

CNMV Consultative committee response to ESMA's Consultation Paper on Guidelines on certain aspects of the MiFID II suitability requirements

General Comments.

The CNMV Consultative Committee welcomes the regulator's objective of ensuring a consistent and harmonized application of the suitability requirements as these are important elements of investor protection; thus, we welcome the opportunity to provide our views on the different issues included in the Consultation Paper published by ESMA.

While we welcome the ultimate objective of the European legislators and supervisors of promoting sustainable development, as a general remark, we would like to stress that the new regulation gives rise to several concerns and doubts which we believe will hinder its implementation.

Before entering in the concrete proposal we would like to take the opportunity to point the **convenience of aligning the application timelines of different ESG rules.**- In the first place, we understand that it would be desirable that the integration of sustainability preferences both in the product governance and suitability processes were made at the same time.

Furthermore, taking into account that: (i) the definition of sustainability preferences incorporated in MIFID 2 for the purposes of the suitability assessment refers to Regulation 2020/852, of 18 June, on the establishment of a framework to facilitate sustainable investment (the "Taxonomy Regulation") and Regulation 2019/2088, of 27 November, on sustainability-related disclosures in the financial services sector (the "SFDR Regulation"); and (ii) the regulatory technical standards developing SFDR Regulation, including those specifying the details as regards financial products information required by arts 5 and 6 of Taxonomy Regulation, have been delayed, we understand that it would make sense to postpone the application of the sustainability preferences delegated act. Otherwise, the misalignment of the application timelines of the aforementioned rules will create great legal uncertainty for investment firms and a huge confusion for their clients.

Regarding ESMA's Consultation Paper, **we believe that ESMA's suggested approach is excessively complex.** Delegated Regulation 1253/2021 already introduces great complexity in order to integrate sustainability preferences in the advisory process (complex legal definitions cross-referenced to Taxonomy and SFDR concepts; lack of clarity in respect of certain types of financial instruments, problems of data availability on the expected implementation timeline, etc.). With this background in mind, we believe that ESMA's approach should try to simplify a

regime that is too complex in origin, especially from an investor/client perspective. Furthermore, ESMA's suggested approach seems to assume that clients are familiar with the sustainability framework and have a proper understanding of the legal definition of sustainability preferences (as defined in the new article 2(7) of MIFID II Delegated Regulation), but this generally will not be the case (at least during a period of time following the implementation of this framework).

ESMA should reconsider the opportunity to develop in detail at this time the obligations of entities that provide investment advice or portfolio management in the incorporation of sustainability in the assessment of suitability:

- (i) As stated, regulations are not complete, there are significant uncertainties and this poses problems for entities in adapting to these new requirements and also presents added difficulties for investors who may not have adequate and sufficient information and may not understand the very detailed approaches on different products.
- (ii) The lack of sustainability data and the level of current availability of sustainable products/assets, it is clear that, at present, market conditions are not appropriate for distributors to implement the revised suitability guidelines in the terms proposed by ESMA.
- (iii) In the current scenario, compliance with the strict criteria reflected in the guidelines submitted for consultation will involve significant efforts, IT design, costs, modification and adaptation of processes, etc., in a very specific way that may not ultimately prove to be definitive. It should be avoided to require things that can later be changed.

This consideration is particularly relevant in view of the fact that the European Commission is currently working on an initiative that it recently submitted to Public Consultation and will make public in 2022 to possibly modify the entire structure of the current suitability and appropriateness test. This may imply relevant modifications and require changing what is now required in the detail reflected in the Guidelines submitted to Public Consultation.

If ESMA still considers the publication of these document the CNMV Consultative Committee would like to **propose that the system shown in these Guidelines is published as "best practices" to be implemented gradually and not as Guidelines**. This approach would achieve a smooth transition that does not impose obligations for entities that goes beyond regulatory obligations and would avoid a disruptive model for clients that in no way is perceived as beneficial for them.

