proportion invested in sustainable investments (as defined in Article 2(17) of SFDR)
- Financial instrument Y: 1000 € - SFDR Art. 9 fund with a 95% proportion invested in sustainable investments (as defined in Article 2(17) of SFDR)
- Financial instrument Z: 1500 € - a (diversified) investment grade bond fund without ESG characteristics

	Product X	Product Y	Product Z	Total
Amount invested	500	1000	1500	3000
Minimum proportion (%) for sustainable part of the portfolio	40%	95%	N/A	N/A
Part of the portfolio invested in products meeting sust pref.				50%

30. In Example 1 above:

- The firm in this example choses to assess the "minimum proportion" at the level of the single instruments rather than at the level of the portfolio.

- This assessment of the "minimum proportion" is made on the two funds that are included in the part of the portfolio the client has chosen to have invested in products meeting his/her sustainability preferences (both these funds individually meet the sustainability preferences expressed by the client).

Example 2

Amount to invest: 3000 €
Client sustainability preferences: 1/2 of portfolio invested in products with the following criteria:

- Preference of SFDR instruments Art 2(7)(b)
- "Minimum proportion": 40%

Investment recommendation

- Financial instrument X: 250 € - SFDR Art. 8 fund with a 15% proportion invested in sustainable investments (as defined in Article 2(17) of SFDR)
- Financial instrument Y: 1250 € - SFDR Art. 9 fund with a 95% proportion invested in sustainable investments (as defined in Article 2(17) of SFDR)
- Financial instrument Z: 1500 € - a (diversified) investment grade bond fund (without ESG characteristics)

	Product X	Product Y	Product Z	Total
Amount invested	250	1250	1500	3000
Minimum proportion (%) for sustainable part of the portfolio	15%	95%	N/A	41%
Minimum proportion (absolute value) for sustainable part of the portfolio	37.5	1187.5	N/A	1225
Part of the portfolio invested in products meeting sust pref.				50%

31. In Example 2 above the firm assesses the "minimum proportion" on average at the level of the part of the portfolio the client wants to have invested in financial instruments with sustainability features.

Q18: Do you have any comment on the above practical examples?

Q19: Have firms implemented an approach similar to the one described in examples 1 and 2? If yes, which of the two approaches have firms implemented? If firms have implemented a different approach, please provide further details.

Q20: What are the issues that firms encountered in the application of the requirements at portfolio level?

Consideration of Principal Adverse Impact (PAI) indicators

32. During the finalisation of the suitability guidelines, ESMA also considered the feedback received in relation to the requirement to collect information from clients concerning which Principle Adverse Impacts (PAIs) should be considered and the elements and indicators to be taken into account in this context.

33. As part of the Final Report on the guidelines, ESMA confirmed that, where a client expresses a sustainability preference for financial instruments that consider principal adverse impacts, it is possible to collect information on the consideration of PAIs on either quantitative or qualitative elements. ESMA has also added further guidance to state that "*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)*". ESMA also confirmed that, while considering it is a good practice, firms are not bound by the use of SFDR PAI indicators and that there is no minimum number of PAIs that have to be considered when collecting clients' sustainability preferences.

34. ESMA, acknowledging the existing challenges, such as reliability of ESG data, tried to present a workable and flexible solution in its guidelines and is interested in sharing further thoughts on this important topic and collecting input, views and comments from stakeholders.

35. In particular, ESMA notes that when sustainability preferences are expressed with regard to the consideration of PAIs on sustainability factors pursuant to Art.2(7)(c) of the MiFID II Delegated Regulation, the consideration of these PAIs can be demonstrated by qualitative or quantitative elements.

36. ESMA is interested in understanding how industry has implemented the assessment of suitability in these situations.

Q21: How are clients' sustainability preferences gathered on the consideration of PAIs? Do firms refer to the PAI indicators listed in Annex I of the SFDR Delegation Regulation exclusively, or may clients express their preferences based on other PAIs? If clients may express their preferences based on other PAIs: what are those PAIs and how were they identified?

Q22: May clients determine qualitative elements in order to demonstrate the consideration of PAIs?

- **If so, what are these qualitative elements and how were they identified, how is the information on qualitative elements gathered?**

- **If not, what are the challenges preventing you from offering such possibility to clients? How could these challenges be overcome?**

Q23: What are the issues that firms encountered in the consideration of PAIs from clients?

