EBF Answers to ESMA’s Consultation Paper on integrating sustainability risks and factors in MiFID II

Key Messages

- We would like to clarify the scope of the proposal, as the mandate of the Commission is clear, focusing on firms offering portfolio management and investment advice services, while ESMA seems to go beyond.
- As to avoid uncertainty or negative impacts, ESG principles shall be included in MiFID after the legislative proposals are finalised, all definitions adopted and fully operational.

- Organisational requirements
  - We are not convinced that amending general organisational requirements for investment firms is the most appropriate way to integrate sustainability risks in their advisory process. If included, it is important to clearly identify the specific organisational requirements and provide further guidance on how they should be applied by firms.
  - We support the high-level principle-based approach for the integration of sustainability risks within the MiFID II requirements, similar to that one already followed for all other relevant risks.
  - We would also like to remark the need of coordination with the EU proposed regulations on Sustainable Finance in order for terms and expressions to be given the same meaning.
  - We would like to see further clarifications on specific aspects of conflicts of interest.

- Product Governance
  - Regarding market standards and “labels”, we advocate for a positive yet gradual approach while warning against their, sometimes, national character, and concerns with possible greenwashing.
  - We urge supervisors and legislators to embrace, as much as possible, pro-active market initiatives already set up. And to not interfere with them until the EU harmonised framework and regulation is in place.
  - Clients that have expressed ESG considerations may be offered “non-ESG” products if appropriately informed about this in the suitability report.

- Suitability
  - It is essential to provide as much flexibility as possible for the methods used by firms for integrating ESG preferences within their suitability model.
  - Two-step approach towards clients’ preferences: Only asking detailed ESG questions when clients indicate a positive interest in ESG considerations.
General Remarks

In the first place, we would like to stress the great relevance that the Action Plan of the European Commission has to mainstream Sustainable Finance. In this spirit, integrating sustainability risks and factors in MiFID II is a critical task to support the transition to a low-carbon economy.

As a core issue, as we will consistently remark below, and asked in a question by the EBF during the public Hearing on ESMA consultations on integrating sustainability held in Paris 4 February, we would like to clarify the scope of the organizational requirements proposed by ESMA in the Consultation Paper.

The mandate from the European Commission to ESMA in the request to the ESAs, specifically states that “it should be clear that these requirements should only apply for investment firms as defined in article 4(1)(1) of MiFID II which provide portfolio management and/or investment advice”. However, the proposed amendments to articles 21, 23 and the new recital 59 (bis) are not limited to these two investment services but apply to the investment firms’ business.

We understand that, together with the clear mandate cited above, ESMA was given a broader ability to look at other regulatory acts. However, we believe that ESMA’s proposals go beyond what is necessary to achieve the objectives of the Commission and create unnecessary legal uncertainty, that we would like to clarify.

The effects of the future legislation are unclear. It should be recommendable that the ESG principles shall be included in MiFID legislation after the legislative proposals are finalised, all definitions adopted and fully operative. It is crucial to know the scope and to analyse the consequences of the new information requirement. Inconsistencies and overlaps have to be avoided because they can mislead investors, markets and can imply a non-negligible burden for the entities.

More concretely regarding the taxonomy, we would like to remark that it does not aim to be the unique and exclusive reference for manufacturers or distributors of ESG investment products. It aims to cover economic activities, with a positive impact on climate mitigation and adaptation. One dimension that the taxonomy will not cover is the companies’ ESG behaviours that can be unrelated to their performance of taxonomy-aligned sustainable activities or not.

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

Also, the integration of sustainability criteria, via a clear distinction between Environmental, Social and Governance (ESG) dimensions, into the product governance regime is only compatible with sufficient available and exploitable underlying issuers ESG data. However, there is today a clear lack of available or exploitable ESG data on issuers’ activities and/or behaviours.

