ASSOCIATION FRANÇAISE DES MARCHÉS FINANCIERS
FINANCIAL MARKET PROFESSIONALS

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FEEDBACKS TO EC
Sustainable Finance
–
MiFID II Delegated Directive (product governance)
-
AMAFI's feedback

INTRODUCTION

About AMAFI. *Association Française des Marchés Financiers* (AMAFI) is the legal trade organisation representing financial market participants in France. AMAFI members are investment firms and credit institutions (French, European and global firms), operating in and/or from France (corporate and investment banks (CIBs), brokers-dealers, market infrastructures, exchanges and private banks). AMAFI has been extremely active on MiFID II issues. We are involved in all regulatory matters that concern commercialization of financial instruments. As far as financial products are concerned, we mostly represent all issuers/manufacturers of products (CIBs) but, through our private bank members, distributors as well. AMAFI has more than 150 members operating in equities and fixed-income and interest rate products, as well as commodities, derivatives and structured products for both professional and retail clients.

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AMAFI welcomes the opportunity to give feedbacks on European Commission proposed amendments to delegated acts under MiFID II[1] to include sustainability factors into the advice that investment firms offer to individual clients. Indeed, AMAFI pays particular attention to the development of ESG criteria in the financial markets and welcomes this objective to develop sustainable investments which are vital for our future.

In that context, AMAFI supports the proposal to clarify that sustainability preferences should be taken into account in the product oversight and governance process as provided by MiFID II, by investment firms manufacturing financial instruments and their distributors.

This is why AMAFI read attentively the Commission proposal of a draft Delegated Directive amending Delegated Directive (EU) 2017/593 in application of MiFID II and would very much like to outline the following general points before suggesting slight changes in the wording.

However, first of all, AMAFI wished to insist on the flexibility and best effort logic needed for investment firms to take into account ESG considerations. Indeed, investment firms should have flexibility for determining ESG considerations of the client as well as for identifying ESG features and products. Indeed, regarding the target market definition in compliance with Product governance requirements, the assessment of ESG features should be implemented with the best effort logic considering that all financial instruments within the scope of MiFID II could have different levels of sustainable investment objective.

[1] Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (link).

Furthermore, AMAFI notes that in order to define the concepts of sustainability preferences, sustainability factors and sustainability risks, the European Commission suggests referring to the Regulation (EU) 2019/2088 commonly referred to as the Disclosure regulation.

AMAFI notes that the Disclosure Regulation applies to a list of 'financial products' as defined in Article 2 (12) (a portfolio manager managed in accordance with point (6) of the 2019/2088 Article, an alternative investment fund (AIF) an IBIP, a pension product, a pension scheme, a UCITS or a PEPP) which are not considered as financial instruments under MiFID 2.

AMAFI is questioning the scope and consequences of this discrepancy: Are MiFID 2 products (equities, bonds, structured products, funds, derivatives, etc.) hence excluded from the scope of application and cannot qualify as ESG under MiFID 2's suitability and product governance regulation? That would be surprising and unforeseen if it is the case.
Conversely, assuming that MiFID 2 instruments are eligible for ESG criteria, on what basis/criteria will investment firms (under MiFID 2) assess the sustainability of their instruments?

In this sense, considering structured products for instance, AMAFI is currently working on developing a grid to categorize financial instruments according to ESG criteria. As such and as an example, a currently drafting decision tree diagram is presented in the annex of this document for this classification.

Given that no reference to the Disclosure Regulation appears in the ESMA consultation paper in 2018/2019, it raises serious questions that cannot be answered within a one-month period. It is therefore kindly suggested that the EU thoroughly considers these questions before publishing a final text.

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AMAFI COMMENTS

1. Implementation schedule

The implementation schedule of such new Delegated Regulation, notably the date of application, should be carefully considered. Indeed, as stated in 2019 in its answer to the consultation of ESMA[2], AMAFI considers that a cost-benefit analysis approach should be taken, between (1) the relative emergency of such measures to be enforced considering the forthcoming work on MiFID II refit and (2) costs for investment firms to implement successively 3 sets (*(i)* MiFID II as of 1rst January 2018, *(ii)* MiFID II as amended by MiFID Refit, and *(iii)* MiFID II as amended by the present Delegated Regulation) of changed requirements within 3 years.

