

2022-04-26

ESMA'S CONSULTATION ON GUIDELINES ON CERTAIN ASPECTS OF THE MIFID II SUITABILITY REQUIREMENTS

The Nordic Securities Association (NSA) fully supports the European joint industry proposal to postpone the implementation of the MiFID II delegated act until 1 July 2023.¹

The NSA emphasises the importance of the timeline regarding the implementation of the new requirements. In particular, if the MiFID delegated act is not postponed, ESMA should take a flexible and proportionate approach to the implementation in order to avoid unintended consequences. The Guidelines must recognise the large extent of uncertainty due to the limited data available. The implementation of the new EU sustainability framework is a long process which will take years; this must be taken into account.

We assume that the sustainability-related data regarding financial instruments (a + b) will not be commonly available by 2 August 2022. It is therefore important that firms are allowed to advise their clients on products that are suitable in other ways (stage 1) but which do not correspond to the suitability preferences expressed by the client, provided that these are documented. The NSA notes that this approach follows from recital 8, but for the avoidance of doubt, it should be confirmed by ESMA in the final final Guidelines. In this connection, ESMA also needs to revise its proposed approach regarding clients' "adaptation". Considering the lack of available products, it would be very strange to require that clients must adapt their own preferences before they can receive otherwise suitable products (stage 1). Therefore, the NSA proposes that the sentence "should not be standard procedure" in point 81 should be removed.

In addition, ESMA must acknowledge the fact that clients expect an advisory service from the firms. If the client has to go through a lengthy and complicated process of learning about sustainability concepts and answering numerous questions, they will rightfully expect there to be a product available that matches the outcome of the process. If the firm is unable to fulfil this expectation due to a lack of flexibility and proportionality, investors' confidence in the advisory service is at risk.

The NSA also considers that the Guidelines should make a clearer distinction between retail clients and professional investors. For retail clients, it is important that the information both given to and asked from them is easy to understand. Firms should be allowed to rephrase/express the requirements especially in article 2(7) a–c using terminology that a retail client can interpret without difficulty. In general, we believe that too extensive information requirements are not in the best interest of the clients, who are already dealing with a vast amount of information (information overload).

In the requirements aimed at professional investors, more technical language can be used. However, professional investors should be able to decide whether they want the more specific (sustainability)

¹ See attachment: Letter to Commission on 28th January 2022.

information not. Only a brief explanation should be enough for those clients (retail or professional) who are not interested in ESG issues. This way, the different needs of different clients can be recognised better. The NSA supports a simplified process in article 2(7) a–c for professional investors. Alternatively, professional investors should have the possibility to opt out of the mentioned requirements.

The Guidelines must also be flexible and proportional regarding non-ESG instruments. Some instruments, for example FX and interest rate derivatives, do not include a sustainable dimension in any meaningful way. Furthermore, some instruments are already covered by sustainability data while some instruments (e.g. government bonds) lack the data entirely, which makes proportionality regarding instruments particularly important.

Due to the highly digital nature of the Nordic securities markets, the NSA wants to stress the importance of ensuring that the Guidelines work fluently in different kinds of environments. The Guidelines should work, for example, also in front office and robo-advisor services. In the digital environment, the use of different tools such as information boxes and hyperlinks to sites providing further information should be allowed. It is crucial that the sustainability preferences may be interpreted in a flexible and adaptable manner when implementing the Guidelines.



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CC: Marcel Haag, Director of Unit FISMA B Horizontal policies
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Brussels, 28 January 2022

Subject: Actions to support the financial sector in making sustainable finance a success including deferral of the application dates of the Markets in Financial Instruments Directive ('MiFID II') and Insurance Distribution Directive ('IDD') ESG Delegated Acts ('DAs'), following deferral of the Sustainable Finance Disclosure Regulation Regulatory Technical Standards ('SFDR RTS')

Dear Ms Power, Dear Mr Berrigan,

As representatives of the financial sector, our associations are committed to supporting the transition to a more sustainable economy and to tackling climate change. We therefore strongly support the Commission's work in developing the taxonomy, the associated reporting requirements and other initiatives to generate transformation projects that will trigger sustainable investments opportunities.

We recognise the urgency, in particular, in relation to climate change, and commend the Commission for its ambition and progress to date. We also welcome the improvements the Commission has made so far to address timing and sequencing issues arising in relation to the phasing in of EU sustainable finance requirements on certain details of the reporting requirements.