Secondly, it is very important that regulation assigns clearly responsibilities to each player. The responsibility of the entities as investment advisor should be clarified. The liability should rest with the issuer of the financial products.
The definition of the ESG concept depends on the criteria and standards outside the scope of the capital markets and on the knowledge and experience of those who operate in them, and particularly of the entities that provide portfolio management and investment advice services. Therefore, embedding the ESG criteria and factors into capital markets should be done in a progressive and sequential way, so agents can interiorize them and guiding their expectations to take better financial decisions.

Therefore, the EC’s legislative proposal on the establishment of a framework to facilitate sustainable investment should also provide a clear definition for the ESG concept, and this legislative proposal -on the integration of ESG criteria in the suitability assessment (MiFID II)- should be fully aligned with the aforementioned classification.

The obligations for these entities should include products with ESG “label” in their offer and in the portfolios of the interested clients, but in any case, should not include the verification of the ESG criteria in the underlying companies or products. These firms are not in a position to make such verifications and liability should rest in the issuer of the relevant instrument.

Furthermore, new regulation should avoid being inflexible or overly prescriptive on such a forward-looking topic as sustainability in MiFID II, especially while there is no taxonomy in place.

Changes in MiFID II delegated acts should not be implemented in two steps as this would create unnecessary cost and administrative burden for both investment firms and their clients. We therefore urge the Commission to coordinate this legislative work, including the implementation dates. All the proposed changes to the MiFID II delegated acts (regulation and directive) should enter into force at the same point in time.

We therefore must underline that it is crucial to find the right balance in integrating the ESG consideration in MiFID II – whose legal and regulatory framework is still evolving – as well as disproportion as far as it regards the importance given within the MiFID II relevant provisions to ESG factors related to financial factors (market risk, credit risk, liquidity risk).

We understand the complexity of working with an evolving framework and regulations. However, we would like to stress the usage of several terms and expressions in the Consultation Paper which are either not defined or which are defined in other draft EU legislation (e.g. “sustainability risks”, “sustainability factors”, “ESG”, “ESG considerations”, “ESG preferences”). This makes it difficult to analyze the effects of some of the proposals. Moreover, as mentioned above, coordination with other legislative initiatives is of outmost importance in order to ensure that the terms and expressions are given the same meaning in different legislative acts. We therefore urge that immediate actions are taken to define above mentioned terms and expressions to ensure correct interpretation of such during the preparation for the legislative acts and avoid unnecessary confusion.

For these reasons, we would like to insist on and second the advice that the Securities and Markets Stakeholder Group (SMSG) has provided to ESMA in September 2018 around the topic of integrating sustainability risks in MiFID II and call for consistency and stable implementation. The SMSG concluded that the new regulatory set should, among others, find a right balance in implementation, and should not create regulatory complexity or legal uncertainty.
Organisational Requirements

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.

A1

In the first place, we would like again to clarify the scope of the approach proposed by ESMA. As mentioned above, the mandate of the European Commission was for the organizational rules to only apply to investment firms which provide portfolio management and/or investment advice. ESMA’s proposal for amendments to article 21 does not include this limitation in scope and therefore go beyond the mandate from the Commission.

The article 21 of the delegated regulation only mentions general organisational requirements (as stated in the title), without making any reference to specific types of “risks”. The “sustainability risk” is implicitly covered in the general provision. Therefore, we consider it unnecessary to add this concrete and specific category of risk to the general provision (art. 21).

We are also aware that skills, expertise and knowledge required for staff involved in the advisory process for the assessment of sustainability risks could be expanded and we agree with ESMA that procedures and mechanisms to integrate sustainability risks and regular internal reporting should be a good practice at the current stage (rather than mandatory).

Moreover, we find it unclear how some of these general organizational requirements should be applied in practice. It would be useful if ESMA, in addition to the example on knowledge and competence of staff, would provide more guidance on what it means that ESG considerations should be taken into account when complying with all the other requirements in article 21 such as the decision-making process, record keeping and performance of multiple functions etc. What type of actions are firms expected to take?

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.

A2

In line with our remarks above, we would like to again mention the need for clarification regarding the scope of application of the organizational rules. The current proposal by ESMA on Article 23, does not limit its scope to firms which provide portfolio management of investment advice as the Commission mandate indicates.

