Questionnaire for assessing client sustainability preferences and motivations

For use with the accompanying Questionnaire on sustainability preferences

2° Investing Initiative

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About

The 2° Investing Initiative (2DII) is an international, non-profit think tank working to align financial markets and regulations with the Paris Agreement goals.

Working globally with offices in Paris and New York, 2DII coordinates some of the world's largest research projects on climate metrics in financial markets. In order to ensure our independence and the intellectual integrity of our work, we have a multi-stakeholder governance and funding structure, with representatives from a diverse array of financial institutions, regulators, policymakers, universities and NGOs.

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DISCLAIMER: This work reflects only the views of 2DII. Other members of the Finance ClimAct Consortium and the European Commission are not responsible for any use that may be made of the information it contains.

1: Introduction

Background

(1) Investment firms providing financial advice and portfolio management should carry out a mandatory assessment of sustainability preferences of their clients or potential clients. Investment firms should then take these sustainability preferences into account in the selection process of financial instruments that are recommended to those clients.

(2) 2DII has developed a Questionnaire and a Guidance for assessing client sustainability preferences (the **Questionnaire & the Guidance**) to assist investment firms in carrying out a comprehensive assessment of a client's sustainability preferences and wider sustainability motivations and harmonise practice among investment firms. 2DII believes that all of these aspects are critical to improving the suitability of the recommended product(s), increasing consumer trust, and ensuring that financial markets work towards societal and environmental goals.

(3) The Questionnaire and Guidance were developed by 2DII taking into account (i) relevant regulatory framework (ii) 2DII expertise and research in relation to the assessment of sustainability preferences of retail clients (iii) discussions of a working group composed of around 20 members (representants of major stakeholders of sustainable finance in France including financial institutions, NGOs and academics) in the framework of Finance ClimAct project and (iv) feedbacks received on a European public consultation on a draft Questionnaire and Guidance opened by 2DII from March 2022 to June 2022.

Overview

(4) The Guidance should be read together with the accompanying Suitability Assessment Questionnaire (the **Questionnaire**). Taken together, the Guidance and the Questionnaire support investment firms ensure legal compliance with the new requirements regarding integration of client sustainability preferences in the suitability assessment.

(5) Given the continually evolving nature of sustainable finance approaches and client expectations regarding sustainability aspects of their investments, the Guidance and the Questionnaire also support investment firms in implementing better practice than currently required by the regulatory framework and avoid certain risks and pitfalls.

Scope

(6) The Guidance and the Questionnaire relate to the provision of investment advice and portfolio management and principally address situations where these services are provided to retail clients.

(7) The Guidance and the Questionnaire relate to the following requirements for the suitability assessment:

a) Directive 2014/65/EU[1] (**MiFID II**)

[1] 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

b) Commission Delegated Regulation (EU) 2017/565[2] (**MiFID II Delegated Regulation**) (as amended by Commission Delegated Regulation (EU) 2021/1253[3]
c) ESMA Guidelines on certain aspects of the MiFID II suitability requirements (**ESMA Guidelines**)[4].

(8) Unless otherwise specified, terms used in MiFID II and the MiFID II Delegated Regulation have the same meaning in the Guidance and the Questionnaire. Recognising that the Guidance and the Questionnaire also support investment firms in implementing better practice than currently required by the regulatory framework, the word 'should' is often used (rather than words such as 'shall', 'must' or 'required to' which are more relevant for mandatory obligations). In addition, the following interpretive principle should be adopted: 'client' refers to client or potential client as applicable

(9) The Guidance and the Questionnaire focus only on how the above requirements relate to the assessment of client sustainability preferences during the suitability assessment. The commentary herein does not cover the part of the suitability assessment related to the assessment of traditional investment objectives such as time horizon, risk appetite etc.

(10) While the Guidance and the Questionnaire are only focussed on the requirements for the suitability assessment articulated under MiFID II, the content could also be useful to the assessment of sustainability preferences now required under Directive 2016/97/EU[5] (**IDD**).

Disclaimer

The Questionnaire and the Guidance is produced by 2DII in the context of a French multistakeholder working group funded by the European Commission. Both documents relate to EU level regulation and guidance and do not cover any national level regulation or guidance that may have been published in any member state in relation to the integration of sustainability preferences of clients to the suitability assessment.

Neither document is endorsed by financial regulators or supervisory authorities at a National or European level. In addition, the Questionnaire and the Guidance include content which in the opinion of 2DII supports investment firms implement better practice than currently required by the regulatory framework. However, investment firms must independently satisfy themselves that they have complied with the overarching duty to act in the best interests of the client (Art 24, MiFID II).

It is important to note that better practices put forward in the Questionnaire and Guidance should not be confused with binding rules or even soft law issued by legislators and regulators. They are advice expressed by 2DII based on their research on sustainable finance and retail investor preferences.

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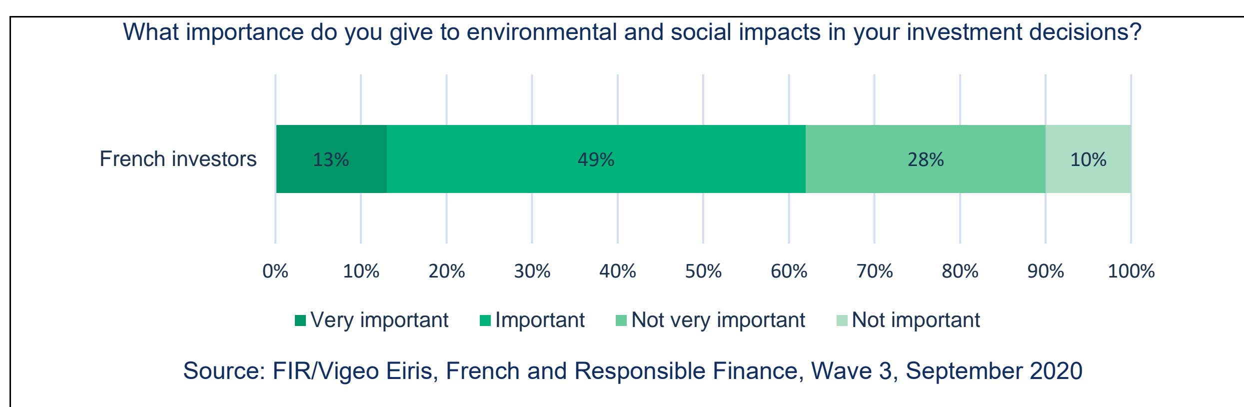
[2] Commission Delegated Regulation (EU) of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive
[3] Commission Delegated 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

[4] Guidelines on certain aspects of the MiFID II suitability requirements, 23 September 2022
[5] Directive 2016/97/EU of the European Parliament and of the Council of 20 January 2016 on insurance distributio

2: Why does the suitability assessment integrate sustainability?

