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| **EFAMA’s comments on the European Commission’s draft legislative proposals in relation to the sustainable Finance Initiative and the MiFID II suitability requirements** |

***General comments***

**Introduction**

EFAMA[[1]](#footnote-1) strongly supports the promotion of sustainable finance in all its forms and looks forward to engaging with policymakers on the European Commission’s proposals on sustainable finance.

European asset managers have been integrating ESG in their investment processes in different ways for many years. It is part of their pursuit of helping asset owner clients mitigate risk and achieve long-term financial returns and is a key element of their operational excellence and competitive advantage. In listening to clients and providing them with solutions to achieve their investment objectives, the asset management industry contributes to a more sustainable economy by:

* Integrating ESG factors in the investment process, where relevant and material;
* Providing investment solutions that respond to clients’ financial, ESG and impact demands;
* Engaging with companies in their portfolios to better understand the management of their ESG risks and opportunities;

With these important points in mind, we would like to provide you with our comments on the European Commission’s draft legislative proposal to amend the current MiFID II Level-2 Delegated Regulation ([link](https://ec.europa.eu/info/law/better-regulation/initiatives/ares-2018-2681500_en)). However, providing detailed a response given the proposal’s considerable practical and operational implications is extremely challenging at such short notice. We believe that further public debate is necessary and would therefore encourage the European Commission to continue this public discussion before issuing final legislative proposals for approval by the European co-legislators.

**(1) Impact on wider distribution of financial instruments**

In general, we are supportive of the overarching principle to clarify the suitability assessment requirements and formally include client preferences on sustainability. In this regard, we believe it is essential that those carrying out suitability assessments on investor needs are fully included in this conversation. These can range from large wealth managers and discretionary managers to the vast number individual advisors and insurance intermediaries who support European consumers in their investment choices. However, we are concerned with how the proposed changes to one of the most integral cornerstones of the new MiFID II framework will impact the wider distribution of financial instruments (in particular on a cross-border basis) to Europe’s retail investors, and how these changes would work on a more technical level as changes to the MiFID II Level-1 Directive are not foreseen.

We acknowledge that distributors of financial instruments can help to further encourage investments into sustainable products. However, there are many concerns with how the currently proposed changes will affect the existing and still-evolving MiFID II suitability process, as ESMA’s crucial Level-3 suitability guidelines[[2]](#footnote-2) were only published days after the Commission’s publication of this proposal. The financial industry has committed considerable resources both in terms of cost and time over the last couple of years to deliver on this new regulatory environment and provide the best possible outcomes to end-investors. Significant changes, such as incorporating sustainability considerations into suitability tests in the short amount of time, as suggested by the European Commission, are likely to delay the much needed implementation of the new MiFID II requirements. This may create additional substantial costs, further ambiguity and disruption throughout the whole distribution chain, not even a year after the going live date. It is therefore crucial to allow sufficient time for a proper public debate in order to achieve the intended outcomes. More precisely, we would strongly encourage a phased-in approach in building these new requirements, with longer implementation times and more consultation with industry participants.

**(2) Sequence of actions and wider economic implications**

This goes hand in hand with another important point, namely the sequence of actions as proposed by the Commission, which intends to put investment processes in place before a European “sustainable” taxonomy has been developed. For example, how can distributors find suitable ESG products in the short run or report on the value added by their recommendations while there is still no taxonomy in place?

In our view, environmental, social and governance effects of investments are intrinsically linked to each other. The current proposal therefore raises even more questions given the fact that the proposed legislation on taxonomy represents the very first stage in a step-by-step process starting with climate change mitigation to be followed at a later stage by “environment” and “social” dimensions. This contradiction is also reflected in the Commission’s draft proposal which correctly references “environmentally sustainable investments” of the published taxonomy proposal, but only defines “social investment” and “good governance” in a general manner, with no apparent linkages to further EU taxonomy discussions. This approach may not only result in advice on sustainability being provided in a “piecemeal fashion”, but also allow for the parallel development of “social investment” and “good governance” standards at Member State level, which could have serious implications for the cross-border distribution of financial instruments and the pan-European developments of ESG products. Hence, we would argue that investment advice should take an integrated approach rather than putting the environmental, social and governance aspects of an investment in separate silos.

In addition, we also believe that the wider economic implications on non-ESG products must be considered. There is a need to preserve the diversity of investment options for retail investors, including that of not investing in ESG products.