We appreciate the intention, expressly stated by ESMA, of adopting a high-level principle-based approach for the integration of sustainability risks within the MiFID II requirements, similar to that one already followed for all other relevant risks (e.g. credit risk, market risk, liquidity risk).

Investment firms are already under a general obligation under MiFID II to manage risks relating to its activities. We are not fully convinced that it is necessary to include a specific provision stating that firms need to consider environmental, social and governance factors.
Article 23 relates to all risks, without providing any examples. Other risks, like credit risk, operational risk, reputational risk, etc. are also not provided in Article 23. Financial market participants should be free to choose how to assess ESG risks and the impact it has on their businesses and clients. If ESG factors are to be mentioned specifically, other relevant risks (as mentioned above) should be included in Article 23 as well.

We would also like to remark the need of coordination with the EU proposed regulations on Sustainable Finance. We believe the changes to this Article are premature in the absence of unified EU classification system of sustainable economic activities and the availability of the final definitions of the Disclosures Regulation, in order for terms and expressions to be given the same meaning.

The Commission is only in the very first stages of developing a taxonomy on what can be considered as an environmentally sustainable economic activity or not. Although ESMA is aware that this taxonomy will be finalised only in the upcoming years and that, at least initially, it will not cover social and governance issues ESMA still proposes changes to article 23 including E as well as S and G risks. With this approach, banks and investment firms are obliged to take a broad approach to assessing potential sustainability risks without a taxonomy. This may lead to very different approaches around how banks implement risk frameworks for S and G sustainability risks on an organizational level which in turn could lead to consumer confusion and ultimately potential greenwashing (including possible reputational risk as well).

Finally, if a definition of “sustainability risk” is included in the Disclosure Regulation, the term should have the same meaning in MiFID II, where relevant. The wording that is proposed to add to article 23 sub (a) is failing the words: “where relevant”.

ESMA emphasizes that, through the inclusion of a reference to ESG considerations in Article 23 of the MiFID II Delegated Regulation, it would be expected that both the Compliance function and Internal Audit will consider issues related to sustainability risks. We believe financial market participants can best assess themselves which internal business unit (be it either audit, compliance or another business unit) should ascertain sustainability risks.

**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?**

**A3**

In line with our remarks above, we would like to again mention the need for clarification regarding the scope of application of the organizational rules. ESMA’s proposal for a new recital 59 (bis) does not include such limitation in scope and therefore go beyond the mandate from the Commission.

Moreover, we question whether the first paragraph in recital 59 (bis) adds any additional value as firms under applicable rules should identify all relevant conflicts of interests, which would include those that stem from distribution of environmentally, social or good governance investments.
However, if it nevertheless is decided that such an amendment should be included in the delegated regulation to MiFID II, we agree that it is more appropriate to address this in a recital than in an article.

In addition, we consider that ESMA’s approach is biased, in the sense that it assumes that conflicts of interest, regarding ESG factors, may arise only due to the distribution of environmentally sustainable investments, social investments or good governance investments. However, some clients may not consider ESG considerations important and conflicts of interest may also arise due to that fact - for example through the sale of shares of a coal company to investors, who do not have an exclusion policy on coal, although this investment may not be in their best interest.

Therefore, although considering, as previously mentioned, that there is no need to include any reference to ESG in the “conflicts of interest”, if nevertheless it is decided that such an amendment should be included, we would suggest a more general approach on conflicts of interest, to be reflected in the new recital 59 (bis) of the MiFID II Delegated Regulation:

“When identifying the types of conflicts of interest whose existence may damage the interests of a client, investment firms should include those that may stem from ESG preferences”.

As regards examples, we believe that the mis-selling practices in paragraph 13 are relevant.

Finally, we have not identified a clear motive to add a new recital on ‘conflicts of interest’. If needed, more guidance on sustainability considerations as triggers for conflicts of interest, more guidance can be provided in a Q&A.

For the moment, we would like to have a clarification of what specific conflict of interest has been identified with adding sustainability risk to the broader risks already addressed in MiFID II. The (proposed) potential conflicts relate to the performance of the investments, rather than conflicts of interests between parties (investment firm and/or clients) that the current articles in the DR relate to.

