Guidance for assessing client sustainability preferences and motivations

For use with the Questionnaire for assessing client sustainability preferences and motivations

2° investing initiative

About

2° Investing Initiative (2DII) is an international, non-profit think tank working to align financial markets and regulations with the Paris Agreement goals. 2DII coordinates some of the world's largest research projects on sustainable finance. Our team of finance, climate and risk experts develop research, tools and policy insights to help financial institutions and regulators hasten and adapt to the energy transition. To ensure our independence and the intellectual integrity of our work, we have a multistakeholder governance and funding structure with representatives from a diverse array of financial institutions, governments and NGOs.

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This Guidance is part of the Retail Investing Research Program at 2DII which is one of the largest publicly funded research programmes on the supply, demand, distribution and policy aspects of retail investment markets in Europe.

Disclaimer

The Guidance and Questionnaire relate to EU 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 client sustainability preferences to the suitability assessment. The Guidance and the Questionnaire include content which in 2DII's opinion supports investment firms implement better practice than currently required by the regulatory framework. These better practices should not be confused with binding rules or soft law issued by legislators or regulators.

Neither document is endorsed by financial regulators or supervisory authorities at national or EU level. 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).

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1. Introduction

(1) Investment firms providing financial advice and portfolio management are required to carry out a mandatory assessment of client sustainability preferences. Investment firms must then take these sustainability preferences into account when selecting financial instruments that are recommended to clients.

(2) This Guidance and accompanying Questionnaire has been developed to assist investment firms in carrying out a comprehensive assessment of client sustainability preferences and wider sustainability motivations and harmonise practice among investment firms. 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 as well as implement better practice than currently required by the regulatory framework to ensure a comprehensive assessment of all sustainability related aspects associated with client investments.

(3) This Guidance and Questionnaire were developed considering: (i) the relevant regulatory framework and any supervisory guidance materials; (ii) 2DII expertise and research in relation to assessing client preferences for sustainable investment; and (iii) extensive stakeholder feedback through working group discussions, public consultation and interviews and focus group sessions.[1]

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

a) Directive 2014/65/EU[2] (**MiFID II**);
b) Commission Delegated Regulation (EU) 2017/565[3] (**MiFID II Delegated Regulation**) (as amended by Commission Delegated Regulation (EU) 2021/1253[4]); and
c) ESMA Guidelines on certain aspects of the MiFID II suitability requirements (**ESMA Guidelines**).[5] [6]

(5) Terms used in MiFID II and the MiFID II Delegated Regulation have the same meaning in the Guidance and Questionnaire. Recognising that the Guidance and Questionnaire support investment firms to implement better practice than currently required by the regulatory framework, the word ‘should’ is often used (rather than ‘shall’ or ‘required to’ which are more relevant for mandatory obligations). Reference to the word ‘client’ should be interpreted to refer to ‘client’ or ‘potential client’ as applicable.

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

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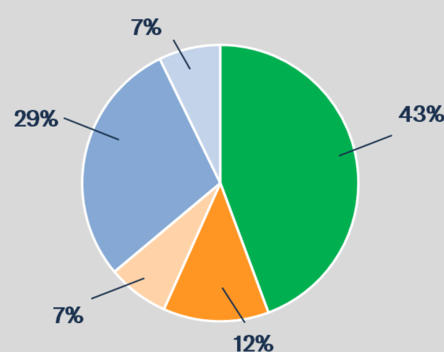
[1] The original version of the Guidance and Questionnaire was developed through a working group established under the Finance ClimAct project in France with around 20 members drawn from financial institutions, academia and civil society. 2DII also conducted a public consultation on a draft Guidance and Questionnaire from March to June 2022 and carried out a series of online focus groups and interviews in May 2023 to develop this EU version of the Guidance and Questionnaire.
[2] 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
[3] 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
[4] 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
[5] ESMA, 2022, *Guidelines on certain aspects of the MiFID II suitability requirements*
[6] While the Guidance and the Questionnaire focus on the assessment of sustainability preferences under MiFID II, the content could also be informative for the assessment of sustainability preferences required under Directive 2016/97/EU (**IDD**).

2. Why are sustainability preferences included in the suitability assessment?

(7) Societal awareness of environmental and social issues is changing the profile of how clients want to invest their money. More and more clients want to invest in a way that takes sustainability considerations into account. A clear and significant trend 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.[7]

Client sustainability goals when investing in sustainable financial products

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.
■ I want to avoid investing in a 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

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

(9) The new rules on sustainability preferences aim to enhance client awareness of financial instruments with sustainability ambition and to ensure that client preferences for sustainable investment are included in the suitability assessment. Investment firms must carry out a mandatory assessment of client sustainability preferences as a top up to the assessment of traditional investment objectives. Investment firms should then take these sustainability preferences into account when selecting financial instruments that are recommended to clients.

[7] 2DII is leading one of the largest research projects on sustainability preferences and motivations of EU retail investors which includes quantitative surveys in 14 member states and qualitative interviews and focus groups in 8 member states. Find more information on trends of sustainability preferences and motivations in: 2DII, 2023, *Moving the blockers of retail sustainable finance*; 2DII, 2022, *Jumping the barriers to sustainable retail investment in France,* 2DII, 2022, *What do your clients actually want?*

3. Using the Guidance and Questionnaire

(10) The Guidance should be read together with the Questionnaire. The Questionnaire guides an investment firm through the part of the suitability assessment related to assessing client sustainability preferences and wider sustainability motivations which are relevant to implement better practice for a comprehensive assessment of all sustainability related aspects associated with client investments. Investment firms should use the Questionnaire to record relevant actions have been completed and document key information about client sustainability preferences and wider sustainability motivations necessary for making a financial product recommendation and complying with record keeping obligations.

(11) The Guidance provides background information for investment firms to complete the Questionnaire during the client meeting for the suitability assessment. The remaining sections of the Guidance are 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 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 for their investments. In addition, sustainable finance approaches and client expectations regarding sustainability aspects of their investments are continually evolving. Therefore 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 for better practice and a comprehensive assessment of all sustainability related aspects associated with client investments.
5: Background preparation	This section explains how investment firms should prepare prior to the client meeting to ensure the investment firm has complied with applicable regulatory requirements and the suitability assessment can proceed smoothly so that the client is satisfied with the advice provided.
6: Assessing client sustainability preferences and wider sustainability motivations	This section provides a process diagram for the three steps to assess 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 *Section 4: Client sustainability preferences and wider 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; and (2) steps to assess wider sustainability motivations which are relevant to implement better practice for a comprehensive assessment of all sustainability related aspects associated with client investments.
7. Record keeping	This section explains how information revealed by the client during the suitability assessment must be included in a report to the client.

4. Client sustainability preferences and wider sustainability motivations

Regulatory concept of sustainability preferences

(12) Client sustainability preferences are conceptualized to be consistent with other EU sustainable finance regulation included in *Table 1*.

Table 1: Relevant EU sustainable finance regulation

Taxonomy Regulation[8]	The Taxonomy Regulation provides a common classification to identify what economic activities can be considered environmentally sustainable through providing a substantial contribution to one of six 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. The Taxonomy Regulation (complemented by the Sustainable Finance Disclosure Regulation) also requires disclosures on the extent to which a financial product finances activities that are 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[9] (**SFDR**)	The SFDR introduces disclosure requirements for financial institutions at organisation, service and product level. In addition to complementing the Taxonomy Regulation by requiring disclosures on 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. • *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.

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

[8] 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
[9] 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

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 six environmental objectives in the Taxonomy Regulation (see *Table 1* above).
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.

(14) Investment firms should bear in mind that the sustainable finance regulatory framework is constantly evolving. Investment firms should ensure they stay up to date with relevant regulatory developments.

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.

Regulatory concept of sustainability preferences does not cover wider sustainability motivations

(15) 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*.

