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European Commission's Sustainable Finance Initiative – MiFID II suitability requirements
BVI's view

Encouraging investments in sustainable products is a core element to move towards a more sustainable environment. BVI[1] is therefore supportive and welcomes the European Commission's Action Plan and the legislative proposals on Financing Sustainable Growth. Responsible and long-term considerations play an increasingly important role in investment decisions. Many institutional investors and asset managers feel the need to act responsibly and to therefore use methods of selecting investments taking also material extra-financial considerations into account (Responsible Investing). Such considerations comprise environmental, social and governance ("ESG") issues. Hence it is of utmost importance that any legislative and non-legislative measures find the right balance between fostering the urgently needed action while facilitating the existing trend without imposing requirements on market participants that may potentially have the reverse effect. In particular, the proper timing of different sustainability actions is key in this regard.

We doubt that the sequence of mandatory incorporation of sustainability into investment advice and building the taxonomy is chosen correctly and that it will jeopardise the objective. Clearly, investment advisors are well positioned to encourage investments in sustainable products. While many institutional investors today request and are already offered advice on ESG considerations, this is often not the case for retail investors. This is also based on the fact that a common understanding of sustainability is still missing. Specialised banks do offer sustainable products to investors, however, their specific investors are always interested or even educated in the matter of sustainability and have an understanding of what they consider sustainable. The broad majority of investors, on the other hand, is not.

Consequently, a common understanding of sustainability is in our view a pre-condition for incorporating ESG considerations mandatorily into the suitability test. On the one hand, the taxonomy will be established step-by-step starting with climate change mitigation which is envisaged to be completed by mid-2020. A common understanding regarding circular economy and pollution prevention is supposed to enter into force by the end of 2021 and regarding water protection and protection of the healthy ecosystem by the end of 2022. Detailed social or governance dimensions are not yet reflected in the legislative proposal. On the other hand, the MiFID II requirements shall enter into force by mid-2020, i.e. at the time only the first step of the taxonomy will be completed – if all goes according to plan. Depending on the investor, however, sustainability preferences might not be covered by the then existing taxonomy. This is also the case for distribution of financial instruments on a cross-border basis where the understanding of sustainability considerably differs. It lays a significant burden on investors and investment advisors to find a common understanding on sustainability within the advice process.

[1] BVI represents the interests of the German fund industry at national and international level. The association promotes sensible regulation of the fund business as well as fair competition vis-à-vis policy makers and regulators. Fund companies act as trustees in the sole interest of the investor and are subject to strict regulation. Funds match funding investors and the capital demands of companies and governments, thus fulfilling an important macro-economic function. BVI's 104 members manage assets of nearly 3 trillion euros for private investors, insurance companies, pension and retirement schemes, banks, churches and foundations. BVI's ID number in the EU Transparency Register is 96816064173-47. For more information, please visit www.bvi.de/en.

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MiFID II has significantly increased advisors' and portfolio managers' duties with the need to question investors about their personal circumstances. Investment firms and investors are still adjusting to the new regulation. While investors sometimes feel interrogated, investment advisors have to question whether it is commercially viable to advise in particular retail clients. In order to properly advise the client on sustainability issues it will be necessary to enquire what his approach and understanding of sustainability is which will take even more time than is already needed for a first time advice. Once a taxonomy is established, this will support a common understanding of sustainability which will also feed into investment advice. Incorporating sustainability now into the duties of an investment advisor while a common understanding is still lacking, might not only negatively influence advisors' but also investors' approach to sustainability which might be difficult to remedy once the damage is done. **To be clear, we believe that incorporating sustainability considerations into investment advice is a logical step. However, any respective mandatory legal duty prior to the establishment of a taxonomy could even jeopardise the intention to encourage investments into sustainable products.**

Furthermore, ESMA has already stated in the final guidelines on MiFID II suitability requirements that it is considered good practice to take ESG considerations into account within the investment advice. This requires investment advisors to regard ESG considerations without imposing a strict legal duty. The latter is handled differently due to potential liability issues. In practice, investment advisors will therefore already have to take into account ESG considerations but without more legal detailed requirements leaving the flexibility which is needed absent a taxonomy. A clear framework will help incentivise advisors to actively approach sustainability within the advice process.

In addition, tying the ESG considerations into suitability requirements by mid-2020 will require investment advisors to build up an internal understanding of sustainability including an IT system reflecting this understanding. An understanding which will likely change with the development of the taxonomy. As a consequence, programming which is done for mid-2020 will have to be adjusted each time another building block of the taxonomy will be finalised. **We therefore call for using the "good practice" requirement foreseen in the ESMA guidelines and change the sequence into first establishing the taxonomy and subsequently incorporating sustainability into the investment advice mandatorily. Given the fact that market participants take "good practice" requirements seriously, we would further propose an evaluation whether a strict legal duty will then still be necessary.**

Furthermore, we would like to raise the following points:

- The text indicates that the investment advisor or portfolio manager has to find the most suitable product (see recital 9). This is not in line with the MiFID II requirements which require investment advisors to find a suitable product. Given the range of products investors and investment firms can choose from, it would in practice not be feasible to identify the most suitable product. Consequently, the text should be amended accordingly.

- Finally, it should be analysed whether the administrative burden foreseen in this proposed regulation is mandatory and supportive for achieving the desired outcome. This pertains in particular to the requirement of taking into account ESG considerations when providing information on financial instruments, of assessing the ESG preferences of each client on a case-by-case basis and of the policies and procedures which shall be extended to ESG considerations. Sustainability is still a matter of personal conviction and beliefs. Integrating it in the day-to-day investment advice will only be successful if the related administrative burden is kept to a strict minimum while at the same time both investment firms and investors will receive the required education. We strictly believe that this is a precondition for a successful integration of ESG considerations into the advice and portfolio management process.