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.

A4

No.

As conclusive remarks on Organisational Requirements, Q’s 1-4:

We are not convinced that amending general organisational requirements for investment firms is the most appropriate way to integrate sustainability risks in their advisory process. However, if included, it is needed to clearly identify the specific organisational requirements (i.e. product governance) which need to be integrated with ESG factors.
According to the current general organisational requirements and risk management provisions, investment firms would consequently be obliged, as per proposed draft of Guidelines, to adequate their processes, systems and controls in their entirety in order to comply with the new specific requirements related to ESG factors.

Product Governance

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.

A5

The EBF is in favor of the development of a common EU taxonomy on sustainability and in that connection, we support the stance by the Commission to base such work on current market standards.

An issue that has been identified is that current market standards or “labels” is that sometimes they have a national character (often based on local/historical grounds) instead of a cross-border character. This very large number of divergent standards and labels which exists today on EU market contributes to the problem with Green Washing.

While understanding the challenges of proposing a fully harmonized approach to sustainability risks and factors in MiFID II before a common EU taxonomy is in place, we support the “high level approach” pro-posed by ESMA in the Consultation Paper. However, we would like to question that firms should be expected to base their specification on the preparatory works of the Commission, as the rules have not yet been adopted by the co-legislators and which could still be subject to change.

As we have also expressed in our response to the Ecolabel Consultation for products offered to retail investors, we advocate for a positive yet gradual approach, both for the type and scope of the products to be offered.

Finding the right balance with a future Ecolabel could however prove to be very problematic. In short: if the requirements for receiving an EU Ecolabel are too high, not a lot of impact can be expected as only a very narrow selection of financial products will receive an Ecolabel. If the requirements are too low, we are not re-allocating capital to more sustainable economic activities. Furthermore, alignment with the taxonomy that is not available yet is deemed crucial.

Short term considerations

In the short term it could be considered to focus on the evaluation of Socially Responsible Investment (‘SRI’) investment process and not on specific ESG criteria (be it separately or as one ESG indicator). In other words; an assessment what kind of SRI instruments are used in the investment process of a fund, instead of focusing on specific E,S and G criteria that are used. We believe this is also more in line with UNPRI. There are many different
SRI approaches and a future Ecolabel should not try to limit the market or put up new boundaries in any way. Portfolio managers will otherwise just structure accordingly which might have a opposite outcome as foreseen by the EC.

So, as long there is no mandatory EU harmonised framework/taxonomy constructed, regulators should be hesitant to interfere with market initiatives.

As additional information; some of our members have developed minimum standards for sustainable funds in their jurisdictions. A majority of big financial market participants will apply for this label for their SRI funds. Our members will also follow-up on the EU taxonomy exercise, but it will take time (and create additional investments) to adapt this (national) SRI rating system or ESG methodology to the European taxonomy (as still under discussion/development).

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.

A6

In principle, we support the inclusion of ESG factors in the investment process on a ‘high-level, principle-based approach’. At this stage, in the absence of a clear and finalized taxonomy, we believe that it is untimely to require more.

We agree with the approach to include ESG characteristics for the two types of target market described: (i) target markets in which certain ESG characteristics are specified (“ESG positive products”) and (ii) target markets without any reference to ESG characteristics (“non ESG products”).

In general, we agree that a potential target market must take into account ESG preferences (embedded in 5th criterion: client’s objectives and needs). Furthermore, we support the statement in paragraph 13 (page 15 of the CP) that a negative target market should not need to be specified with regards to ESG preferences. A product can be compatible with the needs of clients who do not have those specific needs or objectives.

However, we fear that paragraph 9 on page 14 may cause confusion as distributors cannot make changes to product features. Consequently, we suggest deleting ‘distributors’ from this paragraph.

