ESG-related amendments to delegated acts under AIFMD, the UCITS Directive and MiFID 2

This document sets out how the text of the relevant parts of the existing AIFMD, UCITS and MiFID Level 2 measures look when changed by the new delegated acts.

Inserted text is **underlined and in bold**.

Deleted text is ~~**struck through and in bold**~~.

On **2 August 2021**, the following delegated acts were published in the Official Journal of the EU:

AIFMD

- Commission Delegated Regulation amends **Commission Delegated Regulation (EU) No 231/2013** (the AIFMD Delegated Regulation).

  Its provisions come into effect from **1 August 2022**.

  To see the changes to the AIFMD Delegated Regulation, click here.

UCITS Directive

- Commission Delegated Directive amends **Directive 2010/43/EU** (the UCITS Directive Level 2).

  Its provisions come into effect from **1 August 2022**.

  To see the changes to the UCITS Directive Level 2, click here.

MiFID 2 - Organisational requirements and operating conditions

- Commission Delegated Regulation amends **Commission Delegated Regulation (EU) 2017/565** (the MiFID 2 Level 2).

  Its provisions come into effect from **2 August 2022**.

  To see the changes to MiFID 2 Level 2 organisational requirements and operating conditions, click here.

MiFID 2 - Product governance obligations

- Commission Delegated Directive, which amends **Commission Delegated Directive (EU) 2017/593** (the MiFID 2 Level 2).

  Its provisions come into effect from **22 November 2022**.

  To see the changes to MiFID 2 Level 2 product governance obligations, click here.

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AIFMD

Changes to AIFMD Delegated Regulation (EU) 231/2013

Article 1 **Definitions**
[…]
6. 'sustainability risk' means sustainability risk as defined in Article 2, point (22), of Regulation (EU) 2019/2088 of the European Parliament and of the Council*;
7. 'sustainability factors' means sustainability factors as defined in Article 2, point (24), of Regulation (EU) 2019/2088.
*** Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability- related disclosures in the financial services sector (OJ L 317, 9.12.2019, p. 1).**
Article 18 **Due diligence**
1. AIFMs shall apply a high standard of diligence in the selection and ongoing monitoring of investments.
2. AIFMs shall ensure that they have adequate knowledge and understanding of the assets in which the AIF is invested.
3. AIFMs shall establish, implement and apply written policies and procedures on due diligence and implement effective arrangements for ensuring that investment decisions on behalf of the AIFs are carried out in compliance with the objectives, the investment strategy and, where applicable, the risk limits of the AIF.
4. The policies and procedures on due diligence referred to in paragraph 3 shall be regularly reviewed and updated.
5. AIFMs shall take into account sustainability risks when complying with the requirements set out in paragraphs 1 to 3.
6. Where AIFMs consider principal adverse impacts of investment decisions on sustainability factors as described in Article 4(1), point (a) of Regulation (EU) 2019/2088, or as required by paragraphs 3 or 4 of Article 4 of that Regulation, those AIFMs shall take into account such principal adverse impacts when complying with the requirements set out in paragraphs 1 to 3 of this Article.
Article 22 **Resources**
1. AIFMs shall employ sufficient personnel with the skills, knowledge and expertise necessary for discharging the responsibilities allocated to them.
2. For the purposes of paragraph 1, AIFMs shall take into account the nature, scale and complexity of their business and the nature and range of services and activities undertaken in the course of that business.
3. For the purposes of paragraph 1, AIFMs shall retain the necessary resources and expertise for the effective integration of sustainability risks.
Article 30 **Types of conflicts of interest**

For the purpose of identifying the types of conflicts of interest that arise in the course of managing an AIF, AIFMs shall take into account, in particular, whether the AIFM, a relevant person or a person directly or indirectly linked by way of control to the AIFM:

(a) is likely to make a financial gain, or avoid a financial loss, at the expense of the AIF or its investors;

(b) has an interest in the outcome of a service or an activity provided to the AIF or its investors or to a client or of a transaction carried out on behalf of the AIF or a client, which is distinct from the AIF's interest in that outcome;

(c) has a financial or other incentive to favour:

- the interest of a UCITS, a client or group of clients or another AIF over the interest of the AIF,

- the interest of one investor over the interest of another investor or group of investors in the same AIF;

(d) carries out the same activities for the AIF and for another AIF, a UCITS or client; or

(e) receives or will receive from a person other than the AIF or its investors an inducement in relation to collective portfolio management activities provided to the AIF, in the form of monies, goods or services other than the standard commission or fee for that service.

AIFMs shall ensure that when identifying the types of conflicts of interest, the existence of which may damage the interests of an AIF, they shall include those types of conflicts of interest that may arise as a result of the integration of sustainability risks in their processes, systems and internal controls.

Article 40

Risk management policy

1. An AIFM shall establish, implement and maintain an adequate and documented risk management policy which identifies all the relevant risks to which the AIFs it manages are or may be exposed.

2. The risk management policy shall comprise such procedures as are necessary to enable the AIFM to assess for each AIF it manages the exposure of that AIF to market, liquidity**, sustainability** and counterparty risks, and the exposure of the AIF to all other relevant risks, including operational risks, which may be material for each AIF it manages.

3. The AIFM shall address at least the following elements in the risk management policy:

(a) the techniques, tools and arrangements that enable it to comply with Article 45;

(b) the techniques, tools and arrangements that enable liquidity risk of the AIF to be assessed and monitored under normal and exceptional liquidity conditions including through the use of regularly conducted stress tests in accordance with Article 48;

(c) the allocation of responsibilities within the AIFM pertaining to risk management;

(d) the limits set in accordance with Article 44 of this Regulation and a justification of how these are aligned with the risk profile of the AIF disclosed to investors in accordance with Article 23(4)(c) of Directive 2011/61/EU;

(e) the terms, contents, frequency and addressees of reporting by the permanent risk management function referred to in Article 39.

