WWF response to ESMA consultation on MiFID II

1: 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.

For many years there has been a large discussion about the lack of useful sustainability data throughout the investment chain in order for investors to make well-informed decisions factoring sustainability issues everywhere relevant. In the case of retail investors, surveys show convergent findings:

- A survey conducted by Natixis Global Asset Management with over 7000 respondents in 22 countries points out that for around 70% of retail investors, non-financial aspects are important factors for their decision making.

- Similarly, a survey from Schroders surveying 22,100 people from 30 countries found that 78% think sustainable investing is more important to them now than five years ago.

Such high majorities must be adequately captured and integrated in the process to select and offer a product, to ensure that the clients’ investment objectives are fully understood and that suitable products can be recommended on that basis. This is consistent with the objective of the MiFID II product oversight and governance requirements, ensuring that they act in the customer’s best interests during all stages of the lifecycle of the products or services. There is enough evidence to conclude that sustainability considerations should become a mandatory step in the sequence of the advisory dialogue.

WWF has concerns about the high-level principle-based approach, as it is too general – given the climate and other ESG challenges changes, time is tight to shift the trillions to sustainable investments, and financial advisors/investment firms should be required to always ask about, integrate and offer ESG options. As ESMA mentioned in their sustainable finance hearing in Paris in early February, they don’t want to use a prescriptive approach as industries are adapting. In WWF’s opinion, it is precisely because the industry is adapting but has limited information or knowledge on how to do so, that ESMA should be helping them by providing specific guidelines on the steps to follow, not a principle-based approach. Such detailed guidelines would have the multiple benefits of accelerating the process, of reducing the complexity of integrating ESG preferences for the industry, and of reducing the risks of non-compliance.

As part of the advisory process/dialogue, there should be a mandatory question about whether the retail investor has ESG preferences. Such a question should be asked at the end of the usual questionnaire, as it is relevant to start the questionnaire with usual financial issues first. Such a sequence should be clarified by ESMA, as there is no clear sequence in the proposed Commission’s delegated act.

Once this ESG preference question is mandatorily asked and if the retail investor shows interest, an additional ESG-specific questionnaire should be used by the investment adviser to gather more elements on the ESG preferences of the client (which may differ a lot depending on the client). Non-financial investment objectives are diverse in nature and taking them into account might involve trade-offs (e.g. liquidity, diversification). In this context, the design of an unbiased questionnaire can be

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1 Natixis Global Asset Management, 2017: Mind shift – Getting past the screens of responsible investing
2 Schroders (2017), Global perspectives on sustainable investing 2017
complex and thus generate fear of non-compliance with MiFID II basic requirements. **To reduce the cost of implementation and avoid uncertainty, we recommend the development of a standard questionnaire that can be annexed to the ESMA (and EIOPA) guidance and used as a default option by financial advisors and insurance intermediaries, on a voluntary basis.** Such a standard ESG-specific questionnaire would benefit both the clients (as the questionnaire would help to fine-tune their ESG preferences in a clearer way) and the investment advisers (as the questionnaire would structure and facilitate the ESG discussion with the client, reduce complexity and ensure compliance with the new MiFID II ESG-related requirement). Currently, 2° Investing Initiative, together with WWF, are working on the development of a standard questionnaire for suitability assessment, in collaboration with the Bafin, academics, NGOs and the financial industry; and a free and public online financial product comparison tool targeting retail investors directly and financial advisors - funded by the German Ministry of Finance.

Given the very high majority of retail investors that express interest for ESG (financial and non-financial) issues, we believe that in a few years from now, the burden of proof should be reversed, ie the general assumption should be that retail clients do care about ESG issues and those not interested should express it – instead of today’s process where those retail investors who care about ESG issues are the ones required to express it: **an opt out approach on ESG issues should gradually become the new normal, and replace the opt in approach.**

WWF is very concerned about the significant lack of knowledge and common illiteracy on sustainability/ESG issues of most investment advisers: this makes it far less likely that the ESG preference of the client will be integrated properly, as it makes the financial adviser less likely to provide the proper information to the retail investors in case they are interested in these issues. The ESMA should include in its guidance that **sustainability issues shall be integrated as part of the investment advisers’ trainings, to ensure they have the relevant knowledge and ability to answer the client’s ESG-related demand adequately.** Another option is for the ESMA (and the other ESAs) to start working closely with academia that have sustainability expertise.

