



*Just in Time*



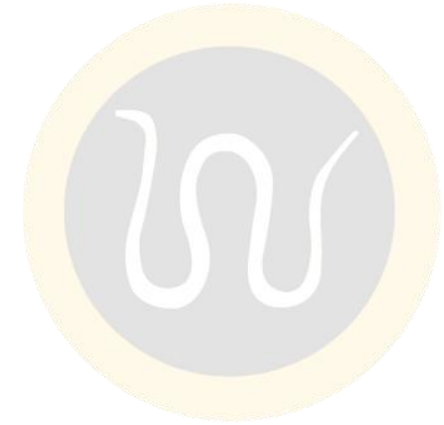
## ESMA Promotes Proportionate Supervision of MiFID II Sustainability Requirements

June 2026



# Executive Summary

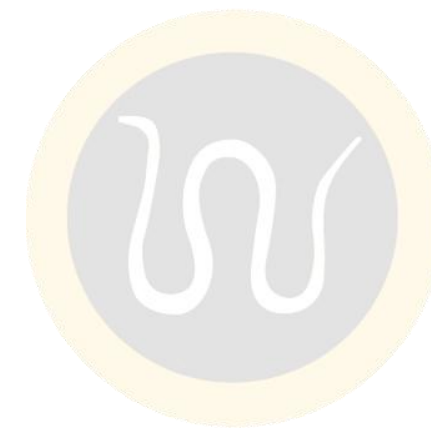
- The **European Securities and Markets Authority** (ESMA) published a public statement summarising the results of its **Common Supervisory Action** (CSA) on the **integration of sustainability considerations into MiFID II suitability assessments and product governance frameworks**.
- Conducted during 2024–2025 with participation from **29 EU** and EEA national competent authorities (**NCAs**), the exercise reviewed **245 firms**, including both credit institutions and investment firms.



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**Keywords:** MiFID II, Sustainable Finance, SFDR



# 01

## Introduction and Regulatory Context



# Introduction and Regulatory Context 1/2

The ESMA published its Public Statement to present the **findings** of the **CSA** carried out jointly with National Competent Authorities (NCAs) regarding the **integration of sustainability considerations within MiFID II suitability assessments and product governance arrangements**. The exercise was launched in October 2023 and conducted throughout 2024 and 2025.

The **CSA** forms part of ESMA's broader supervisory convergence agenda aimed at promoting **a common supervisory culture** and ensuring **consistent application of EU financial regulation across Member States**.

The **exercise** specifically assessed **how** investment firms and credit institutions **implemented the sustainability-related amendments** introduced into the **MiFID II Delegated Acts in 2022**, together with the corresponding **ESMA Guidelines** on suitability and product governance.

The supervisory review focused on **four core dimensions**

Collection of clients' sustainability preferences

Product categorisation and ESG-related product understanding



Integration of sustainability preferences within suitability assessments

Product governance and target market identification relating to sustainability objectives

# Introduction and Regulatory Context 2/2

ESMA reiterates throughout the Statement that sustainable finance remains a **strategic supervisory priority**.

However, the Authority also acknowledges the **complexity** and **fragmentation** of the current sustainable finance **regulatory framework**, particularly the interaction among:

- MiFID II sustainability preferences,
- SFDR classifications,
- Taxonomy alignment concepts, and
- Principal Adverse Impact (PAI) indicators.

ESMA recognises that these complexities generate **operational challenges** for both firms and retail investors.

The Statement is therefore positioned not only as a **supervisory assessment** but also as an **interim supervisory communication** pending broader legislative reforms, especially the ongoing reviews of:

- the Sustainable Finance Disclosure Regulation (SFDR); and
- the Retail Investment Strategy (RIS).

In this context, **ESMA explicitly advocates for a proportionate supervisory approach** during the transitional period.

**NCA**s are encouraged to prioritise **supervisory dialogue** and **remediation over enforcement actions**, except in situations involving clear misconduct, breaches, or mis-selling practices.

