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BEUC The European Consumer Organisation

The Consumer Voice in Europe

MIFID II SUSTAINABILITY REQUIREMENTS

BEUC response to ESMA consultation

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Why it matters to consumers

Investment products are by nature very complex products that consumers find difficult to understand. This means that consumers are exposed to a number of risks and practices which can have very detrimental consequences on consumers' financial interests. The new MiFID II Delegated Regulation is of great importance in the green transition since it introduces the mandatory assessment of client sustainability preferences during the suitability assessment. It is however essential that consumers can make informed decisions about their investments following their true sustainability preferences free of biased advice and therefore the ESMA guidelines on certain aspects of the MiFID II sustainability requirements must close open loopholes.

Summary

BEUC, the European Consumer Organisation, welcomes the opportunity to comment on the update of ESMA guidelines on certain aspects of the MiFID II sustainability requirements.

On the path to a greener and more sustainable economy, consumers face an additional challenge: the risk of greenwashing when their investments are directed to activities that are not aligned with their interests and values. Thus, the ESMA guidelines on certain aspects of the MiFID II sustainability requirements must close loopholes that would allow financial advisors to steer consumers to their most profitable products, without taking sufficient account of the true investment preferences of the customer. To do so, we recommend that the guidelines ensure that:

- *consumers are able to understand the consequences emerging from their sustainability preferences;*
- *consumers' sustainability assessment reflects the real interest and values of the client;*
- *consumers should be able to rank their preferences in order of importance;*
- *consumers should be made aware that there may be controversial activities for which specific disclosure obligations exist as is the case of the proposed taxonomy Delegated Act as regards economic activities in certain energy sectors;*
- *consumers can express preferences regarding creating a transitional impact versus a preference to hold sustainable assets that do not contribute to financing transition but are free of harm;*
- *consumers should be asked whether their sustainability preferences have changed;*
- *consumers should be informed that sustainability-oriented products might be available elsewhere on the market in case the firm cannot match the consumers' sustainability preferences with its own portfolio, <u>before</u> recommending the client to amend their sustainability preferences;*
- *consumers can amend their sustainability preferences, keeping a record of the different changes made by the consumers, in full compliance with the General Data Protection Regulation.*

General remarks

BEUC, the European Consumer Organisation, welcomes the opportunity to comment on the update of ESMA guidelines on certain aspects of the MiFID II sustainability requirements.

Investment products are by nature very complex products that consumers find difficult to understand. This means that they are exposed to several risks and practices which can have very detrimental consequences on consumers' financial interests. As demonstrated by our campaign the "Price of Bad Advice", kickbacks create the wrong incentives for advisors to steer consumers to products that entail the biggest commissions, but not necessarily the benefits consumers expect.

On the path to a greener and more sustainable economy, consumers face an additional challenge: the risk of greenwashing when their investments are directed to activities that are not aligned with their interests and values. Financial advisors have therefore a crucial role to ensure consumers' sustainability preferences are used for the selection of investment products that correspond to consumers' real investment intentions.

The new MiFID II Delegated Regulation is of great importance in the green transition since it introduces the mandatory assessment of client sustainability preferences during the suitability assessment. Furthermore, the upcoming guidelines could help to align practices amongst financial entities and financial advisors in compliance with the MiFID II Delegated Regulation rules.

However, we would like to stress that while these updates are much needed, as long as the incentives stemming from kickbacks are not properly addressed, there will always be a risk that the advice given to consumers can be biased, even with the entering into the application of the new rules on financial sustainability assessment. Most consumers will simply rely on the investment advice provided to them due to the complexity of these markets and the varying level of financial literacy amongst consumers, and, consequently, they can easily be manipulated and steered towards certain products through personalised recommendations. For example, advisors might well try to influence the client's sustainability preferences to match products included in their own portfolio and/or products that leave the biggest commissions.