Client expectations for sustainable investment are increasing

(11) More and more retail clients are looking to invest their money in a way that takes sustainability considerations into account. A 2020 survey of French citizens reveals that 62% say they place environmental and social impacts high on their investment decisions.



Source: FIR/Vigeo Eiris, French and Responsible Finance, Wave 3, September 2020

(12) And societal awareness of environmental and social issues is changing the profile of client goals for how they invest their money. A clear and significant trend in this changing profile of client goals is that clients increasingly want their money to 'do some good' or 'have an impact' in the real world at the same time as providing a financial return.

(13) This client demand for investment opportunities that take sustainability considerations into account is being met by an increasing number of financial instruments with varying degrees of sustainability related ambition and incorporating different environmental or social characteristics. Bloomberg has predicted that responsible and sustainable financial products will account for a third of assets under management by 2025.[6]

Sustainability goals of retail clients in purchasing financial products taking into account environmental criteria

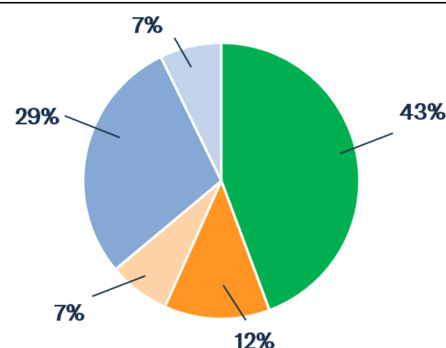
Having an impact in the real economy (43%)
■ I want to have a positive environmental impact in the real economy by investing in the financial product. I want the investment strategy behind the financial product to be designed and managed in such a way that the more money invested the more positive environmental impacts are generated.

Value alignment (19%)
■ I want to invest in companies that have positive environmental impact (e.g. operators of windfarms) even if my investment does not change anything to their activity, because it is a way to symbolically show my support to the environmental cause.

[6] https://www.bloomberg.com/professional/blog/esg-assets-may-hit-53-trillion-by-2025-a-third-of-global-aum/

■ I want to avoid investing in any company that has a negative environmental impact, even if my choice does not affect their activities, because it is a way to show my support to the environmental cause.

ESG integration (36%)
■ I want to invest in companies that have positive environmental impacts (e.g. operators of windfarms) even if my investment does not change anything in their activities, because I believe these companies will have a better financial performance.
■ I want to avoid investing in any company that has a negative environmental impact, even if my choice does not change anything in their activities, because I believe these companies will have a bad financial performance in the future.



Source: 2DII (2020) A Large Majority of Retail Clients want to Invest Sustainably

Updating the suitability assessment to match client expectations

(14) Despite increasing client demand for sustainable financial instruments, the previous suitability assessment framework did not include questions which addressed sustainability considerations.

(15) Investment firms were required to obtain the necessary information about the client's knowledge and experience in the investment field, ability to bear risks and investment objectives including risk tolerance to enable the firm to provide services and products that are suitable for the client.[7] Information regarding the investment objectives of clients included the length of time a client wishes to hold the investment, preferences regarding risk taking, risk profile, and the purposes of the investment.[8] While the former version of the ESMA Guidelines stated that it would be good practice to consider non-financial elements when gathering information on investment objectives[9], typically, these were not addressed in most suitability assessments.

(16) The aim of the new rules on sustainability preferences[10] is to enhance client awareness of the availability of financial instruments with sustainability ambition and to ensure that these considerations are included in the suitability assessment process. Investment firms must now carry out a mandatory assessment of sustainability preferences of their clients as a top up to the assessment of traditional investment objectives. Investment firms must then take these sustainability preferences into account in the selection process of the financial instruments that are recommended to those clients.

[7] Art 54(2) MiFID II Delegated Regulation
[8] Art 54(5) MiFID II Delegated Regulation

[9] ESMA Guidelines, paragraph 28
[10] Commission Delegated Regulation (EU) 2017/565 (MiFID II Delegated Regulation) (as amended by Commission Delegated Regulation (EU) 2021/1253

3: Using the Guidance and Questionnaire

How to use the Guidance

(17) The Guidance is structured as follows:

4: Client sustainability preferences and wider sustainability motivations	This section explains the regulatory concept of client *sustainability preferences* as articulated in the amended MiFID II Delegated Regulation. The primary purpose for this explanation is to support the investment firm's own understanding. *Annex 1: Client explanatory materials* focusses more on how to provide an adequate explanation to clients. The regulatory concept of client sustainability preferences is articulated as a client's preference for one or more of three categories of financial instrument. For some clients, investing in a financial instrument which falls under one of these three categories may not be sufficient to satisfy broader expectations associated with their investments. In addition, sustainable finance approaches and client expectations regarding sustainability aspects of their investments are continually evolving. To address this, the Guidance introduces the concept of *wider sustainability motivations* to denote other considerations (not addressed by the regulatory concept of sustainability preferences) which are relevant to implement better practice for a comprehensive assessment of all sustainability related aspects associated with client investments.
5: Tips for background preparation	This section explains how investment firms should prepare prior to the client meeting to ensure that the suitability assessment during the client meeting can proceed smoothly so that the investment firm has complied with applicable regulatory requirements and the client is satisfied with the advice that has been provided.
6: Assessing client sustainability preferences and sustainability motivations	This section provides a process diagram which establishes three steps to assessing client sustainability preferences and wider sustainability motivations during the suitability assessment. 1. Explanation of sustainability preferences 2. Identification of client sustainability preferences 3. Financial product recommendation For each step, an individual section provides detailed commentary to support investment firms. For the reasons articulated in *4: Client sustainability preferences and sustainability motivations*, the Guidance is structured with a clear distinction between: (1) requirements to meet the threshold for regulatory compliance for assessing client sustainability preferences during the suitability assessment; and (2) steps to assess wider sustainability motivations (not addressed by the regulatory concept of client sustainability preferences) which are relevant to implement better practice for a comprehensive assessment of all sustainability related aspects associated with client investments.

7. Record keeping obligations	This section explains how the information revealed by the client during the suitability assessment must be included in a report to the client.