# 02

## Execution of the Common Supervisory Action



# Execution of the Common Supervisory Action

The CSA involved **extensive cooperation across the European supervisory network.**

A total of **29 EU and EEA NCAs** participated in the exercise.

The **supervisory sample** included 245 firms composed of:

- **153 credit institutions;** and
- **89 investment firms.**

NCAs retained **discretion** regarding sample selection methodologies, allowing each authority to tailor the supervisory review to the characteristics of its domestic market. Nonetheless, ESMA expected the selected sample to be **sufficiently representative** to provide meaningful insights into industry implementation practices.

The **supervisory methodologies** adopted **varied significantly among jurisdictions.**

Authorities relied on:

- desk-based reviews;
- on-site inspections;
- virtual supervisory interactions;
- video and audio conferencing tools.



Some NCAs relied predominantly on **documentary assessments**, while others combined **remote supervision with physical inspections**. This **flexible approach** reflects the **diversity of supervisory practices** across Europe but also demonstrates the **growing reliance on hybrid supervisory methodologies.**

The CSA ultimately confirmed that firms have made **tangible progress in integrating sustainability requirements into their MiFID II frameworks.**

Nevertheless, **ESMA identified substantial divergences** in:

- *implementation quality,*
- *operational maturity, and*
- *interpretative approaches*

*across both firms and jurisdictions.*

# 03

## Sustainability Requirements within the MiFID Suitability Framework

Client Information and Investor Understanding



# Sustainability Requirements within the MiFID Suitability Framework

## Client Information and Investor Understanding

One of the first areas assessed concerned the **manner** in which **firms explain sustainability concepts** and **sustainability preference frameworks** to clients.

ESMA notes that most **firms have introduced educational measures designed to help clients understand sustainability terminology and regulatory concepts.**

However, implementation quality varied considerably.

A recurring challenge identified by firms concerns the **complexity** of the **regulatory definition** of "**sustainability preferences**," which incorporates several highly technical concepts, including:

- Taxonomy alignment;
- Sustainable investments under SFDR;
- Principal Adverse Impacts (PAIs).

Many firms struggled to **translate** these legal and regulatory notions into **language understandable to retail investors.** **Different approaches** emerged:

- some firms **avoided technical terminology entirely;**
- others **supplemented** legal definitions with **simplified explanations** and **educational material.**

**Educational support tools** commonly included:

- brochures;
- explanatory leaflets;
- interactive digital questionnaires;
- clickable information icons;
- hyperlinks;
- pop-up explanatory windows.

ESMA notes that **questionnaires** became the **primary educational tool** used during client onboarding and suitability processes.

The Statement implicitly highlights a **broader structural issue** within the EU sustainable finance framework: the **difficulty of operationalising highly technical sustainability classifications in retail investment contexts without creating excessive complexity or investor confusion.**

# 04

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## Arrangements for Understanding Clients' Sustainability Preferences



# Arrangements for Understanding Clients' Sustainability Preferences

The **CSA** found that firms generally **incorporated sustainability considerations** into their suitability frameworks through **updates** to:

- internal policies;
- procedures;
- operational systems;
- advisory processes;
- portfolio management tools.

Compared with the initial implementation phase following the 2022 amendments, firms increasingly **adopted** more **granular** and **sophisticated sustainability questionnaires**. Nonetheless, **significant inconsistencies** remain across the market.

## Product Availability Constraints

A **key issue** identified concerns the **interaction between client preference collection and product availability**.

Some firms only **collect sustainability preferences relating to product categories already available within their product universe**.

This practice effectively **limits the scope of client preference expression** and **reflects broader market limitations** regarding sustainable product supply.

ESMA observed that where firms **use standardised percentage thresholds for sustainability preferences**:

- Taxonomy-aligned product ranges often remain below 10%;
- SFDR sustainable investment thresholds generally begin between 5% and 10%;
- some firms allow higher ranges of 50–75% or more.

