

NVB response to ESMA Consultation Paper on integrating sustainability risks and factors in MiFID II.

Introduction

The Dutch Banking Association (Nederlandse Vereniging van Banken, or 'NVB') represents all commercial and semi-public, Dutch and foreign banks and credit institutions operating in the Netherlands (approximately 70). The NVB strives to achieve a strong, internationally competitive and sustainable banking system in the Netherlands. Promoting a sustainable economy is currently one of the focal points of the Association's work programme.

The NVB fully supports the Commission's ambition and has already taken various initiatives to increase the Dutch banking sector's contribution to the UN and Paris goals. These include i.a. joint efforts to increase transparency of the (positive and negative) impact of loans and investments on climate change, to promote the respect for human rights in international value chains financed by Dutch banks, and to collectively design innovative financing solutions for the energy efficiency projects and circular business models.¹ The NVB also works closely with the sector associations of insurers, pension funds and asset managers in the Netherlands, united in the Dutch part of the Sustainability Finance Platform, which is hosted by the Dutch central Bank (DNB). Especially interesting regarding this consultation paper, most Dutch banks already have focus on integrating ESG in their retail investment products where relevant.

General comments

The NVB welcomes the opportunity to comment on ESMA's Consultation Paper on integrating sustainability risks and factors in MiFID II, which is an integral part of the Commission proposals on financing sustainable growth ('Sustainable Finance Action Plan'). The NVB agrees with the Commission's goals of redirecting capital to more sustainable economic activities and mainstreaming sustainability in finance. The Sustainable Finance Action Plan can be seen as a landmark regulation that will guide financial market participants in achieving these goals in the future.

In general, the NVB would like to endorse the advice that the Securities and Markets Stakeholder Group (SMSG) has provided to ESMA in September 2018 around the topic of integrating sustainability risks in MiFID II. The SMSG concluded that the new regulatory set should, i.a., find a right balance in implementation, should not create regulatory complexity or legal uncertainty. Furthermore new regulation should avoid being inflexible or overly prescriptive on such a forward looking topic as sustainability in MiFID II, especially because a taxonomy of green assets, project categories and sectors has not been constructed yet.¹

ESMA suggests that there should be 'at this stage the adoption of a high-level approach that leaves sufficient flexibility for implementation by firms .. where, at present, there is very limited practical experience.' The NVB agrees to such a high-level approach. However, by amending MiFID2 delegated acts and the Guidelines on MiFID II suitability requirements, on the contrary, a rule-based change is proposed that – from the start – could have a large and possibly unintended impact for firms and their clients. We believe that the adjustments as proposed by ESMA in its CP could create barriers to market development and current market initiatives and therefore harm the common goal of regulators and market participants, namely to boost the role of finance in achieving a well-performing economy that delivers on environmental and social goals besides financials goals.² The implementation of the proposals of ESMA will cause substantial costs and the burden of implementation will be duplicated when this entire process has to be followed again after the taxonomy has been determined.

Besides answering the CP's specific questions, we propose several possible solutions and considerations for ESMA in this document.

Some topics that we would like to highlight in our reaction:

- The global nature and inter-connectedness of sustainability markets needs clear and at this stage principles-based regulation. With the current proposals the interaction between MiFID II, Ecolabels and the Taxonomy is not clear to us. More specifically, banks question the proposed timeline and order of regulation. The NVB believes changes to MiFID II and its delegated acts are premature in the absence of an unified EU classification system of sustainable economic activities (ie. Taxonomy).
- Implementation of the new legislation will be burdensome and costly for banks and customers (i.e. new questionnaires, review of client profiles, updated systems policies, additional reporting, expanded staff competence). These costs are likely to be incurred by the investor in the end. The unclear and continuously changing legislation on the topic of Product Governance and Suitability Requirements leads to implementation by banks that must be redone over and over (as the legislation is continuously changing) and therefore

¹ Please see SMSG advice to ESMA Sustainable Finance, p.5. (20 september 2018) [Hyperlink](#).