In addition, we see different challenges regarding the proposed approach that we would like to flag:

The current wording entails the risks that local Financial Supervisory Authorities (FSAs) interpret the directive and the mandate very differently, as we have seen in the implementation of the delegated directive of MiFID II so far. ESMA should carefully consider that it may cause problems for international firms and distort international competition depending on how local FSAs chose to interpret and implement these criteria.
Clarifications as regards what impact these new rules may have on the distribution of non-EEA products into EU is important.

Regarding timing, as mentioned in our answers above, we believe the taxonomy must be in place before substantial changes to the MiFID II Delegated Directive Articles are made. Including ESG-factors in the target market framework, means however that these ESG factors will have to be determined in detail / on a financial instrument basis.

These ESG factors are however not defined yet and - given the current status of the legislative process - it is a black box how that will come to look like and (most) producers of investment products are not required to provide such information. Making it mandatory to include ESG factors in the target market criteria, without defining what this means and putting the burden to collect this information on distributors leads to legal uncertainty, interpretation issues with competent authorities, green washing, unequal playing field, etc. In addition, the ESG-factors may be conflicting with other target market criteria (such as "return on the investment"). For these reasons the European Commission envisages to define ESG factors itself (and not by the market).

We propose to put the inclusion of ESG factors as a target market criterion on hold, until the definition thereof is (more) clear. Another reason for putting this on hold is that the process of collecting the preferences of investors regarding to ESG factors is burdensome and costly. This should not have to be redone as a result of changing definitions of ESG factors. On a voluntary basis / good practice, investment firms can (and will) continue the development of “sustainable investments”. There is no need for concern that not putting the (mandatory) inclusion of ESG factors in the target market framework puts the development of sustainable investing on hold.

Sustainable objectives and risks versus financial objectives and risks

Besides the above, we wonder what ESMA’s view is around how ESG preferences can be related and/or compared to the financial interests and goals of retail investors in assessing the target market. When assessing the target market in a product governance process, what should be predominant: financial objectives or sustainable objectives?

In all assets (stranded assets form good examples) financial and sustainable objectives interact with each other. How they exactly interact is however unclear. Therefore, we argue that it is premature to amend the MiFID II Delegated Directive Articles on ‘product governance’.

Conceptual error

MiFID/Delegated Directive relates to investment services and in principle not to the offering/issuance of investment products. Only manufacturers are in scope that qualify as investment firms, meaning investment firms that produce an investment product and provides an investment service regarding to that same investment product. This is an exception to the rule that “manufacturers don’t exist”.
Most investment products (shares, bonds and funds) are not manufactured by investment firms. This is a conceptual error in MiFID/Delegated Directive. The result is that most (nearly all?) “producers” of investment products are not legally required to provide target market information. This puts the burden on distributors to collect this information.

Most target market criteria can be derived from the type, nature and conditions of the investment products and/or regulatory mandatory disclosures regarding to these investment products. This is however in principle not the case for ESG factors. The current target market criteria do not include or indicate the (environmental) activities and governance of the underlying company/issuer.

The target market criteria / ESG factors should be included in the regulatory framework applicable to the offeror/issuer of investment products (UCITS/AIFMD/ etc.). ESMA is aware of this: “Going forward ESMA considers that the EC should consider the possibility to align the relevant UCITS and AIFMD articles with the product governance obligations for manufacturers.” (ESMA Final Report 19 December 2014 | ESMA /2014/1569, paragraph 9, page 52).

**Pro-active inclusion of market initiatives without regulatory scrutiny**

As MiFID II only entered into force 3rd of January 2018, the Product Governance process and the MiFID II data exchange between distributors and product manufacturers only has an active history of one year. The current standard for data exchange is the European MiFID II Template (‘EMT’) that could be viewed as a market initiative that is still under construction. We urge supervisors and legislators to embrace, as much as possible, market initiatives already set up.

Market initiatives developing around ESG Product Governance templates are not available yet. In the case of ESG target markets we would therefore like to point out the ongoing work with European ESG template (EET). The EET document is a functional description of a minimum set of data used by asset managers and investors to support their ESG investment policies and create their reports. In accordance with the EMT, that has become market practice in the MiFID II data exchange between product manufacturers and distributors, this EET could become future market practice. We ask ESMA therefore to let market practices, like the EET, develop further.