Firms justified these low ranges by referencing the limited availability of products capable of meeting stricter sustainability criteria.

## Principal Adverse Impacts (PAIs)

Regarding PAI preferences, most firms adopted **qualitative approaches**.

**Common practices** included grouping impacts under broad ESG categories such as:

- environmental impacts;
- social impacts;
- governance factors.

Only a **minority of firms collected detailed client preferences regarding specific PAI indicators**.

This finding reflects **broader industry challenges** associated with:

- **ESG data quality;**
- **operational usability of sustainability metrics.**
- **disclosure consistency;**

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# 05

## Deficiencies and Supervisory Expectations

Deficiencies in Client Treatment and Neutrality

ESMA Supervisory Expectations on Preference  
Collection



# Deficiencies and Supervisory Expectations 1/2

## Deficiencies in Client Treatment and Neutrality

ESMA identified several **supervisory concerns** regarding the **treatment of clients** who either:

- **express no sustainability preferences**; or
- indicate only a **general interest in sustainability**.

According to ESMA Guidelines, clients without explicit sustainability preferences should generally be **treated as “sustainability neutral”**. However, some firms instead **restricted such clients exclusively to non-sustainable products**.

Similarly, some firms interpreted broad sustainability interest without detailed specification **as equivalent to having no sustainability preferences at all**.

These **practices** were considered **problematic** because they risk **undermining investor choice** and **creating inconsistent suitability outcomes**.

### Neutrality of the Client Engagement Process

Another important issue concerned the **neutrality** of the **advisory process**.

Some firms lacked formal procedures ensuring that sustainability preference collection remained unbiased and neutral. In certain cases, firms included disclaimers or explanatory wording within questionnaires that could potentially influence client responses.

This **issue** is **particularly relevant** given the **sensitivity of sustainability topics** and the **risk** of steering investors toward or away from ESG products.

### Multiple Sustainability Preferences

The CSA also identified divergent practices regarding situations where clients select multiple sustainability preference categories simultaneously.

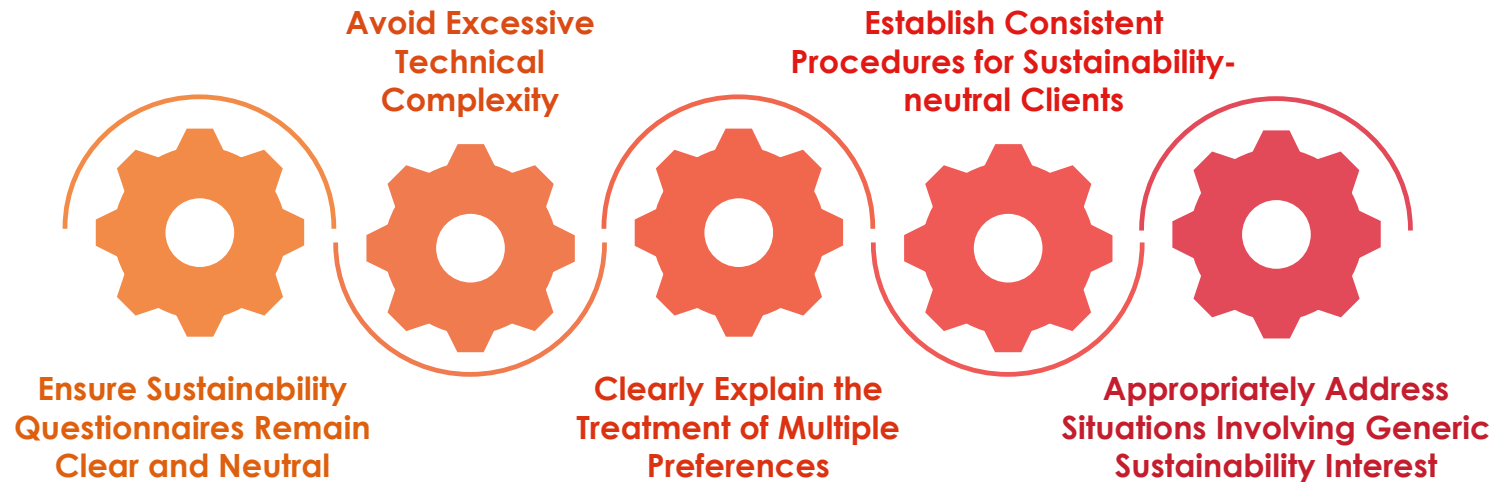
Some firms **treated** preferences **cumulatively**; while others treated them **alternatively**. Most firms failed to clearly explain to clients which interpretative methodology would apply.