Financial undertakings have already been working relentlessly to incorporate sustainability into their financing and other business activities. They are also putting significant time, resources and effort into implementing the new mandatory requirements and anticipating the data from the Corporate Sustainability Reporting Directive ('CSRD'). This data is key for both sustainable decision-making and for compliance with regulations such as the SFDR or the Taxonomy Regulation ('Taxonomy').

Despite these efforts, challenges remain with the timetables, legal definitions, data availability and the supply of sufficient sustainable investments. Without further action, there is a considerable risk that financial undertakings will not be able to meet regulatory requirements, which can result in consequent reputational risk. This would undermine financial undertakings' and investors' ability to consider sustainability-related information in their decision making and jeopardize their ability to drive forward the transition towards a sustainable economy.

Companies need sufficient time and clarity to adapt their reporting processes to the new complex and extensive requirements, particularly those that have so far not been subject to sustainability reporting. At the same time, the financial industry is reliant on the availability of relevant, accurate and consistent data for the purpose of meeting their own reporting obligations as well as for risk management purposes and in order to manage a portfolio towards sustainability goals.

To avoid confusion for preparers and users of the sustainability information, it is critical to have coherence both in terms of content of the reported information and the timelines foreseen for the application of interrelated pieces of legislation. Such alignment is crucial to ensure consistency between data to be reported by companies and disclosures to be adopted by financial undertakings that rely on such companies' data.

The following actions by European policy makers and clear communication is urgently needed not only to properly manage risks (i.e. non-compliance, reputational risk, etc.) for the financial sector but also for the success of sustainable finance and the achievement of the objectives set out in the EU Green Deal. Accordingly, we ask the European Commission to:

1. Defer the application of MiFID II and IDD sustainability related requirements

The recent decision to defer the SFDR Level 2 measures to January 2023 is welcomed to facilitate an orderly implementation. However, the current timing of the new MiFID II and IDD requirements to incorporate customer sustainability preferences in August 2022 remains problematic in terms of data availability. We also understand that, the ESMA guidelines on suitability and product governance and the EIOPA Q&As may not be available by the time the industry will have to incorporate sustainability preferences under the new MiFID II and IDD requirements. Financial undertakings are moving at full speed to be ready as much as possible by 2 August 2022, but data will only be available on a quantitative basis only in Q1 2023.

Therefore, we consider it necessary to defer the ESG MiFID II and IDD Delegated Acts to 1 July 2023 or later. This will ensure greater legal certainty as clients with sustainability preferences will be able to refer to the relevant information at least in the SFDR product templates. However, we would like to note that such deferral to July 2023 does not fully solve the issue of data availability given that:

- **Non-financial undertakings subject to NFRD requirements will start reporting on their taxonomy-alignment in Q1 2023 (they will be published throughout 2023 and not from 1 January 2023) and financial undertakings will also start reporting on their taxonomy alignment later in Q1 2024;**
- **Distributors will need sufficient time to gather, validate, and consolidate the data provided under SFDR level 2 and the Taxonomy;**
- **Product manufacturers will need sufficient time to integrate ESMA's upcoming guidelines on suitability and product governance, and EIOPA's Q&A;**
- **Financial undertakings will be able to accurately report on their PAI consideration only once they will receive the necessary data from the CSRD reporting.**

In practice, this means that companies will not be able to fully comply before July 2024.

2. Ensure a coherent sequencing of sustainability reporting for financial companies to cope with the data gap

As stated above, the necessary input for SFDR reporting will only be available gradually from 2023 on the basis of the DA on Article 8 Taxonomy and only be available from 2024 on the basis of the new CSRD, according to the draft proposal. Therefore, further beyond July 2023, the financial sector still faces a data gap creating very significant compliance challenges. We, thus, ask the European Commission to ensure that companies can comply with the SFDR and Taxonomy Regulation on a 'best-efforts' basis until all the appropriate data becomes available as indicated in the Joint ESA's Final Report on RTS under SFDR (Article 7). This could be done by:

- using information directly from investee companies;
- carrying out additional research; or
- cooperating with third party data providers or external experts or making reasonable assumptions.

The co-legislators should assess a coherent sequence and timing necessary for the CSRD disclosures that would allow for compliance with other regulatory and supervisory requirements of the financial sector. A full alignment should be considered including on scope, content, application dates, reporting frequency and transition. Priority should be given to data needed for the mandatory reporting requirements such as for example SFDR, or Taxonomy Regulation. In this way, reporting of, if not all, such core data from companies needed should still start in line with the current timetable (i.e. 2024). If necessary, more time could be given, for example, to developing and implementing other parts of the sustainability reporting standards or a phased approach could be foreseen for first time adopters.