**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.**

It is positive that ESMA has included in Article 23 ‘*In doing so, investment firms shall take into account environmental, social and governance factors*,’ but WWF believes that it is still too general.

WWF is concerned of ESMA’s focus on (financial) risks: we believe it should go beyond in order to adequately integrate the retail clients’ ESG preferences that are obviously not exclusively a financial risks issue: ESG negative and positive impacts of investments in the real economy should be integrated. According to WWF, when the integration of ESG preferences does not lead to higher financial risks, ESG preferences should be systematically integrated in the process and advice for the retail client. In the cases where the risk profile changes once ESG preferences are integrated, the retail client should be informed about such a risk issue and asked to confirm his/her ESG preferences: the client should be duly informed at all stages of the process, and should be the one ultimately deciding if he/she is willing to go ahead, even if it is riskier financially.
It should be clarified in the draft technical advice and guidelines that the retail client’s ESG preferences need to be properly understood by the financial advisor, so that the ESG objective of the retail client (in term of reducing negative ESG impacts or maximizing ESG positive impacts in the real economy) is clear for the financial advisor. Focusing only on financial risks would be a flawed approach, as retail investors want to create ESG impact in the real economy, which is a different issue from financial risks. For example, the two main motivations for investors to address the topic of climate change are to avoid climate risks and to generate climate impact (reducing emissions in the economy). Both objectives require different approaches, instruments and metrics. Interestingly, the most commonly available climate-focused investment instruments predominantly address the risk side but do not necessarily create impact: Low-carbon indexes, divestment and exclusion help investors reduce their exposure to climate harming practices. If the risks of climate change unfold, investors who make use of such instruments might get hit less hard financially due to their reduced exposure. What they cannot claim, however, is that their low-carbon investments are having a direct impact on the real economy. In order to create such an impact, an investor has to choose an action that can be linked to a change in business practice in the real economy. That objective can be, for example for their portfolio to be aligned with the well below 2° climate target. There are several existing tools available, like the PACTA tool (https://2degrees-investing.org/pacta/) developed by 2° Investing Initiative within an EU research consortium funded by Horizon 2020 (EU budget research fund) and supported by the UN PRI and by the California Insurance Commissioner. The free-to-use, online tool PACTA (https://www.transitionmonitor.com/fr/page-daccueil/) analyses the exposure to climate transition risks of public equity and corporate fixed income portfolios over various climate scenarios. It enables investors to see the gap between their existing portfolio and a below two-degree aligned benchmark.

WWF agrees with ESMA that when the EU taxonomy will be available, it should be integrated in the MiFID II requirements. However, this will take a few years to fully materialise (until 2022 at least). In the meantime, it is therefore necessary that market participants identify ESG classification standards they consider appropriate. It would be useful that ESMA and the Commission recommend one (or few) particular ESG classification standard(s) in order to have the best possible harmonisation.

WWF is concerned that the ESMA consultation paper uses different terminologies for ESG (e.g. ‘ESG considerations/ preferences/ characteristics/ etc.’) that can be very confusing for investment firms. ESMA should clearly define the different terms used in their consultation.

Finally, we agree with ESMA’s following point: “it would also be expected that both the Compliance function and Internal Audit will consider issues related to sustainability risks, as both functions are responsible of monitoring the adequacy and effectiveness of the firms’ risk management policies and procedures”, as sustainability is a cross-cutting issue and should be eventually mainstreamed.

**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?**

Consumer surveys reveal a huge gap between the non-financial objectives of retail clients (‘make a difference’ in the real economy with their money) and the purpose of most ESG products offered today (designed to minimize the exposure of the financial product/footprint to financially material ESG risks).
Intermediaries facing this gap are likely to frame the questions to the retail client in a way that will help them to sell existing ESG products towards their clients. In order to develop evidence-based guidance and avoid exclusive reliance on the information provided by the finance industry, we recommend the EC and the ESMA to support independent research (e.g. consumer surveys, focus groups) on the non-financial investment objectives of pension funds’ beneficiaries and insurance policyholders.