For these reasons, , while the updated guidelines cannot tackle on their own the problem of kickbacks, at least they should aim at ensuring the effectiveness of the new MiFID II rules in what concerns the appropriate assessment of investors' sustainability preferences so consumers can be recommended financial products that meet their interests and not those of the advisor.

The below answers are therefore without prejudice to the urgent need to tackle kickbacks in EU law.

BEUC responses to ESMA's questionnaire

Q1. Do you agree with the suggested approach on the information to clients about the purpose of the suitability assessment and its scope? Please also state the reasons for your answer.

The suggested approach on the information to clients about the purpose of the suitability assessment can be problematic if it does not include an information stating that advice is limited in scope to a single product provider for advice settings where this is the case. Many advisors are limited in this fashion and the sustainability properties of products available on the market may match a consumer's preferences even if those offered by the particular advisor do not. For example, some providers and their bound distributors may only offer a single sustainability product or two with the same sustainability profile but different risk profiles.

It is imperative that consumers are made aware that their preferences may be matched by products that the advisor cannot sell and that the choice is not to match expectations to possibilities but to the limited choice offered.

Q2. Do you agree with the new supporting guideline in relation to the information to clients on the concept of sustainability preference or do you believe that the information requirement should be expanded further? Please also state the reasons for your answer.

Besides the understanding of what Environmental, Social and Governance (ESG) objectives mean, there should also be an explanation of the level of ambition of the sustainability aspects a product can have. It is a different choice to invest to make a positive impact on the environment compared to divesting from harmful and polluting activities, for example. This is because very different financial products and instruments are required for these goals. Consumers must receive information and advice about this difference before being asked for a preference.

Consumers need to be able to understand the consequences emerging from their sustainability preferences – what impact they could have on the environment and society with the choice of financial instruments – as well as what impact this would have on their product's financial performance, respectively.

Furthermore, consumers should be made aware that there may be controversial activities for which specific disclosure obligations exist as is the case of the proposed taxonomy Delegated Act[1] on gas and nuclear energy. It is therefore important that the guidelines stipulate that the consumers' attention needs to be drawn to this information as part of the suitability assessment as well as the fact that there are unsustainable investments included even in the sustainable products being advertised. This provision should also include activities that service or supply the primary, unsustainable activity.

Q3. Do you agree with the suggested approach on the arrangements necessary to understand clients and specifically with how the guideline has been updated to take into account of the clients' sustainability preferences? Please also state the reasons for your answer. Are there other alternative approaches, beyond the one suggested in guideline 2, that you consider compliant with the MiFID II requirements and that ESMA should consider? Please provide examples and details.

[1] https://ec.europa.eu/finance/docs/level-2-measures/taxonomy-regulation-delegated-act-2022-631_en.pdf Article 2.

Conditional to an expressed interest in sustainability aspects, the Guideline should also introduce an assessment of the consumers' preference regarding creating a transitional impact versus a preference to hold sustainable assets that do not contribute to financing transition but are free of harm. The assessment should also include a preference for accepting a weakened financial product.

Q4. Do you believe that further guidance is needed to clarify how firms should assess clients' sustainability preferences?

Yes. The guidelines should indicate that it is appropriate to assess the client's wider sustainability motivations even if that is not explicitly required by the regulatory concept of the client's sustainability preference. This is important to be able to conduct a sustainability assessment that reflects the real interest and values of the client.

Q5. Where clients have expressed preference for more than one of the three categories of products referred to in letters a), b) or c) of the definition of Article 2(7) of the MiFID II Delegated Regulation, do you think that the Guidelines should provide additional guidance about what is precisely expected from advisors when investigating and prioritizing these simultaneous / overlapping preferences?

Yes, the guidelines should provide additional guidance about how advisors should prioritise simultaneous and overlapping sustainability preferences of clients. This can be done for example by requiring advisors to ask consumers how they would rank their preferences in order of importance. This discussion should also include an explanation of harm that neglecting different categories of ESG can do. It should also include a discussion of the intended impact in each ESG category that the product pursues.