(1) If developing sustainable finance is clearly an important and urgent issue, we would like to outline that MiFID II, through Product Governance requirements[3], already consider "*green*" and "*ethical*" investments as possible investment objectives to take into account into target market definition of financial instruments. These sustainability factors are therefore included in the new commercialization framework post MiFID II of financial instruments by both, manufacturers, and distributors.

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[2] ESMA Consultation on Integrations sustainability risks and factors in MiFID II, from 19 December 2018 to 19 February 2019 (link) – Consultation Paper : ESMA35-43-1210. See AMAFI's answer: *AMAFI / 19-22*.

[3] « *The firm should specify the investment objectives and needs of target clients that a product is designed to meet* […]. *For example, a product may be designed to meet the needs of a specific age demographic, to achieve tax efficiency based on clients' country of tax residence, or be designed with special product features to achieve specific investment objectives such as "currency protection",* ***"green investment", "ethical investment",*** *etc., as relevant.* » (*ESMA Guidelines on MiFID II product governance requirements, 2 June 2017, ESMA35-43-620*).

(2) Investment firms subject to MiFID II did a tremendous work in implementing the reform, including review all clients on boarding process in line with MiFID II requirements that apply since January 2018. With those amendments on ESG issues, firms would have to implement those changes within the next two years. They potentially will have to change again once MiFID II/MiFIR Refit will entry into force. As a whole, it may result into 3 sets of the same requirements which might change twice in 3 years.

Would it not be sufficiently reasonable to ask the EU to re-evaluate the current legislative framework through amendments entering into force at the same time? All the more so as the changes incurred by the amendments contemplated will oblige to partially redesign procedures, internal process and IT systems developments, to question again clients to integrate their sustainability preferences (and redefine all onboarding questionnaires), redesign their product governance set up (including necessary exchanges between manufacturers and distributors) as well as training staff. Besides investment firms would need to take into account those changes in exchanges between manufacturers and distributors, notably to determine how a financial product could be considered as sustainable.

At last, AMAFI very much welcomes the Commission position to give competent authorities and investment firms a sufficient time to adapt to these new requirements as stated in article 2 of the Commission Delegated Directive proposal. However, AMAFI considers the proposed implementation period of 12 months is not sufficient. Indeed, according to AMAFI, an implementation period of 18 months is an absolute minimum. And, once again, all the proposed changes to the MiFID II delegated acts (for both ESG and Refit purposes) should enter into force at the same point in time.

2. Best effort logic and need for flexibility

(i) Clients may not have ESG preferences

Another important point in our view is that it seems essential to maintain for investors the possibility of *not* having sustainability objectives or considerations. It shall not be a requirement, for the client, to indicate sustainability preferences. Symmetrically, the investment firm should be in "best effort" logic for determining sustainability factors of the client.

In other words, investment firms should benefit from flexibility in determining and collecting sustainability considerations of the client. **If AMAFI supports the requirements of seeking for ESG preferences from clients, it should be very clear that investment firms should not be required to actually getting it. Moreover, investment firms cannot be required to classify their investors into ESG categories**. When a client does not have sustainability considerations or does not wish to disclose its preferences, this should not prevent the investment firm from providing him advisory or portfolio management services.

This is particularly crucial where the client is a professional client. Firms have generally more difficulty to collect "personal" information from professional clients and in some context; sustainability factors might not be relevant at all for those professional clients where acting on their own behalf. Also, future guidance from ESMA on that particular point might be appreciated to reaffirm that expectations should be lower in the context of the wholesale market.

(ii) Products may not have ESG features

Likewise, not all financial instruments or financial products are supposed to have ESG features.