4. The risk management policy shall include a description of the safeguards referred to in Article 43, in particular:

(a) the nature of the potential conflicts of interest;

(b) the remedial measures put in place;

(c) the reasons why these measures should be reasonably expected to result in independent performance of the risk management function;

(d) how the AIFM expects to ensure that the safeguards are consistently effective.

5. The risk management policy referred to in paragraph 1 shall be appropriate to the nature, scale and complexity of the business of the AIFM and of the AIF it manages.

Article 57

General requirements

1. AIFMs shall:

(a) establish, implement and maintain decision-making procedures and an organisational structure which specifies reporting lines and allocates functions and responsibilities clearly and in a documented manner;

(b) ensure that their relevant persons are aware of the procedures to be followed for the proper discharge of their responsibilities;

(c) establish, implement and maintain adequate internal control mechanisms designed to secure compliance with decisions and procedures at all levels of the AIFM;

(d) establish, implement and maintain effective internal reporting and communication of information at all relevant levels of the AIFM and effective information flows with any third party involved;

(e) maintain adequate and orderly records of their business and internal organisation.

AIFMs shall take into account the nature, scale and complexity of their business and the nature and range of services and activities undertaken in the course of that business.

AIFMs shall take into account sustainability risks when complying with the requirements laid down in the first subparagraph.

Article 60

Control by the governing body, senior management and supervisory function

1. When allocating functions internally, AIFMs shall ensure that the governing body, the senior management and, where it exists, the supervisory function are responsible for the AIFM's compliance with its obligations under Directive 2011/61/EU.

2. An AIFM shall ensure that its senior management:

(a) is responsible for the implementation of the general investment policy for each managed AIF, as defined, where relevant, in the fund rules, the instruments of incorporation, the prospectus or the offering documents;

(b) oversees the approval of the investment strategies for each managed AIF;

(c) is responsible for ensuring that valuation policies and procedures in accordance with Article 19 of Directive 2011/61/EU are established and implemented;

(d) is responsible for ensuring that the AIFM has a permanent and effective compliance function, even if this function is performed by a third party;

(e) ensures and verifies on a periodic basis that the general investment policy, the investment strategies and the risk limits of each managed AIF are properly and effectively implemented and complied with, even if the risk management function is performed by third parties;

(f)	approves and reviews on a periodic basis the adequacy of the internal procedures for undertaking investment decisions for each managed AIF, so as to ensure that such decisions are consistent with the approved investment strategies;
(g)	approves and reviews on a periodic basis the risk management policy and the arrangements, processes and techniques for implementing that policy, including the risk limit system for each AIF it manages;
(h)	is responsible for establishing and applying a remuneration policy in line with Annex II to Directive 2011/61/EU;
(i)	**is responsible for the integration of sustainability risks in activities referred to in points (a) to (h).**

UCITS

Changes to UCITS Delegated Regulation 2010/43/EU

Article 3 Definitions
[…]
11. ‘sustainability risk’ means sustainability risk as defined in Article 2, point (22), of Regulation (EU) 2019/2088 of the European Parliament and of the Council*;
12. ‘sustainability factors’ means sustainability factors as defined in Article 2, point (24), of Regulation (EU) 2019/2088.
* Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability- related disclosures in the financial services sector (OJ L 317, 9.12.2019, p. 1).
Article 4 **General requirements on procedures and organisation**
1. Member States shall require management companies to comply with the following requirements:
(a) to establish, implement and maintain decision-making procedures and an organisational structure which clearly and in a documented manner specifies reporting lines and allocates functions and responsibilities;
(b) to ensure that their relevant persons are aware of the procedures which must be followed for the proper discharge of their responsibilities;
(c) to establish, implement and maintain adequate internal control mechanisms designed to secure compliance with decisions and procedures at all levels of the management company;
(d) to establish, implement and maintain effective internal reporting and communication of information at all relevant levels of the management company as well as effective information flows with any third party involved;
(e) to maintain adequate and orderly records of their business and internal organisation.
Member States shall ensure that management companies take into account the nature, scale and complexity of the business of the management company, and the nature and range of services and activities undertaken in the course of that business.
Member States shall ensure that management companies take into account sustainability risks when complying with the requirements laid down in the first subparagraph.
Article 5 **Resources**
1. Member States shall require management companies to employ personnel with the skills, knowledge and expertise necessary for the discharge of the responsibilities allocated to them.
2. Member States shall ensure that management companies retain the necessary resources and expertise so as to effectively monitor the activities carried out by third parties on the basis of an arrangement with the management company, especially with regard to the management of the risk associated with those arrangements.

3. Member States shall require management companies to ensure that the performance of multiple functions by relevant persons does not and is not likely to prevent those relevant persons from discharging any particular function soundly, honestly, and professionally.

4. Member States shall ensure that for the purposes laid down in paragraphs 1, 2 and 3, management companies take into account the nature, scale and complexity of the business of the management company, and the nature and range of services and activities undertaken in the course of that business.

5. Member States shall ensure that for the purposes laid down in paragraphs 1, 2 and 3, management companies retain the necessary resources and expertise for the effective integration of sustainability risks.

Article 5a

Obligation for investment companies to integrate sustainability risks in the management of UCITS

Member States shall ensure that investment companies integrate sustainability risks in the management of UCITS, taking into account the nature, scale and complexity of the business of the investment companies.

