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Ms. Natasha Cazenave
Executive Director
European Securities & Markets Authority (ESMA)
201-203 Rue de Bercy
Paris

Dear Madame Cazenave,

Re: MiFID II sustainability preferences – placing them at the heart of the suitability assessment

I am writing to you on behalf of Eurosif in the context of the consultation on investors' sustainability preferences as enshrined in MiFID II conducted by ESMA. We have responded to the consultation on the specific draft Guidelines.

The purpose of this letter is to place the specific provisions on sustainability preferences into the broader context of the EU Sustainable Finance agenda and ongoing market developments. We fully appreciate that ESMA's contemplated approach needs to fit within the framework and boundaries set by the legislation as determined by the co-legislators. Therefore, some of our suggestions below are not meant as immediate solutions but rather to inform ESMA's longer term views as the framework is applied in the years to come.

As firms are preparing to adapt to the sustainability preference criteria ('criteria') contained in the Delegated Act (DA) amending MiFID II, it is becoming increasingly clear that within the EU these criteria are likely to have greater significance on the design of financial products than the SFDR classification as these criteria will impact the ability of products to be distributed through various distribution and advisory channels. ***Therefore, it is of paramount importance that these rules operate effectively and achieve the stated policy objectives of rendering sustainability focused investment products more available to end-investors while mitigating risks of greenwashing or financial mis-selling.***

Sustainability preferences fully integrated with suitability assessment

We believe sustainability preferences should be fully integrated with the financial suitability assessment to make one coherent advisory process focusing on determining the financial instruments that match both a client financial profile as well as sustainability objectives, if any.

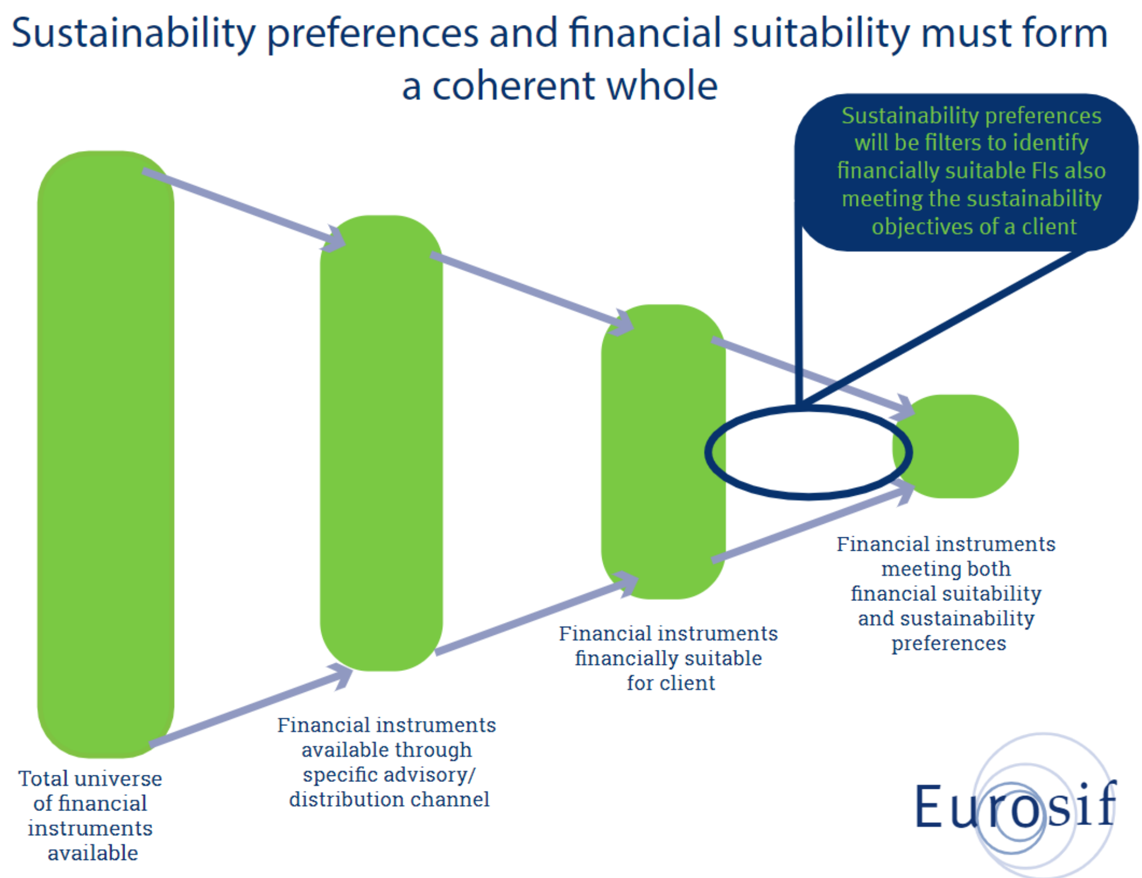

Figure: Eurosif infographic - Sustainability preferences and financial suitability must form a coherent whole

The DA seems to suggest that clients will have to express preferences independently from the sustainability profiles of the financial instruments that have been deemed to be suitable following the suitability assessment. The preferences expressed may therefore be disconnected from the products available at the point of sale or advice. As a result, there may be a significant mismatch between preferences expressed and products available. A client with very strong sustainability preferences may for example express a desire to have products with minimum share of Taxonomy-aligned investments (criteria (a)) representing the majority of investments (>50%). However, as ESMA itself clarified in its technical advice on Article 8 Taxonomy[1], a significant number of investments funds available to retail investors in the EU will have far lower levels (2-8%) of alignment for the foreseeable future. This mismatch between expectations and market reality may unnecessarily cause reputational risk for sustainable products or may lead to situations where investors would have to readjust downwards their expectations. This may act as a deterrent for retail investors to invest, undermining one of the stated policy goals of the Capital Markets Union (CMU) of ensuring European citizens invest more of their savings into retail investment products.

