Dufas (the Dutch Fund and Asset Management Association)\(^1\) welcomes the opportunity to respond to the ESMA Consultation Paper “Consultation Paper On integrating sustainability risks and factors in MiFID II” as published by ESMA on 19 December 2018.

In general Dufas wishes to make the following preliminary comments:

- **High-level principles-based approach**

  - Dufas fully supports ESMA in its view that the integration of sustainability preference and ESG criteria in investment products in MiFID II is better done through a high-level principles-based approach. It supports the notion that ESG considerations should be taken into account where relevant for the investment services to clients. A flexible approach is therefore key. Given the dynamics of the development of European taxonomy and dynamics of the notion of sustainability, a high-level principles-based approach seems the only way forward at this stage;

  - Dufas furthermore believes that sustainability preferences within the MiFID II product governance context should not be approached solely in terms of ‘green’ vs ‘non-green’ meaning good vs. bad. In that sense, it should be in alignment with the proposals of the European Commission on sustainable finance, where the Commission also does not wish to classify investment products into ‘green’ vs ‘non-green or ‘brown’; and

  - Dufas believes that the integration of sustainability preferences and ESG criteria in investment products will increasingly become more important to investors. Hence, at the long term, we believe that all investment firms will take ESG for the investment services they offer to clients into consideration.

- **High-level approach versus ESMA Q&As’**

  Dufas understands that the high-level approach at one point of time should require further guidance. We understand, however, that ESMA is contemplating to provide more specific guidance on the basis of Q&A’s in the future. We do believe that where further guidance is needed, this should not be tantamount to introducing specific rules which materially affects flexibility for investment firms, including asset managers that offers investment services to clients, or even may lead to changing implementation aimed to integrating

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\(^1\) The Dutch Fund and Asset Management Association (Dufas) promotes the collective interests of asset managers, investment firms and custodians, operating on and from the Dutch market place – both Dutch and foreign parties. Dufas has a commercial focus, aimed at creating both institutional and retail business opportunities for its members. Central to this is the promotion of an optimal business climate for asset management in the Netherlands. A level playing field for free supply of investment products and asset management services within the European Union and a broadening of the market for investment products are key. Dufas represents over 90% of the Dutch asset management market, both retail and institutional business. Next to independent asset management firms, self-managed (real estate) funds and custodians, Dufas membership is comprised of asset management firms that are linked to banking, insurance and pension funds. For more information, see: www.dufas.nl
sustainability risks. Where the European legislator or ESMA is of the opinion that new material detailed rules on sustainability risks and factors is necessary, we believe that those changes should be made on a level 1 or level 2 and/or at least should publicly be consulted.

- **Timing & sequence:**

Although Dufas does recognize the sense of urgency for these proposals submitted by ESMA, we are concerned about the sequence as proposed. Integrating sustainability risks and factors in MiFID II should ideally be embedded only after finalising the ongoing principle discussions on taxonomy and disclosures on all ESG criteria. This should preferably not be the other way around. This in other to avoid the risk of double implementation.

DUFAS, The Hague, 19 February 2019

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ANSWERS TO ESMA QUESTIONS

2. 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.

Yes. Dufas supports a high-level and principle based approach as to ‘general organisational requirements’.

The majority of members of Dufas support the approach that the proposed requirements ensure embedding ESG in the investment process, where relevant for the provision of investment services. The phrase “where relevant” leaves room for further developments and also allowing investment firms flexibility to decide for which services ESG considerations is relevant and for which services this may not be the case. It also allows the investment firm flexibility in anticipation of future developments, more in particular the development of the ongoing debate on taxonomy and sustainability risks.

Dufas believes that the integration of sustainability preferences and ESG criteria in investment products in MiFID II will be more relevant where and to the extent clients needs and preferences for ESG products increases. ESG becomes relevant when investment firms enter into dialogue with their clients. And how ESG becomes relevant is depending on the outcome of such dialogue with clients.

At the long term, Dufas expects that the integration of sustainability preferences and ESG criteria in investment products becomes gradually relevant to almost all clients, hence also for investment firms. Some members of Dufas nowadays already per default take ESG factors and preferences from clients into consideration.

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.

Yes. Dufas supports a high-level and principle based approach as suggested. However, similar to the proposal set forth in Article 21 MiFID II Delegated Regulation, also in terms of risk management ESG factors have to be considered by the investment firms only in such cases where ESG considerations are relevant for the provision of the investment services provided to clients.