Article 9

Control by senior management and supervisory function

2. The management company shall ensure that its senior management:

(a) is responsible for the implementation of the general investment policy for each managed UCITS, as defined, where relevant, in the prospectus, the fund rules or the instruments of incorporation of the investment company;

(b) oversees the approval of investment strategies for each managed UCITS;

(c) is responsible for ensuring that the management company has a permanent and effective compliance function, as referred to in Article 10, even if this function is performed by a third party;

(d) ensures and verifies on a periodic basis that the general investment policy, the investment strategies and the risk limits of each managed UCITS are properly and effectively implemented and complied with, even if the risk management function is performed by third parties;

(e) approves and reviews on a periodic basis the adequacy of the internal procedures for undertaking investment decisions for each managed UCITS, so as to ensure that such decisions are consistent with the approved investment strategies;

(f) approves and reviews on a periodic basis the risk management policy and arrangements, processes and techniques for implementing that policy, as referred to in Article 38, including the risk limit system for each managed UCITS

(g) is responsible for the integration of sustainability risks in the activities referred to in points (a) to (f).

Article 17

Criteria for the identification of conflicts of interest

1. Member States shall ensure that, for the purposes of identifying the types of conflict of interest that arise in the course of providing services and activities and whose existence may damage the interests of a UCITS, management companies take into account, by way of minimum criteria, the question of whether the management company or a relevant person, or a person directly or indirectly linked by way of control to the management company, is in any of the following situations, whether as a result of providing collective portfolio management activities or otherwise:

(a) the management company or that person is likely to make a financial gain, or avoid a financial loss, at the expense of the UCITS;

(b) the management company or that person has an interest in the outcome of a service or an activity provided to the UCITS or another client or of a transaction carried out on behalf of the UCITS or another client, which is distinct from the UCITS interest in that outcome;

(c) the management company or that person has a financial or other incentive to favour the interest of another client or group of clients over the interests of the UCITS;

(d) the management company or that person carries on the same activities for the UCITS and for another client or clients which are not UCITS;

(e) the management company or that person receives or will receive from a person other than the UCITS an inducement in relation to collective portfolio management activities provided to the UCITS, in the form of monies, goods or services, other than the standard commission or fee for that service.

2. Member States shall require management companies, when identifying the types of conflict of interests, to take into account:

(a) the interests of the management company, including those deriving from its belonging to a group or from the performance of services and activities, the interests of the clients and the duty of the management company towards the UCITS;

(b) the interests of two or more managed UCITS.

3. Member States shall ensure that, when management companies identify the types of conflicts of interest the existence of which may damage the interests of a UCITS, those management companies include those types of conflicts of interest that may arise as a result of the integration of sustainability risks in their processes, systems and internal controls.

Article 23

Due Diligence requirements

1. Member States shall require management companies to ensure a high level of diligence in the selection and ongoing monitoring of investments, in the best interests of UCITS and the integrity of the market.

2. Member States shall require management companies to ensure they have adequate knowledge and understanding of the assets in which the UCITS are invested.

3. Member States shall require management companies to establish written policies and procedures on due diligence and implement effective arrangements for ensuring that investment decisions on behalf of the UCITS are carried out in compliance with the objectives, investment strategy and risk limits of the UCITS.

4. Member States shall require management companies when implementing their risk management policy, and where it is appropriate after taking into account the nature of a foreseen investment, to formulate forecasts and perform analyses concerning the investment's contribution to the UCITS portfolio composition, liquidity and risk and reward profile before carrying out the investment. The analyses must only be carried out on the basis of reliable and up-to-date information, both in quantitative and qualitative terms.

Management companies shall exercise due skill, care and diligence when entering into, managing or terminating any arrangements with third parties in relation to the performance of risk management activities. Before entering into such arrangements, management companies shall take the necessary steps in order to verify that the third party has the ability and capacity to perform the risk management activities reliably, professionally and effectively. The management company shall establish methods for the on-going assessment of the standard of performance of the third party.

5. Member States shall require that management companies take into account sustainability risks when complying with the requirements set out in paragraphs 1 to 4.

6.	**Member States shall ensure that where management companies, or, where applicable, investment companies, consider principal adverse impacts of investment decisions on sustainability factors as described in Article 4(1), point (a), of Regulation (EU) 2019/2088, or as required by paragraphs 3 or 4 of Article 4 of that Regulation, those management companies or investment companies take into account such principal adverse impacts when complying with the requirements set out in paragraphs 1 to 4 of this Article.**
	Article 38
	Risk management policy
1.	Member States shall require management companies to establish, implement and maintain an adequate and documented risk management policy which identifies the risks the UCITS they manage are or might be exposed to. The risk management policy shall comprise such procedures as are necessary to enable the management company to assess for each UCITS it manages the exposure of that UCITS to market, liquidity, **sustainability** and counterparty risks, and the exposure of the UCITS to all other risks, including operational risks, which may be material for each UCITS it manages. Member States shall require management companies to address at least the following elements in the risk management policy:
(a)	the techniques, tools and arrangements that enable them to comply with the obligations set out in Articles 40 and 41;
(b)	the allocation of responsibilities within the management company pertaining to risk management.

