



**FINANCE
DENMARK**

ESMA Consultation on suitability guidelines

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

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

We fully agree that investment firms have a responsibility with regards to introducing the clients to sustainability investing terminologies and sustainability preferences as a concept. We also agree that the regulatory lingo is too complex for the vast majority of the retail market. We therefore welcome the fact that Guideline 1, point 16 emphasizes that non-technical language should be used. It is important that firms can target the client types in the explanations and advice keeping in mind that the guidelines cover all types of clients. Therefore, it is important to have room for proportionality in the application of the guidelines both when it comes to client types and the type of financial instruments and services offered. As a concrete example it would seem pointless having to explain a professional client about ESG terminology that seeks advice regarding an OTC interest rate swap transaction. At the same time, it would be adjacent to impossible having to explain to a retail client that have limited knowledge on the world of investments about how ESG is measured in the taxonomy or SFDR and what principal adverse impact (PAI) is. Trying to explain these terms will leave most less knowledgeable retail clients completely in the dark.

It is important that the dialogue with the client is carried out in a way that makes it easy for the client to understand and answer the questions used to determine the client's sustainability preferences. Retail clients must be able to relate to the questions and to put them in context. We disagree that it is necessary at all to use references to the taxonomy, SFDR or PAI in the language towards retail clients, why Guideline 1, point 16 should be seen as the overall principle for the dialogue with the client related to ESG and sustainability preferences. It should be noted that firms should be able to differentiate the terminology between clients that have the required knowledge and clients that have limited knowledge of investments including knowledge related to sustainable investing.

Memo

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A preliminary study and testing carried out by our members in preparation of implementation of the statutory obligation to determine the retail investors' sustainability preferences have shown that within a smaller random sample group of retail clients none of them were familiar with the term ESG. In general, retail investors cannot be expected to have familiarized themselves with the complicated ESG-legislation nor that they have the time, the desire, or the capacity to do so. Clients seeking advice must be exactly that – advised. It should be an equal and unbiased dialogue between the retail investor and the investment firm about the retail investor's sustainability preferences and not a session, where the investment firm is forced to use specific terms and definitions that the retail investor has never heard of.

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

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No, we do not see the need for any expansion of the information requirement. We would rather suggest that the last sentence of Guideline 1, point 16 where *"firms should also explain what environmental, social and governance aspects mean"* is seen as conditional (i.e. it should read *"could"* instead of *"should"*). Again, the advisory session should match the type of client – more knowledgeable investors and professional investors already have full and in-depth understanding of the ESG terminology. We therefore encourage that the guidelines allow investment firms flexibility on how they explain the sustainability preferences to their clients in line with Article 54(3) of the MiFID II Delegated Regulation so that the advisory session fits the type of client, otherwise we fear that the guidelines will add unnecessary complexity to advisory processes further discouraging investors from seeking advice as the resource and time consumption is disproportionate for the investor.



Guideline 2: arrangements necessary to understand clients

Q3. Do you agree with the suggested approach on the arrangements necessary to understand clients and specifically with how the guideline has been updated to take into account of the clients' sustainability preferences? Please also state the reasons for your answer. Are there other alternative approaches, beyond the one suggested in guideline 2, that you consider compliant with the MiFID II requirements and that ESMA should consider? Please provide examples and details.

We generally follow the reasoning behind the suggested approach as a long term solution which provides guidance for situations where financial instruments with sustainability features are available and data to support the three legs defining the sustainability preferences is also available. We are, however, greatly concerned that the guidelines are not calibrated to cater for the suitability assessment when the changes to the MiFID II and/or the revised guidelines will take effect later in 2022.

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Firstly, the three legs of the sustainability preferences rely on data that are scarce and will only be available over the coming years. For instance, investments in companies that report according to NFRD will only be required to start disclosing taxonomy-alignment in 2023. Similar data on PAI is not yet available since the final indicators are not yet published.

Secondly, product providers will act with great caution due to potential liability issues and the risk of greenwashing allegations. National competent authorities in Denmark have highlighted the risk of greenwashing in their risk assessment report, and these signals will add to very cautious approaches by product providers and distributors.

Thirdly, product providers might not be ready to provide a broad range of financial instruments with sustainability features that will fit both the risk and return profile, the general investment objectives and in addition the specific sustainability preferences of a client. Product supply will evolve over time as data becomes available on the underlying investments.

