ESMA Consultation Paper: Guidelines on certain aspects of the MiFID II suitability requirements: Consultation response from **Rift**

1. Introduction

RIFT is a start-up for good company that aims to reveal to the public the non-financial characteristics of retail savings products (savings accounts and books, life insurance products etc.). Through an interactive and intuitive mobile application, Rift accompanies savers in discovering the impacts of their savings products, identifying the environmental / social values that make the most sense for them and in realigning their financial portfolio with these values. Thanks to its unique database and technology, RIFT has developed the only mobile application on the market that provides investors and savers with such a deep understanding of the impact of their savings.

In January 2022, the European Securities and Markets Authority (**ESMA**) released a consultation seeking views on proposed amendments to the *Guidelines on certain aspects of the MiFID II suitability requirements* (**ESMA Guidelines**). These proposed amendments follow the Commission's adoption of changes to the MiFID II Delegated Regulation to integrate sustainability factors, risk and preferences into certain organisational requirements and operating conditions for investment firms.[1]

As an actor dedicated to increasing public awareness around sustainable financial products as well as the transparency and quality of impact-oriented metrics for non-financial information, Rift is keeping a close eye on the changes made to the MiFID II regulation. **Given its public interest mission, Rift looks favourably upon any development in the market that support consumers in their understanding of both sustainable products and sustainable investment in general.**

This document provides Rift's general comments in response to the Consultation. Please do not hesitate to contact Léo Garnier (leo@riftapp.fr), director of Rift, should you have any questions about our response.

Finance ClimAct Project

To support the Commission's reform agenda, a working group established under the Finance ClimAct project in France is **working to develop a default suitability assessment questionnaire** and **guidance for investment firms** on how to adequately assess client sustainability preferences and wider sustainability motivations. Rift is proud to be a member of the working group, which is led **2DII** and Finance for Tomorrow (**F4T**) and has approximately 20 members,

1 In addition, the review of the ESMA Guidelines considers the results of the 2020 Common Supervisory Action conducted by national competent authorities on the application of the MiFID II suitability requirements and the amendments introduced through the Capital Markets Recovery Package to Article 25(2) of MiFID II.

comprising a mix of financial institutions, civil society organisations, academic institutions, and regulatory authorities.

In this context, Rift has contributed to the working group's response to the consultation, and fully supports the responses to specific questions therein. Nonetheless, given Rift's unique positioning in the ecosystem, **a separate submission is justified to clarify our take on the ESMA guidelines.**

2. General comments

1. ***The concept of "sustainability preferences" as defined in the regulation is insufficient to assess customer preferences. A more granular perspective is needed to enable satisfactory product recommendations for investors.***

The regulatory concept of client "sustainability preferences" is articulated as a client's preference for one or more of three categories of financial instrument. While sustainability preferences as defined in the regulation are built around the concepts of greenness and sustainability, investor objectives tend to be more about personal values, impact, and financial performance. This creates a risk of many potential mismatches between what sustainability features clients want and sustainability features of recommended products.

To start off, there is a blind spot in the MiFID Delegated Regulation around impact-oriented financial instruments (i.e., those which have an objective of delivering additional, intentional, and measurable environmental or social impact alongside a financial return). These are different to an investment in an economic activity that contributes to an environmental or social objective as defined in SFDR, since they bring about a change in the real economy. **The results of numerous studies we have carried out at Rift suggest that most our users wish to have an "impact" on the real economy through the subscription of impact-oriented financial instruments.** There is a strong risk that the preferences of such customers will not be met as these products cannot be identified through the SFDR and MiFID II product classifications alone.

In addition, just looking at the regulatory concept of "sustainability preferences", as is currently done in the MiFID II Delegated Regulation, may not capture all the granular aspects or how investors interested in SRI want to invest their money. Indeed, financial instruments have a range of investment strategies which are suitable for different investment goals and risk appetites. Equally, some clients may have specific priorities for their investments (excluding a certain sector such as fossil fuels, focusing on a specific Sustainable Development Goal, avoiding companies known to be involved in controversies in relation to environmental standards or human rights violations, corruption, tax avoidance etc.). This type of granularity cannot be rendered by the concept of "sustainability preferences" as defined in the regulation. In practice, this means that an **investor registering an objective of investing specifically in social inclusion could end up with a generic low-carbon product that would match categories A or B of the MiFID Delegated Regulation.**

