CONSULTATION RESPONSE

Brussels, 15.09.2023

EFAMA's REPLY TO ESMA's CALL FOR EVIDENCE ON THE INTEGRATION OF ESG PREFERENCES ON SUITABILITY AND PRODUCT GOVERNANCE ARRANGEMENTS

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

While we agree on the portfolio approach taken by ESMA, we are of the opinion that the format used to compare products is not always applicable in practice. For institutional clients, asset managers offering portfolio management services will respond to a request for proposal (including all investment guidelines predefined by the clients) and follow a selection process predefined by the clients. As a result, in this scenario, the examples provided by ESMA will not be applicable as there will be no recommended products and the sustainability assessment will be limited to document the content of the RFP.

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

In relation to the composition of portfolios, our members report challenges stemming from the varying sustainability preferences of clients across different segments of their total asset holdings. Defining the risk-return profile of the client comes before applying any sustainability preferences that the client may have.

We note that government bonds are key to building efficient diversified portfolios/funds, especially for the cautious risk profiles of many retail clients. Not recognizing sovereign bonds as possible eligible sustainable investments implies a poor match of low-risk offers with clients that have high sustainability investment expectations. As a result, advised retail clients are actually more unlikely to invest in products with high proportions of "SFDR" sustainable investments. Furthermore, unadvised clients trading on their own with sustainable expectations are likely to invest in sustainable products at the cost of proper diversification (one cannot concentrate all fixed-income exposure on Green Bonds, for example). In this context, we would like to reiterate that it is in the interest of all stakeholders that authorities should clarify the eligibility of government bonds as "sustainable investment" under SFDR to avoid national divergences.

Lastly, we find that ESG is a moving target for (potential) investors as they get acquainted, inter alia, with the related terminology and the scale of sustainable investment strategies available. Consolidation in the market will eventually take place, yet its course will be highly influenced by clients' evolving preferences and emerging trends.

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?

While the absence of data may restrict the consideration of certain PAIs, it is also likely that investors are constrained by the multitude of factors available for portfolio optimization. Identifying additional PAIs that universally resonate with the majority of investors could prove challenging. Hence, pursuing further expansion of PAIs may not be advisable.

We use this occasion to highlight that only PAIs chosen in the list of PAIs explicitly outlined in the SFDR should be considered in the suitability test. Introducing additional PAIs beyond those specified in Annex I of the SFDR Delegated Regulation, or employing alternative methods based on PAIs not covered by SFDR as outlined in Article 2(7) of the MiFID II Delegated Regulation, could potentially introduce further and unnecessary complexity.

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.

As a product manufacturer, defining the target market for the sustainability-related strategy generally involves a two-step process.

First, it requires addressing the question of whether the financial instrument aligns with the sustainability preferences of the end client. This question is present in both the European MiFID Template (V4.1) and the European ESG Template (EET V1.1.1), both developed by FinDatEx.

Second, the features of the product that are disclosed through the SFDR annexes are communicated to the distributor through the EET or national adaptations. This allows for a comparison between the individual preferences of the end client and the specifics of the product.

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 objectives are defined by the disclosures under the SFDR. In order to provide the annual reports, this data is generated on a yearly basis.

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/manufacturers generally adhere to the ESMA Product Governance guidelines (dated March 2023) when treating products that do not consider sustainability factors (i.e., Article 6 funds). This means that the negative target market concept is applied concerning sustainability in relation to Article 6 instruments, ensuring that clients with strong sustainability preferences do not receive recommendations for 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.

As our industry is, in many cases, not client-facing, we currently lack representative data on trends regarding client's declared sustainability preferences in the suitability test. Moreover, the short period of time that has passed since implementation (many clients have not even yet reached the one-year renewal period) makes it very difficult to assess how the framework is working in practice.

However, anecdotal evidence suggests that investors with higher financial literacy tend to decline sustainability preferences more frequently than the average retail investor. When asked by advisors about their reason for responding "no" to the ESG preferences question, the most common response is that financially savvy clients do not want to restrict their investment options to products with sustainability features, and prefer recommendations based on the entire investment universe.

We also understand that many retail clients who declare having a sustainability preference are not able to further provide details of such preference, suggesting that many retail clients are unable to navigate the complex sustainable investment landscape and related 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?

The fundamental issue stems from the absence of universally applicable standards for sustainable products disclosures that can be (a) linked to broader concepts, e.g., achieving sustainability goals, supporting companies in transition, or mitigating sustainability risks; and (b) readily comprehensible to retail investors. The forthcoming SFDR review presents an opportunity to assess the advantages of introducing such standards and refining the regulatory framework for sustainability preferences.

Another key hurdle for fund manufacturers is that reliable data from providers and investee companies is not always available. We also note that taxonomy alignment data are generally only available on a yearly basis.

ABOUT EFAMA

EFAMA is the voice of the European investment management industry, which manages EUR 28.5 trillion of assets on behalf of its clients in Europe and around the world. We advocate for a regulatory environment that supports our industry's crucial role in steering capital towards investments for a sustainable future and providing long-term value for investors.

Besides fostering a Capital Markets Union, consumer empowerment and sustainable finance in Europe, we also support open and well-functioning global capital markets and engage with international standard setters and relevant third-country authorities. EFAMA is a primary source of industry statistical data and issues regular publications, including Market Insights and the EFAMA Fact Book. More information is available at www.efama.org

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