

SUMMARY OF CONCLUSIONS

Securities and Markets Stakeholders Group

Date: 13 May 2022
Time: 11:00 – 17:00h
Location: ESMA, 201-203 rue de Bercy, 75012 Paris
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1. Report from the Steering Committee

The SMSG Chair welcomed the new members, Stephan Balthasar and Ben Granjé, and reported on the SMSG activities since the last meeting: 1) the SMSG's response to the MIFID II Suitability Guidelines and 2) the SMSG's own initiative advice on inflation and investor protection. The ESMA Chair welcomed the new SMSG members and thanked the SMSG for the work conducted over the last two months.

2. Adoption of summary of conclusions from 3 February 2022

The summary of conclusions from 3 February 2022 was adopted.

3. Recent market developments

Crypto-assets

SMSG member Ivana Gažić gave a presentation on several aspects of the crypto-market structure, including the demographics and size. She highlighted that for many young people crypto-assets are an investment opportunity. Whilst noting that women are less inclined to take risk, the percentage of women investing in crypto assets is increasing. She gave an overview of the risks, the general lack of awareness that the market is unregulated, the consumer protection issues and ongoing scams. She highlighted the importance of regulating this market through the adoption of the Markets in Crypto-Assets Regulation (MiCA). Despite the sense of urgency, it will be pivotal to understand how this will affect the competitiveness of the EU market.

SMSG member Christian Martin Stiefmüller gave a presentation on crypto assets, highlighting the high volatility and the related losses for retail investors. He also gave an overview of the risk factors and highlighted that liquidity is concentrated in very few assets. Regarding MiCA, he emphasised the need

for an outcome-focused approach and for clarity as to the definition of a financial instrument noting that crypto-assets markets are global.

SMSG members discussed the presentations by underlining the need to assess both the opportunities and risks arising from crypto-assets and the importance of financial education. Regarding the former, certain members highlighted the potential to enhance cross border payments and access to capital. Finally, SMSG members flagged the importance of a timely adoption of MiCA and expressed concerns that some asset managers are building exposure to crypto-assets in long term-saving plans.

In its response, ESMA staff referred to the March 2022 joint ESAs warning, which is being actively promoted on social media, with a view to (re-)alerting consumers to the high risks of many crypto-assets. ESMA is looking forward to the entry into force of MiCA, which together with the DLT pilot regime regulation, will provide for a comprehensive EU regulatory framework for crypto-assets, and agrees with the need to have a clear and consistent definition of financial instruments. Finally, ESMA is actively contributing to international fora and workstreams on the topic, considering the cross-border nature of the phenomenon.

Inducements

Adina Gurau Audibert (SMSG) presented the French and German parts of the KPMG report titled “*Commission-based remuneration versus fees-based remuneration: is there a better model for retail investors?*”, developed in light of the European Commission’s MIFID review and the retail investment strategy. She highlighted that a comparison between the commission-based and fees-based model was needed and she argued that a ban on inducements would shift the provision of investment services towards a fee-based model aiming at a very different retail investor profile and leaving the majority of retail investors with no other choice than self-investing or relying on robo-advisors. She concluded that EU law should not restrict the freedom of retail investors to choose according to their preferences and should allow every distribution model, as long as it doesn’t impair clients’ best interest.

Guillaume Prache presented BETTERFINANCE’s Research Report on Detrimental Effects of “Inducements”. He highlighted that most of retail investors do not understand “inducements” because of the use of non-intelligible terms for commissions and retrocessions received by distributors of retail financial products for selling them. He advised the European Commission to consider the harmonisation of the regulatory frameworks across all European categories of retail investment products and banning commissions for execution-only services, e.g. payment for order flow (PFOF). Furthermore, he advised to clarify that “acting in the best interest of clients” should imply the obligation to “not charge undue costs”. He concluded that the clarification of the wording in EU law and applying it to all retail investment products would contribute to its enforcement and thus to retail investor protection.

SMSG members highlighted that, based on a survey among members of the Certified Financial Analyst (CFA) Institute, 64% of respondents believe that the fees-based structure aims to steer the sales. Overall, SMSG members flagged the importance of fulfilling the obligation of transparency but also the importance of a further cost-benefits analysis. Referring to the United States, some SMSG members highlighted that the quality of the advice is not necessarily linked to the related costs, where the asset management industry is large despite the investment advice services being inexpensive. Other SMSG members highlighted that the cost is inherently linked to the value and quality of the advice.

