

5 October 2022

**The Board of Directors
The Compliance Officer**

Dear Sirs,

Re: Publication of the ESMA Final Report on Guidelines on Certain Aspects of the MiFID II Suitability Requirements – Implications on Investment Firms’ existing Procedural and Organisational arrangements relating to the Client Suitability Assessment processes following Commission Delegated Regulation (EU) 2021/1253 and the incorporation of sustainability elements in the revised Guidelines

This letter is addressed in particular to **investment firms and credit institutions providing investment advice or discretionary portfolio management services**, and relates specifically to the provision of suitable personal recommendations to their clients or the taking of suitable investment decisions on behalf of their clients, as applicable.

I. Background

On 2 February 2022, the MFSa issued a Circular in relation to ESMA’s Consultation relating to the revision of the ESMA Guidelines on certain aspects of the MiFID II Suitability Requirements, highlighting the fact that firms are expected to take into consideration sustainability factors of investment products as part of their policies and procedures. **Further to the said Consultation, on 23 September 2022, ESMA published its Final Report on Guidelines covering certain aspects of the MiFID II suitability requirements.** The report is available on our website and may be accessed here.

The assessment of suitability is one of the most important requirements for investor protection in the MiFID II framework. It applies to the provision of any type of investment advice (whether independent or not) and portfolio management.

As outlined in MFSa Circular of 29 July 2022, the 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, has been implemented in MFSa’s Conduct of Business Rulebook. The new MiFID II requirements on suitability set out in the said Regulation have been applicable as from **2 August 2022**.

The amendments brought by means of the said Commission Delegated Regulation (EU) 2021/1253 have subsequently triggered the update and further review of the existing 2018 ESMA Guidelines on certain aspects of the MiFID II suitability requirements. The 2018 ESMA Guidelines have been reviewed to take into account:

- (a) the changes made to the MiFID II Delegated Regulation (EU) 2017/565 to integrate sustainability factors, risk and preferences into organisational requirements and operating conditions for investment firms;
- (b) the good and poor practices identified in ESMA's 2020 Common Supervisory Action (CSA) the application of the MiFID II suitability requirements. These good and poor practices will give practical guidance to firms in some areas where lack of convergence was identified; and
- (c) the amendments introduced through the Capital Markets Recovery Package to Article 25(2) of MiFID II.

The main amendments introduced by the Commission Delegated Regulation (EU) 2021/1253 and reflected in the guidelines on the topic of **sustainability** are:

- (a) *Information to clients about the purpose of the suitability assessment, including the sustainability preferences* – Firms need to help clients understand the concept of sustainability preferences and the choices to be made in this context. In this respect they need to explain the term and the difference between the different elements mentioned in the definition of "sustainability preferences" under paragraphs (a) to (c) thereof; as well as explain the difference between these products with and without sustainability features in a clear manner, avoiding technical language. Firms are also expected to explain what environmental, social and governance aspects mean;
- (b) *Collection of information from clients on sustainability preferences* – Firms need to collect information from clients on their preferences in relation to the different types of sustainable investment products and to what extent they want to invest in these products. This information should include all aspects mentioned in the definition of "sustainability preferences" and should be sufficiently granular to allow for a matching of the client's sustainability preferences with the sustainability-related features of financial instruments. In addition, throughout the process, firms need to adopt a neutral and unbiased approach as to not influence clients' answers;
- (c) *Assessment of sustainability preferences* – Once the firm has identified a range of suitable products for the client. The firm shall identify the product(s) that fulfil the client's sustainability preferences.

When matching Clients with suitable products, the quantitative indication of the client's preferences in terms of a minimum proportion of investments with

sustainability features in his/her portfolio should be used when applying a portfolio approach to the suitability assessment, in line with the additional guidance provided in guideline 8. When adopting a portfolio approach, firms should also decide to ask which part of the portfolio (if any) the client wants to be invested in products meeting the client's sustainability preferences.