AMAFI totally supports ESMA reasoning developed in its former Consultation Paper[4] where it said that "*ESMA notes that these proposed amendments do not require that all investment products always need to have a reference, in their target market, as to whether the products fulfils ESG preferences or not. It does require, however, that manufacturers need to assess whether products possess identified ESG characteristics. ESMA interprets the initiative of the Commission in a way that "positive" ESG characteristics*

[4] See footnote number 2, §10, p. 14-15.

of a product shall be identified so that it will be easier to identify which investment products provide a substantial contribution to environmental, social and/or good governance objectives. In contrast, firms are not expected to identify products that have negative impact on these objectives. Generally speaking, this will result in two types of target market: target markets in which certain ESG characteristics are specified ('ESG positive products') and target markets without any reference to ESG characteristics ('non ESG products'). ***That is why ESMA proposes to include 'where relevant' in paragraphs 9 and 14 of Article 9 of the MiFID II Delegated Directive****"* and, in particular, agreed with ESMA proposal to include "where relevant" in § 9, 14 of Article 9 of the MiFID II Delegated Directive.

That is why AMAFI would again suggest adding the indication **"*where relevant*"** with "sustainability factors or preferences" in all relevant articles of the draft Delegated Directive. Indeed, according to AMAFI, the Commission's suggestion of wording "*any* sustainability preferences/factors" does not exactly reflect the principle involving that clients do not have necessarily sustainability considerations; nor that such sustainability preferences/factors are necessarily relevant.

(iii) Flexibility is needed

Flexibility is also essential for identifying sustainable product. Manufacturers responsible for defining such target markets of products, face a challenge regarding data availability and reliability. Manufacturers rely on a variety of ESG data providers which do not necessarily have harmonised methodologies. In practice, only a limited number of companies today issues clear, comprehensive, and usable sustainability data although the situation keeps improving on developed countries. Also, there is still a variety of different methodologies to measure a company carbon footprint as each methodology is highly sector specific and may also be specific to the data provider.

Regarding the target market definition in compliance with Product governance requirements, **the assessment of ESG features should be implemented with the best effort logic considering that all financial instruments within the scope of MiFID II could have different levels of sustainable investment objective** (see AMAFI's comment in the *Introduction* and its current work on this issue provided in the *Annex*). In addition, this new assessment should not be required for products marketed before the date of its application but only taken into account for the next regular reviews of target markets.

(iv) Integration of ESG makes sense for defining positive target market but does not for the negative target market

AMAFI also agrees with ESMA that the idea that only "positive" ESG characteristics of a product shall be identified. Firms should not be expected to identify products that have so called negative impact on these objectives. Like ESMA, we believe that is would be inappropriate to require defining a negative target market as far as ESG features are concerned.

That's why, for the sake of better clarity, we would like to suggest an amendment in the proposition made in Article 9(9) of the MiFID II Delegated Directive: "*Member States shall require investment firms to identify at a sufficiently granular level the potential target market for each financial instrument and specify the type(s) of client for whose needs, characteristics and objectives, including ESG preferences (where relevant), the financial instrument is compatible. As part of this process, the firm shall identify any group(s) of clients for whose needs, characteristics and objectives the financial instrument is not compatible.* **With regard to any ESG preferences in the 'objectives and needs' category, a negative target market does not need to be identified**". We would have the same comment for article 9(14), 10(2): it has to be clear that negative market does not apply when it comes to ESG characteristics.

3. Investment in a broader sense

Finally, AMAFI would like to remind that an investment product could be “sustainable” without “directly” invest in an “ESG asset”. For instance, this could be the case for a structured product that tracks performance of a basket of shares of companies within energy sector selected on the basis of an environmental or green rating. Another example could be a product that replicates the value of a “low carbon benchmark” or a “positive carbon impact” as proposed by the Commission in its amendment of Regulation (EU) 2016/1011. Such investment from the investor point of view, promote environmental standard through general promotion of sustainability performances. It could indeed induce companies to reach good ESG rating. Therefore, such “indirect” environmental investment could be considered as suitable for a client that has environmental preference. AMAFI considers that structured products have features which are very useful for investors. One of these features could be ESG promotion in general. It would be highly detrimental for investors and the industry to disqualify structured products from ESG financial instrument definition (see AMAFI’s comment in the *Introduction* and its current work on this issue provided in the *Annex*).

AMAFI proposes to slight change the wording of the first definition of article 1 (1) to clarify this point.

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AMAFI AMENDMENTS PROPOSALS

To conclude, AMAFI would like to propose the following changes (identified in **bold and underlined** police as being addition and ~~strikeout~~ police as removed) in the proposed Delegated Regulation and will be happy to discuss those further with the European Commission if needed.

