Société Générale’s response to ESMA consultation on integrating sustainability risks and factors in MiFID II.

Introduction

Société Générale\(^1\) is pleased to have the opportunity to respond to “ESMA consultation on integrating sustainability risks and factors in MiFID II”.

Société Générale is fully and unambiguously committed into the transition to a more sustainable economy. We are undertaking a great diversity of initiatives with a positive impact on the environment and society\(^2\).

This is from this perspective that Société Générale is supportive of EU policymakers’ objectives to increase and reorient capital towards sustainable activities and behaviors/practices. We also share the Commission’s and ESMA’s assessment that one of the conditions to meet this objective is an appropriate integration of sustainability factors into the investment decision making, the risk management, product governance and advisory processes.

As a preliminary remark, we believe that the criteria on the integration of sustainability factors into risks management, market participants’ product governance and advisory processes should be consistent with existing market standards (as well as the forthcoming taxonomy) and the level of sophistication and availability of underlying issuers’ sustainability data.

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\(^1\) Société Générale is one of the leading European financial services groups. Based on a diversified and integrated banking model, the Group combines financial strength and proven expertise in innovation with a strategy of sustainable growth, aiming to be the trusted partner for its clients, committed to the positive transformations of society and the economy. Active in the real economy for over 150 years, with a solid position in Europe and connected to the rest of the world, Société Générale has over 147,000 members of staff in 67 countries and supports on a daily basis 31 million individual clients, businesses and institutional investors around the world by offering a wide range of advisory services and tailored financial solutions.

Indeed, a twofold prerequisite to achieve sustainability objectives is i) **appropriate definitions** and ii) **available and exploitable underlying issuers data**.

- **A need for appropriate definitions of sustainability that are mindful of the diversity and complementarity of the various existing sustainability approaches**

Manufacturers of financial products marketed as Environmental, Social and Governance (ESG) sustainable currently rely on a variety of market standards and labels to meet clients’ sustainability preferences. ESG standards will need to be perfected and standardized at the EU level but **what exists today is a good starting point and we already see good progresses**.

Also, we harbor **much hopes in the creation of an EU taxonomy on sustainable activities** which we would expect to result in an effective and user-friendly tool enabling market participants to make a fair sustainability assessment of investee companies’ activities. However, we caution that **this taxonomy should not be seen or expected to be the unique and exclusive reference in the design and assessment of ESG financial products**. The taxonomy only aims to cover activities and the first available version of it will only focus on activities with a positive impact on climate mitigation and adaptation.

**One key sustainability dimension that the taxonomy is not expected to cover, and which should be an important consideration for ESG assessment is the companies’ behaviors/practices.** These are not activity-related but are an important differentiator of ESG-friendly policies (e.g. firms’ ESG policies on natural resources consumption, waste recycling, decarbonization, gender equality etc.) and thereby an instrumental driver for a more sustainable economy.

Therefore, even after the taxonomy is available, **maintaining complementarity with the variety of evolving ESG market standards will remain key** to meet clients’ sustainability preferences.

- **A need for more widely available and exploitable ESG data**

The integration of sustainability criteria, via a clear distinction between ESG dimensions, into the product governance regime requires as a necessary pre-condition **sufficiently available and exploitable ESG data from underlying issuers**. There are already multiple reliable ESG data providers and we see good progresses in corporate ESG reportings, however we stress that, despite progressive enhancements, there is today **still insufficient available or exploitable ESG data** on a wide array of issuers’ activities and/or behaviors.

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Société Générale’s detailed response to ESMA consultation on integrating sustainability risks and factors in MiFID II.

Q1: Do you agree with the suggested approach and the changes to the Article 21 of the MiFID II Delegated Regulation on ‘general organisational requirements’? Please state the reasons for your answer.

Société Générale is supportive of an integration of ESG considerations in organizational requirements when this is relevant. However, from a pure compliance perspective, we suggest inserting this change, which is understandably voluntarily unspecific, in a recital to reflect the flexibility that is needed for firms on the way they meet this high-level standard.

