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To:	Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of the European Union

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Subject:	COMMISSION DELEGATED REGULATION (EU) .../... of 21.4.2021 amending Delegated Regulation (EU) 2017/565 as regards the integration of sustainability factors, risks and preferences into certain organisational requirements and operating conditions for investment firms

Delegations will find attached document C(2021) 2616 final.

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Brussels, 21.4.2021
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COMMISSION DELEGATED REGULATION (EU) .../...

of 21.4.2021

amending Delegated Regulation (EU) 2017/565 as regards the integration of sustainability factors, risks and preferences into certain organisational requirements and operating conditions for investment firms

(Text with EEA relevance)

EXPLANATORY MEMORANDUM

1. CONTEXT OF THE DELEGATED ACT

This Regulation is part of a broader Commission's initiative on sustainable development. It lays the foundation for an EU framework which puts sustainability considerations at the heart of the financial system to support transforming Europe's economy into a greener, more resilient and circular system in line with the **European Green Deal**¹ objectives.

Following the adoption of **2016 Paris agreement on climate change** and the **United Nations 2030 Agenda for Sustainable Development Goals (SDGs)**, the Commission announced in the **Action Plan: Financing Sustainable Growth**² the intention to incorporate sustainability when providing financial advice and to clarify the integration of sustainability in so-called fiduciary duties in sectoral legislation. The **European Green Deal** Communication confirms the need for long-term signals to direct financial and capital flows to green investment and to avoid stranded assets. This Delegated Regulation will contribute to this specific objective.

Commission Delegated Regulation (EU) 2017/565³ supplements Directive 2014/65/EU of the European Parliament and of the Council⁴ (MiFID II) by further specifying organisational requirements and operating conditions for investment firms. This Regulation modifies Delegated Regulation (EU) 2017/565 in two ways:

First, it integrates client's preferences in terms of sustainability as a top up to the suitability assessment. Under the existing MiFID II framework, firms providing investment advice and portfolio management are required to obtain the necessary information about the client's knowledge and experience in the investment field, their ability to bear losses, and objectives including the client's risk tolerance to enable the firm to provide services and products that are suitable for the client (suitability assessment). The information regarding the investment objectives of clients includes information on the length of time for which clients wish to hold the investment, their preferences regarding risk taking, risk profile, and the purposes of the investment. However, the information about investment objectives generally relates to financial objectives, while other non-financial objectives of the client, such as sustainability preferences, are usually not addressed. Existing suitability assessments generally do not include questions on clients' sustainability preferences, while the majority of clients would not raise such preferences themselves. As a result, investment firms could give more appropriate consideration to sustainability factors in the selection process.

Regulation (EU) 2019/2088 of the European Parliament and of the Council (SFDR)⁵ requires a financial product's documentation to describe how its stated levels of sustainability or

¹ Communication from the Commission to the European Parliament, to the European Council, the Council, the European Economic and Social Committee, and the Committee of the Regions: the European Green Deal (COM(2019)640 final).

² Communication from the Commission to the European Parliament, to the European Council, the Council, The European Central Bank, the European Economic and Social Committee, and the Committee of the Regions Action Plan: Financing Sustainable Growth (COM(2018)097 final).

³ Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive (OJ L 87, 31.3.2017, p. 1).

⁴ Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (OJ L 173, 12.6.2014, p. 349).

⁵ 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).

