THE INVESTMENT ASSOCIATION

# PROPOSED CHANGES TO MIFID II SUITABILITY ASSESSMENT – IA RESPONSE

The Investment Association (IA) thanks the Commission for the opportunity to comment on proposed changes to the MiFID II Suitability Assessment. Overall, we are supportive of the Commission's proposal to better integrate clients' ESG preferences into the suitability assessment, including the introduction of questions to help identify ESG preferences, offering financial products that correspond to those ESG preferences and disclosing, where relevant, information on the ESG features of each financial product offered to clients before providing investment services.

Asset managers are increasingly seeking to integrate an assessment of environmental, social and governance (ESG) factors in their investment process and decisions and to monitor and mitigate their risks and opportunities, where these factors are deemed to have a material impact on performance. Along with integrating material ESG factors into the investment decision-making process, asset managers often actively engage with companies to identify and reduce ESG risks in order to ensure they remain a sustainable long-term investment proposition. This will include engagement on not just the company's governance, but also on the company's management of social and environmental risks, such as climate change and human capital development.

As asset managers, it is our role to help end investors achieve their goals and objectives – both financial and non-financial – as well as contributing to economic growth through the efficient allocation of capital. We also recognize the key part that our industry can play in signposting opportunities/products for investors that contribute to sustainable growth and in the development of innovative products to contribute to such goals.

We stand ready to work together with the Commission and other key stakeholders to progress the sustainable finance agenda in its aim of boosting the role of finance in achieving a well-performing economy that delivers on environmental and social goals as well. We are of course supportive of efforts to align investments with investors' preferences and for asset managers to take account of sustainability risks. However, we have a number of concerns around possible unintended consequences arising from certain aspects of the current drafting.

**1. Scope of the Definitions (Article 1(1))**

We are concerned that the definitions as set out in Article 1(1) scope sustainable investing too narrowly.

In particular, there is an important difference between "ESG preferences" and "ESG considerations" that should be more accurately reflected.

Above all, it is important to differentiate between investment *outcomes* and investment *process* in this context.

It is our understanding that "ESG preferences" refers to the environmental and social *outcomes* that a client has a preference for, which sit alongside their financial requirements. Whereas, "ESG considerations" refers to the consideration of environmental, social **and** governance concerns in the context of the risk management *process*, where such concerns are deemed to be relevant and material, which sits alongside the consideration of other relevant and material risks and opportunities.

Current drafting does not reflect this. We would suggest that "ESG preferences" be defined more clearly, for example, as "the environmental and social outcomes a client has a preference for", and that "ESG considerations" be defined more broadly to refer to the "consideration of environmental, social **and** governance risks and opportunities, where relevant and material".

Furthermore, it is crucial that ESG considerations are applied not only to "environmentally sustainable investments, social investment or good governance investment" but also to the entire investment universe. **ESG considerations should refer to the process of taking into account all material factors relating to environmental social and governance concerns as they arise and would not be restricted to those investments that have a specific and defined sustainability target.** This approach – commonly referred to as ESG integration – is a key part of asset managers' contribution to sustainable growth. If this is not reflected in the drafting, this could massively curtail investments that can deliver on different clients' ESG preferences. For example, an investor who expresses concern over climate change does not necessarily want a green fund. Instead, they may want to invest in listed companies that are working hard – in many cases with the input and stewardship of asset managers – to manage their transition towards better alignment with climate change mitigation practices. Investment in such companies can be better suited to the clients' preferences and also has a significant impact on improving sustainable growth.

It is of greatest importance that the proposed amendments to the MiFID II Suitability Assessment reflect that ESG considerations extend beyond clients' preferences for a particular sustainable investment and we would stress the crucial role that the consideration of all relevant and material environmental, social and governance risks and opportunities play in meeting investors' needs and in growing sustainable finance.

To further reflect the difference between "ESG considerations" and "ESG preferences", we would suggest the following amendment to Article 1(5):

| | |
|---|---|
| Article 1<br><br>[…]<br><br>5. Article 54 is amended as follows:<br>(a) in paragraph 2, point (a) is replaced by the following:<br><br>"(a) it meets the investment objectives of the client in question, including the client's risk tolerance and any <u>preferences including environmental, social and governance considerations"</u> | Article 1<br><br>[…]<br><br>5. Article 54 is amended as follows:<br>(a) in paragraph 2, point (a) is replaced by the following:<br><br>"(a) it meets the investment objectives of the client in question, including the client's risk tolerance ~~and any preferences including environmental, social and governance considerations~~**<u>, of which ESG considerations should be one part, as well as any ESG preferences."</u>** |

This would highlight the importance of taking into account ESG considerations as a normal part of appropriate risk management, where relevant, as well as the need to act on ESG preferences, if the client should have any.

