

A black and white photograph of a city skyline across a body of water. A large, arched steel bridge spans the water in the foreground. In the background, several skyscrapers are visible, including a prominent, modern building with a unique, angular facade on the right. The sky is overcast.

# NON-FINANCIAL MESSAGE IN A BOTTLE

## HOW THE ENVIRONMENTAL OBJECTIVES OF RETAIL INVESTORS ARE OVERLOOKED IN MIFID II – PRIIPS IMPLEMENTATION

*A contribution to the EC High-Level Expert Group on Sustainable Finance, with the support of:*

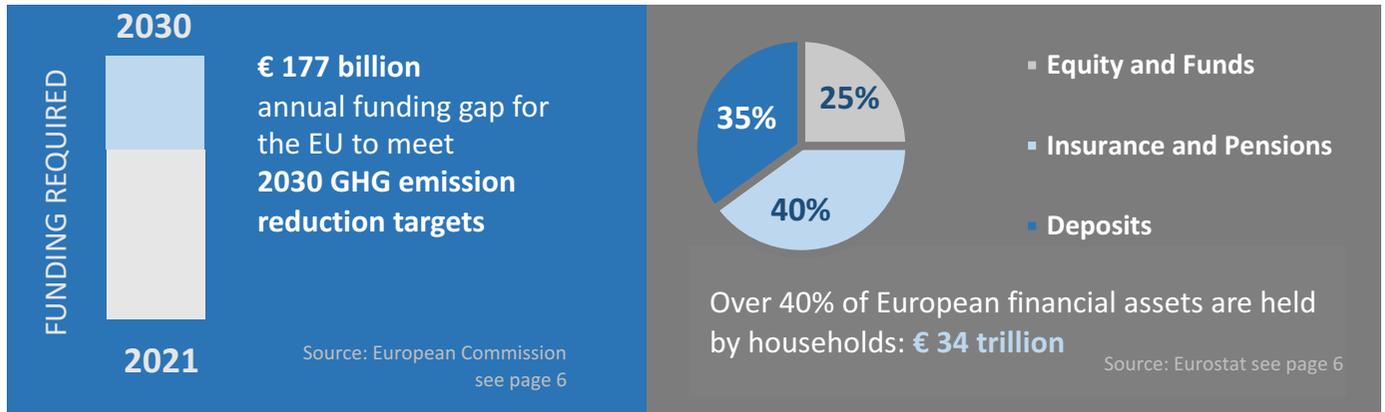


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# EXECUTIVE SUMMARY

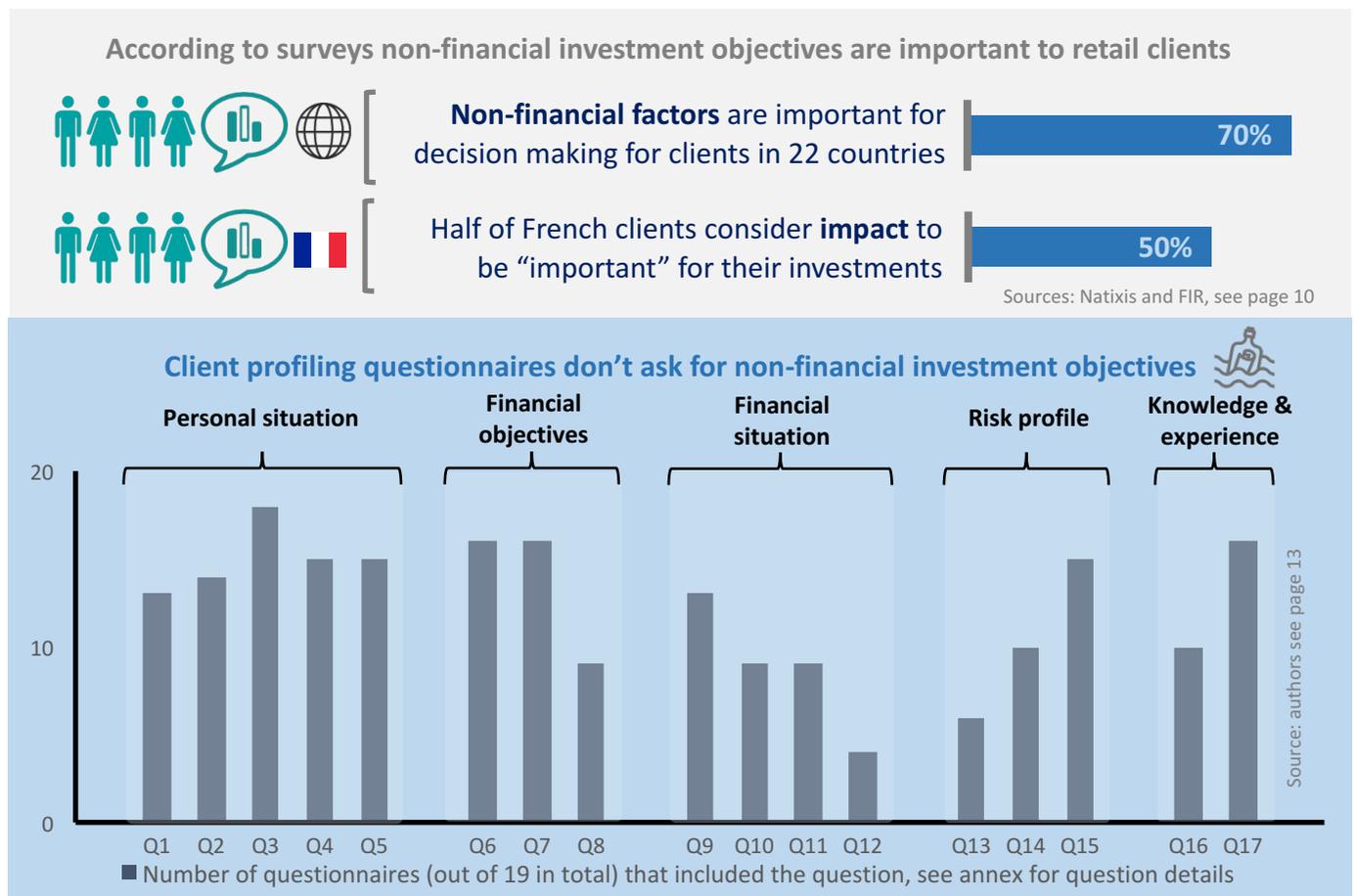
Retail investors (referred to as clients in all following text) hold significant amounts of assets and are therefore an important decision maker for the allocation of financial resources. Mobilising retail investors to take investment decisions in line with international climate goals could be an important factor in closing the funding gap to meet emission reduction goals.



## 1. Retail clients have non-financial investment objectives, but these are not discussed in client meetings

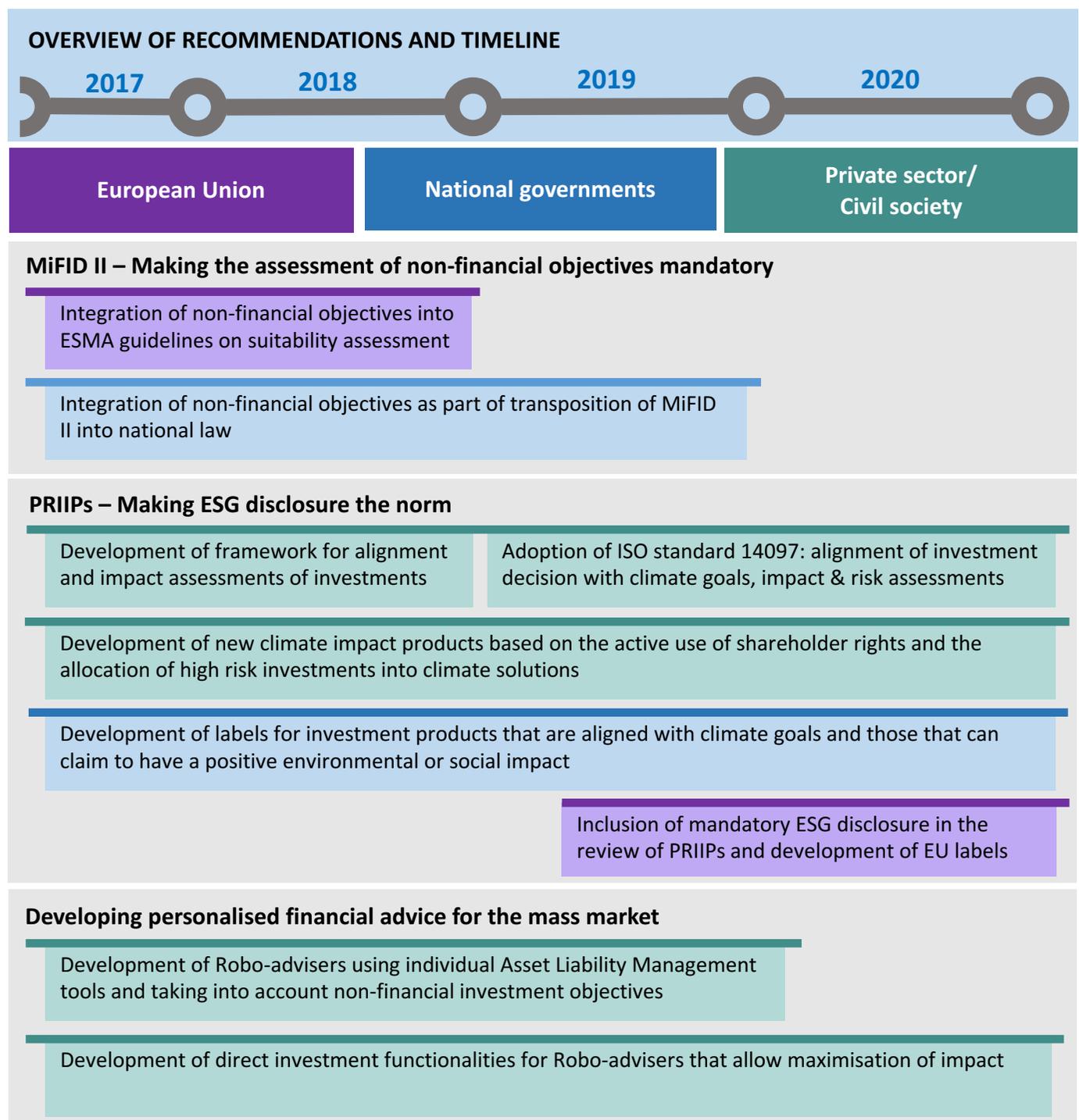
Opinion polls clearly indicate the widespread existence of non-financial investment objectives among retail clients. However, analysis of current practices in client meetings and questionnaires used by mainstream retailers for client profiling, shows that non-financial investment objectives are hardly ever discussed. Even when discussed, the information is not recorded together with other information on the client’s needs and preferences.

Clients’ non-financial investment objectives are like a message in a bottle: in most cases they will get lost and not reach their intended destination: taken into account for product selection and design. A standardised integration into client profiling is necessary. In Europe, the authors conclude that it can be achieved through regulatory reforms (MIFID, PRIIPS) and public-private partnerships in developing the next generation of robo-advisors.



## 2. Regulatory analysis identifies options for including the discussion of non-financial investment objectives as a mandatory part of client meetings under the MiFID II Directive

The report analyses relevant provisions of the MiFID II Directive including related secondary regulation and guidelines. The aim is to understand the existing regulatory framework and the extent to which there is scope to include the discussion of non-financial investment objectives in financial advice from a regulatory perspective. The mandatory suitability assessment requires the discussion of the client's investment objectives including his/her risk tolerance. While some clarification has been provided for the term "risk tolerance", the term "investment objectives" is not further specified. An early analysis of the transposition of the directive into national laws in France, Germany, Austria, Sweden and the UK showed that the term "investment objectives" is not well defined on a national level either, and it remains unclear whether or not non-financial objectives are included. Draft transposition documents in further countries show a same approach. The ESMA Guidelines on Certain Aspects of Suitability Requirements, which clarify concepts used in MiFID that need further definition, are currently under review. These guidelines could be updated to include a clarification on the definition of the clients' "investment objectives" which includes financial and non-financial investment objectives. Concrete wording for amending the guidance is proposed.



**3. Further standardisation of client profiling questionnaires should be considered with the aim of maximising their clarity and effectiveness, to ensure that investors' impact preferences are considered.**

In addition, the authors recommend a greater standardisation of questionnaires, specifically in relation to questions on non-financial investment objectives. In the absence of clear definitions, diverging approaches by retailers could lead to increased confusion among clients and overlook solutions which would better take into account clients' objectives, including their preferences for impact products. National public or industry-led harmonisation efforts are recommended and could then potentially pave the way for standard setting on a European level.

**4. The extension of ESG disclosure requirements to all retail products as part of the scheduled revision of the PRIIPs directive would create greater transparency for clients and allow informed decision making.**

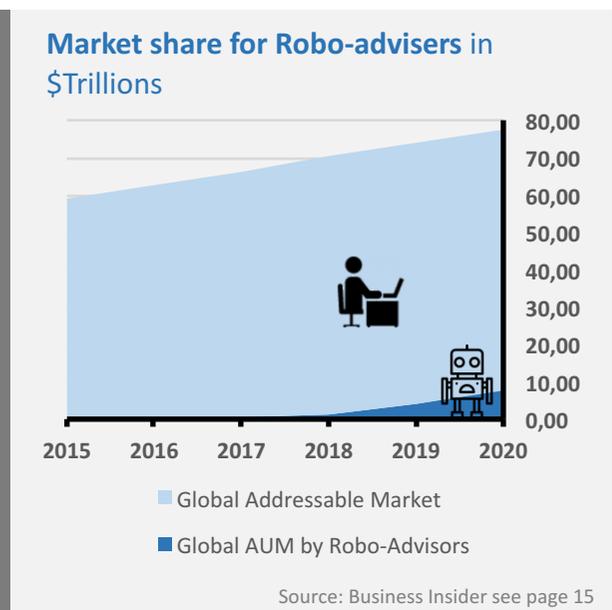
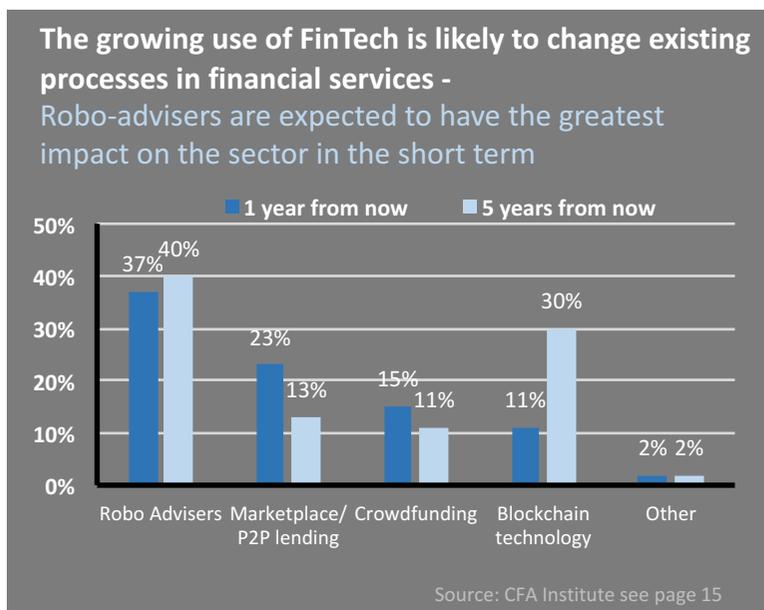
While strict transparency requirements are likely to be put in place for EOS PRIIPs, (the delegated act detailing the exact requirements is still to be published), mainstream products are currently not required to specify if and how they take into account ESG risks. The authors recommend making two types of ESG related information mandatory as part of the scheduled review of the PRIIPs directive: transparency on the exposure to sensitive business activities and the alignment with climate goals for all products, and the provision of evidence if the manager claims that the produce has a positive social or environmental impact. There is still some debate on the appropriate definitions and metrics to be used. However, while a detailed timeline for the review of the regulation has not yet been announced, the review process will allow sufficient time to develop a harmonised approach across Europe. Research and standardisation efforts are already underway and the prospect of the integration in European regulation would give these efforts a further push.