In addition, there may be another conflict of interest between retail clients and intermediaries. Retail clients who are very interested in the ‘real economy’ as mentioned above, care about the sustainability impact of their investments, i.e. the impacts on environment and society. This is totally different from the typically narrow view of financial advisers who focus on financially material ESG risks for their portfolio. This issue is reflected in the following priority recommendation of the High-Level Expert Group’s (HLEG): ‘Require investment advisers to ask about, and then respond to, retail investors’ preferences about the sustainable impact of their investments, as a routine component of financial advice.’

WWF agrees with ESMA that there can be conflicts of interests because retail client’s ESG preferences will most likely not be addressed adequately by investment firms/advisers. This is because even if the retail clients mention their ESG preferences, there is a high risk that the final range of products proposed will not integrate such issues: this is due to the common lack of products containing non-financial objectives in the investment firms’ selected packages. The objective of the MiFID II product oversight and governance requirements, which is to ensure they act in the customer’s best interests during all stages of the lifecycle of the product or service, including with ESG preferences, should be ensured for the investment strategy designed for the clients’ assets.

Regarding shareholder rights, WWF supports the HLEG’s final recommendations: ‘Facilitate retail investor choice by increasing transparency on the sustainability impact and processes of retail funds. The Commission should request all funds, destined for the retail market to disclose clear and understandable information on their sustainability impact, as well as information on the exercise of voting rights’.

**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.**

See Question 1.

**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.**

ESG integration is increasingly seen by the industry as key to sustainable investment. But it is questionable whether, and to what degree, considering such factors leads to positive environmental outcomes in the real economy. We have major concerns on how current market practices design ESG metrics and apply them, as they tend to mainly focus on processes without properly assessing and integrating impacts. ESG scoring is primarily based on companies’ policies and processes, but the focus is
on their adoption, less so their implementation and even more rarely on their impact (positive or negative) in the real economy and society. For example a fossil fuel company may design an oil spill plan, a risk management plan or an energy efficiency plan, and this can be considered best practice by the finance industry. However, this is not measuring the most important issue, which is whether the business model of the fossil fuel company is aligned (or will align) with the climate Paris Agreement, i.e. whether the core of the company’s business model is or will become sustainable or not. Compared to this issue, the oil spill plan, the risk management plan or the energy efficiency plan are secondary as they are add on to mitigate risks inherent to the business model (‘damage control’ add on), but they don’t change the core of the business model.

In the short-medium term, the ESG approach needs to significantly evolve in order to focus on outcomes and impacts, not solely on policies and direct operations, to become forward looking and shape impact metrics everywhere possible.

**Question 6:** 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.

While WWF agrees that the focus on the ‘target market assessment’ is more relevant, as it influences all the stages of the life-cycle of products, we are concerned with the general wording used by ESMA in their draft technical advice, that should be made more specific.

WWF is concerned that the proposed amendments across articles 9 and 10 may lead to different interpretations by investment firms, with worrying wording used such as ‘where relevant’ or ‘including ESG preferences, if any’ that may be interpreted in a very narrow way by investment firms. With this wording, we strongly fear that investment firms providing investment advice and portfolio management could interpret the consideration of clients’ ESG preferences as a ‘comply or explain’ exercise, which would significantly weaken the whole purpose of the delegated acts. The wording “where relevant” should be removed from the text, and the wording about ESG preferences should be framed as “including any ESG preferences” to ensure consistency. Given the Commission’s Action Plan on sustainable finance and its objective to mainstream sustainability in the financial system, the ESG issue should be reflected in all types of products and for all types of customers. ESMA should properly reflect the Action Plan’s main objective in their technical advice, and not state “ESMA notes that these proposed amendments do not require that all investment products always need to have a reference, in their target market, as to whether the products fulfils ESG preferences or not. (...) ESMA interprets the initiative of the Commission in a way that “positive” ESG characteristics of a product shall be identified so that it will be easier to identify which investment products provide a substantial contribution to environmental, social and/or good governance objectives. In contrast, firms are not expected to identify products that have negative impact on these objectives.”

WWF is very supportive of retail clients (and more generally stakeholders) having useful and complete information (in this case about ESG issues), including both positive and negative ESG impacts of the financial product/portfolio in the real economy. Many retail investors will not only want to invest their money in a ‘positive ESG impact product’, but would also disagree if they money is used in ‘ESG negative impact products’. Both are complementary and important, so ESMA should not suggest to focus on the ‘positive ESG impact product’.
WWF agrees that when the ‘EU taxonomy’ will be available, it should be integrated in the product oversight and governance requirements of MiFID II. However, this will take a few years to fully materialise (until 2022 at least). In the meantime, it is therefore necessary that market participants identify ESG classification standards they consider appropriate. It would be useful that EIOPA and the Commission recommend one (or few) particular ESG classification standard(s) in order to have the best possible harmonisation.