Q2: Do you agree with the suggested approach and the changes to the Article 23 of the MiFID II Delegated Regulation on ‘risk management’? Please state the reasons for your answer.

We welcome ESMA’s statement that “singling out sustainability risks (...) is unnecessary to achieve the Commission’s objectives and would be disproportionate”. To go further, we even consider that looking at sustainability risk as a standalone risk is not appropriate. From a pure risk management perspective, sustainability does not create an additional separate risk. It is instead only a risk factor that increases/worsens or decreases/alleviates existing risks (already under management) such as credit, market, operational or reputational risks. In this respect, we highlight that sustainability is already the first risk factor quoted in Société Générale registration document.

Importantly, when assessing to which extent sustainability factors impact an underlying borrower/issuer’s credit, market, operational or reputational risks, the risk management functions should still be able to consider the extent to which the borrower/issuer has planned its transition to a more sustainable model over the medium to long term, instead of only considering the picture in T0. There are therefore situations where borrowers/issuers greatly exposed today to certain sustainability vulnerabilities, such as climate change, should not necessarily see their risk evaluation mechanistically and symmetrically deteriorated if they are showing a strong and credible sustainability strategic medium to long term plan.

Q3: Do you agree with the suggested approach and the new recital on ‘conflicts of interest’? Please state the reasons for your answer. What would be specific examples of conflicts of interests that might arise in relation to sustainability considerations?

We would recommend adding further clarifications on what is expected from firms to avoid conflicts of interest when distributing ESG products. We believe that MiFID II provisions on conflict of interests already have a broader scope than the question of distribution of financial instruments and are currently adequate to capture the risk identified. As a result, we believe that any conflict of interest avoidance may already be appropriately achieved via current practices and with a robust suitability process. The risk of greenwashing can also be mitigated via clear marketing documentations describing
The incorporation of ESG characteristics in the investment strategy; ii) the type of data used to support that incorporation and iii) the use of proceeds, where relevant.

Q4: Do you think that on the topic of ‘organisational requirements’ other amendments should be made to the MiFID II Delegated Regulation in order to incorporate sustainability risks and factors? If yes, which ones? Please state the reasons for your answer.

Société Générale does not think that, at this stage, additional measures on ESG integration within the MiFID II Delegated Regulation should be envisaged. We do also understand that PRIIPs Regulation will be revisited shortly to integrate ESG considerations in the KIDs.

Q5: Which existing market standards or “labels” are you intending to take into account or already taking into account for the consideration of ESG factors? Do you see any issues when relying on current market standards or “labels”? Please describe.

Société Générale relies on a number of market standards for the manufacturing of ESG structured products. We mainly refer to the AMF position 2010/05 (reviewed in October 2018) and AMAFI/AFG guide on ESG indices but we do also use the UNEP FI tools and methodologies to assess the sustainability and Positive Impact of issuers’ activities and projects. For green bonds, we mainly rely on the Green Bond Standard (which closely follows the current ICMA Green Bond Principles).

Labels currently exist mostly for investment funds and successful initiatives are still at the national levels and mainly include:

- **SRI** label (Socially Responsible Investment) and **TEEC** label (Transition Ecologique et Climat) launched in 2016 by the French Government
- **FNG** (Forum Nachhaltige Gelandlagen) label launched in Germany and adopted in Austria and Switzerland from 2008 in partnership with **EUROSIF** (European Sustainable Investment Forum)
- **LuxFLAG labels** launched in 2016 in Luxembourg including: LuxFLAG Environment Label and LuxFLAG Climate Finance Label and LuxFLAG ESG Label
- **Nordic Swan Ecolabel** launched in 2017 in the Scandinavian countries
- **Febelfin** launched in Belgium can also be used for structured products but it has an exclusion requirement that in our view significantly limits its scope of application.

