Response to
ESMA Consultation on integrating sustainability risks and factors in MiFID II
(ESMA35-43-1210)

Berlin, February 19, 2019

General comments

On behalf of the German Savings Banks Association¹ and the German Association of Cooperative Banks² we want to take the opportunity to submit a common response regarding the Questions 6, 7 and 8 concerning Product Governance.

With regard to the other questions raised in the Consultation we refer to the response of the German Banking Industry Committee.

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.

We refer to the response of the German Banking Industry Committee.

¹ The German Savings Banks Association (DSGV) represents the interests of the Savings Banks Finance Group (Sparkassen-Finanzzgruppe), Germany’s largest banking group. The group consists of around 400 credit institutions with a balance sheet total of more than 2 trillion euros, including 385 Savings Banks (Sparkassen) and 6 Landesbanken. Its unique strength is the savings banks’ locally based business model and the close cooperation among its members. With their 18,000 branches, a strong digital presence, and 312,800 employees, they provide a full range of financial services to all parts of the population.

² The National Association of German Cooperative Banks (BVR) is the umbrella association for the cooperative banking sector in Germany. Its members are all of the cooperative banks – Volksbanken, Raiffeisenbanken, Sparda banks, PSD banks, banking institution for churches and cooperative specialized institutions – as well as the cooperative central bank, companies in the Cooperative Financial Network and cooperative audit associations. The BVR promotes the interests of the Cooperative Financial Network at national and international level. Within this network, it coordinates and develops the cooperative banks’ common strategy. At the same time, the BVR advises and supports its members in legal, tax and business matters. It also runs the Cooperative Financial Network’s protection scheme – the oldest bank protection scheme in Germany – along with the institutional protection scheme set up under the German Deposit Guarantee Act, the BVR Institutssicherung GmbH (BVR-ISG). In addition, the around 200 BVR staff ensure that member banks are informed continuously about current economic and political developments affecting banking.
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 refer to the response of the German Banking Industry Committee.

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 refer to the response of the German Banking Industry Committee.

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.
We refer to the response of the German Banking Industry Committee.

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.
We refer to the response of the German Banking Industry Committee.

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 welcome ESMA’s proposal to integrate sustainability in the target market as a new target market criterion. This clarifies that the classification of a product as sustainable is the responsibility of the manufacturer. Only the manufacturer has the necessary knowledge of the product to undertake the classification.

In terms of practical implementation, it is important for distributors to be able to rely on the manufacturer’s classification. This also applies if the manufacturer – as is the case for investment fund companies, for example – is not itself subject to MiFID. This too is ensured through inclusion in the target market.

However, it is important that the particularities of the target market criterion of sustainability are taken into account in its inclusion in the existing product governance framework. We still see room for improvement here (for the details we refer to our answer Q 7).

It is also striking that ESMA does not propose a period for the implementation of the additional requirements under product governance. In order to take account of the technically challenging adaptations (provision of the manufacturer’s target market data for the distributors; adaptation of the IT-supported mapping processes of the distributors), an implementation period of 18 months
from publication of the legislative text in the Official Journal of the EU is necessary. This point should be added to the ESMA draft.

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.

ESMA’s proposed high-level approach is very positive. Through this approach, ESMA takes account of the fact that the current legal framework for sustainability is still very fragmentary and it makes little sense already to draw up detailed specifications now. This approach should also be continued in the finalisation of the Guidelines.

At the same time, some points in the Guidelines should be supplemented to take account of the particularities of the target market criterion of sustainability. These include the following aspects:

a) Practical design of the target market characteristics

The big problem with sustainability is that the taxonomy is still being developed and there are no legal guidelines on how a manufacturer evaluates the sustainability of its product when the new product governance requirements come into force. This distinguishes the new target market criterion from other criteria, such as client category or the risk/reward profile, for which legal provisions exist, on which manufacturers can base the target market definition (client categories under MiFID II or PRIIPs-SRI).

In order to achieve a certain standardisation in the case of the new target market criterion too in spite of the lack of corresponding guidelines, ESMA should provide information on the target market characteristics. Otherwise, it is to be feared that the open architecture pursued by the Guidelines on Product Governance (see Guideline 16 of the ESMA Guidelines on Product Governance) cannot be achieved in the case of the ESG criteria.

At the same time, it should be borne in mind that the extensions currently preferred for the suitability assessment and product governance are only a first step. In this respect, a high-level approach should also be chosen for the target market characteristics (at least in a first step). In our view, the target market criterion should be described in two forms until legal requirements exist:

- Sustainable: Yes (the product is declared to be sustainable by the manufacturer)
- Sustainable: No (the manufacturer has not declared the product to be sustainable).