Q6. Do you agree with the proposed approach with regard to the assessment of ESG preferences in the case of portfolio approach? Are there alternative approaches that ESMA should consider? Please provide possible examples.

N/A

Q7. Do you agree with the suggested approach on the topic of 'updating client information'? Please also state the reasons for your answer.

For the suitability assessment to be performed in a manner that reflects the client's sustainability preferences it is essential that the information remains up to date throughout the relationship with the firm. This implies regular updates of the client's information, even after the first meeting or investment advice. For example, the firm could ask the client once a year whether his sustainability preferences have changed or on subsequent occasions when seeking investment advice.

However, it should be avoided to set an incentive to „move a client to a new product" whenever the level of sustainability awareness or ambition changes. Should an advisor offer a new product because of changed preferences, the cost of this change, including opportunity cost must be made clear to consumers in their own country's currency and percent.

Q8. Do you agree with the suggested approach with regards to the arrangements necessary to understand investment products? Please also state the reasons for your answer.

Only financial instruments that show some level of sustainability-related materiality should be recommended to clients who expressed their sustainability preferences. This means that there should be a clear categorisation of financial products in the guidelines. Unfortunately, while Art. 2(17) of Sustainable Finance Disclosure Regulation (SFDR) does include a listing of objectives that are required to be sustainable, it indicates no threshold for these. As such, it is not suitable to function as a basis for advice because it is an "empty" definition, any product may match it because 0% compliance is also possible.

Q9. Do you believe that further guidance is needed to clarify how firms should take into consideration the investment products' sustainability factors as part of their policies and procedures? Please also state the reason for your answer.

N/A

Q10. Do you agree with the additional guidance provided regarding the arrangements necessary to ensure the suitability of an investment concerning the client's sustainability preferences? Please also state the reasons for your answer.

As a general remark on this section: the suitability criteria are insufficient because they do not prescribe a recommendation to be the most suitable, only suitable in general. This gives commission-based advisors leeway to recommend a product that is more suitable to their interest than to the consumers. This problem does carry over to the sustainability assessment.

In addition, Guideline 84 should be amended to include a clarification towards the consumer that sustainability-oriented products are available elsewhere on the market and that the absence or unsatisfactory nature or quality of such products is not reflective of the set of possibilities.

Q11. Do you agree with the approach outlined with regards to the situation where the firm can recommend a product that does not meet the client's preferences once the client has adapted such preferences? Do you believe that the guideline should be more detailed? Please also state the reasons for your answer.

BEUC's concern is that this approach could mean that firms might try to push their own products by influencing the client's sustainability preferences by suggesting a non-availability of products that match the clients' preferences. In the consultation paper ESMA acknowledges that some firms may need time to adapt their offerings to consumers preferences. BEUC strongly disagrees with the assessment that this must be accommodated. If a suitable product is available on the market, not referring to it in favour of selling a less matching product is an active disservice to the client and a potential unfair commercial practice.

An additional complication is given by the fact that firms might even then try to push consumers to the financial instruments that are most beneficial to the firm due to higher kickbacks, seeing as the suitability rules allow for such actions. The combination of these two factors could jeopardize the effectiveness of the new rules and expose consumers to further mis-selling practices.
In any case where an advisor recommends a product that does not match the original sustainability preference, the guidelines should mandate that the commissions paid to the advisor need to be highlighted again, in this context in particular.

Q12. Do you agree with the approach outlined with regards to the situation where the client makes use of the possibility to adapt the sustainability preferences? Please also state the reasons for your answer.

Tracing changes in the client's sustainability preferences is a good first step. While it may be out of scope for this consultation, it would be wise to also establish a reporting obligation on the relative incidence of such occurrences in a firm's advice offerings towards the competent authorities and the public. Establishing such reporting would disincentivise the overuse of this last resort measure and would generate additional data that could be very useful in future reviews.