**5. National and private sector initiatives are needed to define and label 'impact' investment products.**

Definitions and standards for investment decisions need to be transformed into labels for investment products that are easy to understand for retail clients. National and private sector initiatives can lay the groundwork for a set of labels on European level in the medium term.

**6. Build on the upcoming Fintech revolution to develop more personalised services capable of servicing financial and non-financial investment objectives.**

In parallel, the rising use of FinTech and, in particular, the growing importance of Robo-advisers, is a clear window of opportunity to review existing processes and to develop more personalised services, capable of taking the non-financial investment objectives of clients into account. Many retailers of financial products have currently projects underway to develop Robo-advice and new FinTech start-ups are entering the market. This is a unique opportunity not only to automate the existing process of financial advice but to rethink the offer, and to develop more personalised services for the mass market inspired by the existing offer for wealth management services. There is likely to be cost cutting potential through the automation of such services as well as along the chain of financial intermediaries. Cutting costs in both areas could allow the design of personalised services accessible to the mass market.



## CONTEXT AND APPROACH

### **Mobilising retail savings for the sustainable economy of the future**

Ensuring the long-term financing of the European economy has emerged as a crucial issue in the context of the financial and Eurozone crises. As sovereign debt levels rise and public investment decreases, private investment has become increasingly important for the long-term health of the European economy. While historically similar savings and investment ratios suggest that there are sufficient funds available to meet investors needs on aggregate, current data shows that certain sectors of the economy (e.g. SME's, energy, infrastructure, innovation) lack funding. For example, in its interim report, the HLEG on Sustainable Finance estimates that an additional €177 billion of annual investments between 2021-2030 are needed for the EU to meet its 2030 green house gas emission reduction targets (EC, 2017f).

In 2015 European households held 34 trillion euros of financial assets representing over 40% of total financial assets in Europe. Households are therefore, in theory, one of the main decision-makers regarding capital allocation in Europe. Mobilising these assets even only partly would be a major lever for financing the energy transition and the sustainable economy of the future. About 25% of their assets are invested in equity and funds for which the retail investor carries the risk and choose the product. Another 40% is invested in insurance and pensions (including defined contribution schemes). The remaining part relates to deposits, for which households have currently limited influence on allocation decisions taken by the banks (Eurostat, 2017).

### **The role of financial advisers in the allocation of savings capital**

Retail clients are heavily dependent on financial advice. The level of financial literacy among retail clients is generally low (OECD, 2016) and packaged investment products proposed to retail clients are difficult to understand without any background in finance. Due to this situation, only few retail clients are actively engaged in product choice. In France, for example, while over 50% of respondents to a survey declared that environmental and social impact were important for making investment decisions, only 22% were ready to actively ask their adviser for SRI products (FIR, 2016; 949 respondents). This, as well as a misalignment of financial advisers incentives on the numerous levels of financial intermediation in line with commercial or marketing goals, has created distortions in investment decisions and allocation of savings capital (FCA, 2016a).

### **Financial advice lacks a personalised approach and is faced with low levels of trust by clients**

PWC has pointed out in a recent study the low levels of quality of service provided to clients. Even in wealth management, issues of consistency persist when comparing advice given to clients with similar profiles and truly personalised advice remains the exception rather than the rule (PWC, 2017a).

The European commission's Green Paper on Retail Financial Services has highlighted that low consumer trust in financial institutions is prevalent in Europe (EC, 2013). The EU's yearly Market performance index (MPI), which tracks consumer perception of the functioning of economic service sectors, has consistently ranked the banking sector in last place since 2010 (EC, 2016a).

### **The political context of MiFID II: the financial crisis and consumer protection**

While MiFID II has the broad objectives to make financial markets "more efficient, resilient, and transparent" (EC,2011), the context of the financial crisis has put investor protection at the core of the revised directive. The reforms included in MiFID II aim to protect investors by preventing financial advisers conflict of interest and introducing rules for manager responsibility and corporate governance. These changes may however not be sufficient to address a number of issues leading to the the current lack of allocative efficiency and consumer satisfaction. The present report provides an in depths analysis of current investment advice practices and assesses how these are able to react to a rising customer demand for green investments and non-financial investment objectives in general.

## The reports structure

The report's objective is to formulate recommendations to reform the investment advice in line with Europe's long-term funding needs. It is divided in three parts. The first part aims to provide a detailed analysis of the status quo. It starts by setting out the current demand for green savings products according to existing surveys. It then analyses in detail the prevalent structure of retail investment products with the aim to see if the current process is able to capture the demand. It concludes with an overview of how current trends of automatization and increasing use of Fintech are likely to impact investment advice processes. The second part provides a regulatory analysis of the MIFID II directive as well as the new PRIIPS regulation in order to assess the potential impacts that this new regulatory environment may have. The third part provides recommendations to public and private sector stakeholders on how to better take into account the non-financial investment objectives in investment advice.

### A qualitative approach combining desk review, interviews and field research

Aiming to provide a realistic picture of current investment advice practices, the report was undertaken in cooperation with public and private sector stakeholders from overall 12 EU countries and 5 non-EU countries. The starting point of the study was an international benchmark study of relevant private and public sector initiatives (see annex). Research activities included:

- A. A literature review of available studies, surveys and European and national regulation documents.
- B. Field research: 16 "client meetings" in four European countries for which 2dii researchers made regular appointments with mainstream banks pretending to look for investment opportunities for an amount of about €30.000. The aim was to test and compare real life client meetings and to understand the role and content of the questionnaires used for suitability assessments under MiFID.
- C. Telephone interviews with financial institutions and other stakeholders who agreed to contribute to the research. Interviews with financial sector associations (of banks, independent investment advisors as well as fund managers), were used to cross-check findings obtained by the discussion with individual actors.
- D. Feedback on findings and recommendations by national and European financial regulatory and supervisory bodies

Using this approach, the report aims to obtain a holistic picture of a highly diverse sector, in which practices vary not only across countries, but also across banking institutions.

### Context and target audience

This report has three main target groups: private sector stakeholders, national governments and regulators and European regulators. The primary aim of the report is to promote improvements in European regulation. The report thus provides recommendations in response to the ongoing ESMA public consultation on MiFID Suitability requirements (ESMA, 2017b) and feeds into the work of the High-Level Expert Group (HLEG) on Sustainable Finance. The HLEG on Sustainable Finance is a consulting body to the European commission created in 2017, aiming to produce recommendations for a comprehensive EU strategy on sustainable finance as part of the Capital Markets Union.

**TABLE 1: Primary research activities compiled input from 67 institutions in 17 countries** (source: authors)

Stakeholder group	Type of interaction and number of institutions	Countries
Financial regulatory and supervisory bodies	Informal feedback (6)	Austria, France, Germany, Portugal, Sweden, EC
Financial sector associations	Telephone interviews (6)	France, Germany, Luxemburg, Netherlands, Spain
Individual banks and insurances	Client meetings (16) and telephone interviews (15)	Austria, France, Germany, Italy, Netherlands, Spain, Sweden, Switzerland, UK and Canada
Other (fund managers, research organisations, NGOs, consulting firms, national ministries, etc.)	Telephone interviews (24)	Belgium, Finland, France, Germany, Netherlands, Sweden, Switzerland, UK as well as Australia, Japan and USA

### What do we call ‘Non-Financial’ objectives?

A number of concepts such as *non-financial*, *extra-financial*, *sustainability*, *green* or *ESG* (Environmental, Social, Governance) are used interchangeably by market participants and policy-makers to refer to the various criteria that are allegedly not properly factored into financial analysis and investment decisions. A closer look at the criteria and approaches suggests the existence of different concepts that do not overlap with the various terms used, leading to confusion about the objectives of the approaches. The following pages aim at disambiguating these concepts. The report then builds on these concepts and definitions.

**Integration of ESG factors into investment product design.** This concept is the most largely used by market players and is also largely adopted by policy-makers. It broadly refers to the process of taking into account a range of criteria related to social aspects (e.g. compliance with human rights standards, good HR practices), environmental impacts (e.g. climate mitigation actions, water management, etc.) and governance practices (e.g. independence of board members). The most common approaches to take into account those factors are exclusions of industries (e.g. weapons or tobacco) or specific companies (e.g. worst performers in a sector with regard to ESG issues), the positive selection of companies exposed to specific business activities (e.g. climate friendly technologies) or companies (e.g. best performing companies of their sector), the re-weighting of the portfolio according to these criteria, and the use of shareholder rights to push resolutions related to these criteria (Eurosif, 2017). In most cases the investors (or the policy-makers promoting this approach) remain ambiguous about the underlying objective. Further analysis suggests the existence of two different goals:

- *Better risk management.* Many investors present the integration of ESG factors as a way to factor in certain long-term financial risks, driven by the strengthening of public policies, changes in consumer preferences and innovation. These are not properly captured by standard financial analysis, notably due to its short term focus (2dii, 2017b). In this case, the underlying objective is to maximize long-term returns for the investor, assuming that the markets misprice these long-term factors. According to this logic, only the ESG criteria that are *financially material* to the investors over his/her investment horizon should be factored in.
- *Impact on the real economy.* Another objective relates to the willingness of certain investors and beneficiaries to positively contribute to social and environmental outcomes via the influence of their exercise on investee companies, through the allocation of their portfolio and/or the use of their shareholder rights. Under this approach, the investor is supposed to take into account criteria that are not necessarily financially material. As discussed hereafter, surveys suggest that this objective is the priority of retail investors. The review of policy incentives, notably tax breaks on incomes from retail investment products in France (2dii, 2017a), also suggests that this topic is a key concern for certain policy makers and one the main justification for existing fiscal incentives on capital.

These two goals are obviously interconnected: better risk management can support positive social outcomes and vice versa. However, they also sometimes contradict and fundamentally require specific metrics and approaches.

**The impact of an investment product.** What investors and policy-makers call the ‘impact’ of an investment product is very loosely defined in policy documents, product descriptions, and literature in general. The general idea is that investment decisions such as sector allocation, stock picking, and the use of shareholder rights have an influence on the behaviour of investee companies. They can therefore be used to support positive outcomes in the real economy (e.g. better gender equality, climate mitigation) or can have negative unintended consequences if such impacts are not measured and factored in decisions. This objective can lead to two types of practices:

- *Impact investing* refers to the development of investment products that actively seek to ‘make a difference’ in the real economy. Traditionally, to achieve this objective the investor invests in new ventures and projects with low ROI (e.g. due to the priority given to social outcomes) or high risk (e.g. due to new technology). This practice leads to products with a very specific profile that only target a niche market. The penetration of such product is, in most markets, below 1% (Eurosif, 2017, GIIN, 2017).

- *Managing unintended consequences.* A second approach, that is not yet associated with a specific concept or terms, emerged in the past few years. This approach is implemented by asset managers who manage ‘standard’ diversified portfolios (e.g. large listed equities from mainstream stock indexes), but want to control for the unintended negative consequences of modern investment practices (e.g. unnecessary lay-offs or reduction of low carbon R&D expenditures by companies to boost quarterly earnings). In this approach, stock picking and sector allocation is used to send a signal to issuers, and marginally seek to influence their cost of capital. Shareholder engagement is used as the preferred method to directly seek influence on the decisions of the investee companies on social and environmental matters.

As far as impact measurement is concerned, it is to be noted that a review of practices suggests a lack of assessment frameworks, and a widespread use of deceptive marketing practices (a.k.a. greenwashing). Indeed most products marketed with an ‘impact’ narrative turn out to mostly provide a ‘*feel good effect*’ to the beneficiaries, rather than actually making a difference in the real economy. A notable example include ‘tilted’ equity funds, where the allocation to different components of an index fund is marginally modified based on a non-financial criteria (e.g. carbon intensity of the activity). In this case, the impact on the investee companies behaviour is likely to be inexistent, but the asset managers communicate on the reduction of the carbon intensity of the product (CO2 per € of AuM) in a way suggesting reduction of emissions in the real economy.

### **Where does the EU stand on disambiguation of concepts and standardisation of metrics?**

**Ambiguity is the norm.** On this topic, market practices, standardisation processes, and policy-making are currently dominated by confusion and ambiguity. Traditionally, both investors and policy-makers have used the various terms listed above interchangeably, and have not disentangled the two goals defined above. As a consequence, the first laws and regulations that address the topic (e.g. the French NRE law (Legifrance, 2017) and the PRIIPS regulation (EC, 2014)) refer to the “integration of ESG factors” or equivalent wording, while remaining unclear about the underlying objective.

**Recent progress on clarifying concepts.** Progress have been made recently with the Article 173 of the French Energy Transition law that requires investors to disclose their exposure to climate-related risks, but also how they ‘contribute’ to the achievement of international climate targets, thus explicitly introducing the concept of ‘impact’ of investment products (French treasury, 2015). Similarly the conclusions of the consultation on PRIIPS emphasises this concept of ‘impact’ and suggest that it should be the main goal of ESG integration from a retail investor perspective (JC ESA, 2017).

**Towards standardization on climate-related criteria?** The recent interest of both investors and policy-makers for the integration of investment climate-related criteria has accelerated the work on definitions and clarification of objectives. While the TCFD (Taskforce on Climate-related Financial Disclosures) initiated by the Financial Stability Board has put emphasis on the management of financial risks related to environmental policies and physical changes, the newly created ISO 14097 working group (2017-2019), co-led by 2Dii and the UNFCCC Secretariat aims at defining and standardising how to measure the ‘climate impact’ of investments. The EC High Level Expert Group on Sustainable Finance also has put on the top of its list of recommendations the creation of a taxonomy for green assets and the development of standard for funds. The progress in thinking made on this topic has led to the recent introduction on the following concepts, that are currently specific to climate issues, but are likely to be adapted to other issues in the future:

- *Exposure indicators* (measured in carbon intensity, share of the portfolio in certain sub-sectors such as coal mining or renewable power) can be used to map which assets in the portfolio are relevant to be managed from a climate perspective;
- *The alignment of a portfolio with 2°C scenario* can be assessed by comparing some of these indicators (e.g. deployment of renewable power, carbon emissions) with the same metrics in a decarbonisation roadmap (e.g. from the IEA);
- Based on these indicators, investors can then try to influence investee companies so that they implement *climate actions* (e.g. speed up the deployment of renewables) with the objective of delivering ‘climate impact’ or/and managing ‘climate-related’ risks.

Rapid progress in this field is likely to pave the way for the policy actions envisioned in this paper.