This means that distributors in practice will be obligated to explain concepts and ask clients very detailed questions on whether they have an interest in such concepts without being able to offer any financial instruments with sustainability features in many instances. ESMA recognizes this situation in Section 2.2, point 34, and suggests the possibility to indicate that no products are available that would meet the client's sustainability preferences.



However, this approach will be against the client's understanding of and expectation to an advisory service process. A firm should already be able to indicate when collecting client information that products might not be available to meet certain preferences. Also, certain financial instruments offered to retail clients cannot in any meaningful way be considered sustainable e.g., an interest rate or FX derivative. The process of assessing the client's sustainability preferences as laid out in Guideline 2 has the risk of becoming confusing and frustrating for both the client and the investment advisor. We strongly urge that the guidelines acknowledge that for some instruments it could be the right cause of action to state up-front that there are no sustainable products available.

We welcome ESMA's approach in Guideline 2, point 25 and 26 containing examples on how to reveal the clients' sustainability preferences. However, more flexibility and proportionality should be implemented in the guidelines rather than prescribing the process and questions to be asked to ensure a meaningful advisory process to all clients and for all product types.

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This is crucial since the ability to differentiate between types of investors and products is key to deliver client services of value to the individual investor. As another example ESMA must keep in mind that professional investors already possess knowledge about ESG terminology.

It is important to receive confirmation in the final guidelines that there is no obligation to use the legal definitions in Article 2(7) of the MiFID II Delegated Regulation when assessing clients' sustainability preferences. A dialogue based on technical details from the taxonomy, SFDR and PAI is not in the clients' best interest. While the legal definitions will be used to match a client's sustainability preferences with available product groups, specifically asking whether they have preferences for (a)-(c) of Article 2(7), will simply lead to confusion among most investors disregarding that firms initially attempt to explain the concepts.

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

For reasons explained in previous questions the guidelines should give more flexibility on how to receive the relevant and necessary client information. This flexibility is essential to deliver a service that is valuable to all client types and to be able to reveal clients' sustainability preferences as efficiently and naturally as possible, considering the type of client and the range of available financial instruments with sustainability features for that client.



Guideline 2, point 25 states that the information to be collected should be "*sufficiently granular*". It is our understanding that Guideline 2, point 25 aims at requiring firms to collect the necessary information rather than asking too many detailed questions that makes it impossible to arrive at a suitable product. We strongly support that sustainability is an add-on to the existing framework – as it also follows from recital 5 of the MiFID II Delegated Regulation – but if too detailed and too many questions are envisaged then sustainability might be an add-on, but the dialogue on sustainability will severely extend the existing process, and the clients will not understand that a long process of revealing sustainability preferences will lead to no products available that match. This is detrimental to a meaningful advisory process and what clients should expect from an advisory service. It must also be recognized as a risk that this will have the opposite effect than the intention behind the rules, i.e. instead of leading investments in a direction that support the transmission towards more sustainability this might frighten retail clients away from such investments.

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Guideline 2, point 25, second bullet states "*combination of one or more of the three aspects*". However, such combinations are bound to happen automatically (e.g., SFDR Article 9 product with PAs). ESMA should confirm that a client should not be explicitly asked about their preference for combinations, and that questions asked in a non-technical language will be able to reveal preferences for more than one of the three aspects.

It should be made clear that Guideline 2, point 26 is one suggested approach (others might also work equally well) to fulfill Guideline 2, point 25 of the guidelines. ESMA should confirm that the collection of information in relation to sustainability shall follow the regular collection of information on risk etc. Also there could be some guidance about the frequency with regards informing the client about what sustainable investing is and what is meant by sustainability preferences. As an example, a client might be trading on a monthly basis under an advisory service without changing his sustainability profile for every transaction and the client should not go through the same information session about sustainability investing and preferences at every advisory session. Another example will be a client who has invested one amount of money with a certain risk profile, time horizon etc. including his sustainability preferences. Shortly after, the same client wants to invest another amount with another risk profile and time horizon. For such a client it will be unnecessary burdensome and time-consuming if he must to go through the general information and education before his sustainability preferences are revealed.

The first bullet of Guideline 2, point 26 suggests that the investment firm asks the client very detailed questions to reveal the client's sustainability preferences. The



second bullet of Guideline 2, point 26 further suggests that the investment firm when revealing the client's sustainability preferences in relation to SFDR and PAI asks whether the client has focus on environmental, social or governance criteria. We believe that disclosure is key when recommending suitable financial instruments to the client and instead of asking the client very detailed questions it should be possible for the investment firm to disclose how the financial instrument in question meets (or does not meet) the client's sustainability preferences according to the three legs of the definition of sustainability preferences in Article 2(7) of the MiFID II Delegated Regulation.