(18) The commentary in each section of the Guidance is supplemented by:

Summary of regulatory requirements

A summary of legal requirements is used to identify and explain the law or regulation which underlies an aspect of the Guidance. These summaries are an outline only and are not intended as a comprehensive analysis of the law or regulation.

How to use the Questionnaire

(19) The Guidance should be read together with the accompanying Questionnaire. The Guidance provides information and support for investment firms to complete the Questionnaire during the client meeting for the suitability assessment.

(20) The Questionnaire mirrors the three steps articulated above and guides an investment firm through the part of the suitability assessment related to assessing client sustainability preferences and wider sustainability motivations (not addressed by the regulatory concept of client sustainability preferences) which are relevant to implement better practice for a comprehensive assessment of all sustainability related aspects associated with client investments. The Questionnaire provides a means for an investment firm to record relevant actions have been completed and document key information about a client’s sustainability preferences and wider sustainability motivations necessary for making a financial product recommendation and complying with record keeping obligations.

4: Client sustainability preferences and wider sustainability motivations

Regulatory concept of a client's sustainability preferences

(21) A client's sustainability preferences are conceptualized to be consistent with other EU sustainable finance regulation included in the table below.

Table 1 : Relevant EU sustainable finance regulation

Taxonomy Regulation[11]	The Taxonomy Regulation provides businesses and investors with a common classification to identify what economic activities can be considered environmentally sustainable through providing a substantial contribution to one of six environmental objectives: 1. climate change mitigation; 2. climate change adaptation; 3. sustainable use and protection of water and marine resources; 4. transition to a circular economy; 5. pollution prevention and control; 6. protection and restoration of biodiversity and ecosystems. The Taxonomy Regulation (complemented by the Sustainable Finance Disclosure Regulation) also requires disclosures of the extent to which a financial product finances activities that are classified as environmentally sustainable (i.e. what has come to be known as the degree to which a financial product can be considered as *taxonomy aligned*).
Sustainable Finance Disclosure Regulation[12]	The Sustainable Finance Disclosure Regulation (**SFDR**) introduces disclosure requirements for financial institutions at organisation, service and product level. In addition to complementing the Taxonomy Regulation by requiring disclosures relating to the taxonomy alignment of certain financial products, the SFDR also requires disclosure of other sustainability related information. The SFDR also categorises financial products according to the degree of sustainability related ambition for that product. • *Article 6 products* do not pursue sustainable investment but may or may not integrate sustainability risk into the investment process. These are generally not marketed as having any sustainability credentials. • *Article 9 products* (often referred to as dark green products) have sustainable investment as an objective and their underlying assets will always be in sustainable investment.

[11] Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088
[12] Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector

	• *Article 8 products* sit between the other two categories and are those that promote environmental or social characteristics. They may or may not pursue sustainable investments and may invest in a wide range or underlying assets.

(22) The definition of a client's sustainability preferences is included in the box below.

Summary of legal requirements

'sustainability preferences' means a client's or potential client's choice as to whether and, if so, to what extent, one or more of the following financial instruments shall be integrated into his or her investment:
(a) a financial instrument for which the client or potential client determines that a minimum proportion shall be invested in environmentally sustainable investments as defined [the Taxonomy Regulation];
(b) a financial instrument for which the client or potential client determines that a minimum proportion shall be invested in sustainable investments as defined in [the SFDR];
(c) a financial instrument that considers principal adverse impacts on sustainability factors where qualitative or quantitative elements demonstrating that considerations are determined by the client or potential client.

(23) The regulatory definition of a client's sustainability preferences therefore comprises three categories of financial instrument.

Table 2: Financial products comprising each category of sustainability preference

Category A	Financial instruments which invest in economic activities providing a substantial contribution to one or more of the following environmental objectives: • climate change mitigation; • climate change adaptation; • sustainable use and protection of water and marine resources; • transition to a circular economy; • pollution prevention and control; • protection and restoration of biodiversity and ecosystems.
Category B	Financial instruments which pursue sustainable investments more broadly. This is a wider category of financial instruments because it includes economic activities that contribute to other environmental objectives and/or to social objectives.
Category C	Financial instruments that consider negative externalities of investments on the environment or society in terms of principal adverse impacts on sustainability. Principal adverse impacts on sustainability are impacts of investment decisions and advice that result in negative effects on environmental, social and employee matters, respect for human rights, anti-corruption, and anti-bribery matters. Contrary to category A and B, here the financial instrument does not aim at any positive contribution but merely consider negative impacts of the investment on sustainability.

(24) Investment firms should bear in mind that the regulatory framework in this area is constantly developing and evolving. At the time of this Guidance, in relation to Category A financial products, the technical screening criteria for the climate mitigation and climate adaptation environmental objectives under the Taxonomy Regulation are established but the technical screening criteria for the four remaining

environmental objectives are still under development. Furthermore, likely policy changes will mean that the Taxonomy framework is extended to cover certain economic activities that contribute to greenhouse gas emissions reductions or is extended to recognise activities with an intermediate level of performance. Likewise, in relation to Category C financial products, adverse sustainability indicators are contained in the Draft SFDR Regulatory Technical Standards, but these have yet to be formally implemented.

(25) Investment firms should ensure they stay up to date with relevant regulatory developments.

Regulatory concept of sustainability preferences may not cover wider client sustainability motivations

(26) As set out in the previous section, the regulatory concept of sustainability preferences relates principally to financial instruments falling in Category A, B or C of *Table 2: Financial products comprising each category of sustainability preference*.

(27) For some clients, investing in a financial instrument which falls under Category A, B or C may not satisfy wider sustainability motivations. In addition, there are other financial instruments which pursue sustainability related objectives but would not ordinarily fall under Category A, B or C. Sustainability preference categories of MiFID II Delegated Act are built around the concepts of greenness and sustainability, investor broader sustainability goals are about impact, personal values and integration of ESG risks and opportunities, leading to many potential mismatches between what product features clients actual want and features of recommended products if only based on Category A, B or C. This approach to clearly distinguish between the key sustainability goals is increasingly used by the scientific community, industry, financial regulators and experts.[13] Similar to the idea to start with the assessment of the client's financial objective to ensure consistency between the actual intention for the investment and the recommended products, it should be equally ensured that the actual intention for the sustainable investment is reflected in the recommended products.

