Nederlandse Vereniging van Banken

NVB response to Commission proposals on financing sustainable growth- MiFID II suitability requirements

The Dutch Banking Association (Nederlandse Vereniging van Banken, or 'NVB') welcomes the opportunity to comment on the amendments to MiFID II delegated act, which is part of the Commission proposals on financing sustainable growth ('Commissions package').
The NVB represents all commercial and semi-public, Dutch and foreign banks and credit institutions operating in the Netherlands (approximately 70). The NVB strives to achieve a strong, internationally competitive and sustainable banking system in the Netherlands. Promoting a sustainable economy is currently one of the focal points of the Association's work programme.

Governments from around the world have chosen a more sustainable path for our planet and our economy by adopting the 2016 Paris Agreement on climate change and the United Nations (UN) 2030 Agenda for Sustainable Development. The Commission aims to reorient capital flows towards sustainable investments to achieve sustainable and inclusive growth. The Commission's package follows global efforts towards a more sustainable economy.

The NVB fully supports this ambition and has already taken various initiatives to increase the Dutch banking sector's contribution to the UN and Paris goals. These include i.a. joint efforts to increase transparency of the (positive and negative) impact of loans and investments on climate change, to promote the respect for human rights in international value chains financed by Dutch banks, and to collectively design innovative financing solutions for the energy efficiency projects and circular business models.[1] The NVB also works closely with the sector associations of insurers, pension funds and asset managers in the Netherlands, united in the Dutch part of the Sustainability Finance Platform, which is hosted by the Dutch central Bank (DNB).[2] On top of these collective, pre-competitive efforts, Dutch banks have set goals for themselves regarding their contribution to the Sustainable Development Goals.

Main comments:

- In essence, the NVB endorses the intention behind the Commissions package's goals. The SDG's and Paris Agreements present a clear dot on the horizon for banks and the Commissions package could create some important guidance for increased sustainable investing.
- However, we do have serious concerns on both **timing** and **method** that might lead to unintended and unforeseen consequences. Like the European Commission, the NVB expects that the establishment of an EU classification system of sustainable economic activities ('taxonomy') will be decisive for the implementation of the other proposals. This adaptive classification system will not be easy to design. The process concerning the realization of taxonomy must be designed in such a way that the objectivity of sustainability of activities is guaranteed. To define the ESG definitions, to create a coherent taxonomy and to make sure all parties are able to have operations in place to report on these criteria, considerable action is needed. In our view, ESG suitability requirements can **only** be effective when the taxonomy framework has been completed. **The current timeline however focusses on embedding ESG in suitability testing without a completed taxonomy framework, including delegated acts, being in place. This entails i.a. the risk of double implementation burden, i.e. one time now and again once separate E, S and G taxonomies have been established and implemented.**
- Besides the problematic timing, the **proposed methods could also prove counter-productive**. Amending MiFID II in order to include ESG preferences in suitability testing without a taxonomy entails the risk of confusing clients and could create biased methods regarding matching ESG-preferences to sustainable investments (i.e. exclusionary

[1] Please refer to the NVB Corporate responsibility factsheet (updated December 2016): https://www.nvb.nl/media/document/002093_nvb-fact-sheet-corporate-responsibility-2017-eng.pdf
[2] More information on the DNB website: https://www.dnb.nl/en/about-dnb/co-operation/platform-voor-duurzame-financiering/index.jsp

screening vs. positive screening). It could also lead to a possible shift away from advice and individual portfolio management to execution-only because the client is not always interested in time consuming suitability tests**.**

- **From a legal standpoint, we see no clear basis in Directive 2014/39 to amend the Delegated regulation 2017/565 as proposed.** The existing framework on suitability assessments aims to ensure investor protection. The amendments aim to make investments more sustainable by considering ESG factors in the investment decision making process. **Furthermore, there is no clear impact assessment yet on how the existing and new suitability assessment factors will interact.**
- **The transitional period in the MiFID II regulation should not start before the Commission will have specified the taxonomy in delegated acts.** In this way, a client knows better what he agrees upon when he/she indicates his/her preference for ESG investing. To banks it is then clear how to match such preferences against possible investments. **If the EC does stick to the proposed timeline the NVB suggests that only high level (non-detailed) ESG preference questions should be incorporated in a suitability test.**

<u>**Concerns regarding the method**</u>

How does the current suitability assessment, that aims to secure investor protection, interact with the 'new' suitability assessment?