From its side, ESMA staff highlighted that, since its 2020 technical advice to the Commission in the context of MIFID, ESMA underlined the key importance to properly regulate inducements, in the perspective of investor protection. In that context, ESMA recommended that the European Commission conducts a thorough analysis of inducements and distribution models across the EU, including in

jurisdictions in which inducements are banned. Furthermore, ESMA also worked hard to support further convergence in the application of inducements requirements; while some Q&As have promoted further convergence, it should be acknowledged that the current legislation leaves clear margins for divergent application. Specifically, on PFOF, ESMA expressed strong concerns on the use of PFOF in a statement adopted in July 2021; lately, in its technical advice on certain retail aspects (March 2022), ESMA supported the ban of PFOF proposed by the European Commission in its legislative proposal on the review of MiFIR.

Sustainability Reporting Standards

SMSG member Piotr Biernacki presented the draft report of the European Financial Reporting Advisory Group's (EFRAG) European Lab Project Task Force on European sustainability reporting standards (PTF-ESRS) whilst referring to the European Commission's legislative proposal a Corporate Sustainability Reporting Directive (CSRD). EFRAG's advice to the European Commission, which is currently subject to public consultation, includes draft European Sustainability Reporting Standards (ESRS) which will enhance ESG reporting in the EU on the basis of the International Sustainability Reporting Standards developed by the IFRS Foundation.

The SMSG discussed the draft report. The ESMA Chair highlighted the importance of the proposed ESRSs to ensure clear and consistent information to allowing investors to assess their investments on the basis of ESG criteria. ESMA will assess EFRAG's proposed standards with a focus on investor protection and financial stability and intends to respond to the consultation.

The SMSG Chair raised the question whether the group had an interest to set up a WG on this topic. The minimum threshold for setting up a WG was reached, so that a WG was established on this topic.

Russian invasion of Ukraine

Referring to the various statements published by ESMA over the past months, ESMA staff provided an overview of ESMA's activities in relation to the impact on financial markets of the Russian invasion of Ukraine. ESMA enhanced its market monitoring through risk analysis, in close co-operation with national competent authorities, and with a particular focus on commodity markets and its supervisory mandate in relation to credit rating agencies and central counterparties. Furthermore, ESMA maintained a close dialogue with the regulatory authorities in the United States and in the United Kingdom, in particular in relation to the implementation of the sanctions imposed against Russian individuals and entities.

SMSG member Pieter Schuurs presented the evolution of European energy commodity markets since 2021. He also highlighted the role of energy exchanges and clearing houses in times of political and market turmoil and the regulatory responses at EU and international level. He concluded the presentation by addressing the liquidity challenges, in particular in relation to margins calls in case there would be extreme price developments. This would have an effect both on financial and energy markets and thus their consumers.

SMSG members raised the question whether crypto assets have been used to avoid sanctions. They also pointed to problems for the financial industry to ensure compliance with sanctions and to deal with transactions "stuck in the tunnel", and requested as much coordination as possible. Other members referred to the need for liquidity management tools for funds (which exist for instance in France, but not in Luxembourg) in order to ensure equality between investors.

ESMA confirmed that they are much pre-occupied with the use of crypto, that it is very difficult to assess to what extent they have been used to avoid sanctions, but that, based on market developments ESMA has the impression that they have not been massively used. ESMA follows up closely on the 6 packages of sanctions which have been issued so far, assembles questions for the European Commission to answer. In respect of liquidity management tools, ESMA confirmed that there is currently no common framework on how to segregate stranded assets and how to deal with the suspension of funds due to valuation issues.

4. SMSG's own initiative advice on inflation and investor protection

Giovanni Petrella and Veerle Colaert presented the SMSG's own advice on inflation and investor protection highlighting that inflation represents a source of risk which should be considered by the ESAs and the European Commission. The group highlighted that the regulatory framework already establishes certain obligations about fair, clear and not misleading information, but that ESMA / the ESAs could take certain steps to ensure that inflation risks are adequately dealt with in this context. In addition, they gave advice to ESMA on how ESMA could clarify the MiFID frameworks on suitability and appropriateness, product governance, and reporting to ensure that investment firms adequately deal with the impact of inflation when applying those frameworks. Overall, they highlighted the importance of financial education, also in respect of the impact of inflation on certain investments, on the need for the ESAs to report not only on nominal return but also on real return in their reports, and on the need for the ESAs to ensure a level playing field in any initiatives they would take following this advice.

ESMA staff thanked the SMSG for the analysis of the impact of inflation on investor protection and particularly its focus in identifying concrete retail investors aspects. ESMA agreed that inflation is one of the major risks it is monitoring in the current environment from a retail investor protection and financial stability angle. ESMA will carefully analyse and discuss the proposals put forward by the SMSG within ESMA and consider the actions that could be taken.