As such, the ESMA Guidelines would do well to assist distributors in helping their clients understand the limits of the categories contained within the MiFID II Delegated regulation. It should be made apparent that the "sustainability preferences" collected cannot be translated into specifically impact-oriented products, or products focusing solely on social and societal objectives, leaving out environmental aspects. One way to achieve this could be for banking advisors to introduce the distinction between ***wider sustainability motivations* (i.e., impact, value alignment or financial performance through ESG) and more *granular sustainability goals* (thematic investing, sectoral exclusion, SDGs etc.).** Doing so, financial institutions would then communicate on the fact that a recommendation may meet *wider sustainability motivations* but not *granular sustainability goals*, thus limiting greenwashing.

2. ***More clarity should be encouraged on the link between the nature of a financial product and ist SRI strategy and real-world impacts.***

Once the notion of "sustainability preferences" has been adequately explained to clients, **the next step is to build on this by detailing the ways in which certain products available on the market may match these sustainability preferences or not.** Particular attention should be brought to the link between the type of financial product and the real-world impact. For instance, it should be explained that a product that is branded as "low-carbon" is one which invests in companies or sectors which have a reduced carbon footprint. **Such an investment strategy would necessarily only invest in a subset of the "real-economy" as leaving out the most polluting sectors.** Likewise, information should be provided on the fact that many products branded as, or labelled SRI might well invest in fossil fuels if they follow a "best-in-class logic" and do not have an exclusion policy.

This sort of practice is key to ensure investor confidence in SRI products. The limit of each SRI strategy should be clearly laid out. For instance, Rift recently showed that in many thematic "water" funds distributed on the market, a significant share of companies invested in were swimming pool manufacturers, golf course watering unit producers, plastic bottle distributors etc. While these businesses are all linked to the topic of water, they are perhaps not the type of ventures that someone who wishes to contribute to SDG 6 (clean water and sanitation) has in mind. **A clear indication of the scope of an investment product should be provided.**

On this topic, we believe that ESMA should go further to provide homogeneous information on each type of SRI strategy (e.g., low-carbon, sectoral exclusion, thematic investment). This would ensure that all clients have the same level of understanding and can make a more educated choice about their preferred allocation of products.

3. ***High level principles and general guidelines are difficult for financial institutions to operationalise, such that uptake is sometimes painful and inconsistent***

The MiFID II Delegated Regulation introduces a mandatory assessment of client sustainability preferences during the suitability assessment. This represents a significant change to current market practice. As such, Investment firms will need to ensure many changes to be compliant with the new requirements – from revising operational procedures to ensuring relevant staff develop the necessary expertise. To achieve uptake across industry and ensure that the end goal of providing better tailored products for clients is met, extensive support and guidance is needed**. In its current state, the proposed amendments to the ESMA Guidelines do not contain significantly more information or guidance than what is already contained in the MiFID II Delegated Regulation.**

Our exchanges with financial institutions around the MiFID II regulation package suggest that the current state of knowledge is not what it should be to ensure successful implementation of the Delegated Regulation. Because of this, we are worried that the ESMA Guidelines may not yield the desired effect in terms of providing additional tools to the investor to make sense of the options available on the market. As such, we believe that additional work is required to bring about the behavioural change in financial institutions and ensure that they have a firm grounding in sustainability issues before implementing the MiFID package. **This will ensure that institutions have skin in the game and align with the spirit of the MiFID II Delegated Regulation – helping clients discover the different types of sustainable products available on the market, rather than stick to mere compliance.**

We consider that there are three key areas, which map the chronological steps in the collection of sustainability preferences, where the ESMA Guidelines could do more to assist investment firms understand how to comply with the requirements in the MiFID II Delegated Regulation. These are:

1. **Explaining sustainability preferences to clients**
2. **Collecting information about sustainability preferences from clients**
3. **Matching products to client sustainability preferences**

For each of these areas, we see the need for ESMA to provide guidelines that can be directly translated into client-facing interactions. For instance, this could include a sample script explaining sustainability preferences in the most succinct and relevant way possible. In the same way, for the collection of information, we believe that ESMA should provide a sample questionnaire to homogenise the collection of information across financial institutions and minimise the interference that may occur from the advisor in shaping sustainability preferences. **At Rift, we believe that the drafts produced by the Finance ClimAct go a long way to increase the clarity of the MiFID II Delegated Regulation general guidelines and make these more operational.**