Wider sustainability motivations

The concept of "wider sustainability motivations" captures additional information about the client's sustainability goal(s) and additional values and priorities the client wants to support or to avoid and which are not covered by MiFID II Delegated Act on sustainability preferences.[14] The main sustainability goals (i.e. why the client wants to invest sustainably) can be split into three categories (see Annex I):

i) to have a real-world impact
ii) to align the investment with her or his values and/or
iii) to integrate ESG risks and opportunities.

Wider sustainability motivations can be used to link a client profile to more product features than the ones described in MiFID II Delegated Act and can increase the suitability of the recommended product(s) (see Annex II).

[13] See for instance usage by some of the most influential researchers in sustainable finance here and here, industry associations such as Eurosif and AMAS/SSF, industry participants such as Natixis and Hermes, regulators such as FCA and Federal Office for the Environment Switzerland (n.d.).
[14] See 2DII (2022): Please Don't Let Them Be Misunderstood! - How financial advisors consider clients' sustainability motivations before upcoming MiFID II Delegated Act: Insights and recommendations from European mystery shopping campaigns

(28) This is most clearly illustrated in the case of impact oriented financial instruments i.e. those which have an objective of delivering positive environmental or social impact alongside a financial return.[15] An impact oriented financial instrument does not fall under Category A, B or C. And at the same time given the proportion of retail clients who are interested in having an impact in the real economy it is these impact oriented financial instruments which are most suitable for a financial product recommendation to these clients.

Table 3: What are impact oriented financial instruments?

At the time of the publication of this Guidance, while client express demand for impact products, the European and French regulatory framework do not provide any clear definition of impact. Finance for Tomorrow launched in March 2021 a Paris Financial Centre Task force dedicated to Impact Finance.

The Paris Financial Centre Task force published a pledge for the development of Impact Finance in November 2021 that contains a definition of Impact Finance.

Impact Finance is an investment or financing strategy that aims to accelerate the just and sustainable transformation of the real economy, by providing evidence of its beneficial effects. It is based on the pillars of intentionality, additionality and impact measurement, to demonstrate:

1. The joint search, over time, for an ecological and social performance and a financial return, while controlling the occurrence of negative externalities;

2. The adoption of a clear and transparent methodology describing the causal mechanisms through which the strategy contributes to the targeted environmental and social objectives, the relevant period of investment or financing, as well as the measurement methods – according to the concept of theory of change.

3. The achievement of environmental and social objectives aligned with frameworks of reference, in particular the Sustainable Development Goals, defined at the international, national and local levels.[16]

Building on previous studies of investor impact by the Impact Management Project and University of Zurich, 2° Investing Initiative mapped the climate impact potential of financing solutions and developed a Climate Impact Potential Assessment Grid. The grid includes four criteria to assess the climate impact potential of a financial instrument:

- Signalling a commitment to the green energy transition;
- Servicing new or undersupplied markets;
- Providing flexible capital;
- Pressuring funded organisations to align their climate strategy with a 1.5°C scenario.[17]

(Additional information is available in Annexe III)
18

(29) In addition, just looking at the regulatory concept of sustainability preferences may not capture all the granular aspects of how some retail clients want to invest their money. Financial instruments have a range of investment strategies which are suitable for different sustainability goals. Financial advisors should propose products with an investment strategy suitable to meet their sustainability preferences

[15] Note that the objective of delivering positive environmental or social impact with an investment is different to an investment in an economic activity that contributes to an environmental or social objective as defined in SFDR Art. 2 (17) (see Kölbel et al. (2020). While the concept of investor impact implies that positive change should be achieved by the investor, real world impact is not yet required under SFDR and the concept of sustainable investment.
[16] Definition of F4T contained in the Pledge for the development of impact Finance dated November 2021
[17] 2DII (2021) I've got the power! Really?

and wider sustainability motivations (see Annex II). Financial advisors should also be able to explain different investment strategies to clients when necessary and relevant. The table below provides high level information on the different investment strategies.

Table 4: Investment strategies

There are many different types of sustainable financial instruments which rely on different sustainable financial strategies, including: • **ESG integration**: financial instruments which include sustainability information alongside financial information in the process of selecting assets; • **Stewardship (voting or engagement):** financial instruments that seek to use shareholder or investor power to influence corporate behaviour. For example: Communicating with senior management and/or boards of companies, filing or co-filing shareholder proposals, and proxy voting guided by comprehensive ESG guidelines; • **Sector/Norm based exclusion:** financial instruments which exclude from a fund or portfolio certain sectors, companies or countries based on certain criteria. Exclusion criteria can be based on product categories (e.g. weapons, tobacco), company practices (e.g. animal testing, violation of human rights, corruption) or controversies; • **Best in class/positive screening:** financial instruments which use positive screening techniques to select companies or countries with the best practices in sustainability topics; • **Thematic investing:** financial instruments that invest in companies because they positively contribute to the advance of a certain sustainability topic, either environmental or social; or • **Impact investing:** Investing to achieve positive, social and environmental impacts - requires measuring and reporting against these impacts, demonstrating the intentionality of investor and underlying asset/investee, and demonstrating the investor contribution; • **Income-sharing:** investments that include a mechanism to donate part of the generated income to charities or NGOs.

(30) Equally, some clients may have specific priorities for their investments such as wanting to:

a) focus on one or more of the Sustainable Development Goals (**SDGs**) which establish 17 global goals to achieve a better and more sustainable future for all by 2030 and were adopted by all the United Nations Member States in 2015;

b) avoid financing certain economic sectors such as fossil fuels, arms, tobacco, alcohol, GMO etc.

c) avoid financing certain companies which are known to be subject to controversies in relation to environmental standards or violation of labour rights, business malpractice, tax avoidance etc.

(31) Although clients will have differing levels of financial literacy and knowledge and engagement with sustainability considerations, solely focussing on the regulatory concept of sustainability preferences may not cover these wider sustainability motivations for investments.

(32) Moreover, taking into account wider sustainability motivations of clients could enable financial institutions to better understand client's expectations and adapt product offer.

(33) For this reason, this Guidance and the accompanying Questionnaire are structured so that there is a clear distinction between: (1) requirements to meet the threshold for regulatory compliance for assessing client sustainability preferences during the suitability assessment; and (2) steps to assess wider sustainability motivations (not addressed by the regulatory concept of client sustainability preferences) which are relevant to implement better practice for a comprehensive assessment of all sustainability related aspects associated with client investments.

5: Tips for background preparation

A: No systematic matching between labels, SFDR categories and categories of sustainability preference and wider sustainability motivations

(34) Since the SFDR has been in force, financial institutions must categorise their financial products according to the three categories of financial product established in the SFDR (see *Table 1: Relevant EU sustainable finance regulation*).