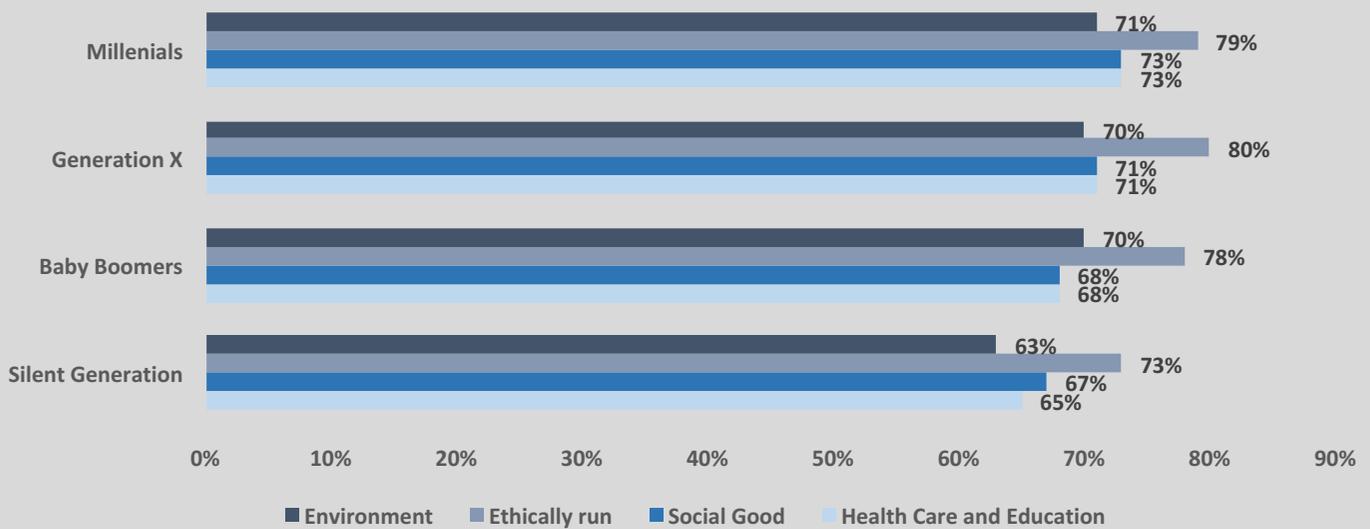
# I. CURRENT PRACTICE: NON FINANCIAL OBJECTIVES IGNORED BY INVESTMENT ADVICE

## 1. THE EVIDENCE FOR NON FINANCIAL INVESTMENT OBJECTIVES IN OPINION POLLS

### Non-financial objectives are an important factor in the investment decision-making of retail clients

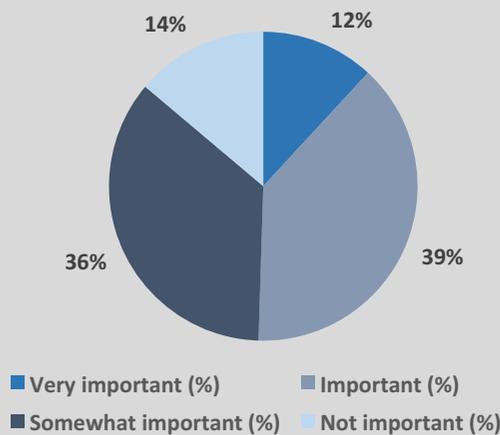
Despite inherent biases in the collection of survey data, opinion polls show that a majority of retail investors would like to invest their capital into products with environmental or social impact. Case studies on a global, and national level show that over half of all retail investors want to take these issues into account (Figures 1, 2, 3). As the generational breakdown in figure 1 shows, this trend is even more pronounced among young people and is likely to continue in following years. The Natixis “Mind Shift” study, which questioned over 7000 people in 22 countries, highlights how an increasing number of individuals wants their investment to represent their personality and values. Most investment professionals do not share these sentiments, revealing a disagreement on the nature of investment objectives between retail clients and their advisors (Natixis, 2017). Further studies are showing similar results (Schroeders, 2017; Wisdom Council, 2017; Morgan Stanley, 2017).

**FIG. 1 Over 2/3 of retail investors in 22 countries consider non-financial factors in their investment decisions to be “important” (Natixis, 2017)**



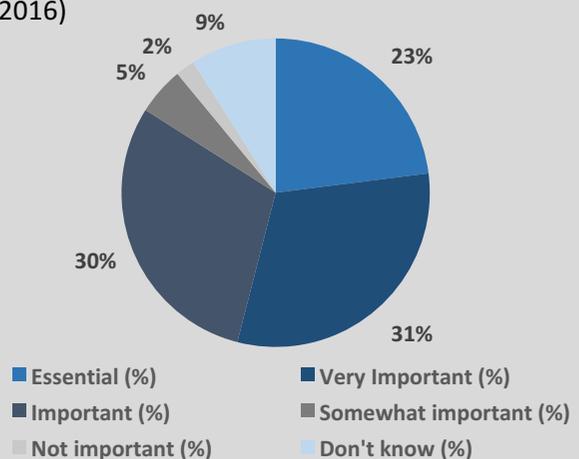
Q: Do you consider that one, or several, of the following factors is important to your investment decision-making? (7100 respondents in 22 countries)

**FIG. 2 Over 50% of French retail investors consider impact “important” for their investments (FIR, 2016)**



Q: What importance do you assign to environmental and social impact in your present investment decisions? (949 respondents in France)

**FIG. 3 Over 80% of French retail investors want their bank to act in favour of the fight against climate change (FIR, 2016)**



Q: Do you consider that its important that your bank invests taking the fight against climate change into account? (1094 respondents in France)

## **Retail investors are interested in impact in the real economy**

Retail investors seem to be specifically interested in investment approaches that lead to impacts in the real economy (see definition page 8-9). As a French marketing study has shown, the majority of individuals interested in green financial products cited “societal impact” as the main purchase criteria, aiming to “make a difference” (ADVIR, 2007). The joint consultation paper of the three European Supervisory Authorities on financial products with environmental or social objectives confirms these findings, highlighting that while institutional investors are more likely to adhere to ESG criteria to avoid risks, retail investors want to “align their investment with their values” and “have an impact on society” (JC ESA, 2017).

## **Despite growing demand, products addressing non-financial objectives face structural biases**

Despite the presented survey results and evident customer demand for products addressing non-financial objectives, the market share of assets managed with investment strategies which could potentially respond to this demand remains low, although there has been considerable growth in recent years. Both, environmentally themed investments and *impact investments* had a market share of less than 1% each in Europe in 2015 (for institutional and retail investors combined). While assets with active shareholder engagement strategies are at about 20% of the total market share, it remains unclear if the engagement is used for non-financial investment objectives and what the share of assets held by retail investors is (Eurosif, 2017). This mismatch between customer demand and assets managed with clear strategies addressing non-financial investment objectives is a result of a number of barriers in the financial sector, which create structural barriers for market growth.

As the French Social Investment Forum (FIR) showed in an unpublished study from 2015 on the barriers to green demand within the banking system, retailers of investment products are a major bottleneck. Based on interviews with financial advisers and marketing directors (13 respondents, limited to France), their qualitative study highlighted a number of structural biases in consulting practices. In the absence of commercial or marketing incentives for the sale of ESG products, advisers have no reasons to promote them. The study reveals a negative image of alternative products among advisers, including the perception that they perform badly, or that they are unattractive to customers. While these attitudes can be explained by the absence of ESG-specific trainings and a general lack of knowledge on related issues, they are also linked to other issues with the evaluation of both green products (see benchmark study in the annex).

## **Behavioural biases are enabling “greenwashing” and misleading marketing practices**

There exists a strong consensus on the positive impact of a “green” marketing strategy on the image of retailers of investment products and customer perception (Yeng & Yazdanifard, 2015). However, marketing strategies are not automatically linked to improvements in the retailer’s environmental or social impact. Analyses of green marketing practices have confirmed that customers are more receptive to direct and visible impacts of selected activities than a broader change in business strategies (Polonksy, 2011). A Greek study on the impact of “green” banking activities on consumers, showed that community outreach and small scale changes in banks operations (such as recycling, or water savings in their offices) improved the banks image more, than an actual change in investment practices or lending activities (including green product development) (Lymperopoulos et al., 2012). This has incentivized “greenwashing”-practices, in which a broad range of company activities are misleadingly portrayed as having societal impact, making it difficult for consumers to identify truly impactful firms and products (Parguel et al, 2011).

Such behavioural biases can be exploited by marketing practices. It is easier for retailers to focus on communication activities and minor organisational changes, rather than developing new products and business models which cater to the non-financial investment objectives of clients. This has artificially channelled the existing demand for “impact” products, towards products with strong marketing power but potentially limited impact in the real economy. In the context of low trust in banking institutions and emergent regulation, third-party evaluations, such as sustainability ratings and labels, need to emerge as a point of reference for consumers (Parguel et al, 2011).

## 2. CURRENT SALES PRACTICES STRUGGLE TO CATER TO CUSTOMERS' INDIVIDUAL INVESTMENT OBJECTIVES

Even though the exact process of financial advice differs widely in the details according to the banking institution and country, some general conclusions on current practices can be drawn.

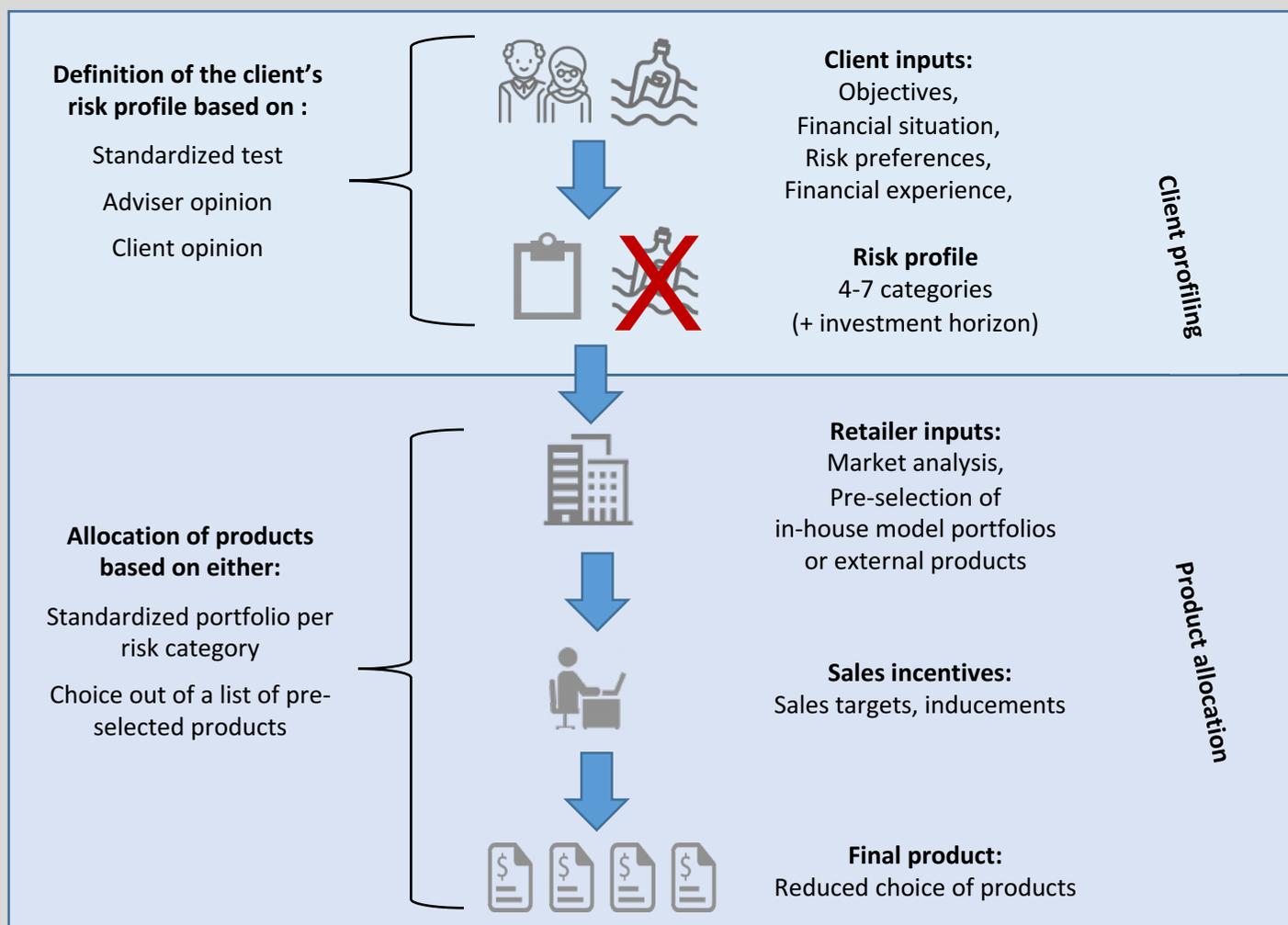
### Product selection is to a large extent determined by the risk profile of the customer

Financial advice includes typical elements that can be broadly subdivided in two stages: client profiling and product selection. Client profiling usually consists of two elements: filling out a client profiling questionnaire, and determining the client's risk profile. In theory, all the information gathered in this stage should be used as an input into the second phase of product selection (fig. 4). However, the authors' field research lead to the conclusion that it is primarily or even solely the risk profile of the client that is used to select products.

### Packaged products and limited product choices make it difficult to cater for clients' individual objectives

Providing financial advice is a sales activity. Packaged products reduce handling costs, and these products are often linked to mass discounts. Streamlining the number of offered products through bundling is considered to be a good sales technique, as it increases the adviser's product knowledge and therefore sales. (McKinsey, 2014/ BCG, 2009). While this practice provides benefits for retailers, it biases the decision of the client. A limited choice of products makes it difficult to take into account the client's specific situation and investment objectives (financial and non-financial). Packaged products may also be more difficult to understand, given their complex structure and the limited information on the exact destination of the investment. As discussed detail in the following page, the non-financial investment objectives of clients are rarely assessed in this process and thus unlikely to be taken into account for product selection.

FIG. 4 Typical elements of client profiling and product allocation processes (Source: 2dii)



**Client profiling questionnaires are harmonised to some degree across Europe and do not include the assessment of non-financial investment objectives**

At the time of writing, the client profiling questionnaires in use are regulated through the European Directive MiFID I, the related delegated directive and their transposition into national law, as well as the ESMA guidelines on certain aspects of the MiFID suitability requirements (ESMA, 2012). The revised directive MiFID II is scheduled to be applied as of January 2018 (see part II of this report). The following analysis is based on field research covering 16 client meetings with retailers of investment products and the analysis of a sample of 19 questionnaires used by mainstream retailers in 5 EU countries representing together about 2.5 trillion assets under management.

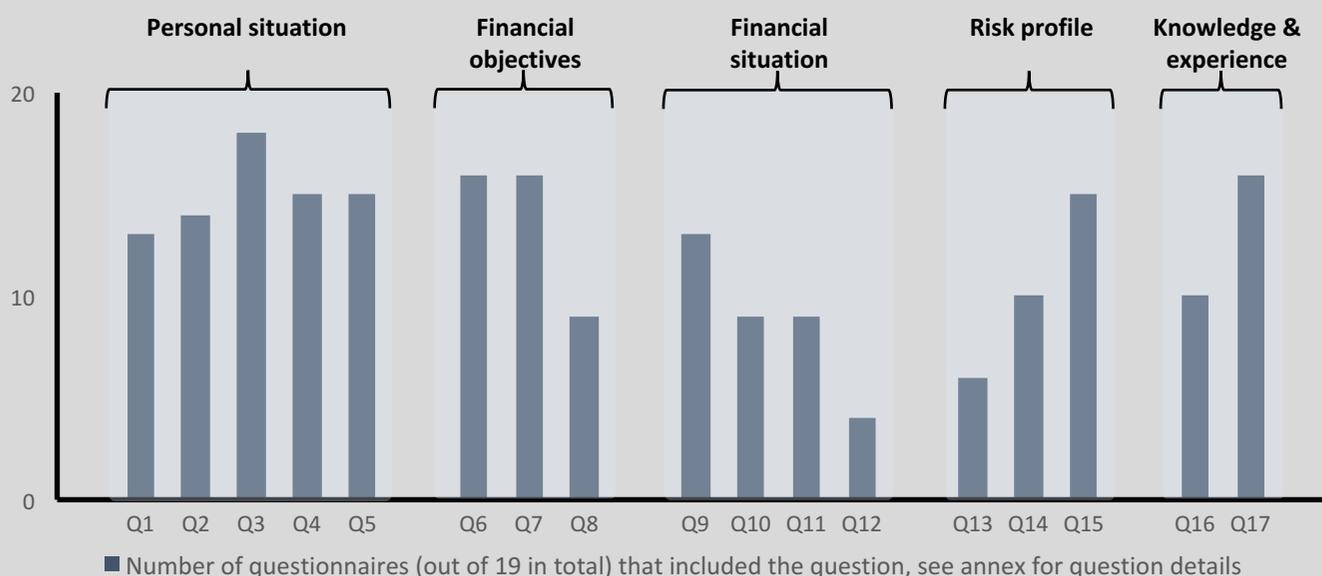
The sample results show that all questionnaires cover the required areas of personal situation (elements that may impact the client’s financial situation or objectives), financial situation, knowledge and experience and risk profile and investment objectives, in varying degrees of detail. The analysis also shows clearly that all retailers in the sample have chosen to interpret investment objectives as covering only financial objectives and thus excluding non-financial objectives. Some retailers, when questioned, indicated that non-financial objectives may be discussed during the client profiling phase. In these instances, however, the questionnaire used did not allow the recording of any such objectives of the client alongside other client information.