MiFID 2

Changes to MiFID 2 Delegated Regulation (EU) 2017/565

(Organisational requirements)

Article 2 **Definitions**
[…]
7. 'sustainability preferences' means a client's or potential client's choice as to whether and, if so, to what extent, one or more of the following financial instruments shall be integrated into his or her investment:
(a) a financial instrument for which the client or potential client determines that a minimum proportion shall be invested in environmentally sustainable investments as defined in Article 2, point (1), of Regulation (EU) 2020/852 of the European Parliament and of the Council*;
(b) a financial instrument for which the client or potential client determines that a minimum proportion shall be invested in sustainable investments as defined in Article 2, point (17), of Regulation (EU) 2019/2088 of the European Parliament and of the Council **;
(c) a financial instrument that considers principal adverse impacts on sustainability factors where qualitative or quantitative elements demonstrating that consideration are determined by the client or potential client;
8. 'sustainability factors' means sustainability factors as defined in Article 2, point (24), of Regulation (EU) 2019/2088;
9. 'sustainability risks' means sustainability risks as defined in Article 2, point (22), of Regulation (EU) 2019/2088.
*** Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088 (OJ L 198, 22.6.2020, p. 13).**
**** Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability- related disclosures in the financial services sector (OJ L 317, 9.12.2019, p. 1)**
Article 21 **General organisational requirements**
1. Investment firms shall comply with the following organisational requirements:
(a) For the purposes of paragraph 1, AIFMs shall take into account the nature, scale and complexity of their business and the nature and range of services and activities undertaken in the course of that business.
(b) ensure that their relevant persons are aware of the procedures which must be followed for the proper discharge of their responsibilities;
(c) establish, implement and maintain adequate internal control mechanisms designed to secure compliance with decisions and procedures at all levels of the investment firm;
(d) employ personnel with the skills, knowledge and expertise necessary for the discharge of the responsibilities allocated to them;
(e) establish, implement and maintain effective internal reporting and communication of information at all relevant levels of the investment firm;

(f) maintain adequate and orderly records of their business and internal organisation;

(g) ensure that the performance of multiple functions by their relevant persons does not and is not likely to prevent those persons from discharging any particular function soundly, honestly, and professionally.

Investment firms shall take into account sustainability risks when complying with the requirements set out in this paragraph.

When complying with the requirements set out in this paragraph, investment firms shall take into account the nature, scale and complexity of the business of the firm, and the nature and range of investment services and activities undertaken in the course of that business.

2. Investment firms shall establish, implement and maintain systems and procedures that are adequate to safeguard the security, integrity and confidentiality of information, taking into account the nature of the information in question.

3. Investment firms shall establish, implement and maintain an adequate business continuity policy aimed at ensuring, in the case of an interruption to their systems and procedures, the preservation of essential data and functions, and the maintenance of investment services and activities, or, where that is not possible, the timely recovery of such data and functions and the timely resumption of their investment services and activities.

4. Investment firms shall establish, implement and maintain accounting policies and procedures that enable them, at the request of the competent authority, to deliver in a timely manner to the competent authority financial reports which reflect a true and fair view of their financial position and which comply with all applicable accounting standards and rules.

5. Investment firms shall monitor and, on a regular basis, evaluate the adequacy and effectiveness of their systems, internal control mechanisms and arrangements established in accordance with paragraphs 1 to 4, and take appropriate measures to address any deficiencies.

Article 23

Risk management

1. Investment firms shall take the following actions relating to risk management:

(a) establish, implement and maintain adequate risk management policies and procedures which identify the risks relating to the firm's activities, processes and systems, and, where appropriate, set the level of risk tolerated by the firm. **In doing so, investment firms shall take into account sustainability risks**;

(b) adopt effective arrangements, processes and mechanisms to manage the risks relating to the firm's activities, processes and systems, in light of that level of risk tolerance;

(c) monitor the following:

(i) the adequacy and effectiveness of the investment firm's risk management policies and procedures;

(ii) the level of compliance by the investment firm and its relevant persons with the arrangements, processes and mechanisms adopted in accordance with point (b);

(iii) the adequacy and effectiveness of measures taken to address any deficiencies in those policies, procedures, arrangements, processes and mechanisms, including failures by the relevant persons to comply with such arrangements, processes and mechanisms or follow such policies and procedures.

Article 33

Conflicts of interest potentially detrimental to a client (Article 16(3) and Article 23 of Directive 2014/65/EU)

For the purposes of identifying the types of conflict of interest that arise in the course of providing investment and ancillary services or a combination thereof and whose existence may damage the interests of a client,

including his or her sustainability preferences, investment firms shall take into account, by way of minimum criteria, whether the investment firm or a relevant person, or a person directly or indirectly linked by control to the firm, is in any of the following situations, whether as a result of providing investment or ancillary services or investment activities or otherwise:

(a) the firm or that person is likely to make a financial gain, or avoid a financial loss, at the expense of the client;

(b) the firm or that person has an interest in the outcome of a service provided to the client or of a transaction carried out on behalf of the client, which is distinct from the client's interest in that outcome;

(c) the firm or that person has a financial or other incentive to favour the interest of another client or group of clients over the interests of the client;

(d) the firm or that person carries on the same business as the client;

(e) the firm or that person receives or will receive from a person other than the client an inducement in relation to a service provided to the client, in the form of monetary or non-monetary benefits or services.

Article 52

Information about investment advice

1. Investment firms shall explain in a clear and concise way whether and why investment advice qualifies as independent or non-independent and the type and nature of the restrictions that apply, including, when providing investment advice on an independent basis, the prohibition to receive and retain inducements.

   Where advice is offered or provided to the same client on both an independent and non-independent basis, investment firms shall explain the scope of both services to allow investors to understand the differences between them and not present itself f as an independent investment adviser for the overall activity. Firms shall not give undue prominence to their independent investment advice services over non-independent investment services in their communications with clients.

2. Investment firms providing investment advice, on an independent or non-independent basis, shall explain to the client the range of financial instruments that may be recommended, including the firm's relationship with the issuers or providers of the instruments.