Guideline 2, point 25, fourth bullet and point 26, fourth bullet of the guidelines need to be revised to clarify that the PAI information collected can cover "qualitative OR quantitative elements" rather than "qualitative AND quantitative elements" to align with the MiFID II Delegated Regulation.

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We strongly support ESMA's suggestion in guideline 2, point 26, third bullet point to allow for ranges rather than particular percentages in relation to the "*minimum proportion*". These ranges should not be aligned with fixed and specific percentages for several very important reasons. While a "high" range will not match a high e.g. taxonomy-aligned percentage in the first years, these percentages will change over time as data becomes available, as financial instruments with sustainability features evolve and as the world moves in a greener direction. Especially in the coming years sufficient flexibility must be given to firms to translate ranges (or particular percentages) to match with the range of existing financial instruments in the market. Naturally firms must have a re-evaluation process and argumentation behind the choices made with regards to how they choose their grouping – here one could give the guidance to evaluate against the market at a given point in time within a particular product type (instrument type, product risk profile etc.). The guidelines could give guidance as to how the firm should re-evaluate and document on a regular basis. This will allow firms to progressively address the biggest hurdle in introducing sustainability-related aspects into the advice process which otherwise will suffer from a clear mismatch between investors' very high sustainability-related expectations and the products currently available in the market when evaluated against the scarce data available. Not allowing for this flexibility would lead to very long advisory processes ending with no financial instruments recommended to the client matching the preferences detrimental to what the clients rightfully expect from their advisor. Finally it will also in this context be relevant to mention the risk of pushing retail investors away from sustainable investments instead of guiding them in that direction.

We strongly support ESMA's proposed flexibility on grouping PAI indicators as laid out in the fourth bullet point of Guideline 2, point 26. However, there should be



flexibility with regards to choosing a number of PAIs and not covering necessarily all PAI indicators. This is both a meaningful approach with regards to the vast different clients and product types and thereby meaningful client journeys (as already argued) and with regards to the scarcity of data in the short to medium run.

In the same bullet point there is a reference to the SFDR RTS as regards PAI. Since there is no reference to SFDR in Article 2(7)(c) of the MiFID II Delegated Regulation, also other ways could potentially be used to demonstrate PAI. However, ESMA should confirm that this is not the intention and only the PAIs mentioned in the SFDR should be taken into account.

Q5. Where clients have expressed preference for more than one of the three categories of products referred to in letters a), b) or c) of the definition of Article 2(7) of the MiFID II Delegated Regulation, do you think that the Guidelines should provide additional guidance about what is precisely expected from advisors when investigating and prioritizing these simultaneous / overlapping preferences?

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Investment firms should be able to make pre-defined client categories catering for one or more of the three categories of financial instruments referred to in (a), (b) or (c) of the definition of Article 2(7) of the MiFID II Delegated Regulation. We think that this approach is possible within the proposed guidelines and do not see a need for further guidance on what is expected from advisory services with regards to investigating and prioritizing overlapping preferences. Generally, ESMA must be aware that clients often face investment firms having for instance different risk profiles or objectives for different portfolios or parts of their total invested assets. Likewise, we expect that a significant number of clients will have different sustainability preferences within different parts of their asset base. A likely scenario might be that a client has high sustainability preferences within a long-term equity portfolio while having little or no sustainability preferences in a short-term bond portfolio.

Q6. Do you agree with the proposed approach with regard to the assessment of ESG preferences in the case of portfolio approach? Are there alternative approaches that ESMA should consider? Please provide possible examples.

In general, we agree to apply the same approach for client exploration regarding portfolio management or investment advice on a portfolio level. However, it is not clear what is meant with "portfolio approach". As we see it it's not a legal or regulatory definition and therefore there is a risk of it being interpreted differently across firms and jurisdictions. So we see a need for it to be defined in the guidelines.



It is unclear how the portfolio approach interacts with the guidelines' requirements to ensure updated suitability tests e.g., would monitoring under the portfolio approach require investment firms to update the suitability test on a client, if it reveals a deviation regarding the sustainability preferences.

We agree that clients should not be pushed in a specific direction but in practice, clients need to be informed about the type of available suitable financial instruments with sustainability factors even if they do not match their specific sustainability preferences.