In fact, whether relying on market standards or labels, data availability remains a challenge. The non-financial reporting directive guidelines contribute to the availability of non-financial quantitative data from voluntary companies with more than 500 employees. Also, industry initiatives such as **SAS-B** help businesses around the world identify, manage and report on the sustainability topics that matter most to investors. However, although we have seen good progress from a number of companies, in practice where data is available, it is not always clear and/or comprehensive and/or comparable and/or granular enough for market participants to make a fair sustainability assessment of the companies’ activities and behaviors. We understand that this specific issue is currently in the EU policymakers’ radar, mainly from a climate change perspective. However, it is to be noted that the lack of available or exploitable ESG data is an even bigger concern in third countries.
For ESG structured products, we do rely on multiple external data providers such as Vigeo-Eiris, Trucost, Sustainalytics, ISS oekom, Beyond Ratings, and RobecoSAM and also on our cross-asset research. External data providers and research analysts assess the sustainability degree of a company’s activities and behaviors based on two types of information that are more or less available:

1. The first type of information refers to quantitative data provided by companies via multiple canals such as public documentation including tax declaration, social and economic assessment, income statements or responses to questionnaires sent directly to companies.

2. The second type of information concerns more qualitative aspects such as policies, commitments, good practices etc. that companies do not necessarily report or if they do, not on an exploitable basis. Data providers and research analysts reach out to companies directly via meetings/calls organized with the different companies ‘stakeholders to investigate and discuss non-sensitive information that the companies have not necessarily thought about disclosing or for whose disclosure that they have not yet drawn the appropriate format (one reason to this may be that they are not necessarily aware of the usefulness of such information for investors).

Data provided by the data providers and research analysts listed above are today the “state of the art” and we are optimistic on the progressive increase of companies’ sustainability data disclosures in the future, notably in the climate change impact dimension. However, on the quantitative aspects relative to GHG emissions, there is still a variety of different methodologies to measure a company’s carbon footprint as each methodology is highly sector specific and may also be specific to the data provider. There is even greater variety in methodologies used to estimate company’s future GHG emissions. This undermines comparability of available carbon-related data.

Meanwhile, the integration of sustainability criteria, via a clear distinction between ESG dimensions, into the product governance regime would not be compatible with the current degree of ESG data availability, clarity, comparability and standardization.

Q6: Do you agree with the suggested approach and the proposed amendments to the MiFID II Delegated Directive Articles on ‘product governance’? If not, please explain.

We agree that the target market is the best tool to indicate the ESG nature of a financial product and that the ESG preferences should continue being embedded in the “client’s objectives and needs” category rather than being referenced into a sixth criterion. We also find totally logic not to have a negative target market related to ESG preferences. This clarification should be added into the MiFID II Guidelines.

However, for the reasons detailed below, we believe the guidelines should ensure that sufficient flexibility is left in practice for investment firms to determine the ESG or non-ESG indications for each product they manufacture and/or distribute in the target market. In the case of structured products, this is completed with manufacturers producing marketing documentations describing: i) the
incorporation of ESG characteristics in the investment strategy; ii) the type of data used to support that incorporation and iii) the use of proceeds, where relevant.

From that angle, we recommend that the following considerations are taken into account in ESMA’s final technical advice to the Commission:

**From a pure practical perspective:**

1. The ability to integrate a high granularity of ESG preferences is dependent on the granularity of available ESG data. Making a clear distinction between E, S and G is a very complex exercise from a pure data availability perspective. Also, in terms of IT complexity, it implies to capture 3 additional indicators in the target market instead of a single ESG indicator for each product. This also adds complexity to perform the matching between clients’ preferences and target markets for the suitability test.

2. Within the E, until the taxonomy is ready with detailed sustainability criteria for activities (only) and in the absence of a more robust, common, and large set of sustainability data, it is not feasible at this stage to distinguish the 6 environmental objectives\(^3\) set out in the EC proposal as proposed in this consultation paper.