**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.**

**A7**

While we support the principle-based approach, we have mixed views with the proposed changes to ESMA guidelines on MiFID II product governance requirements.

Part of our argumentation towards this can be found in our answers to question 6 above.

We agree that guideline 18(e) is the most adequate place to stiffen the inclusion of ESG preferences, since the current version of the ESMA Guidelines on MiFID II product
governance requirements already mentions “green investment”, “ethical investment” as examples of “specific investment objectives”.

We support the fact that firms are not expected to identify products that have a negative impact on ESG objectives (= no negative target market). Products will be compatible with the needs clients who do not have those specific objectives.

However, we think that it is necessary to clarify what is allowed when a client who expresses an ESG objective, but there is no such ESG product available. The offer of a “no ESG” product should not be per definition forbidden (but for example requires the express approval of the client). Under the suitability assessment, this scenario is described and allowed. We propose clients to be offered these products with explicit remarks mentioning that the products offered are “no ESG” in the suitability report. Product governance and suitability rules should preferably be parallel.

We welcome the inclusion of an additional case study, but we have objections to the described case as a representative market example.

First and foremost, impact funds currently take up only a very limited part of the total amount invested by (retail) investors. Besides, the described funds are hardly available in the current market. It therefore is not a representative case as the goal of the Sustainable Finance Action Plan is to redirect capital flows from non-sustainable assets (which arguably is not an impact fund) to more economic sustainable activities -where appropriate- economic sustainable assets.

Finally, the example is described as a fund that has relatively low risk. The fund will be investing in renewable energy, organic farming, sustainable real estate, nature and landscape projects and environmental technology. The fund aims to provide explicit positive impact on the environment, measured in carbon footprint, as well as a positive cash flow to its investors, created by the projects funded. The fund invests mainly in loans, secured by mortgages, (state) guarantees, or alternative collateral. The risk indicator of this fund is 2 on a scale of 7 (low risk, low return). More than 70% of the fund is invested in projects certified as “green projects”. The activities that this fund invests in, especially in the short term, could arguably not be described as low risk. For example, liquidity in these activities could be classified as rather low compared to other listed securities. The fund is described as an open-end fund, whereas the activities typically would better fit in a fund structure classified as closed-end.

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

A8

From the manufacturer’s point of view: it is possible to indicate the ESG character, either ESG in its entirety or subcomponents. At distribution side, we would suggest establishing the following:

- Only in the situation where the company distributes fully ESG products (where the 3 characteristics are fulfilled), we can use the reference to “ESG” or sustainability as a whole. If a client expresses a preference for “green products” but is not interested in Governance or social characteristics, it is sufficient to asses E preference of the investor
and there should not be an obligation to assess the Governance or Social preferences. In the latter situation, we can also offer this client a full ESG product, but for example not a product that solely focuses on Governance. It is not allowed to use the term “ESG” or sustainable as a whole for those products that do not contain the 3 characteristics.

- Investors who have not expressed a preference for ESG should have full access to ESG. This means that ESG products can be offered to them without any warning. ESG products can be considered to be in the positive target market for clients who have not expressed an ESG preference (at least if other target market elements are OK).

- Investors who have indicated an ESG preference should not be excluded from buying non ESG products. We would suggest that this be done through the neutral target market concept. In that sense it may be appropriate to require that firms clearly indicate in the suitability report that the product which has been found suitable for the ESG-client is in fact a non-ESG product.

Further guidance on these issues is welcomed, given the importance, but also the somewhat lack of interconnectedness between ESG factors and financial products. We consider that the three topics listed in paragraph 15 are a good starting point, but we urge that such guidance must be in close connection with the developments and level of detail of the EU taxonomy proposals, that will follow a stage-by-stage approach.

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.

A9

With regards to the single indicator we are inclined to believe that ideally an approach to identify environmental, social and governance criteria should take form in a single indicator only. The most important reason to take this standpoint, is that a single indicator is more or less comprehensible, simple and meaningful to implement.