sustainability ambitions are to be achieved or are achieved. As it is not a labelling regime, different sustainability-related ambitions might be described. Whilst financial products referred to in Article 9 of the SFDR must pursue the objective of sustainable investments, with no significant harm, as defined in Article 2, point (17), of the SFDR, financial products that fall under Article 8 of the SFDR might integrate different strategies, even including those that, despite claiming environmental, social and governance (ESG), socially responsible investing (SRI) or sustainability orientation, might lack sustainability-related materiality. Given this and given different product scopes of MiFID II, the SFDR and Regulation (EU) 2020/852 of the European Parliament and of the Council⁶⁷ (Taxonomy Regulation), this draft Regulation ensures that financial instruments that have some level of sustainability-related materiality are eligible for recommendation to the clients or potential clients who express clear sustainability preferences. Sustainability preferences therefore comprise financial instruments that are either invested, at least to some extent, in taxonomy-compliant activities under the Taxonomy Regulation, or in sustainable investments, as defined in Article 2, point (17), of the SFDR, that also encompass taxonomy-compliant activities, or that consider negative externalities of investments on the environment or society in terms of principal adverse impacts on sustainability. The rules on sustainability preferences support and strengthen the policy objective of reducing the occurrence of greenwashing and mis-selling and encourage the financial system's transition, so that it genuinely supports businesses on their transition path towards sustainability, as well as continuing to support businesses that are already sustainable.

The rules on sustainability preferences ensure consistency with the SFDR and the Taxonomy Regulation and considerably strengthen the effectiveness of sustainability-related disclosures under those Regulations. The Taxonomy Regulation requires disclosures of the degree to which investments are aligned with the EU Taxonomy.

In operational terms, to facilitate internal processes and in particular the development of recommendations to clients or potential clients, based on a preceding analysis of financial instruments, investment firms might rank in advance and group financial instruments in terms of the proportion invested in economic activities that qualify as environmentally sustainable, the proportion of sustainable investments, or the consideration of principal adverse impacts, such as categories of principal adverse impacts, types of commitments and qualitative or quantitative indicators. Since investments pursued by financial instruments might cause different principal adverse impacts on sustainability factors, investment firms should explain to the clients or potential clients that the elements demonstrating the consideration of principal adverse impacts on sustainability factors might be relevant for various environmental, social, employee or governance matters, should allow for demonstrating that consideration and for showing the respective commitment to address principal adverse impacts over time, and might be represented by qualitative or quantitative indicators, including but not limited to those in accordance with the SFDR.

Second, this Regulation integrates sustainability risks into the organisational requirements. This part on the sustainability risk is based on a Final Report on technical advice⁸ by the European Securities and Markets Authority (ESMA). The technical advice concludes that

⁶ 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).

⁷ Regulation of the European Parliament and of the Council (EU) 2020/852 of 18 June 2020 on the establishment of a framework to facilitate sustainable investment (OJ L 198, 22.6.2020, p. 13).

⁸ Final report on integrating sustainability risks and factors in the MIFID II (ESMA35-43-1737).

further clarifications are needed in respect of the integration of sustainability risks and sustainability factors in Delegated Regulation (EU) 2017/565 and Commission Delegated Directive 2017/593⁹ and identifies specific provisions in this respect.

This Regulation and other sectoral delegated acts that adapt rules on fiduciary duties and that were adopted alongside also reinforce **the SFDR, Regulation (EU) 2019/2089 of the European Parliament and of the Council¹⁰ and the Taxonomy Regulation**. Those rules integrate sustainability considerations into the investment, advisory and disclosure processes in a consistent manner across sectors. They anchor environmental, social and governance (sustainability) considerations at the heart of the financial system to help transform Europe's economy into a greener, low-carbon, more resilient, resource-efficient and circular system.

This Regulation is based on the empowerment set out in Articles 16, 24(13) and 25(8) of MiFID II.

2. CONSULTATIONS PRIOR TO THE ADOPTION OF THE ACT

In December 2016, the Commission set up a High-Level Expert Group on Sustainable Finance (HLEG) to help develop an EU strategy on Sustainable Finance through recommendations. The HLEG published an interim report on "Financing a Sustainable European Economy" in mid-July 2017 and presented its final report at a stakeholder event on 18 July 2017, followed by a consultation questionnaire.

A feedback statement that was published along with the HLEG final report on Financing a Sustainable European Economy on 31 January 2018 summarises the respondents' answers. In its final report, the HLEG recommends to "*require investment advisers to ask about, and then respond to, retail investors' preferences about the sustainable impact of their investments, as a routine component of financial advice*". It also recommended to "*discuss the governance of addressing long-term and sustainability risks*".