Concerning the negative target market we refer to our remarks below under d).

In view of the lack of a taxonomy, all further characterisations would lead only to IT-relevant implementations now being undertaken, which within a short time would no longer correspond to the legal requirements. This would mean that investment firms would have to bear a double burden of very high implementation costs. This would be contrary to the principle of proportionality, which is very strongly emphasised precisely in relation to product governance (see Guideline 11 of the ESMA Guidelines on Product Governance) and should be avoided at all costs.
b) Assistance for manufacturers in the classification

In view of the lack of a taxonomy, there is great legal uncertainty for manufacturers as to when they can declare a product to be sustainable. Many manufacturers are currently refraining from declaring their product to be sustainable due to potential liability risks.

For manufacturers which are subject to MiFID and therefore in future will be required to classify their products with regard to sustainability in the target market definition, the assistance of the supervisory authorities is an absolute must until a legal framework is in place. ESMA should therefore stipulate in the Guidelines or in the Final Report that the determination of the target market criterion of sustainability can occur, for example, through certification by independent certification bodies (such as the certification bodies listed in footnote 6).

Such a clarification would clearly boost readiness to declare products to be sustainable. Otherwise it is to be feared that manufacturers will continue to be very reluctant to declare their products to be sustainable, which may lead to the distributors being unable to offer any suitable products to their clients with sustainability preferences. The aim pursued by the legislator of strengthening sustainable investments would therefore fail. In this respect, ESMA should provide information in the Final Report so as to reduce legal uncertainty with respect to the taxonomy.

c) Linking to manufacturer information

In order to provide clients with greater transparency, ESMA should include the indication that a manufacturer which declares its product to be sustainable in the target market should also do so (as far as possible) in the relevant product-related information documents. Here it is essential for synchronisation to be achieved between the information provided by the issuer to the distributor (as machine-readable data) and the information used to describe its product in the relevant product information document:

- In the key information documents under the PRIIPs Regulation, a reference appears under the heading “What is this product?”, since in Article 8(3)(c)(ii) of the PRIIPs Regulation, provision is already made for an indication if a product pursues environmental and social objectives (this opportunity should be taken by the European legislator, however, to adopt the delegated act provided for in Article 8(4), which, to our knowledge, is still outstanding).

- In the case of investment funds, a corresponding reference could be included under “objectives and investment policy” in the key investor information document.

d) No negative target market

It is very positive that ESMA stated in the Consultation Paper that a positive declaration of the target market suffices and a negative differentiation via the negative target market is not necessary (see CP p. 14, point 10).

In our view, however, this aspect should also be stipulated directly in the Guidelines. For example, a corresponding reference could be considered in Guideline 68 of the ESMA Guidelines on Product Governance that no negative target market has to be defined with respect to sustainability.
e) Restriction to investment advice

In the Guidelines on Product Governance, ESMA correctly takes account of the fact that in business without provision of investment advice, distributors can consider only the target market criteria of clients’ knowledge and experience (see in particular Guideline 45 of the ESMA Guidelines on Product Governance).

ESMA should include a reference in the Final Report to the fact that sustainability also does not have to be taken into account in the case of orders without investment advice or in execution only business. This already results from the fact that sustainability is a characteristic of the target market criterion of client objectives and needs. For reasons of legal certainty, we should nevertheless welcome explicit clarification in the Final Report.

f) Synchronisation with the suitability assessment

In the passage concerning the suitability assessment, ESMA correctly points out that a sustainable product which is sold to a client without ESG preferences is not per se unsuitable for the client. Conversely, a product declared as not sustainable need not automatically be unsuitable for a client with ESG preferences.

This correct evaluation concerning the suitability assessment should also apply for the target market assessment:

- ESMA already correctly stated in the Consultation Paper that the sale of a sustainable product to a client without ESG preferences does not represent non-compliance with the target market (CP p. 15, paragraph 13).
- Conversely, it should be stated in addition that the sale of a product declared not to be sustainable to a client with sustainability preferences is also possible with appropriate justification.

Both aspects are immensely important in business practice. This is particularly the case for the latter aspect mentioned, if it is borne in mind that, in view of the existing legal uncertainty, manufacturers could continue only restrictively to declare their products to be sustainable. It should be made clear that distributors can nevertheless recommend investment products to their clients.

