European Fund and Asset Management Association

EFAMA'S RESPONSE TO THE COMMISSION'S DRAFT AMENDMENTS ON THE INTEGRATION OF SUSTAINABILITY CONSIDERATIONS INTO MIFID II

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EXECUTIVE SUMMARY

EFAMA[2] has always been a firm supporter of creating a strong framework for sustainable investing which facilitates the transition to a more sustainable European economy. In this context, we see the Commission's work on integrating sustainability considerations into MiFID II as an essential milestone that will further encourage the distribution of ESG products to European investors.

However, to create a supportive environment, it is essential to balance the regulatory framework to enable consistent outcomes. This is especially the case in the current situation, with multiple, parallel regulatory initiatives in the area of sustainable finance. Without consistent underlying concepts, the idea of an enabling "smart" regulation will not materialise.

The question we are faced with now is whether we simply create a tick-the-box exercise, putting sustainability in a niche, or whether we opt for an approach promoting further the dynamic development in sustainable investing, while fostering a race to the top with a big push to transition our economy. The MiFID II delegated acts (as well as UCITS and AIFMD) should ensure ESG mainstreaming.

However, we are concerned that the currently proposed amendments to the delegated acts will hinder the availability of ESG products to investors. Instead of simply inserting the necessary references to the Sustainable Finance Disclosures Regulation (SFDR) Article 8 products (i.e. products promoting environmental and social characteristics, aka ESG strategy products) and Article 9 products (i.e. products pursuing sustainability objectives) into MiFID II, the Commission proposes additional requirements for Article 8 products, which are not part of the SFDR framework. This will create a subset of Article 8 products that are considered non-ESG compliant under MiFID II while blurring the crucial line between Article 8 and Article 9 products.

It is therefore essential that the Commission makes changes to the current proposals to ensure that the final delegated acts are fully aligned with SFDR. There should be a clear distinction between Article 8 and Article 9 products and only the latter should be required to invest in sustainable investments as defined by SFDR Article 2(17) .

[1] European Commission consultations on
- amending Delegated Regulation (EU) 2017/565 as regards the integration of sustainability factors, risks and preferences into certain organisational requirements and operating conditions for investment firms
- amending Delegated Directive (EU) 2017/593 as regards the integration of sustainability factors and preferences into the product governance obligations

[2] EFAMA, the voice of the European investment management industry, represents 28 member associations and 59 corporate members. At end 2019, total net assets of European investment funds reached EUR 17.8 trillion. These assets were managed by close to 34,200 UCITS (Undertakings for Collective Investments in Transferable Securities) and 29,000 AIFs (Alternative Investment Funds). More information available at www.efama.org.

The introduction of principal adverse impact (PAI) goes beyond the existing SFDR requirements, significantly extending the scope of PAI at product-level beyond what was agreed by the European co-legislators. **Considerations of product-level principal adverse impact should, therefore, be deleted.**

Last but not least, due to its many interlinkages, we ask the Commission to also consider our submission to the draft delegated acts on UCITS and AIFMD.

DETAILED ANALYSIS

EFAMA is supportive of the Commission's objectives to integrate sustainability considerations into MiFID II. Its integration will further encourage the distribution of ESG products to European investors.

We commend the Commission for having maintained a high-level principle-based approach in line with ESMA's 2019 recommendations and note that the Commission has removed the overly prescriptive examples of conflicts of interest that were present in ESMA's final technical advice. We also welcome the proposed 12-month implementation period which is important for the whole value chain to properly integrate these changes.

MiFID II revisions are misaligned with SFDR Article 8 products

That being said, our biggest concern is the misalignment of "sustainability preferences" in MiFID II and the scope of "sustainable products" under SFDR. This will create severe problems if not addressed immediately.

At present, Level 2 discussions within SFDR are still ongoing, to outline dedicated rules for products promoting environmental and social characteristics (i.e. Article 8 products) and those pursuing sustainability investments (i.e. Article 9 products).

Both categories of sustainable products are meant as complementing, alternative solutions for sustainable investing, suiting different investor preferences. In this context, the MiFID II delegated acts should not restrict investors' choice – at the point of sale – by imposing additional requirements on Article 8 products. **Which type of products can be considered as sustainable must be consistent throughout all relevant pieces of EU law. We must avoid a situation in which a client who expresses sustainability preferences cannot be offered an Article 8 product while the very same product can be marketed as promoting environmental or social characteristics under SFDR.**

That being said, we are strongly against amending the notion of Article 8 products at this point. However, if the Commission believes that certain conceptual elements are missing, those must be properly introduced and discussed under the SFDR framework rather than through technical changes to MiFID II, effectively limiting what types of ESG products can be distributed throughout Europe.