ESMA emphasises that where preferences are treated alternatively rather than cumulatively, **clients should receive transparent disclosure** to ensure communications remain fair, clear, and not misleading.

# Deficiencies and Supervisory Expectations 2/2

## ESMA Supervisory Expectations on Preference Collection

In response to the identified shortcomings, **ESMA sets out several interim supervisory expectations.**  
Firms are encouraged to:



ESMA also stresses proportionality in relation to **updating sustainability preferences.**

Firms are **discouraged** from repeatedly **recollecting information** where **sufficiently recent** and **relevant preference data already exists, unless material changes** in client circumstances justify reassessment.



This position reflects ESMA's broader objective of **reducing operational burden** and **avoiding unnecessary duplication** within the client journey.

# 06

## Product Governance, Suitability and Sustainability Preferences

Arrangements Necessary to Understand Investment  
Products

Arrangements Necessary to Ensure Suitability  
Adaptation of Sustainability Preferences



# Product Governance, Suitability and Sustainability Preferences 1/3

## Arrangements Necessary to Understand Investment Products

The **CSA** assessed **how** firms **categorise** and **understand ESG characteristics** of financial instruments. Most firms implemented **policies** and **methodologies for ESG mapping** and **product categorisation**. However, **implementation maturity varied substantially**.

Many firms rely on grouping or ranking methodologies based on the **three sustainability preference categories** embedded within **MiFID II**.

Nevertheless, some firms only consider **selected sustainability dimensions**, for example relying solely on:

- **SFDR classifications**; or
- **PAI indicators**.

These **limitations** often stem from:

- **insufficient ESG data availability**;
- **inconsistent manufacturer disclosures**;
- **technical uncertainties regarding product classification**.

**ESMA** recognises these operational constraints and therefore **adopts a pragmatic supervisory stance**.

Pending broader reforms to SFDR and the Retail Investment Strategy, **firms may apply proportionate categorisation methodologies** provided such approaches are:

- consistent;
- Well-documented;
- sufficiently robust to support MiFID-compliant suitability assessments.

Importantly, **ESMA** explicitly states that **firms should not be expected to apply excessive granularity where data limitations make such precision unreliable**.

### Non-SFDR Products

The Statement also addresses **products with sustainability characteristics falling outside SFDR classifications**.

NCA's identified wide **divergences in market practice** concerning such products, including differences in:

- **methodologies**;
- **ESG data sources**;
- **assessment criteria**.

**ESMA** concludes that **current legislation provides limited basis for convergence in this area** and implicitly signals the need for **future legislative clarification**.

# Product Governance, Suitability and Sustainability Preferences 2/3

## Arrangements Necessary to Ensure Suitability

The CSA further evaluated **how firms integrate sustainability preferences into actual suitability assessments. Several weaknesses emerged.**

### Matching Difficulties

Firms frequently **struggled to match client preferences** with available products due to:

- **limited product availability;**
- **insufficient product granularity;**
- **simplified questionnaires;**
- **low sustainability threshold ranges.**

These operational limitations **reduced firms' ability to deliver fully tailored sustainability recommendations.**

### Portfolio Approach

Many firms **implemented sustainability preferences through a portfolio-level methodology** rather than product-by-product matching. Typically, firms apply sustainability preferences:

- across the overall portfolio average; or
- to a designated portion of the portfolio intended for sustainable investments.