3. Investment firms shall provide a description of:

(a) the types of financial instruments considered;

(b) the range of financial instruments and providers, analysed per each type of instrument according to the scope of the service~~, and~~;

(c) **where relevant, the sustainability factors taken into consideration in the selection process of financial instruments**;

(d) when providing independent advice, how the service provided satisfies the conditions for the provision of investment advice on an independent basis and the factors taken into consideration in the selection process used by the investment firm to recommend financial instruments, ~~such as~~ including risks, costs and complexity of the financial instruments.

4 When the range of financial instruments assessed by the investment firm providing investment advice on an independent basis includes the investment firm's own financial instruments or those issued or provided by entities having close links or any other close legal or economic relationship with the investment firm as well as other issuers or providers which are not linked or related, the investment firm shall distinguish, for each type of financial instrument, the range of the financial instruments issued or provided by entities not having any links with the investment firm.

5. Investments firms providing a periodic assessment of the suitability of the recommendations provided pursuant to Article 54(12) shall disclose all of the following:

(a) the frequency and extent of the periodic suitability assessment and where relevant, the conditions that trigger that assessment;

(b) the extent to which the information previously collected will be subject to reassessment; and

(c) the way in which an updated recommendation will be communicated to the client.

Article 54

Assessment of suitability and suitability reports

1. Investment firms shall not create any ambiguity or confusion about their responsibilities in the process when assessing the suitability of investment services or financial instruments in accordance with Article 25(2) of Directive 2014/65/EU. When undertaking the suitability assessment, the firm shall inform clients or potential clients, clearly and simply, that the reason for assessing suitability is to enable the firm to act in the client's best interest.

   Where investment advice or portfolio management services are provided in whole or in part through an automated or semi-automated system, the responsibility to undertake the suitability assessment shall lie with the investment firm providing the service and shall not be reduced by the use of an electronic system in making the personal recommendation or decision to trade.

2. Investment firms shall determine the extent of the information to be collected from clients in light of all the features of the investment advice or portfolio management services to be provided to those clients. Investment firms shall obtain from clients or potential clients such information as is necessary for the firm to understand the essential facts about the client and to have a reasonable basis for determining, giving due consideration to the nature and extent of the service provided, that the specific transaction to be recommended, or entered into in the course of providing a portfolio management service, satisfies the following criteria:

(a) it meets the investment objectives of the client in question, including **the** client's risk tolerance **and any sustainability preferences;**

(b) it is such that the client is able financially to bear any related investment risks consistent with his investment objectives;

(c) it is such that the client has the necessary experience and knowledge in order to understand the risks involved in the transaction or in the management of his portfolio.

3. Where an investment firm provides an investment service to a professional client it shall be entitled to assume that in relation to the products, transactions and services for which it is so classified, the client has the necessary level of experience and knowledge for the purposes of point (c) of paragraph 2.

   Where that investment service consists in the provision of investment advice to a professional client covered by Section 1 of Annex II to Directive 2014/65/EU, the investment firm shall be entitled to assume for the purposes of point (b) of paragraph 2 that the client is able financially to bear any related investment risks consistent with the investment objectives of that client.

4. The information regarding the financial situation of the client or potential client shall include, where relevant, information on the source and extent of his regular income, his assets, including liquid assets, investments and real property, and his regular financial commitments.

5. The information ~~regarding~~ **about** the investment objectives of the client or potential client shall include, where relevant, information ~~on~~ **about** the length of time for which the client wishes to hold the investment, his **or her** preferences regarding risk taking, his **or her** risk ~~profile, and~~ **tolerance,** the ~~purposes~~ **purpose** of the investment **and in addition his or her sustainability preferences.**

6. Where a client is a legal person or a group of two or more natural persons or where one or more natural persons are represented by another natural person, the investment firm shall establish and implement policy as to who should be subject to the suitability assessment and how this assessment will be done in practice, including from whom information about knowledge and experience, financial situation and investment objectives should be collected. The investment firm shall record this policy.

Where a natural person is represented by another natural person or where a legal person having requested treatment as professional client in accordance with Section 2 of Annex II to Directive 2014/65/EU is to be considered for the suitability assessment, the financial situation and investment objectives shall be those of the legal person or, in relation to the natural person, the underlying client rather than of the representative. The knowledge and experience shall be that of the representative of the natural person or the person authorised to carry out transactions on behalf of the underlying client.

7. Investment firms shall take reasonable steps to ensure that the information collected about their clients or potential clients is reliable. This shall include, but shall not be limited to, the following:

(a) ensuring clients are aware of the importance of providing accurate and up-to-date information;

(b) ensuring all tools, such as risk assessment profiling tools or tools to assess a client's knowledge and experience, employed in the suitability assessment process are fit-for-purpose and are appropriately designed for use with their clients, with any limitations identified and actively mitigated through the suitability assessment process;

(c) ensuring questions used in the process are likely to be understood by clients, capture an accurate reflection of the client's objectives and needs, and the information necessary to undertake the suitability assessment; and

(d) taking steps, as appropriate, to ensure the consistency of client information, such as by considering whether there are obvious inaccuracies in the information provided by clients.

Investment firms having an on-going relationship with the client, such as by providing an ongoing advice or portfolio management service, shall have, and be able to demonstrate, appropriate policies and procedures to maintain adequate and up-to-date information about clients to the extent necessary to fulfil the requirements under paragraph 2.

8. Where, when providing the investment service of investment advice or portfolio management, an investment firm does not obtain the information required under Article 25(2) of Directive 2014/65/EU, the firm shall not recommend investment services or financial instruments to the client or potential client.

