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AFG's Response to ESMA's call for Evidence of the integration of ESG preferences on suitability and product governance arrangements

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AFG'S RESPONSE TO ESMA'S CALL FOR EVIDENCE OF THE INTEGRATION OF ESG PREFERENCES ON SUITABILITY AND PRODUCT GOVERNANCE ARRANGEMENTS

AFG welcomes ESMA's call for evidence on integration of ESG preferences on suitability and product governance arrangements.

Since August 2022, distributors shall adapt their suitability assessment process and include questions about the clients' sustainability preferences (references to SFDR, PAI and Taxonomy).

While we believe that this CfE may be premature (requirements have only applied for 1 year) it is really interesting to have an insight into the difficulties faced by actors in implementing these new requirements.

Q18: Do you have any comment on the above practical examples?

AFG agrees on the approach taken by ESMA with regards the "portfolio approach", however we believe that the format used to compare products may not always be practical. In the case of institutional clients, asset managers offering portfolio management services respond to a request for proposal (RFP). Consequently, the examples provided by ESMA may not be relevant because there are no recommended products and the ESG preferences assessment will be limited to the filling in of the RFP.

Q20: What are the issues that firms encountered in the application of the requirements at portfolio level?

First, firms encountered issues with regards to the composition of their portfolios. They report challenges due to clients' multiple sustainability preferences across different segment of their asset holdings. The definition of the risk-return profile of the client precede the application of any sustainability preferences that clients whish.

Notably, government bonds play an important role in retail's portfolio diversification. It is important to recognize sovereign bonds as possible eligible sustainable investments to have a perfect match between a low-risk offer and clients high sustainability needs. In some cases, unadvised retail clients who trade on their own with high sustainable investment expectations could be in a situation where they invest in sustainable products at the expense of the portfolio's diversification .

Last, we would like to reiterate that it is important for the authorities to clarify the eligibility of government bonds as « sustainable investments » under SFDR to avoid national discrepancies.

Q21: How are clients' sustainability preferences gathered on the consideration of PAIs? Do firms refer to the PAI indicators listed in Annex I of the SFDR Delegation Regulation exclusively, or may clients express their preferences based on other PAIs? If clients may express their preferences based on other PAIs: what are those PAIs and how were they identified?

Clients generally express PAIs by groups of PAIs (climate/environmental/social/etc) in line with ESMA's guidelines of September 2022 and not by strategies. We believe that distributors are the best suited to answer this question.

We take the opportunity of this CfE to recall that there is a lack of data with regards some PAIs consideration. Hence, we believe that adding news PAI indicators at this stage could pose considerable challenges.

While we appreciate flexibility offered by ESMA with regards PAI consideration (as per ESMA Final Report on Guidelines on certain aspects of the MiFID II suitability requirements – Annex III, §27). We believe that the PAI considered under the sustainability preferences should be limited to the one listed in Annex 1 – table 1 of the SFDR Delegated Regulation to avoid any data issues.

Q30: How are firms, in their capacity as manufacturers and/or distributors, defining the target market for products with sustainability-related objectives, in terms of granularity? Please specify the elements that are defined for this purpose. Do firms adopt one single approach for all products, irrespective of whether they are in scope of SFDR? In case approaches differ, please explain why and how.

The definition of target market by a product manufacturer involves a two-step procedure:

1. Determine if the financial instrument aligns with the client's sustainability preferences. This information is included in both templates developed by FinDatEx (EMT and EET).
2. The sustainability features of the product are communicated to the distributor by the EET. The EET facilitates the comparison between the client's specific preferences and the product's attributes.

Q31: What are the factors that firms, in their capacity as manufacturers and/or distributors, would consider for the periodic product reviews with respect to sustainability-related objectives?

The sustainability related goals are determined based on the disclosures required by SFDR. This data is generated annually.

Q33: How are firms, in their capacity as manufacturers and/or distributors, treating products that do not consider sustainability factors in their product governance processes, specifically concerning the target market assessment related to the sustainability-related objectives (e.g. are sustainability-objectives considered in the negative target market assessment for such products? If so, please explain how).

We understand that distributors and manufacturers usually follow ESMA's guidelines on Product Governance. when products do not consider sustainability factors. This implies that clients with strong sustainability preferences are not recommended such funds.

Q34: Have firms noticed increased demand by clients of financial instruments with sustainability features? Please provide any relevant available statistics on this topic (e.g. percentage of clients asking information about these products; trends over time). Furthermore, please explain if factors such as age, gender, level of education or level of income/wealth play a role in the demand for financial instruments with sustainability features.

We don't have enough representative data to answer this question. However, evidence shows that clients with higher financial knowledge tend to decline sustainability preferences more frequently than the average retail investor. Such investors don't want to be limited to investments with sustainability features only and prefer being advised on the entire investment universe.

Additionally, it seems that many retail clients who declare higher sustainability preferences are not able to provide details about their sustainability preferences. This shows that there is a need to educate clients on these new and complex concepts.

Q36: Are firms facing specific issues related to data availability/data quality with respect to financial instruments with sustainability features? If yes, how are firms dealing with these issues?

We believe that one of the main issues relates to the absence of universally applicable standards for sustainability products that can be simultaneously linked to a wider concept (for example sustainable objectives or supporting an undertaking's transition) and easily understood by retail investors.

The upcoming SFDR review offers a chance to evaluate the benefit of implementing such standards and improving the regulatory framework regarding sustainability preferences.

As already explained in other questions, another main challenge is the lack of available, comparable and reliable data for fund manufacturers.

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