(16) While Category A, B and C are built around the concepts of greenness and sustainability, many client ***sustainability goals*** when investing in sustainable financial products are about Impact, Value alignment or ESG integration (see *Section 2: Why are sustainability preferences included in the suitability assessment?*). This focus on sustainability goals is increasingly used by the scientific community, industry, financial regulators, and experts.[10]

(17) Equally, some clients may have ***specific values and priorities*** for their investments such as wanting to: focus on one or more of the Sustainable Development Goals (**SDGs**); avoid financing economic sectors such as fossil fuels, arms, tobacco, alcohol etc.; or avoid financing companies subject to controversies in relation to the environment, labour rights, tax avoidance etc.

(18) If investment firms focus solely on assessing sustainability preferences, this can lead to potential mismatches between the features of recommended products (based only on Category A, B or C) and what product features clients actually want.[11]

[10] See for instance use by 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.

[11] See 2DII's latest market reports which summarise research findings on the supply, demand and distribution of sustainable finance products in 7 member states. The reports reveal a significant mismatch between the supply of impact-oriented financial products and

(19) 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.[12] An impact-oriented financial instrument does not necessarily fall under Category A, B or C. But given the high proportion of clients who have a sustainability goal of having an impact, it is these impact oriented financial instruments which are most suitable for a financial product recommendation to these clients. Please see *Annex 3: Advising impact-oriented clients* for further information.

Wider sustainability motivations
*We use the term wider sustainability motivations to denote additional information about client **sustainability goal(s)** (Impact, Value alignment or ESG integration) or **specific values and priorities** to support or avoid which are not accommodated by the definition of sustainability preferences.[13] Assessing wider sustainability motivations (as well as sustainability preferences) provides further information that can increase the suitability of recommended financial products (see Annex 2: Financial product eligibility for recommendation).*

(20) Clients will have differing levels of knowledge and engagement with sustainability considerations, but solely focussing on the regulatory concept of sustainability preferences will not cover wider sustainability motivations. Moreover, assessing wider sustainability motivations enables investment firms to provide more suitable financial product recommendations. For this reason, the Guidance and Questionnaire are structured with a clear distinction between: (1) requirements to meet the threshold for regulatory compliance for assessing client sustainability preferences; and (2) steps to assess wider sustainability motivations which are relevant to implement better practice for a comprehensive assessment of all sustainability related aspects associated with client investments.

demand of impact-oriented investors (which represent approximately 50% of retail investors): 2DII, 2023, *Moving the blockers of retail sustainable finance*; 2DII, 2022, *Jumping the barriers to sustainable retail investment in France*

[12] 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 Art 2(17) SFDR.

[13] See 2DII, 2023, *Moving the blockers of retail sustainable finance*; 2DII, 2022, *Please Don't Let Them Be Misunderstood!*

5. Background preparation

No systematic matching between categories of sustainability preference and SFDR categories or sustainability labels

(21) Category A, B and C of sustainability preferences do not mirror the three categories of financial product established in the SFDR (see *Table 1: Relevant EU sustainable finance regulation*). Therefore it is not possible to develop a protocol which matches categories of financial product established in the SFDR to categories of client sustainability preferences which is universally applicable.

(22) Investment firms should adopt a precautionary approach and assess financial instruments against categories of client sustainability preferences and wider sustainability motivations separately to categorising the same financial instruments under SFDR for disclosure purposes. The same logic should be applied to financial products with a sustainability label - all labelled financial products should be assessed against the categories of client sustainability preferences and wider sustainability motivations.

Ranking of financial products according to sustainability features should not influence clients

(23) To ensure that the suitability assessment during the client meeting can proceed smoothly, investment firms should rank available financial instruments in terms of:
a) the proportion invested in economic activities that qualify as environmentally sustainable (i.e. Category A);
b) the proportion of sustainable investments (i.e. Category B); 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).

(24) Investment firms should also rank financial instruments according to their relevance to wider sustainability motivations (e.g. an investment strategy more adapted for impact-oriented clients).

(25) Investment firms can use the information contained in the Findatex European ESG Template to carry out the ranking but might need to conduct further due diligence on the sustainability characteristics of a financial product (e.g. evaluating the credibility of the stewardship activities on a sustainability issue by a product manufacturer).

(26) This pre-ranking is meant to help the financial advisor identify suitable financial products once the client has expressed its sustainability preferences and wider sustainability motivations. It should not be used to influence how the client articulates its sustainability preferences and wider sustainability motivations.

Advisor sustainable finance knowledge and competence

(27) Advisors should be sufficiently trained to understand client sustainability preferences and wider sustainability motivations and select suitable financial products. Advisors should also be able to explain all the sustainability features of financial products to the client. This will allow the advisor to provide proper advice to ensure compliance with legal requirements and duty to act in the best interest of the client.

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).

(28) The requirement to assess client sustainability preferences is conceived as a top up to the assessment of investment objectives. 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. Once these requirements have been satisfied the suitability assessment can then proceed to assess client sustainability preferences and wider sustainability motivations.

Process for assessing client sustainability preferences

(29) The diagram articulates the process investment firms should follow for assessing client sustainability preferences:

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.
Step 2: Identification of client sustainability preferences Ask the right questions to comprehensively assess the client's sustainability preferences and wider sustainability motivations.
Step 3: Financial product recommendation Use the information revealed by the client to make a financial product recommendation.

(30) Investment firms should use the Questionnaire to record relevant actions have been completed and document key information about client sustainability preferences and wider sustainability motivations necessary for making a financial product recommendation and complying with record keeping obligations. The Guidance provides background information 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).

(31) The explanation of sustainability preferences is critical and 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.

(32) Investment firms should avoid introducing unconscious bias in the way 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 of knowledge and own preconceptions about different financial instruments. An unconscious bias can relate to different aspects of sustainability oriented financial instruments (cost, financial return, level or risk etc.).

(33) 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 financial instruments which the investment firm can recommend). 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.

(34) The explanation of sustainability preferences should accommodate differing levels of 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.

(35) Investment firms can choose how to provide an explanation of sustainability preferences. However, investment firms should develop client explanatory materials to ensure the explanation of sustainability preferences is effective and enable control checks to take place.

(36) *Annex 1: Client explanatory materials* articulates key considerations and content which should be included in client explanatory materials to ensure that the explanation of sustainability preferences and wider sustainability motivations is effective. These key considerations and content 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 sustainable finance regulatory framework is constantly evolving and ensure they stay up to date with relevant regulatory developments.

(37) A pure focus on the regulatory concept of sustainability preferences may not cover wider sustainability motivations. *Annex 1: Client explanatory materials* therefore covers 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 sustainability preferences) and more granular aspects of how some clients want to invest their money (e.g. specific SDG topics or exclusion criteria etc.).

(38) 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).

(39) 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 *Step 2: Identification of client sustainability preferences.*

(40) 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.

(41) The Questionnaire accommodates different levels of client interest in sustainability preferences and wider sustainability motivations through introducing three levels of assessment: Short Assessment, Medium Assessment and Long Assessment.

Short Assessment

(42) The Short Assessment is required for all clients and is designed to identify those who have no sustainability preferences. 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

(43) 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 sustainability goals.

(44) Investment firms should encourage the client to articulate 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.

(45) 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.

(46) Q3 aims at understanding the client's sustainability goal(s): Impact, Value alignment and/or ESG integration. Further detail on sustainability goals is provided in *Annex 1: Client explanatory materials*.

(47) Investment firms should keep an accurate record of the client's sustainability preferences and wider sustainability motivations which are 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.

(48) 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.*

(49) In Q4, 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.

(50) In relation to the minimum proportion to be invested in accordance with Category A or B of client sustainability preferences, investment firms should collect this information by minimum percentages rather than an exact percentage. These percentages should be presented in a neutral way to the client and should be sufficiently granular. For best practice, investment firms should ask the client to pick between a minimum proportion of 25%, 50%, 75% or 100%.[14] Investment firms should explain the meaning of opting for the different minimum proportions for Categories A and B.