**From an investors’ interest perspective:**

3. Making a clear distinction between ESG dimensions is not appropriate for all types of investment vehicles. For structured products as well as ETFs, we usually apply either ESG behavioral filters and/or ESG activities filters and have ESG thematic and/or ESG exclusion and/or ESG selection approaches either separately or all together. We do not only manufacture products that specifically target E or S or G only. Based on our experience, our investor clients have very diverse ESG investment requests that they combine with a number of other preferences that are not ESG-related such as portfolio liquidity, long term performance or diversification. They do not usually limit their ESG request to one very specific dimension. We would also highlight that the use of overly granular filters could result in a highly limited and poorly diversified investable universe, which could undermine non-ESG suitability criteria.

4. It is not, in our view, necessarily sensible to require investment firms to assess whether all the non-ESG products (existing and new) that they manufacture and/or distribute possess identified ESG characteristics as in any case firms will endeavor to offer ESG products to clients with ESG preferences. Given the required level of sophistication of sustainability filters and data to create an ESG product, it is even quite likely that after making a sustainability assessment based on the available set of data, only products that are manufactured with an ESG purpose

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\(^3\) 1) climate change mitigation; 2) climate change adaptation; 3) sustainable use and protection of water and marine resources; 4) transition to a circular economy, waste prevention and recycling; 5) pollution prevention and control; (6) protection of healthy ecosystems)
would be identified / identifiable as providing a substantial contribution to ESG objectives (whether the other non-ESG products contribute positively or not in practice to ESG objectives). Accordingly, mandating such an assessment for non-ESG products would simply be an additional and unnecessary cost-burden which would act as a drag on investors’ returns.

5. The taxonomy on sustainable activities will be relevant for ESG products with an activities-focused approach (e.g. sectors, activities, specific geography) but not for ESG products with an ESG behavioral approach. ESG indices and products should therefore continue to be able to rely on market standards mapping behaviors and not only on the future taxonomy on sustainable activities.

Q7: Do you agree with the proposed changes to the ESMA Guidelines on MiFID II product governance requirements and the addition of an additional case study? If not, please explain what changes should be made and why.

Société Générale agrees with ESMA’s assessment on the irrelevance of a negative target market related to ESG preferences and we would recommend that this clarification is added into the MiFID II Guidelines.

However, we believe that the case study is too granular for both manufacturers and distributors. On the short term, it is not possible to have such granularity within the “ESG preferences” criterion as explained above.

Q8: Do you think extra guidance is needed on the elements listed in paragraph 15 above? If yes, please provide details.

1. How the target market assessment and the matching of a client vis-à-vis the target market should be done if a product does not have ESG characteristics while the client has certain ESG preferences.

The clients with ESG preferences may also have other preferences that are not necessarily ESG-related. In the case where a product does not have ESG characteristics while the clients have certain ESG preferences, the clients may still wish to trade that product if the product matches their characteristics and other preferences. Therefore, we suggest a 2-step approach offering a clear framework to such a situation to protect investors.

- **Step 1:** The firm should send a clear statement (e.g. in the suitability report) to the clients that the product meets all the clients’ characteristics (type, knowledge and experience, risk tolerance, financial situations and non-ESG related objectives and needs) except ESG preferences.
- **Step 2:** The clients respond to the firm via recorded phone call, e-mails or other media whether they wish to trade the product even if the product in question does not meet their ESG preferences.

2. How ESG considerations can be either specified separately from each other or as a single indicator.
3. How the target market assessment and the matching of a client vis-à-vis the target market should be done if ESG considerations of a product are specified separately from each other and a client has differing preferences in all or some of these criteria (e.g. a product shows strong environmental criteria and little governance criteria while the client has little environmental preferences and strong governance preferences).

ESG considerations should better be specified as a single indicator.

**From a pure practical perspective:**

- The granularity of ESG preferences’ description is dependent on the granularity of available ESG data. Making a clear distinction between E, S and G is a very complex exercise from a pure data availability perspective. Also, in terms of IT complexity, it implies to capture 3 additional indicators in the target market instead of a single ESG indicator for each product. This also adds complexity to perform the matching between clients’ preferences and target markets for the suitability test.

