SWEDISH
SECURITIES MARKETS
ASSOCIATION

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SSMA response to COMs consultation on integration of sustainability risks and factors in MiFID II

The Swedish Securities Markets Association (SSMA) welcomes the opportunity to respond to the European Commission's consultation on amendments to MiFID II Delegated Regulation (EU) 2017/565 and the Delegated Directive (EU) 2017/563 regarding the integration of sustainability factors, risks and preferences into certain organisational requirements and into the product governance obligations.

Key Issues

- Need to review the proposed definition of "sustainability preferences" in Article 2 MiFID II delegated acts.
- Additional guidance is important as regards the suitability requirements and rules on conflict of interest.
- Guidance is needed whether investment firms can offer suitable investments which are not sustainable to a client that has expressed sustainability preferences according to art 2.17, art 8 or 9 SFDR.
- The scope of target market obligations for distributors should be clarified, in particular taking into account that necessary sustainability data will not be available from manufacturers which are outside the scope of the SFDR or which are established outside EU.

1. Definition of "sustainability preferences"

The SSMA has several concerns in respect of the proposed new definition of "sustainability preferences" in Article 1 and 2 of MiFID II delegated acts. We note that the definition is not in line with the scope of SFDR, which in our view risks creating a lot of implementation difficulties as well as legal uncertainties for investment firms and their clients.

In particular, the following issues should be further analysed:

- The SFDR distinguishes between on one hand financial products with sustainability objectives (Article 9) and on the other hand financial products that promote ESG-characteristics (Article 8). Furthermore, SFDR defines "Sustainable investments" (Article 2.17). However, the proposed MiFID II definition of "sustainability preferences" introduces a new type of instrument which, in addition to the requirements in Article 8 SFDR, either (i) has sustainable investment as their objectives or (ii) consider principle adverse impacts. In our view, this definition creates an unfortunate sub-class of article 8 products which cannot be considered as sustainable investment products under MiFID II thereby forcing many manufacturers of financial products to re-engineer Article 8 products by the MiFID II definition. This conflicts with the message under SFDR, i.e. that the intention with the regulation, is not to change current investment strategies of managers.

- The MiFID II definition of sustainability preferences in art 2 refers to "financial instruments" and not "financial products", which is the term used in SFDR. As a result, the MiFID II rules will include instruments for which financial market participants do not have obligation to publish data under SFDR, such as bonds and shares, or the obligation to categorise these instruments in accordance with the requirements in article 2.17, 8 or 9. This will lead to implementation challenges that must be carefully analysed by the Commission. Moreover, by using the term "financial instruments", instruments which are not even used for investment purposes are in scope of the MiFID II rules, i.e. derivatives used for hedging. We also note that other sectorial legislation proposed by the Commission as part of the same ESG-package have been drafted differently. In fact, in IDD, UCITS, AIFMD and Solvency II, the definition of "sustainability preferences" refer to "financial products" and not "financial instruments". No explanation has been provided in the consultation paper for why another term is used to define "sustainability preferences" in MiFID II compared to other sector legislation such as IDD.

- Another issue which needs to be further considered is the fact that under MiFID II, portfolio management is an investment service whereas "a portfolio" is a financial product under SFDR. Under the current drafting, a significant number of products covered by Article 8 and 9 SFDR will therefore not be included in the proposed new MiFID II regime on level 2. Is the meaning of the proposed Article 2 that the investor shall be asked about his/hers sustainability preferences on the portfolio (which will not be covered by the definition in the proposed Article 2) or of the underlying financial instrument that the portfolio may or may not invest in (which will be covered by the definition in the proposed Article 2)?

Based on the above concerns, the SSMA proposes the following amendments to the definition to "sustainability preferences" in Article 1 and 2 of MiFID II delegated acts:

"(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;~~

Amendments will also have to be made to recital 6 of the MiFID II Delegated Regulation 2017/565 in order to ensure that it is in alignment with the adjusted Article 2. Moreover, if the term "financial instrument" is kept in the definition of "sustainability preferences", it should be clarified in a recital that the intention is to include instrument used for investment purposes and that derivatives used for hedging is outside scope. Otherwise we see a risk that the terminology used will lead to implementation difficulties and unintended consequences.

2. <u>Existing contracts</u>

The SSMA considers that the new suitability requirements should be applicable also for existing clients and that the requirements should apply, at the latest, when the firm makes its next "annual assessment" following the date of application of the amended level 2. If that is not possible, we consider that a sufficiently long transition period is necessary for investment firms to have enough time to implement the new requirements.

3. <u>Suitability</u>

The SSMA agrees with the two-step approach but would welcome further guidance on the relationship between sustainable investments in general and a client's sustainability preferences.

4. <u>Organisational requirements</u>

The SSMA has in its response to previous consultations highlighted that the scope of the organizational requirements in Article 21 should be clarified. It would be useful if ESMA, in addition to the example on knowledge and competence of staff, would provide more guidance on what it means that sustainability risks should be taken into account when complying with all the other requirements in Article 21 such as the decision-making process,

record keeping and performance of multiple functions etc. What type of actions are firms expected to take?

5. Conflict of Interest

The SSMA questions whether the amendments to Article 33 adds any additional value as investment firms under applicable rules should identify all relevant conflicts of interests, which would include those that stem from distribution of environmentally, social or good governance investments. In our view all conflicts of interests stem from some form of economic interest which is already included in the provisions. However, if it is nevertheless decided that such an amendment should be included in the delegated regulation to MiFID II, we believe that further guidance should be provided on level 3. Preferably including practical examples of conflicts of interest that arise from ESG-investments.

6. Target market

With the proposed amendment to Article 9(9) of the Delegated Directive (EU) 2017/593 investment firms are required to identify at a sufficiently granular level which sustainability preferences a financial instrument is compatible with. According to the proposed recitals a general statement that a financial instrument has a sustainability-related profile is not considered to be enough. Instead, investment firms should specify to which group of clients with "specific sustainability preferences" the financial instrument is supposed to be distributed. In our opinion, there is a need for further clarification regarding the obligation of investment firms to define which sustainability preferences a financial instrument is compatible with. Is sustainability to be considered as a new category or part of "clients objectives and needs"? Is it sufficient to identify that a financial instrument has sustainable investments as its objective or is it also necessary to define, whether a client should have an environmental or social investment objective?

7. Product governance requirements for distributors

According to the amended Article 10(2) of the Delegated Directive (EU) 2017/593, distributors are required to establish appropriate product governance arrangements to ensure that the products and services they intend to offer or recommend are compatible with the sustainability preferences of a specific target group. In this context, the SSMA wants to underline the existing challenges with access to relevant data on sustainability. A distributor must therefore be able to rely on the information which is received from manufacturers. An obligation for distributors to validate the sustainability profile is not workable in practice. Moreover, it should be noted that many products are issued by non-MiFID firms and firms which are not subject to the SFDR.

8. Continuous dialogue with stakeholders, including ongoing self-regulation

The SSMA would like to underline the need for co-legislators to continue the dialogue with stakeholders in relation to the integration of sustainability risks and factors. In particular as regards the implementation of product governance rules, it should be noted that FindatEx is the standard that many investment firms in EU use for the exchange of information between producers and distributors.