19 February 2019

Steven Maijoor

European Securities Markets Authority
ESMA
75007 Paris
France

ESMA public consultation on Integrating Sustainability Risks and Factors in MiFID II

Dear Mr Maijoor,

CFA Institute welcomes the opportunity to comment on the ESMA’s draft technical advice for the integration of sustainability risks and factors into the Markets in Financial Instruments Directive II (MiFID II). CFA Institute is the global association of investment professionals that sets the standards for professional excellence. We are a champion for ethical behaviour in investment markets and a respected source of knowledge in the global financial community. Our mission is to lead the investment profession globally by promoting the highest standards of ethics, education, and professional excellence for the ultimate benefit of society. CFA Institute has more than 160,000 charterholders in 163 countries and territories, working locally on the ground through 154 local member societies.

Please find below our responses to the questions stated in the consultation paper.

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.

CFA Institute believes that there is no best approach on how to handle ESG integration but agrees that the integration of sustainability risks into legislation should not be too prescriptive as integration of ESG criteria can be executed in different ways.

We also agree that staff involved in the advisory (and decision) process should have skills, knowledge and expertise for the assessment of sustainability risks. However, according to the CFA Institute Environmental, Social and Governance (ESG) global survey 2017, only 31% of the respondents said that they receive training at their firm on how to consider ESG issues. Of these respondents whose
firms provide training, 70% provide it through a vast array of sources, including research papers, books, conferences, and case studies.

CFA Institute does provide adequate education and instruction on ESG issues and strategies. These have been included in the CFA Program curriculum for some time now. We also regularly carry out practice analysis sessions in order to make sure that the curriculum readings on ESG investing reflect current market practice. CFA Institute will also update its materials and exam as ESG practices and strategies evolve.

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.

CFA Institute believes that material ESG risks and opportunities should be disclosed by issuers in order for investors to make the most informed investment decisions possible. It is therefore imperative for asset owners and asset managers to ensure that they incorporate ESG considerations into their investment processes in order to make investment decisions that include all material information (both financial and non-financial information in nature). We agree that firms should communicate to clients and prospective clients thoroughly concerning how they incorporate ESG integration in their investment process.

We caution that an overly prescriptive disclosure system, or a rigid and inflexible taxonomy will not best serve financial firms or their clients. Such a taxonomy needs to be broad enough and flexible enough to allow for a myriad of ESG integration policies and procedures, as we are in early days of ESG integration, with best practices in integration and disclosure emerging. Best in class disclosures from both issuers and financial firms are emerging and will continue to do so. In our conversations with investors around the world concerning ESG integration, we learned that there are many different styles of analysis and disclosure, depending on size, expertise and regulatory environment of a financial firm. We call for a certain degree of flexibility in the establishment of a sustainable taxonomy to allow different best practices to develop and steer away from a one size fits all model.

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, CFA Institute agrees that the addition of a recital would be a useful approach to avoid misrepresentations. We advocate that ESG factoring be consistent with a manager’s fiduciary duty so as to take all relevant and material ESG Information into account when making investment analysis and decisions. A major explanation in the identification of conflicts of interest deriving from ESG investments is fundamental to lead to more investor trust, and especially incentivise investment managers to consider ESG issues as they would have much more clarity that doing so does not conflict with their fiduciary duty.

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 believe that it is reasonable for firms to incorporate ESG considerations within their processes, systems and controls to ensure that the investment and advisory process correctly takes them into account. We agree that these disclosures could include information concerning the ESG integration skills and training of investment firm staff.
This information could also include a brief discussion of methodologies used in ESG integration to give clients a better understanding of how ESG integration is done.

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.

CFA Institute is not an investor or investment manager.

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.