Another important insight from the survey were differences in the timing of the profiling during the meeting. A number of advisers discussed first products and suggested investment opportunities before proceeding with profiling. This indicates that the questionnaire is not always used to guide product selection, but filled in after product selection to comply with the regulation.

From our fieldwork, we believe that in a large majority of client meetings extra-financial investment objectives are not discussed, an assumption that has been largely confirmed by interviews with finance sector associations. Only few exceptions exist, e.g. retailers with a specific mandate dedicated to sustainable development include questions on non-financial investment objectives.

This constitutes a major barrier for taking into account clients’ existing non-financial investment objectives in investment advice. Making the discussion of non-financial investment objectives mandatory seems to be the only way to improve the situation. A regulatory analysis in Part II of this report will discuss the existing regulatory framework in more detail.

**FIG. 5 Common questions featured in investment client profiling questionnaires: non-financial investment objectives are missing** (Source: authors’ field research)



This survey is based on 19 questionnaires from mainstream retailers from five EU countries (UK, France, Germany, Italy, Spain).

### How the client’s objectives get lost in the profiling process

A significant amount of time in financial advice is spent on client profiling: client meetings often take 45 to 60 minutes and about half of the time is spent on client profiling. As shown above, questionnaires currently do gather significant amounts of information. However, extra-financial investment objectives remain a notable exception, despite a rising recognition that customers want these objectives to be taken into account. On top of that, only a fraction of the information provided seems to play a role in product selection.

### The risk profile is most important factor in product selection

Lessons drawn from the financial crisis have rightfully put more emphasis on consumer protection and respect for the client’s risk profile when it comes to product selection. However, the current system of a reduced choice of packaged products makes it almost impossible to cater for any other objective that the client may have.

The first categorisation of clients is to divide them into those that require investment advice and those that independently manage their portfolio with the retailer simply executing their decisions. The latter are called “execution only” clients, and require only an appropriateness assessment to ensure that the client has a sufficient level of knowledge and experience to take the investment decision on his or her own behalf.

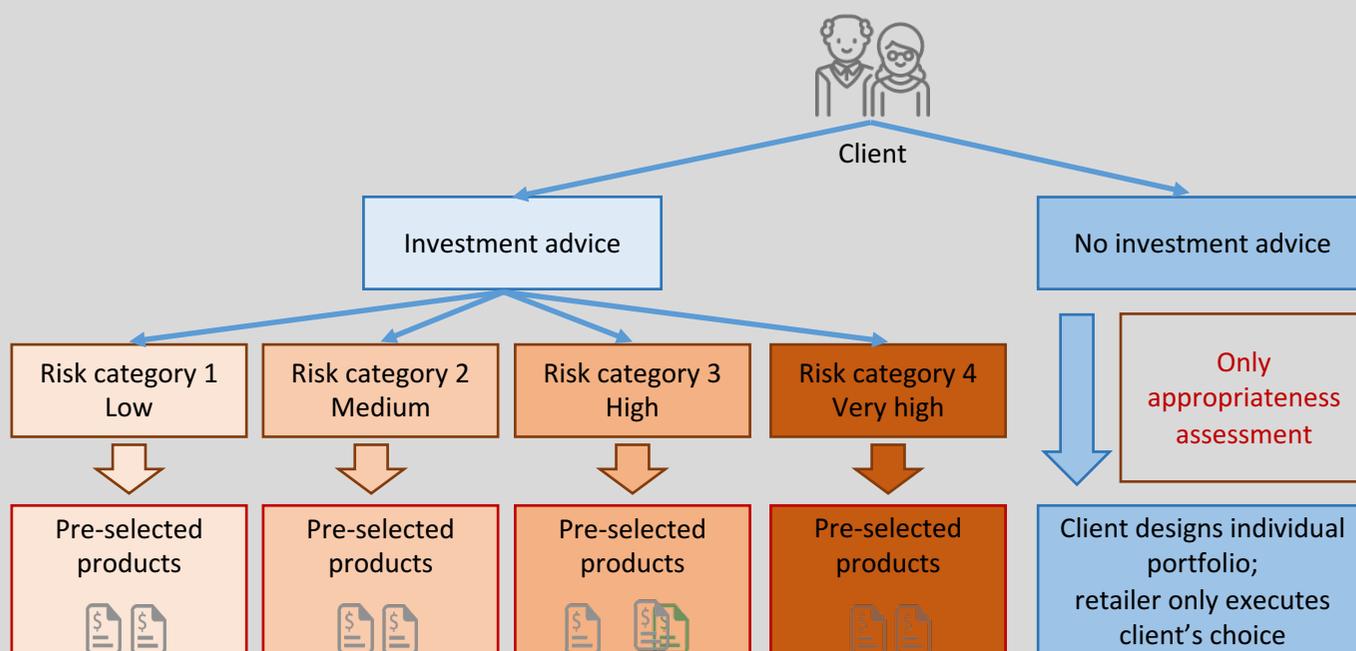
Clients that require investment advice are placed in one of the pre-determined risk categories. Retailers usually have four to seven risk categories. Once the risk category is selected, there is usually a very limited choice of packaged products proposed to the client. Pre-packaged products may sometimes include limited elements of choice, however most of the time only in terms of the geography of investment (e.g. emerging markets fund vs. European fund).

The time horizon of the investment may determine the ultimate choice. The investment amount and the financial knowledge of the client may also play a role, but act rather in the sense of a threshold to invest, as some products require a minimum investment or a minimum level of knowledge (e.g. any kind of university degree).

### Green products don’t fit in the current system

Clients asking specifically for green products are faced with difficult choices. As green products are rarely available for all the risk categories, clients may have to change their risk preference in order to be able to subscribe to a green product. In other cases, where standard green products are not available, they may even have to move into the category without investment advice in order to be able to design a green portfolio themselves.

FIG. 6 Typical elements of client profiling and product allocation processes (Source: 2dii)



### 3. THE UPCOMING DIGITAL REVOLUTION

#### The emergence of FinTech will disrupt the financial sector

There is a general consensus that financial services will be highly affected by an increased use of high tech solutions (FinTech). The McKinsey Global Institute estimates that up to 45% of processes in the finance and insurance sector can be automated by adapting already available technologies; most of these processes are currently used to collect and process data (McKinsey Global Institute, 2017). A PwC survey among top tier managers of financial institutions and FinTech companies globally shows that sector insiders are expecting their business to be disrupted by FinTech with consumer banking and investment and wealth management being ranked in first and third position respectively (Fig. 7). Interestingly, the disruption potential is rated even higher by the incumbents of the respective sectors compared to outsiders (PwC, 2016b).

Articles and blogs on the changing expectation of customers in the face of the rising use of technologies in many areas of life are univocal on the fact that today's customers are looking for faster (no waiting), accessible (by multi-channel), available (24/7), low cost and very important personalised solutions (e.g. CMI, 2016; Customer Experience Insight, 2016 and ICMI, 2015).

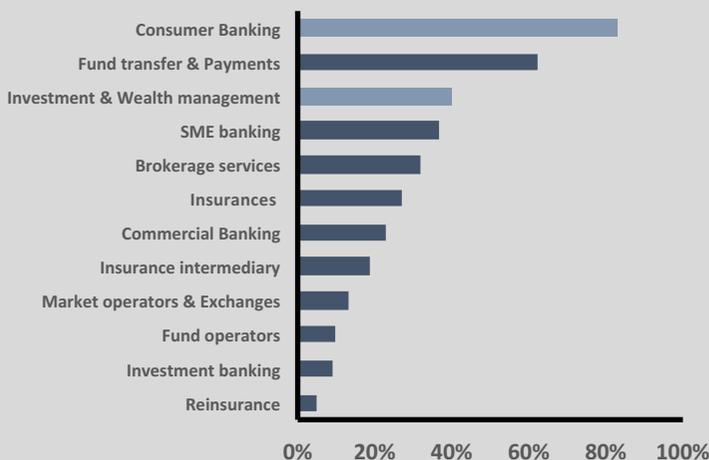
#### Robo-advisers are expected to rapidly gain market share

Robo-advisers are cited by investment management professionals as the technology with the highest short term impact and for the next five years to come (Fig. 8). Such evolutions are also confirmed by customers: a survey among over 1000 HNWI's concluded that, 14% of them already use robo-advisers and about half of those who are not yet using robo-advice tools consider using them in the future (PwC, 2016a).

Forecasts project that by 2020 a 10% of the global assets under management will be controlled by robo-advisers (Fig. 9) which is equivalent to \$8 trillion, a very fast increase from the current market share of less than 1% (Business Insider, 2017). Europe has 73 robo-adviser running services, the biggest players are Germany with 26, UK with 19 and Switzerland with 6 (Techinfluence, 2017).

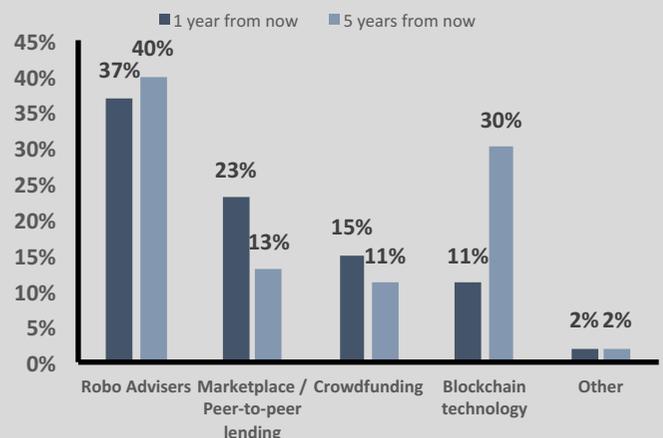
Robo-advisers determine the client's investing needs through an algorithm based on inputs from a questionnaire about the client's risk profile, liquidity factors and in their other existing assets (Better Finance, 2017).

**FIG. 7 Sub-sectors to be most disrupted in the short term** (Source: PwC, 2016b)



Q: Which part of the financial sector is likely to be most disrupted by FinTech over the next 5 years? (544 respondents world wide; 56% from Europe)

**FIG. 8 Technologies with expected high impact** (Source: CFA Institute, 2016)



Q: Which technology do you see as having the greatest impact on the financial services industry in 1 and 5 years from now? (544 respondents world wide; 56% from Europe)

The term “robo-adviser” (on top of being spelled in many different ways) is used to describe quite varying functionalities, which can be broadly summarised in three different categories:

- Advice only: the platform provides only advice and does not execute investments
- Hybrid approaches: The platform includes some form of human interface/ assists a human adviser
- Full robo-trader: No human intervention

Robo-advisers that include a focus on ESG issues are mainly in the advice only category. In Europe no ESG robot with investment execution has been identified (see benchmark study in the annex).

**Clients are attracted currently mainly due to their accessibility and low cost structure**

The attractiveness of robo-advisers resides in the cost and accessibility. Most robo-advisers profit from a fee-based model that is simpler than traditional commission/fee schemes, therefore making it more transparent (Better Finance, 2017). This might be key for winning customers as in many cases fees are lower than for human financial advisors, as most platforms use exchange traded funds (ETFs). As these funds track an index and are not actively managed and can be purchased without an intermediary, the fees are lower.

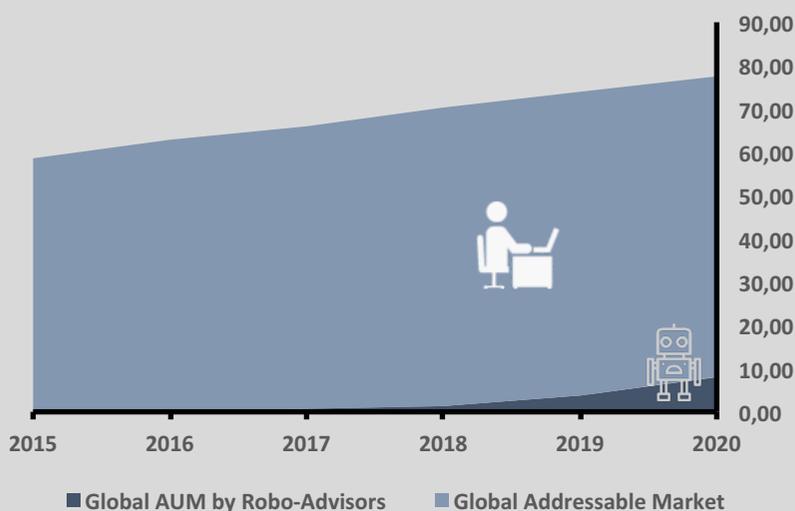
A important limitation of traditional investment management services is that these are underserving a portion of the market that doesn’t meet minimum capital requirements. Robo-advisers provide investment management for portfolios starting from \$5000. Providers typically charge between 0.15% and 0.75% of assets under management, against typical fees of 1% plus expenses for traditional advisors. This is one of the reasons for high popularity among young investors (Equities, 2016; Investor Junkie, 2017a).

**Good and bad news - expected effects for consumers are going in both directions**

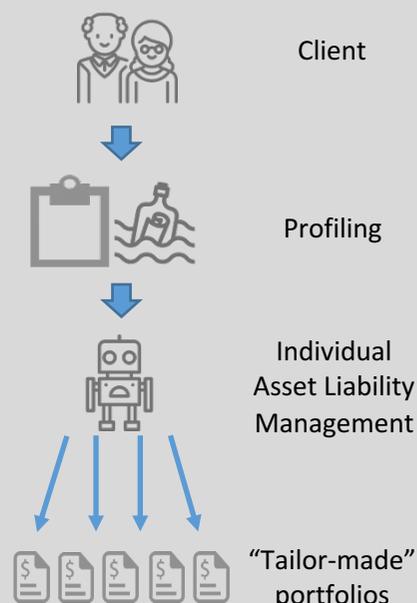
Effects of automated financial advice on consumers are judged to be positive by a majority of investment management professionals when it comes to costs (89% positive, 6% negative), access to advice (62% positive, 30% negative) and also product choice (55% positive, 30% negative). However, there seem to be serious concerns in the areas of quality of service (37% positive, 47% negative) and market fraud/ miss-selling (37% positive, 38% negative). Respondents from the EU are slightly more positive on all effects than respondents from non-EU countries (CFA Institute, 2016: survey among CFA members, 775 respondents, response rate 20%).

The ability to better address changing customer needs, as well as the ability to leverage existing data and analysis are the two most important impacts expected by professionals when integrating FinTech approaches into their businesses (PwC, 2016a). However a review of existing robo-advisers has shown that the majority of the existing tools only offer very limited elements of choice. For example, of the 23 European robo-advisers compared on the site [robo-advisors.eu](http://robo-advisors.eu), only one enables the client to invest directly in stocks and 13 are limited to exchange traded funds.