(35) However, the categories of client sustainability preferences do not mirror the categories of financial product established in the SFDR. Category A, B and C of the regulatory definition of sustainability preferences are instead based on the sustainability related concepts in the SFDR and the Taxonomy Regulation (as illustrated in *Table 2: Financial products comprising each category of sustainability preference*).

(36) Therefore, it is not possible to develop a protocol which matches the categories of financial product established in the SFDR to the categories of a client's sustainability preferences which is universally applicable. And further, the categories of a client's sustainability preferences are also impacted by the client's determination of the minimum proportion which should be invested in accordance with the specific criteria.

(37) Investment firms should therefore adopt a precautionary approach and assess financial instruments against the categories of a client's sustainability preferences and wider sustainability motivations separately and in parallel to categorising the same financial instruments under SFDR for disclosure purposes. The same logic should be applied to financial products with labels such as ISR label. All labelled financial products should similarly be assessed against the categories of a client's sustainability preferences.

B: Warning: The ranking of available financial instruments and their sustainability features should not be used to influence the expression of sustainability preferences and wider motivations

(38) To ensure that the suitability assessment during the client meeting can proceed smoothly, investment firms should prepare a ranking of available financial instruments that are ranked in terms of:
   a) the proportion invested in economic activities that qualify as environmentally sustainable (i.e. Category A of a client's sustainability preferences);
   b) the proportion of sustainable investments (i.e. Category B of a client's sustainability preferences); or
   c) the consideration of principal adverse impacts, such as categories of principal adverse impacts, types of commitments and qualitative or quantitative indicators (i.e. Category C or a client's sustainability preferences).

(39) We also advise to rank the instruments according to their level of relevance depending on the wider sustainability motivations of the client (ex: those having an investment strategy more adapted for impact-oriented clients…).

(40) Investment firms can use the information contained in the Findatex European ESG Template to carry out the ranking.

(41) **This pre-ranking is meant to help the financial advisor decide on suited products once the client has expressed its preferences and motivations, it should however not be used to help the client decide on its preferences and wider sustainability motivations.**

C: Training of financial advisors

(42) Financial advisors should be sufficiently trained to understand client sustainability preferences and wider sustainability motivations and select suitable products. Financial advisors should also be able to explain all the sustainability features of the products to the client.

(43) This training will allow the financial advisor to properly advice the client thus complying with its legal requirement and duty to act in the best interest of the client. Moreover, trained advisors will help fighting growing distrust of retail clients in sustainable finance.

6: Assessing client sustainability preferences and wider sustainability motivations

Ensure other aspects of the suitability assessment are completed

Summary of legal requirements

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 (Recital 5, MiFID II Delegated Act).

(44) The requirement to assess a client's sustainability preferences are conceived as a top up to the assessment of investment objective. Therefore, investment firms should first satisfy the requirements to obtain the necessary information about the client's knowledge and experience in the investment field, ability to bear risks and investment objectives including risk tolerance to enable the firm to provide services and products that are suitable for the client.

(45) Once these requirements have been satisfied the suitability assessment can then proceed to assess client sustainability preferences and wider sustainability motivations.[19]

Process for assessing client sustainability preferences

(46) The following process diagram articulates what is required for investment firms to:

a) **Step 1: Explanation of sustainability preferences** Explain the different categories of sustainability preferences to provide sufficient information to enable the client to make an informed decision about his or her sustainability preferences and wider sustainability motivations;

b) **Step 2: Identification of client sustainability preferences** Ask the right questions to comprehensively assess the client's sustainability preferences and wider sustainability motivations;

c) **Step 3: Financial product recommendation** Use the information revealed by the client to make a financial product recommendation.

(47) These steps are replicated in the Questionnaire. It is intended that the Questionnaire is used to record information to demonstrate that relevant actions have been completed and document key information about a client's sustainability preferences and wider sustainability motivations necessary for making a financial product recommendation and complying with record keeping obligations. The Guidance should therefore be understood to provide information and support for investment firms to complete the Questionnaire during the client meeting for the suitability assessment.

[19] Note that as set out in Paragraph (8), the Guidance and the Questionnaire focus only on the assessment of client sustainability preferences during the suitability assessment. The commentary does not cover the part of the suitability assessment related to the assessment of traditional investment objectives such as time horizon, risk appetite etc.

Process for assessing client sustainability preferences and sustainability motivations

(48) The following section of the Guidance provide further commentary on each of Steps 1-3 to provide information and support for investment firms to complete the Questionnaire during the client meeting for the suitability assessment.

Step 1: Explanation of sustainability preferences

Summary of legal requirements

Investment firms that provide investment advice and portfolio management services should explain the distinction between financial instruments which fall into one of the three categories of client sustainability preferences and financial instruments which do not have the same features and should not be eligible for recommendation to a client or potential client that has expressed sustainability preferences (MiFID II Delegated Regulation, Recital 6).

Investment firms that provide investment advice shall provide a description of the types of financial instruments considered, the range of financial instruments and providers and where relevant, the sustainability factors taken into consideration in the selection process of financial instruments (MiFID II Delegated Regulation, Art 52, Paragraph 3).

(49) The explanation of sustainability preferences is critical to enable the client to understand the different degrees of sustainability which are possible for financial instruments. The explanation should provide accurate and sufficient information to enable clients to take informed decisions and advocate effectively in relation to their own sustainability preferences and wider sustainability motivations.

(50) Investment firms should take steps to avoid introducing unconscious bias in the way that the explanation of sustainability preferences is articulated. An unconscious bias can be driven by various factors including the existence of an inducement to recommend certain financial instruments or the advisor's level or knowledge and own preconceptions about different financial instruments. And an unconscious bias can relate to different aspects of sustainability oriented financial instruments (cost, financial return, level or risk etc.)

(51) Investment firms should provide an explanation of sustainability preferences which relates to all financial instruments available on the market rather than being limited to the sustainability preferences which relate to the financial instruments which the investment firm is able to recommend. For this reason, the

explanation of sustainability preferences should occur before and in the absence of any presentation of financial products which the investment firm is able to recommend.

(52) The explanation of sustainability preferences will need to accommodate differing levels of financial literacy and knowledge of sustainability issues by the client. Many concepts are unlikely to be familiar to the average client and investment firms should ensure relevant information is conveyed in a meaningful manner for each client. Investment firms should inquire about the client's level of financial literacy and knowledge of sustainability issues to ensure that the explanation of sustainability preferences is effective.