5. Suitability issues

Chris Vervliet, rapporteur of the working group on Suitability Guidelines, presented the SMSG's response to the MIFID II Suitability Guidelines. The SMSG made the following general remarks about the sustainable finance legislation: complexity, timing, inconsistencies between different pieces of legislation including suitability and sustainability. There is a risk of mismatch between expectations and availability of products. Furthermore, the SMSG agreed that, while green-washing should be avoided, a possible reverse problem is emerging: the phenomenon of "green-bleaching", which is related to the fact that certain fund managers invest into sustainable activities but refrain from claiming that in order to avoid the related disclosure obligations. In light of these reasons, the SMSG suggested a regular feedback process between financial market participants, stakeholders, regulatory authorities and legislators, including a scheduled evaluation of the SFDR as trigger for finetuning of legislation. The SMSG also suggested that ESMA organises a consultation on how sustainability preferences are assessed and on possible alternative approaches.

ESMA staff thanked the SMSG for the work conducted, highlighting the complexity of the legislation which comes very prominently in the advice.

Sari Lounasmeri introduced the discussion on the EC targeted consultation on options to enhance the suitability and appropriateness assessments. Some SMSG members highlighted the importance of the

portability of the information included within the assessment. Others mentioned the difficulties raised by the portability of the assessment. ESMA referred to its letter to the European Commission on this topic.

6. ESMA Annual Statistical Report on Performance and Costs of EU Retail Investment Products

Giovanni Petrella gave a presentation on the 4th edition of ESMA's Annual Statistical Report on Performance and Costs of EU Retail Investment Products, which highlights that the performance and costs of EU retail investment products for 2020 has been substantially affected by the COVID-19 pandemic while costs only marginally declined over time, and that ESG funds outperformed non-ESG peers, while ESG funds remained cheaper overall.

SMSG members discussed the report. Some members proposed to reach out to academics to develop the analysis further, and suggested to split between light and dark green products, and between gross return, net return and value for money delivered to investors, since there may be good reasons for the difference in costs for retail versus wholesale investors. Other SMSG members pointed out that the reference period of three months, within the active-passive analysis, was short. SMSG members also flagged the importance not only of the management costs but also of the distribution costs when evaluating final investor outcomes. Others highlighted that future research work on ESG funds could be further developed.

ESMA staff informed the SMSG that additional work is currently being conducted on the composition of the costs, management, and performance fees, whilst noting the lack of data. The availability of clear and understandable information on the impact of costs on returns is pivotal to allow investors to make informed investment decisions. For what concerns the analysis of active and passive management during COVID-19, that was an ad-hoc analysis focusing on the crisis related to the break out of the pandemic. For its next report, to be published at the end of 2022, ESMA staff will furtherly develop ESG aspects and analyse cross-border marketing in the European Union.

7. Call for Evidence on ESG ratings

ESMA staff provided a preliminary overview of responses to ESMA's call for evidence on the market for ESG ratings and data providers in the EU. ESMA staff outlined that responses had been sought from three categories of respondents: providers, users and covered entities. The responses received had allowed ESMA to build a reliable picture of the ESG rating providers that are currently active in the EU and some of their principal characteristics. ESMA staff outlined that the responses indicated that the market for ESG rating providers in the EU is similar to that for credit rating agencies. It is composed of a small number of predominantly non-EU entities and a large number of smaller EU entities. The levels of market concentration among the larger non-EU entities also bears a significant resemblance to that which has been seen with CRAs. ESMA staff outlined that in their response to the European Commission they would provide an overview of the constituents of this market, as well as key findings per category of respondent.

SMSG members stressed the need for regulation in this field, also taking into account the need for digitization of ESG-information. They stressed that the industry needs to rely on them because there are not enough data available, which raises the question, however, where they get their data from and how reliable those data are.

ESMA confirmed that ESG rating regulation is one of the missing chains. They clarified that there is need for rules on transparency, governance and conflicts of interests, whereas there is not need to streamline the different methodologies, since the variety in methodologies is good. Investor protection and market efficiency are key objectives in this field.

8. Peer review on supervision of cross-border activities of investment firms

ESMA staff presented the outcome of the peer review on the supervision of cross-border activities of investment firms. ESMA staff highlighted the importance of the peer review in promoting retail investor protection across the EU Single Market. The peer review identified that the national competent authorities (NCAs) covered by the peer review did not specifically, adequately and structurally consider firms' cross-border activities in their supervision or take sufficient supervisory actions to effectively address cross-border risks. The peer review also noted that the Republic of Cyprus had the highest level of outgoing cross-border activities, and by far the highest number of complaints relating to firms' cross-border activities, assessing that a large number of Cypriot firms pose a high risk of investor detriment, due to the frequent provision of services involving speculative products, with aggressive marketing behaviour. As a result of the peer review, ESMA has issued an article 16 recommendation to the Cyprus Securities and Exchange Commission (CySEC) to significantly strengthen the supervision of Cypriot firms' cross-border services. Finally, the peer review identified that overall, NCAs appear to have established adequate processes in relation to the passport notifications and in the context of bilateral cooperation.

