



## **ESMAs consultation on integrating sustainability risks and factors in MiFID II**

The Nordic Securities Association (“NSA”)<sup>1</sup> welcomes the opportunity to respond to ESMAs consultation on integrating sustainability risks and factors in MiFID II (“Consultation Paper”).

The Nordic capital markets are at the forefront of the development of sustainable finance and investments. Significant efforts are being made to promote “green” financial products. Market participants have a high-level of awareness and there is a clear demand from investors for sustainable investment products. Further, the Nordic governments put significant resources into climate and sustainability overall and has presented several legislative initiatives for sustainable capital markets. For example, the Swedish government recently explored the possibilities of issuing “green” government bonds and in 2018 it presented a Government Inquiry on the facilitation of green bonds.<sup>2</sup>

The development of well-calibrated and proportionate rules which do not lead to unintended negative consequences for well-functioning markets require that ESMA and the Commission has a close dialogue with stakeholders. The NSA stands ready to meet with ESMA and/or the Commission to discuss our views on the proposed amendments to the MiFID II delegated acts and to also provide more information as regards Nordic market developments in the area of sustainable finance.

### **1. Key points**

- NSA generally supports the high-level approach taken by ESMA in the CP. It is important that regulation on a forward-looking topic such as sustainability avoids being inflexible and too prescriptive, especially while there is no EU taxonomy in place.
- Coordination with other legislative initiatives in the Commission’s Sustainable Action Plan is of outmost importance in order to ensure that the terms and expressions are given the same meaning in different legislative acts.

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<sup>1</sup> Nordic Securities Association (NSA) is a Nordic cooperation that works to promote a sound securities market primarily in the Nordic region. The association is formed by the Danish Securities Dealers Association (Børsmæglerforeningen), the Finance Finland (Finanssialan Keskusliitto), the Norwegian Securities Dealers Association (Verdipapirforetakenes Forbund) and the Swedish Securities Dealers Association (Svenska Fondhandlareföreningen).

<sup>2</sup> SOU 2017:115 “Att främja gröna obligationer”

- The scope of the organizational requirements in article 21 and 23 should be clarified. NSA finds it unclear how the integration of ESG into some of the general organizational requirements are intended to be carried out in practice.
- All the proposed changes to the MiFID II delegated acts (regulation and directive) should enter into force at the same point in time. An implementation period of 18 months is an absolute minimum.
- We strongly support the proposal by ESMA that firms should be able to update a client's profile with "ESG preferences" in connection with the next regular review following the implementation date.

## **2. General comments**

As a general comment, the NSA is positive to the European Commission's Sustainability Action Plan, including the proposals to integrate ESG considerations into the advisory process of investment firms.

To our understanding there are currently two separate legal procedures relating to MiFID II; the Commission's draft proposals for amendments to the MiFID II delegated regulation and ESMA's Consultation for technical advice. In the opinion of the NSA, changes in MiFID II delegated acts should not be implemented in two steps as this would create unnecessary cost and administrative burden for both investment firms and their clients. We therefore urge the Commission to coordinate this legislative work, including the implementation dates. All the proposed changes to the MiFID II delegated acts (regulation and directive) should enter into force at the same point in time.

During the past year, investment firms have undertaken an extensive work implementing MiFID II, including new rules on product governance, conflict of interest and suitability. The amendments which ESMA proposes in the Consultation Paper will require additional changes to firm's internal procedures and IT systems. It is therefore important that investment firms are given enough time to implement these changes in an orderly manner including necessary training of staff and information to clients. An implementation period of 18 months is an absolute minimum.

The NSA notes that there are a number of terms and expressions in the Consultation Paper which are either not defined or which are defined in other draft EU legislation (e.g. "sustainability risks", "sustainability factors", "ESG", "ESG considerations", "ESG preferences"). This makes it difficult to analyze the effects of some of the proposals. Moreover, as mentioned above, coordination with other legislative initiatives is of utmost importance in order to ensure that the terms and expressions are given the same meaning in different legislative acts. We therefore urge that immediate actions are taken to define above mentioned terms and expressions in order to ensure correct interpretation of such during the preparation for the legislative acts in order to avoid unnecessary confusion.

The NSA is in favor of the development of a common EU taxonomy on sustainability with the objective to correctly categorize sustainable economic activities. We support the stance by the Commission to base such work on current market standards. In fact, the very large number of divergent standards and labels which exists today on EU market (often based on local/historical grounds) contributes to the problem with Green Washing.

However, we also understand that it is a challenge to propose a fully harmonized approach to sustainability risks and factors in MiFID II before a common EU taxonomy is in place. Therefore, we support the “high level approach” proposed by ESMA in the Consultation Paper. We do however not agree with the statement in the Consultation Paper that firms should be expected to base their implementation on the preparatory works of the Commission, i.e. the six objectives. There can be no legal requirements for firms to apply rules which have not yet been adopted by the co-legislators and which could still be subject to change.