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Article 1
Amendments to Delegated Directive (EU) 2017/593

Delegated Directive (EU) 2017/593 is amended as follows:

(1) in Article 1, the following paragraphs 5 and 6 are added:

“5. ‘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**, direct or indirect,** strategy:

- 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*;
- 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;

6. ‘sustainability factors’ means sustainability factors as defined in Article 2, point (24), of Regulation (EU) 2019/2088.

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* Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability- related disclosures in the financial services sector (OJ L 317, 9.12.2019, p. 1).";

(2). Article 9 is amended as follows:

(a) in paragraph 9, the first subparagraph is replaced by the following:

"9. Member States shall require investment firms to identify at a sufficiently granular level the potential target market for each financial instrument and specify the type(s) of client for whose needs, characteristics and objectives, including any sustainability preferences, **where relevant,** the financial instrument is compatible. As part of this process, the firm shall identify any group(s) of clients for whose needs, characteristics and objectives the financial instrument is not compatible. **With regard to any sustainability preference in the 'objectives and needs' category, a negative target market does not need to be identified.** Where investment firms collaborate to manufacture a financial instrument, only one target market needs to be identified.";

(b) paragraph 11 is replaced by the following:

"11. Member States shall require investment firms to determine whether a financial instrument meets the identified needs, characteristics and objectives of the target market, including by examining the following elements:
(a) the financial instrument's risk/reward profile is consistent with the target market;
(b) the financial instrument's sustainability factors**, where relevant,** are consistent with the target market;
(c) the financial instrument design is driven by features that benefit the client and not by a business model that relies on poor client outcomes to be profitable.";

(c) paragraph 14 is replaced by the following:

"14. Member States shall require investment firms to review the financial instruments they manufacture on a regular basis, taking into account any event that could materially affect the potential risk to the identified target market. Investment firms shall consider if the financial instrument remains consistent with the needs, characteristics and objectives, including any sustainability preferences, **where relevant,** of the target market and if it is distributed to the target market, or reaches clients for whose needs, characteristics and objectives the financial instrument is not compatible. **With regard to any sustainability preference in the 'objectives and needs' category, a negative target market does not need to be identified.**"

(3). Article 10 is amended as follows:

(a) in paragraph 2, the first subparagraph is replaced by the following:

"2. Member States shall require investment firms to have in place adequate product governance arrangements to ensure that products and services they intend to offer or recommend are compatible with the needs, characteristics, and objectives, including any sustainability preferences, **where relevant,** of an identified target market and that the intended distribution strategy is consistent with the identified target market. **With regard to any sustainability preference in the 'objectives and needs' category, a negative target market does not need to be identified.** Investment firms shall appropriately identify and assess the circumstances and needs of the clients they intend to focus on, so as to ensure that clients' interests are not compromised as a result of commercial or funding pressures. As part of this process, investment firms shall identify any group of clients for whose needs, characteristics and objectives the product or service is not compatible.";

(b) paragraph 5 is replaced by the following:

> “5. Member States shall require investment firms to review the investment products they offer or recommend and the services they provide on a regular basis, taking into account any event that could materially affect the potential risk to the identified target market. Firms shall assess at least whether the product or service remains consistent with the needs, characteristics and objectives, including any sustainability preferences, **where relevant,** of the identified target market and whether the intended distribution strategy remains appropriate. Firms shall reconsider the target market and/or update the product governance arrangements if they become aware that they have wrongly identified the target market for a specific product or service or that the product or service no longer meets the circumstances of the identified target market, such as where the product becomes illiquid or very volatile due to market changes.”.

Article 2
Transposition

(1) Member States shall adopt and publish, by [***PO: Please insert a date – exactly twelve months minus one day after entry into force of this delegated act***] at the latest, the laws, regulations and administrative provisions necessary to comply with this Directive. They shall forthwith communicate to the Commission the text of those provisions.

They shall apply those provisions from [***OJ: please insert date exactly ~~12~~18 months after entry into force of this delegated act***]**after the publication of Directive XX/XX/EU (“MiFID II Refit”) in the *Official Journal of the European Union***.

When Member States adopt those provisions, they shall contain a reference to this Directive or be accompanied by such a reference on the occasion of their official publication. Member States shall determine how such reference is to be made.

