ESMA Consultation Paper
On integrating sustainability risks and factors in MiFID II
19 February 2019
The Association Française de la Gestion financière (AFG) represents and promotes the interests of third-party portfolio management professionals. It brings together all asset management players from the discretionary and collective portfolio management segments. These companies manage at end 2017 €4,000 billion in assets, including €1,950 billion in French funds and €2,050 billion in discretionary portfolios and foreign funds.

The AFG’s remit:

- Representing the business, financial and corporate interests of members, the entities that they manage (collective investment schemes) and their customers. As a talking partner of the public authorities of France and the European Union, the AFG makes an active contribution to new regulations,
- Informing and supporting its members; the AFG provides members with support on legal, tax, accounting and technical matters,
- Leading debate and discussion within the industry on rules of conduct, the protection and economic role of investment, corporate governance, investor representation, performance measurement, changes in management techniques, research, training, etc.
- Promoting the French asset management industry to investors, issuers, politicians and the media in France and abroad. The AFG represents the French industry – a world leader – in European and international bodies. AFG is of course an active member of the European Fund and Asset Management Association (EFAMA), of PensionsEurope and of the International Investment Funds Association (IIFA).
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 would like to emphasize that all changes should be appropriate to the size, nature, scope and complexity of the investment firms activities and the relevant investment strategies pursued.

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 suggest adding “proportionate to the availability of appropriate and significant data.”

It would be read in Article 23 of the MiFID II Delegated Regulation: “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, proportionate to the availability of appropriate and significant data.”

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 do not see conflicts of interest that are linked in particular with sustainability risks.

Therefore, singling out these particular risks in the case of conflicts of interest seems unnecessary and we would be in favor of deleting this recital.

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.

No
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”?

As of today, labels cannot be the exclusive criteria.

We strongly favor the creation and use of labels - there are several public labels in France - yet, labels are not extensively used by the funds and therefore don’t encompass the entire offer of ESG products existing in the market.

As of today, current market standards are not developed enough to be used in a comprehensive manner by European distributors and clients.

That is the reason why we have strong reservations with ESMA’s suggestion (§8 page 14) that market participants should incorporate “current market standards”.

We need taxonomy to be completed before going further into detail.

We have strong reservations also when ESMA suggests to incorporate “the preparatory work that has been published by the Commission” until the Commission’s taxonomy is in place. (§8 page 14).

This is disproportionate for market participants who cannot constantly adapt their standards each time the Commission issues “preparatory work” until such a taxonomy is in place. Such standards can only be adopted after they have been agreed at EU level. Constantly evolving standards based on the most current discussions in Brussels will be impossible in order to adapt the EMT on a constant basis.

The example given to illustrate the current work of the commission ¹ are far too granular and sophisticated at this stage to be utilized in a customer’s relationship. Investors usually do not distinguish between climate mitigation and climate adaptation or between waste prevention and a healthy ecosystem. We therefore believe that this approach is too complex and would probably overburden investors.

As a consequence, we strongly suggest to keep the high principle approach announced by ESMA in its consultation’s overview and only ask manufacturers to indicate that their products are “ESG”, based on the fact that their prospectus (and/or KIID) indicates it clearly.

It could be envisaged for thematic funds to add 3 others indications, (E) for environmental focused funds, (S) for Social focused funds and (Others) for any other specific ESG exposure.

In any case, we believe a future European label could bring clarity for the European investors by setting minimum common criteria that would allow national labels to be recognized at European level and favor cross-border distribution of labelled products.

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¹ These are: (1) climate change mitigation; (2) climate change adaptation; (3) sustainable use and protection of water and marine resources; (4) transition to a circular economy, waste prevention and recycling; (5) pollution prevention and control; and (6) protection of healthy ecosystems.
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.

Yes, but with two remarks:

1. we recommend using the expression ‘ESG preference’ instead of “ESG preferences” : although most of the clients are opened to the ESG concept, they are not ready yet to select a specific type of investments within the ESG universe except for (E) or (S) as described above.

2. it is unclear whether the negative target market should apply when it comes to ESG preference:

Page 16 [Article 9(9) of the MiFID II Delegated Directive to be amended as follows

Member States shall require investment firms to identify at a sufficiently granular level the potential target market for each financial instrument and specify the type(s) of client for whose needs, characteristics and objectives, including ESG preferences (where relevant), the financial instrument is compatible. As part of this process, the firm shall identify any group(s) of clients for whose needs, characteristics and objectives the financial instrument is not compatible. Where investment firms collaborate to manufacture a financial instrument, only one target market needs to be identified. ]

We suggest

[Member States shall require investment firms to identify at a sufficiently granular level the potential target market for each financial instrument and specify the type(s) of client for whose needs, characteristics and objectives, including ESG preferences (where relevant), the financial instrument is compatible. As part of this process, the firm shall identify any group(s) of clients for whose needs, characteristics and objectives the financial instrument is not compatible. With regard to the ESG preferences in the ‘objectives and needs’ category, a negative target market does not need to be specified. Where investment firms collaborate to manufacture a financial instrument, only one target market needs to be identified. ]

Same remarks for article 9(14), 10(2): it has to be clear that negative markets don’t apply when it comes to ESG characteristics.