**FIG. 9 Market share for robo-advisers in \$ Trillions (Source: Business Insider, 2017)**



**FIG. 10 The financial advice of the future: (Source: authors)**



## Developing a vision for the future

In wealth management FinTech is currently rather seen as a way to facilitate existing business processes and few actors have a vision of using FinTech to radically transform and improve their offering (PwC, 2016a). As discussed above, most existing robo-advisers have only relatively simple functionalities and present an offer with at the most comparable but in many cases less product choice than the one offered by bank advisers.

However, technological limits are far from being reached and it is rather a question of human imagination to better use the technological capabilities for designing robo-advice that builds perfectly tailor made investment portfolios for a mass market of individuals. The mass market of investors could provide sufficient economies of scale to develop much more sophisticated tools using individual asset-liability-management techniques (iALM) in order to develop tailor made investment portfolios with direct investment in stocks instead of investments in pre-packaged products.

Such more sophisticated investment tools will require higher development costs and thus could lead to higher fees for the client. However, there is likely a substantial cost cutting potential in the existing chain of financial intermediation (see focus below). Targeting the transaction costs and streamlining the chain of intermediaries could be a promising way of refinancing the higher development costs of such sophisticated tools even in times of margins under pressure.

### Focus: The financial intermediation chain in investment management

Arjaliès et al. (2017) studied in depth the actors in the financial intermediation chain that links a retail investor to the actual investment in the market (see fig. 11). Most of the chain is not visible to retail investors, who are only in contact with their adviser. The intermediation chain exists in many variations, however in most cases a significant number of people participate in advising clients and executing their decisions.

The authors argue that there are good reasons for the existence of many of the actors, such as the access to specialised knowledge and expertise, as well as requirements related to regulation put in place to protect retail investors.

However, they also put forward the hypothesis that efficiency gains created in recent decades through the increased used of technology have not lead to major cost reductions for financial intermediation, but may have been largely captured as rents by senior staff through increased remuneration. They argue that there is cost-cutting potential in the fees paid to the financial intermediaries. Moreover, costs could be reduced through vertical integration reducing by outsourcing of expert services. Providing transparency on the fees paid along the financial intermediation chain could help identify the most promising cost-cutting opportunities.

FIG. 11 Stylised financial intermediation chain (Source: adapted from Arjaliès et al., 2017)



## II. REGULATORY ANALYSIS: MISSED OPPORTUNITIES IN EUROPEAN FINANCIAL SECTOR REFORMS

### 1. INTRODUCTION TO THE EUROPEAN REGULATORY FRAMEWORK

Part II of the report provides an analysis of the MiFID II directive and the PRIIPs regulation, outlining the current landscape of legal requirements in relation to non-financial investment objectives for investment advice (MiFID II) as well as for investment product information (PRIIPs).

#### MiFID II in the context of European financial reforms

In response to the financial crisis, the EU's approach to market reform has had various objectives. After the creation of a new supervisory framework for banking and capital markets, as well as new prudential requirements for banks aimed at preventing systemic crises, the objective of the MiFID II process was to harmonize EU capital markets law. MiFID II is a revision of the 2014 Markets in Financial Instruments Directive (MiFID I: 2004/39/EC), which was combined with the MiFIR regulation (No 648/2012) with the aim of improving consumer protection, while ensuring the efficiency and competitiveness of EU markets (EC, 2014).

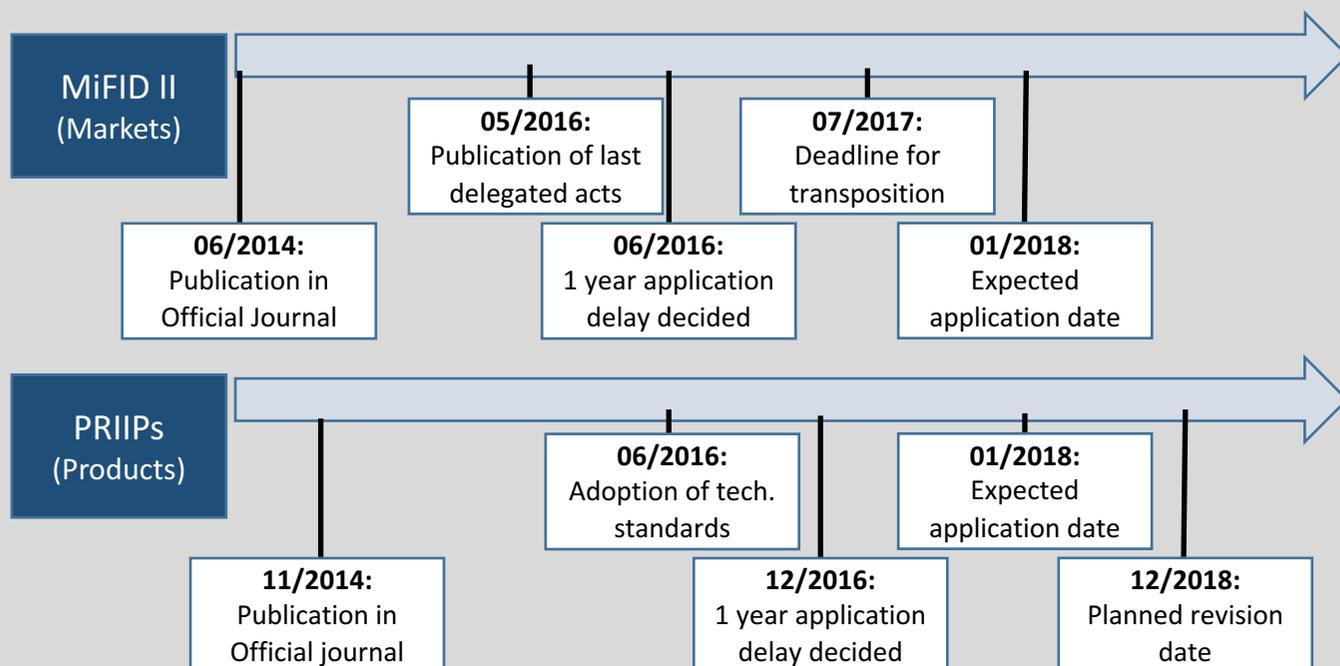
In the context of this report, a number of MiFID II's provisions on market transparency, consumer protection, and conflict of interest are highly relevant, as they harmonize European procedures for retailers. The general objective to regulate markets, including market participants, directly influences financial advice, reforming current practices. New rules for investor protection and market transparency will likely influence the process of financial advice.

#### The scope of PRIIPs and its articulation with MiFID II

The PRIIPs regulation (1286/2014) on key information documents for packaged retail and insurance-based investment products has similar objectives and was introduced shortly after MiFID II. While its main objective of improving the transparency of financial products for the sake of customer information is similar to MiFID II, its approaches differ substantially in form and content. It has a smaller scope than MiFID II and only applies to product information documents for packaged products and not to numerous types of markets as is the case for MiFID II. Content-wise, however, MiFID II and PRIIPs are strongly linked. MiFID II requirements on the definition of a target market for consumers whenever offered financial products are strongly linked to the information requirements included in the key information documents established through PRIIPs. This link also explains why the application date of both packages was simultaneously delayed by one year in order for them to come into force at the same time (see fig. 12).

MiFID II, being a directive, needs to be integrated into domestic law and includes a more complex and diverse process of delegated acts (see fig. 14), whereas PRIIPs as a regulation is directly applicable in member states.

FIG. 12 MiFID II and PRIIPs timelines



## Regulation of FinTech use in financial advice

The growing use of FinTech has led to a spike in EU-regulator and policy maker interest. In the context of EU initiatives to increase access to cross-border financial services, digital innovation is perceived as a tool to reduce entry barriers, reduce costs, and unlock economic growth (ESAS, 2016). Commission communications on the “Digital Single Market” were quick to point out the potential benefits of financial innovation, but also highlighted concerns about how to regulate such a dynamic sector (EC, 2017b). Especially liability, as well as consumer and data protection issues were highlighted by the European Supervisory Authorities report on “automation in financial advice” (ESAS, 2016).

The ESMA consultation on suitability requirements (ESMA, 2017b) highlighted how practices in “robo-advice” could lead to distortions in investment decisions. Biases introduced through questions in client profiling are the main point of emphasis in this regard. While “robo-advice” tools reduce biases created by human financial intermediaries, experiences in behavioural finance show that the form and presentation of a question can highly influence an investor's response. There are additional concerns that consumers would insufficiently take product and other required information into account when profiling themselves, and over-evaluate their own financial knowledge, leading to overly risky investment decisions. The consultation proposes a number of rules governing the layout, wording, and format of both answers and questions in the profiling process, but does not specify additional content.

According to the consultation, providers of robo-advice have to comply with MiFID II regulations as soon as their service qualifies as investment advice or portfolio management (ESMA, 2017a). No additional organisational requirements are proposed in this document. This is relevant due to the large differences in the business-models and structures of robo-advice-tools (Advice-only, Hybrids, Full robo-traders). While the additional risks of focussing on an algorithm without human support are highlighted, no requirements concerning human interaction, or client support are made. Open questions surround mainly the adequate way of presenting information to clients, and how to profile them as to ensure that advice is made in their “best interest”.

### Focus: Fiduciary duty and climate change – The current debate and its relevance for retail investors

While the exact definition varies across jurisdictions, fiduciary duty usually includes two main principles : loyalty (acting in good faith in the interest of the beneficiary) and prudence (acting with due care, skill and diligence) (United Nations, 2015). The HLEG on Sustainable Finance is advocating for the mandatory integration of sustainability factors in a harmonised way across EU financial regulation (HLEG, 2017).

**What should be integrated?** In the ongoing discussion, it is often not clear what the integration of sustainability or ESG factors should actually include and what the objective is. Two different approaches need to be considered:

- 1. The assessment of ESG related risks** that may have implications on financial performance: there is a growing understanding that the integration of such criteria is in line with existing definitions of fiduciary duty and should be integrated as part of the principle of prudence (e.g. UK Law Commission 2014).
- 2. The pursue of non-financial investment objectives:** if the asset owner sets concrete non-financial objectives (e.g. contributing to climate mitigation), these could in principle be equally be already integrated under the principle of loyalty. However, at least in some jurisdictions, fiduciary duty includes the duty to seek profitability and the achievement of some non-financial investment objectives could include trade-offs in relation to financial objectives.

**How to deal with potential trade offs?** Where such trade offs exist, it is important to discuss with the client a clear strategy of how to deal with them and if and to what extent the client may be ready and able to sacrifice potential financial gains or incur higher risks in order to achieve the extra-financial objectives that were defined.

**How is this relevant for retail investors?** While the discussion is today much focussed on the institutional investors' perspective, the issues at stake are however also relevant for retail investors. Packaged retail products designed for mass market do not allow for tailored individual preferences related to non-financial objectives and the approach to dealing with potential trade-offs. The description of a products' target market should include its extra-financial objectives and the approach of dealing with trade offs, where they exist. In the UK, pension fund trustees are permitted by the law to take into account non-financial objectives as long as “there is reason to think that the scheme members share the objective and that there is no significant detriment to the fund” (UK Law commission, 2014).

## 2. MIFID II: HOW NON-FINANCIAL OBJECTIVES GOT LOST IN THE PROCESS

### The inclusion of non-financial objectives is in line with MiFID II's political objectives

While the initial memo announcing MiFID II highlighted how non-informed risk-taking by retail savers increased the effects of the financial crisis, it did not focus on risk-reduction as the primary goal. Establishing “Investor confidence” and “a more responsible financial system that works for the economy and society as a whole” were cited as expected outcomes. The inclusion of provisions facilitating access to capital markets for small- and medium-sized enterprises (SMEs) shows how other political goals were also considered (EU, 2011). Further defining non-financial objectives, especially in light of increasing demand for impact oriented green products, (p. 5) is therefore both in line with MiFID II's objectives and investor demand.

### The creation of a bias against the inclusion of non-financial objectives in MiFID II

MiFID II will heavily influence current sales practices. Through changes in the remuneration schemes of investment advisers, its aim is to ensure that there are no conflicts of interest, and that the incentives of the adviser align with the best interest of the client (Art. 9c (3) and 24 (10)). As shown on p. 7, this is not current practice, because sales incentives from marketing departments and commission-based advice still play an important role. This is due to customer unwillingness to pay for fee-based advice and the increased barrier to entry this would cause in access to financial advice (Moellers, 2015). This trade-off was recognized in the technical standards guidelines on the client assessment by ESMA, which focussed on additional requirements for financial advice, rather than forbidding a certain type of payment scheme (ESMA, 2015).

According to these guidelines, financial advisers have to fulfil certain criteria regarding their expertise, and are required to carry out a “suitability” and “appropriateness” assessments when profiling a client in order to provide advisory services. This approach is supposed to be a compromise, but fails to resolve all the existing biases. The current structure of client profiling questionnaires (see p. 8) puts the focus on risk, and does not include questions with regard to extra-financial investment objectives. As can be seen in Article 25-2 of MiFID II (see table 2), the text of the directive does not define profiling questions, but rather anchors a number of topics in the assessment process, including investment objectives. The related delegated act further refines the scope of the article, but increasingly focusses on risk, without providing further indications on how to define investment objectives. Our analysis of current practices (p. 9) shows, that this focus creates a bias against non-financial investment objectives, as risk becomes the almost exclusive determinant of product selection.