SMSG members reacted that these are alarming results requiring close monitoring and asked how and when ESMA will follow up on its recommendation to CySEC. They stressed the need for cooperation between NCAs in relation to cross-border activities.

9. AOB

ESMA staff updated the SMSG on the mandate received from the European Commission to amend the Regulatory Technical Standards (RTS) under the Sustainable Finance Disclosure Regulation (SFDR) in relation to product exposures to gas and nuclear activities. Given the short deadline of only five months, ESMA was suggested to forego a public consultation by the European Commission owing to the urgency of the matter. ESMA would like to at least provide the SMSG with an opportunity to comment on the draft disclosures. The SMSG chair asked whether there was an interest in the group to set up a WG on this issue, which would be ready to respond once ESMA would send its draft. At the meeting the minimum threshold for a WG was not established, but this would be followed up by email after the meeting.

ESMA staff informed the SMSG that the mandate of Veerle Colaert as Chair and Rainer Riess and Christiane Hölz as Vice-Chairs of the SMSG is coming to an end in July 2022. The SMSG will therefore be invited to appoint its next Chair and Vice-Chairs during its 8 July 2022 meeting.

PARTICIPANT LIST – SMSG 13 May 2022

Name	Organisation	
Alemanni, Barbara	University of Bocconi	absent
Avgouleas, Emilios	University of Edinburgh	absent
Balthasar, Stephan	Allianz SE	present
Bergmann, Henning	Deutscher Derivate Verband (German Derivatives Association)	excused
Bezzina, Geoffrey	Head of the Arbitrer's office, Malta	present
Biernacki, Piotr	Polish Association of Listed Companies	present
Bindelle, Florence	EuropeanIssuers AISBL	present
Christov, Lubomir	Advisor to the Bulgarian National Association "Active Consumers"	present
Colaert, Veerle	KU Leuven University	present
Funered, Urban	Swedish Securities Dealers Association	present
Gažić, Ivana	Zagreb Stock Exchange	present
Granjé, Ben	The Flemish Federation of Investors	present
Gurau Audibert, Adina	Association Française de la Gestion financière (AFG)	present
Hölz, Christiane	Deutsche Schutzvereinigung für Wertpapierbesitz e.V. (DSW)	present
Jewell, Dermott	Consumers' Association of Ireland	present
Litvack, Eric	Société Générale	present
Lounasmeri, Sari	Finnish Foundation for Share Promotion	present
Mandic, Stjepan	Concepto Ltd	present
Oberndorfer, Martha	Advisor to Austrian Public Sector Clients of ESG	present
Pedersen, Morten Bruun	Danish Consumer Council	present
Petrella, Giovanni	Università Cattolica	present

Prache, Guillaume	Better Finance	present
Riess, Rainer	Federation of European Securities Exchanges (FESE)	present
Saade, Virginie	Citadel	present
Santillán, Ignacio	Spanish Investors Compensation Scheme for investment firms (FOGAIN)	present
Scheck, Martin	International Capital Market Association (ICMA)	present
Schuurs, Pieter	Index	present
Stiefmüller, Christian Martin	Finance Watch AISBL	present
Van de Werve de Schilde, Tanguy	EFAMA	present
Vervliet, Chris	European Works Council at KBC Group	present

ESMA PARTICIPANT LIST – SMSG 13 May 2022

Verena Ross	ESMA Chair
Natasha Cazenave	ESMA Executive Director
Frederiek Vermeulen	Team Leader of Governance and Strategy unit
Salvatore Gnoni	Head of Unit of Investor Protection and Intermediaries unit
Claudia Guagliano	Head of Unit of Innovation, Products and Technologies unit
Anne Chone	Senior Risk Analysis Officer of Innovation, Products and Technologies unit
Tania de Renzis	Senior Risk Analysis Officer of Innovation, Products and Technologies unit
Alessandro d'Eri	Senior Policy Officer of Credit Ratings Agency
Cristina Iudice	Senior Convergence Officer of Investor Protection and Intermediaries unit
Stephen Hynes	Senior Policy Officer of Corporate Finance and Reporting unit
Patrik Karlsson	Senior Policy Officer of Investment Management unit