In this respect, the possible two-stage approach proposed for the suitability assessment should also be transferred to the target market assessment. Furthermore, this aspect should be stipulated in the Guidelines themselves and not only in the Final Report. A supplement could be considered here to Guideline 70 of the ESMA Guidelines on Product Governance.

g) Consequences for the feedback regime to the manufacturer

The points presented above under f) also have an impact on the feedback regime to the manufacturer. Since in the first configuration mentioned (client without sustainability preferences is recommended a sustainable product), no target market non-compliance exists, any feedback from the distributor to the issuer can also be dispensed with.

We request corresponding clarification on this aspect in the Guidelines (for example, in Guideline 74).
h) Example should be omitted

The new example for target market definition should be omitted, as the target market described there is too granular. As far as we know, the description extends far beyond the target market definitions used in the market.

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

The questions raised by ESMA are of great importance in business practice. From our point of view, the following applies here:

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

In this configuration, it should be borne in mind that, in view of the existing legal uncertainty, manufacturers could continue only restrictively to declare their products to be sustainable. It should be made clear that distributors can nevertheless recommend investment products to their clients.

In this respect, it should be stated in the Guidelines that the sale of a product declared not to be sustainable to a client with sustainability preferences is also possible with appropriate justification. This would correspond to the possible two-stage approach proposed for the suitability assessment. This should also be transferred to the target market assessment.

This aspect should be stipulated in addition in the Guidelines themselves and not only in the Final Report. A supplement could be considered here to Guideline 70 of the ESMA Guidelines on Product Governance.

b) Can ESG considerations be either specified separately from each other or as a single indicator?

The big problem with the ESG criteria is that the taxonomy is still being developed and there are no legal guidelines on what is to be understood by sustainability when the new product governance requirements come into force. This distinguishes the new target market criterion from other criteria, such as client category or the risk/reward profile, for which legal provisions exist, on which manufacturers can base the target market definition (client categories under MiFID II or PRIIPs-SRI).

In order to achieve a certain standardisation in the case of the new target market criterion too in spite of the lack of corresponding guidelines, ESMA should provide information on the target market characteristics. Otherwise, it is to be feared that the open architecture pursued by the Guidelines on Product Governance (see Guideline 16 of the ESMA Guidelines on Product Governance) cannot be achieved in the case of the ESG criteria.

At the same time, it should be borne in mind that the extensions currently preferred for the suitability assessment and product governance are only a first step. In this respect, a high-level approach should also be chosen for the target market characteristics (at least in a first step). In our view, the target market criterion should be described in two forms until legal requirements exist:
• Sustainable: Yes (the product is declared to be sustainable by the manufacturer)
• Sustainable: No (the manufacturer has not declared the product to be sustainable).

Concerning the negative target market we refer to our remarks to Question 7 under d).

In view of the lack of a taxonomy, further characterisations would lead only to IT-relevant implementations now being undertaken, which within a short time would no longer correspond to the legal requirements. This would mean that suppliers would have to bear a double burden of very high implementation costs. This should be avoided at all costs.

c) How should the target market assessment and the matching of a client vis-à-vis the target market 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)?

If the target market criterion of sustainability is subdivided into small parts (for example into environmental, social and good governance), implementation would be considerably more complex for investment houses. The background is that client surveys would have to be considerably more granular and the storage of client data in the advice would be considerably more extensive. The assessment would also be considerably more complex, since the corresponding special characteristics of clients and products have to be reconciled. The problems become clear in the example that ESMA has incorporated in the question.

In view of the still outstanding taxonomy and the associated immense legal uncertainty in product classification, the inclusion of sustainability in the suitability assessment and the product governance should occur (at least in one step) in general form. Further subdivisions should occur only when the legal bases exist (i.e. the Taxonomy Regulation has been finalised).

This gradual approach is also in accordance with the principle of proportionality, which has been explicitly highlighted in both the legal bases (Article 9(1), second subparagraph, and 10(1), first subparagraph, MiFID II Implementing Directive) and in Guideline 11 of the ESMA Guidelines on Product Governance. Against this background, no further subdivisions should occur at present.

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.

We refer to the response of the German Banking Industry Committee.
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.
We refer to the response of the German Banking Industry Committee.

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?
We refer to the response of the German Banking Industry Committee.

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.
We refer to the response of the German Banking Industry Committee.

Q13:
Do you agree with the suggested approach and the amendments to paragraph 70 of the suitability guidelines?
We refer to the response of the German Banking Industry Committee.

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 refer to the response of the German Banking Industry Committee.

Contact:
Dr. Birgit Seydel
Phone: +49 30 20225-5353
Fax: +49 30 20225-5665
E-Mail: birgit.seydel@dsgv.de

Contact:
Thomas Nicht
Phone: +49 30 2021-1609
Fax: +49 30 2021-191600
E-Mail: t.nicht@bvr.de