Needless to say risk management techniques as to ESG may evolve depending on the development of ongoing debates on taxonomy, but also depending on relevant third-party data required to make such assessment. Hence, the high level principles-based approach is at this stage the best way forward.

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?
Dufas comments on the ESMA CP On integrating sustainability risks and factors in MiFID II

No. Dufas is of the opinion that it is unnecessary to include a specific recital on potential conflict of interest relating to the distribution of ESG investment products. Normally conflict of interest policies apply to all investment products, irrespective whether they are considered to be ESG or non-ESG investment products.

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.

Yes: Dufas is of the opinion that the incorporation of sustainability risks and factors into the investment process of the investment firm is dependent on the quality of data from ESG research providers. Such quality is absolute key. One should consider how to improve the quality of the work of ESG research providers. In addition one may even consider to subject such data providers to some sort of regulation. The current value of ESG research makes it difficult for the individual investment advisor or portfolio manager to take this into account in his/her advice or portfolio management. ESG data (what is being measured, accessibility of data, how is something being measured, quality of the data etc) is of the utmost importance to (retail) investors, and its advisors. And should therefore have more attention.

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.

No. Dufas supports the reliance on existing national or regional eco or ESG national market standards or labels. However, Dufas is of the opinion that a uniform pan-European Ecolabel or ESG label should at the long term being developed for investment products distributed across the EU. It should at the long term replace labels on a national level. Apart from uniformity this also reduces the undesirable effect of ‘greenwashing’ practices, and promotes cross border marketing of investment products within the European single market. Dufas welcomes therefore the European Commission’s Joint Research Centre’s recent stakeholder questionnaire on “EU Ecolabel for Financial Products”, which seems to be aimed at the development of a pan-European Ecolabel. However, the following should be considered:

First of all, as mentioned in the absence of an European eco label of ESG, Dufas supports the reliance on existing eco or ESG national market standards or labels. Such standards may be crucial for the development of an European eco label of ESG label at the long term. Hence, the future of a pan-European ESG or Ecolabel should not hamper innovation on labels on a national or regional level. Nor one market standard or label should be preferred over another. All these efforts must be considered as equally worthwhile activities with slightly different approaches to fostering responsible investments.

Secondly, such label should be certified by third-party auditors which is the best way to both serve European (retail) investors with ESG preferences. At least such certification should take place on an ‘ex-ante’ basis, not on an ‘ex-post’ basis. This in the absence of (independent) monitoring systems and controls based on which it can be assessed whether the label is also fully adhered to. For the avoidance of a doubt certification by third party auditors should not relate to organisational requirements.
Thirdly, for some thematic funds with e.g. a social aim, the positive relative environmental benefits of these funds may be too insignificant to warrant the EU Ecolabel. In such case, we believe that it should be clearly disclosed that the EU Ecolabel’s purpose is to “certify” environmental contribution and not social.

3. PRODUCT GOVERNANCE

**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 and No.** Dufas agrees with ESMA’s approach that addresses amendments to MiFID II product governance rules. The principle-based approach leaves sufficient flexibility for implementation. Here again the proposed requirements into the target market ensure embedding ESG in the process, where relevant for the targeted client. The phrase “where relevant” leaves room for further developments.

However, first of all, Dufas disagrees with ESMA’s suggestion that financial market participants should incorporate “current market standards and the preparatory work defined by the Commission” until the Commission’s taxonomy is in place. We believe that standards within the MiFID II product governance context can only be adopted and implemented after final agreement on an European level. In the meantime, manufacturers and distributeurs should be allowed to integrate ESG considerations into their overall investment policies in the same high level principle based manner as proposed under UCITS and AIFMD and/or in the way what is already current market practice.

Furthermore, we noticed the suggestion of linking ESG factors to the EU’s taxonomy proposal in paragraph 8 page 14 of the Consultation Paper. We believe the EU’s currently proposed classification is not the right tool to address ESG preferences in the product governance rules. While investors do request the ability to invest in ESG products, they frequently do not distinguish between different aspects of ESG such as climate mitigation and climate adaptation or between waste prevention and a healthy ecosystem in their investment preferences, even though at a societal level they may care deeply about these issues. The scope and applicability of the taxonomy is still under discussion and only covers the environmental economic activities as such is not yet ready for inclusion in product governance disclosures. More importantly investors ESG preferences go beyond economic activities and we could therefore not fully rely on this classification system to meet these preferences. Limiting the assessment to a number of tightly defined economic activities only would make it very complex for investors, distributors and advisors and overwhelm them with information they might or might not fully understand.

