

Introduction

The Dutch Banking Association ('Nederlandse Vereniging van Banken' or NVB) welcomes the possibility to respond to the consultation of amending Delegated Directive (EU) 2017/593 as regards the integration of sustainability factors and preferences into the product governance obligations and 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 (resp. Suitability and Product Governance).

On two previous occasions, the NVB has raised questions and issues and answered CP questions around integrating ESG in Suitability and Product Governance.¹ In general, we still share the ESMA's Securities and Markets Stakeholders Group's (SMSG) view on this topic: "Implementation of such suitability guidelines by ESMA in the absence of a detailed finalised objectives, taxonomy may be complex as it will come to re-designing client profiling questionnaires to capture investment objectives, and to define the criteria and tools to scan products according to new complex criteria... It should take into account the needs of the individual investor and avoid overly complex language or too lengthy disclosure requirements that already hinder consumer protection in financial services".

Unfortunately, none of the concerns raised by the SMSG have disappeared with the publication of the Commission drafts. Below we highlight our main concerns.

Unclear definitions

The EC is proposing to amend Delegated Regulation (EU) 2017/565 i.a. Article 2. The EC proposes to add point (7), (8) and (9). These amendments mostly entail definitions of sustainable investments, sustainability risks and sustainability factors. We are worried that these definitions are not coherent with the categorisation of products as described in the Sustainable Finance Disclosure Regulation (SFDR, Regulation (EU) 2019/2088). As MiFID obligations and SFDR interact on several occasions (for example regarding periodic disclosure requirements) fixed and coherent definitions of sustainability is of importance.

From an SFDR perspective, we can identify three sorts of 'financial products'²: 1) so called 'Darkgreen' or 'Article 9' products, 2) 'Lightgreen' or 'Article 8' products and 3) 'Mainstream' or 'non-Article 8 or 9' products. This categorisation can also be found in the Regulation on the establishment of a framework to facilitate sustainable investments ('Taxonomy'). Respectively, art. 4α, 4β, 4γ reflect the three different categories of SFDR products as well.

We believe more clarity is needed in the amendments of point (7) in Article 2 of the proposed amendments in Delegated Regulation (EU) 2017/565, as they do not seem to be in sync with the abovementioned three categories of products. According to the drafts '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:

- 1) **a financial instrument that has as its objective sustainable investments as defined in Article 2, point (17), of SFDR.**

As there are questions on the scope of Article 2(17) i.e. a 'sustainable investment' and 'Darkgreen products', why not simply refer to Article 9 SFDR products in point (1)?
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- 2) **a financial instrument that promotes environmental or social characteristics as referred to in Article 8 of Regulation (EU) 2019/2088 and that either:**
 - a) **pursues, among others, sustainable investments as defined in Article 2, point (17), of that Regulation;**

¹ Please see <https://www.nvb.nl/media/1293/nvb-consultation-reaction-on-integrating-sustainability-risks-and-factors-in-mifid-ii.pdf> (2019) and <https://www.nvb.nl/media/1125/nvb-consultation-reaction-mifid-amendments.pdf> (2018)

² Financial products as described in Regulation (EU) 2019/2088 Article point (12)

If an SFDR Article 8 product pursues sustainable investments, it basically is an Article 9 product.

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

As things stand now with the SFDR RTS consultation, an FMP (>500 employees) that makes available 'financial products' be them darkgreen, lightgreen or mainstream products, always considers adverse impacts on sustainability factors. Therefore point (b) does not fit very well under the definition of an Article 8 product, but better under the category of 'mainstream products'.

Furthermore, we believe that this category of mainstream products, although considering principle adverse impacts, might (or might not) be very suitable for clients with sustainability preferences. We therefore believe it is better under point (2) to refer to Article 8 products, and delete paragraph (b) which seems to aim at mainstream products. Therefore, only referring to SFDR article 8 and 9 products seems more appropriate to us.

Other issues

Existing versus new clients

From the introduction of the draft texts, we learn that this change does not apply to existing customers.³ However, there is no reference made to this consideration in the draft legal text. Therefore, we would request the EC to incorporate the wording of the relevant part of the feedback statement on earlier consultations also in the legal text of the amendment of Delegated Regulation (EU) 2017/565.⁴

Suitability: a two-step approach?