Assessment of client preferences when the client expresses preferences for multiple categories

37. ESMA has noted in the Final Report on the suitability guidelines that, should a client express preferences 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, firms can interpret these options as alternative, unless specifically expressed by the client.

38. In practice, by checking several boxes on a form reflecting the options set out in letters a), b) or c) of Article 2(7) of the MiFID II Delegated Regulation, a retail client may reasonably assume that all of them would be taken into account. Therefore, in such situation and in order to provide clients with fair, clear and not misleading information and ensure compliance with their obligation to only issue recommendations that are suitable, clients would have to be clearly informed that their preferences will be considered as alternative and not cumulative. Such information could, for instance, be provided directly within the questionnaire(s) used by the investment firm to obtain information on a client's sustainability preferences.

Q24: Does this correspond to practices adopted by firms? If firms have implemented a different approach, please provide further details.

Assessment of clients' preferences for groups of natural persons

39. ESMA provides details in its Guidelines on MiFID II suitability requirements (Guideline 6) regarding the requirement for firms to have in place a policy defining how they conduct the suitability assessment in situations where the client is a group of natural persons or a natural person represented by another natural person. ESMA notably states under §60 that "*This policy should specify […] the procedure and criteria that should be followed in order to comply with the MiFID II suitability requirements*". This general principle is also applicable to the assessment of sustainability preferences.

Q25: How do firms ensure the consistency of the investment advice or portfolio management service provided when conducting suitability assessment with respect to

the sustainability preferences expressed by a group of natural persons when no representative has been designated?

Understanding ESG products

40. In the Guidelines, ESMA has clarified, by way of example, that firms when considering the sustainability factors of products could "*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 consideration of principal adverse impacts and other environmental, social and governance sustainability features*".

41. In practice, other approaches can be implemented to assess products' ESG features in view of their subsequent matching with the client's sustainability preferences.

42. ESMA is interested in understanding how the industry is implementing the requirement of understanding products ESG features.

Q26: What approach and criteria have firms adopted for the mapping of products' ESG features in view of their matching with clients' sustainability preferences?

Q27: How do firms apply sustainability-related concepts of Taxonomy Regulation and SFDR to MiFID II financial instruments that are outside the scope of SFDR (e.g., shares, bonds, certificates, etc.)? How do firms apply the "minimum proportion" concept to such instruments? In particular, how is the "minimum proportion" calculated?

Q28: Are firms making use of ESG rating/scoring systems for products mapping in terms of sustainability? If yes, please provide details.

Q29: In case of a positive reply to Q28, how do these interrelate with information gathered from manufacturers (or other sources)?

3.4 Product governance and sustainability

43. In brief, based on the amendments to the MiFID II Delegated Directive, manufacturers and distributors are required to specify, as part of the target market assessment, any sustainability-related objectives the product is compatible with. Sustainability-related objectives must also be considered in the context of periodic product reviews.

44. ESMA is interested in understanding how the new requirements are being implemented in practice by manufacturers and distributors and what the main challenges are.

Q30: How are firms, in their capacity as manufacturers and/or distributors, defining the target market for products with sustainability-related objectives, in terms of granularity? Please specify the elements that are defined for this purpose. Do firms adopt one single approach for all products, irrespective of whether they are in scope of SFDR? In case approaches differ, please explain why and how.

Q31: What are the factors that firms, in their capacity as manufacturers and/or distributors, would consider for the periodic product reviews with respect to sustainability-related objectives?

Q32: How are firms, in their capacity as distributors, collecting relevant information from manufactures on sustainability-related objectives of the target market? Is the information received from manufacturers sufficient, or are firms considering other inputs? If so, please explain why and describe such additional inputs.

Q33: How are firms, in their capacity as manufacturers and/or distributors, treating products that do not consider sustainability factors in their product governance processes, specifically concerning the target market assessment related to the sustainability-related objectives (e.g. are sustainability-objectives considered in the negative target market assessment for such products? If so, please explain how).

3.5 Other

Retail investors' demand of financial instruments with sustainability features and availability of products

45. During the public consultation of the suitability guidelines, many 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.