(51) In relation to qualitative or quantitative elements demonstrating consideration of principal adverse impacts for Category C, the Questionnaire allows the client to pick between the main families of principal adverse impact indicators using the categories presented in the SFDR regulatory technical standards. The client is asked if he or she wants to use these principal adverse impact indicators for exclusion purposes, for engagement purposes or other purposes (such as mere monitoring for example). Adequate explanations on these elements should be provided to the client.

(52) At the end of the Medium Assessment the client is asked if he or she wants to provide more detail on specific values or priorities for his or her investment. If the client does not wish to provide more detail, 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*.

[14] These are defined based on the following elements: given the low sustainable finance literacy of retail clients, consumer associations recommend using predefined ranges for minimum proportions. Moreover, based on market research, 2DII identified enough funds to be available for clients in these ranges for sustainability preferences Category B. 2DII did not identify enough funds to be available for clients in all ranges for sustainability preference 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 proportion or must inform the client that he or she has no suitable product available. The client can either decide to adapt his or her preference or decide to find other investment solutions available on the market.

Long Assessment

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

(54) 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.*

(55) 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)).

(56) 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 (note that all scenarios assume client investment objectives are met):

a) *Outcome 1:* A suitable financial instrument is available for recommendation by the investment firm which satisfies sustainability preferences and wider sustainability motivations.

b) *Outcome 2:* No suitable financial instrument is available for recommendation by the investment firm which satisfies all wider sustainability motivations (even though sustainability preferences can be met). In this scenario, investment firms can still propose financial instruments to the client but not as meeting wider sustainability motivations. 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 all sustainability preferences. Where this is the case clients should have the opportunity to adapt information on their sustainability preferences.[15]

(57) *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 assess 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.

[15] Recital 8, MIFID II Delegated Regulation and Paragraph 82, ESMA Guidelines

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

(58) 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.[16]

(59) 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*.

(60) 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 maximize potential of impact.

(61) 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 financial product is available (meeting sustainability preferences but not wider sustainability motivations)

(62) As a reminder, assessing wider sustainability motivations is not a legal requirement but should be considered as better practice. However, based on the overarching duty of the investment firm 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).

(63) 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, investment firms are encouraged to 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).

(64) 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).

(65) 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 seek to reduce the risk of any unconscious bias or influence in this decision making by the client. Where

[16] In certain cases, incoherence might demonstrate an evolution of the client sustainability preferences and wider sustainability motivations throughout the assessment.

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.

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

(67) 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*.

(68) Assessing wider sustainability motivations of clients should not create additional legal risks, therefore, investment firms are encouraged to use their best efforts to match the client's wider sustainability motivations but should inform the client that they accept no responsibility or liability if the recommended financial products do not comply with client expectations beyond minimum legal requirements. A template disclaimer is integrated at the beginning of the Questionnaire.

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

(69) 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).

(70) 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).

(71) 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.

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

(73) 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

(74) Where a client does not answer the question whether it has sustainability preferences or answers "no", regulatory guidance states that investment firms may consider this client as "sustainability-neutral" and recommend financial products both with and without sustainability-related features.[17]

(75) Investment firms are encouraged to go beyond this regulatory guidance by making their best efforts to include financial products with sustainability features in the list of recommended financial products (provided they also satisfy client investment objectives).[18]

(76) In all cases, investment firms should explain all features of recommended financial products, including sustainability features when relevant.[19]

(77) Where a client expresses multiple sustainability preferences (e.g. a preference for more than one of Category A, B or C), regulatory guidance states that investment firms can interpret these options as alternatives, unless specifically expressed by the client.[20]

(78) Where client sustainability preferences are unclear, investment firms are encouraged to refer to the main sustainability goal of the client to filter the most suitable financial products. If the sustainability goal of the client is also unclear, investment firms are encouraged to make their best efforts to propose financial products matching all choices and explain the differences between the financial products in terms of sustainability ambition.

(79) Inconsistent and unclear answers from the client should not be interpreted as a lack of interest in financial products with high sustainability ambition but rather as an opportunity for educating the client on the topic of sustainable finance. Inconsistent answers throughout the Questionnaire could also demonstrate the evolution of client thinking on the topic while answering questions and receiving explanations. Investment firms should not hesitate to seek to clarify certain answers with the client.

[17] Paragraph 85, ESMA Guidelines
[18] This 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. See 2DII, 2022, *Jumping the barriers to sustainable retail investment in France*.
[19] Clients not providing an answer could be considered as sustainability-uncertain rather than sustainability-neutral and investment firms should provide more information to assist client decision making.
[20] 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.

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).

(80) 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.

(81) The report to the client therefore covers the entirety 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, investment firms should use the Questionnaire 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.

(82) 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 any client explanatory materials used by the investment firm);
b) a record of the sustainability preferences and wider sustainability motivations which were originally 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.

Annex 1: Client explanatory materials

(1) Investment firms 'should explain the term and the distinctions between the different elements of the definition of sustainability preferences under points (a) to (c) […] and also between these products and products without such sustainability features in a clear manner, avoiding technical language. Firms should also explain terms and concepts used when referring to environmental, social and governance aspects.'[21] The information should be provided in simple language and understandable for retail clients.

(2) Investment firms can choose how to provide an explanation of sustainability preferences. However, investment firms should develop client explanatory materials to ensure the explanation of sustainability preferences is effective and enable control checks to take place.

(3) Investment firms are free to choose the format of client explanatory materials, which may consist of one or more of the following:

a) a script which an investment firm can use to provide an explanation of sustainability preferences in open dialogue during the client meeting;
b) E-learning or short videos which provide an explanation of sustainability preferences and may either be watched in advance of the client meeting or during the client meeting itself; or
c) a leaflet which provides an explanation of sustainability preferences and may either be circulated in advance of the client meeting or during the client meeting itself.

(4) Client explanatory materials should be designed to accommodate differing levels of financial literacy and/or levels of interest in sustainability issues by the client. In all cases the client explanatory materials should provide accurate and sufficient information on the key features associated with an explanation of sustainability preferences and wider sustainability motivations.

(5) In terms of differing levels of interest in sustainability issues by the client, the Questionnaire and Guidance accommodates this through introducing three levels of assessment in *Step 2: Identification of client sustainability preferences* – Short Assessment, Medium Assessment and Long Assessment.

(6) Set out below are 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 follow the suggested approach in the Questionnaire and the different levels of assessment of client sustainability preferences and wider sustainability motivations. The key content for client explanatory materials below is structured in a way which provides a minimum degree of explanation of sustainability preferences to all clients. This minimum degree of explanation will allow the client to decide if he or she has any interest on sustainability issues linked to the investment. Then further explanation and details are provided for clients who express interest in sustainability issues.

(7) The figure below illustrates the key content which investment firms should cover in the explanation of sustainability preferences and wider sustainability motivations.

[21] Paragraph 16, ESMA Guidelines

<table>
<tr><td rowspan="1">Step 1: Explanation of sustainability preferences</td><td>Explanation to be provided to all clients</td><td>Investment firms should provide an explanation of sustainability preferences 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.

At this stage, investment firms should provide an explanation in relation to:
• link between financial investment and the environment and society
• explanation on what environmental, social and governance aspects mean;
• different types of sustainable financial instruments available on the market;
• different categories of sustainability preferences;
• articulation between sustainability preferences and other investment objectives.</td></tr>
<tr><td rowspan="3">Step 2: Identification of client sustainability preferences</td><td rowspan="3">Additional information depending on the level of interest of the client</td><td>Specific to the Short assessment

The Short Assessment is required for all clients and is designed to identify those who have no interest in sustainability. At this stage, the investment firm need not provide any further explanation of sustainability preferences and wider sustainability motivations beyond what is given under Step 1 above.</td></tr>
<tr><td>Specific to the Medium Assessment

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.