Guideline 2, point 27 suggests that when recommending a model portfolio as meeting a certain level of sustainability preferences, all preferences (Article 2(7)(a)-(c) of the MiFID II Delegated Regulation) need to be asked for and matched with the sustainability-related features of the model portfolio at a sufficiently granular level. It should be reflected in the guidelines that it is possible to divide the clients into pre-set categories for sustainability preferences, e.g. low preference, medium preference and high preference, when recommending portfolios as it would be impossible for an investment firm to have model portfolios for every combination of the criteria (a)-(c) in Article 2(7) of the MiFID II Delegated Regulation.

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Guideline 5: updating client information

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

We agree with the update cycle for ongoing relationships.

Guideline 7: arrangements necessary to understand investment products

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

Point 70 and 71 of Guideline 7 seem to concern product governance and it would be more appropriate to include these sections in the upcoming update of the product governance guidelines rather than having them in the suitability guidelines.



Q9. Do you believe that further guidance is needed to clarify how firms should take into consideration the investment products' sustainability factors as part of their policies and procedures? Please also state the reason for your answer.

We believe that further guidance is needed, however, it should be included in the upcoming update of the product governance guidelines.

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

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

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We agree with ESMA's proposal to only address sustainability preferences once all other criteria have been assessed and the aim of providing both the client with a clear view on sustainability but also supporting transformation of Europe's economy into a greener, more resilient and circular system.

However, if the investment firm must openly ask the clients - without providing information on available products - how much positive contribution to environmental objectives they would like to see in a product, we create the expectation that such a product is available. But that is not the case at this stage due to e.g., lack of data, and we fear that clients could perceive the whole process as unnecessarily burdensome and discourage clients from wanting to invest in sustainable products altogether. Therefore, we strongly recommend that it is reflected in the guidelines that firms should be able to explain from the outset of the available ranges of products with respect to sustainability factors.

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

We find that the guidelines are unclear on this matter and that they cause more confusion than guidance. Point 80 of Guideline 8 suggests that where a firm intends to recommend a product that does not meet the initial sustainability preferences it can only do so once the client has adapted his/her sustainability preferences. The use of the word "only" creates confusion on how to read recital 8 of the MiFID II Delegated Regulation.



The recital states that *"it is necessary to clarify that financial instruments that are not eligible for individual sustainability preferences can still be recommended by the investment firms, but not as meeting the individual sustainability preferences"*.

In the situation where the investment firm is not able to recommend a financial instrument that meets the client's sustainability preferences, the guidelines should distinguish between two options for the clients to choose between:

- 1) The client can adapt his/her sustainability preferences, or
- 2) The investment firm can recommend the product without altering the client's sustainability preferences.

If option 1 is the only possibility, which is indicated in the guidelines and in our view in opposition with recital 8 of the MiFID II Delegated Regulation, this leaves the client with the choice of either changing his/her sustainability preferences, start searching for an investment firm that might have a financial instrument that meet his/her sustainability preferences or not invest at all, which conflicts with the intentions of the Capital Market Union. It also seems to be conflicting with the overreaching approach that the gathering of information from clients on their sustainability preferences is based on self-assessment, cf. point 26 of section 2.2 of the Consultation Paper. If a self-assessment is carried out with a given result, why then afterwards adapt the preferences? In our view, the client should then be given the information that no product exists matching the sustainability preferences, and if the client accepts a product otherwise matching the existing suitability test, then it would be odd to adapt self-assessed sustainability preferences.

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Depending on the client's sustainability preferences it might not be possible to find a financial instrument in the market that meets the client's sustainability preferences. Also, there will be product types for which there will never be a sustainable investment option available as for example certain derivatives. It is therefore important that option 2 is available for the guidelines to meaningfully cover all products and services.

We support that whether option 1 or 2 is chosen the firm's explanation regarding the reason to resort to either possibility as well as the client's decision should be documented in the suitability report as stated in Guideline 8, point 80.

Guideline 8, point 81 states that *"With regards to the possibility for the client to adapt the sustainability preferences referred in Article 54(10) of the MiFID II Delegated Regulation, firms are reminded that this possibility should not be the standard procedure."*



We are uncertain what is meant by a "standard procedure" and remind ESMA that the guidelines should be able to support the growing market of digital advisory solution which seems important for the Commission to support given the recent consultation on exactly this topic. We do not see how the guidelines embrace this market given our understanding of the term "standard procedure". We therefore urge ESMA to remove this sentence or at least clarify the terminology used.