The NSA questions the scope of the organizational requirements proposed by ESMA in the Consultation Paper. In fact, the mandate from the Commission specifically states that *“it should be clear that these requirements should only apply for investment firms as defined in article 4(1)(1) of MiFID II which provide portfolio management and/or investment advice”*. However, the proposed amendments to articles 21, 23 and the new recital 59 (bis) apply to all investment services such as execution of orders, underwriting and operation of MTF/OTF. ESMA’s proposals therefore go beyond what is necessary to achieve the objectives of the Commission and create unnecessary legal uncertainty. We also find it unclear how the integration of ESG into some of these general organizational requirements is intended to be carried out in practice.

### **3. Specific comments**

**Q1: Do you agree with the suggested approach and the changes to the Article 21 of the MiFID II Delegated Regulation on ‘general organizational requirements’? Please state the reasons for your answer.**

No. As mentioned under “General Comments”, it is clear from the Commission’s mandate that the organizational rules should only apply to investment firms which provide portfolio management and/or investment advice. ESMA’s proposal for amendments to article 21 does not include this limitation in scope and therefore go beyond the mandate from the Commission.

Moreover, we find it unclear how some of these general organizational requirements should be applied in practice. 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 ESG considerations 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?

**Q2: Do you agree with the suggested approach and the changes to the Article 23 of the MiFID II Delegated Regulation on ‘risk management’? Please state the reasons for your answer.**

No. As mentioned under “General Comments”, it is clear from the Commission’s mandate that the organizational rules should only apply to investment firms which provide portfolio management and/or investment advice. ESMA’s proposal for amendments to article 23 does not include this limitation in scope and therefore go beyond the mandate from the Commission.

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As regards terminology, to our understanding, the Disclosure Regulation will include a definition of “sustainability risk”. In our opinion, coordination between the different legislative initiatives is of utmost importance in order to ensure that the terms and expressions are given the same meaning. If a definition of “sustainability risk” is included in the Disclosure Regulation, the term should have the same meaning in MiFID II, where relevant.

We also note that ESMA in article 23 speaks of “environmental, social and governance factors” rather than the abbreviation “ESG” which is used in other parts of the MiFID II delegated regulation. What is the reason for this?

**Q3: Do you agree with the suggested approach and the new recital on ‘conflicts of interest’? Please state the reasons for your answer. What would be specific examples of conflicts of interests that might arise in relation to sustainability considerations?**

No. As mentioned under “General Comments”, it is clear from the Commission’s mandate that the organizational rules should only apply to investment firms which provide portfolio management and/or investment advice. ESMA’s proposal for a new recital 59 (bis) does not include such limitation in scope and therefore go beyond the mandate from the Commission.

Moreover, we question whether the first paragraph in recital 59 (bis) adds any additional value as 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.

However, if it is nevertheless decided that such an amendment should be included in the delegated regulation to MiFID II, we agree that it is more appropriate to address this in a recital than in an article.

As regards examples, we believe that the mis-selling practices in point 13 (page 10 of the CP) are relevant.

**Q4: Do you think that on the topic of ‘organizational requirements’ other amendments should be made to the MiFID II Delegated Regulation in order to incorporate sustainability risks and factors? If yes, which ones? Please state the reasons for your answer.**

We have no such additional proposals.

**Q5: Which existing market standards or “labels” are you intending to take into account or already taking into account for the consideration of ESG factors? Do you see any issues when relying on current market standards or “labels”? Please describe**

The NSA is in favor of the development of a common EU taxonomy on sustainability and in that connection, we support the stance by the Commission to base such work on current market standards. In fact, the very large number of divergent standards and labels which exists today on EU market (often based on local/historical grounds) contributes to the problem with Green Washing. However, we also understand that it is a challenge to

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propose a fully harmonized approach to sustainability risks and factors in MiFID II before a common EU taxonomy is in place. Therefore, we support the “high level approach” proposed by ESMA in the Consultation Paper.

However, question the statement in the Consultation Paper that firms are expected to base their specification on the preparatory works of the Commission, i.e. the six objectives (point 8, page 14 of the CP). There can be no legal requirements for firms to apply rules which have not yet been adopted by the co-legislators and which could still be subject to change.

**Q6: Do you agree with the suggested approach and the proposed amendments to the MiFID II Delegated Directive Articles on ‘product governance’? If not, please explain.**

Yes. The NSA supports a principle-based approach.

However, it entails the risks that local FSAs interpret the directive and the mandate very differently, as we have seen in the implementation of the delegated directive of MiFID II so far. ESMA should carefully consider that it may cause problems for international firms and distort international competition depending on how local FSAs chose to interpret and implement these criteria. Clarifications as regards what impact these new rules may have on the distribution of non-EEA products into EU is important.

We also agree with the statement in point 13 (page 15 of the CP) that a negative target market should not need to be specified.