9. Investment firms shall have **in place**, and be able to demonstrate **that they have in place**, adequate policies and procedures ~~**in place**~~ to ensure that they understand the nature, features, including costs ~~**and,**~~ risks of investment services**,** and financial instruments selected for their clients**, including any sustainability factors,** and that they **shall** assess, while taking into account cost and complexity, whether equivalent investment services or financial instruments can meet their client's profile.

10. When providing the investment service of investment advice or portfolio management, an investment firm shall not recommend or decide to trade where none of the services or instruments are suitable for the client.

An investment firm shall not recommend financial instruments or decide to trade such instruments as meeting a client's or potential client's sustainability preferences when those financial instruments do not meet those preferences. The investment firm shall explain to the client or potential clients the reasons for not doing so and keep records of those reasons.

Where no financial instrument meets the sustainability preferences of the client or potential client, and the client decides to adapt his or her sustainability preferences, the investment firm shall keep records of the decision of the client, including the reasons for that decision.

11. When providing investment advice or portfolio management services that involve switching investments, either by selling an instrument and buying another or by exercising a right to make a change in regard to an existing instrument, investment firms shall collect the necessary information on the client's existing investments and the recommended new investments and shall undertake an analysis of the costs and benefits of the switch, such that they are reasonably able to demonstrate that the benefits of switching are greater than the costs.

12. When providing investment advice, investment firms shall provide a report to the retail client that includes an outline of the advice given and **that explains** how the recommendation provided is suitable for the retail client, including how ~~**it**~~ **the recommendation** meets the client's **investment** objectives ~~**and,**~~ **his or her** personal circumstances with reference to the investment term required, **the** client's knowledge and

experience ~~and~~, the client's attitude to risk ~~and~~, his or her capacity ~~for loss~~ to sustain losses and his or her sustainability preferences.

Investment firms shall draw clients' attention to and shall include in the suitability report information on whether the recommended services or instruments are likely to require the retail client to seek a periodic review of their arrangements.

Where an investment firm provides a service that involves periodic suitability assessments and reports, the subsequent reports after the initial service is established may only cover changes in the services or instruments involved and/or the circumstances of the client and may not need to repeat all the details of the first report.

13. Investment firms providing a periodic suitability assessment shall review, in order to enhance the service, the suitability of the recommendations given at least annually. The frequency of this assessment shall be increased depending on the risk profile of the client and the type of financial instruments recommended.

The requirements to meet the sustainability preferences of clients or potential clients, where relevant, shall not alter the conditions laid down in the first subparagraph.

MiFID 2

Changes to MiFID 2 Delegated Directive (EU) 2017/593

(Product governance)

Article 1 **Scope and Definitions**
[…]
5. ‘sustainability factors’ means sustainability factors as defined in Article 2, point (24), of Regulation (EU) 2019/2088*.
*** Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability- related disclosures in the financial services sector (OJ L 317, 9.12.2019, p. 1)**

Article 9 **Product governance obligations for investment firms manufacturing financial instruments**
1. Member States shall require investment firms to comply with this Article when manufacturing financial instruments, which encompasses the creation, development, issuance and/or design of financial instruments. Member States shall require investment firms manufacturing financial instruments to comply, in a way that is appropriate and proportionate, with the relevant requirements in paragraphs 2 to 15, taking into account the nature of the financial instrument, the investment service and the target market for the product.
2. Member States shall require investment firms to establish, implement and maintain procedures and measures to ensure the manufacturing of financial instruments complies with the requirements on proper management of conflicts of interest, including remuneration. In particular, investment firms manufacturing financial instruments shall ensure that the design of the financial instrument, including its features, does not adversely affect end clients or does not lead to problems with market integrity by enabling the firm to mitigate and/or dispose of its own risks or exposure to the underlying assets of the product, where the investment firm already holds the underlying assets on own account.
3. Member States shall require investment firms to analyse potential conflicts of interests each time a financial instrument is manufactured. In particular, firms shall assess whether the financial instrument creates a situation where end clients may be adversely affected if they take:
(a) an exposure opposite to the one previously held by the firm itself; or
(b) an exposure opposite to the one that the firm wants to hold after the sale of the product.
4. Member States shall ensure that investment firms consider whether the financial instrument may represent a threat to the orderly functioning or to the stability of financial markets before deciding to proceed with the launch of the product.
5. Member States shall require investment firms to ensure that relevant staff involved in the manufacturing of financial instruments possess the necessary expertise to understand the characteristics and risks of the financial instruments they intend to manufacture.
6. Member States shall require investment firms to ensure that the management body has effective control over the firm's product governance process. Investment firms shall ensure that the compliance reports to the management body systematically include information about the financial instruments manufactured by the firm, including information on the distribution strategy. Investment firms shall make the reports available to their competent authority on request.

7. Member States shall require investment firms to ensure that the compliance function monitors the development and periodic review of product governance arrangements in order to detect any risk of failure by the firm to comply with the obligations set out in this Article.

8. Member States shall require investment firms, where they collaborate, including with entities which are not authorised and supervised in accordance with Directive 2014/65/EU or third-country firms, to create, develop, issue and/or design a product, to outline their mutual responsibilities in a written agreement.

9. Member States shall require investment firms to identify at a sufficiently granular level the potential target market for each financial instrument and specify the type(s) of client ~~for~~ **with** whose needs, characteristics and objectives**, including any sustainability related objectives,** the financial instrument is compatible. As part of this process, the firm shall identify any group(s) of clients ~~for~~ **with** whose needs, characteristics and objectives the financial instrument is not compatible**, except where financial instruments consider sustainability factors**. Where investment firms collaborate to manufacture a financial instrument, only one target market needs to be identified.