Article 8 products are considered as fully-fledged ESG products under SFDR

Based on our reading of the current draft texts, we strongly reject the Commission's suggestion that financial products promoting environmental or social characteristics "do not necessarily achieve" a certain level of sustainability.

Article 8 products must apply dedicated ESG strategies for the selection of their investments. There is a wide variety of ESG investment strategies existing for funds, including in particular "best in class" approaches, exclusions and ESG engagement. In essence, **Article 8 must be recognised as an appropriate ESG alternative to sustainable investments under Article 9**. They offer material added value to investors, in particular to those wishing primarily to achieve financial returns, while at the same time adhering to certain sustainability standards. Moreover, 'impact investing', which qualifies as ‘sustainable investment’ under Article 9, is a relatively new and immature market segment. The practicability of sustainable investments cannot be taken for granted for all asset classes and investment styles.

Also, prescribing elements of ‘sustainable investments’ for Article 8 products would drastically limit the number of products with sustainability preferences available to investors. This will hinder the goal of mainstreaming ESG products in these crucial early days of the transition to a greener economy. SFDR already has sufficient entity and product-level disclosures which will efficiently frustrate attempts to ‘greenwash’ financial products.

Introducing elements of sustainable investments into **Article 8 products also poses significant challenges to distributors and investors**. The draft SFDR RTS acknowledge that Article 9 products can set aside a portion of their investments which do not qualify as sustainable investments, provided that it does not affect the overall sustainable investment objective(s). However, since the portfolios of Article 9 products cannot be made up of only sustainable investments, it is impossible to determine which proportion of sustainable investments qualifies Article 8 and Article 9 products. A clear delineation between the two categories of sustainable products is key for distributors and investors to understand underlying concepts and to allow for well-informed investment decisions.

Consideration of principal adverse impact

As explained above, maintaining full consistency between the understanding of “sustainable products” under SFDR and the definition of “sustainability preferences” is essential for a practicable and workable EU sustainable finance framework. However, the introduction of principal adverse impact (PAI) considerations also goes beyond the existing SFDR requirements, essentially going against the agreement of the co-legislators. It significantly extends the scope of PAI and interferes with the already categories of ESG products. This, again, creates a crucial misalignment between MiFID II and SFDR which will substantially hinder the mainstreaming of ESG products.

According to SFDR, product-level PAI considerations (Article 7) are only required for financial market players in scope of Article 4 (either by exceeding the ‘500 employees’ threshold or through a voluntary opt-in). The proposed MiFID II DAs would, however, force smaller firms (i.e. under the employee threshold) to opt into Article 4 to produce product-level PAI (i.e. Article 7) disclosures to, in turn, be considered as ESG products under MiFID II.

Furthermore, the current SFDR draft RTS suggest an all-encompassing definition of 34 (!) different indicators, substantially limiting investors’ choice to integrate the sustainability factors they deem most important to them. This definition of PAI, therefore, makes ESG investing a one-size-fits-all approach rather than allowing investors to express their values/views through their investments – something to be fostered rather than hindered through MiFID II’s suitability assessment.

Thus, any references regarding principle adverse impact should be deleted from MiFID II’s final delegated acts.

Availability of reliable information

The final MiFID II delegated acts should make clear that considerations of sustainability risk can only be properly conducted if ESG information is reliable and publicly available to make such assessments possible.

Clarifications regarding the suitability assessment

We would also value clarification that suitability considerations should not take precedence over a client's investment objectives. Also, it would be helpful to make clear that for existing clients, for whom a suitability assessment has already been undertaken, investment firms should be able to rely on the existing suitability assessment until the next planned assessment.