Furthermore, we also agree with the following “ESMA notes that manufacturers and distributors should specify with a meaningful level of granularity which ESG preferences the investment product fulfils”, as this can be very relevant for the whole process, especially when matching with the retail client’s ESG preferences. In most cases, even if the clients mention their ESG preferences, there is a high risk that the final range of products proposed will not integrate such issues. This is due to the common lack of products containing non-financial objectives in the investment firms’ selected packages. The objective of the MiFID II product oversight and governance requirements, which is to ensure they act in the customer’s best interests during all stages of the lifecycle of the product or service, including with ESG preferences, should be ensured for the investment strategy designed for the customers’ assets.

**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.**

WWF would like to reiterate that using the language ‘where relevant’ can be confusing and misinterpreted by investment firms: it could be interpreted as a ‘comply or explain’ approach that is not the purpose of the exercise nor what the Commission introduced in its delegated acts. Again, a high-level approach can be equivalent to too much flexibility and lack of granularity.

Regarding the inclusion of what ESMA calls ‘ESG-like objectives’ like “green investment” and “ethical investment”, it is positive that they are included as a special product feature, but this can still be way more specific, with a meaningful level of granularity about ESG preferences and which ones the investment product aims to fulfil (e.g. avoid human rights violations, reduce greenhouse gas emissions, ensure fair taxes, etc).

Regarding the additional case study, as we previously mentioned, WWF supports the HLEG’s final recommendations: ‘Facilitate retail investor choice by increasing transparency on the sustainability impact and processes of retail funds. The Commission should request all funds, destined for the retail market to disclose clear and understandable information on their sustainability impact, as well as information on the exercise of voting rights.’ So we are very supportive of the KIID containing useful ESG information for the investor, but it should focused on the sustainability impacts of the products on the real economy, and such impacts should be evidenced to avoid misleading claims (greenwashing). ESMA mentions here ‘provide explicit positive impact on the environment’, which is excellent; however the metric chosen specifically in that case (‘measured in carbon-footprint’) is inadequate: the carbon footprint of a financial products does not give information on whether the product has an impact in the real economy in term of reducing emissions, as the fund’s methodology can simply reject a high carbon company compared to a similar type of fund, hence have a lower carbon footprint – but this is not
reducing emissions in the real economy. Fund managers need to prove that their fund(s) have climate benefits and evidence them robustly in a transparent and science-based way, to prevent greenwashing.

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

Regarding paragraph 15’s first point, WWF believes, as expressed in Question 1, given the significant majority of retail investors that express interest for ESG (financial and non-financial) issues, we believe that in a few years from now, the burden of proof should be reversed, i.e. the general assumption should be that retail clients do care about ESG issues and those not interested should express it – instead of today’s process where those retail investors that care about ESG issues are the ones required to express it: an opt out approach should gradually become the new normal, and replace the opt in approach. We also believe that the new normal should be for all products to integrate ESG factors, and in case this is not done, it should be clearly explained why (a ‘comply or explain’ approach is relevant for this specific issue).

Regarding paragraph 15’s second and third point, we believe that environmental, social and governance issues will become increasingly specific and sophisticated. Environmental issues will be increasingly detailed in sub-issues like climate mitigation, biodiversity protection, renewable energy support, pollution prevention; it will be the same for social issues (gender equality, decent wages, human rights, indigenous people’s rights, etc) and governance issues (corruption, fair taxes, etc.). This is logical and relevant to develop such growing sophistication, to answer ESG preferences of retail clients in a more and more granular and sophisticated way. However, this is leading to growing complexity and a growing number of potential trade-offs. To solve this complexity, we believe that robo-advice should be developed: retail clients could select different E / S / G sub-issues (and even attribute each of them a score, e.g. 1:priority issue to consider, 2:recommended issue, 3:nice to have); on that basis, a robo-advisor connected to a database of all relevant retail products with all their ESG characteristics would be able to propose several options to the retail client, that are the closest to his/her ESG preferences. Such robo advice is already routine in other sectors to buy a plane or train ticket, or to rent a house for a weekend, with many criteria proposed to the client: robo-advice is therefore certainly feasible for the financial sector, in order to properly integrate the growing complexity of ESG preferences of retail clients.