In preamble (5) of the draft Delegated Regulation there is an indication that, in line with this letter, the sustainability preferences are only taken into account following the other (financial) objectives. In the draft Delegated Regulation itself, nothing on this subject is however mentioned. The EC reiterates that banks first will need to assess the 'ordinary' (i.e. financial) suitability, before the ESG suitability test can take place.

Is this indeed the case? How correlated ESG and 'ordinary' risk/return characteristics of products and objectives of clients are, is still unclear. We wonder what the Commission's view is around how ESG preferences can be related and/or compared to the financial interests and goals of retail investors in assessing the target market. What should be predominant in case of discrepancy: financial objectives or sustainable objectives? There should be some coherence regarding the issue that some clients may not have sustainability preferences.

We agree with the EC that a two-step approach should take place. When taken into account the preferences in the suitability process (if any), both ESG and financial preferences should be taken into account.

Single risk indicator

³ The explanatory memorandum states on page 3: "To enhance legal certainty, the references to sustainable investments were specified and the recitals were amended: it was clarified that a new suitability assessment for existing contracts will generally not be necessary."

⁴ For example: "For the purposes of the provisions of this Regulation requiring investment firms to assess the suitability of investment services or products offered or demanded, a client who has engaged in a course of dealings involving a specific type of product or service beginning before the date of application of this Regulation xxx should be presumed to meet the client's suitability preferences in relation to that product or investment service. Where a client engages in a course of dealings of that kind through the services of an investment firm, beginning after the date of application of that Regulation, the firm is not required to make a new assessment on the occasion of each separate transaction."

As mentioned in our reaction to ESMA's CP 'integrating sustainability risks in MiFID II', the NVB believes that any future approach to identify environmental, social and governance criteria should take form in a single indicator only. A more granular approach, would be unfeasible at this point in time.

The most important reason to take this standpoint, is that a single indicator is more or less comprehensible, simple and meaningful to implement. Specifying E, S and G considerations separately (and thus more granular) will be complex for both distributors, product manufacturers and clients and will require a granular set of rules how to deal with conflicting sustainability preferences of clients. Furthermore, we believe this might lead to investment products that are more skewed to a certain topic, and therefore more impose more risk.

How are products vs. ESG preferences measured?

Can banks in practice only offer 'sustainable' (i.e. art. 8 and art. 9 products) to customers who have, very high level only, indicated their sustainability preferences? Or can mainstream products also be distributed to clients who have indicated sustainability preferences, because they are suitable based on other (financial) preferences?

'Financial product or Financial Instrument?

In general the difference between the term 'financial instrument' according to MiFID and the term 'financial product' according to the SFDR causes confusion and legal uncertainty and put a lot burden and costs on FMP/FA's. Financial products consist out of financial instruments. Issuers of financial instruments are however not legally required to disclose the needed sustainability related information. These issuers are referred to as "investee companies" in the SFDR (and currently consulted draft RTS). It will be difficult – if not impossible – for financial market participants / financial advisors to obtain the necessary data from the investee companies that don't have to provide this information. We would also like to comment that, there are differences between the MiFID II definition of 'sustainability preferences' and art 8 and art 9 definitions. We believe that this new definition which refers to 'financial instruments', to SFDR article 2(17) have made things even more confusing than before.