In addition, there will need to be a common understanding of these criteria by all stakeholders and converted into machine readable format if they are to be used effectively in the European MiFID II Template (“EMT”). It would in practice require significant expansion of the EMT and at this stage the EMT does not accommodate ESG products that cover multiple factors. At this stage we do not believe investors would benefit from the industry taking on board this level of complexity and cost.

Secondly, Dufas questions whether or not target market of investment products should be categorised in either ‘ESG positive products’ and ‘non ESG products’. Not only because of the absence of an agreed taxonomy framework within the EU, but also because Dufas believes that the target market of investment products should not solely be approached in terms of ‘green’ vs ‘non-green’ meaning good vs bad.

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2 The EMT template as currently designed within the European market enables market parties to comply with MiFID II product governance rules.
Thirdly, however we believe that at the long term- when the EU taxonomy and disclosure framework is well established- all investment products are likely to provide references and information on ESG factors anyway. This in order for (retail) investors to have adequate information on all investment products.

**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.** Dufas agrees with the high-level approach and proposed amendments of the ESMA product governance guidelines in relation to the ‘client’s objectives and needs’ section. This is also in line with the European Commission proposals. More in particular, Dufas agrees with ESMA’s approach that:

- ESG preferences in the ‘objectives and needs’ category should not imply that the investment product is not compatible with clients who do not have those specific objectives or needs;
- where ESG preferences are included in ‘objectives and needs’ this does not lead to a ‘negative target market’ for those investors that do no have those same objectives and needs; and
- where clients have ESG preferences and objectives distribution of non-ESG investment products may not necessarily lead to negative target market distribution in a portfolio approach or where such distribution is done for hedging purposes. This may obviously be different where a client has expressed that he or she only wants to invest in ESG investment products.

As to the case study. Dufas doubts whether a case study would be of added value. Furthermore, one has to bear in mind that the proposed case study of ESMA used may not be a realistic case study. First of all, an UCITS fund that largely invest in loans may be a bit too exotic to serve as an useful example for new ESG products to be developed. Secondly, we doubt whether or not the investment product may have such a low risk indicator as suggested by ESMA due to the potential non-liquidity of such portfolio. In that sense the header used by ESMA “a simple investment fund” may not be that “simple” after all.

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

**Yes.** Dufas welcomes when manufacturers and distributors specify in their target market the ESG considerations separately from each other. Whilst at the same time, financial market parties should be allowed to capture ESG considerations in a single factor. We would welcome additional guidance from ESMA in this context as suggested under paragraph 15 of the Consultation Paper.

**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.**
Dufas recommends as a first step to see environmental, social and governance criteria as a single indicator. In the event the indicator has a “yes” at least one of the three criteria is met. At a later stage, a shift may be made to a multiple indicator approach which may lead to separate identification of environmental, social and governance criteria.

4. **SUITABILITY**

10. 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.

Dufas refers to the comments set forth in Question 5 on the existing national or regional labels and market standards. Please consider such comments also in connection with the suitability considerations.

11. 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?

Most members of Dufas welcome the European Commission’s clarifications in its draft amendments to the Delegated Regulation\(^3\) in relation to suitability and client’s ESG preferences which state that “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 effectively makes ESG considerations more an additional aspect to the other suitability criteria. As opposed to a criterium with the same weight.

Some members of Dufas are, however, of the opinion that ESG factors should be assessed in the same manner and time as the current suitability factors. It should not merely be considered as an additional aspect, particularly where indicated as such by the investor. It should carry the same weight. ESMAs’ approach on this seems from that perspective contrary to ESMAs overall approach that these requirements should be principle based in order to allow investments firms and their every individual client to decide what factor they find important (most) and what investments are suitable for that client. Following this principle based approach, ESMA should trust investment firms in assessing and weigh all suitability factors, including ESG, in a proper manner for each individual client taking into account each individual preference.

12. 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.

Dufas notes that environmental, social and governance criteria are not mutually exclusive. They are highly linked with each other. This calls for a more holistic approach to ESG which should furthermore be developed.

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

Yes. Dufas agrees with ESMA’s approach that ESG considerations should be taken into account when classifying investment products in order to assess whether these products are suitable for those clients of the investment firm that have expressed ESG preferences.

14. 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.

At this stage Dufas is not able to provide costs figures for its members at this stage.

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