(53) It is the investment firm's choice as to how to provide an explanation of sustainability preferences, and that choice may be shaped by decisions made in relation to the wider suitability assessment (i.e. not related to client sustainability preferences). However, investment firms should develop client explanatory materials to ensure the explanation of sustainability preferences is effective and enables controls to check if the explanation of sustainability preferences was adequately provided.

(54) *Annex 1: Client explanatory materials* articulates key considerations and content which should be included in the client explanatory materials to ensure that the explanation of sustainability preferences and wider sustainability motivations is effective. These key considerations and content are structured to follow the suggested approach in the Questionnaire and the different levels of assessment of client sustainability preferences and wider sustainability motivations. However, investment firms should bear in mind that the regulatory framework in this area is constantly developing and evolving. Investment firms should ensure they stay up to date with relevant regulatory developments.

(55) A pure focus on the regulatory concept of sustainability preferences may not cover wider sustainability motivations or capture all the granular aspects of how some clients want to invest their money. The content included in *Annex 1: Client explanatory materials* therefore cover information which is relevant to wider sustainability motivations (e.g. impact oriented financial instruments or other financial instruments which pursue sustainability related objectives which do not fall under Category A, B or C of the regulatory concept of sustainability preferences) and more granular aspects of how some clients want to invest their money (e.g. specific SDG topics or exclusion criteria etc.)

(56) Investment firms should ensure the client has an opportunity to ask further questions for clarification and to assist with the client's own understanding of the explanation of sustainability preferences.

Step 2: Identification of client sustainability preferences

Summary of legal requirements

Investment firms shall obtain from clients or potential clients the necessary information to understand their position and be able to determine that the recommendation meets the investment objectives of the client, including the client's risk tolerance and any sustainability preferences (MiFID II Delegated Regulation, Art 54, Paragraph 2). The information about the client's or potential client's investment objectives should include, where relevant, the length of time for which the client wishes to hold the investment, his or her preferences regarding risk taking, his or her risk tolerance, the purpose of the investment and his or her sustainability preferences (MiFID II Delegated Regulation, Art 54, Paragraph 5).

(57) The identification of any client sustainability preferences and wider sustainability motivations is a core part of the investment firm's duty to act in the best interests of the client. The process and questions articulated in the Questionnaire for this *Step 2: Identification of client sustainability preferences* rely on an explanation of sustainability preferences having been adequately provided. Investment firms should therefore be satisfied that the explanation of sustainability preferences is effective before proceeding to this *Step 2: Identification of client sustainability preferences.*

(58) Investment firms should ensure the client has an opportunity to ask further questions for clarification and to assist with the client's own understanding of the explanation of sustainability preferences. In addition, investment firms should ask the client if he or she has invested in sustainability oriented financial instruments in the past.

(59) The Questionnaire accommodates different levels of interest in sustainability preferences and wider sustainability motivations by clients through introducing three levels of assessment in *Step 2: Identification of client sustainability preferences* – Short Assessment, Medium Assessment and Long Assessment.

Short Assessment

(60) The Short Assessment is required for all clients and is designed to identify those who have no interest in sustainability. If having provided an explanation of sustainability preferences as per *Step 1: Explanation of sustainability preferences*, the client does not have any interest in sustainability at the end of the Short Assessment, then no further assessment of sustainability preferences is necessary, and the investment firm can proceed to *Step 3: Financial product recommendation.*

Medium Assessment

(61) If at the end of the Short Assessment, the client expresses any interest in sustainability or a need for further information, the investment firm should proceed to the Medium Assessment which focusses on assessing sustainability preferences and wider sustainability motivations for the client.

(62) Investment firms should encourage the client to explain sustainability preferences in his or her own words where possible in their response to Q2. This will reduce the risk of any unconscious bias or influence by the investment firm. The investment firm should pick up on any interest in sustainability expressed by the client.

(63) Investment firms should be prepared for clients to express their sustainability preferences and wider sustainability motivations in a variety of different ways in their response to Q2. One likely possibility here is that the client may first express general sustainability motivations (e.g., "I would like to have a positive

impact on the planet", "I don't want my money to be invested in the weapon industry") rather than precise sustainability preferences for certain types of financial instrument.

(64) Q3 aims at understanding the client main sustainability goal(s): impact, value alignment and/or ESG integration. More detail on the different goals is provided in Annex I Client explanatory material.

(65) Investment firms should keep an accurate record of the client's sustainability preferences and wider sustainability motivations which are freely expressed. This information is critical for *Step 3: Financial product recommendation*. If the investment firm is not able to recommend a financial instrument which satisfies all sustainability preferences and wider sustainability motivations, then the investment firm needs to precisely articulate what is not met so that the client can decide whether to pursue investment.

(66) Investment firms should consolidate the client's understanding of the regulatory concept of sustainability preferences prior to asking Q4. Further guidance to support investment firms is available in *Annex 1: Client explanatory materials.*

(67) Investment firms should ask for a client's minimum proportion to be invested in accordance with Category A or B of client sustainability preferences or qualitative or quantitative elements demonstrating consideration of principal adverse impacts for Category C of client sustainability preferences **without** presenting any predefined menu of financial instruments.

(68) In relation to the minimum proportion to be invested in accordance with Category A or B of client sustainability preferences, ESMA Guidelines indicates that 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.

(69) As better practice, 2DII recommends to ask the client to pick between a minimum of 25%, 50%, 75% or 100% of the investment. Minimum ranges have been defined based on the following elements: Given the low sustainable finance literacy of retail clients, consumer associations recommend to use predefined ranges for minimum proportions. Moreover, based on market research, 2DII identified enough funds to be available for clients in these ranges for category B of MIFID II. 2DII did not identify enough funds to be available for clients in all ranges for category A, however, the client should still have the free choice to define the minimum proportion according to his or her preferences. Either the financial advisor can find products which fit to the minimum proportions or must inform the client that he or she has no suitable product available. The client can either decides to adapt his or her preference or decides to find other investment solutions available on the market.

(70) The financial advisor should explain to the client the meaning of opting for the different ranges of minimum proportions for categories A and B.

(71) In relation to qualitative or quantitative elements demonstrating consideration of principal adverse impacts for Category C of client sustainability preferences, the questionnaire allows the client to pick between the main families of principal adverse impact indicators, using the categories presented in the SFDR RTS. As for qualitative elements, the client is asked if he or she wants to use PAI indicators for exclusion purposes or for engagement purposes or others (such as mere monitoring for example). Adequate explanations on these elements should be provided to the client.