Finally, we would like to stress that a transition period is unavoidable:

- Fundamentally because ESMA Guidelines must provide for a regulatory response to the lack of market readiness (due to lack of data as regards sustainable investments/assets/products, legal uncertainty, etc.) and, as previously mentioned, ESMA proposal could only be implemented gradually and/or articulated as “best practices” (instead of Guidelines).
- But also, firms will need sufficient time and clarity to adapt their processes to the final set of guidance adopted.

Therefore, we believe that ESMA should allow for a sufficient broad implementation period following the publication of the final document.

Guideline 1 – Information to clients about the purpose of the suitability assessment and its scope

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

Please see the concerns described in response to Question 2 regarding the particular approach proposed.

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.

In our opinion, the information to be provided is excessively broad and complex. We question whether clients are actually willing to receive all such information. In fact, normally clients will not be familiar with Taxonomy and SFDR regulations and they may not even be interested in understanding in depth the differences between them, but just willing to express their preferences for sustainable investments more generally.

ESMA’s suggested approach seems to assume that clients are familiar with the sustainability framework and have a proper understanding of the legal definition of sustainability preferences, but this generally will not be the case. Those clients that are not familiar with the legal definitions and the sustainability preferences concept (which we believe will be the majority for the time being), will not be prepared/willing to receive such a broad information on the concept of sustainability preferences.

Keeping the advisory process simple is essential in order to avoid unintended consequences. Otherwise, we believe that the introduction of complex explanations on the different limbs/options regarding the definition of sustainability preferences together with the initial lack of availability of products meeting these preferences may result in: **(a)** clients being frustrated and confused and, therefore, losing interest in this kind of products; and **(b)** potential limitation on the availability of investment advice services.

In addition, given the state of development of sustainability regulation, some necessary information on individual financial instruments may not be available for assessing sustainability preferences, even when they are set up to observe one or more of the aspects considered in the definition of "sustainability preferences".

It could also happen that firms have financial instruments that only fit in one of the categories of paragraphs a) to c) of the definition of sustainability preferences. In these cases, we understand that informing the client about the different concepts and categories within the definition of sustainability preferences would not make much sense and it would be more useful for clients to be informed from the very beginning about the unavailability of products that may meet their sustainability preferences or to focus the explanations only in the category/categories for which the firm has products.

Finally, in line with the proportionality principle that guides MIFID 2, we believe it is essential to differentiate between categories of clients and adapt any information requirements, as professional clients may already have more knowledge (or at least better access to knowledge) about sustainable finance than retail clients.

Guideline 2 - arrangements necessary to understand clients

Q3. Do you agree with the suggested approach on the arrangements necessary to understand clients and specifically with how the guideline has been updated to take into account 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.

Please see the General comments section and our response to Q2 above.

We generally understand that ESMA's suggested approach provides guidance for situations where investors have a proper understanding of sustainability preferences (as defined in the new

article 2(7) of MIFID II Delegated Regulation) and there are products available to address all types of sustainability preferences clients may indicate. We have, however, concerns that this might not be the case when changes in MIFID II made by Delegated Regulation 2021/1253 or the revised guidelines enter into force.

In consequence, we are of the opinion that the new supporting guideline included in paragraph 25 could go beyond its initial purpose (i.e. to enhance clarity regarding the integration of sustainability preferences in the suitability assessment). In this regard, we find that paragraph 25 is excessively detailed, introduces great complexity and seems to introduce a set of strict criteria/requirements that entities should follow in order to obtain information from the client on its sustainability preferences.

Furthermore, in line with our response to Q2 above, we believe that the suggested approach is too rigid and complicates in excess the suitability assessment. The current proposal could mean that distributors would be obliged to explain still unclear concepts and ask clients whether they have an interest in such concepts, when the vast majority of clients will probably not be familiar with such technical concepts and will not even be prepared/willing to receive such a broad information on the concept of sustainability preferences.