**Q7: Do you agree with the proposed changes to the ESMA Guidelines on MiFID II product governance requirements and the addition of an additional case study? If not, please explain what changes should be made and why.**

Yes. The NSA welcomes the addition of an additional case study per se. However, it is important to incorporate the principle of proportionality and not make the requirements too granular.

However, please note that the principle-based approach entails the risks that local FSAs interpret the directive and the mandate very differently, as we have seen in the implementation of the delegated directive of MiFID II so far. ESMA should carefully consider that it may cause problems for international firms and distort international competition depending on how local FSAs chose to interpret and implement these criteria. Clarifications as regards what impact these new rules may have on the distribution of non-EEA products into EU is important.

If the text “*including ESG preferences of the client (where relevant)*” is added in Principle 18 e of the guidelines, the reference to “green investment” in the same paragraph can be deleted (page 18 of the CP).

**Q8: Do you think extra guidance is needed on the elements listed in paragraph 15 above. If yes, please provide details.**

We have no comments at this stage.

**Q9: Please specify any approach you see to identify environmental, social and governance criteria separately from each other or as a single indicator. Please explain how the criteria would interact with each other and how the target market assessment and matching would be performed in such cases.**

Before an EU taxonomy is in place and in line with ESMA's intention to keep the proposed requirements high level and not too prescriptive, the NSA suggests leaving it to the market to determine the way to present the information.

We would however also like to underline that the different EU legislative proposals on sustainability must be coordinated on this point.

In this connection, the NSA also would like to ask for clarification how ESMA's interpretation interact with the Commission's proposal on taxonomy. In fact, we question whether the interpretation that ESMA does on page 15 in the Consultation Paper (*"investment products provide a substantial contribution to environmental, social and/or good governance objectives"*) is in line with the Commission's approach. To our understanding, the taxonomy will define 6 E areas of substantial impact and other E areas on a do no harm basis. Further, taxonomy will have minimum safe guards for S and G (not substantial contribution to S and G, as ESMA interpret). Please clarify in the feed-back statement if any difference to the Commission's taxonomy proposal is intended and, if so, what impact this will have on the application of the MiFID II rules.

**Q10: What current market standards or "labels" are you intending to take into account or already taking into account for the consideration of ESG factors? Do you see any issues when relying on current market standards or "labels"? Please describe.**

See response to Q 5.

One additional issue could be that market standards or labels does not exist for all financial products (most common for investment funds and bonds).

**Q11: Do you agree with the suggested approach and the amendments to paragraph 28 of the suitability guidelines? If not, do you have any suggestions for developing a more detailed approach with regard to (a) the collection of information from clients and (b) the assessment of ESG preferences with the assessment of suitability?**

The NSA supports the proposal that firms should specify what they consider to be "ESG preferences" or "ESG considerations".

To our understanding, until there is an EU taxonomy in place, ESMA's approach means that the producer and the distributor of a financial product could have different views as regards what is an "ESG product". A distributor may therefore classify external products in accordance with its own standard, i.e. not be obligated to use the same standard as the producer.

We support ESMA's proposal that a client's "ESG preferences" should be addressed only once the suitability has been addressed in accordance with the criteria of knowledge and experience, the financial situation and investment objectives (point 11 page 23 of the CP).

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However, we note that in the Commissions draft proposal for amendments to article 54 delegated regulation to MiFID II, it appears as if the ESG preferences should be included in the “investment objectives”. This appears to be an inconsistency which should be investigated by ESMA.

As regards the amendments to paragraph 28 in ESMA Guidelines, we are concerned with the wording that the information collected from clients should be “granular enough”. In our view, firms should not be required to ask detailed questions if a client has clearly stated that it does not have ESG preferences. We propose that this principle is made clear in the ESMA guidelines.

**Q12: Please specify any approach you see to assess environmental, social and governance criteria separately from each other or as single preferences. Please explain how the criteria would interact with each other and how the suitability assessment would be performed in such cases.**

See response to Q 9.

**Q13: Do you agree with the suggested approach and the amendments to paragraph 70 of the suitability guidelines?**

Yes.

The amendments will require additional changes to firm’s internal procedures and IT systems. It is therefore important that investment firms are given enough time to implement these changes in an orderly manner including necessary education of staff and information to clients. An implementation period of 18 months is an absolute minimum.

Moreover, we support ESMA’s view that in respect of existing clients, firms should be able to update the client’s profiles when they do the next regular review following the implementation date.

**Q14: What level of resources (financial and other) would be required to implement and comply with the proposed changes (risk-management arrangements, market researches and analyses, organisational costs, IT costs, training costs, staff costs, etc., differentiated between one off and ongoing costs)? When answering this question, please also provide information about the size, internal organisation and the nature, scale and complexity of the activities of your institution, where relevant.**

The examples provided in the question are relevant. In particular, the IT costs and training costs should not be under estimated.

Depending on the outcome there is a high probability that the cost of service will increase as market actors adapt, this cost will most often end up with the consumer.

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