At this stage, the investment firm should provide an explanation in relation to:
• main sustainability goals;
• specific explanation to be provided to all clients who have an interest in impact;
• further explanation on the different categories of sustainability preferences when needed.</td></tr>
<tr><td>Specific to the Long Assessment

If at the end of the Medium Assessment if 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 sustainability values and priorities.

At this stage, the investment firm should provide further explanation in relation to values and priorities.</td></tr>
</table>

(8) Investment firms should bear in mind that the sustainable finance regulatory framework is constantly evolving and ensure they stay up to date with relevant regulatory developments.

(9) The content below applies the following interpretive principles:

a) ‘I’ or ‘we’ refers to the investment firm (or advisor) which is carrying out the suitability assessment
b) ‘you’ refers to the client or potential client
c) ‘client’ refers to client or potential client as applicable

Step 1: Explanation of sustainability preferences

To be provided to all clients

Link between financial investment and the environment and society

(10) Climate change and environmental degradation are defining global challenges of our time. Countries across the world are working to limit climate change, reverse biodiversity loss and environmental degradation and leave nobody behind in the process. Sustainable finance means taking sustainability considerations into account when making investment decisions and has a key role in delivering the climate, environmental and social policy objectives of governments around the world.

(11) A sustainable finance approach can lead to new sustainable economic activities and projects. It can support economic growth while reducing pressures on the environment and considering social and governance aspects.

Environmental, social and governance aspects

(12) Sustainability considerations of investment decisions can relate to different environmental, social, and governance aspects.
   a) Environmental considerations can include climate change mitigation and adaptation, preservation of biodiversity, pollution prevention etc.
   b) Social considerations can include issues of inequality, inclusiveness, labour relations, human rights, gender equality etc.
   c) Governance considerations can include diversity in corporate governance, corruption and bribery, tax transparency etc.

Different sustainable financial instruments available on the market

(13) You can decide to invest your money considering ESG aspects of financial instruments. It is important to note that there are several types of financial product with different degrees of ambition in terms of sustainability.

(14) Some financial products merely consider ESG aspects, for example by calculating and disclosing negative externalities of investments on the environment or society, while other financial products aim to make a real contribution to environmental or societal improvement. Financial products can take account of several environmental, social and governance considerations or focus on only one or two of these aspects.

(15) You should know that in case our range of financial product does not meet your expectations in term of sustainability characteristics, you can consult other investment firms or publicly available platforms to learn more about other sustainable financial products available on the market (e.g. My Fair Money).

Different categories of sustainability preference

(16) Under the current regulatory framework, a client's sustainability preferences are understood as a client's preferences for three categories of financial instrument.

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.

(17) You may also wish to express wider sustainability motivations such as sustainability goals or more precise values and priorities.

Articulation between sustainability preferences and other investment objectives

(18) Please feel free to express any sustainability preferences (or wider sustainability motivations) you may have since these are considered as a top up to the investment objectives you already expressed (i.e. sustainability preferences wider sustainability motivations do not affect the investment objectives you have expressed).

Step 2: Identification of client sustainability preferences

Short Assessment

(19) Having provided the explanation of sustainability preferences in *Step 1: Explanation of sustainability preferences*, the Short Assessment is required for all clients and is designed to identify those who have no interest in sustainability. If you have no interest in sustainability at the end of the Short Assessment, then no further explanation or assessment of sustainability preferences is required, and I can proceed to *Step 3: Financial product recommendation*. If you express any interest in sustainability or a need for further information, then I should provide further explanation during the Medium Assessment.

Proceed to Q1 of the Questionnaire. If the client answers a) or b), please provide the explanations below related to the Medium Assessment.

Medium Assessment

(20) As you have expressed an interest in sustainability or a need for further information, I can now provide an overview of the different sustainability goals and further detail in relation to sustainability preferences if needed. This information should help you form an opinion and express your sustainability goals and sustainability preferences so that I can ensure these are reflected in any financial product I recommend.

(21) Sustainability oriented clients usually have one or more of three main ***sustainability goals*** for their investments (in addition to achieving a financial return).[22]

a) *Impact:* Have a positive impact on the environment and/or society with the investment.
b) *Value alignment:* Align the investment with personal values (either by prioritising or avoiding financing specific economic activities).

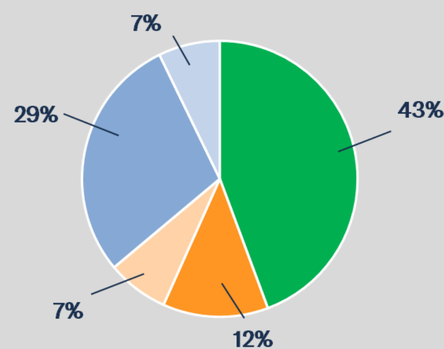
[22] This heuristic is already used in the scientific community, industry, regulators and experts to distinguish between the main sustainability-related objectives (e.g. Busch et al., 2021, *Impact investments: a call for (re)orientation*; Eurosif, 2022, *Classification Scheme for Sustainable Investments*; FCA, 2022, *Sustainability Disclosure Requirements (SDR) and investment labels*; AMAS/SFF, 2021, *How to avoid the Greenwashing Trap*; Natixis, 2021, *ESG Investor Insight Report*).

c) *ESG integration:* Invest in a manner which takes account of sustainability factors because it will improve the risk/return profile of the investment.

Client sustainability goals when investing in sustainable financial products

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.
■ 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.



Aggregated survey results: n=1000 German and n=1000 French

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

(22) For clients who want to have a positive impact on the environment and/or society with the investment some specific explanations should be provided (see *Annex 3: Advising impact-oriented clients* for detailed information).

Info Box: Difference between investor impact and investee company impact

Investor impact is not the same as investee company impact. Investor impact is the change in an investee company's activities caused by the investor. In other words it is the effect the investor has through its actions or with its money on the investee company's decisions (which then impact on environment and society). Investor impact is the change that the investor has caused in the activities of the investee company benefiting from the investment. In the context of climate change mitigation, this change can either take the form of a growth in a "green" company's activities (e.g. a growth of its green power production) or of a change in the quality of a company's activities (e.g. an increase in the energy efficiency of a plant)."[23]

Currently, the measurement of investor impact cannot be guaranteed since methodologies are lacking and the quantification of investor impact is highly complicated due to its indirect nature For example, companies need investment to finance their activities and have shareholders who can influence company decisions. Shareholder pressure or lack of investment can force companies to close unsustainable factories or invest in sustainable activities. Both shareholder pressure and lack of investment can have an impact on environment and society, but it is difficult to measure the individual impact of an individual shareholder or third party on a company's activities. For example, if an energy company closes a coal-fired power plant, emissions reductions can be measured but how much of these emissions reductions are attributable to an individual shareholder or third party is complicated (an investor's individual influence may have helped but the collective influence of all investors is more determinative and other factors – coal prices, carbon taxes etc - may have played a part).[24]

[23] Kölbel et al., 2020, *The investor guide to impact*
[24] While the measurement of investor impact remains very difficult, it is possible to assess the impact potential (the additionality) of financial products, which can help to assess the suitability of a financial product for an impact-oriented client. See for instance 2DII, 2023, *The Impact Potential Assessment Framework*

However, academic research reveals that certain investment strategies have higher impact potential than others (e.g. stewardship, impact investing, income-sharing) and help to identify financial products which are more suitable for impact-oriented clients.

(23) In addition to your main sustainability goal(s), I will collect information on your sustainability preferences for certain types of financial instruments. Do you need more explanation on the three categories of sustainability preferences?

At this point, if the client requests, I should provide further explanation on concepts linked to the definition of sustainability preferences, such as environmental vs. social aspects, climate change mitigation / adaptation, explain principal adverse impact indicators etc.

(24) Once you express your sustainability goal(s) and sustainability preferences, I will be able to identify suitable financial products in our range of offer. However, please note that you will also have the possibility to provide more information on ***specific values and priorities*** in the Long Assessment if you wish to do so.