(72) At the end of the Medium Assessment the client is asked if he or she wants to provide more detailed information on values or priorities for his or her investment. If the client does not wish to provide more detailed information, then no further assessment of sustainability preferences and wider sustainability motivations is necessary, and the investment firm can proceed to *Step 3: Financial product recommendation*.

Long Assessment

(73) If at the end of the Medium Assessment the client wants to provide more information on specific values or priorities for his or her investment, the investment firm should proceed to the questions in the Long Assessment which relate to values and priorities.

Values and priorities

(74) Investment firms should provide an explanation of the Sustainable Development Goals and the possibility to avoid financing certain economic activities or companies to enable the client to respond to Q6 to 9. Further guidance to support investment firms is available in *Annex 1: Client explanatory materials.*

(75) Following this assessment, the investment firm can proceed to *Step 3: Financial product recommendation.*

Step 3: Financial product recommendation

Summary of legal requirements

Investment firms shall ensure that the recommendation meets the investment objectives of the client, including the client's risk tolerance and any sustainability preferences and in addition the further criteria specified in MiFID II Delegated Regulation, Art 54(2). 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. (MiFID II Delegated Regulation, Art 54(10)).

(76) Following the identification of client sustainability preferences and wider sustainability motivations, investment firms can proceed *to Step 3: Financial product recommendation*. The Questionnaire accommodates three scenarios here:

a) **Outcome 1:** A suitable financial instrument is available for recommendation by the investment firm which satisfies the investment objectives of the client and any sustainability preferences and wider sustainability motivations.
b) **Outcome 2:** No suitable financial instrument is available for recommendation by the investment firm which satisfies at the same time investment objectives of the client, and all expressed wider sustainability motivations (even though *sustainability preferences* as defined by the regulation can be met). In this scenario, investment firms can still propose financial instruments to the client but not as meeting wider sustainability motivations expressed. Where this is the case clients should have the opportunity to adapt information on their wider sustainability motivations.
c) **Outcome 3:** No suitable financial instrument is available for recommendation by the investment firm which satisfies the investment objectives of the client and any sustainability preferences. In this scenario, investment firms could still propose financial instruments to the client but not as meeting sustainability preferences, in case the client decides to adapt its preferences[20].

(77) *Annex 2: Financial product eligibility for recommendation* articulates features of financial instruments which correlate to minimum requirements for satisfying client sustainability preferences and wider sustainability motivations. This information can support investment firms form a view on which financial instruments can be recommended to satisfy different client sustainability preferences and wider sustainability motivations. However, investment firms should bear in mind that sustainability features of financial instruments are constantly evolving. In addition, *Annex 2: Financial product eligibility for recommendation* represents a starting point for determining whether a financial instrument satisfies sustainability preferences and wider sustainability motivations. Investment firms must independently satisfy themselves that any financial instrument they recommend does in fact satisfy the specific sustainability preferences expressed by the client in that case.

[20] Recital 8 of MIFID II Delegated Regulation and Paragraph 82 of ESMA Guidelines

Outcome 1: A suitable product is available (Financial product(s) meeting sustainability preferences and wider sustainability motivations)

(78) Investment firms should assess the coherence of the answers provided by the client in relation to their sustainability preferences and wider sustainability motivations before proceeding to recommend a financial instrument. In case of incoherence, the investment firm should discuss with the client to better understand and clarify the position[21].

(79) Investment firms should be satisfied that any financial instrument which is recommended to the client satisfies the sustainability preferences and wider sustainability motivations of the client. Further guidance on assessing if a financial instrument satisfies the client's sustainability preferences and wider sustainability motivations is provided in *Annex 2: Financial product eligibility for recommendation*.

(80) For impact-oriented clients, investment firms should explain the difficulty of measuring impact of the investment in the real world. Product recommendation should focus on the products with maximized potential of impact.

(81) The sustainability features of the financial instruments should be presented in a transparent way that allows investment firms to engage in dialogue with clients at a sufficiently granular level in relation to how the financial instrument meets the sustainability preferences and wider sustainability motivations of the client.

Outcome 2: No suitable product is available (Financial product meeting sustainability preferences but not wider sustainability motivations)

(82) As a reminder, asking the client about its wider sustainability motivations is nor a legal requirement neither soft law but a better practice developed by 2DII. However, based on the overarching duty of the financial advisor to act in the best interest of the client, we consider that a financial product should not be presented as suitable if it does not match wider sustainability motivations of the client (even when it matches expressed sustainability preferences).

(83) In our opinion, where an investment firm does not have access to financial instruments which are eligible for recommendation to the client because they do not meet wider sustainability motivations, the investment firm should explain to the client why the investment firm is not able to recommend a financial instrument (for example through articulating which elements of the wider sustainability motivations are not met in the financial instrument which the investment firm has access to).

(84) Before asking the client if he or she wants to adapt his or her wider sustainability motivations, the investment firm should inform the client that such a financial instrument may be available elsewhere (e.g. though a different investment firm). The investment firm should inform the client of online platforms which compare the sustainability features of different financial instruments (such as My Fair Money, a platform built by 2DII).

(85) The investment firm may then ask the client if he or she wants to adapt his or her wider sustainability motivations or whether the client wants to find alternative investment solutions. Investment firms should

[21] In certain cases, incoherences might demonstrate an evolution of the client preferences and motivations throughout the assessment.

seek to reduce the risk of any unconscious bias or influence in this decision making by the client. Where the client decides to adapt his or her wider sustainability motivations, the investment firm should keep records of the decision and the reasons for that decision.

(86) After a client decides to adapt its wider sustainability motivations, and not before, the firm has the possibility to disclose to the client, information about the offering of products with sustainability features.

(87) If the client adapts elements of his or her wider sustainability motivations, the investment firm may then have the possibility of recommending a suitable financial instrument. Investment firms should be satisfied that any financial instrument which is recommended to the client satisfies the adapted wider sustainability motivations. Further guidance on assessing if a financial instrument satisfies the client's wider sustainability motivations is provided in *Annex 2: Financial product eligibility for recommendation*.

(88) Assessing wider sustainability motivations of clients should not create additional legal risks, therefore, investment firms should use their best efforts to match the client's wider sustainability motivations but should inform the client that they accept no actual responsibility or liability whatsoever if the financial products advised don't comply with the client's expectations beyond MIFID II and MIFID II Delegated Regulation requirements. A template of disclaimer is integrated at the beginning of the Questionnaire.