Under the existing MiFID II framework, firms providing investment advice and portfolio management are required to obtain the necessary information about the client's knowledge and experience in the investment field, their ability to bear losses, and objectives including the client's risk tolerance. This information will enable the firm to provide services and products that are suitable (suitability assessment). The existing framework on suitability assessments aims to ensure investor protection. The amendments aim to make investments more sustainable by considering ESG factors in the investment decision making process. As there are still a lot of uncertainties around the impact (negative and positive) that ESG investing could possibly have on the financial results of investments, **we have concerns on how the existing and new suitability assessment factors will interact from an investor protection standpoint.**

The NVB wants to raise some concerns regarding the amendments:

- We assume **financial literacy** of retail clients is rather low, there is a lack of education on the impact of ESG factors on risk and performance. Therefore, too difficult and lengthy ESG questions to investors should be avoided. Experience has shown that too many options could confuse and distract clients. In fact, we warn that it could even impel these potential retail investors to go to execution-only platforms, where suitability on ESG preferences could, potentially, even be less incorporated and monitored. **We therefore propose that initially by default only a very high level questionnaire to identify ESG preferences should exist.**
- Regarding the method: if **ESG preferences are taken into account during suitability tests**, will they constitute a **coherent ESG approach**? Or will the Environmental, Social, and Governance be separately dealt with? In the first case, for example, a multinational oil company might score great on G, mediocre on S and below average on E factors. As an average, the stock then will have a middle of the road score. This whilst the company actually scores very poor on climate change risk mitigation and adaptation. In the other case, clients should be asked specifically about each ESG factor on itself, which in turn is both very cumbersome for clients and banks. It could even lead to higher costs for the end client as every single client assessment could lead to a one in a kind sustainable portfolio, thus reducing the scalability of the investment proposition. This could potentially lead to higher costs. **It therefore should be considered how and if these ESG preferences should be asked to investors separately, and if so, to what extent.**

- Except for scoring all individual stocks and bonds, **we are concerned about the *method* of ESG investing that will be taken into account in the client's preferences**. One could think about ESG integration vs impact investing. And how could active ownership be incorporated (as in: Asset Stewardship programs)? The proposal explains ESG considerations from an inclusive point of view. So what activities could be considered in light of social, environmental and governance impact. It doesn't refer, however, to activities that are or should be excluded for investment. Both inclusive and exclusive could be included in a suitability test and we therefore suggest the text in the proposal is balanced for exclusion preferences as well. One could argue that if all these important questions of method will be included in the suitability test it could lead to even more pressure on relatively non-informed clients.
- From a legal standpoint, MiFID II already aims to protect an individual client as approached from an investor protection standpoint. The question is: what is more important for a client, reaching their financial goals or their sustainable goals? How do costs interact with a possible ESG preference and is this from an investor duty standpoint justifiable? The same goes for possible ESG modifications in the risk/return-profile of a client: does this serve the overall (financial) interest of a client? **As MiFID II already incorporates investor protection to a high level, we do not see a clear legal basis to amend MiFID II from an investor duty standpoint.**

<u>Concerns regarding the timing</u>

Should an E, S and G taxonomy not be fully in place before the amendments on MiFID kick in?

If the amendments on MiFID II will be implemented in shorter notice than the 3 proposed regulations (including level 2 taxonomy and investor duty & disclosure) there could emerge a two-speed initiative. This two speed initiative could give rise to uncertainties. Article 2 of this Regulation sets out the date of application of the proposed Regulation, including the transitional period of 18 months. **We strongly recommend to link the start of the transitional period to a complete and working taxonomy.**

- During the suitability assessment ESG preferences should be asked and moreover be matched with appropriate investments. In the current proposals there is only a brief taxonomy for E, but the possibly even more difficult to formulate taxonomies for S and G are not in scope (yet). **We therefore argue that a distributor is not able to ask for specific ESG preferences unless the taxonomy is complete.**
- Furthermore, a distributor **can't match these ESG preferences** (as obligation under the suitability assessment) to investments, as long as the framework for both taxonomy and disclosure & investor duty is far from complete. **Continuously changing suitability tests take both a lot of effort and investment and could confuse investors as they will be confronted with changed principles of what is defined as ESG in different suitability tests over time.**
- If the ESG taxonomy is being rolled out with delegated acts over time, financial product designers might first **wait with creating new investment solutions up until all E, S and G taxonomies are published and clear**. If, for example, only the environmental taxonomy is clear to all market participants, banks (with investment propositions) or asset managers (with investment funds) could decide to postpone the launch or adjustment of ESG-propositions and funds until all taxonomies are clear. If they launch beforehand, they wage the risk of creating ESG propositions that are not fit for purpose and therefore need to be shut or changed over time. Issuers might in the last case then consider not to launch any products at all which could prove counter-productive in terms of reaching the SDG and Paris goals.
- Taxonomy is thus key for a consistent and correct suitability test. Once this is in place, a distributor or investment advisor could ask the client if 1) he/she wants to invest in ESG 2)

that he/she understands the definitions of ESG as proposed by the European Commission and 3) that he/she understands that ESG might have an impact on the risk/reward profile.

- **As a conclusion we propose that the transitional period in the MiFID II regulation should not start before the Commission will have specified the taxonomy in delegated acts.**