46. ESMA research shows that over the past few years the availability on the market of ESG investment products has increased substantially. The share of UCITS funds promoting ESG characteristics that are disclosing under SFDR Article 8 has reached 48% of all UCITS fund assets in late 2022, with an additional 3% managed by funds with a sustainable investment objective disclosing under SFDR Article 9. Meanwhile, the total value of ESG bonds outstanding from EU issuers reached EUR 1.5 trillion (mainly green bonds).[16]

Q34: Have firms noticed increased demand by clients of financial instruments with sustainability features? Please provide any relevant available statistics on this topic (e.g. percentage of clients asking information about these products; trends over time). Furthermore, please explain if factors such as age, gender, level of education or level of income/wealth play a role in the demand for financial instruments with sustainability features.

Q35: Which percentage of products in firms' offering have sustainability features? Please provide breakdowns and details, where available. Are retail clients satisfied with the availability of products with sustainability features (number, type, characteristics)?

Q36: Are firms facing specific issues related to data availability/data quality with respect to financial instruments with sustainability features? If yes, how are firms dealing with these issues?

[16] See ESMA TRV Risk Monitor No. 1, 2023 (forthcoming).

4 Annexes

4.1 Annex I - Summary of questions

Q1: What actions did firms implement within their organisation to take into account the new requirements related to sustainability preferences? Please elaborate especially on the following:

- **What proportion of firms' employees (differentiating between client facing staff and the other staff) have received training on sustainability topics? What these trainings consisted of? Was any test or exam put in place?**

- **Which conflicts of interest relating to the integration of clients' sustainability preferences did firms identify and which measures did firms take to ensure that these conflicts of interest do not damage the interest of clients?**

Q2: Are there specific aspects of sustainable finance that retail investors struggle to understand? For example:

- **Understanding of general aspects such as why it is important to consider sustainability risks and factors when investing?**

- **Understanding differences between sustainable products and products without sustainability features?**

- **Understanding that sustainability characteristics and (expected) return are two separate issues?**

- **Understanding the new legal definition of "sustainability preferences" and its components (e.g., categories a), b) and c), minimum proportion, principal adverse impact indicators (PAIs), etc)?**

Q3: Are there specific financial education initiatives on sustainable finance developed by consumer associations, trade associations or other organisations and that are used by investment firms that you can bring to ESMA's attention? Please accompany your reply with any relevant background information on the initiative and/or with details on its effectiveness/usefulness.

Q4: What is the main way firms currently provide information to retail clients about sustainable finance? For example:

- **Orally during the meetings with clients**

- **Through educational brochures or other (paper) documents**
- **Through dedicated website and apps**
- **A combination of the above**
- **Other**

In your opinion, are these approaches effective? Please provide details. Are retail clients satisfied with the quality of information provided?

Q5: What are clients' experiences/reactions to the new questionnaires including questions on "sustainability preferences"? (e.g. do they require guidance to be able to answer to the questions? Do they show interest in the topic?)

Q6: Are there practical examples of questions used to collect information from clients on their sustainability preferences that you can share with ESMA? (as for other parts of this CfE, respondents can opt for their input to ESMA not to be made public)

Q7: Which of the sustainable investment definitions do clients most often opt for? (EU Taxonomy alignment? Sustainable investment within the meaning of SFDR? Consideration of PAI? All of them?) Please provide any statistics, where available.

Q8: How are firms collecting information from clients on their preferences concerning the minimum proportion? With regards to the use of standardised minimum proportions, which standardised minimum proportions are presented to clients?

Q9: What is approximately the average minimum proportion of sustainable investments requested by clients? Please provide details, where available.

Q10: Are firms currently able to satisfy the sustainability preferences expressed by clients (in particular in relation to the three categories (Taxonomy, SFDR, PAI))? If so, for which categories and/or types of financial instruments do firms find it most difficult to satisfy clients' preferences?

Q11: How often has the adaptation of clients' sustainability preferences been necessary during these first months of application of the rules (e.g. in terms of percentage considering new clients and existing clients whose profiles have already been updated to include information on sustainability preferences)?

Q12: What kind of operational arrangements have firms put in place to allow clients to adapt their sustainability preferences?

Q13: How were clients informed about the possibility to adapt their preferences?

Q14: Have firms imposed limits on how frequently a client can adapt its sustainability preferences during the investment advice?

Q15: If available: what percentage of those who adapted decided to (1) lower the level of ambition within an option (i.e. reducing the "minimum proportion" or lowering the threshold of sustainable investments in a portfolio), (2) change between the three options (i.e. categories a, b and c) (3) opt for a combination/ for a different combination between the three options (i.e. categories a, b and c) (4) express no sustainability preferences anymore.

