Aviva Response to ESMA consultation “On integrating sustainability risks and factors in MiFID II”

A. General remarks
1. Aviva is strongly supportive of targeted policy and regulatory measures to promote sustainable finance. We have been closely involved in this agenda for many years, including as members of the EU Sustainable Finance High-Level Expert Group (HLEG).
2. We therefore welcome the European Commission and European Supervisory Authorities’ (ESAs) willingness to enact legislative and regulatory change to promote a more sustainable financial system in the EU.
3. We believe the European Commission, in consultation with the ESAs, should develop an indicative, non-binding list of relevant sustainability risks, for firms who wish to do so to use as a reference point when complying with these changes and others introduced elsewhere in the Commission’s Sustainable Finance Action Plan (e.g. the Disclosure Regulation).

B. Response to questions.

Organisational requirements

General 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. (p.9)

We broadly agree with the approach but consider that it could be slightly amended to ensure that all investment firms were taking into account sustainability risks and factors and that the emphasis is on both risks and opportunities that consideration of sustainability brings, rather than solely risks:

MiFID II Delegated Regulation Article 21(1)

ESMA proposal:
Investment firms shall comply with the following organisational requirements: [...] When complying with the requirements set out in this paragraph, investment firms shall take into account the nature, scale and complexity of the business of the firm, and the nature and range of investment services and activities undertaken in the course of that business. Where ESG considerations are relevant for the provision of investment services to clients, firms should take them into account when complying with the above requirements.

Aviva proposal:
When complying with the requirements set out in this paragraph, investment firms shall take into account the nature, scale and complexity of the business of the firm, and the nature and range of investment services and activities undertaken in the course of that business, and the effect of sustainability risks and factors.
Risk management

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.

Again, we broadly agree but would recommend a slightly different form of wording to reflect the focus on risk in this instance, and to align with references to “sustainability risk” in the Commission’s work on this issue and elsewhere:

Article 23 (1)(a) of the MiFID II Delegated Regulation to be amended as follows

ESMA proposal:
1. Investment firms shall take the following actions relating to risk management: (a) establish, implement and maintain adequate risk management policies and procedures which identify the risks relating to the firm’s activities, processes and systems, and where appropriate, set the level of risk tolerated by the firm. In doing so, investment firms shall take into account environmental, social and governance factors.

Aviva proposal:
Article 23(1)(a)
1. Investment firms shall take the following actions relating to risk management:
(a) establish, implement and maintain adequate risk management policies and procedures which identify the risks relating to the firm’s activities, processes and systems, including sustainability risks, and where appropriate, set the level of risk tolerated by the firm;

Conflicts of interest

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?

Yes. We agree that it is essential that firms consider and where possible avoid conflicts between the firm and its products on one hand, and clients’ interests and ESG (and other) preferences on the other.

These could be potentially relevant to the consideration of both suitability and product governance – if a firm’s products are not aligned with a client’s preferences then a potential conflict arises, and it behaves the firm undertaking a suitability assessment to explain this and ensure that the client understands whether or not the firm’s products or the recommended products or investments meet or align with their preferences.

This information should then form part of the information flow into product reviews within the product governance regime, and is also a reason that we recommend that consideration of clients’ preferences relating to ESG are considered for all products, not just those with a particular ESG or sustainability outcome of focus, without consideration of ESG preference in all cases, there is a risk of an incomplete picture of clients’ interests and the interests of the target market.
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.

Based on the request from DG FISMA, which included technical advice regarding potential amendments to the MiFID II Delegated Acts to explicitly require the integration of sustainability risks into the investment decision processes as part of the duties towards clients, we would recommend that an additional article be added to the Delegated Regulation to clarify the duty owed by investment firms to their clients under Article 24(1) of the MiFID II Directive.

This is linked to Action 7 in the Commission’s Sustainable Finance Action Plan – clarification of institutional investors’ and asset managers’ duties. We consider that this would also be consistent with the approach taken by EIOPA regarding their technical advice for the integration of sustainability risks into the ‘prudent person’ principle in Solvency II, which saw them recommend an additional article to be added to the Delegated Regulation. ESMA may also wish to add a new recital to the Delegated Regulation to clarify their intention for an additional article.