3. Set and communicate appropriate and realistic expectations

The ability of financial market participants to invest in and for financial advisors to recommend sustainable assets and therefore support the sustainable transition is directly linked to the availability of sustainable investments. **The EU institutions should set and communicate appropriate and realistic expectations given the need for a clear legal framework and both the data from the CSRD and a very considerable increase in the availability of Taxonomy compliant investments** — it will take a number of years for these significant initiatives (SFDR, Taxonomy, CSRD, Fit for 55, etc.) to be implemented, for the availability, consistency and quality of reporting data to mature and for financial companies to be able to show progress towards their targets for sustainable investments and sustainable products.

We refer to the annexes to this letter which provide further background.

Financial institutions are currently committing significant resources to ensure that the new MiFID II / IDD requirements are implemented. Therefore, a timely reaction by the European Commission would be greatly appreciated to bring clarity to implementation projects.

We remain available to discuss further and provide clarifications on the content of this letter/annexes.

Sincerely,

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ANNEX I: Further background on the need for the time-table adjustments

The amendments to the MiFID II and the IDD DAs will take effect on 2 August 2022. These amendments relate amongst others to sustainability preferences. In order to establish these preferences, SFDR Level 2 legislation has to be in place. Furthermore, the amendments rely on the availability of sustainability information to be available under the additional product governance rules as of 22 November 2022 and information to be reported under the SFDR, Taxonomy Regulation, and NFRD/CSRD. We have identified several sequencing issues that will pose significant challenges and potential reputational risks for financial institutions (including, European asset managers, insurers, manufacturers, investment advisors and distributors) in their efforts to implement the ESG suitability assessment ahead of the publication of input information under the SFDR level 2 measures that will be in force as of January 2023. Moreover, timeline inconsistencies and sequencing mismatches lead to disclosure and data gaps, a likely decrease in available sustainable products, as well as, the risk of presenting misleading information to clients. This might result in a decline of the capital flow towards sustainable investments, which is contradictory to the objective of the sustainable finance action plan.

Specifically, the implementation of ESG amendments to MiFID II and IDD in relation to sustainability preferences relies on:

- **Pre-contractual and periodic disclosures in relation to the percentage of sustainable investments as defined under Article 2(17) SFDR for Article 8 and 9 SFDR products.** These obligations are outlined in the SFDR level 2 measures, which will only take effect on 1 January 2023. The level 1 SFDR does not provide for standardised information.
- **Pre-contractual and periodic disclosures under Articles 5 and 6 of the Taxonomy and/or Taxonomy alignment for Article 8 and 9 SFDR products (as per Article 6 and 5 Taxonomy respectively) in regard to the percentage of environmentally ‘sustainable investment’.** The Article 5 and 6 Taxonomy-alignment disclosures under SFDR are rightly being phased-in from 1 January 2022 with respect to the first two climate objectives (however, regarding SFDR financial products, due to the SFDR RTS deferral, disclosures are made on the basis of the level 1 requirements and therefore mainly on a qualitative basis) and from 1 January 2023 with respect to the remaining four environmental objectives. Furthermore, useable quantitative disclosures made under the Article 8 Taxonomy DA, will not be available before end-Q1 2023 for non-financial undertakings and end-Q1 2024 for financial undertakings, referencing reporting periods 2022 and 2023, respectively. It is noteworthy that MiFID II ESG scope is not limited to SFDR products, but concerns all financial instruments, for which EU texts only partially detail regulatory sustainability classification rules. This means that on 2 August 2022, financial institutions will lack the necessary data for assessing their holdings or credits against the EU Taxonomy and it will be challenging to commit to certain minimum shares of Taxonomy-aligned investments. Indeed, before the SFDR Level 2 disclosures and the Taxonomy-alignment reporting, there will be hardly any SFDR-financial product or financial instrument declaring a minimum proportion of Taxonomy-aligned investments. As a result, financial institutions and distributors will not be able to carry out a robust suitability assessment based on a ‘minimum proportion’ of environmentally sustainable investments under the Taxonomy (as required by Article 1(1)(7)(a) of MiFID II DA and Article 2 (1) (4) a) of IDD DA).
- **Pre-contractual and periodic disclosures in relation to PAI consideration at product level, as foreseen by Article 7(1) SFDR.** These disclosures will only take effect on 30 December 2022 and corporates will accurately disclose their PAI indicators with the entry into application of CSRD, i.e. in 2024. In the meantime, financial undertakings would consider and assess PAIs of a financial product – and the DNSH test for sustainable investments – on the basis of voluntary

disclosures or estimations/proxies. That means that one of the three types of eligible financial instruments for matching investor's sustainability preferences (under Article 1(1)(7) the Delegated Regulation (EU) 2021/1253) will only be available months after the foreseen kick-off date.