Outcome 3: No suitable product is available (No financial product meeting sustainability preferences)

(89) Where an investment firm does not have access to financial instruments which are eligible for recommendation to the client because they do not meet sustainability preferences, the investment firm should explain to the client why the investment firm is not able to recommend a financial instrument (for example through articulating which of the sustainability preferences are not met in the financial instrument which the investment firm has access to).

(90) Before asking the client if he or she wants to adapt his or her sustainability preferences, the investment firm should inform the client that such a financial instrument may be available elsewhere (e.g. though a different investment firm). The investment firm should inform the client of online platforms which compare the sustainability features of different financial instruments (such as My Fair Money, a platform built by 2DII).

(91) The investment firm may then ask the client if he or she wants to adapt his or her sustainability preferences or whether the client wants to find alternative investment solutions. Investment firms should seek to reduce the risk of any unconscious bias or influence in this decision making by the client. Where the client decides to adapt his or her sustainability preferences, the investment firm should keep records of the decision and the reasons for that decision.

(92) After a client decides to adapt its preferences, and not before, the firm has the possibility to disclose to the client, information about the offering of products with sustainability features.

(93) If the client adapts his or her sustainability preferences, the investment firm may then have the possibility of recommending a suitable financial instrument. Investment firms should be satisfied that any financial instrument which is recommended to the client satisfies the adapted sustainability preferences of the client. Further guidance on assessing if a financial instrument satisfies the client's sustainability preferences is provided in *Annex 2: Financial product eligibility for recommendation*.

Unclear sustainability preferences

(94) No answer on sustainability preferences:

(95) ESMA indicates that 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.[22]

(96) 2DII’s better practices are in line with ESMA recommendations in relation to clients who answer “no” to the question whether they have sustainability preferences.

(97) However, regarding clients who don’t answer the question, 2DII encourages financial advisors to go beyond ESMA recommendations by making their best effort to include at least some products with sustainability features in the list of products recommended to the client, provided they are suitable with other investment objectives of the client. This 2DII better practice is based on the opinion that many clients may refrain from answering questions on sustainability due to a lack of understanding and knowledge (or a lack of trust) rather than a lack of interest. [23]

(98) In all cases, 2DII encourages financial advisors to explain all features of products recommended, including sustainability features when relevant.[24]

(99) Multiple sustainability preferences:

(100) ESMA clarifies 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 alternatives, unless specifically expressed by the client. Similarly, ESMA notes that, while clients are expected to provide a prioritization in case of simultaneous/overlapping sustainability preferences, in the case where no prioritization is given, advisors should make such assessment in the client’s best interest.[25]

(101) Where the sustainability preferences of the client are unclear, 2DII advises that financial advisors refer to the main sustainability goal of the client to filter most suitable products. If the sustainability goals are also unclear, then the financial advisor should make its best effort to propose products matching all choices and explain the differences between the different products in terms of sustainability ambitions.

(102) Inconsistent and unclear answers from the client should not be interpreted as a lack of interest in products with high sustainability ambitions but rather as an opportunity for educating the client on the topic of sustainable finance. Moreover, inconsistencies in answers throughout the questionnaire could also demonstrate the evolution of the thinking of the client on the topic while answering questions and receiving explanations. Hence, financial advisors should not hesitate to come back on certain answers with the client to clarify them.

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[22] ESMA guidelines, Paragraph 85

[23] Jumping the barriers to sustainable retail investment in France, 2DII, 2022: notably page 29 “researchers have reported the negative effects of a generalized distrust against financial institutions as distributors or manufacturers of financial products, a lack of knowledge or information about sustainable investments, negative perceptions about the returns of sustainable investments […].

[24] Clients not providing an answer could be considered as “sustainability-uncertain” rather than “sustainability-neutral” and should be provided with more information to provide an answer.

[25] ESMA Final Report Guidelines on certain aspects of the MiFID II suitability requirements - Annex III - Feedback on the consultation paper, Paragraph 35

7: Record keeping

Summary of legal requirements

When providing investment advice, investment firms shall provide a report to the client that outlines the advice. The report should identify why the recommendation provided is suitable including how the recommendation meets the client's investment objectives, his or her personal circumstances, the client's knowledge and experience, the client's attitude to risk his or her capacity to sustain losses and his or her sustainability preferences (Article 54, Paragraph 12).

(103) Following the client meeting for the suitability assessment, investment firms should provide a report to the client that explains how the recommendation meets the client's investment objectives, his or her personal circumstances, the client's knowledge and experience, attitude to risk, capacity to sustain losses and sustainability preferences.

(104) The report to the client therefore covers all the subject matter of the suitability assessment (rather than solely the aspects of the suitability assessment which relate to the assessment of suitability preferences and wider sustainability motivations). However, the Questionnaire provides a means to record information to demonstrate that relevant actions have been completed and document key information about a client's sustainability preferences and wider sustainability motivations necessary for making a financial product recommendation and which should be included in this report to client.

(105) In relation to the parts of the report to client which relate to assessment of sustainability preferences and wider sustainability motivations, investment firms should include:

a) confirmation that an explanation of sustainability preferences and wider sustainability motivations was provided including reference to the client explanatory materials that were used by the investment firm;
b) a record of the sustainability preferences and wider sustainability motivations which were expressed by the client;
c) where a financial instrument was recommended as meeting the client's sustainability preferences and wider sustainability motivations, an explanation as to why the financial instrument met these sustainability preferences and wider motivations;
d) where a financial instrument could not be recommended as meeting the client's sustainability preferences and/or wider sustainability motivations as originally stated, the reasons why no financial product recommendation was possible;
e) where the client decided to adapt the sustainability preferences and/or wider sustainability motivations, information on how the sustainability preferences and/or wider sustainability motivations were adapted and the reasons for doing so;
f) where a financial instrument was subsequently recommended as meeting the client's adapted sustainability preferences and/or wider sustainability motivations, an explanation as to why the financial instrument met these adapted sustainability preferences and/or wider sustainability motivations.

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The Finance ClimAct project contributes to the implementation of France's National Low Carbon Strategy and the European Union's Sustainable Finance Action Plan. It aims to develop tools, methods and new knowledge that will enable (1) savers to integrate environmental objectives into their investment choices, and (2) financial institutions and their supervisors to integrate climate issues into their decision-making processes and align financial flows with energy and climate objectives.

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