Investment firms manufacturing financial instruments that are distributed through other investment firms shall determine the needs and characteristics of clients for whom the product is compatible based on their theoretical knowledge of and past experience with the financial instrument or similar financial instruments, the financial markets and the needs, characteristics and objectives of potential end clients.

10. Member States shall require investment firms to undertake a scenario analysis of their financial instruments which shall assess the risks of poor outcomes for end clients posed by the product and in which circumstances these outcomes may occur. Investment firms shall assess the financial instrument under negative conditions covering what would happen if, for example:

(a) the market environment deteriorated;

(b) the manufacturer or a third party involved in manufacturing and or functioning of the financial instrument experiences financial difficulties or other counterparty risk materialises;

(c) the financial instrument fails to become commercially viable; or

(d) demand for the financial instrument is much higher than anticipated, putting a strain on the firm's resources and/or on the market of the underlying instrument

11. Member States shall require investment firms to determine whether a financial instrument meets the identified needs, characteristics and objectives of the target market, including by examining the following elements:

(a) the financial instrument's risk/reward profile is consistent with the target market; ~~and~~

(b) the financial instrument's sustainability factors, where relevant, are consistent with the target market;

(c) **the** financial instrument design is driven by features that benefit the client and not by a business model that relies on poor client outcomes to be profitable.

12. Member States shall ensure that investment firms consider the charging structure proposed for the financial instrument, including by examining the following: (a) financial instrument's costs and charges are compatible with the needs, objectives and characteristics of the target market; (b) charges do not undermine the financial instrument's return expectations, such as where the costs or charges equal, exceed or remove almost all the expected tax advantages linked to a financial instrument; and (c) the charging structure of the financial instrument is appropriately transparent for the target market, such as that it does not disguise charges or is too complex to understand.

13. Member States shall require investment firms to ensure that the provision of information about a financial instrument to distributors includes information about the appropriate channels for distribution of the financial instrument, the product approval process and the target market assessment and is of an adequate standard to enable distributors to understand and recommend or sell the financial instrument properly.

The sustainability factors of the financial instrument shall be presented in a transparent manner and provide distributers with the relevant information to duly consider any sustainability related objectives of the client or potential client.

14. Member States shall require investment firms to review the financial instruments they manufacture on a regular basis, taking into account any event that could materially affect the potential risk to the identified target market. Investment firms shall consider ~~if~~ **whether** the financial instrument remains consistent with the needs, characteristics and objectives**, including any sustainability related objectives,** of the target market and if it is ~~being~~ distributed to the target market, or ~~is reaching~~ **reaches** clients ~~for~~ **with** whose needs, characteristics and objectives the financial instrument is not compatible.

15. Member States shall require investment firms to review financial instruments prior to any further issue or re-launch, if they are aware of any event that could materially affect the potential risk to investors and at regular intervals to assess whether the financial instruments function as intended. Investment firms shall determine how regularly to review their financial instruments based on relevant factors, including factors linked to the complexity or the innovative nature of the investment strategies pursued. Firms shall also identify crucial events that would affect the potential risk or return expectations of the financial instrument, such as:

(a) the crossing of a threshold that will affect the return profile of the financial instrument; or

(b) the solvency of certain issuers whose securities or guarantees may impact the performance of the financial instrument.

Member States shall ensure that, when such events occur, investment firms take appropriate action which may consist of:

(a) the provision of any relevant information on the event and its consequences on the financial instrument to the clients or the distributors of the financial instrument if the investment firm does not offer or sell the financial instrument directly to the clients;

(b) changing the product approval process;

(c) stopping further issuance of the financial instrument;

(d) changing the financial instrument to avoid unfair contract terms;

(e) considering whether the sales channels through which the financial instruments are sold are appropriate where firms become aware that the financial instrument is not being sold as envisaged;

(f) contacting the distributor to discuss a modification of the distribution process;

(g) terminating the relationship with the distributor; or

(h) informing the relevant competent authority.

Article 10

Product governance obligation for distributors

1. Member States shall require investment firms, when deciding the range of financial instruments issued by themselves or other firms and services they intend to offer or recommend to clients, to comply, in a way that is appropriate and proportionate, with the relevant requirements laid down in paragraphs 2 to 10, taking into account the nature of the financial instrument, the investment service and the target market for the product.

Member States shall ensure that investment firms also comply with the requirements of Directive 2014/65/EU when offering or recommending financial instruments manufactured by entities that are not subject to Directive 2014/65/EU. As part of this process, such investment firms shall have in place effective arrangements to ensure that they obtain sufficient information about these financial instruments from these manufacturers.

Investment firms shall determine the target market for the respective financial instrument, even if the target market was not defined by the manufacturer

2. Member States shall require investment firms to have in place adequate product governance arrangements to ensure that products and services they intend to offer or recommend are compatible with the needs, characteristics, and objectives**, including any sustainability related objectives**, of an identified target market and that the intended distribution strategy is consistent with the identified target market. Investment firms shall appropriately identify and assess the circumstances and needs of the clients they intend to focus on, so as to ensure that clients' interests are not compromised as a result of commercial or funding pressures. As part of this process, **investment** firms shall identify any ~~**groups**~~ **group** of clients ~~**for**~~ **with** whose needs, characteristics and objectives the product or service is not compatible **except where financial instruments consider sustainability factors**.

   Member States shall ensure that investment firms obtain from manufactures that are subject to Directive 2014/65/EU information to gain the necessary understanding and knowledge of the products they intend to recommend or sell in order to ensure that these products will be distributed in accordance with the needs, characteristics and objectives of the identified target market.