(2) Member States shall communicate to the Commission the text of the main provisions of national law which they adopt in the field covered by this Directive.

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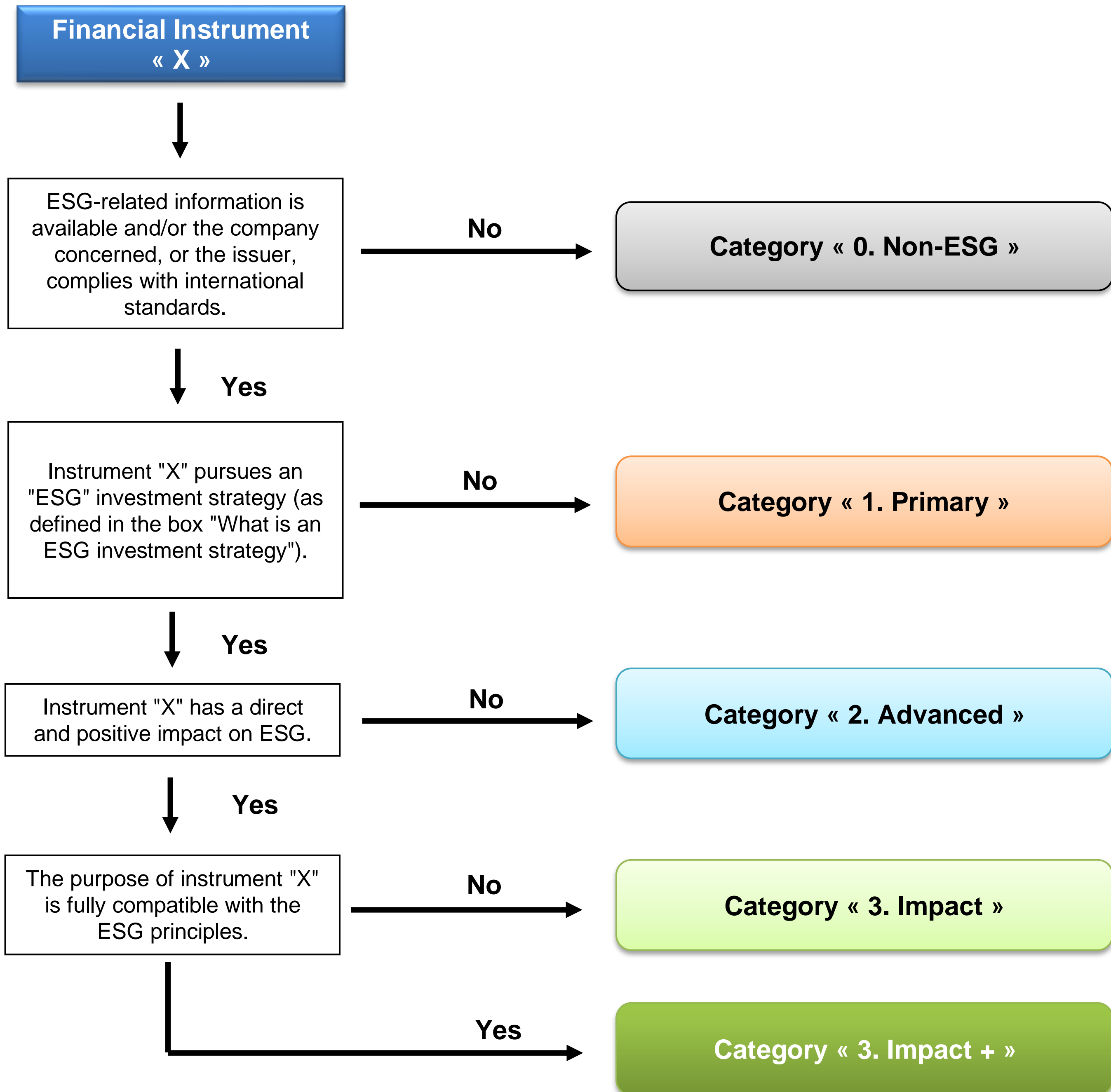
ANNEX

Decision Tree Diagram for Categorizing Financial Instruments According to ESG Criteria



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