- **ESG MiFID II DAs, which are not synchronised.** The ESG MiFID II DA that requires to integrate sustainability factors into the product governance obligations will only take effect on 22 November 2022 – more than three months later than the ESG MiFID II DA on the integration of the client's sustainability preferences in the suitability assessment. Distributors rely on a timely delivery of the respective ESG data on sustainability factors via the target market before that date in order to carry out the mandatory assessment on sustainability preferences of their (potential) clients by 2 August 2022. The deferral of the application dates of the MiFID II DAs would help to allow for a consistent legal framework in this regard.
- **Taxonomy reporting and the disclosure of PAI indicators of investees.** These constitute the science-based, quantitative foundations of the framework put in place by the SFDR, the MiFID II and the IDD amendments. A proper sequencing is critical for consistent and clear ESG reporting that is necessary for the industry to properly translate the new standards into understandable and robust information directed to clients, and to categorize the current product universe of distributors within the new client sustainability preferences categories.
- **ESMA guidelines on suitability and product governance and EIOPA Q&As.** We understand that the ESMA guidelines on suitability and product governance and the EIOPA Q&As may not be available by the time the industry will have to incorporate sustainability preferences under the new MiFID II and IDD requirements. Depending on the granularity of these ESMA Guidelines and EIOPA Q&As, financial undertakings would need to dedicate additional time and effort to update internal processes and information already implemented in their systems and documentation in preparation for the new MiFID II and IDD requirements.

We include below a table summarising the different conflicts between the implementation deadlines:

Date	Regulatory changes	Updates needed from the industry
1 January 2022	Article 8 Taxonomy DA applies	The Delegated Act does not apply in full, and both financial and non-financial undertakings will primarily report qualitative information. The only quantitative information reported will regard the proportion of taxonomy eligible assets, which is not relevant to the % of taxonomy aligned assets utilised in the MiFID II DA ESG preferences.
2 August 2022	Application of the Delegated Regulation (EU) 2021/1253, Delegated Regulation (EU) 2021/1257	The suitability assessment will need to include the new sustainability preferences regime. This will require producers (including asset managers and insurers) to send distributors the following products' ESG information: <ul style="list-style-type: none"> • Percentage of sustainable investments under SFDR • Percentage of Taxonomy alignment • PAIs taken into consideration
22 November 2022	Application of the Delegated Directive (EU) 2021/1269	The target market will need to include any sustainability related objectives the financial instrument is compatible with.
30 December 2022	Application of SFDR Article 7 (Transparency of adverse sustainability impacts at financial product level)	Updates needed to reflect the following: <ul style="list-style-type: none"> • Clear and reasoned explanation of whether, and, if so, how a financial product considers principal adverse impacts • Statement that information on principal adverse impact is available in periodic reports
1 January 2023	Application of the SFDR RTS	Pre-contractual templates need to be added to existing pre-contractual documents. This will include the percentage of sustainable investments under SFDR and the disclosure of the percentage of the products' Taxonomy alignment for Article 8 products with sustainable investments and all Article 9 SFDR products.
From 1 January 2023	Full application of the Article 8 Taxonomy DA to non-financial undertakings	First quantitative taxonomy reporting on taxonomy alignment for non-financial undertakings subject to NFRD for the 2022 reporting period. Before this date, no taxonomy data will be available on investee companies.
From 1 January 2024	Application of the Article 8 Taxonomy DA to financial	First quantitative taxonomy reporting on taxonomy alignment for financial

<p>[financial years starting on or after 1 January 2023]</p> <p>[Listed SMEs three years later (1 January 2026)]</p>	<p>undertakings.</p> <p>CSRD (still to be published)</p>	<p>undertakings subject to NFRD for the 2023 reporting period.</p> <p>First reporting under CSRD [except listed SMEs, 3 years later]</p>
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