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.

We agree with the change in the guidelines.

However, the case study put forward is unrealistic, as it describes a product being invested into primarily illiquid assets but which still provides both daily pricing and daily liquidity. In practice, such a product would not have a low risk indicator. Furthermore, it is unclear what the ‘green project’ certificate would be based on. Lastly, the fund cannot be a UCITS since unlisted assets are not eligible UCITS assets, but the specific reference to the UCITS KIID implies otherwise. We therefore do not believe that this specific case study will be helpful and suggest it is deleted or changed.
Should ESMA want to keep an example, now that the EMT (European MiFID Template developed by the European Working Group) is used throughout the EU for funds and structured products, in our view, ESMA should use the criteria developed in the EMT to develop a target market.

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

We do not think extra-guidance is necessary at this point; on the contrary, flexibility should be given until the market finds its marks.

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 strongly believe that ESG should be used as a single indicator until the taxonomy and methodologies are determined at a European level.

In some cases it could be envisaged for thematic funds to specify 3 indications, (E) for environmental focused funds, (S) for Social focused funds and (Others) for any other specific ESG exposure.

No further details should be explored at this point as to how the criteria would interact with each other and how the target market assessment and matching would be performed in such cases.

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.

See Q.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?

1. We support ESMA’s approach described §6 page 22: “With these amendments, ESMA suggests at this stage the adoption of a high-level approach that leaves sufficient flexibility for implementation by firms and for developing some supervisory practice by NCAs in a field where, at present, there is very limited practical experience.”

In this spirit, we do not agree with the amendments to para. 28 when ESMA asks for the ESG preferences collected from the client to be “granular enough” and “consistent with the EU’s classification system of ESG investment products, once developed “.

This is not consistent with the maturity of the market both from the manufacturers’ side and the investors’ side.
Granularity is not possible beyond (E) or (S)\(^2\); For instance, investors usually do not distinguish between climate mitigation and climate adaptation or between waste prevention and a healthy ecosystem. We therefore believe that a granularity inspired by the Commission’s taxonomy approach is too complex and would probably overburden investors.

In addition, the Taxonomy proposal is still under discussion, meaning that the final definitions are still uncertain. To implement such preliminary considerations, followed by an adjustment later on, would further confuse investors and require the market to adjust recently implemented systems.

Furthermore, we doubt that the Taxonomy, once completed, will allow specification of ESG preferences. The Taxonomy focuses only on economic activities and is therefore on a different level to ESG preferences applicable to financial instruments covering solely such activities such as green bonds. For the majority of financial instruments, the Taxonomy alone will not allow retail investors to identify environmentally sustainable investments.

2. It would be useful that ESMA indicates in its guidelines that knowledge and experience, financial situation and investment objectives ought to be assessed and matched before ESG preferences, as described in para. 11 page 23 of the CP and in the draft amendments to the Delegated Regulation (Recital 6):

[“investment firms providing investment advice should first assess the investor's investment objectives, time horizon and individual circumstances, before asking the client for his or her potential ESG preferences.”]

This indication in the guidelines would secure the selling process and the way ESG is incorporated in the investment advice.

We also recommend that clients are offered two (or more) products; one that matches the financial criteria only and another one that matches both financial criteria and ESG preference; that will allow the client for comparison and help him to make an informed decision.

3. ESMA suggests in para. 12 page 23 two approaches, “simplified” and “advanced”. Unfortunately, the latter is based on metrics measuring sustainability that are still under development and thus do not provide sufficient standardization to use this data confidently for the time being.

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 strongly believe that ESG should be used as a single indicator until the taxonomy and methodologies are determined at a European level. In some cases it could be envisaged for thematic funds to specify 3 indications, (E) for environmental focused funds, (S) for Social focused funds and (Others) for any other specific ESG exposure.

\(\text{\textsuperscript{2}}\) this proposal of granularity should only be optional and not compulsory as most of our products are ESG altogether.
No further details should be explored at this point as to how the criteria would interact with each other and how the target market assessment and matching would be performed in such cases.

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

We agree.