- Within the E, until the taxonomy is ready with detailed sustainability criteria for activities (only) and in the absence of a more robust, common, and large set of sustainability data, it is not feasible at this stage to distinguish the 6 environmental objectives set out in the EC proposal as proposed in this consultation paper.

**From an investors’ interest perspective:**

Making a clear distinction between ESG dimensions is not appropriate for all types of investment vehicles. For structured products and ETFs, we usually apply either ESG behavioral filters and/or ESG activities filters and have ESG thematic and/or ESG exclusion and/or ESG selection approaches either separately or all together. We do not manufacture products that specifically target E or S or G only. Based on our experience, our investor clients have very diverse ESG investment requests that they combine with a number of other preferences that are not ESG-related such as portfolio liquidity, long term performance or diversification. They do not usually limit their ESG request to one very specific dimension. We would also highlight that the use of overly granular filters could result in a highly limited and poorly diversified investable universe, which could undermine non-ESG suitability criteria.

Q9: Please specify any approach you see to identify environmental, social and governance criteria separately from each other or as a single indicator. Please explain how the criteria would interact with each other and how the target market assessment and matching would be performed in such cases.

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4 1) climate change mitigation; 2) climate change adaptation; 3) sustainable use and protection of water and marine resources; 4) transition to a circular economy, waste prevention and recycling; 5) pollution prevention and control; (6) protection of healthy ecosystems)
Making a clear distinction between E, S and G is a very complex exercise from a pure data availability perspective and in terms of IT complexity. It implies to capture 3 additional indicators in the target market instead of a single ESG indicator for each product. This also adds complexity to perform the matching between clients’ preferences and target markets for the suitability test.

Q10: What current market standards or “labels” are you intending to take into account or already taking into account for the consideration of ESG factors? Do you see any issues when relying on current market standards or “labels”? Please describe.

Société Générale relies on a number of market standards for the manufacturing of ESG structured products. We mainly refer to the AMF position 2010/05 (reviewed in October 2018) and AMAFI/AFG guide on ESG indices but we do also use the UNEP FI tools and methodologies to assess the sustainability of issuers’ activities. For green bonds, we mainly rely on the Green Bond Standards (which closely follows the current ICMA Green Bond Principles).

Labels currently exist mainly for investment funds but Société Générale manufactures and markets ESG structured products and green bonds for ESG “labelled” investment funds.

Successful label initiatives are still at the national levels and mainly include:

- **SRI** label (Socially Responsible Investment) and the **TEEC** label (Transition Ecologique et Climat) launched in 2016 by the French Government
- **FNG** (Forum Nachhaltige Gelandlagen) label launched in Germany and adopted in Austria and Switzerland from 2008 in partnership with **EUROSIF** (European Sustainable Investment Forum)
- **LuxFLAG labels** launched in 2016 in Luxembourg including: LuxFLAG Environment Label and LuxFLAG Climate Finance Label and LuxFLAG ESG Label
- **Nordic Swan Ecolabel** launched in 2017 in the Scandinavian countries
- **Febelfin** launched in Belgium can also be used for structured products but the issue we see with this label is that it has at this stage a too simplistic exclusion approach that we do not always find appropriate.

We are supportive of the idea to develop an EU Ecolabel for certain types of financial products such as investment funds and bonds (as long as for bonds this is well articulated with the existing Green Bond Standards). However, it is important to take into consideration the highly sophisticated nature of structured sustainable investment solutions to meet very specific investors’ needs. What would be relevant for structured products marketed as ESG, and to avoid labels layering, is to rely on EU Ecolabels for underlying assets and sustainability certification for activities and uses of proceeds (use of the funding raised by the banks from the structured notes). An EU Ecolabel on the whole investment strategy may indeed be very complex to define and lead to too simplistic or irrelevant criteria that would limit the flexibility that is needed for this specific type of products.

Q11: Do you agree with the suggested approach and the amendments to paragraph 28 of the suitability guidelines? If not, do you have any suggestions for developing a more detailed approach
with regard to (a) the collection of information from clients and (b) the assessment of ESG preferences with the assessment of suitability?