**TABLE 2 The assessment of customer objectives in MiFID II (EU, 2014a and EU, 2016a)**

Level 1 Legislation	MiFID II Directive 2014/65/EU	<p><u>Article 25-2 on Assessment of suitability and appropriateness:</u> When providing investment advice (...) the investment firm shall obtain the necessary information regarding the client's (...) knowledge and experience in the investment field relevant to the specific type of product (...), that person's financial situation including his/her ability to bear losses, and <b>his/her investment objectives including his/her risk tolerance</b> so as to enable the investment firm to recommend to the client (...) <b>the investment services and financial instruments that are suitable for him</b> and, in particular, are in accordance with his/her risk tolerance and ability to bear losses.</p>
Level 2 Regulation	Delegated Regulation (EU) 2017/565	<p><u>Article 54-2 on Assessment of suitability and suitability reports:</u> Investment firms shall obtain from clients or potential clients such information as is necessary for the firm <b>to understand the essential facts about the client</b> and to have a reasonable basis for determining (...) that the specific transaction to be recommended (...) satisfies the following criteria:</p> <ol style="list-style-type: none"> <li>a) it meets the investment objectives of the client in question, <b>including client's risk tolerance;</b></li> <li>b) it is such that the client is able financially to <b>bear</b> any related <b>investment risks consistent with his/her investment objectives;</b></li> <li>c) it is such that the client has the necessary experience and knowledge in order to <b>understand the risks</b> involved in the transaction (...)</li> </ol>

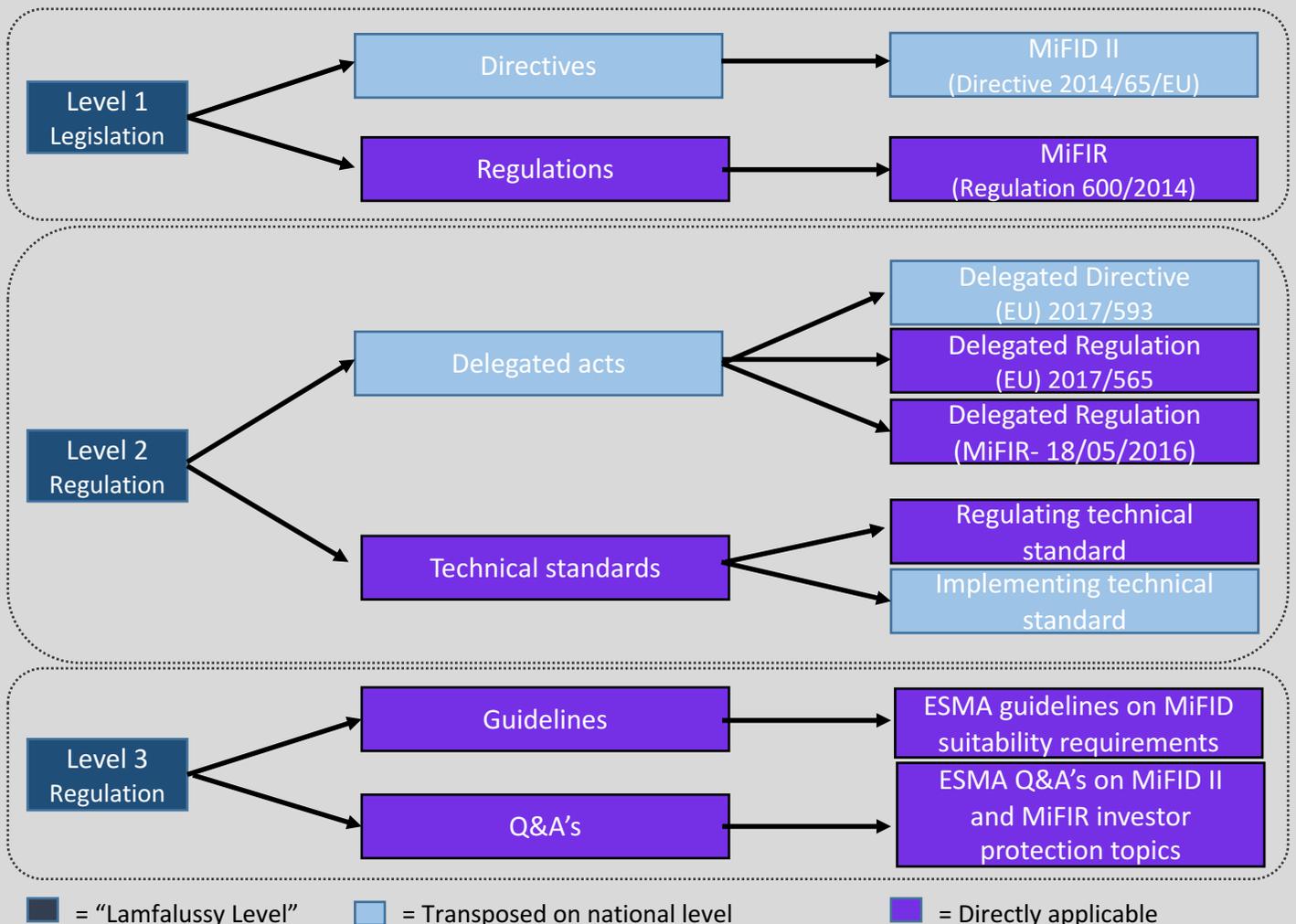
### Institutional biases inherent in the process are likely to blame

Due to the complexity of issues concerning the financial industries, the EU has adopted the Lamfalussy process, an approach to specifically regulate the financial service sector. In this process, the broader legislative framework is adopted by the traditional co-decision procedure, involving the European Commission, Parliament, and Council. The Level 1 document then identifies a number of complex topics, on which consultative bodies draft technical implementing measures, which then need to be approved by the political institutions and are published by the Commission. In the case of MiFID II, the consultative body was the ESMA, which drafted the technical standards, consulting with national regulators and public stakeholders. ESMA then also publishes Guidelines and Q&A's (Level 3), which further define the dispositions of the Level 2 measures (AMF, 2016 and EC, 2017c).

The lack of a further definition of "investment objectives" can be interpreted as a result of this process. As discussed by De Visscher, Maisocq, and Varone in their analysis of the Lamfalussy reform from a "principal-agent" perspective, the increased participation of the private sector in the regulatory process potentially creates a risk of agency loss by the Commission (De Visscher, Maisocq, and Varone, 2008). This would mean that the asymmetry of information between the representatives of the private sector, and regulators can lead to outcomes that are not fully in line with the political goals of the Commission (inclusion of non-financial objectives). While this report has not employed additional empirical analysis to validate this hypothesis, the fact that the majority of the over 60 responses to the ESMA consultation on "Draft Guidelines on the assessment of knowledge and competence", stemmed from asset managers and investment service companies, is an indication of the information used for the standards (ESMA, 2015). Only one organization representing retail investors responded.

Even though it is not the objective of this report to reform the Lamfalussy process, this analysis shows that the non-integration of non-financial objectives is the result of a number of institutional biases in favour of a reduced amount of profiling questions during financial advice. Retailers of investment products have little interest in more extensive profiling practices, which is also represented in MiFID II's final content. The focus on risk as the main determinant of product selection has therefore potentially excluded other important factors.

**FIG. 13 The MiFID II regulatory package- implementation process** (AMF, 2016 and EC, 2017c)



## An early assessment of national transposition shows no corrective action in favour of non-financial objectives

As shown in table 2, MiFID II Delegated Directives defines three main topics to assess the suitability of an investment product for a client: clients' investment objectives including their risk tolerance, their financial situation and their knowledge and experience (EU, 2016). These requirements have been integrated into the national law of 4 of the countries analysed. Based on the analysis of these countries' transposition documents, it is obvious that differences in the definition of these concepts remain. For example, the UK and France have both integrated the rules on suitability requirements into their regulators code of conduct for investment advisers (FCA and AMF respectively), but varied a lot in their scope. The French transposition spans 4 short articles, whereas the British rulebook includes 24 articles, and a 22-point annex. (AMF, 2017, and FCA, 2017).

The divergence in the interpretation of the topics by national authorities is more relevant to some topics than to others. The table below summarises three key topics; the first topic of investor objectives is further subdivided in risk preferences, financial and non-financial investment objectives:

- **Investor objectives including risk tolerance:** Definitions of investor objectives typically include the time horizon of the investment, and at what point and to what purpose the invested sum needs be available in the future. Transposition of investor objectives is largely harmonised and does only include financial objectives. No country makes explicit mention of non-financial objective. Risk tolerance establishes a client's risk preferences, analysing to what extent the client is ready to lose capital for the sake of larger returns. The risk tolerance is emphasised in all countries.
- **Financial situation:** Includes information on clients' current revenue, assets and liabilities. Interpretation varies on how to use this information for either only assessing the client's ability to carry risk or a broader assessment of the suitability of the product for the clients' investment objectives.
- **Knowledge and experience:** Assesses the financial knowledge of the client. Implementation varies; some countries focus on academic education, whereas others focus on experience in handling financial products.

As the recent ESMA consultation on suitability assessments shows, the agency aims to reach EU-wide harmonization (ESMA, 2017b). Yet while the guidelines for the questionnaire are getting ever more detailed, the agency refrains so far from prescribing the exact information to be collected, or imposing profiling questions. Given the omission of non-financial investment objectives in regulatory documents as well as profiling practices of retailers, part III of this report provides recommendations to include them as a mandatory part of client profiling.

**TABLE 3 Diverging interpretations of required information concerning suitability assessments (Source: authors)**

		France	Germany	Austria	UK	Sweden	Spain	Ireland	Belgium
<b>Objectives</b>	Financial objectives	+	+	+	+	+	-	-	-
	Non-financial objectives	0	0	0	0	0	-	-	-
	Risk tolerance	++	++	++	++	++	-	-	-
<b>Financial situation</b>		++	+	+	++	++	-	-	-
<b>Knowledge and experience</b>		+	++	+	++	++	-	-	-

0 = no mention    + = mention    ++ = emphasis    - = not transposed yet

**Disclaimer:** The table is based on the authors comparative analysis of legislative transposition texts and official government communications as of 25/07/2017. Further changes are expected soon. The information may not be used for assessing legal compliance.

### 3. PRIIPS: TRANSPARENCY REQUIREMENTS ARE STRICTER FOR ESG PRODUCTS

#### The Key Information Document requires no disclosure of ESG information for general PRIIPs products

The PRIIPs regulation establishes a mandatory key information document (KID) for packaged retail and insurance-based investment products. It is to be provided by the product manufacturer and aims to improve comparability of investment products, as well as customer information. The 3-page document includes a number of sections concerning practical information, but also includes recommendations and indicators on risk, performance and costs. The template provided by the EU is featured in the annex.

ESG related information is not mandatory in the KID. According to the regulation document, the section called "what is this product" shall include a description of the objectives of the product, including "where applicable" a description of the environmental and social objectives of the product (EC, 2014). Interestingly, all further guidance including the delegated act, the regulatory standards and the official KID template and guidance document, never mention again the environmental and social objectives. Instead a specific delegated act on PRIIPs with environmental and social objectives is under preparation as required by the Art. 8.4 in the Level 1 PRIIPs Regulation. This makes it clear that mainstream PRIIPs are not expected to disclose any information in relation of ESG issues.

The primary objective of the regulation is consumer protection including the prevention of misleading information. Greenwashing is an obvious case of misleading information. However it can be argued that missing information may also enter in this category, if it is considered to be essential information. If basic ESG risk assessments as well as an assessment of the alignment of the investment product with international climate goals can be considered essential information for investment decision making, this information should become part of mandatory transparency requirements. This approach will be further discussed in Part III of the report.

**TABLE 4 Excerpts of PRIIPs documents in relation investment objectives of products**

(Sources: EC, 2014; EC, 2017d; JC ESA, 2017)

Level 1 Legislation	KIDs for PRIIPs Regulation 1286/2014	<p><b>Art. 8.3 The KID shall contain the following information:</b> (...) (c) under a section titled 'What is this product?', the nature and main features of the PRIIP, including: (i) the type of the PRIIP; <b>(ii) its objectives and the means for achieving them</b>, in particular whether the objectives are achieved by means of direct or indirect exposure to the underlying investment assets, including a description of the underlying instruments or reference values, including a specification of the markets the PRIIP invests in, <b>including, where applicable, specific environmental or social objectives targeted by the product</b>, as well as how the return is determined; (iii) a description of the type of retail investor to whom the PRIIP is intended to be marketed, in particular in terms of the ability to bear investment loss and the investment horizon;</p>
Level 2 Regulation	Delegated Regulation PRIIPs- 2017/653	<p><b>Art. 2.3 "The description of the type of retail investor to whom the PRIIP is intended to be marketed</b> in the section entitled 'What is this product?' of the KID shall include information on the target retail investors identified by the PRIIP manufacturer, <b>in particular depending on the needs, characteristics and objectives of the type of client for whom the PRIIPs is compatible</b>. This determination shall be based upon the ability of retail investors to bear investment loss and their investment horizon preferences, their theoretical knowledge of, and past experience with PRIIPs, the financial markets as well as the <b>needs, characteristics and objectives of potential end clients.</b>"</p>
	Delegated act on EOS PRIIPs - to be adopted	<p>ESA draft technical advice to the Commission: "Manufacturers of EOS PRIIPs shall establish, (...), an investment policy statement (IPS), specifying in detail the scope of the EOS objectives that are being targeted as well as the constraints. (...).The IPS shall explain in detail to retail investors, (...), what exact impact is aimed at by the investment and why a just and equitable person would regard this as an environmental or social objective."</p>

## PRIIPs with environmental and social objectives may have to aim for “impact”

At the time of writing the Commission is still due to publish a delegated act specifying the procedures to be used to establish whether a PRIIP targets specific environmental or social objectives. A public consultation paper on the draft technical advice from the European Supervisory Authorities (ESAs) to the Commission showed that the ESAs tend to recommend a rather ambitious approach. While the mandate explicitly excludes any labelling or definition setting approach at this stage, the draft guidance seems to suggest that PRIIPs with environmental or social objectives (EOS PRIIPs) should by definition strive to have an ‘impact’ in the real economy (JC ESA, 2017).

A clear definition of impact is, however, lacking, and will not be included in the technical advice at this stage. Instead, as part of the upcoming review of the regulation, it is planned to “assess the feasibility, costs and possible benefits of introducing a label for social and environmental investments” (EC, 2014).

## In the absence of a standard definition for ‘impact’, greenwashing is unlikely to be prevented

The approach of defining ESG products as impact products could lead to two different outcomes, depending on the definition of impact generally used.

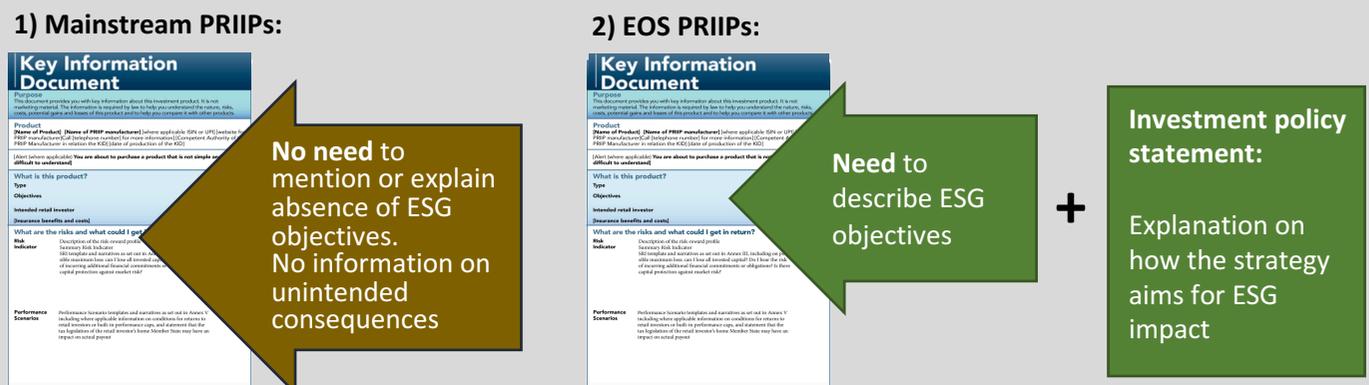
- **Strict definition:** The general use of a strict understanding of impact along the lines outlined on p. 7 would very likely lead to only a very small number of products being labelled as EOS PRIIPs. Few of the existing SRI products will be able to demonstrate in a credible way how their investment strategy is generating positive impact in the real economy.
- **Vague definition:** The absence of an agreed definition is however more likely to lead to a broad variety of interpretations of the term *impact*. Today most ‘ESG products’ are, by design, unlikely to be associated with significant impacts. Managers of such products may be tempted to use very vague definitions of impact in order to be included in the EOS PRIIPs category. Such a development would not only increase the difficulty of retail investors to understand and compare products but also undermine the ultimate goal of avoiding greenwashing.

Given that there is a clear indication that there is a specific demand from retail clients for products that generate a positive social or environmental impact in the real economy, it seems to be the right approach to create a specific product group that responds to this demand. Yet in order to be effective, a clear definition of impact needs to be provided.

## The missing dimension: transparency on standard investment products

The analysis of best practices and emerging self-labelling and labelling initiatives seems to call for the introduction of another type of transparency requirements, applicable to all PRIIPs products. From a climate perspective, the transparency of products can be improved by disclosing the exposure to climate-relevant activities (e.g. renewable, coal, etc.), providing an assessment of how the investee companies are aligned with climate goals (see page 8) and how the use of voting rights supports (or not) better alignment. Such requirements have been introduced in France with Article 173 of the Energy Transition law (French treasury, 2015) and more recently in Sweden for UCITS (Regeringskansliet, 2017). They are now discussed at European level in the context of the High Level Expert Group on sustainable finance. Such an approach, feasible for climate today, could potentially be adapted to other issues at a second stage, as metrics evolve.