In March 2018, the Commission sent a targeted questionnaire on the integration of environmental, social and governance considerations in the suitability assessment. The consultation showed that only a minority of the clients proactively raise sustainability issues during the advisory process. Some of the reasons for this are: i) the available information on sustainability-related financial instruments is not transparent; ii) the risk of 'greenwashing' in existing documentation is high; and iii) there is a lack of education on its impact on risk and performance. Only in rare cases, clients seem to systematically raise interest in sustainability factors during the advisory process.

In addition, the draft Delegated Regulation amending the suitability assessment was published for feedback in line with the Better Regulation guidelines in the period between 24 May and 21 June 2018. The Commission received 51 answers referring to this Delegated Regulation amending Regulation (EU) 2017/565. Stakeholders from different backgrounds (e.g. NGOs, financial industry associations, public bodies)¹¹ commented on diverse aspects of this

⁹ Commission Delegated Directive (EU) 2017/593 of 7 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to safeguarding of financial instruments and funds belonging to clients, product governance obligations and the rules applicable to the provision or reception of fees, commissions or any monetary or non-monetary benefits (OJ L 87, 31.3.2017, p. 500).

¹⁰ Regulation (EU) 2019/2089 of the European Parliament and of the Council of 27 November 2019 amending Regulation (EU) 2016/1011 as regards EU Climate Transition Benchmarks, EU Paris-aligned Benchmarks and sustainability-related disclosures for benchmarks (OJ L 317, 9.12.2019, p. 17).

¹¹ The feedback received is published on: https://ec.europa.eu/info/law/better-regulation/initiatives/ares-2018-2681500/feedback_en

Delegated Regulation. While there was generally strong support to enhance the focus on non-financial objectives within the investment process, some stakeholders were reluctant to change their newly implemented processes based on MiFID II. As described above, the Commission is not only convinced of the urgency of moving ahead with its Sustainable Finance Agenda but is also of the view that the newly introduced reference to the SFDR proposed timeline for the application of this delegated act (12 months after entry into force) provides for sufficient flexibility.

As regards some of the objectives within the suitability assessment process, the Commission included some modifications in order to allow for the necessary differentiation between investment objectives, on the one hand, and sustainability preferences, on the other hand. This differentiation is important in order to avoid mis-selling. Sustainability factors should not take precedence over a client's personal investment objective. Therefore the sustainability preferences should only be addressed within the suitability process once the client's investment objective has been identified. The aim of the rules on sustainability preferences is to enhance potential clients' or clients' awareness of the availability of financial instruments' with sustainability ambition. Given the rules on sustainability preferences, financial instruments with different levels of sustainability-related ambition will not need to be adapted. Those financial instruments will either benefit from the regime of sustainability preferences or will continue to be recommendable, but not as financial instruments meeting the sustainability preferences of the client or potential client, as defined in this Regulation. In operational terms, the sustainability features of the financial instruments should be presented in a transparent way that allows investment firms to engage in dialogue with clients or potential clients in order to have sufficiently granular understanding of the clients' individual sustainability preferences. To avoid churning, for existing clients, for whom a suitability assessment has already been undertaken, investment firms should have the possibility to identify the client's individual sustainability preferences at the next regular update of the existing suitability assessment

The rules on sustainability preferences strengthen the use of the EU taxonomy for sustainable activities, i.e. economic activities that qualify as environmentally sustainable under Article 3 of the Taxonomy Regulation, and the pursuance of sustainable investments, as defined in Article 2(17) of the SFDR and also include investments in the aforementioned economic activities that qualify as environmentally sustainable. The rules also incentivise the recommendation of financial instruments that consider and reduce material negative externalities caused by those investments, i.e. principal adverse impacts.

The Commission requested ESMA to issue a technical advice on potential amendments to delegated acts to be adopted under MiFID II with regard to the integration of sustainability risks and sustainability factors in the areas of organisational requirements, operating conditions, risk management and target market assessment.