Q16: How often did clients refrain from adapting their sustainability preferences, accepting that the firm could not recommend any financial instruments or invest on their behalf?

Q17: In relation to the update of clients' profiles:

- **Which percentage/average proportion of clients have updated their (MiFID) profiles following the entry into application of the new regime on 2 August 2022?**
- **On average, taking into account the number of clients whose profile has already been updated, what is the proportion of clients who express sustainability preferences in your firm/jurisdiction?**
- **On average, taking into account the number of clients who express sustainability preferences, what is the proportion of clients that have expressed a specific preference for one or more of the three categories (Taxonomy, SFDR, PAI) in your firm/jurisdiction? (How many clients are only expressing whether or not they have sustainability preferences i.e. yes, no?).**

Q18: Do you have any comment on the above practical examples?

Q19: Have firms implemented an approach similar to the one described in examples 1 and 2? If yes, which of the two approaches have firms implemented? If firms have implemented a different approach, please provide further details.

Q20: What are the issues that firms encountered in the application of the requirements at portfolio level?

Q21: How are clients' sustainability preferences gathered on the consideration of PAIs? Do firms refer to the PAI indicators listed in Annex I of the SFDR Delegation Regulation exclusively, or may clients express their preferences based on other PAIs? If clients

may express their preferences based on other PAIs: what are those PAIs and how were they identified?

Q22: May clients determine qualitative elements in order to demonstrate the consideration of PAIs?

- **If so, what are these qualitative elements and how were they identified, how is the information on qualitative elements gathered?**

- **If not, what are the challenges preventing you from offering such possibility to clients? How could these challenges be overcome?**

Q23: What are the issues that firms encountered in the consideration of PAIs from clients?

Q24: Does this correspond to practices adopted by firms? If firms have implemented a different approach, please provide further details.

Q25: How do firms ensure the consistency of the investment advice or portfolio management service provided when conducting suitability assessment with respect to the sustainability preferences expressed by a group of natural persons when no representative has been designated?

Q26: What approach and criteria have firms adopted for the mapping of products' ESG features in view of their matching with clients' sustainability preferences?

Q27: How do firms apply sustainability-related concepts of Taxonomy Regulation and SFDR to MiFID II financial instruments that are outside the scope of SFDR (e.g., shares, bonds, certificates, etc.)? How do firms apply the "minimum proportion" concept to such instruments? In particular, how is the "minimum proportion" calculated?

Q28: Are firms making use of ESG rating/scoring systems for products mapping in terms of sustainability? If yes, please provide details.

Q29: In case of a positive reply to Q28, how do these interrelate with information gathered from manufacturers (or other sources)?

Q30: How are firms, in their capacity as manufacturers and/or distributors, defining the target market for products with sustainability-related objectives, in terms of granularity? Please specify the elements that are defined for this purpose. Do firms adopt one single approach for all products, irrespective of whether they are in scope of SFDR? In case approaches differ, please explain why and how.

Q31: What are the factors that firms, in their capacity as manufacturers and/or distributors, would consider for the periodic product reviews with respect to sustainability-related objectives?

Q32: How are firms, in their capacity as distributors, collecting relevant information from manufactures on sustainability-related objectives of the target market? Is the information received from manufacturers sufficient, or are firms considering other inputs? If so, please explain why and describe such additional inputs.

Q33: How are firms, in their capacity as manufacturers and/or distributors, treating products that do not consider sustainability factors in their product governance processes, specifically concerning the target market assessment related to the sustainability-related objectives (e.g. are sustainability-objectives considered in the negative target market assessment for such products? If so, please explain how).

Q34: Have firms noticed increased demand by clients of financial instruments with sustainability features? Please provide any relevant available statistics on this topic (e.g. percentage of clients asking information about these products; trends over time). Furthermore, please explain if factors such as age, gender, level of education or level of income/wealth play a role in the demand for financial instruments with sustainability features.

Q35: Which percentage of products in firms' offering have sustainability features? Please provide breakdowns and details, where available. Are retail clients satisfied with the availability of products with sustainability features (number, type, characteristics)?

Q36: Are firms facing specific issues related to data availability/data quality with respect to financial instruments with sustainability features? If yes, how are firms dealing with these issues?