   Member States shall require investment firms to take all reasonable steps to ensure they also obtain adequate and reliable information from manufacturers not subject to Directive 2014/65/EU to ensure that products will be distributed in accordance with the characteristics, objectives and needs of the target market. Where relevant information is not publicly available, the distributor shall take all reasonable steps to obtain such relevant information from the manufacturer or its agent. Acceptable publicly available information is information which is clear, reliable and produced to meet regulatory requirements, such as disclosure requirements under Directive 2003/71/EC (1) or 2004/109/EC (2) of the European Parliament and of the Council. This obligation is relevant for products sold on primary and secondary markets and shall apply in a proportionate manner, depending on the degree to which publicly available information is obtainable and the complexity of the product.

   Investment firms shall use the information obtained from manufacturers and information on their own clients to identify the target market and distribution strategy. When an investment firm acts both as a manufacturer and a distributor, only one target market assessment shall be required.

3. Member States shall require investment firms, when deciding the range of financial instrument and services that they offer or recommend and the respective target markets, to maintain procedures and measures to ensure compliance with all applicable requirements under Directive 2014/65/EU including those relating to disclosure, assessment of suitability or appropriateness, inducements and proper management of conflicts of interest. In this context, particular care shall be taken when distributors intend to offer or recommend new products or there are variations to the services they provide.

4. Member States shall require investment firms to periodically review and update their product governance arrangements in order to ensure that they remain robust and fit for their purpose, and take appropriate actions where necessary.

5. Member States shall require investment firms to review the investment products they offer or recommend and the services they provide on a regular basis, taking into account any event that could materially affect the potential risk to the identified target market. Firms shall assess at least whether the product or service remains consistent with the needs, characteristics and objectives**, including any sustainability related objectives**, of the identified target market and whether the intended distribution strategy remains appropriate. Firms shall reconsider the target market and/or update the product governance arrangements if they become aware that they have wrongly identified the target market for a specific product or service or that the product or service no longer meets the circumstances of the identified target market, such as where the product becomes illiquid or very volatile due to market changes.

6. Member States shall require investment firms to ensure their compliance function oversee the development and periodic review of product governance arrangements in order to detect any risk of failure to comply with the obligations set out in this Article.

7. Member States shall require investment firms to ensure that relevant staff possess the necessary expertise to understand the characteristics and risks of the products that intend to offer or recommend and the services provided as well as the needs, characteristics and objectives of the identified target market.

8. Member States shall require investment firms to ensure that the management body has effective control over the firm's product governance process to determine the range of investment products that they offer or recommend and the services provided to the respective target markets. Investment firms shall ensure that the compliance reports to the management body systematically include information about the products they

offer or recommend and the services provided. The compliance reports shall be made available to competent authorities on request.

9. Member States shall ensure distributors provide manufacturers with information on sales and, where appropriate, information on the above reviews to support product reviews carried out by manufacturers.

10. Where different firms work together in the distribution of a product or service, Member States shall ensure the investment firm with the direct client relationship has ultimate responsibility to meet the product governance obligations set out in this Article. However, intermediary investment firms shall:

(a) ensure that relevant product information is passed from the manufacturer to the final distributor in the chain;

(b) if the manufacturer requires information on product sales in order to comply with their own product governance obligations, enable them to obtain it; and

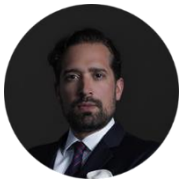
(c) apply the product governance obligations for manufacturers, as relevant, in relation to the service they provide.

Contacts

Lucian Firth
Partner
T +44 20 7825 4155
E lucian.firth@simmons-simmons.com

Craig Bisson
Partner
T +44 20 7825 4691
E craig.bisson@simmons-simmons.com

Sarah Crabb
Partner
T +44 20 7825 3597
E sarah.crabb@simmons-simmons.com



Daniel Lühmann
Managing Associate, Rechtsanwalt
T +49 69 907454 25
E daniel.luehmann@simmons-simmons.com

Richard Perry
Partner
T +44 20 7825 4310
E richard.perry@simmons-simmons.com

Niamh Ryan
Partner
T + 353 1266 2115
E niamh.ryan@simmons-simmons.com

Neil Simmonds
Partner
T +44 20 7825 3151
E neil.simmonds@simmons-simmons.com

Catherine Weeks
Partner
T +44 20 7825 3940
E catherine.weeks@simmons-simmons.com

Ursula Goniszewska
Supervising Associate
T +44 20 7825 3108
E ursula.goniszewska@simmons-simmons.com

Grace Chong
Of Counsel
T +65 6831 5 626
E grace.chong@simmons-simmons.com

Nick Colston
Partner
T +44 20 7825 4147
E nicholas.colston@simmons-simmons.com

Dr Harald Glander
Partner
T +49 69 907454 44
E harald.glander@simmons-simmons.com

Louise Tudor-Edwards
Managing Associate
T +44 20 7825 4539
E louise.tudor-edwards@simmons-simmons.com

Iris Dingemans
Partner
T +31 20 722 2335
E iris.dingemans@simmons-simmons.com

Matthew Pitman
Partner
T +44 20 7825 4629
E matthew.pitman@simmons-simmons.com

Devarshi Saksena
Partner
T +44 20 7825 3255
E devarshi.saksena@simmons-simmons.com

Augustin de Longeaux
Partner
T +352 26 21 16 34
E Augustin.DeLongeaux@simmons-simmons.com

David Williams
Partner
T +44 20 7825 4150
E david.williams@simmons-simmons.com

James Wallace
Supervising Associate
T +44 20 7825 4249
E james.wallace@simmons-simmons.com

Katherine Tracey
Managing Associate
T +44 20 7825 4820
E katherine.tracey@simmons-simmons.com