The **overall portfolio approach** was found to be the **dominant practice** because relatively few firms collect detailed information regarding what exact portfolio share clients expect to allocate to sustainable investments.

ESMA accepts that different portfolio implementation approaches may legitimately coexist depending on firms':

- business models;
- operational capabilities;
- product offerings.

However, **firms must clearly define and document their chosen methodologies to ensure consistent application.**

# Product Governance, Suitability and Sustainability Preferences 3/3

## Adaptation of Sustainability Preferences

A particularly important section of the Statement concerns situations where **firms cannot identify products matching a client's initial sustainability preferences.**

Most firms implemented **automated controls** identifying such situations and allowing clients to adapt their preferences. However, **practices differed** considerably regarding:

- **timing of adaptation discussions;**
- **communication methods;**
- **operational implementation.**

In line with ESMA Guidelines, firms generally inform clients about adaptation possibilities only after determining that no suitable products exist.

Nevertheless, **problematic practices** were identified, including situations where:

- **firms recommended unsuitable products** before formal adaptation occurred;
- **clients were merely informed** that products deviated from their sustainability profile;
- **adaptation procedures affected the client's entire profile** without sufficient disclosure.

*ESMA reiterates that any recommendation must **remain MiFID II** compliant and that **clients must always have the opportunity to adapt their preferences** before a recommendation is made.*

*At the same time, ESMA adopts a practical supervisory tone by recognising that **firms may present "closest matching" products** where exact alignment is impossible due to market limitations.*

***Transparent disclosure** regarding the degree of alignment between products and **original preferences** is considered **essential** for maintaining **investor protection.***

# 07

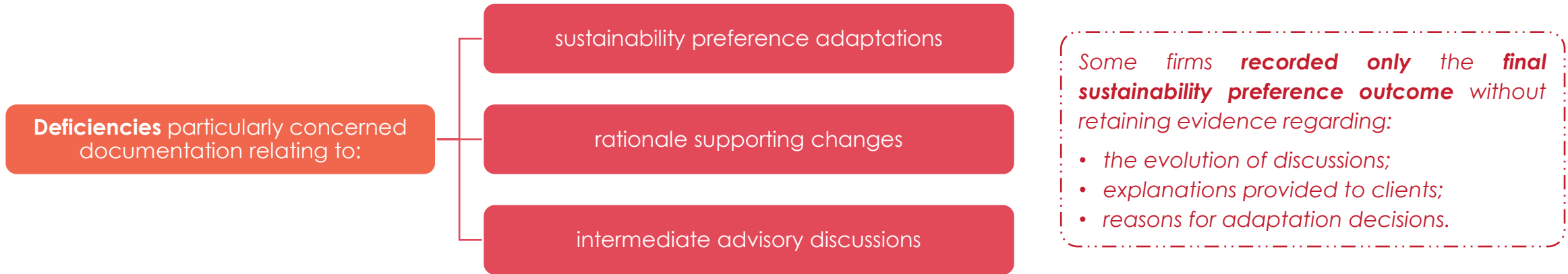
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## Record Keeping Requirements



# Record Keeping Requirements

The CSA also identified **shortcomings** in **firms' record-keeping frameworks**.



ESMA stresses that **complete** and **traceable documentation** is essential for:



Firms are therefore encouraged to **strengthen governance** and **documentation standards** surrounding sustainability-related suitability assessments.