To avoid this situation, ***our proposal is that clients should be asked in broad, non-technical terms about their sustainability preferences or objectives, which then allows the advisor to identify which of the criteria are the most relevant in matching these preferences. This will then allow the advisor to identify from the group of suitable financial products the ones that have the best results on the identified criteria.***

[1] ESMA Final Report: Advice on Article 8 of the Taxonomy Regulation (Link)

Significant risks associated with combining complex criteria with self-assessment

For many retail investors the criteria in which they must articulate their sustainability preferences will prove complex. Consumer testing exercises done in the context of the SFDR pre-contractual and periodic reporting templates demonstrated the complexity of translating technical jargon from the EU Sustainable Finance agenda.

Unlike the suitability assessment which places the onus on the advisor to identify the financial product suitable to the client, the text of the DA seems to suggest that the main responsibility to identify preferences remains with the client. This carries the risk that clients may end up with products not matching their expectations because they struggled to articulate preferences according to these complex criteria.

Our proposal would ensure that the client express sustainability objectives and preferences that are then matched by the advisor with the relevant criteria. Benchmarking the suitable financial products against these criteria will allow the advisor to recommend products that are both suitable and match the client's sustainability preferences.

This will require ensuring that advisors have adequate knowledge on sustainability matters to advise clients. This will need to be complemented by adequate tools and neutrally worded questionnaires that allow the criteria best matching the objectives of the clients to be identified. It will ensure that the client is provided sustainability advice rather than left to a self-assessment of technically complex matters.

Even in a fully integrated suitability assessment, data accuracy and comparability across MiFID criteria may remain elusive

The system of sustainability preferences as identified by the criteria of the DA will only work effectively in the long run if a high level of accuracy and comparability between different products can be achieved. And here, specific concerns exist for each criterion of the DA.

First, on Taxonomy alignment, it is very likely that firms will rely to a significant degree on third-party data vendors to comply with the requirements laid down in SFDR and the Taxonomy Regulation. We are receiving strong indications that eligibility or alignment with the Taxonomy of identical portfolios or issuing companies may vary significantly between data vendors. As a result, it is likely for the foreseeable future that comparability between products will be far from perfect.

Second, on the minimum share of sustainable investments as defined in Article 2(17) SFDR, there are significant concerns around the applicability of the definition. As a result, we are seeing many frameworks being developed by firms and data vendors to identify companies that would qualify as sustainable investments. The result though is that it will be very challenging to compare shares of sustainable investments between products from different firms, casting doubts over the reliability of this data point. Therefore, comparability will be elusive, as long as no solution is found to provide a more granular and comparable approach to the definition of sustainable investment.

Third, a similar challenge to the Taxonomy data is likely to exist for PAI indicators which are critical to the third criteria of the DA. Firms are combining in-house research with data solutions by data vendors to measure and report on the PAIs at entity level as mandated by SFDR as well as at product level to operationalize this category. Research however shows again the wide discrepancies which may exist between products depending on the data vendor consulted.[2] This is largely explained by the fact that some PAIs for certain companies or sovereign issuers are simply not available. Data vendors are therefore seeking alternative data to fill out these gaps.

Conclusion

Comparability will be an issue across all the MiFID criteria for the foreseeable future. To mitigate this, further guidance on the methodologies to calculate PAIs and Taxonomy alignment and eligibility will be necessary. For the share of sustainable investments, legislative changes may be necessary to refine further the definition in Article 2(17) SFDR.

However, we must consider the possibility that data comparability may remain elusive, particularly as there may be a divergence in data availability between the European investable universe of companies subject to CSRD and the non-EU investable universe.

Therefore, in the long run there may be a case for an alternative approach based on a stronger and more robust classification of financial products, for example through a system of European-wide labels. A set of labels for retail investment products focused on either investment processes or outcomes, or a combination thereof, may be a more realistic and pragmatic way of matching sustainability preferences of retail investors with financial products.

Thank you in advance for your consideration.

Yours Sincerely,

Victor van Hoorn

Executive Director

About Eurosif

Eurosif is the leading pan-European sustainable and responsible investment (SRI) membership organisation. Based in Brussels, its mission is to promote sustainability through European financial markets through the adoption of enlightened policies and regulations. Eurosif works as a partnership of Europe-based national Sustainable Investment Fora (SIFs) with the direct support of their network which spans over 400 Europe-based organisations drawn from the sustainable investment industry value chain. These organisations include institutional investors, asset managers, financial services, index providers and ESG research and analysis firms totalling over €20 trillion in total assets. Eurosif' s main mission is of a general interest as it represents a multistakeholder vision of sustainable investment, supported by philanthropic foundations. Eurosif works on public policy, research and creating platforms to foster best practices in sustainable investment.

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[2] Irish Funds, Principal Adverse Impacts Reporting: Practical insights for the next stage of SFDR implementation (Link)