In practical terms, since the ongoing regulatory proposals in the EU have a progressive approach, reflecting the priority given to climate-related issues over social and governance issues, the adoption of an approach that identifies environmental, social and governance criteria separately from each other may prove to be more feasible.

In general terms, if a bank uses a reference to “ESG”, it is necessary that the product itself contains the characteristics of all the 3 criteria. It is not possible to refer to “ESG” if only one or two of the 3 criteria are fulfilled. The most prevailing difference in the fund business is the difference between ‘ESG’ and ‘not ESG’.

However, one can easily imagine situations where only one or two components of ESG is/are present. In that case, it is not possible to sell it under an “ESG” logo or reference, but the bank can sell it but has to clarify that only one characteristic that is fulfilled without calling it “ESG”.

Most likely, that would be the E (environmental). The EMT allows to distinguish these from one another by using one single code (S for ESG; E for environmental). The need to exchange data between manufacturers and distributors requires codifiable data. Hence,
a more descriptive approach (see case study proposed by ESMA guidelines), although useful, is made impossible by the feedback loop (exchange of information) required by MiFID II.

As already explained in our answers to questions above, we do not believe that ESG elements should result in investment being excluded from clients. Clients that have explicitly expressed their ESG preferences, can be offered “no ESG” products. In such cases, it may be appropriate to require that firms clearly indicate in the suitability report that the product which has been found suitable for the ESG-client is in fact a non-ESG product.

Before an EU taxonomy is in place and in line with ESMAs intention to keep the proposed requirements high level and not too prescriptive, we would suggest leaving it to the market to determine the way to present the information.

We would however also like to underline that the different EU legislative proposals on sustainability must be coordinated on this point.

In addition, we believe it is premature to conduct a target market assessment and match this vis-à-vis client preferences and knowledge. As long as there is no taxonomy, it may even be not in the best interests of end consumers. Besides prematurity, E, S and G factors may interact with each other whilst we have no insights or data how they exactly interact.

Suitability

We believe it is essential to provide as much flexibility as possible to the methodological approaches through which investment firms can integrate ESG preferences within their suitability model.

**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.**

**A10**

Please see our answers to question 5.

One additional issue could be that market standards or labels does not exist for all financial products (most common for investment funds and bonds).

**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?**
A11

We support that firms should specify what they consider to be “ESG preferences” or “ESG considerations”. So far, firms have implemented sound policies and procedures in order to properly classify investment products (including also ESG factors). Yet, taking into account that the market is far from having reached enough maturity, it would be premature to include far-reaching amendments until there is an EU taxonomy in place.

Since the taxonomy system is under development and not available yet, investment firms should be left free in their considerations to ask clients about ESG preferences or considerations. Firms could use own methodologies or (other) current market standards and practices to collect information from clients as a good practice. We share the SMSG’s view on this topic: “Implementation of such suitability guidelines by ESMA in the absence of a detailed finalised objectives, taxonomy may be complex as it will come to re-designing client profiling questionnaires to capture investment objectives, and to define the criteria and tools to scan products according to new complex criteria... It should take into account the needs of the individual investor and avoid overly complex language or too lengthy disclosure requirements that already hinder consumer protection in financial services”

We understand that ESMA’s approach means that the producer and the distributor of a financial product could have different views as regards what is an “ESG product”. A distributor may therefore classify external products in accordance with its own standard, i.e. not be obligated to use the same standard as the producer.

We support ESMA’s proposal that a client’s “ESG preferences” should be addressed only once the suitability has been addressed in accordance with the criteria of knowledge and experience, the financial situation and investment objectives (point 11 page 23 of the CP). However, it is yet unclear to us whether ESMA foresees a fully harmonised and single suitability test or whether it will be a multi stage suitability test (i.e. first financial goals and risks, then sustainability goals and risk more on a recommendation basis). Instead of asking specific preferences around E, S and G factors separately, firms - as a good practice - could collect general ESG preferences on a very high level. A more granular approach could only be undertaken by firms after there is clarity around the taxonomy. It doesn’t, however, dismiss firms completely from their duty to assess (ESG) preferences. But to match these high-level preferences to products that are suitable could have outcomes that are not in the best interest of clients.