However, we understand that this could be confusing and frustrating for clients and, therefore, as stated in the previous question, we understand that informing the client about the different concepts and categories within the definition of sustainability preferences would not make much sense, being more transparent and useful for clients to inform them from the very beginning focussing the explanations only in the category/ies for which the firm has products

We understand that ESMA's suggested approach could only be implemented gradually (increasing granularity requirements at the same pace as sustainability data, legal certainty and availability of sustainable products/assets allows it). For instance, different questions could be included regarding the different kinds of sustainability preferences as per the suggested approach, but it also seems that in some cases, and for the time being, it could be less burdensome to include only one question that merges all the options set forth in paragraphs (a) to (c) of the definition of sustainability preferences or to directly ask the client whether he/she has specific sustainability preferences. In fact, this last option could be easier and more realistic from an investor perspective as normally clients will not be familiar with Taxonomy and SFDR regulations and they may not even be interested in understanding in depth the differences between them, but just willing to express their preferences for sustainable investments more generally.

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

We believe that ESMA's suggested approach is too prescriptive and excessively detailed and more flexibility should be provided to firms when assessing client's sustainability preferences. We believe that this flexibility is essential to achieve an understanding of client's sustainability preferences as efficiently and naturally as possible, taking into account the type of client and the range of available products.

Supporting guideline 25 requires the information to be collected on a "**sufficiently granular**" basis in order to allow for matching of the client's sustainability preferences. The understanding of this should be that it aims at requiring firms to collect the necessary information (e.g. if a client has a specific sustainability focus or preferences) rather than asking too many detailed questions that may it impossible to arrive at an (existing) suitable product. This consideration is essential. If too detailed questions are asked and no suitable products are available at the end, it may require more frequent sustainability reassessments necessary and this could be confusing and frustrating for clients.

In addition, with regards to **PAI considerations** we understand that the fourth bullet of supporting guideline 26 should be revised to clarify that the PAI information collected can cover "qualitative **OR** quantitative elements" rather than "qualitative AND quantitative elements" currently mentioned in order to align them with Delegated Regulation 2021/1253 as paragraph c) of the definition of sustainability preferences included in such regulation refers to "*a financial instrument that considers principal adverse impacts on sustainability factors where qualitative OR quantitative elements demonstrating that consideration are determined by the client or potential client*".

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?

Only a clarification would be desirable that the query of the preferences according to a) to c) is a so-called "or" link, i.e. the client who defines and selects several preferences as sustainable can be offered financial instruments that fulfil only one of the selected preferences (see also the wording of Art. 2 para. 7 MiFID II Regulation 2017/565 - "[...] to what extent, one or more of the following financial instruments shall be integrated into his or her investment").

In particular, it should be rejected that the client, who specifies several categories, has to be consulted with regard to a prioritisation of the categories. This would unnecessarily complicate the process. Furthermore, it must be considered that the client, for whom prioritisation is important, will indicate this autonomously.

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.

In point 27 on page 30, ESMA states that firms should therefore ask the client which part of the portfolio (if any) the client wants to be invested in products meeting the client's sustainability preferences.

When portfolio management or investment advisory services are provided on a portfolio approach, where appropriate, the decision to obtain information from the client on which part of the portfolio should be invested in products that observe its sustainability preferences should be optional for the entity, not mandatory. By default, sustainability preferences should be considered by the institution for the entire managed or advised portfolio.

Guideline 5 - updating client information

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

Customer information should be adapted to sustainability preferences within the suitability test review process or at the occasion of an advisory meeting, but not at the first information update, as such updates may occur frequently and it is not practical or efficient to require this to be done at that time.

Guideline 7 - arrangements necessary to understand investment products

Q8. Do you agree with the suggested approach with regards to the arrangements necessary to understand investment products? Please also state the reasons for your answer.

In our opinion, the new supporting guidelines included regarding the arrangements necessary to understand investment products would be more appropriately considered in the context of the product governance framework.

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.

As stated in our response to Q8, this topic seems more related to the product governance obligations and not with the suitability assessment.

Guideline 8 - arrangements necessary to ensure the suitability of an investment

Q10. Do you agree with the additional guidance provided regarding the arrangements necessary to ensure the suitability of an investment concerning the client's sustainability preferences? Please also state the reasons for your answer.