FIG. 14 Transparency requirements differ widely for mainstream and EOS PRIIPs (Source: authors)



## III. RECOMMENDATIONS

### 1. MiFID II – MANDATORY ASSESSMENT OF NON-FINANCIAL OBJECTIVES

#### **Current suitability requirements are a barrier for the discussion of non-financial investment objectives**

The preceding analysis has made it clear that the suitability assessments as required under MiFID II generally do not include the assessment of extra-financial investment objectives. Given the strong influence of the assessment on the discussion between the client and the adviser, this is a clear impediment to creating transparency around client demand, and for taking non-financial investment objectives into account in financial advice.

#### **Options for including non-financial objectives as a mandatory part of the suitability assessment**

The current wording in the MIFID II Directive is in principle sufficiently vague to allow the interpretation that the formulation “investment objectives of the client” includes the financial and non-financial objectives. However, the clarification that both are actually required as a mandatory part of the suitability assessment would need to be included somewhere. Three – non mutually exclusive - options are possible:

- 1) Clarification within the MIFID II Directive or Delegated Regulation (Level 1+2):** Reopening a directive or delegated directive involves lengthy procedures and a heavy administrative burden. The integration into the directive itself seems not necessary and it is common practice to provide more detailed explanations of concepts used in directives rather at lower levels of regulation. While a clarification could be considered in level 2 documents, an integration at lower levels seems preferable from a practical point of view, given the administrative burden involved for a relatively small change. However, if a revision of the delegated regulation for other reasons would become necessary, this clarification could be introduced at the same time.
- 2) Clarification in national transposition documents:** The feasibility of including the clarification as part of the transposition into national law depends naturally on the national context. While in some countries, this may be easy to achieve through a minor change in regulatory texts, it has the disadvantage that a harmonised approach at European level is unlikely to be achieved. However, especially countries that have not yet finalised their process of transposition should consider including this clarification from the start.
- 3) Clarifications in ESMA Guidelines (Level 3):** The ongoing consultation on the revision of ESMA guidelines on suitability requirements (ESMA, 2017b) is a concrete opportunity for including this clarification at a European level without creating additional administrative processes (see next page Fig. 17). The guidelines serve exactly the role of providing additional clarity to Level 1 and 2 documents. Including the clarification at this stage seems to be thus the most cost efficient option. Detailed guidance could be refined over time in ESMA Q&A documents.

#### **Focus: Inclusion of non-financial investment objectives: a role for the regulator or the legislator?**

Legislators (governments and parliaments) and regulators (financial market supervisors) have different roles and responsibilities. Legislators, which are under democratic control, make political choices and decide on the general direction of travel. The role of regulators is to oversee and ensure the implementation of the policy choices made.

Legislative texts (e.g. Level 1 directives or national laws) often do not provide detailed provisions and it is common practice for the regulator to provide more detailed guidelines defining minimum standards (e.g. Level 3 or national guidelines) in interpretation of the legislative acts. These minimum standards are then applied to control the applications of the laws by market actors.

It is therefore necessary to raise the question of whether the inclusion of non-financial investment objectives is a policy choice that needs to be made by the legislator, or whether it is part of the regulator’s role to interpret the laws and to define the minimum standard in line with the policy choices defined.

In principle, both viewpoints have merit. Two main questions need to be answered:

1. Does the policy mandate by the legislator provide sufficient ground for the regulator to include a clarification of this kind?
2. Can it be argued that the inclusion of non-financial investment objectives should become a minimum standard to ensure investor protection?

Based on the preceding analysis, the authors have concluded that both questions can be answered positively and encourage ESMA to develop an opinion from a legal point of view.

## Options for increasing standardisation of questionnaires

Providing detailed guidance can be cumbersome and retailer approaches idiosyncratic, leading to the question whether a standardised template for questionnaires would not be more efficient. Past experience with SRI has demonstrated that the absence of clear definitions and standardisations leads to a myriad of approaches, which are difficult for retail investors to understand and whose positive impact in the real economy has not been demonstrated. There may be sufficient good reasons against a standardised questionnaire (e.g. the costs involved for retailers in adapting the established systems of collecting and storing data). A cost-benefit analysis of standardising the questionnaire would be helpful to shed more light on the question. Standardisation efforts could concern the questionnaire as a whole, or be limited to the (yet to create) questions on non-financial investment objectives. Several options for such standardisation efforts could be explored:

- 4) **Public sector standardisation initiatives:** national working groups could be set up as a joint initiative by economic ministries, environment ministries and the regulating bodies in order to assess the costs and benefits of a standardised questionnaire. This could start with a more in-depth landscaping of questionnaires used by retailers of investment products. In cooperation with industry and civil society representatives, best practice standard questionnaires could be developed. These could then be used to inform the policy making process at the European level. If an industry wide approach is not considered to be feasible from the start, alternatively a national initiative could be launched inviting interested industry representatives to develop best practice questionnaires and test them internally, before using them as a basis for setting industry wide best practice standards.

FIG. 15 Recommended additions (in blue) to the ESMA guidelines on certain aspects of suitability requirements

### V.II KNOW YOUR CLIENT AND KNOW YOUR PRODUCT

#### Arrangements necessary to understand clients (...)

##### Supporting guidelines (...)

26. Information necessary to conduct a suitability assessment includes different elements that may affect, for example, the analysis of the client's financial situation (including his/her ability to bear losses) or investment objectives (financial objectives including his/her risk tolerance, as well as non-financial objectives). Examples of such elements are the client's:
  - a) Marital status (...);
  - b) family situation (...);
  - c) age (...);
  - d) employment situation (the fact that the client might lose his/her job or is close to retirement may impact his/her financial situation or its financial investment objectives);
  - e) the need for liquidity in certain relevant investments;
  - f) Personal preferences related to the environmental and/or social impacts of investments, including for instance the willingness to invest in way not consistent with climate policy goals.
27. The assessment of preferences regarding environmental or social impacts should include questions about the willingness to invest in entities that run strategies inconsistent with the client's objectives, the use of shareholder rights to support or/and influence the management of these entities, and the trade off that the investor is willing to make to prioritize social or environmental outcomes. The assessment will at least confirm the intention of the investors vis-à-vis the support to the implementation of the Paris agreement. ESMA Q&A on investor protection will be updated to provide further guidance and include definitions of relevant concepts.

**5) Private sector standardisation initiatives:** The initiative for standardising the questionnaire or at least the questions on non-financial investment objectives could also come from and be lead by industry associations. While in the past few years very few industry associations have developed internal best practices for such questionnaires, the inclusion of a new aspect could be seized as an opportunity to develop a common approach from the start. Coordination among associations on the European level could help to develop a standardised format that is applicable in all countries and would be especially useful for retail institutions with business in several countries.

**Proposal for standardised questions on non-financial investment objectives:**

Formulating questions for assessing non-financial investment objectives is likely to need discussion among stakeholders. The authors provide initial suggestions:

1. Do you expect the manager of your investment product to support the achievement of social and environmental objectives through the selection of investments and the use of shareholder rights?
  - Yes                       No
  
2. If yes, which types of social and environmental objectives do you want the manager to support? Please deselect the options that are not relevant:
  - I want to support the implementation of international climate goals;
  - I want to support compliance with human rights standards;
  - [list continues...]
  
3. Are you ready to accept trade offs on your financial investment objectives to favour social and environmental outcomes?
  - No, my social and environmental preferences should only be taken into account if they have a positive or neutral impact on all my other investment objectives.
  - I would be ready to invest for a bit more time in the product [...follow up question on the level]
  - I would be ready to take a little bit more risk [...follow up question on the level]
  - I would be ready to slightly limit my expected returns on investment [...follow up question on the level]

**FIG. 16 Overview of recommendations to integrate non-financial objectives into client profiling questionnaires**

**EU-level recommendations**

Level 1 Legislation	MiFID II (Directive 2014/65/EU)	1. No direct recommendations (integration only in level 2 if there is a plan to revise the delegated directive for other reasons)
Level 2 Regulation	Delegated Regulation (EU) 2017/565	
Level 3 Regulation	ESMA guidelines on MiFID suitability requirements	2. Clarification of "investment objectives" to include non-financial objectives as part of ongoing review of guidelines

**Country-level recommendations**

Public sector	Transposition of MIFID II into national law	1. No direct recommendations (integration only in level 2 if there is a plan to revise the delegated directive for other reasons)
Public sector	Standardisation of questionnaires	4. Consider standardisation initiatives at national level
Private sector	Standardisation of questionnaires	5. Consider the development of voluntary industry standards and their coordination at European level

## 2. PRIIPs – MAKING ESG DISCLOSURE THE NORM FOR RETAIL PRODUCTS

### Creating a level playing field on disclosure

The legal ground is prepared for a step change in the integration and disclosure of ESG risk analysis. The interpretation of fiduciary duty is currently changing in this regard (see focus on p. 14) and it would be a timely step to apply this new interpretation also to retail investment products. In order to avoid greenwashing, information requirements for ESG investment products are rightfully increasing. However, there is no reason to exclude mainstream products from ESG related disclosure requirements. Ensuring customer protection means providing sufficient information on all products, in order to enable informed investment choices and create a level playing field between all investment products.

### Defining minimum disclosure standards

In order to generalise ESG disclosure, minimum standards needs to be defined. The authors recommend that minimum requirements for disclosure should include an assessment of the exposure of the product to socially and environmentally sensitive industries, the way shareholder rights are used to promote (or not) social and environmental objectives in these industries, as well as an assessment of the alignment of the investment product with international climate goals. Product managers who fail to provide such information or do not take into account any social and environmental criteria should then be required to feature a highly visible warning to customers, comparable with the warnings currently used for cigarettes (see fig. 17).

### Definitions should be ready by the time the new approach needs to be applied

A positive side effect of generalising ESG disclosure is that research into metrics and evaluation approaches would likely increase significantly with the user group for such metrics. Assessment metrics for climate alignment are already in the pilot testing phase and an ISO standard for climate alignment, and impact of investment and lending portfolios, is under development with publication scheduled for early 2020.

### Recommended voluntary initiatives

Private sector actors can support research on metrics and minimum standards for ESG risk and climate alignment checks, as well as for ESG impact, testing and refining their applicability. Currently, they can review and improve their product choices including the development of new products with various impact approaches and risk profiles (e.g. low risk products based on active engagement strategies with investees or higher risk impact products based on investments in non liquid asset classes).

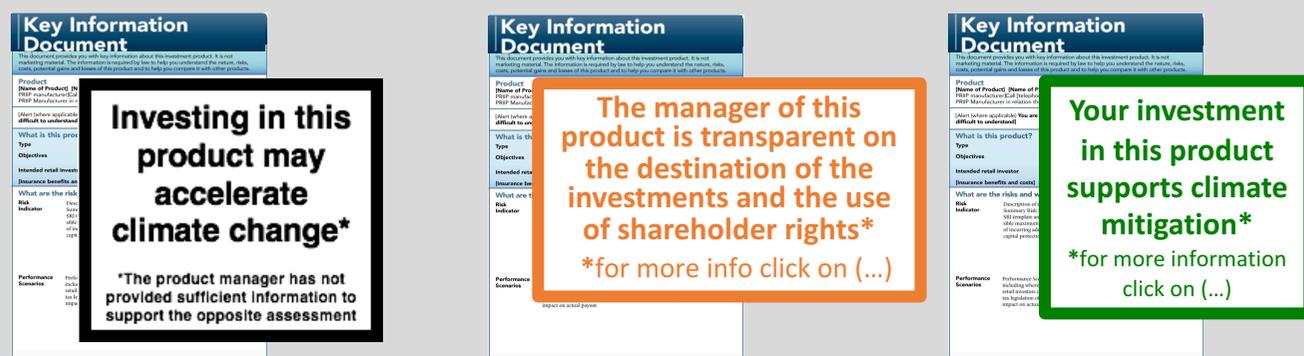
### Country-level recommendations

National policy makers can support the development of new or the refinement of existing labels setting standards for ESG/ climate alignment checks and impact products, which can at a later stage be used for standard setting at European level.

### Recommendation for EU-financial reform

EU policy makers should use the scheduled revision of the PRIIPs regulation to generalise ESG disclosure. A consultation on this approach could prepare the ground as early as the beginning of 2018. Application should start at the latest at the end of 2020, leaving ample time for definition testing and refining and product adjustment by product developers.

FIG. 17 Three future categories of PRIIPs products: no information provided, climate aligned & ESG impact (Source: authors)



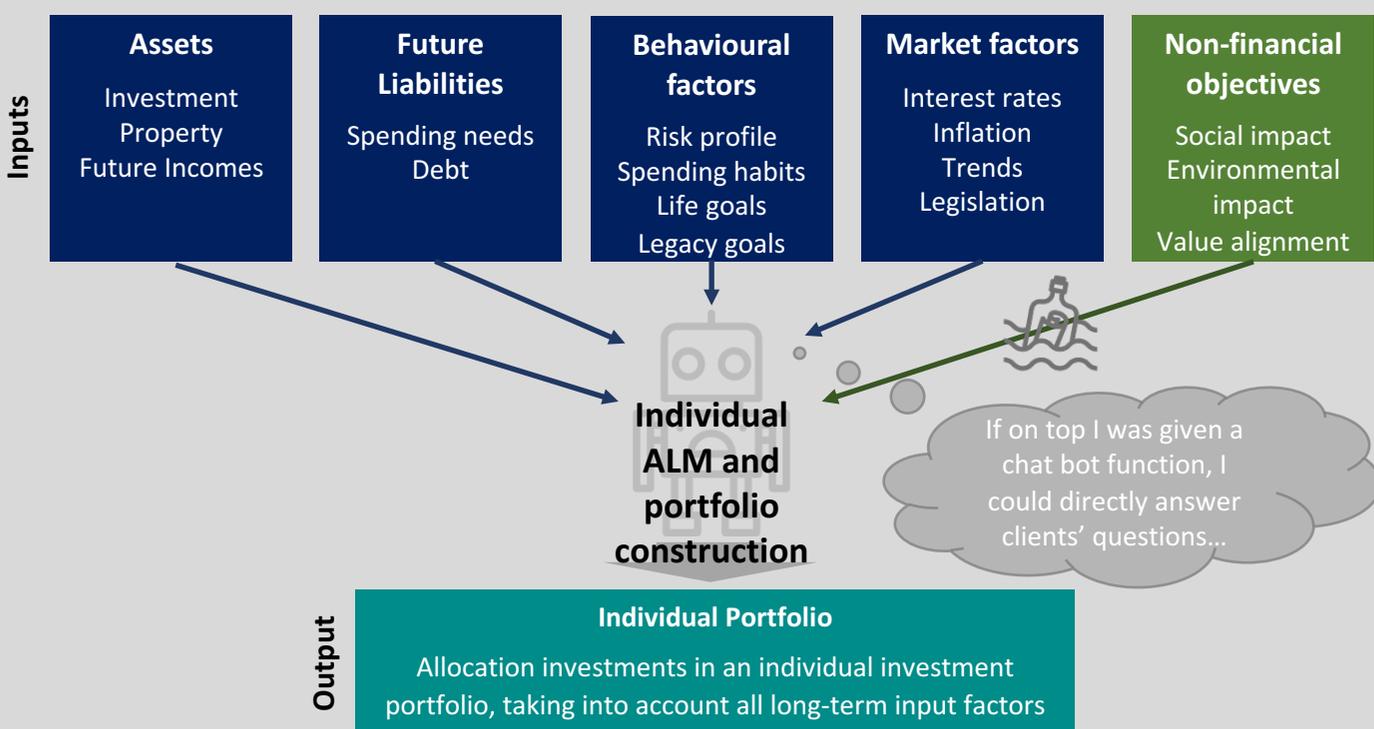
### 3. PERSONALISED FINANCIAL ADVICE FOR THE MASS MARKET

**Individual Asset Liability Management 2.0: Extra-financial preferences built-in from the start.** The preceding analysis has shown that regular retail clients are not regularly offered personalised services when it comes to investment advice. Individual Asset Liability Management (iALM) is already used by wealth managers to provide personalised advice to wealthy clients (Fig. 19). Such tools could be automated and offered to mass market clients who are interested in better and more personalised services. They could also be combined with a pro-active chat bot function, able to provide customised explanations (e.g. on differences in investment options, risk levels, fee structures, etc.) and in a language adapted to financial literacy level of the client. Such automated tools could radically improve the service to the customer compared with current service levels (human and robot). As such tools are newly developed, there is a window of opportunity to include non-financial preferences explicitly from the start. In addition, existing iALM tools often already have this feature. The increased product choice should ensure that taking into account extra-financial preferences does not mean compromising on other preferences.