# 08

## Sustainability Requirements within the MiFID Product Governance Framework



# Sustainability Requirements within the MiFID Product Governance Framework

## Sustainability-Related Target Market Assessment

The CSA assessed how firms integrate sustainability objectives within MiFID product governance frameworks and target market assessments. Most firms incorporated **sustainability-related objectives** into their **target market methodologies** using the **MiFID II sustainability preference categories** as reference points. However, ESMA found **considerable divergence** regarding the level of granularity applied.

Some firms:

- defined sustainability objectives too broadly;
- lacked sufficient precision for effective client-product matching;
- had not yet fully operationalised sustainability target market procedures.

ESMA therefore **encourages** firms to continue **refining target market methodologies** to facilitate more **accurate alignment** between **products** and **investor sustainability preferences**.

## Negative Target Market

Another important finding concerns the “**negative target market**” **assessment**.

Only a **limited number of firms** considered sustainability-related objectives when defining negative target markets for products lacking sustainability characteristics.

ESMA reminds firms that **sustainability considerations should also inform negative target market assessments** where relevant to ensure coherent distribution strategies.

# 09

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## Conclusions and Take-aways

Take-aways



# Conclusions and Take-aways 1/2

The Statement concludes by reaffirming **ESMA's strategic commitment** to sustainable finance while recognising the **ongoing transformation of the EU sustainable finance framework**. ESMA explicitly acknowledges that **forthcoming** reforms are likely to be substantially shaped by:



The Authority therefore adopts an interim supervisory stance focused on:



The CSA demonstrates that while firms have made meaningful implementation progress, **significant inconsistencies** remain regarding:

- **client questionnaires;**
- **product categorisation;**
- **preference matching;**
- **portfolio methodologies;**
- **record keeping;**
- **product governance.**

ESMA's supervisory messaging throughout the Statement reflects a careful **balancing exercise** between maintaining **investor protection** and **acknowledging practical market constraints** arising from:

- limited sustainable product availability;
- incomplete ESG data;
- evolving regulatory standards;
- implementation complexity.

The Statement also indicates that ESMA may use CSA findings to inform future revisions of:

- MiFID II Delegated Acts;
- ESMA Guidelines on suitability;
- ESMA product governance guidance.

# Conclusions and Take-aways 2/2

## Take-aways

- 1** Firms have generally progressed in integrating MiFID II sustainability requirements, but implementation remains uneven across jurisdictions and market participants.
- 2** The complexity of sustainability regulation remains a major operational challenge, particularly regarding investor understanding and product classification.
- 3** Client questionnaires and sustainability preference collection methodologies require further refinement, especially regarding neutrality, granularity, and treatment of multiple preferences.
- 4** Product categorisation practices remain inconsistent, largely due to ESG data limitations and regulatory ambiguities.
- 5** Portfolio-based approaches dominate sustainability suitability implementation, but firms must ensure methodologies are clearly documented and consistently applied.
- 6** Adaptation of sustainability preferences remains a sensitive area, requiring enhanced transparency and strict adherence to MiFID II suitability principles.
- 7** Record-keeping deficiencies continue to pose supervisory concerns, especially regarding traceability of preference adaptation processes.
- 8** Product governance frameworks require additional development, particularly concerning sustainability-related target markets and negative target market identification.
- 9** ESMA advocates a proportionate supervisory approach during the current regulatory transition period, prioritising dialogue and remediation over enforcement except in cases involving serious breaches or mis-selling.

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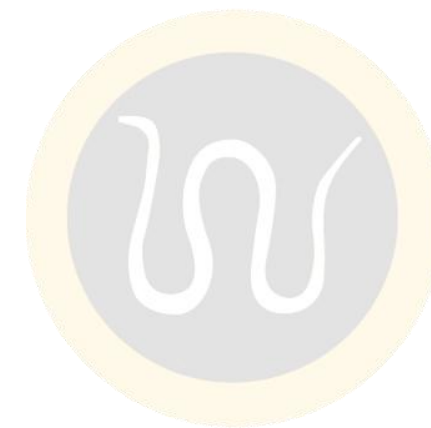


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