² Please see EC press release Sustainable finance: Commission's Action Plan for a greener and cleaner economy. [Hyperlink](#).

- could drive overall costs for investors to a higher level. We will substantiate this topic in question 14.
- We also wonder what ESMA's view is on how ESG preferences can be related to the financial interests and goals of investors. It is unclear yet whether ESMA foresees a fully harmonised and single suitability test or whether it will be a multi stage suitability test (i.e. first financial goals and risks, then sustainability goals and risks).
 - In the Netherlands we do not have a national Eco labelling scheme for financial products. We therefore have at this stage no strong view with regard to the proposal of the EC to create Ecolabels on a European level. Finding the right balance with a future Ecolabel could prove very problematic. In short: if the requirements for receiving an EU Ecolabel are too high, not a lot of impact can be expected as only a very narrow selection of funds will receive an Ecolabel. If the requirements are too low, we are not re-allocating capital to more sustainable economic activities.
 - On an overall basis, we would like to highlight that the title of the consultation paper is 'CP on integrating sustainability risks and factors in MiFID II', whereas in the paper the Insurance Distribution Directive ('IDD') is mentioned on multiple occasions. We suggest that ESMA publishes MiFID II and IDD as separate consultations, for either parties to which MiFID II or IDD applies. This is to avoid ambiguity.
 - Furthermore we note that question 5/10 and 9/12 are identical.

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

Timing

We agree with the approach and the changes to Article 21 of the MiFID II Delegated Regulation on 'general organisational requirements'. Dutch banks are aware that skills, expertise and knowledge required for staff involved in the advisory process for the assessment of sustainability risks could be expanded. We also agree with ESMA that procedures and mechanisms to integrate sustainability risks and regular internal reporting should be a good practice at the current stage (rather than mandatory).

Besides, we would like to clarify the scope of the approach proposed by ESMA. The mandate of the European Commission was for the organizational rules to only apply to investment firms which provide portfolio management and/or investment advice. ESMA's proposal for amendments to article 21 do not include this limitation in scope and therefore go beyond the mandate from the Commission.

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.

Timing

In essence we endorse ESMA's changes to Article 23. But we do however believe the changes to this Article are premature in the absence of unified EU classification system of sustainable economic activities. The Commission is only in the very first stages of developing a taxonomy on what can be considered an environmentally sustainable economic activity or not. Although ESMA is aware that this taxonomy will be finalised only in the upcoming years and that, at least initially, it will not cover social and governance issues ESMA still proposes changes to article 23 including E as well as S and G risks. With this approach, banks and investment firms are obliged to take a broad approach to assessing potential sustainability risks without a taxonomy. This may lead to very different approaches around how banks implement risk frameworks for S and G sustainability risks on an organizational level which in turn could lead to consumer confusion and ultimately potential greenwashing (including possible reputational risk as well). This is contrary to the EC's objective

Sustainability risks

There's no need to make reference to ESG factors specific. Article 23 relates to all risks, without providing any examples. Other risks, like credit risk, operational risk, reputational risk, etc. are also not provided in Article 23. Financial market participants should be free to choose how to assess ESG

risks and the impact it has on their businesses and clients. If ESG factors are to be mentioned specifically, other relevant risks (as mentioned above) should be included in Article 23 as well. Furthermore, in the wording that is proposed to add to article 23 sub (a) is failing the words: “where relevant”.

Compliance and Audit

ESMA emphasizes that, through the inclusion of a reference to ESG considerations in Article 23 of the MiFID II Delegated Regulation, it would be expected that both the Compliance function and Internal Audit will consider issues related to sustainability risks. We believe financial market participants can best assess themselves which internal business unit (be it either audit, compliance or another business unit) should ascertain sustainability risks.

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?

Article 59 (and above) DR relates to underwriting / placing. The more generic considerations on this topic are: 45-47 DR. This seems a more appropriate place.

