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Consultation Paper on integrating sustainability risks and factors in MiFID II

Finanzplaner Forum is a network of qualified and certified financial advisors and planners, who directly serve their clients. It is from this position that our comments are made. FPF is pleased to comment on the Consultation Paper on integrating sustainability risks and factors in MiFID II, ESMA35-43-1210, released 19 December 2018.

Finanzplaner Forum supports the EU Commission's initiative on fostering sustainable investments, and the EU Commission's Action Plan on this matter. We agree that the financial industry can have a pivotal role in this fundamental change.

COMMENT

Finanzplaner Forum welcomes the opportunity to comment on the Consultation Paper on integrating sustainability risks and factors in MiFID II. The aim of the consultation paper is to incorporate ESG components into the financial advice process. Although we welcome and support any initiative supporting sustainable investments, we have to stress the fact that MiFID II and its accompanying legal acts already place a heavy burden on people and firms providing financial advice.

Thus we would like to refer to the consultation document, para 1 Overview, subpara 8 third bullet point: '… not create regulatory complexity or legal uncertainty ….' For our comment we would also like to highlight the second bullet point of subpara 8 'The critical prerequisite for an orderly development is a clear and harmonised taxonomy on green assets, project categories and sectors.'

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.

In general, we agree. However, we would like to emphasize that there is a possible mismatch in time between the duty to comply with the amended suitability guidelines and the fact that, as ESMA put it, this taxonomy will be finalised in the upcoming years and that, at least initially, it will not cover social and governance issues. Investment firms shall take a broad approach to assessing potential sustainability risks.

As long as no common language exits to identify to what degree economic activities can be considered environmentally-sustainable this his leaves advisors and investment firms with the risk that there might be no common ground of understanding between client and advisor. Even worse, if there is no strict and binding taxonomy clients facing an unfavourable, yet sustainable investment could claim wrongful advice.

Therefore, we plea that first the taxonomy is being put in place and only then additional suitability requirements with regard to ESG matters should be enforced.

With reference to the additional training requirements for staff providing advice on ESG-related investments we would like to emphasize that the demand for training and qualification of staff was met by NCAs in a very different manner, some staying rather vague, some being very explicit about the requirements and the degree of qualification. Perhaps these amendments to implementing measures for MiFID II and to the suitability guidelines could be a perfect chance to more harmonise the approach towards knowledge and competency requirements for people providing advice.

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.

No comment

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?

As MiFID II calls for advice in the client's best interest we do not see any necessity to include a special type on conflict of interest. The distribution of own products instead of the distribution of ESG-related products favoured by the client would be a clear action against the client's interest. The same applies to the selling of more costly products or the trial to 'churn' the client's portfolio.

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 comment

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.

This consultation paper highlights six environmental objectives: (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. We very much doubt that this temptingly simple classification really meets reality.

The area of sustainable investments provides a huge variety of approaches and thus of choices. It would be tempting to rely on publicly accepted national labels e.g. TEEC, FNG or Swan Ecolabel, as mentioned in the consultation paper. But we should keep in mind that these labels comprise a huge diversity of approaches to sustainability and ESG criteria. It is similar to the rating of one of the accepted rating agencies: it will not always reflect reality. We have experienced that during the financial crisis when investment graded securities immediately lost value when Lehmann broke down. And one has to explore how and to what extent a CAT bond might be sustainable, even when awarded the FNG Siegel. Therefore, we warn of any euphoria in looking at labels as a perfect remedy.

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.

No comment

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.

No comment

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

No comment

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.

No comment

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.

Given our caveat provided in our comment to Q5 we have to reiterate that it is tempting to rely on recognised national and / or Europe-wide labels. Seen aside from the fact that the organisations awarding these labels will become even more powerful, one has to face the fact the diversity of assessing sustainability with these labels contradicts to the mentioned six very generalised environmental objectives laid out by the Commission.

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 just see a practical problem: The amended suitability guidelines require an investment firm to collect information about the client's ESG preferences, even granular enough to enabling the assessment of the suitability of the investment and, even more, being consistent with the EU's classification system of ESG investment products, once developed. We are afraid that the vast majority of clients is not aware of their ESG preferences. Given this, how should clients provide sufficiently granular information on their ESG preferences – which they don't know? Here the provision should be that the investment firm asks the client on her ESG preferences. And if there is no clear answer this should be clearly stated in a protocol and signed by the client.

The underlying problem is that there will be no simple answer to ESG preferences of clients. Each individual client will have different preferences. Due to this fact a simplified methodology will not meet practical needs.

If, on the other hand, a taxonomy provided by the legislator can be used as a safe haven for product governance and suitability when advising clients we would very much welcome this.

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 are afraid that even well educated advisors will be challenged by assessing ESG factors either separately or to realise how such criteria would interact with each other. Even financial analysts need specialised education to perform their job as an ESG analyst. We have revert to our demand for a strict taxonomy provided by the legislator.

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

Any taxonomy provided by the legislator which can be used as a safe haven for product governance and suitability when advising clients is highly welcome. But we see a liability risk that in the absence of such an ‘official’ taxonomy any investment firm has to ‘build’ and use its own taxonomy.

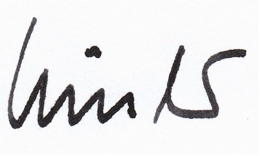
Q14: What level of resources (financial and other) would be required to implement and comply with the proposed changes (risk-management arrangements, market researches and analyses, organisational costs, IT costs, training costs, staff costs, etc., differentiated between one off and ongoing costs)? When 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

No comment

Lastly we are happy to learn that these new amendments to the suitability guidelines are coming into force together with the updated MiFID II Delegated Regulation.

We do hope that our comments are useful and offer our help in any committee work that needs to be undertaken.

Sincerely



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