Q12. Do you agree with the approach outlined with regards to the situation where the client makes use of the possibility to adapt the sustainability preferences? Please also state the reasons for your answer.

We refer to our above reply to Q11.

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Q13. Could you share views on operational approaches a firm could use when it does not have any financial instruments included in its product range that would meet the client's sustainability preferences (i.e. for the adaptation of client's preferences with respect to the suitability assessment in question/to the particular transaction and to inform the client of such situation in the suitability report)?

We refer to our above reply to Q11.

Q14. Do you agree with the proposed approach for firms to be adopted in the case where a client does not express sustainability preferences, or do you believe that the supporting guideline should be more prescriptive? Please also state the reasons for your answer.

We agree with the proposed approach and the supporting guideline should not be more prescriptive.

Q15. Do you agree with the proposed approach with regard to the possibility for clients to adapt their sustainability preferences in the case of portfolio approach? Do you envisage any other feasible alternative approaches? Please provide some possible examples.

We refer to our reply to Q11 and regarding the use of the words "portfolio approach" we refer to our reply to Q6.

Guideline 8, point 82 suggests that when providing investment advice with a portfolio approach, investment firms should assess the client's sustainability preferences including the minimum proportion when conducting the initial suitability



assessment. Then the firm should monitor whether those preferences are still met or not at portfolio level and issue appropriate recommendations as the case may be. We do not see that there is a legal requirement in the MiFID II Delegated Regulation to monitor whether the sustainability preferences are met or not and ESMA should confirm that the issuance of recommendations should not happen more frequently for sustainability preferences and that the regular suitability criteria have priority over the sustainability preferences of the client in the ongoing monitoring.

We also need more guidance on when an investment firm can recommend a switch based only on the sustainability preferences, i.e. when the regular suitability criteria are already met.

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

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We refer to our reply to Q11 above.

Guideline 10: costs and benefits of switching investments

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

No, we do not see a need for a specific explanation as long as the reasoning for the switch and the costs follow from the suitability report in general.

Guideline 11: qualifications of firm staff

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

Yes, we find it natural that the knowledge and competence of the staff giving investment advice or information on financial instruments etc. should include criteria of the sustainability preferences.



Guideline 12: record-keeping

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

Yes, and we do not see a need for more guidance.

Questions not related to specific revisions

Q20. Do you agree on the alignment of the two sets of guidelines (where common provisions exist for the assessment of suitability and appropriateness)? Please also state the reasons for your answer.

We do not support a “copy paste” approach since there can be differences between advisory and non-advisory services that we need to take into consideration. Each guideline needs to be analyzed from the perspective of whether it works well in the context of suitability or appropriateness respectively.

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

We foresee that the guidelines will be published either too close to the start of the application date of the MiFID II Delegated Regulation or will be published afterwards. It leaves the investment firm having to start implementation based on not yet finalized guidelines or to revise their established processes when the guidelines are finalized. At least a 12 months implementation period should be granted following publication of the final guidelines.

We are also awaiting the revised product governance guidelines (ESMA consultation), and they provide complementary information that needs to be aligned with revised suitability processes.

In general, there need to be some flexibility in the guidelines until the financial instruments/products and data are aligned with the intention of the legislation.

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

It seems that there is an increase in non-binding guidance issued by the ESAs, e.g. public statements, opinions, Q&A, supervisory briefings and letters to and from the EU Commission. With this increasingly non-binding guidance the EU rulebook will be complex and create compliance risks. It is difficult to see what the difference is between guidelines, supporting guidelines and good and poor



practices. One should be careful not to “hide” important interpretations and guidelines in good and poor practices making the rules and regulations too complex. The good and poor practices could therefore be included e.g. in a separate report and not be a part of the ESMA guidelines.

Q23. What level of resources (financial and other) would be required to implement and comply with the guidelines (organisational, IT costs, training costs, staff costs, etc., differentiated between one off and ongoing costs)? When answering this question, please also provide information about the size, internal organisation and the nature, scale and complexity of the activities of your institution, where relevant.

The changes in the MiFID II regulation regarding sustainability preferences are quite extensive so the level of resources to implement the guidelines will be quite high (in terms of resources in general, organisational, IT costs, training costs, staff costs etc.). Revealing the clients' sustainability preferences will be an add-on to the existing suitability assessment and introducing a new “level” on the existing suitability assessment requires comprehensive changes in many areas.

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