The NVB has not identified a clear motive to add a new recital on ‘conflicts of interest’. Which specific conflict of interest has been identified with adding sustainability risk to the broader risks already addressed in MiFID II? The (proposed) potential conflicts relate to the performance of the investments, rather than conflicts of interests between parties (investment firm and/or clients) that the current articles in the DR relate to.

We see no additional value of the proposed consideration.

Q4: Do you think that on the topic of ‘organisational 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.

No.

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.

National character of current labels and a future EU Ecolabel

In the Netherlands we do not have a national Eco labelling scheme for financial products. The main issue the NVB identifies with current market standards or “labels” is that they have a national character instead of a cross-border character. We therefore, in principle have a positive view on the proposal of the EC to create Ecolabels on a European level. Finding the right balance with a future Ecolabel could however prove to be very problematic. In short: if the requirements for receiving an EU Ecolabel are too high, not a lot of impact can be expected as only a very narrow selection of funds will receive an Ecolabel. If the requirements are too low, we are not re-allocating capital to more sustainable economic activities. Furthermore, alignment with the taxonomy that is not available yet is deemed crucial.

The NVB would like to emphasize that cooperation and communication between supervisors and legislators around Ecolabels must be streamlined. On 14th of December 2018 the Joint Research Centre (Directorate B, Unit 5) published its 1st Stakeholder Questionnaire for Financial Products. The outcome of this questionnaire and how a future Ecolabel will take shape directly impacts MiFID II firms and the Product Governance they conduct. But no cross reference is made in the JRC to

ESMA’s MiFID II consultation and neither a cross reference is made in JRC’s initial questionnaire on Ecolabels to MiFID II. Below, we share some considerations for both ESMA as well as the JRC around EU Ecolabels and market standards.

Short term considerations

In the short term it could be considered to focus on the evaluation of Socially Responsible Investment ('SRI') investment process and not on specific ESG criteria (be it separately or as one ESG indicator). In other words; an assessment what kind of SRI instruments are used in the

investment process of a fund, instead of focusing on specific E,S and G criteria that are used. We believe this is also more in line with UNPRI. There are many different SRI approaches and a future Ecolabel should not try to limit the market or put up new boundaries in any way. Portfolio managers will otherwise just structure accordingly which might have a opposite outcome as foreseen by the EC.

So, as long there is no mandatory EU harmonised framework/taxonomy constructed, regulators should be hesitant to interfere with market initiatives.

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.

Timing

We agree to including ESG factors in the investment process on a 'high-level, principal based approach'. We do not agree with the proposed amendments as we, in line with our answers to questions 1.-2., believe a taxonomy must be in place before a change to the MiFID II Delegated Directive Articles could be made. Including ESG-factors in the target market framework, means however that these ESG factors will have to be determined in detail / on a financial instrument basis. These ESG factors are however not defined yet and - given the current status of legislation / process - it is a black box how that will come to look like and (most) producers of investment products are not required to provide such information. Making it mandatory to include ESG factors in the target market criteria, without defining what this means and putting the burden to collect this information on distributors leads to legal uncertainty, interpretation issues with competent authorities, green washing, unequal playing field, etc.. Especially since the ESG-factors may be conflicting with other target market criteria (such as "return on the investment"). For these reasons the European Commission envisages to define ESG factors itself (and not by the market). We propose to put the inclusion of ESG factors as a target market criterion on hold, until the definition thereof is (more) clear. Another reason for putting this on hold is that the process of collecting the preferences of investors regarding to ESG factors is burdensome and costly. This should not have to be redone as a result of changing definitions of ESG factors. On a voluntary basis / good practice, investment firms can (and will) continue the development of "sustainable investments". There is no need for concern that not putting the (mandatory) inclusion of ESG factors in the target market framework puts the development of sustainable investing on hold.