**Packaged investment products – tomorrow’s dinosaur?** Packaged investment products are inherently rigid and based on the principle of a minimum common denominator compromise as they are built to cater for a large audience and allow scale economies. By design they are the opposite of a tailor-made investment product, and may lose market share if retail investors are given the opportunity to customize their portfolios based on specific investment objectives such as non-financial preferences. However the development of automation, for client profiling, portfolio construction and trades is offering the opportunity to combine customization with scale economies. If this approach is still in its infancy so far, our preliminary analysis suggests that it has the potential to suppress the need for packaged investment products.

**Public-private partnerships on robo-advisors development.** This report primarily focus on the options to change regulation in order to improve current marketing processes. However, the rise of advanced robo-advisors is likely to open new possibilities and fundamentally change the playing field. An alternative approach is therefore to directly work with the start-ups and companies involved in the development of robo-advisors, in order to help them integrate social and environmental criteria into customer profiling and product design. With the financial support of the government, 2Dii will pilot-test such an approach on the German market in 2018.

**FIG. 18 Individual Asset Liability Management (iALM)** (Source: 2dii, based on Dempster& Medova, 2011 )



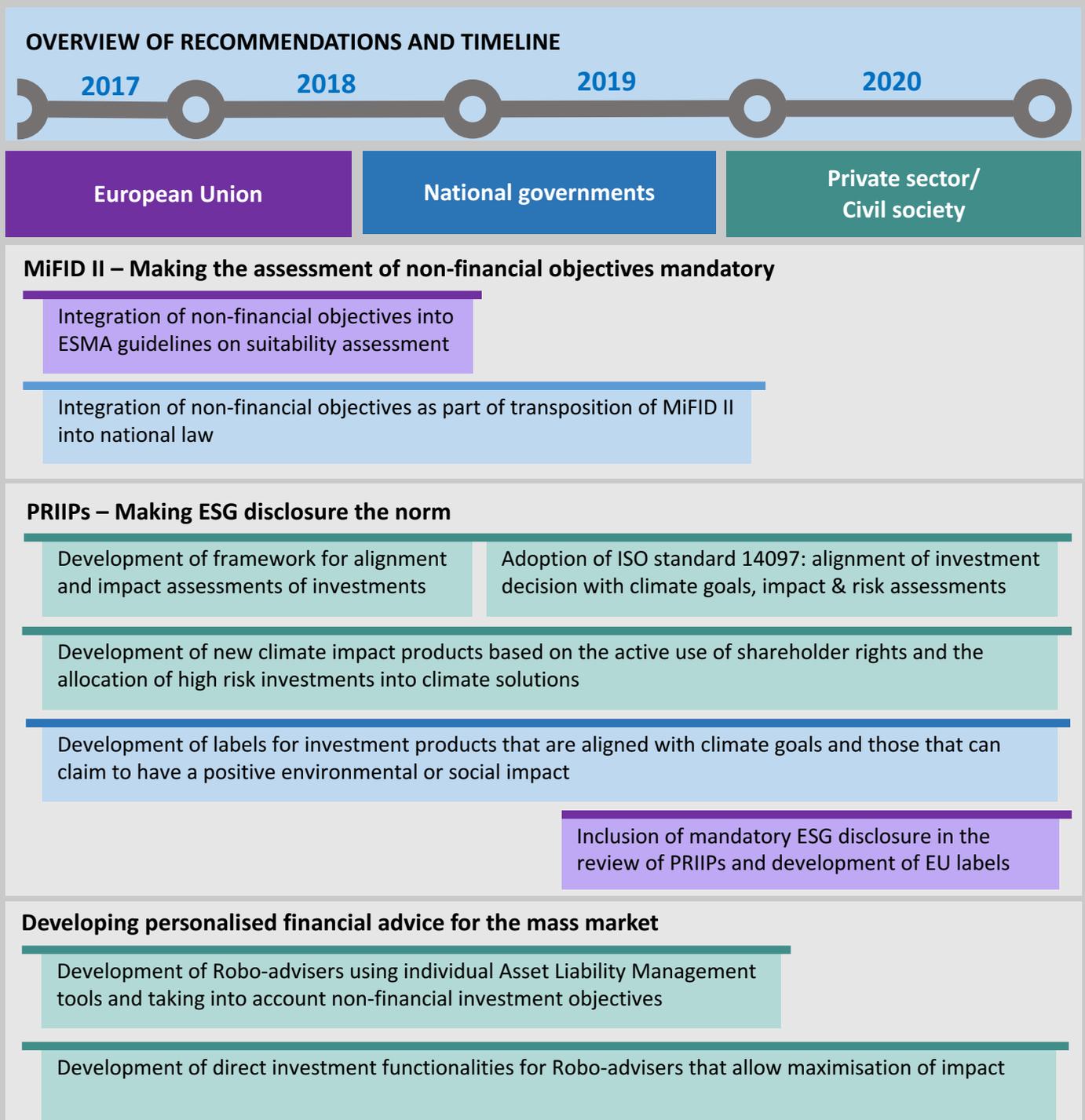
Asset-Liability Management (ALM) is a risk-management practice used in the banking sector to balance assets and liabilities in the long term, controlling for different financial risks (e.g. liquidity, equity, currency). Individual ALM’s scale this process down to the individual level, introducing elements of life planning to account for future liabilities (car, house, children) and future assets. Investments are then allocated to products who fit in this long-term perspective (Dempster& Medova, 2011 and Banque & Stratégie, 2013).

#### 4. CONCLUSIONS AND OVERVIEW OF RECOMMENDATIONS

There are exciting times ahead for the retailers of investment products and their clients alike. It is certain that the relationship between the two is coming into a period change and, reason to hope that this change will be for the better.

Private sector innovation and public sector regulation can go hand in hand to ensure high level customer protection and alignment of retail investments with the best interests of the client. Such developments are also first and foremost in the interest of the financial sector, which is still struggling to regain customer trust and suffering from a negative image as a result of the financial crisis. This lack of trust combined with quickly rising expectations from clients on the quality of services (accessibility and individualised services) and rising competition from FinTech start ups, should alert the incumbents and lead to a pro active and positive race to the top, where retailers compete to best service client needs and objectives.

**FIG. 19 Overview and timeline of recommendations**



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Table 5: List of questions for Figure 5

No.	Question (Answer Yes/No)
1: Marital status	Did the adviser ask whether you were married?
2: Children	Did the adviser ask whether you had children?
3: Employment Status	Did the adviser ask what your current employment status was?
4: Housing Status	Did the adviser ask what your current housing situation was?
5: Age	Did the adviser ask about your age?
6: Size of Investment	Did the adviser ask about the size of the investment?
7: Investment Horizon	Did the adviser ask about the time period for which you wanted to allocate your funds?
8: Objectives	Did the adviser ask whether you had any specific investment objectives (House/car/ pension)?
9: Current income	Did the adviser ask about you current income?
10: Current assets	Did the adviser ask whether you had any other financial or real estate assets?
11: Current liabilities	Did the adviser ask whether you had any outstanding debt?
12: Expected changes	Did the adviser ask whether you expect your current situation to change in the future?
13: Influence on risk category	Did the adviser let you choose your risk category yourself instead of determining?
14: Ability to carry risk	Did the adviser try to determine your ability to carry risk?
15: Risk preferences	Did the adviser try to determine your risk preferences?
16: Education	Did the adviser ask about your degree of education?
17: Experience with financial products	Did the adviser ask whether you had experience with financial products?

**Table 6: References for Table 3**

	France	Germany	Sweden	Austria
Authority responsible of Implementation	AMF (Autorité des Marchés Financiers)	BaFin (Bundesanstalt für Finanzsicht)	Swedish Financial Supervisory Authority (Finans-inspektionen)	FMA (Finanzmarktaufsicht)
Document(s) of transposition	Code Monétaire et Financier (CoMoFi) Règlement AMF	Zweites Finanzmarktnovellierungsgesetz	Swedish Securities Market Act, Finansinspektionen's regulations regarding securities business	Wertpapieraufsichtsgesetz 2018 – WAG 2018
Relevant Articles	Article 314 44-47 Règlement AMF Article L 533-12 CoMoFi	Wertpapierdienstleistungs-Verhaltens- und Organisationsverordnung - WpDVerOV) § 6 Einholung von Kundenangaben	Swedish Securities Market Act: 2007:528; (FFFS 2007:16) Chapter 15.	2. Hauptstück, 6. Abschnitt 55-57
Inclusion of non-financial objectives (Yes/No)	No	No	No	No
Transposed as of 31/07/2017 (Yes/No)	Yes	Not completed	Yes	Yes
Informational Requirements	<p><u>Assets and Liabilities:</u> sources and size of regular income, debt, financial, and real estate assets.</p> <p><u>Objectives:</u> investment horizon, risk profile, and risk preferences, purpose of investment.</p> <p><u>Any information necessary to ensure that:</u></p> <ol style="list-style-type: none"> <li>1. the service provided responds to the clients objectives.</li> <li>2. the client is able to financially handle the risk incurred and it corresponds to his objectives.</li> <li>3. The client has the necessary experience and knowledge to understand the risk incurred</li> </ol>	<p><u>Assets and liabilities:</u> sources and size of regular income, debt, financial and real estate assets.</p> <p><u>Objectives:</u> investment horizon, risk preferences, purpose of investment.</p> <p><u>Knowledge about specific financial instruments and investment services.</u></p> <p><u>Investment experiences:</u> kind, amount, frequency, duration. <u>Educational and professional experience:</u> education and current or preceding relevant professional experience.</p>	<p><u>Financial situation:</u> regular income and its source; assets, including liquid assets; investments and real property; primary financial commitments.</p> <p><u>Objectives:</u> Investment horizon, risk preferences and risk profile, purposes of investment.</p> <p><u>Knowledge and experience:</u> the types of service, transaction and financial instrument with which the client is familiar; the nature, volume and frequency of the client's transactions in financial instruments and the period over which the transactions were carried out, and; the client's level of education and profession or relevant former profession.</p>	<p><u>Financial Knowledge and situation:</u> Experience and knowledge about different types of products.</p> <p><u>Objectives:</u> purpose of investment including risk preferences, with the objective of offering products which correspond to : <u>risk preferences</u> as well as <u>capacity to carry risk</u></p>

Table 6 continued: References for Table 3

	Ireland	Spain	UK	Belgium
Authority responsible of Implementation	Central Bank of Ireland	Comisión Nacional de Mercados de Valores	FCA (Financial Conduct Authority), PRA (Prudential Regulation Authority)	FSMA (Financial Services and Markets Authority)
Document(s) of transposition	No document issued as of now, only consultation	1. Real Decreto de adaptación reglamentaria a la ley del mercado de valores. 2. Anteproyecto de Ley XX/2017, de...de..., del mercado de valores (draft)	2 Policy Statements (PS 17/5 and 17/14) and 5 Consultation papers	Royal Decree amending FSMA rules
Relevant Articles		1. Art. 80. Evaluación de la idoneidad. Art 82. Disposiciones comunes a las evaluaciones de idoneidad y conveniencia. 2. Art. 254. Evaluación de la idoneidad	FCA Handbook: COBS 9.1 -9.2 (Consultation of Business Sourcebook)	
Inclusion of non-financial objectives (Yes/No)		No	No	
Transposed as of 31/07/2017	No	Not completed	Yes	No
Informational Requirements		<u>Knowledge:</u> Financial instruments, transactions and services. Volume, frequency and period of transactions done. Education level and relevant previous occupations. <u>Assets and Liabilities:</u> Client's income source and level, and assets. Financial commitments <u>Objectives:</u> Compliance with client's investment objectives. Time horizon, risk assumption preference and investment purpose. <u>Risk Tolerance</u> of their client.	<u>Knowledge and experience:</u> types of services and transactions with which client is familiar, nature, volume, frequency of transactions, general education and profession of client. <u>Affordability:</u> Amount of investment, income. <u>Financial priority and debt:</u> debt, insurance, liquidity. <u>Saving and investment objectives:</u> time horizon, type of objective, needed liquidity. <u>Tolerance of risk:</u> under which circumstances the client would take the risk of losing capital.	

<h2 style="text-align: center;">Key Information Document</h2> <p><b>Purpose</b>                  This document provides you with key information about this investment product. It is not marketing material. The information is required by law to help you understand the nature, risks, costs, potential gains and losses of this product and to help you compare it with other products.</p> <p><b>Product</b>                  [Name of Product] [Name of PRIIP manufacturer] [where applicable ISIN or UPI] [website for PRIIP manufacturer] [Call [telephone number] for more information] [Competent Authority of the PRIIP Manufacturer in relation to the KID] [date of production of the KID]</p> <p>[Alert (where applicable) You are about to purchase a product that is not simple and may be difficult to understand]</p>	<p><b>What is this product?</b></p> <p>Type</p> <p>Objectives</p> <p>Intended retail investor</p> <p>[Insurance benefits and costs]</p>	<p><b>What are the risks and what could I get in return?</b></p> <p><b>Risk Indicator</b>                  Description of the risk-reward profile                  Summary Risk Indicator                  SRI template and narratives as set out in Annex III, including on possible maximum loss: can I lose all invested capital? Do I bear the risk of incurring additional financial commitments or obligations? Is there capital protection against market risk?</p>	<p><b>Performance Scenarios</b>                  Performance Scenario templates and narratives as set out in Annex V including where applicable information on conditions for returns to retail investors or built-in performance caps, and statement that the tax legislation of the retail investor's home Member State may have an impact on actual payout</p>	
<p><b>What happens if [PRIIP Manufacturer] is unable to pay out?</b>                  Information on whether there is a guarantee scheme, the name of the guarantor or investor compensation scheme operator, including the risks covered and those not covered.</p>	<p><b>What are the costs?</b>                  Template and narratives according to Annex VII</p> <p><b>Costs over Time</b></p>	<p><b>Composition of Costs</b>                  Template and narratives according to Annex VII</p> <p>Narratives on information to be included on other distribution costs</p>	<p><b>How long should I hold it and can I take money out early?</b></p> <p><b>Recommended [required minimum] holding period: [x]</b></p> <p>Information on whether one can disinvest before maturity, the conditions on this, and applicable fees and penalties if any. Information on the consequences of cashing-in before the end of the term or before the end of the recommended holding period</p>	<p><b>How can I complain?</b></p> <p><b>Other relevant information</b></p>



## ABOUT 2° INVESTING INITIATIVE

The 2° Investing Initiative is a multi-stakeholder think tank working to align the financial sector with 2° C climate goals. Our research work seeks to align investment processes of financial institutions with climate goals; develop the metrics and tools to measure the climate friendliness of financial institutions; and mobilize regulatory and policy incentives to shift capital to energy transition financing. The association was founded in 2012 and has offices in Paris, London, Berlin, and New York City.

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