On 30 April 2019, ESMA published its "Final report on integrating sustainability risks and factors in MiFID II". The advice took into account the views expressed by stakeholders during the public consultation between 19 December 2018 and 19 February 2019. It includes a cost-benefit analysis. In addition, ESMA carried out an open public hearing on 4 February 2019 in order to gather additional feedback. The Securities and Markets Stakeholder Group of ESMA was also consulted.

In line with Better Regulation Principles, this draft proposal was published for a second consultation from 8 June 2020 to 6 July 2020. After due consideration of the feedback received further modifications were introduced into the text.

This report addresses the inclusion of sustainability risks and sustainability factors into the organisational requirements and product governance and oversight structures of investment firms. The recommendations on organisational requirements prepared and publicly consulted by ESMA were integrated into this Delegated Regulation.

3. LEGAL ELEMENTS OF THE DELEGATED ACT

The legal basis for this Regulation is set out in Article 16(12), Article 24(13) and Article 25(8) of Directive 2014/65/EU.

This Regulation covers the following amendments to Regulation (EU) 2017/565:

Article 1 aims at clarifying that investment firms providing financial advice and portfolio management should carry out a mandatory assessment of sustainability preferences of their clients or potential clients. These investment firms should take these sustainability preferences into account in the selection process of the financial instruments that are recommended to those clients. Three categories of financial instruments should be integral to sustainability preferences, namely financial instruments that pursue a minimum proportion of sustainable investments in economic activities that qualify as environmentally sustainable under Article 3 of the Taxonomy Regulation or financial instruments that pursue a minimum proportion of sustainable investments, as defined in Article 2, point (17), of the SFDR, where the minimum proportion is determined by the client or potential client. The third category of financial instruments eligible for individual sustainability preferences are financial instruments that consider principal adverse impacts on sustainability factors, where elements demonstrating that consideration are determined by the client or potential client.

Since the product scopes of, on one side, MiFID II and, on the other side, the SFDR and the Taxonomy Regulation, are different, sustainability preferences are not restricted to financial products within the meaning of the SFDR and the Taxonomy Regulation, but are instead based on the Regulations' sustainability-related concepts. This allows investment firms recommend not only investment funds, but also other relevant financial instruments.

By way of example, "financial instruments that pursue a minimum proportion of sustainable investments" will always include financial products referred to in Article 9 of the SFDR and financial products referred to in Article 8 of the SFDR, provided such financial products pursue, at least to some extent, sustainable investments. That minimum extent is determined by clients or potential clients, thus the rules on sustainability preference take into full account their sustainability-related ambitions. Other examples include financial instruments with environmental or social characteristics that are, among others, based on an exclusion strategy and that might fall under sustainability preferences provided they, at least to some extent, pursue sustainable investments or they prove the principal adverse impacts are considered and addressed or mitigated, in line with minimum investment proportions or elements demonstrating consideration of principal adverse impacts on sustainability factors respectively, as determined by the client or potential client. This also means that financial instruments that promote environmental or social characteristics without a proportion of sustainable investments or without a proportion of investments in taxonomy-compliant activities or where they do not consider principal adverse impacts will not be eligible for recommendation to the clients or potential clients based on their individual sustainability preferences. However, such financial instruments can still be recommended within the suitability test, but not as financial instruments meeting individual sustainability preferences.

Further, it requires investment firms to prepare a report to the client that explains how the recommendation to the client meets his investment objectives, risk profile, capacity for loss bearing and sustainability preferences (ex-post information disclosure).

In addition, Article 1 requires investment firms to take into account sustainability risks, either in qualitative or quantitative terms, when complying with the organisational requirements and to integrate sustainability risk into their risk management policies.

Finally, Article 2 sets out the date of application of this Regulation, including the transitional period of 12 months.

COMMISSION DELEGATED REGULATION (EU) .../...

