THE INVESTMENT ASSOCIATION

Response to consultation

Consultation on the amendments to the Delegated Directive (EU) 2017/593 as regards the integration of sustainability factors and preferences into the product governance obligations

About the Investment Association

The Investment Association (IA) champions UK investment management, a world-leading industry which helps millions of households save for the future while supporting businesses and economic growth in the UK and abroad. Our 250 members range from smaller, specialist UK firms to European and global investment managers with a UK base. Collectively, they manage € 8.5 trillion for savers and institutions, such as pension schemes and insurance companies, in the UK and beyond. 40% of this is for overseas customers. The UK asset management industry is the largest in Europe and the second largest globally.

Overarching Comment

As investment managers, we seek to deliver on our clients' investment goals, including the generation of long-term sustainable returns and, where appropriate to the investor, allocation of capital to investment strategies with environmental or social characteristics or in the pursuit of certain sustainability objectives. We are committed to the growth and development of sustainable finance and support European policymakers' demonstration of global leadership. Specifically, we welcome the Sustainable Finance Package with its broad objectives to 1) reorient capital flows towards sustainable investments, 2) manage financial risks stemming from ESG issues; and 3) foster transparency and long-termism in financial and economic activity.

We thank the Commission for this opportunity to provide feedback on the Draft amendments to the Delegated Directive (EU) 2017/593 as regards the integration of sustainability factors and preferences into the product governance obligations. We particularly welcome the efforts to bring about alignment across regulations.

Nonetheless, we have some concerns around aspects of the drafting, specifically whether it will achieve the Commission's objectives. We set these out in more detail below – alongside proposed amendments – in an attempt to help achieve the goals of the Action Plan in practice.

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Summary of Key Points

1. **Definition of “Sustainability preferences.”**

We have serious concerns about the definition of “sustainability preferences”. The proposed definition narrows the universe of sustainability-related products beyond the categories set out in Regulation (EU) 2019/2088. It also reduces the scope of investment approaches and products which could be offered to investors in line with their needs and goals.

2. **Integration of sustainability factors within the product governance process**

We support European policymakers’ commitment to make Europe a global leader in sustainable finance and recognise the need to implement adequate practice through regulations as soon as possible. We would, however, like to highlight the practical complexities associated with the integration of sustainability factors within existing product governance processes.

Detailed comments and drafting suggestions

1. **The definition of “Sustainability preferences.”**

We welcome the efforts to bring about alignment across regulations by introducing a definition of “sustainability preferences” that references the Regulation (EU) 2019/2088.

However, flexibility in the market must be retained to draw on any one of a number of different sustainable and responsible investment approaches, which cater to investors’ multiple and varied investment objectives.

The draft proposals limit the remit of sustainability preferences to financial instruments that have as their objective sustainable investments as defined in Article 2, point (17), of Regulation (EU) 2019/2088 and to financial instruments that promote environmental or social characteristics as referred to in Article 8 of Regulation (EU) 2019/2088 provided that these either pursue specific sustainable investments or consider adverse impacts at fund level.

a. <u>Misalignment with other regulations</u>

The Regulation (EU) 2019/2088 distinguishes between products promoting environmental and social characteristics (i.e. Article 8 products) and those pursuing sustainability objectives (i.e. Article 9 products). Restricting the scope of Article 8 products which could be made available as per the new sustainability preferences definition can potentially create greater confusion among investors.
The Regulation (EU) 2019/2088 allows for Article 8 products which do not follow the added conditions prescribed by the definition of sustainability preferences to be classified as products promoting environmental and social characteristics.

In fact, many ESG products would fall into the Article 8 category as a "light green" ESG product but then unless they meet these additional constraints, would not be deemed to be suitable for clients with sustainability preferences.
Excluding these products from the offering might create confusion for investors and be challenging when complying with MiFID Article 24(3) "*All information, including marketing communications, addressed by the investment firm to clients or potential clients shall be fair, clear and not misleading".*
The type of products which can be considered as sustainable must be consistent throughout all relevant pieces of EU law.

b. Restricted view of investors potential needs and goals

The definition as it stands excludes products that promote environmental or social characteristics without the added layer of sustainable investment or consideration of adverse impact and limits the primary offering without considering the broader scope of investors' possible investment objectives when it comes to products which promote environmental or social characteristics. This narrowing of the universe of funds could result in investors not being matched with funds that suit their needs and goals.

c. Effect on investment universe

Narrowing the universe of funds in this way specifically precludes offering products that may be contributing to sustainability through facilitating transition, but which would not necessarily be captured by "sustainability preferences" under these amendments. The new rules need to afford room for investors to choose approaches that use stewardship to engage and improve businesses that may not yet be deemed environmentally sustainable. This risks channelling capital into assets that are already sustainable and not necessarily helping to decarbonise the economy as a whole.

Proposed changes to Delegated Directive (EU) 2017/593 as regards the integration of sustainability factors and preferences into the product governance obligations

We suggest amending the sustainability preferences definition in Article 1 (5)

"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 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;~~

2. Integration of sustainability factors within the product governance process

As mentioned above the IA supports European policymakers' commitment to make Europe a global leader in sustainable finance and recognise the need to implement adequate practice through regulations as soon as possible.
However, we would like to highlight that adding sustainability factors to existing processes may be complicated as this stage. The regulator should be mindful that some orchestration between advice firms and asset managers is needed.
Furthermore, data sets are improving but far from universally accepted. Investment firms will need to consider how usable data and proxies can be used to include sustainability factors and how these can be made available to firms in a cost-effective way. In practice, how sustainability and non-financial factors are incorporated into the product governance processes is more complicated than the integration of financial metrics such as risk/reward.

3. Additional clarifications

Within the draft amendments, specifically in Recital 5, we note that investments firms are deemed to be manufacturing and distributing products when these activities are distinguished across Mifid product governance requirements.
We recommend amending the provision to clarify this point and delete the reference to product approval process as it is part of the overall product governance and oversight arrangement.

> *(5)Investment firms manufacturing* ***or*** *~~and~~ distributing financial instruments should consider sustainability factors in ~~the~~* **<u>their respective</u>** *~~product approval process of each financial instrument and in the other~~ product governance and oversight arrangements for each financial instrument that is intended to be distributed to clients seeking financial instruments with a sustainability-related profile. Considering that the target market should be defined at a sufficient granular level, a general statement that a financial instrument has a sustainability-related profile should not be sufficient. It should rather be specified by the investment firms manufacturing and distributing financial instruments to which group of clients with specific sustainability preferences the financial instrument is supposed to be distributed.*

We would like to thank the Commission again for this opportunity to provide feedback on the draft amendments and hope our comments will positively contribute to the effort to include sustainability risks and preferences within existing Directives.