PROPOSED AMENDMENTS

Based on the arguments above, we propose the following amendments to the draft Commission Delegated Regulation (EU) 2017/565:

Recitals

(3) In March 2018, the Commission published its Action Plan 'Financing Sustainable Growth', setting up an ambitious and comprehensive strategy on sustainable finance. One of the objectives set out in the Action Plan is to reorient capital flows towards sustainable investments to achieve sustainable and inclusive growth. The impact assessment underpinning subsequent legislative initiatives published in May 2018 demonstrated the need to clarify that sustainability factors should be taken into account by investment firms as part of their duties towards clients. Investment firms should therefore consider not only all relevant financial risks on an ongoing basis, but also all relevant sustainability risks***, where appropriate, based on the availability of public, transparent, relevant and reliable information related to ESG considerations,*** as referred to in Regulation (EU) 2019/2088 of the European Parliament and of the Council that, where they occur, could cause an actual or potential material negative impact on the value of an investment. Commission Delegated Regulation (EU) 2017/56513 does not explicitly refer to sustainability risks. For that reason and to ensure that internal procedures and organisational arrangements are properly implemented and adhered to, it is necessary to clarify that processes, systems and internal controls of investment firms reflect sustainability risks, and that technical capacity and knowledge is necessary to analyse those risks.

(5) Investment firms that provide investment advice and portfolio management should be able to recommend suitable products to their clients and should therefore be able to ask questions to identify the client's individual sustainability preferences. In accordance with the investment firm's obligation to act in the best interest of its client, recommendations to clients should reflect both the financial objectives and any sustainability preferences expressed by those clients. It is therefore necessary to clarify that investment firms should have in place appropriate arrangements to ensure that the inclusion of sustainability factors in the advisory process and portfolio management does not lead to mis-selling practices or to the misrepresentation of instruments or strategies as fulfilling sustainability preferences where they do not. In order to avoid such practices or misrepresentations, investment firms providing investment advice should first assess the investor's' investment objectives, time horizon and individual circumstances, before asking their clients for their potential sustainability preferences, ***which should not take precedence over a client's personal investment objectives. For existing clients, for whom a suitability assessment has already been undertaken, investment firms should be able to rely on the existing suitability assessment.***

(6) Sustainable products with various degrees of ambition have been developed so far. To enable clients to better understand those products, investment firms that provide investment advice and portfolio management services should clearly explain the distinction between financial products that promote environmental or social characteristics and financial products that pursue sustainable investment objectives. ***Each of these types of financial products is intended to offer added value to clients with different sustainability preferences.*** ~~***Whilst financial products that pursue sustainable investment objectives guarantee the attainment of certain level of sustainability, financial products that promote environmental or social characteristics do not necessarily achieve that. That is why the identification of the client's sustainability preferences should in case of financial products that promote environmental or social characteristics take into account those financial products that at least to some extent pursue sustainable investment objectives, or consider principal adverse impacts on sustainability factors, as laid down by Regulation (EU) 2019/2088. Since, in accordance with that Regulation, certain manufacturers of financial products should be obliged to provide information on how their financial products consider principal adverse impacts on sustainability factors at the latest as of 30 December 2022, investment firms should be able to increasingly***~~

~~recommend also those products as suitable in terms of clients' sustainability preferences after that day.~~

Article 1

Delegated Regulation (EU) 2017/565 is amended as follows:

(1) in Article 2, the following points (7), (8) and (9) are added:

"(7) 'sustainability preferences' means a client's or potential client's choice as to whether either of the following financial instruments should be integrated into his or her investment strategy:

(a) a financial instrument that has as its objective sustainable investments as defined in Article 2, point (17), of Regulation (EU) 2019/2088 of the European Parliament and of the Council;

(b) a financial instrument that promotes environmental or social characteristics as referred to in Article 8 of Regulation (EU) 2019/2088***.~~; and that either:~~***

~~(i) pursues, among others, sustainable investments as defined in Article 2, point (17), of that Regulation; or~~

~~(ii) as of 30 December 2022, considers principal adverse impacts on sustainability factors, as referred to in Article 7(1), point (a), of that Regulation; or~~

(new 10) Sustainability risks, where appropriate, are based on the availability of public, transparent, relevant and reliable information related to ESG considerations. Those sustainability risks might be assessed by investment companies either in qualitative terms or quantitative terms, as consistent with Recital 15 of SFDR.

(4) Article 33 is replaced by the following:

[…]

(d) in paragraph 12, the first subparagraph is replaced by the following:

"12. When providing investment advice, investment firms shall provide a report to the retail client that includes an outline of the advice given and explains how the recommendation provided is suitable for the retail client, including how the recommendation meets the client's investment objectives, his or her personal circumstances with reference to the investment term required, the client's knowledge and experience, the client's attitude to risk, his or her capacity to sustain losses and his or her sustainability preferences***, if any***.";

Similar amendments need to be made to Article 1(1) of the draft Commission Delegated Directive (EU) 2017/593.

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