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amending Delegated Regulation (EU) 2017/565 as regards the integration of sustainability factors, risks and preferences into certain organisational requirements and operating conditions for investment firms

(Text with EEA relevance)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU¹², and in particular Article 16(12), Article 24(13) and Article 25(8) thereof,

Whereas:

- (1) The transition to a low-carbon, more sustainable, resource-efficient and circular economy in line with the Sustainable Development Goals is key to ensuring the long-term competitiveness of the economy of the Union. In 2016, the Union concluded the Paris Agreement¹³. Article 2(1), point (c), of the Paris Agreement sets out the objective of strengthening the response to climate change by, among others, making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development.
- (2) Recognising that challenge, the Commission presented the European Green Deal¹⁴ in December 2019. The Green Deal represents a new growth strategy that aims to transform the Union into a fair and prosperous society with a modern, resource-efficient and competitive economy where there are no net greenhouse gas emissions from 2050 onwards and where economic growth is decoupled from resource use. That objective requires that clear signals are given to investors with regard to their investments to avoid stranded assets and to raise sustainable finance.
- (3) In March 2018, the Commission published its Action Plan ‘Financing Sustainable Growth’¹⁵, setting up an ambitious and comprehensive strategy on sustainable finance. One of the objectives set out in the Action Plan is to reorient capital flows towards sustainable investments to achieve sustainable and inclusive growth. The impact assessment underpinning subsequent legislative initiatives published in May 2018¹⁶ demonstrated the need to clarify that sustainability factors should be taken into

¹² OJ L 173, 12.6.2014, p. 349.

¹³ Council Decision (EU) 2016/1841 of 5 October 2016 on the conclusion, on behalf of the European Union, of the Paris Agreement adopted under the United Nations Framework Convention on Climate Change (OJ L 282, 19.10.2016, p. 1).

¹⁴ COM(2019) 640 final.

¹⁵ COM(2018) 97 final.

¹⁶ SWD(2018) 264 final.

account by investment firms as part of their duties towards clients and potential clients. Investment firms should therefore consider not only all relevant financial risks on an ongoing basis, but also all relevant sustainability risks as referred to in Regulation (EU) 2019/2088 of the European Parliament and of the Council¹⁷ that, where they occur, could cause an actual or potential material negative impact on the value of an investment. Commission Delegated Regulation (EU) 2017/565 does not explicitly refer to sustainability risks. For that reason and to ensure that internal procedures and organisational arrangements are properly implemented and adhered to, it is necessary to clarify that processes, systems and internal controls of investment firms should reflect sustainability risks, and that technical capacity and knowledge is necessary to analyse those risks.

- (4) To maintain a high standard of investor protection, investment firms should, when identifying the types of conflicts of interest the existence of which may damage the interests of a client or potential client, include those types of conflicts of interest that stem from the integration of the client's sustainability preferences. For existing clients, for whom a suitability assessment has already been undertaken, investment firms should have the possibility to identify the client's individual sustainability preferences at the next regular update of the existing suitability assessment.
- (5) Investment firms that provide investment advice and portfolio management should be able to recommend suitable financial instruments to their clients and potential clients and should therefore be able to ask questions to identify a client's individual sustainability preferences. In accordance with an investment firm's obligation to act in the best interest of its clients, recommendations to clients and potential clients should reflect both the financial objectives and any sustainability preferences expressed by those clients. It is therefore necessary to clarify that investment firms should have in place appropriate arrangements to ensure that the inclusion of sustainability factors in the advisory process and portfolio management does not lead to mis-selling practices or to the misrepresentation of financial instruments or strategies as fulfilling sustainability preferences where they do not. In order to avoid such practices or misrepresentations, investment firms providing investment advice should first assess a client's or potential client's other investment objectives, time horizon and individual circumstances, before asking for his or her potential sustainability preferences.
- (6) Financial instruments with various degrees of sustainability-related ambition have been developed so far. To enable clients or potential clients to understand those different degrees of sustainability and take informed investment decisions in terms of sustainability, investment firms that provide investment advice and portfolio management services should explain the distinction between, on the one hand, financial instruments that pursue, fully or in part, sustainable investments in economic activities that qualify as environmentally sustainable under Regulation (EU) 2020/852 of the European Parliament and of the Council¹⁸, sustainable investments as defined in Article 2, point (17), of Regulation (EU) 2019/2088, and financial instruments that consider principal adverse impacts on sustainability factors that might be eligible for recommendation as meeting individual sustainability preferences of clients, and, on

¹⁷ 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).

