

## **EUROSIF RESPONSE TO ESMA CONSULTATION ON THE REVIEW OF THE GUIDELINES ON MiFID II PRODUCT GOVERNANCE REQUIREMENTS**

ESMA invites comments on all matters in this paper and in particular on the specific questions summarised in Annex I. Comments are most helpful if they:

- respond to the question stated;
- indicate the specific question to which the comment relates;
- contain a clear rationale; and
- describe any alternatives ESMA should consider.

ESMA will consider all comments received by 7 October 2022

### *Question 1 (Q2 on the consultation)*

Do you agree with the suggested approach on the identification of any sustainability-related objectives the product is compatible with? Do you believe that a different approach in the implementation of the new legislative requirements in the area of product governance should be taken?

Please also state the reasons for your answer.

Eurosif largely endorses the proposed additions made to the ESMA guidelines on the identification of a potential target market by the manufacturer. However, we have a number of suggestions to enhance the applicability of the Guidelines and ensure they build upon the recently published Guidelines on certain aspects of the suitability requirements.

Demand for sustainable and ESG investments has increased substantially in recent years. MiFID II requirements on the integration of client sustainability preferences in the suitability assessment will result in clients expressing their sustainability preferences in specific terms, namely a minimum proportion of Taxonomy-alignment, the share of ‘sustainable investments’ as defined by Article 2(17) of the SFDR, and/or consideration of Principal Adverse Impacts (PAIs).

Accordingly, in many instances, clients will likely include sustainability-related goals as part of their broader objectives and needs. The manufacturer should thus identify and describe the sustainability-related objectives with which a product is compatible based on its features.

Moreover, in the interest of facilitating the distribution of products with sustainability-related features or objectives, the terminologies used by manufacturers and distributors should be harmonised to the greatest extent possible. Ideally, the term ‘sustainability preferences’ should be applied in the context of the product governance regime with the same meaning as applied in the context of the suitability assessment.

Accordingly, to ensure that the exact same definitions are used across the Guidelines, Eurosif suggests deleting the three bullets that are included under paragraph 20 on page 29 which refer

to taxonomy alignment (1st bullet), sustainable investments (2nd bullet) and PAIs (4th bullet). Instead, paragraph 20 should solely refer to the definition of “sustainability preferences” according to Article 2(7) of the MiFID II Delegated Regulation, and as further detailed in the ESMA Guidelines on certain aspects of the MiFID II suitability requirements. In that way it can be ensured that no new definitions and interpretations of “sustainability preferences” arise.

However, as further outlined in our response to Q2 below, the concept of minimum proportion is not practically applicable to certain financial instruments. Also, at the current juncture, manufacturers and distributors do not currently have clear data on the level of sustainable investments and PAI for financial instruments other than products subject to SFDR disclosures while the product governance regime applies more broadly to financial instruments.

Therefore, we support retaining the third bullet point in paragraph 20 on page 29 as an alternative way of specifying sustainability related objectives for products to which the criteria for determining client “sustainability preferences” cannot be applied. However, it is essential that clarity is provided as to how this third bullet point should be applied and that the broader approach it envisages only be used when other criteria are non-applicable.

In addition, in order to ensure consistency across the Guidelines, paragraph 42 (page 33) in the guideline should be changed so that paragraph 42 not only cross-references the target market categories as defined in paragraph 19, but also refers to the suggested paragraph 20, above.

### *Question 2 (Q3 on the consultation)*

What are the financial instruments for which the concept of minimum proportion would not be practically applicable?

Please also state the reasons for your answer.

In the case of certain financial instruments, specification of a minimum proportion or share of Taxonomy-alignment or ‘sustainable investment’ may not be entirely practical or fully relevant, particularly in relation to certain types of derivatives, such as currency swaps and interest rate swaps.

More generally, applying the concept of minimum proportion to financial products for the purposes of the MiFID II provisions on gathering client sustainability preferences is practically challenging due to limited and/or unreliable data from investee companies and divergent interpretations of ‘sustainable investment’ as envisaged in Article 2(17) of the SFDR.

For example, the proportion of ‘sustainable investments’ in a product depends on the framework for qualifying ‘sustainable investments’ being applied and these differ across financial institutions. Experience in the market has revealed that asset managers differ dramatically in the share of the MSCI ACWI index that qualifies as ‘sustainable investments’, reflecting just how divergent their approaches are.

Equally, determining a minimum proportion of ‘sustainable investment’ in the case an equity holding or share in a company is challenging. While Taxonomy-alignment and PAIs can be calculated for individual companies, determining the share of their activities, and calculating revenue derived therefrom, that qualify as sustainable for the purposes of Article 2(17) (the so-called ‘look-through’ or ‘revenue-weighted approach’) would be a far more challenging exercise.

As mentioned in Q2 in order to ensure consistency across the Guidelines, Eurosif finds, that the Guidelines’ paragraph 42 (page 33) should be changed so that paragraph 42 not only cross-references the target market categories as defined in paragraph 19, but also refers to the new paragraph 20.

However, since the concept of minimum proportion of sustainable investment would not be practically applicable to all financial instruments (e.g. not applicable to shares and bonds) the new paragraph 20 should only apply to certain financial instruments. Eurosif therefore suggests that - when cross-referencing paragraph 20 in paragraph 42 - add an extra sentence into paragraph 42 stating that paragraph 20 can be used as guidance when distributing UCITS and AIFs and stating that it might be difficult for distributors to use paragraph 20 as guidance for situations where distributors are selling shares and bonds due to difficulty determining the proportion of these financial instruments that qualify as a sustainable investment as defined by Article 2(17).

In other instances, such as securitised products, it may also be difficult to apply the concept of minimum proportion (for the purposes of determining sustainability features) depending on the complexity of the instrument.

### *Question 3 (Q10 on the consultation)*

Do you agree with the suggested approach on the negative target market assessment in relation to a product with sustainability factors? Please also state the reasons for your answer.

Eurosif is of the understanding that for all products - financial products which consider sustainability factors as well as financial products which do not consider sustainability factors – it is not necessary to define a negative target market with respect to the product’s sustainability-related objectives but the firm should always perform a negative target market assessment with respect to the five “old” target market categories (client type, knowledge and experience, financial situation, risk tolerance and objectives and needs).

Eurosif agrees, for the most part, with ESMA that sustainability factors should not be a basis, in and of themselves, to limit the target market for a product. Supervisors should nevertheless recognise that the sustainability-related features of a product may affect its risk/return profile and charging structure. Accordingly, the sustainability-related features of a product may contribute to said product being inappropriate for certain target markets.

Accordingly, we underline and fully endorse the following excerpt from draft Guideline 81;

“Hence, for products which consider sustainability factors, the firm should always perform a negative target market assessment with respect to the five target market categories (client type, knowledge and experience, financial situation, risk tolerance and objectives and needs), but should not consider the sustainability-related objectives of the products. This is to assess whether these other target market aspects might be incompatible with certain target market clients, for example, if the product that considers sustainability factors concerns a risky product ... “