MiFID/Delegated Directive relates to investment services and in principle not to the offering/issuance of investment products. Only manufacturers are in scope that qualify as investment firms, meaning investment firms that produce an investment product and provides an investment service regarding to that same investment product. This is an exception to the rule that "manufacturers don't exist". Most investment instruments (shares, bonds and funds) are not manufactured by investment firms. This is a conceptual error in MiFID/Delegated Directive. Result is that most "manufacturers" of investment instruments are not legally required to provide target market information. This puts the burden on distributors to collect this information. Most target market criteria can be derived from the type, nature and conditions of the investment instruments and/or regulatory mandatory disclosures regarding to these investment instruments (prospectus). This is however in principle not the case for ESG factors. The current target market criteria do not include or indicate the (environmental) activities and governance of the underlying company/issuer. The target market criteria / ESG factors should be included in the regulatory framework applicable to the offeror/issuer of investment instruments (UCITS/AIFMD/Prospectus Regulation/etc.). ESMA is aware of this: "Going forward ESMA considers that the EC should consider the possibility to align the relevant UCITS and AIFMD articles with the product governance obligations for manufacturers." (ESMA Final Report 19 December 2014 | ESMA /2014/1569, paragraph 9, page 52) In our view ESMA forgot to mention the Prospectus Regulation. As long as the "producers" of investment products are not legally required to provide information regarding to the ESG factors, it is not legitimate to put the obligation to provide the same information on the distributors. (If investment products are offered directly to the investor without the intervention of an investment firm the ESG-factors do not have to be disclosed!)

Exclude Execution Only services from ESG Product Governance requirements

The investment services investment advice and individual portfolio management⁵ are in scope of the SFDR⁶. Other investment services, such as the reception and transmission of orders in relation to one

⁵ See definition; annex I section A (4) and (5) MiFID II (Directive 2014/65/EU)

⁶ Individual portfolio management is included in the definition of Financial Product and FMP in article 2 SFDR and investment advice is included in the definition of FA/Financial Advisors in the same article.

or more financial instruments and/or the execution of orders on behalf of clients⁷, are not in scope of the SFDR. That makes sense, because a (potential) investor will have to be informed if and, if so, how a FMP / FA considers sustainable preferences in the investment process (when making investment decisions respectively providing personalised investment recommendations). When providing other investment services – such as the reception and transmission of orders and/or executing orders on behalf of clients – an investment firm will not consider sustainable preferences because it will not make an investment recommendation nor an investment decision. Likewise we are of the opinion that it should not be mandatory to include sustainable preferences in the product governance relating to these other services (than investment advice or individual portfolio management). This should be made explicitly clear in for example the considerations to the Delegated Directive.

Including sustainability preferences in the product governance for - for example - execution only services, makes no sense. The product governance rules do not require an investment firm to disclose this information to investors. Furthermore, as things stand with the current revision of MiFID 2, discussions have arisen any way whether Product Governance obligations shall or shouldn't apply with regard to non-complex products, in particular not to plain vanilla bonds, shares traded on a regulated market, initial public offerings (IPOs) and services on execution-only basis. This strengthens our view that integration of ESG in Product Governance (EO) provisions is not desirable.

We believe any amendments to Product Governance should be restricted to investment firms that provide portfolio management and/or investment advice. With integrating ESG in Product Governance requirements, we believe the scope is being broadened. We believe that it should be acknowledged that not all products have a sustainability focus and that sustainability preferences by investors may not exist.

Negative target market

Dutch banks believe it should be clearly indicated in the legal texts that there should be no negative target market whatsoever for products that would fall under “sustainability preferences”. For this purpose, the terms “where relevant” and/or “if any” could be used.

Hedging

Banks / investment firms trade as counterparty with clients which have to hedge the risks in their portfolio. E.g. FX, interest and commodity risks. Although these are investment activities which are in scope of MiFID II, we emphasize that the specific aspects of hedging should be taken into account.

As in this context, the hedging transactions of banks/ investment firms with their clients are related to the specific risks of the clients in their portfolio, we assume that sustainability preferences and factors don't have to or even can't be taken into account.

We would appreciate clarification on this in the recitals of these draft Commission Delegated Directive and Commission Delegated Regulation.

Timelines

The implementation deadline should be sufficient and consistent with (1) other MiFID amendments and (2) other sustainable finance regulations like the NFRD, Taxonomy and Benchmark Regulation.

Currently, that is not the case, therefore we believe a significant grace period should be applied to both the amendments to suitability as well as to product governance.

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⁷ See definition: annex I section A (1) and (2) MiFID II (Directive 2014/65/EU)

Attachments

- [NVB - Consultation reaction on integrating sustainability risks and factors in MiFID II](#)
- [NVB consultation reaction Mifid ESG amendments](#)