4. ***Without adapted safeguards, it is difficult to see how investment firms will be prevented from influencing client expression of sustainability preferences and wider sustainability motivations.***

The process articulated in the MiFID II Delegated Regulation leaves too much room for manoeuvre, and therefore affords plenty of opportunity for investment firms – either unwittingly or wittingly – to influence how clients understand and express their sustainability preferences and wider sustainability motivations. **A more prescriptive approach should be communicated by ESMA to investment firms.**

Even if meaning well, there are different ways in which an investment firm can suffer from an unconscious bias in registering sustainability preferences from customers:

- If affected by any number of factors including the existence of company policy to recommend certain financial instruments or the advisor's knowledge and preconceptions about different financial instruments; or
- In the case of an interference with other aspects of sustainability oriented financial instruments (cost, financial return, level of risk etc.)

In practice, clients can be influenced through an explanation which does not relate to all financial instruments available on the market but is instead geared towards those products that the investment firm is able to offer. For instance, as so few investment firms provide the option of purchasing impact-oriented products, this may be entirely kept out of explanations, despite being a product that we at Rift know our community is interested in. **To limit the risk, we believe that bank advisors should be trained on a prescriptive script, requiring them to present a comprehensive list of products available both in-house and elsewhere. Such a box-ticking exercise may be tedious in practice but is necessary to ensure that clients are given sufficient information about what products are available on the market.**

Finally, the ESMA guidelines would benefit from some clarification around the chronological process by which the client can adapt his/her sustainability preferences. Currently, the guidelines are not sufficient to prevent the investment firm from encouraging the client to adopt sustainability preferences which match the product range available. Our position at Rift is that clients should always be able to seek out the financial products that most closely match their preferences, even if this means looking elsewhere on the market.

One procedural safeguard could be the necessity for investment firms to disclose to the client which products the firm would not be able to offer, after the totality of SRI products has been presented (see general comment n°3). **Financial institutions would always be able to offer the closest alternative in the case that no financial products match client preferences exactly.** In many cases, it may be that the client is pursuing many sustainability objectives at the same time which cannot be brought together under a single product. This should be explained clearly by the advisor. From a commercial standpoint, the frustration at not being able to subscribe to a product matching all preferences would thus be offset by the appreciation for greater transparency.

5. ***<u>Further guidance is required on the matching process between financial products and sustainability preferences.</u>***

The Explanatory Memorandum to the MiFID II Delegated Regulation recognises that "whilst financial products referred to in Article 9 of the SFDR must pursue the objective of sustainable investments … financial products that fall under Article 8 of the SFDR might integrate different strategies, even including those that, despite claiming environmental, social and governance (ESG), socially responsible investing (SRI) or sustainability orientation, *might lack sustainability-related materiality*".

As Rift understands this, the mapping between the categories of sustainability preferences under MiFID II and the product category under FDR is unclear. **While *some* article 8 and article 9 products under SFDR may match the requirements of categories A, B or C for sustainability preference as described under MiFID II, no automatic correlation can be drawn.** For MiFID II category A in particular, the SFDR classification is not particularly useful, and a much more in-depth analysis of the product would be required to determine whether it is linked to a real environmental materiality and meets one of the sectoral objectives as described under category A (mitigation, adaptation, circular economy, waste prevention, biodiversity…).

Currently, the momentum behind the SFDR product categorisation induces a risk that this becomes the standard definition of sustainability preferences, leading investment firms to pursue a matching strategy between MiFID II categories of sustainability preferences and SFDR categories of financial products. **This would be truly counterproductive at a generalised level and lead to a loss of confidence in the capacity of investment firms to recommend relevant products.** ESMA should be clear on the imperative to separate the two classification systems, reminding all that SFDR should only be used for disclosure purposes, not to feed into recommendations made to consumers. Having said this, the entry into force of the PAI regime with the second level of the SFDR regulation in January 2023 is a reassuring prospect. This will support the ability of financial institutions to communicate on the real-world impact of products (see general comment n°1), thus reinforcing capacities to consider more granular sustainability preferences.