In general terms, each bank has its own model for assessing ESG product governance and suitability, and do not all work with the “two-step approach”. Selection of a range of products takes place before the actual suitability process and is based on selection procedures. Thereafter, the assessment of suitability is performed per financial instrument.

We would like to propose a “two-step” approach to the collection of information on clients’ ESG preferences.

In our understanding, before aiming towards increased granularity in the information collected (due to the current situation – lack of framework), clients should be asked if they are interested of taking into account ESG considerations.
If the clients express that ESG considerations should not be taken into account in their investment preferences and/or services, there is no need to ask further questions in relation to ESG factors. Would the answer be positive, further questions should be asked.

Against this background, we would like to suggest rewording the proposed text change for Paragraph 28 of the guidelines:

“When collecting information about their clients’ ESG preferences, firms should firstly ask if ESG considerations should be taken into account. Only in the affirmative case, firms should ask questions in relation to environmental, social and governance factors. The information collected on clients’ ESG preferences should be granular enough to allow the firm to assess the suitability of the investment and should be consistent with the EU’s classification system of ESG investment products, once developed. While this classification system is under development, investment firms should clearly specify what they consider to be ESG preferences or considerations, while taking into account current market standards.”

Lastly, we note that in the Commissions draft proposal for amendments to article 54 delegated regulation to MiFID II, it appears as if the ESG preferences should be included in the “investment objectives”. This appears to be an inconsistency which should be investigated by ESMA

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.

A12

Please see our answers to question 9.

With regard to the two methods to determine the ‘ESG’ level of a client (paragraph 12 on p. 23), both seem to be identical.

We would like to suggest another alternative, especially when offering product advice approach (where we do not consider the portfolio as a whole but advise the client per transaction (individually -especially for smaller clients-). In that case, we prefer that the client is requested per transaction whether he has, for that transaction, an ESG preference or not or has confirmed his preference. Each factor should always be assessed separately, but we think it’s important to have the possibility to use a single indicator.

We are convinced that with a single indicator approach, each element is indispensable to obtain the “ESG” label in order to avoid mis-selling practices or misrepresentations and ensure a clear and transparent implementation of this approach. When the work of the taxonomy is completed, the final indicator of the references should be single.

Q13: Do you agree with the suggested approach and the amendments to paragraph 70 of the suitability guidelines?
A13

While the amendments leave room for flexibility, we do not agree with the timing. As we stated above, we believe a taxonomy must be in place before changes to the MiFID II Delegated Directives or Guidelines could be made.

Until that moment in time the wording should remain limited to a recommendation and not be written down as an obligation.

The amendments will then require additional changes to firm’s internal procedures and IT systems. It is therefore important that investment firms are given enough time to implement these changes in an orderly manner including necessary education of staff and information to clients. An implementation period of 18 months is an absolute minimum.

Moreover, we support ESMA’s view that in respect of existing clients, firms should be able to update the client’s profiles when they do the next regular review following the implementation date.

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.

A14

Implementing the ESG requirements as proposed in this consultation paper will require an impactful change in the product offering and review process, as well as the client intake and review of existing clients. All products on offer will have to be assessed on ESG criteria and the onboarding of new clients and the review of existing clients has to be adapted. Therefore, the level of necessary (financial) resources will be substantial. The related costs will be duplicated when this entire process has to be followed again after the taxonomy has been determined. A really principles-based ESG framework rather than a de facto rule-based framework will be an important factor herein.

We would like to stress that the examples provided in the question are very relevant. In particular, the IT costs and training costs should not be under estimated. Measuring the costs with a precise scale is uncertain at the moment but depending on the outcome there is a high probability that the cost of service will increase as market actors adapt.

Since at the end of the day, Banks’ (retail) clients most often will have to pay for these additional costs, it may even turn out that especially for smaller investors it is no longer cost efficient (taking into account the possible return after deduction of the total costs) to continue their investment services.
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