Proceed to Q2-5 of the Questionnaire. If the client answers a) to Q5 please provide explanations below related to the Long Assessment.

Long Assessment

(25) As you have expressed an interest in providing more detail regarding your ***specific values and priorities***, I can provide further explanation on these other elements of wider sustainability motivations.

(26) If you want to be more detailed about specific values and priorities you want to advance through your investments, the United Nations Sustainable Development Goals (**SDGs**) articulate 17 global goals to achieve a better and more sustainable future for all by 2030 and can be a framework to provide more precision on the values and priorities which are most important to you and where you would like to see progress.

a) *Environmental matters:* These include conservation and protection of marine and land resources, ensuring access to affordable, reliable, sustainable and modern energy for all and taking urgent action to combat climate change.
b) *Social and governance matters:* These include combating hunger worldwide, ensuring that all people can go to the doctor when they are ill, ensuring quality education for all or achieving gender equality and empowering all women and girls.

(27) If you want to be more detailed about economic activities you refuse to be financially exposed to, it is possible to define negative screening criteria to specify what a financial instrument must avoid investing in.

a) *Environmental exclusions:* These can include pesticides and biocides, animal testing, genetic engineering, coal, factory farming etc.
b) *Social and ethical exclusions:* These can include weapons and armaments, tobacco, alcohol, gambling, and pornography.
c) Breach of international norms where negative screening criteria can include for example violation of the principles of the UN Global Compact.

(28) Equally, you may want to be more detailed about countries you refuse to be financially exposed to. For example, you may want to avoid being financially exposed to countries involved in the following controversies: nuclear weapons, wars, corruption etc.

Proceed to Q6-9 of the Questionnaire.

Annex 2: Financial product eligibility for recommendation

Financial product recommendation

(1) Following the identification of client sustainability preferences and wider sustainability motivations, investment firms can proceed to *Step 3: Financial product recommendation*.

(2) The information below can support investment firms form a view on which financial products can be recommended to satisfy different client sustainability preferences and wider sustainability motivations. It articulates a methodology for recommending financial products through matching features of financial instruments to minimum requirements for satisfying client sustainability preferences and wider sustainability motivations.

(3) 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*. As explained in Section 4, just looking at the regulatory concept of sustainability preferences may not capture all the granular aspects of how some clients want to invest their money. We use the term wider sustainability motivations to denote additional information about client ***sustainability goal(s)*** or specific ***values and priorities*** to support or avoid which are not accommodated by the definition of sustainability preferences. Assessing wider sustainability motivations (as well as sustainability preferences) enables investment firms to provide more suitable financial product recommendations. For this reason, the Guidance and Questionnaire are structured with a clear distinction between: (1) requirements to meet the threshold for regulatory compliance for assessing client sustainability preferences; and (2) steps to assess wider sustainability motivations which are relevant to implement better practice for a comprehensive assessment of all sustainability related aspects associated with client investments.

(4) Investment firms should bear in mind that sustainability features of financial instruments are constantly evolving. In addition, the content below 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.

Compulsory financial product features to satisfy client sustainability preferences

(5) The following financial product features are compulsory for financial products to be suitable for clients who express a sustainability preference for Category A, B or C.

Table 1: Matching table between sustainability preference categories and compulsory financial product features

Sustainability preference category	Compulsory financial product features
Category A	Taxonomy alignment Exclusion Do No Significant Harm (according to Taxonomy) Minimum Safeguards (according to Taxonomy) exclusion
Category B	Impact alignment Exclusion Do No Significant Harm (according to SFDR)

Category C	Principal Adverse Impact consideration

(6) A qualitative description of the investment strategies referred to in *Table 1* above is as follows[25]:

a) *Taxonomy alignment:* Financial instruments that invest in companies with economic activities which are aligned with the EU taxonomy technical screening criteria.

b) *Exclusion Do No Significant Harm (according to Taxonomy):* Financial instruments that exclude companies with activities which do significant harm to any of the EU taxonomy's environmental objectives.

c) *Minimum Safeguards (according to Taxonomy) exclusion:* Financial instruments that exclude companies which do not comply with the *UN Guiding Principles on Business and Human Rights*, the *Declaration of the International Labour Organisation on Fundamental Principles and Rights at Work*, the *International Bill of Human Rights* and the *OECD Guidelines for Multinational Enterprises*.

d) *Impact alignment:* Financial instruments which pursue sustainable investments (as defined in SFDR), thus financial instruments that invest in companies with sustainable economic activities which are not covered by the EU taxonomy.

e) *Exclusion Do No Significant Harm (according to SFDR):* Financial instruments that exclude companies which do not comply with the principles of the *UN Global Compact* or the *OECD Guidelines for Multinational Enterprises*.

f) *Principal Adverse Impact consideration:* Financial instruments that qualitatively or quantitatively consider principal adverse impacts from company activities by either engaging with those companies to reduce their negative impact, excluding companies with certain negative impacts or other strategies to reduce the principal adverse impact of the portfolio.

Optional financial product features to satisfy client wider sustainability motivations

(7) Provided that compulsory financial product features are satisfied; investment firms are encouraged to use their best efforts to match the client's wider sustainability motivations by similarly matching financial product features with wider sustainability motivations. Information on the client's wider sustainability motivations can be used as a further filter to narrow down the financial product universe to those most suitable for matching the client's investment objectives, sustainability preferences and wider sustainability motivations.

(8) The Questionnaire and the Guidance include wider sustainability motivations as follows:

a) *Sustainability goals* which clients have for their investments (in addition to achieving a financial return) and are assessed in the Medium Assessment.

b) *Values and priorities* which relate to specific details for investments (e.g. focussing on one or more of the Sustainable Development Goals or avoiding financing certain economic sectors) and are assessed in the Long Assessment.

(9) The Questionnaire and the Guidance include the following three ***sustainability goals***[26]:

a) *Impact:* Have a positive impact on the environment and/or society with the investment.

b) *Value alignment:* Align the investment with personal values (either by prioritising or avoiding financing specific economic activities).

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[25] Most of these product features can be found in the Findatex EET ESG data template.

[26] This heuristic is already used in the scientific community, industry, regulators and experts to distinguish between the main sustainability-related objectives (e.g. Busch et al., 2021, *Impact investments: a call for (re)orientation*; Eurosif, 2022, *Classification Scheme for Sustainable Investments*; FCA, 2022, *Sustainability Disclosure Requirements (SDR) and investment labels*; AMAS/SFF, 2021, *How to avoid the Greenwashing Trap*; Natixis, 2021, *ESG Investor Insight Report*).

c) *ESG integration:* Invest in a manner which takes account of sustainability factors because it will improve the risk/return profile of the investment.

(10) The following financial product features are optional for financial products to be suitable for clients who express a sustainability goal for Impact, Value alignment or ESG integration:

Table 2: Matching table between sustainability goals and optional financial product features[27]

Optional financial product features (investment strategy)	Impact	Value alignment	ESG integration
ESG integration			x
Stewardship	x	x	
Exclusion		x	
Best-in-class		x	
Thematic screening		x	
Impact investing	x		
Income-sharing	x		

X = Investment strategy is to a great extent suitable for the sustainability goal

(11) A qualitative description of the investment strategies referred to in *Table 2* above is as follows[28]:

a) *ESG integration:* Financial instruments which include sustainability information alongside financial information in the process of selecting assets.

b) *Stewardship:* Financial instruments that seek to use shareholder or investor power to influence corporate behaviour. For example: engaging with senior management and/or boards of companies, filing or co-filing shareholder proposals and proxy voting guided by comprehensive ESG guidelines.

c) *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.

d) *Best-in-class:* Financial instruments which use positive screening techniques to select companies or countries with the best practices in sustainability topics.

e) *Thematic screening:* Financial instruments that invest in companies because they positively contribute to advancing a certain sustainability topic (either environmental or social).

f) *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.

g) *Income sharing:* Investments that include a mechanism to donate part of the generated income to charities or NGOs.