**(3) What it means in practice**

A third crucial aspect – from a legal perspective – is what distributors are meant to do with this information in their investment processes. This is significant as all the information received during a suitability test is required to inform the choice of financial products being offered and being advised on. Currently these criteria are based on the client’s personal situation and risk appetite to be matched with suitable products in terms of costs, returns and risk. Even more importantly, suitability should not be seen just as a set of questions asked at a single point in time, but rather as a process which leads to a regular refresh of the client’s requirements and an ongoing assessment of how the instruments chosen continue to meet the client’s requirements. In this context, it is important to underline that e.g. environmentally sustainable investments are not automatically less risky. In our view, sustainable investment advice does not overlook investing in businesses just because they fail to tick certain boxes; instead it is also about helping businesses improve their ESG policies and processes thus mitigating risks and identifying opportunities. The draft text could risk that (retail) clients indicating an ESG interest are directed into narrow specific investment types.

The question therefore remains: *how will this new process balance or “rank” among these existing criteria, which are very much focused on financial benefits and financial costs, with criteria for measuring ESG outcomes, in particular, before these criteria have been agreed?*[[3]](#footnote-3)

**Conclusion**

We would like to reiterate that we are mindful of the Commission’s objectives with regard to these changes. It is certainly possible to extend the Level-2 framework in the time and manner, as suggested by the European Commission, to simply ask the investor about their disposition towards sustainability. Nevertheless, introducing such important concepts through Delegated Acts, without the proper public debates and missing input from the European co-legislators is not the right preconditions to achieve the intended outcomes.

***Detailed comments to the draft legislative proposal***

With these important considerations about the correct staging of these ESG initiatives in mind and in the event of the proposal on the modification of MiFID suitability rules being maintained, we would also like to provide you with the following comments on the draft legislative proposal (in no particular order):

1. we believe that the assessment of “ESG preferences” or “ESG considerations” in Articles 47, 48, 52 and 54 should apply to instances were such information is relevant to the particular investment advice or portfolio management processes. We therefore suggest to add in each instance the wording “where relevant”.
2. To allow an integrated approach for investment advice we replace the wording in Art. 2 points (7) and (8) “environmentally sustainable investments, social investments or good governance investments” with “environmentally sustainable investments, social investments and good governance investments”.
3. In line with the above comment, we consider the Commission’s proposal to insert “ESG considerations” into Article 48(1) of the Delegated Regulation not in line with the objective and scope of integrating ESG factors in the investment/advisory process, as this paragraph covers the provision of any investment services including any type of ancillary services (such as safekeeping and administration of financial assets). We believe that the references should therefore be deleted.
4. Recital 9 requires investment advisors or portfolio managers to recommend “the most suitable” product to the client. This is not in line with the MiFID II requirements which require investment advisors to find “a suitable” product. Given the range of products investors and investment firms can choose from, it would in practice not be feasible to identify the most suitable product. The proposal should therefore be amended accordingly.

We are grateful in advance for your attention to the concerns expressed in this response and we welcome the opportunity to discuss these with you in further detail. In case there is any additional information that we can provide, please contact EFAMA at info@efama.org or +32 (0) 2513 3969.

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Brussels, 27 June 2018

[18-4033]

1. EFAMA is the representative association for the European investment management industry. EFAMA represents through its 28 member associations and 62 corporate members close to EUR 23 trillion in assets under management of which EUR 14.1 trillion managed by 58,400 investment funds at end 2016. Just over 30,600 of these funds were UCITS (Undertakings for Collective Investments in Transferable Securities) funds, with the remaining 27,800 funds composed of AIFs (Alternative Investment Funds). For more information about EFAMA, please visit [www.efama.org](http://www.efama.org/). [↑](#footnote-ref-1)
2. The ESMA guidelines, in its final version, are for the first time suggesting that it should be good practice for investment advisors and portfolio managers to enquire about an investor’s ESG preferences. There was no public debate over this good practice which was added unilaterally to better align the ESMA guidelines with the Commission’s proposals. [↑](#footnote-ref-2)
3. For example, Article 54(11) of the MiFID Implementing Regulation requires “investment advice or portfolio management services that involve switching investments […] to demonstrate that the benefits of switching are greater than the costs”. [↑](#footnote-ref-3)