Q13. Could you share views on operational approaches a firm could use when it does not have any financial instruments included in its product range that would meet the client's sustainability preferences (i.e. for the adaptation of client's preferences with respect to the suitability assessment in question/to the particular transaction and to inform the client of such situation in the suitability report)?

If there is no financial product that matches the client's sustainability preferences in the portfolio of an investment firm, it should be required that the firm indicates to the consumer that other firms might be able to offer financial products that correspond with their preferences <u>before</u> recommending the client to amend their sustainability preferences.

The firm should also be advised to make consumers aware of not-for-profit options of financial advice available in the respective country – such as that offered by local consumer-organisations or similar institutions.

Q14. Do you agree with the proposed approach for firms to be adopted in the case where a client does not express sustainability preferences, or do you believe that the supporting guideline should be more prescriptive? Please also state the reasons for your answer.

We agree that where there are no sustainability preferences expressed, after consumers are asked, firms can advise financial products with and without sustainability-related features.

Q15. Do you agree with the proposed approach with regard to the possibility for clients to adapt their sustainability preferences in the case of portfolio approach? Do you envisage any other feasible alternative approaches? Please provide some possible examples.

N/A

Q16. What measures do you believe that firms should implement to monitor situations where there is a significant occurrence of clients adapting their sustainability preferences? What type of initiatives do you envisage could be undertaken to address any issues detected as a result of this monitoring activity?

The recommended approach is not ambitious enough to require firms to evaluate their portfolio on the basis of changing sustainability preferences of their clients. Record keeping could be further detailed in the guidelines not only for internal monitoring but also for compliance purposes.

As suggested in the answer to Q12, BEUC would welcome a general reporting obligation on significant occurrences, including the relative likelihood of it happening to that firm's clients in a given year.

Q17. Do you agree with the proposed amendment to supporting guideline 10? Please also state the reasons for your answer.

BEUC supports this change. Switching of financial products can be quite expensive for consumers, incurring additional fees, unfavourable sales and other detriments to the investment purpose.

The requirement should also include making the total cost of the switch apparent to the consumer in the currency of the consumers' country and percent of the investment.

Q18. Do you agree with the additional guidance regarding to the qualification of firms' staff or do you believe that further guidance on this aspect should be needed? Please also state the reasons for your answer.

In such complex markets, the preparation of the staff that will provide investment advice to clients is essential. This implies not only knowledge about the specific financial instruments but also the implications of the client's sustainability preferences to each of them. For example, how a given financial instrument will materialise the client's preference for the support of biodiversity, and what are the type of activities that will be financed through this investment product? Which are the organisations and entities involved in a given project? Clients need to be able to understand that their investment choices will matter and make a change. This is the only way consumers will be able to feel part of the green transition.

Furthermore, training of staff should not be voluntary as implied in the guidelines, it must be a requirement closely monitored to ensure clients are getting the information they need to make informed choices.

Q19. Do you agree on the guidance provided on record keeping? Please also state the reasons for your answer.

The record-keeping of the client's sustainability preferences must be done in a way that reflects the real intentions of the client, the actual preferences as expressed by the client, and not an interpretation of the investment advisor. Any updates must be recorded as well, and the client should be able to compare these updates with their original preferences.

Furthermore, it is essential that the process of collection, recording, and updating of sustainability preferences are done in accordance with the General Data Protection Regulation.

Q20. Do you agree on the alignment of the two sets of guidelines (where common provisions exist for the assessment of suitability and appropriateness)? Please also state the reasons for your answer.

N/A

Q21. Do you have any further comment or input on the draft guidelines?

N/A

Q22. Do you have any comment on the list of good and poor practices annexed to the guidelines?

N/A

Q23. What level of resources (financial and other) would be required to implement and comply with the guidelines (organisational, 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.

N/A

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