It is early days in the creation and marketing of ESG financial products, and we therefore find a wide range of products that claim to be “responsible, sustainable, or ESG” in nature. Some such “ESG” products have sound assumptions and rigorous analysis behind them and some do not. To avoid greenwashing and allow clients to best match their ESG preferences to the correct product, care must be taken to require the right kind of disclosure concerning whether a product is an “ESG” product or not, and if it is an ESG product – what that exactly means.

Over the past 18 months CFA Institute has worked in partnership with the Principles of Responsible Investment (PRI) to meet with, interview and research financial professionals around the world and their views on ESG integration. One of the fundamental truths that we found is that there are many different definitions of what is “responsible investment, sustainable investment, or ESG compliant investment”. Many think that ESG is simply negative screening, others assume that it is best in class screening, others still think of impact investing when they refer to ESG integration. We consider ESG integration as incorporating all material ESG information into a fundamental financial analysis. However, we acknowledge that not all investment professionals and not all investors share this definition.

It is therefore imperative that each product includes a succinct but complete description of what kind of ESG product it is (negative screening, positive screening, ESG integration, actively managed, passive benchmark follower, etc.). Investors need to know if the products they are offered define ESG the same way they do, so that they can make informed investment decisions.

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 encourage ESMA to provide investment firms and investors with as many case studies that ESMA can to give these groups real world examples to help them better understand the current ESG landscape. Through our partnership with PRI we have produced a report on ESG integration in the Americas1 and are currently finalizing a report due in mid-March on ESG Integration in Europe, Middle East and Africa (EMEA). Investors have found these documents useful, but we have had far more interest (measured by document downloads, web traffic, and anecdotal evidence) in a collection of ESG integration case studies2, which we recently published showing how over 30 different asset managers incorporate ESG into their investment process. This broad range of real-world case studies have given practitioners examples of how to integrate ESG that were more than theoretical. We encourage ESMA to do something similar.

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

We do not believe that extra guidance is needed.

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.

Many organizations are looking to evaluate, and rate issuers and investment firms based on ESG criteria. There are some promising developments such as the Sustainability Accounting Standards Board (SASB) focusing on issuer ESG disclosure, and in particular, on material key performance indicators that will differ from sector to sector. However, these standards, which meant to rate or grade funds and asset managers on the basis of their ESG policies or performance are nascent in their development, so the efficacy of any such rating should be taken with a grain of salt.

The ESG policies, procedures and even performance of investment firms depends somewhat on the quality of their policies and procedures and the expertise of their staff, but also depends on how ESG is defined by those rating them.

Any effort to identify what ESG criteria is most important and why will be limited by the assumptions made and definition of ESG used by those creating the criteria. Such criteria should be created by individuals steeped in ESG integration in the investment world and should be flexible enough to evolve and change as needed to reflect best practices in ESG integration.

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.

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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 argue that investment managers do not need to specifically ask questions regarding ESG factors to their clients, and in general, enquire if and how to take relevant and material issues, including ESG criteria, into consideration in their investment analysis and decision-makers. They do not need approval from their clients on how to do so. However, investment managers can inform their clients that they consider ESG factors in the investment process, and should be able to detail how they do so. We therefore believe that investment managers ought to disclose how they take sustainability factors into account.

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.
No further comment.

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

We agree with the suggested approach and the amendments to paragraph 70.

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 are not an investment firm; thus we cannot answer this question in detail, but in our discussions with investors around the world we see that there is a general disconnect with the interests of clients in ESG integration and the expertise of financial advisors, with the ESG knowledge of advisors playing catch up. The same can be said concerning the ESG integration training of most financial professionals. We therefore encourage ESMA to find ways to facilitate training and education for investment professionals around the topic of ESG integration so that they can better inform and better serve their clients.

Conclusion

We thank ESMA for giving us the opportunity to comment on this matter and are happy to discuss such issues further if ESMA wishes to do so. Should you have any further question about our position, please do not hesitate to contact Josina Kamerling, Head of Regulatory Outreach, EMEA at Josina.kamerling@cfainstitute.org or +32 22071212.

Sincerely,

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