(12) The Questionnaire and the Guidance include the following ***values and priorities***[29]:

a) *Environmental matters as defined by the Sustainable Development Goals (SDGs):* Clean water and sanitation; Affordable and clean energy; Sustainable cities and communities; Responsible consumption and production; Climate action; Water quality and fish stocks; Nature conservation and biodiversity.

b) *Social and governance matters as defined by the SDGs:* No poverty; Zero hunger; Good health and well-being; Quality education; Gender equality; Decent work and economic growth; Sustainable industry, infrastructure and innovation; Reduce inequalities; Peace, justice and strong institutions.

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[27] This approach is also recommended for instance by the Swiss Asset Management Association and the Swiss Sustainable Finance platform: https://www.sustainablefinance.ch/upload/cms/user/RecommendationsforSustainableInvestmentProducts_AMAS_SSF.pdf

[28] Note that you can find some of these datapoints in the Findatex EET ESG data template (such as a link to the stewardship strategy of the product manager, exclusion criteria beyond those mentioned under MiFID II and thematic screening criteria).

[29] Note that you can find most of these datapoints in the Findatex EET ESG data template.

c) *Environment exclusions:* Pesticides; Animal testing; Genetic engineering; Palm oil; Coal; Oil; Nuclear energy; Gas; Fur; Factory farming.
d) *Social & ethics exclusions:* Weapons and/or armament; Tobacco products; Alcohol; Gambling; Pornography; Research on human embryos.
e) *Breach of international norms exclusions:* Violation of the principles of the UN Global Compact; Violation of OECD guidelines for multinational enterprises; Violation of International Labour Organisation rules.
f) *Country exclusions:* Nuclear weapons; Non-proliferation treaty of nuclear weapons; Democracy; Corruption; Death sentence; War; Non-ratification of Paris-Agreement.

(13) Financial product features which relate to: Environmental matters as defined by the Sustainable Development Goals (SDGs), Social and governance matters as defined by the SDGs, Environment exclusions, Social & ethics exclusions, Breach of international norms exclusions or Country exclusions are optional for financial products to be suitable for clients who express values and priorities beyond those covered by the definition of sustainability preferences.

Using sustainability preferences and wider sustainability motivations for financial product recommendation

(14) All information on financial product features to match client sustainability preferences and wider sustainability motivations should be retrieved from an ESG data template[30] which is used between product manufacturers and product distributors. If data points are missing in the ESG data template there may be additional data sources provided by the product manufacturers.

Process for recommending a financial product following the Medium Assessment

(15) In the Medium Assessment, the client's sustainability preferences and sustainability goals are assessed (but there is no assessment of specific values or priorities). The information on sustainability preferences and sustainability goals is used to filter the available product universe to identify suitable financial products.

(16) Step 1 is to filter the available product universe according to the compulsory financial product features which match the sustainability preference categories selected by the client (see *Table 1*).

(17) Step 2 is to filter the remaining product universe (i.e. after first filtering according to the compulsory financial product features which match the sustainability preference categories selected by the client) according to the optional financial product features which match any sustainability goals expressed by the client (see *Table 2*). The investment strategies which match the sustainability goals are not compulsory, however including these investment strategies in the matching process reduces the risk of mismatch between product recommendation and the client's sustainability goals.

(18) Where the client has more than one sustainability goal, the client should prioritise. The prioritization will help to recommend a product which is most suitable if not all sustainability goals can be met, and the client agrees to amend her or his sustainability goals. The sustainability goal with the highest priority will be prioritized to filter optional financial product features in Step 2.

(19) *Table 3* below shows the matching of sustainability goals to compulsory financial product features as well as optional financial product features. Please find more information about the rationale of the

[30] See for instance Findatex EET ESG data template.

matching of compulsory financial product features and sustainability goals in *Annex 3: Advising impact-oriented clients*.[31]

Table 3: Matching table between sustainability goals and compulsory and optional financial product features

Compulsory financial product features (investment strategy)	Impact	Value alignment	ESG integration
Taxonomy alignment		x	
Exclusion DNSH (Taxonomy)		x	
Minimum safeguards (UN GC exclusion)		x	
Impact alignment		x	
Exclusion DNSH (SFDR)		x	
PAI consideration (through engagement* or exclusion**	x*	x**	
Optional financial product features (investment strategy)	**Impact**	**Value alignment**	**ESG integration**
ESG integration			x
Stewardship	x	x	
Exclusion		x	
Best-in-class		x	
Thematic screening		x	
Impact investing	x		
Income-sharing	x		

x = Investment strategy is to a great extent suitable for the sustainability goal

(20) If a financial product has financial product features which satisfy more than one sustainability goal of the client goals and the financial product is recommended to the client, then the investment firm should explain why the financial product features are suitable for the client's sustainability goal(s). The investment firm should provide concrete details about how the financial product applies the investment strategy in practice (criteria used, thresholds, voting reports etc.).

(21) *Figure 1* below shows a simple illustration of following Step 1 to filter the available product universe according to the compulsory financial product features which match the sustainability preference categories selected by the client and Step 2 to filter the remaining product universe according to the optional financial product features which match any sustainability goals expressed by the client.

[31] Note that this approach is also proposed by the Swiss Asset Management Association and the Swiss Sustainable Finance platform but adds the compulsory financial product features to the matching table, see Swiss Asset Management Association/Swiss Sustainable Finance, 2021, *How to Avoid the Greenwashing Trap*.

Figure 1: Illustration of Step 1 and Step 2 filtering of product universe

Green = Suitable, Yellow = Partly suitable, Red = Not suitable

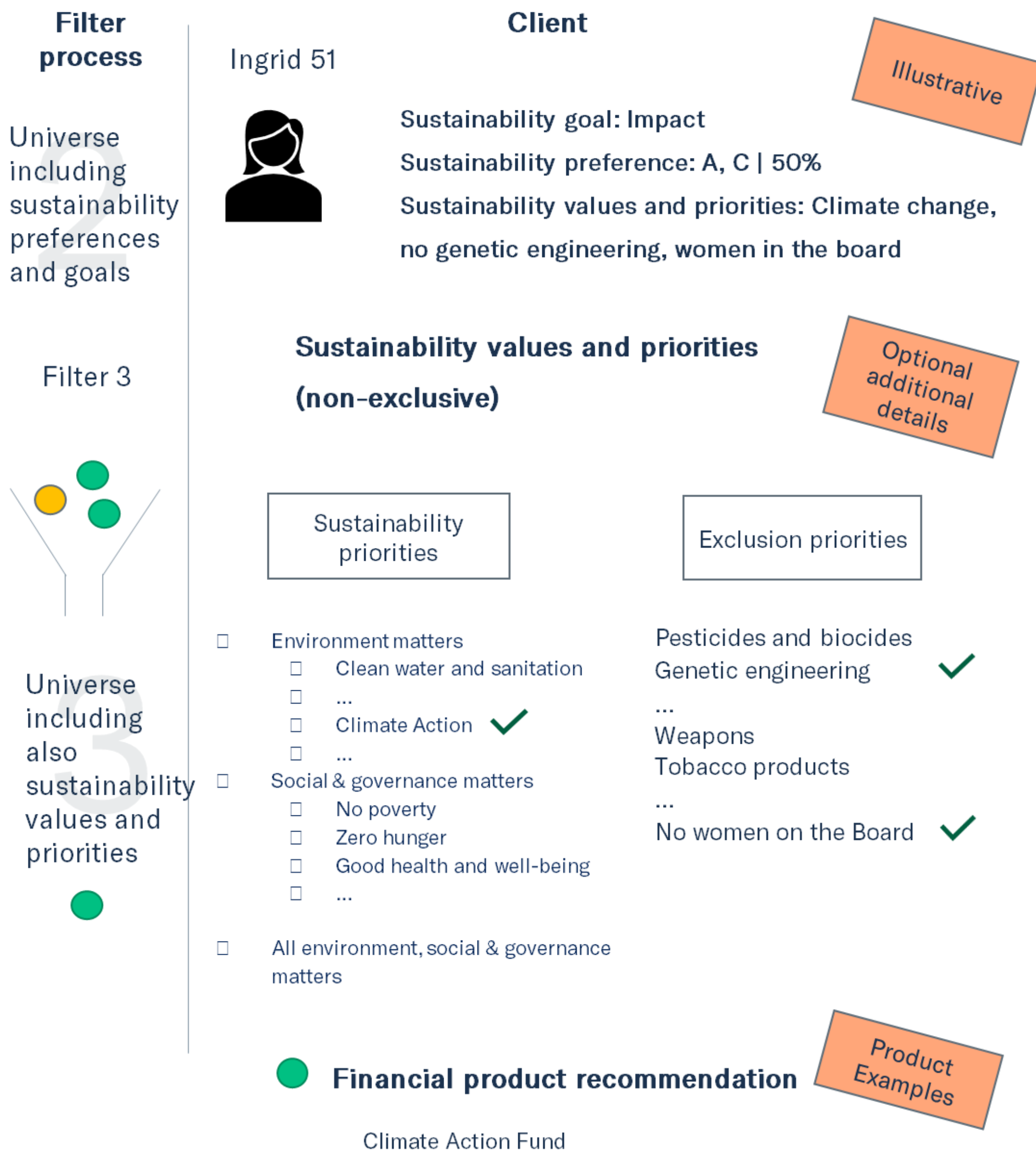
Process for recommending a financial product following the Long Assessment