More specifically, when a firm conducts a suitability assessment based on the consideration of the client's portfolio as a whole it could assess suitability as regards the sustainability preferences, for example, by applying those preferences (including the minimum proportion that shall be invested in investments with sustainability features) on average at the level of the portfolio as a whole or at the level of the part/percentage of the portfolio the client wants to be invested in products with sustainability features; and

- (d) *Arrangements necessary to understand investment products*: Firms should adopt robust and objective procedures, methodologies and tools that allow them to appropriately consider the different characteristics of each investment product they may recommend or invest in on behalf of clients also considering the sustainability factors of products in view of the subsequent matching with the client's sustainability preferences;
- (e) *Organisational requirements* – Firms will need to give staff appropriate training on sustainability topics and keep appropriate records of all relevant information about the suitability assessment and the sustainability preferences of the client (if any) and of any adaptation of these preferences (including a clear explanation of the reasons for such adaptation).

II. Compliance by Firms and MFSA Expectations

Kindly note that the MFSA has been communicating its expectations with respect to the SFDR legal framework as well as the amending Delegated Acts by means of various Circulars (in particular, in the [MFSA Report of 12 April 2022](#) on Operational and Compliance Readiness by Financial Market Participants and Financial Advisers) whereby it has been emphasised that firms were required to take the necessary steps to ensure compliance and enhance their operational preparedness in complying with *inter alia* the changes brought by means of Commission Delegated Regulation (EU) 2021/1253, by 2 August 2022.

MFSA would like to remind firms that they are required, amongst other matters, to:

- (a) **incorporate the collection and analysis of the necessary information about the client's or potential client's ESG/sustainability preferences** within their suitability policies and procedures, as part of the client's suitability assessment. In this respect, firms need to:
 - (i) ensure that (even though, at this stage, the availability of financial instruments with sustainability features may be limited and the introduction of these financial instruments in the firm's product scope

might be gradual), *“where, at the time the information is collected from the client, firms do not have any financial instruments included in their product range that would meet the client’s sustainability preferences. they should nevertheless collect all information concerning sustainability preferences”*.¹ In this situation, firms should clearly indicate that there are currently no products available that would meet those preferences and the client should be given the possibility to adapt the sustainability preferences. This should also be documented in the suitability report;

- (ii) **integrate considerations of the client’s individual sustainability preferences into the Firm’s client suitability assessments and product selection process.** This requires firms to update and/or review the existing procedural and organisational arrangements to the new sustainability requirements and impact firms’ underlying processes, IT systems and databases. In this respect firms are required to update and/or review for instance, the MiFID questionnaires, suitability assessment, suitability report, repapering of pre-contractual information;

- (iii) **to update and/or review the process of collecting sustainability preferences from clients** (for instance, providing advisors and portfolio managers with the necessary tools to recommend/select a suitable financial instrument, review/update of the algorithms/models used to match the client’s profile with suitable financial instruments).

In this respect, it is important also to note that a firm cannot recommend a product that does not match the client’s sustainability preferences, unless the client adapts his or her preferences. Firms are also reminded that that the possibility to adapt clients’ preferences only refers to the sustainability preferences and that with regard to the other criteria of the suitability assessment, the product has to meet the client profile; otherwise shall not be recommended.

- (iv) **integrate client’s suitability preferences** (as outlined above) **as a top up to the suitability assessment**, so that, firms first identify a range of suitable products for the client (in accordance with the criteria of knowledge and experience, financial situation, and other investment objectives); and then proceed by identifying the products that fulfil the client’s sustainability preferences;

- (v) **keep adequate record-keeping** and ensure in particular that, if the client states that he/she has sustainability preferences, and the firm does not have any products with sustainability related factors available, this should also be documented in the suitability report.

¹ Refer to [MFSa Circular of 2 February 2022](#) regarding Consultation on Guidelines on certain aspects of the MiFID II suitability requirements issued by ESMA.

- (b) update and/or review processes relating to **ESG data sourcing**, including those related to obtaining reliable ESG information from products manufacturers;
- (c) **provide appropriate training** to relevant staff, including with respect to assessing client's sustainability preferences. The legal requirements in terms of Commission Delegated Regulation (EU) 2021/1253 have entered into force on 2 August 2022 and therefore, it is important that staff providing investment advice possess the necessary knowledge and competence to fulfil their obligations under Article 24 and Article 25 of MiFID II.