We fully agree with ESMA's proposal in paragraph 79 in order to clarify that 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. This is fully in line with the spirit of Delegated Regulation 1253/2021, specifically with recital 5 that clarifies that *"investment firms providing investment advice should first assess a client's or potential client's other investment objectives, time horizon and individual circumstances, before asking for his or her potential sustainability preferences"*.

We do not share ESMA's interpretation that in order for a firm to recommend a product that does not meet the client's sustainability preferences, the client should adapt such preferences. This approach is not aligned with Delegated Regulation 1253/2021 which expressly foresees the possibility of recommending a financial instrument that does not meet the client's sustainability preferences provided it is not recommended as meeting individual sustainability preferences. Adjustment of the sustainability preferences is not established as a prior requirement for recommending a product that initially does not meet the client's sustainability preferences.

In this regard, new paragraph 10 of art. 54 of MIFID II Delegated Regulation states that *"An investment firm shall not recommend financial instruments or decide to trade such instruments as meeting a client's or potential client's sustainability preferences when those financial instruments do not meet those preferences. **The investment firm shall explain to the client or potential clients the reasons for not doing so and keep records of those reasons.** Where no financial instrument meets the sustainability preferences of the client or potential client, and **the client decides** to adapt his or her sustainability preferences, the investment firm shall keep records of the decision of the client, including the reasons for that decision"*.

What the aforementioned article does not state is that the client must necessarily adapt its preferences so that the firm can issue its recommendation. In fact, the aforementioned articles should be read in accordance with Recital 8 of Delegated Regulation 1253/2021 which expressly addresses this point: *It is necessary to **clarify that financial instruments that are not eligible for individual sustainability preferences can still be recommended** by investment firms, but not as meeting individual sustainability preferences. In order to allow for further recommendations to clients or potential clients, where financial instruments do not meet a client's sustainability preferences, the client **should have the possibility** to adapt information on his or her sustainability preferences.*

Q11. Do you agree with the approach outlined with regards to the situation where the firm can recommend a product that does not meet the client's preferences once the client has adapted such preferences? Do you believe that the guideline should be more detailed? Please also state the reasons for your answer.

The approach outlined in this Supplementary Guideline is not appropriate in any case should be redrafted in accordance with the applicable regulation. As stated in Q10, Recital 8 of Delegated Regulation (EU) 2021/1253 determines as the only requirement for issuing recommendations on products/investments that are not in line with the client's sustainability preferences, that these products/investments are not presented as being in line with the sustainability preferences: "(...) investment firms may continue to recommend financial instruments that cannot be considered suitable for meeting individual sustainability preferences, provided that they do not present them as being in line with those preferences (...)"

It should be concluded that it should be possible to issue the recommendation that is not in line with the client's sustainability preferences, provided that:

- The recommended product/investment is suitable for the client according to the client's knowledge, experience, financial situation and investment objectives; and
- There is no suitable product/investment available that is suitable and in line with the client's investment preferences (in the case of portfolio approach advice, the alignment with sustainability preferences should be considered on a portfolio-wide basis); and
- The client is informed that the product/investment is not in line with his sustainability preferences; and
- The client is offered the possibility to adapt his/her sustainability preferences for future investments.

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.

Although we have sympathy for the policy objective of this statement (which we understand to be avoidance of mis-selling and greenwashing) some elements could be seen as beyond level 1 and 2 regulation.

In this respect, the client decision to adapt its suitability preferences should always be respected and firms are not in the position to refuse - even if it should happen often. The need to adapt will depend on the market situation and investment firms' product offering which will be developed over time.

Based on the above, we propose that the statement in point 81 is deleted. The requirement of documentation in the suitability report of a client's adaptation should however be kept.

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)?