(22) In the Long Assessment, the client's specific values and priorities are assessed (in addition to the client's sustainability preferences and sustainability goals being assessed in the Medium Assessment). The additional information on values and priorities is used to further filter the available product universe to identify suitable financial products.

(23) After following Step 1 and Step 2 referred to above in the process for recommending a financial product following the Medium Assessment, Step 3 is to filter the remaining product universe according to the optional financial product features which match any values and priorities expressed by the client.

(24) *Figure 2* below shows a simple illustration of following Step 3 to filter the available product universe according to the optional financial product features which any values and priorities expressed by the client.

Figure 2: Illustration of Step 3 filtering of product universe



Green = Suitable, Yellow = Partly suitable, Red = Not suitable

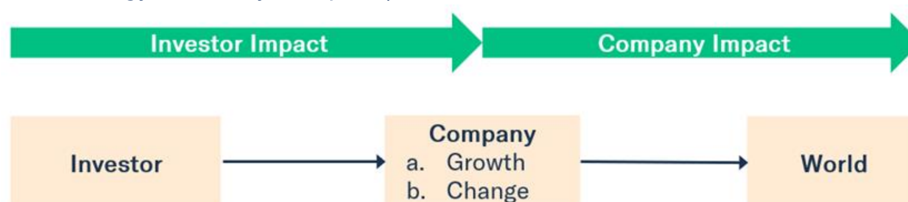
Annex 3: Advising impact-oriented clients

What is investor impact and how is it different to investee company impact?

(1) When clients express the sustainability goal to 'have a positive impact on the environment and/or society with the investment' this relates to achieving a positive *investor impact*.

(2) An impact analysis can be performed for any economic agent, including investors and investees. When applied to investee companies (or other investees), *investee company impact* is the additional outcome to the world caused by the investee company compared to a counterfactual scenario when the investee company did not exist. When applied to investors, *investor impact* is the additional outcome to the world caused by the investor compared to a counterfactual scenario when the investor did not invest. There is a positive investor impact when the investments causally improve outcomes.

(3) Following their review of academic research, Kölbel et al.[32] produced the following synthetic definition of *investor impact*: '*The **impact of an investor is the change that the investor has caused in the activities of the company benefiting from his investment**. In the context of climate change mitigation, this change can either take the form of a **growth** in a "green" company' activities (e.g. a growth of its green power production) or of a change in the **quality** of a company's activities (e.g. an increase in the energy efficiency of a plant)."*



(4) Following the distinction between *investor impact* and *investee company impact*, researchers have advocated for distinguishing between impact-aligned investments (i.e. investments in positive-impact companies that do nothing significant to grow the positive impact of the companies) and impact-generating investments (which aim to grow the positive impact of investee companies because of the investment).[33] Only the latter are suitable for impact-motivated clients.

What is the relationship between investor impact and financial return?

(5) Research has not yet clarified the relationship between investor impact and financial returns. Theoretically, financial returns do not reflect impact but risk. Consequently, there should be no obvious relationship between impact and financial returns if impact is not related to risk. But impact may become related to (transition) risk when legislation imposes taxes on negative externalities (like carbon emissions).

(6) Some impact mechanisms are more expensive, either because of increased implementation costs (engagement) or higher cost asset purchases (signalling).

[32] Kölbel, J., et al., 2020, *Can Sustainable Investing Save the World? Reviewing the Mechanisms of Investor Impact*
[33] Busch et al., 2021, *Impact investments: a call for (re)orientation*

(7) But impact strategies may also lead to positive financial performance (as observed for successful ESG engagement campaigns[34] when it changes the market perception of the engaged company).

How can investors have an impact?

(8) The Impact Management Project (**IMP**) developed a taxonomy of different investor strategies to generate an impact. The taxonomy includes four main investor *impact mechanisms*[35]*:*

a) *Signalling that impact matters:* Investors can send market and non-market signals that they are committed to impact. Market signals through investments and divestments based on sustainable screening contribute to changing the conditions to access capital in financial markets for companies. Investors can also send non-market signals that do not directly affect financial markets but influence stakeholders through stigmatization (publicly stating opposition to certain companies or industries), endorsement or benchmarking (passively applying benchmark portfolios of companies with the highest sustainability performance).

b) *Grow new or undersupplied capital markets*: Investors can make a difference by enabling the growth of impactful companies whose growth is constrained by limited access to external financing.

c) *Provide flexible capital*: Investors can help impactful companies by offering beneficial financing, for instance by accepting below-market returns, taking subordinated debt or equity or agreeing on custom-made exit terms.

d) *Engage actively*: Investors may influence the companies they are invested in through different means (voting at shareholder meetings, dialoguing with management, asking for board seats etc.).

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[34] Barko et al., 2021, *Shareholder Engagement on Environmental, Social, and Governance Performance*; Bauer et al., 2022, *Private Shareholder Engagements on Material ESG Issues*.
[35] Impact Management Project, 2019, *Investor contribution in public and private markets*

Which financial products can deliver impact?

Combinations of impact mechanisms

(9) A comprehensive review[36] shows that, among the above four impact mechanisms, there is little empirical evidence to support that *Signalling that impact matters* generates an impact. In contrast, other impact mechanisms are supported by empirical evidence.

(10) It is also possible to combine the above impact mechanisms in a single investment strategy. The IMP has distinguished and ranked six combinations of impact mechanisms that can be actioned by an investor from the least to the most effective (see *Figure 1*).

Figure 1: IMP's investor contribution categories

	INVESTOR'S CONTRIBUTION
1	Signal that impact matters + Engage actively + Grow new/undersupplied capital markets + Provide flexible capital
2	Signal that impact matters + Engage actively + Grow new/undersupplied capital markets + Provide flexible capital
3	Signal that impact matters + Engage actively + Grow new/undersupplied capital markets + Provide flexible capital
4	Signal that impact matters + Engage actively + Grow new/undersupplied capital markets + Provide flexible capital
5	Signal that impact matters + Engage actively + Grow new/undersupplied capital markets + Provide flexible capital
6	Signal that impact matters + Engage actively + Grow new/undersupplied capital markets + Provide flexible capital

Investor impact in different asset classes

(11) Researchers have highlighted that the impact potential of investments in public (bond or equity) markets is limited in comparison to investments in private markets.[37] Investments in public markets cannot achieve the same investor impact as they cannot grow new/undersupplied markets nor provide flexible capital. They are restricted to signalling that impact matters and engagement.