In this respect, staff is to have the necessary knowledge and competence with regard to the criteria of the sustainability preferences and be able to explain to clients the different aspects in non-technical terms. In addition, other staff that does not directly face clients but is involved in the suitability assessment in any other way must still possess the necessary skills, knowledge and expertise required depending on their particular role in the suitability process.

In so far as point (ii) of paragraph (a) above is concerned, we would like to note that in the Final Report on the revised Guidelines, ESMA clarified that firms are required, in terms of Commission Delegated Regulation (EU) 2021/1253:

"to have the new client questionnaires ready at the date of application of the new requirements on 2 August 2022. This will allow any new client or any existing client that wishes to update their profile to do it from that date. That said, ESMA would also like to clarify that, in line with Recital 4 of the Delegated Regulation (EU) 2021/1253, firms could also decide to collect the client's individual sustainability preferences at the "next regular update" of the client profile review.

However, in this respect and in consideration of the importance of the topic and the operational complexities that a complete update of client profiles can entail, ESMA would expect firms to launch the campaign to proactively invite clients to update their profiles with regard to sustainability preferences (unless they have already done so) no later than 12 months after the entry into application of the rules. ESMA further clarifies that, until the firm acquires information on the client's sustainability preferences, the client will be considered as "sustainability-neutral" and therefore, in line with paragraphs 57 and 85 of the final guidelines, the client could be recommended products both with and without sustainability-related features."[emphasis added]

III. Next Steps – Action Required

In its Final Report relating to the revised Guidelines, ESMA noted that it is aware of the challenges firms are facing to implement the EU sustainability legal framework and in light of this, the revised guidelines will apply as from **six (6) months** from the date of publication of the said revised Guidelines on ESMA's website in all EU official languages. The previous ESMA guidelines issued under MiFID II (that is, the existing 2018 ESMA Guidelines) will cease to apply on the same date.

The revised ESMA Guidelines on certain aspects of the MiFID II suitability requirements will be implemented in the Conduct of Business Rulebook in due course.

However, it is important to highlight that your Firm is required to fully comply with the legal requirements as set out in Commission Delegated Regulation (EU) 2021/1253 as from 2 August 2022 and with the Guidelines as from six (6) months from the date of publication of the said revised Guidelines on ESMA's website in all EU official languages.

Therefore, you are kindly requested to submit to the Authority relevant extracts of:

- (a) An explanation of the changes which were implemented in the Company's suitability policies and procedures (including the Client Fact Find template) following the referred Commission Delegated Regulation (EU) 2021/1253 and the revised ESMA Suitability Guidelines whilst considering the Company's business model. You are expected to cross-refer the above explanation with the relevant requirements of Commission Delegated Regulation (EU) 2021/1253 and the sections of the revised ESMA Suitability Guidelines;
- (b) The relevant section of your policies and procedures relating to the suitability assessment; with specific reference to the sustainability preferences as well as an explanation of the changes which were implemented in the Client Fact Find following the referred Commission Delegated Regulation (EU) 2021/1253 and the revised ESMA Suitability Guidelines; and
- (c) The Client Fact Find (template questionnaire), detailing the collection of information on the client's suitability preferences in so far as sustainability factors are concerned, sufficiently demonstrating that these have been updated and/or reviewed to take into account and ensure compliance by your Firm with the above-mentioned requirements, in particular in relation to the client sustainability preferences.

Kindly submit your response on offsiteinv@mfsa.mt by not later than 31st March 2023.

Furthermore, kindly note that we will monitor the market to assess compliance and we do not exclude that there may be future supervisory interactions in respect of the above.

Should you require any clarifications on the above, please do not hesitate to contact the following persons, Ms Sara Antonia Magri, Deputy Head Conduct Supervision (sara.antoniamagri@mfsa.mt), Dr Krista Calleja, Senior Analyst Conduct Supervision (krista.calleja@mfsa.mt) and Ms Abigail Attard, Technical Expert Conduct Supervision (abigail.attard@mfsa.mt).

Yours faithfully,
Malta Financial Services Authority



Dr Christopher P. Buttigieg
Chief Officer Supervision

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