## 2. Interaction with the Proposal for a new Sustainable Finance Taxonomy

We have concerns around the interaction between proposed changes to the Delegated Act and the Proposal for a new sustainable finance taxonomy.

The Delegated Act makes reference to an "environmentally sustainable investment" as defined in Article 2 of the incoming taxonomy Regulation. However, the environmentally sustainable objectives for the proposed new taxonomy are not scheduled to be finalised

before 2020. For the definitions of "social investment" or "good governance investment", there is no provision for a link to the new Taxonomy Regulation. Therefore, it is not clear how any preferences regarding such investments would fit with the Taxonomy. This could result in advice being provided in a piecemeal fashion. Furthermore, it could also mean the parallel development of "social investment" and "good governance investment" at Member State level, which could have serious implications for the cross-border distribution of financial instruments and the pan-European developments of ESG products.

It is imperative that industry receives clarity on the interaction between the amended Delegated Act and the Proposal for a new sustainable finance taxonomy and that asset managers are able to take as their reference existing best practice where a Taxonomy does not yet exist.

Lastly, we would point out that environmental, social and governance effects of investments are intrinsically linked to each other. We would therefore argue that investment advice should take an integrated approach rather than putting the environmental, social and governance aspects of an investment in separate silos.

## 3. Hierarchy of Risks

In the interests of protecting investors, we would stress the importance of treating ESG considerations proportionately, alongside other relevant risks. Equally we should ensure the consideration of risks is expanded to ensure opportunities are also considered in the assessment. In Article 1(3), we would therefore suggest the removal of "in particular" and propose the following change to the proposed wording. This should help to ensure that ESG risks are viewed alongside all relevant and material risks to the client:

| EC proposed language | IA proposed amendment |
|---|---|
| Article 1<br><br>[…]<br><br>3. In Article 48(1) the first sentence is replaced by the following:<br><br>"Investment firms shall provide clients or potential clients in good time before the provision of investment services or ancillary services to clients or potential clients with a general description of the nature and risks of financial instruments, taking into account in particular any ESG considerations and the client's categorisation as either a retail client, a professional client or eligible counterparty." | Article 1<br><br>[…]<br><br>3. In Article 48(1) the first sentence is replaced by the following:<br><br>"Investment firms shall provide clients or potential clients in good time before the provision of investment services or ancillary services to clients or potential clients with a general description of the nature and risks of financial instruments, taking into account ~~in particular~~ any **relevant** ESG considerations and the client's categorisation as either a retail client, a professional client or eligible counterparty." |

## 4. Most suitable products vs suitable products

Recital 9 of the draft MiFID II delegated regulation proposes that investment firms recommend "the most suitable product to the client". This places an unrealistic burden on investment firms that is not in line with the most recent suitability guidelines or the MiFID II text which states "suitable products and services".

| EC proposed language | IA proposed amendment |
|---|---|
| (9) to enable those investment firms to recommend the most suitable products to the client, investment firms providing | (9) 'to enable those investment firms to recommend ~~the most~~ suitable products to the client, investment firms providing |

| investment advice and portfolio management should introduce questions in their suitability assessment that would help identify the client's investment objectives, including ESG preference. | investment advice and portfolio management should introduce questions in their suitability assessment that would help identify the client's investment objectives, including ESG preference. |
|---|---|

**5. Information Flow**

We have concerns around the mechanics of the process needed to carry out the proposed requirements. In the proposed scenario, the adviser will need to get information on ESG aspects of funds from the product manufacturer. In most member states, the product manufacturer will not need to comply with MiFID II so it is unclear how we can ensure the necessary information flow, where there are no rules to facilitate this on the part of the product manufacturer.

## FINAL REMARKS

We would like to reiterate our support for the Commission's broad proposals on sustainable finance and to state that we stand ready to assist in the appropriate calibration of all aspects of this initiative.

## ABOUT THE INVESTMENT ASSOCIATION

***The Investment Association is the trade body that represents asset managers based in the UK, whose 240 members collectively manage over €8.1 trillion on behalf of clients across the globe.***

***Our mission is to make investment better. Better for clients, so they achieve their financial goals. Better for companies, so they get the capital they need to grow. And better for the economy, so everyone prospers.***

***Our purpose is to ensure investment managers are in the best possible position to:***

- ***Build people's resilience to financial adversity***
- ***Help people achieve their financial aspirations***
- ***Enable people to maintain a decent standard of living as they grow older***
- ***Contribute to economic growth through the efficient allocation of capital***

***The money our members manage is in a wide variety of investment vehicles including authorised investment funds, pension funds and stocks & shares ISAs.***

***The UK is the second largest investment management centre in the world and manages 36% of European assets.***