We would suggest adding an additional article as follows:

Article XX
(Article 24(1) of Directive 2014/65/EU)
1. When providing investment services or activities, or where appropriate ancillary services to clients, in acting in the best interests of its clients an investment firm shall have regard to all financially material risks and opportunities, including (but not limited to) sustainability factors.

Product governance
MiFID II Delegated Directive

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.

The British Standards Institute (BSI) are currently developing a set of sustainable investment standards, at both the product and asset manager level. BSI are also leading work within the International Organisation for Standardisation (ISO) to develop internationally recognised sustainable investment standards. The Investment Association has launched its own consultation with members on a possible product label for the retail market. We believe that together this work will be instrumental in raising the bar in sustainable investment practices and driving investment into sustainable investments.
Moreover, in France we also apply to the French SRI Label under the Article 173-6 of the decree of the French Energy Transition for Green Growth of January 2016. Up to December 2018 Aviva Investors France obtained the French SRI Label for 7 funds. Our strategy is to continue the efforts in that sense and to improve the number of funds with the label.

It is important that any new EU label doesn’t duplicate this existing work as this would create confusion in the market.

In terms of the set of labels, we would favour a joint EU-ISO approach resulting in a label spanning the full spectrum of ESG issues and taking into account the regulatory requirements already in place. Standards should work at the fund manager as well as fund level, the asset class and then the underlying security. Ultimately the final work would therefore need to tie into the existing taxonomy work, the Shareholder Rights Directive, the Non-Financial Reporting Directive, and the other existing areas of the EU Sustainable Finance Action Plan (eg MiFID/ IDD suitability requirements, Disclosure etc).

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 broadly agree, except we think in all instances “where relevant” should not be included, since this will create significant room for firms not to comply. As set out in the answer to question 3 above, we see a need for consideration of ESG preferences in all cases, even if the result of that consideration is that they are not relevant to that product or target market. Without considering preferences in all cases, it is not possible to understand whether or not they are relevant, and a firm making a pre-judgment of whether or not there are relevant ESG preferences within the target market potentially creates a situation where relevant preferences are not being considered.

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.

Yes, with the omission of “where relevant”. Further case studies showing how there are a wide range of possible client responses to the question of their ESG preferences and also a wide range of potential approaches and products that could meet them would be useful in terms of increasing awareness of the wide variety in this area.

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

Not currently – again, this should be reviewed once current proposals have been in place for a reasonable amount of time.

The first bullet point under paragraph 15 shows the importance of considering ESG preferences in all cases – if a product does not have ESG characteristics, the proposed wording might lead a firm to consider it is “not relevant” to consider ESG preferences of clients and potential clients, but as the
bullet anticipates, there may be clients and potential clients within the target market for a non-ESG focussed product who, nonetheless, have ESG preferences that should be considered.

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.

A useful guide is Principles for Responsible Investment document here: https://www.unpri.org/download?ac=1453

Suitability

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.

Please see answer to (7) above.

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?

Yes; in addition we would encourage ESMA to ensure that guidance is sufficiently broad in terms of defining ESG preferences that is can be client-led rather than restricted by definitions.

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.

See answer to Q9 above please.

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

Yes.

Other

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
There is a significant question of knowledge, competence and understanding, both inside the asset management industry and amongst the general public regarding sustainability and financial products and services.

Despite numerous studies and mounting evidence to the contrary, many within the industry believe that there is an inevitable performance trade-off from integration of ESG considerations and in ESG-focussed products when compared to non-ESG-focussed ones.

Too little of the industry understand the variety of possible ways that firms can undertake “sustainable investment” and how these can interact with and meet clients’ preferences. There is also a need for education of the public of the fact that, and the ways in which, their preferences can be reflected in their investments, whether the ones they hold directly or ones though institutional investors. This is particularly the case in relation to the suitability changes (which we warmly welcome).