Société Générale agrees with ESMA’s suggested approach to ask clients whether they have ESG preferences when entering into a new relationship with that client or when reviewing existing clients’ profiles. We also welcome ESMA’s example mentioned in the paragraph 17 page 24 regarding the regular review of the existing clients’ profiles.

Before asking clients whether they have any ESG preferences and investigating on a granular basis the exact type of ESG dimensions that clients would like to target, a first step would be to make sure that clients are clear on what ESG means. For this reason, we believe that it is premature to insert the amendments to paragraph 28 of the guidelines.

A first step should be to collect clients’ ESG preferences as a single indicator and to make sure that ESG questionnaires are clear enough for clients to understand what ESG means and what the consequences of investing in ESG products are:

- Investing in ESG products contribute to allocate more capital to firms with sustainable activities and/or behaviors and as such increase chances to secure investment portfolio’s long-term performance; but
- Restricting investments to ESG financial products limits diversification and investments options as well as the ability to increase portfolio liquidity or meet specific hedging or risk management needs. This is particularly the case at a time when the ESG market is not yet very mature and that all investment products cannot all be ESG yet (for a number of still legitimate reasons that we would not develop in our response)

With regards to the suitability test itself, we are very supportive of ESMA’s proposal which is, in our view, pragmatic. It is consistent with the flexibility that is left to investors with ESG preferences to invest in products that have non-ESG related preferences, subject to a clear framework described in our answer to question 8 point 1.

On this issue, we welcome ESMA’s clarifications on point 14 p. 23, which is the corollary of the fact that no negative target market shall be identified on financial products’ ESG characteristics (point 10, point 14). This should be added clearly into MiFID II guidelines.

**Q12:** Please specify any approach you see to assess environmental, social and governance criteria separately from each other or as single preferences. Please explain how the criteria would interact with each other and how the suitability assessment would be performed in such cases.

Based on our experience as manufacturer and distributor, our investor clients have very diverse ESG investment requests that they combine with a number of other preferences that are not ESG-related such as portfolio performance, liquidity, risk management or diversification. They do not usually limit their ESG request to one very specific E or S or G dimension. They would usually request either ESG behavioral and/or activities filters and have ESG thematic and/or ESG exclusion and/or ESG selection
approaches either separately or all together. Hence, it is critical that firms are left with great flexibility in the way they collect and describe ESG clients’ preferences instead of forcing them to classify their clients’ ESG preferences into an E or S or G column.

Q13: Do you agree with the suggested approach and the amendments to paragraph 70 of the suitability guidelines?

Yes, we agree with the suggested amendments to paragraph 70 in so far as the paragraph 14, page 23 is directly inserted into the MiFID II guidelines for clarity purpose.

Q14: What level of resources (financial and other) would be required to implement and comply with the proposed changes (risk-management arrangements, market researches and analyses, organisational costs, IT costs, training costs, staff costs, etc., differentiated between one off and ongoing costs)? When answering this question, please also provide information about the size, internal organisation and the nature, scale and complexity of the activities of your institution, where relevant.

We agree with the potential and incremental costs that the concerned firms will have to face to comply with the modifications of MiFID II Delegated Regulations and guidelines. We would also add that there will be costs attached to the collection of ESG preferences from all existing clients.

We expect the costs to comply with the integration of the ESG preferences and considerations within our internal Target Market process and our advisory process will be significant. These additional costs will come soon after the end of MiFID II implementation last year, on which we are still carrying out operational developments, especially on the advisory process. They will also come before the taxonomy on sustainable activities is completed and available. For this, we do also expect significant costs of integration into our systems as well as significant costs to buy the data from external providers who will have the heavy task of collecting it from issuers and crunching it to make it comparable. While we remain fully supportive of the objectives, we caution that measures should be calibrated appropriately with a view to avoid an excessive burden of cost on ESG financing, which could undermine the objective of aligning financial flows with ESG requirements.