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 believe that environmental, social and governance issues will become increasingly specific and sophisticated. Environmental issues will be increasingly detailed in sub-issues like climate mitigation, biodiversity protection, renewable energy support, pollution prevention; it will be the same for social
issues (gender equality, decent wages, human rights, indigenous people’s rights, etc.) and governance issues (corruption, fair taxes, etc.). This is logical and relevant to develop such growing sophistication, to answer ESG preferences of retail clients in a more and more granular and sophisticated way.

However, this is leading to growing complexity and a growing number of potential trade-offs. **To solve this complexity, we believe that robo-advice should be developed:** retail clients could select different E / S / G sub-issues (and even attribute each of them a score, e.g. 1:priority issue to consider, 2:recommended issue, 3:nice to have); on that basis, a robo-advisor connected to a database of all relevant retail products with all their ESG characteristics would be able to propose several options to the retail client, that are the closest to his/her ESG preferences. Such robo advice is already routine in other sectors to buy a plane or train ticket, or to rent a house for a week end, with many criteria proposed to the client: **robo-advice is therefore certainly feasible for the financial sector, in order to properly integrate the growing complexity of ESG preferences of retail clients.**

**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.**

Answered in Question 5.

**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?**

While WWF agrees that it makes sense to include ESG preferences when gathering information on the client’s investment objectives as proposed by ESMA in paragraph 28 of the suitability guidelines, we believe that ESMA should clarify how firms should best incorporate client’s ESG preferences within their existing suitability processes. As highlighted by ESMA in their sustainable finance hearing in Paris at the beginning of February, the industry is adapting to these new issues, so it should not be left up to them to decide how to do so.

As mentioned before in Question 1, WWF’s suggestion: as part of the advisory process/dialogue, there should be a mandatory question about whether the retail investor has ESG preferences. Such a question should be asked at the end of the usual questionnaire, as it makes sense to start the questionnaire with financial issues first. Such a sequence should be clarified by ESMA, as there is no clear sequence in the proposed Commission’s delegated act.

Once this ESG preference question is mandatorily asked and if the retail investor shows interest, an additional ESG-specific questionnaire should be used by the investment adviser to gather more elements on the ESG preferences of the client (which may differ a lot depending on the client). Non-financial investment objectives are diverse in nature and taking them into account might involve trade-offs (e.g. liquidity, diversification). In this context, the design of an unbiased questionnaire can be complex and thus generate fear of non-compliance with MiFID II basic requirements. **To reduce the cost**
of implementation and avoid uncertainty, we recommend the development of a standard questionnaire that can be annexed to the ESMA and EIOPA guidance’s and used as a default option by financial advisors and insurance intermediaries, on a voluntary basis. Such a standard ESG-specific questionnaire would benefit both the clients (as the questionnaire would help to fine-tune their ESG preferences in a clear way) and the investment advisers (as the questionnaire would structure and facilitate the ESG discussion with the client, reduce complexity and ensure compliance with the new MiFID II ESG-related requirement).

We agree with ESMA’s reminder “the willingness of a client to invest in ESG products should not be used against the interests of that client”. Going against the interests of the client would obviously go against the investor duties. The guidelines should include a paragraph where the assessment of preference regarding environmental or social impacts should include questions about the willingness to invest in entities that run strategies inconstant with the expected behaviour, the use of shareholder rights to support or/influence the management of these entities, and the trade off that the investor is willing to make to prioritize social or environmental outcomes. The assessment will at least confirm the intention of the investors vis-à-vis the support to the implementation of the Paris agreement (see 2° Investing Initiative’s study ‘Non-financial message in a bottle’).

WWF agrees with ESMA’s statement “the assessment of ESG preferences should not be limited to wealthier clients”: it should be for all clients.

**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.**

N/A – same as Question 9.

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

WWF agrees that there should be consistency between the assessment made as part of the product governance obligations and the rest that cover other product features. The composition of the funds’ underlying assets should be in line with the retail client’s preferences (including ESG preferences). This will contribute to ensuring consistency between the target market and the assets, which is very important.

**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.**
N/A