Sustainable objectives and risks versus financial objectives and risks

Besides the above, we wonder what ESMA's view is around how ESG preferences can be related and/or compared to the financial interests and goals of retail investors in assessing the target market. When assessing the target market in a product governance process, what should be predominant: financial objectives or sustainable objectives? In all assets (stranded assets form good examples) financial and sustainable objectives interact with each other. How they exactly interact is however unclear. Therefore we argue that it is premature to amend the MiFID II Delegated Directive Articles on 'product governance'.

Conceptual error

MiFID/Delegated Directive relates to investment services and in principle not to the offering/issuance of investment products. Only manufacturers are in scope that qualify as investment firms, meaning investment firms that produce an investment product and provides an investment service regarding to that same investment product. This is an exception to the rule that "manufacturers don't exist". Most investment products (shares, bonds and funds) are not manufactured by investment firms. This is a conceptual error in MiFID/Delegated Directive. Result is that most (nearly all?) "producers" of investment products are not legally required to provide target market information. This puts the

burden on distributors to collect this information. Most target market criteria can be derived from the type, nature and conditions of the investment products and/or regulatory mandatory disclosures regarding to these investment products (prospectus). This is however in principle not the case for

ESG factors. The current target market criteria do not include or indicate the (environmental) activities and governance of the underlying company/issuer. The target market criteria / ESG factors

should be included in the regulatory framework applicable to the offeror/issuer of investment products (UCITS/AIFMD/Prospectus Regulation/etc.). ESMA is aware of this: "Going forward ESMA considers that the EC should consider the possibility to align the relevant UCITS and AIFMD articles with the product governance obligations for manufacturers." (ESMA Final Report 19 December 2014 | ESMA /2014/1569, paragraph 9, page 52) In our view ESMA forgot to mention the Prospectus Regulation. As long as the "producers" of investment products are not legally required to provide information regarding to the ESG factors, it is not legitimate to put the obligation to provide the same information on the distributors. (If investment products are offered directly to the investor without the intervention of an investment firm the ESG-factors do not have to be disclosed!)

Pro-active include market initiatives without regulatory scrutiny

With MiFID II only entered into force 3rd of January 2018, the Product Governance process and the MiFID II data exchange between distributors and product manufacturers only has an active history of one year. The current standard for data exchange is the European MiFID II Template ('EMT') that could be viewed as a market initiative that is still under construction. We urge supervisors and legislators to embrace, as much as possible, market initiatives already that are already set up.

Market initiatives developing around ESG Product Governance templates are not available yet. In the case of ESG target markets we would therefore like to point out the European ESG template (EET). The EET document is a functional description of a minimum set of data used by asset managers and investors to support their ESG investment policies and create their reports (namely those defined by Article 173 of the French "Loi de transition énergétique pour la croissance verte" for example). In accordance with the EMT, that has become market practice in the MiFID II data exchange between product manufacturers and distributors, this EET could become future market practice. We ask ESMA therefore to let market practices, like the EET, develop further.

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.

We do not agree with the proposed change to ESMA guidelines on MiFID II product governance requirements. Our argumentation can be found in the answer to question 6.

Case Study

The NVB believes a case study could add value, but we have objections to the described case as a representative market example.

First and foremost, impact funds currently take up only a very limited part of the total amount invested by (retail) investors. Besides, the described funds are hardly available in the current market. It therefore is not a representative case as the goal of the Sustainable Finance Action Plan is to redirect capital flows from non-sustainable assets (which arguably is not an impact fund) to more economic sustainable activities c.q. economic sustainable assets.

Second, the example is described as a fund that has relatively low risk. The fund will be investing in renewable energy, organic farming, sustainable real estate, nature and landscape projects and environmental technology. The fund aims to provide explicit positive impact on the environment, measured in carbon footprint, as well as a positive cash flow to its investors, created by the projects funded. The fund invests mainly in loans, secured by mortgages, (state) guarantees, or alternative collateral. The risk indicator of this fund is 2 on a scale of 7 (low risk, low return). More than 70% of the fund is invested in projects certified as "green projects". The activities that this fund invests in,

especially in the short term, could arguably not be described as low risk. For example, liquidity in these activities could be classified as rather low compared to other listed securities. The fund is

described as an open-end fund, whereas the activities typically would better fit in a fund structure classified as closed-end.