¹⁸ 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).

the other hand, other financial instruments without those specific features that should not be eligible for recommendation to the clients or potential clients that have individual sustainability preferences.

- (7) It is necessary to address concerns about ‘greenwashing’, that is, in particular, the practice of gaining an unfair competitive advantage by recommending a financial instrument as environmentally friendly or sustainable, when in fact that financial instrument does not meet basic environmental or other sustainability-related standards. In order to prevent mis-selling and greenwashing, investment firms should not recommend or decide to trade financial instruments as meeting individual sustainability preferences where those financial instruments do not meet those preferences. Investment firms should explain to their clients or potential clients the reasons for not doing so, and keep records of those reasons.
- (8) It is necessary to clarify that financial instruments that are not eligible for individual sustainability preferences can still be recommended by investment firms, but not as meeting individual sustainability preferences. In order to allow for further recommendations to clients or potential clients, where financial instruments do not meet a client’s sustainability preferences, the client should have the possibility to adapt information on his or her sustainability preferences. In order to prevent mis-selling and greenwashing, investment firms should keep records of the client’s decision along with the client’s explanation supporting the adaptation.
- (9) Delegated Regulation (EU) 2017/565 should therefore be amended accordingly.
- (10) Competent authorities and investment firms should be given sufficient time to adapt to the new requirements contained in this Regulation. Its application should therefore be deferred,

HAS ADOPTED THIS REGULATION:

Article 1

Amendments to Delegated Regulation (EU) 2017/565

Delegated Regulation (EU) 2017/565 is amended as follows:

- (1) in Article 2, the following points (7), (8) and (9) are added:
 - “(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).”;

- (2) in Article 21, paragraph 1 is amended as follows:
- (a) the second subparagraph is replaced by the following:
- “Investment firms shall take into account sustainability risks when complying with the requirements set out in this paragraph.”;
- (b) the following subparagraph is added:
- “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.”;
- (3) in Article 23(1), point (a) is replaced by the following:
- “(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;”;
- (4) Article 33 is replaced by the following:

“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.”;
- (5) in Article 52, paragraph 3 is replaced by the following:
- “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;
 - (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, including risks, costs and complexity of the financial instruments.”;
- (6) Article 54 is amended as follows:
- (a) in paragraph 2, point (a) is replaced by the following:
 - “(a) it meets the investment objectives of the client in question, including the client’s risk tolerance and any sustainability preferences;”;
 - (b) paragraph 5 is replaced by the following:
 - “5. The information about the investment objectives of the client or potential client shall include, where relevant, information 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 tolerance, the purpose of the investment and in addition his or her sustainability preferences.”;
 - (c) paragraph 9 is replaced by the following:
 - “9. Investment firms shall have in place, and be able to demonstrate that they have in place, adequate policies and procedures 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 assess, while taking into account cost and complexity, whether equivalent investment services or financial instruments can meet their client’s profile.”;
 - (d) paragraph 10 is replaced by the following:
 - “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 do 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.”;

(e) in paragraph 12, the first subparagraph is replaced by the following:

“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 the recommendation meets the client's investment objectives, his or her personal circumstances with reference to the investment term required, the client's knowledge and experience, the client's attitude to risk his or her capacity to sustain losses and his or her sustainability preferences.”;

(f) in paragraph 13 a new subparagraph is added:

“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.”.

Article 2

Entry into force and application

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

It shall apply from [**PO: Please insert a date - 12 months after publication in the Official Journal of the European Union**].

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels, 21.4.2021

For the Commission
The President
Ursula VON DER LEYEN