Achieving impact through sustainable strategies

(12) In practice, sustainable financial products are not designed to conform to any of the specified impact mechanisms or combinations but apply various investment strategies.

(13) For instance, the commentary in these materials uses the following categorisation of investment strategies:

a) *ESG integration:* Financial instruments which include sustainability information alongside financial information in the process of selecting assets.

b) *Stewardship:* Financial instruments that seek to use shareholder or investor power to influence corporate behaviour. For example: engaging with senior management and/or boards of companies, filing or co-filing shareholder proposals and proxy voting guided by comprehensive ESG guidelines.

c) *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.

d) *Best-in-class:* Financial instruments which use positive screening techniques to select companies or countries with the best practices in sustainability topics.

e) *Thematic screening:* Financial instruments that invest in companies because they positively contribute to advancing a certain sustainability topic (either environmental or social).

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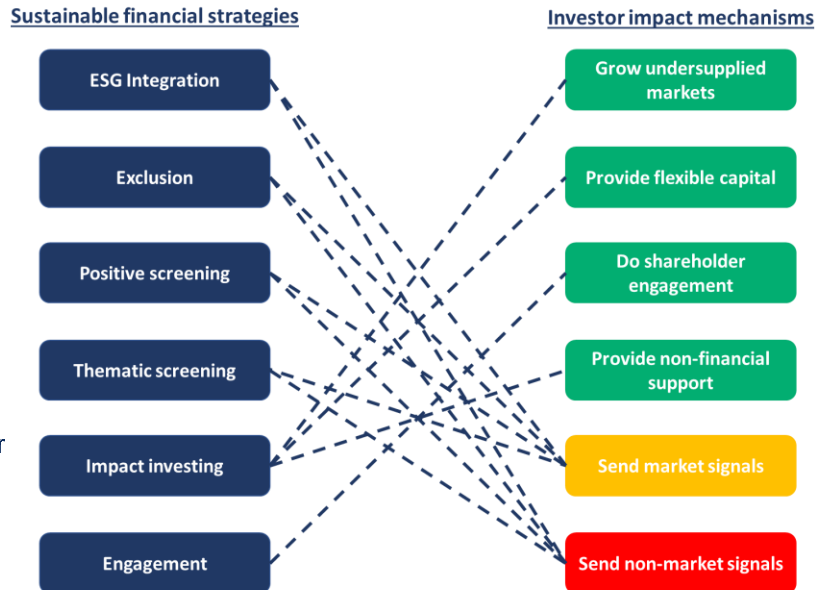
[36] Heeb and Kölbel, 2020, *The Investor's Guide to Impact*
[37] Caldecott et al., 2022, *Sustainable Finance and Transmission Mechanisms to the Real Economy*

f) *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.

g) *Income sharing:* Investments that include a mechanism to donate part of the generated income to charities or NGOs.

(14) By nature, these investment strategies may implement one or more of the above impact mechanisms more or less intensively. *Figure 2* shows which impact mechanisms are intensively actioned by the different investment strategies.

Figure 1: Main impact mechanisms activated by investment strategies



(15) Most mainstream investment strategies (excluding engagement and impact investing) only action impact mechanisms that are weakly supported by academic evidence (namely market and non-market signalling).

(16) Note that compulsory product features under the three MiFID sustainability preference categories can be related to the main investment strategies and respective impact mechanisms (find all compulsory product features in *Annex 2, Table 1*). Taxonomy or impact alignment strategies on secondary markets are thematic screenings which are related to market and non-market signalling as impact mechanisms (see Figure 2). Exclusion strategies under Taxonomy, SFDR or PAI equally relate to market and non-market signalling as impact mechanisms. Only the consideration of PAI with engagement (investor stewardship) can be potentially considered as a relevant strategy for impact-oriented clients given that the asset manager can prove credible and impactful stewardship activities.[38]

(17) Therefore the capacity of most investment strategies related to the MiFID sustainability preference categories to deliver impact is considered poor by researchers. For instance, the Swiss Asset Management Association[39] concluded that products using ESG integration, exclusion or positive screening contributed to a minor extent or not at all to the impact goal of retail investors (unlike stewardship (engagement) or impact investing products[40]). Regarding thematic investing, the Swiss Asset Management Association consider the potential of thematic investing to deliver impact to be minor in public markets but more significant in private markets, where private equity or private debt investors can encourage young companies with sustainable solutions to grow by providing fresh capital. In fact, the recommendation of private equity or private debt products with high impact potential could be suitable for impact-oriented clients.

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[38] You can apply for instance the stewardship assessment methodologies from InfluenceMap or ShareAction. See InfluenceMap, 2023, *Asset Managers & Climate Change 2023* and ShareAction, 2023, *Point of No Returns 2023.*

[39] Swiss Asset Management Association, 2021, *How to Avoid the Greenwashing Trap.*

[40] Exclusion or positive screening can deliver real-world effects only if multiple conditions are met. First, they require similar and simultaneous actions of many investors to significantly affect market prices. Second, the market price change needs to trigger the expected behaviours by targeted companies' managers, which is not straightforward. Therefore, those investment strategies imply a high risk of not delivering impact.

Impact-oriented financial products do not report… impact

(18) Most (if not all) so called impact-oriented financial products for retail investors do not sufficiently substantiate their impact claims. However, new guidelines on responsible environmental impact claims for financial products might address this issue.[41]

(19) In fact, if a certain level of rigor in impact measurement is not established across the finance sector, the label “impact investing” runs the risk of becoming diluted and used merely as a marketing tool.[42]

(20) However, new methodologies are emerging to assess the impact potential of various financial product based on their additionality. This can be a valuable source of information to assess the impact potential of (impact-labelled) financial products offered by product manufacturers. Currently, only a small minority of product manufacturers provide sufficient information to fully assess the impact potential of their financial product. However, product distributors should require this information to ensure that their product recommendation to impact-oriented clients is not misleading.[43]

A methodology to assess the impact potential of financial products

(21) 2DII has developed a new science-based framework to assess the impact potential of financial products. The Impact Potential Assessment Framework (**IPAF**) has been designed to be used by impact-motivated clients and their advisors to discriminate financial products based on their potential to deliver impact (per additional euro invested).[44] The IPAF assesses two dimensions of the impact potential of financial products.

a) First, it assesses the *Category's Impact Potential Score* as the (maximum) impact potential of financial products based on impact mechanisms they supposedly apply (in relation to communicated elements in marketing documents). Those impact mechanisms are the ones widely documented by academic research and articulated in Paragraph (8) above.

b) Second, it evaluates the *Product's Implementation Score* as the implementation of the impact potential based on the intensity with which financial products action the various impact mechanisms in connection to success factors documented by academic research.

(22) At the end of the scoring process, the IPAF delivers an *Impact Potential Score* which is the product of the two intermediary scores:

*Impact Potential Score = Category's Impact Potential Score * Product's Implementation Score*

(23) The Impact Potential Score is transformed into an Impact Potential Rating that goes from A (products with highest impact potential) to G (products with lowest impact potential).

[41] See 2DII, 2023, *Market review of environmental impact claims of retail investment funds in Europe* and 2DII, 2023, *Guide on environmental impact claims for EU financial products*

[42] Reisman, J. and Olazabal, V., 2016, *Situating the Next Generation of Impact Measurement and Evaluation for Impact Investing*

[43] The lack of information about key impact mechanisms used by financial products is an insight from a European funded research project in which 2DII is applying the IPAF on impact-oriented primary market products in six countries (France, Germany, Spain, Sweden, Ireland and Switzerland). The results will be published in a new public database for product distributors which will feature financial products with high impact potential which can be recommended to impact oriented clients (launch in October 2023).

[44] The IPAF also provides avenues to product manufacturers to muscle up their impact actions and improve their impact communication.