Third, investing with specific ESG preferences like a positive impact on the environment by investing capital in green projects, while preserving capital seems contradictory. Investing in the example fund or projects mentioned (with a positive impact effect) could reduce performance.

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

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.

In line with the answers on previous questions in this CP, we believe it is premature to conduct a target market assessment and match this vis-à-vis client preferences and knowledge. As long as there is no taxonomy, it may even be not in the best interests of end consumers. Besides prematurity, E, S and G factors may interact with each other whilst we have no insights or data how they exactly interact.

Single Indicator

The NVB is inclined to believe that any future approach to identify environmental, social and governance criteria should take form in a single indicator only. The most important reason to take this standpoint, is that a single indicator is more or less comprehensible, simple and meaningful to implement. Specifying E,S and G considerations separately will be complex for both distributors, product manufacturers and clients.

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.

Please see our answer to question 5.

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?

We do not agree with the suggested approach and the amendments to paragraph 28 of the suitability guidelines, in line with our previous statements (prematurity). Since the taxonomy system is under development and not available yet, investment firms should be left free in their considerations to ask clients about ESG preferences or considerations. Firms could use own methodologies or (other) current market standards and practices to collect information from clients as a good practice.

We share the SMSG’s view on this topic: “Implementation of such suitability guidelines by ESMA in the absence of a detailed finalised objectives, taxonomy may be complex as it will come to re-designing client profiling questionnaires to capture investment objectives, and to define the criteria and tools to scan products according to new complex criteria... It should take into account the needs of the individual investor and avoid overly complex language or too lengthy disclosure requirements that already hinder consumer protection in financial services”.³

³ Please see SMSG advice to ESMA Sustainable Finance, p.9. (20 september 2018) [Hyperlink](#).

To the NVB, it is unclear yet whether ESMA foresees a fully harmonised and single suitability test or whether it will be a multi stage suitability test (i.e. first financial goals and risks, then sustainability goals and risk more on a recommendation basis). Instead of asking specific preferences around E, S

and G factors separately, firms - as a good practice - could collect general ESG preferences on a very high level. A more granular approach could only be undertaken by firms after there is clarity around the taxonomy. It doesn't, however, dismiss firms completely from their duty to assess (ESG)

preferences. But to match these high level preferences to products that are suitable could have outcomes that are not in the best interest of clients.

Depending on the sustainability preferences and risk tolerance of the customer, investment services could already be filled in by banks. For example, there are customers who only want to invest in a sustainable manner if they do not have to make concessions in terms of risk and return. In addition, there are customers who are prepared to accept lower returns or take more risks for a more sustainable portfolio. As far as banks are concerned, the suitability test as it exists today already provides enough openings for determining this "sustainability profile". We believe a client questionnaire should be determined very high-level only and not granular as proposed in this CP.

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.

Please see our answer to question 9.

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

We do not agree with the proposed amendments as - in line with our answers to previous questions - we believe a taxonomy must be in place before changes to the MiFID II Delegated Directives or Guidelines could be made. Until that moment in time the wording should remain limited to a recommendation and not be written down as an obligation.

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.

Implementing the ESG requirements as proposed in this consultation paper will require an impactful change in the product offering and review process, as well as the client intake and review of existing clients. All products on offer have to be assessed on ESG criteria and the onboarding of new clients and the review of existing clients has to be adapted. Therefore the level of necessary (financial) resources will be substantial. The related costs will be duplicated when this entire process has to be followed again after the taxonomy has been determined. A really principles-based ESG framework rather than a de facto rule-based framework will be an important factor herein.

Since at the end of the day, our (retail) clients will have to pay for these additional costs, it may even turn out that especially for smaller investors it is no longer cost efficient (taking into account the possible return after deduction of the total costs) to continue their investment services.



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