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

For some investment services, it is clear from the outset that sustainability considerations are not relevant at all. For example, when a professional client receives advice on investments in FX or interest rate derivatives for hedging purposes. For such services, it is not reasonable to require that the investment firm and client go through the whole process of providing and collecting detailed information on sustainability preferences. Instead, a simplified procedure should allow the firm to inform the client beforehand that sustainability considerations are not relevant for the type of service in question.

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.

If the customer does not express a preference for sustainability, there is no reason to have to inform him about the sustainability or non-sustainability characteristics of the products in which he invests.

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.

With regard to the portfolio management service, it should be considered that the client's sustainability preferences should be taken into account in the same way as the client's financial situation and investment objectives, at the level of the portfolio as a whole.

Q16. What measures do you believe that firms should implement to monitor situations where there is a significant occurrence of clients adapting their sustainability preferences? What type of initiatives do you envisage could be undertaken to address any issues detected as a result of this monitoring activity?

In accordance with the MIFID II Delegated Regulation, firms can recommend financial products that do not meet the client's individual sustainability preferences, provided this is clearly stated, with no need for a mandatory adaptation of the client's preferences. In any case, regarding potential adaptations of sustainability preferences, we understand that as long as the firm is transparent with the client and provides the necessary information in a clear manner, the fact that clients adapt their sustainability preferences in a relatively frequent manner should not be considered problematic. Thus, we believe that this will be quite common, especially in the short term, as the availability of financial instruments with sustainability features may be initially limited and the introduction of these financial instruments in the firm's product scope might be gradual (as ESMA recognised in paragraph 34 of the Consultation Paper), as well as the evolution of the client's knowledge in the sustainability universe.

Guidelines 9 - costs and complexity of equivalent products

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

It should be made clear that the assessment of costs and benefits refers to a general and qualitative approach, not a quantitative one.

In case a quantitative approach is intended, more detail should be provided, as it does not seem easy to make a quantitative assessment of costs and benefits when talking about investments over a certain period of time.

It should be noted that, according to the new Art. 29a(2) of Directive 2014/65/EU (as amended by Directive (EU) 2021/338), the obligations to analyse the costs and benefits of switching

financial instruments and, where applicable, to inform the client about such analysis, would NOT apply in case of professional clients (both per se and on request) unless they inform the institution that they wish to benefit from such rights: "The requirements set out in the third subparagraph of Article 25(2) and in Article 25(6) shall not apply to services provided to professional clients unless they inform the investment firm in electronic or paper format that they wish to benefit from the rights provided for in those provisions."

Guideline 11 - qualifications of firm staff

Q18. Do you agree with the additional guidance regarding to the qualification of firms' staff or do you believe that further guidance on this aspect should be needed? Please also state the reasons for your answer.

For staff training, the content of such training needs to be determined and a reasonable timeframe set for it to take place, in terms similar to those that have been applied in the general staff training regime.

ESMA should, in this respect, complement its guidelines on training and competences.

Guideline 12 - record-keeping

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

In principle, we agree with the record presented. In our opinion, this corresponds to the process already in place.

Other changes 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.

In principle, we agree with an alignment of both guidelines. In particular, identical wording would be desirable. Only the regulation of sustainability should be treated differently, as it plays no role in "appropriateness/execution only".

Where the provisions are identical, e.g. knowledge and competence, we see no reason that the guidelines differ.

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

The extreme complexity of the subject matter, which is external to capital markets and to the knowledge of operators, supervisors, regulators and investors, should be stressed.

Sharing the aim of integrating everything related to sustainability in the capital markets and in the investment decisions of investors, including retail investors, we must insist on the need for a flexible approach, based on simultaneous learning, monitoring the evolution of the regulations already in force and the approval of those yet to be approved, the consolidation of concepts, etc.

All of this should lead to an evaluation of the timeliness of these Guides at this time, or at least the need of pushing them as best practices and no Guidelines.

Good and bad practices

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

No

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.

Employees and staff training, the incorporation of sustainability into the organisation's processes, the modification of all suitability assessment processes, etc., will involve significant efforts and costs.

Therefore, rigid rules should not be established that require incurring costs that then have to be modified or developed in a different way.