

BVI's comments on the draft Commission Delegated Regulation amending the Level 2 provision to MiFID II and IDD as regards the integration of sustainability factors, risks and preferences

The EU Action Plan for facilitating sustainable growth and the multiple initiatives resulting therefrom will significantly impact the EU regulatory environment for financial services. BVI¹ is fully supportive of creating an enabling framework for sustainable investments that will facilitate the transition to a more sustainable European economy. Our members are willing to contribute to the ultimate objective of “shifting the trillions” by increasing their offerings of sustainable investments resulting in a wide range of investment solutions that suit different client needs.

However, in order to create an enabling environment, it is of essential importance to keep the right balance in terms of regulation and to achieve consistent outcomes. This pertains specifically to the current situation involving multiple regulatory initiatives in the area of sustainable finance that are simultaneously underway. Without consistent underlying concepts, the idea of an enabling “smart” regulation will not materialise.

Against this background, we request the Commission to fully align the understanding of “sustainability preferences” of clients under MiFID II and IDD with the scope of “sustainable products” under SFDR. In any event, ESG strategy products under Article 8 SFDR must be clearly distinguishable from sustainable investments under Article 9 SFDR and not be required to follow sustainability objectives. Consideration of principal adverse impact, if retained as a standard for sustainable products, must be allowed before 30 December 2022.

We can explain the reasoning underlying our requests as follows:

- 1. Alignment of the concept of “sustainability preferences” under MiFID II and IDD with the scope of “sustainable products” under SFDR:** The SFDR framework that is currently subject to specifications at Level 2 will provide for dedicated rules for products promoting environmental and social characteristics (Article 8 products) and those pursuing sustainability objectives (Article 9 products). Both categories of sustainable products are to be introduced under SFDR as fully-fledged alternative solutions for sustainable investments suiting different preferences of investors. The main conceptual difference is that while Article 9 products strive to achieve specific sustainability objectives alongside financial yield, Article 8 products define only financial return objectives, but in order to achieve those select their investments in accordance with a dedicated ESG strategy.

In this context, it is entirely unreasonable to restrict investors' choice by proposing additional requirements under MiFID II and IDD for Article 8 products that need to be observed at the point of sale. The understanding of products that are allowed to be offered as sustainable must be

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. Asset Managers 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 114 members manage assets more than 3 trillion euros for retail investors, insurance companies, pension and retirement schemes, banks, churches and foundations. With a share of 22%, Germany represents the largest fund market in the EU. BVI's ID number in the EU Transparency Register is 96816064173-47. For more information, please visit www.bvi.de/en.



consistent alongside all relevant pieces of EU law. A situation whereby a product is issued in full conformity with Article 8 SFDR and hence entitled to be marketed as promoting environmental or social characteristics, but cannot be offered to clients with sustainability preferences in the first place, must be avoided by any means.

Should the Commission take the stance that certain elements are missing in the concept of products promoting environmental or social characteristics, then such elements would need to be discussed and introduced under the SFDR framework, not through the backdoor of standards applicable at the point of sale. However, we are firmly of the view that the concept of Article 8 products should not be amended for reasons explained below.

- 2. The concepts of sustainable products under Article 8 and 9 SFDR must not be mixed up:** We reject the insinuation that financial products promoting environmental or social characteristics “do not necessarily achieve” a certain level of sustainability. As explained above, Article 8 products are supposed to apply dedicated ESG strategies for the selection of their investments. There is a wide variety of ESG investment strategies in use in the fund market, including in particular “best in class” approaches, exclusions and ESG engagement, that shall not be further restricted by regulation². However, on the basis of the draft RTS currently consulted by the ESAs at Level 2 SFDR, we can assume that those strategies must include binding criteria for selecting investments in order to attain environmental or social characteristics³. The attainment of those characteristics shall be measured by means of sustainability indicators that will be disclosed to investors as part of pre-contractual information⁴. Information about the extent to which those characteristics were attained, including the performance of the sustainability indicators used, shall be disclosed to investors each year as part of the periodic reports⁵. In addition, it is proposed to provide historical comparisons about the level of attainment of environmental or social characteristics during the lifetime of a product⁶.

Having regard to those requirements, **ESG strategy products under Article 8 SFDR must not be stigmatised as inferior, but should be recognised as a fully-fledged legitimate alternative to sustainable investments under Article 9.** They offer material added value to investors that are interested in achieving financial returns in the first place, but at the same time wish to ensure that their investments adhere to certain standards in sustainability terms. Moreover, it is important to recognise that impact investing that qualifies as sustainable investment under Article 9 is a relatively new and immature market segment. Practicability of sustainable investments cannot be taken for granted for all asset classes and investment styles. Requiring elements of sustainable investments in Article 8 products would thus very likely limit the choice of investment solutions available for clients with sustainability preferences and be particularly obstructive for diversified multi-asset products that from the risk-reward perspective are generally deemed suitable for retail investors.

Introducing elements of sustainable investments into Article 8 products would also blur the distinction to Article 9 products and pose significant challenges to distributors and investors. The draft RTS to SFDR acknowledge that Article 9 products can plan for a proportion of investments that does not qualify as sustainable investments, provided that such proportion does not affect the

² Cf. recital 18 of the draft RTS to SFRD as presented in the Joint Consultation Paper on ESG disclosures from 23 April 2020 (hereinafter: draft RTS).

³ Art. 17 (a) of the draft RTS on description of the investment strategy.

⁴ Art. 18 of the draft RTS.

⁵ Art. 37 (1)(a) of the draft RTS.

⁶ Art. 37 (1)(b), 51 of the draft RTS.



attainment of the sustainable investment objective(s)⁷. Since the portfolios of Article 9 products must not consist in total of sustainable investments, it would be hardly possible to determine when a product qualifies for Article 9 and Article 8 respectively. This would significantly impede clear explanations at the point of sale as anticipated in recital 6 of the draft Delegated Regulations. A clear delineation between the two categories of sustainable products, however, is key for distributors in order to be able to explain the underlying concepts to their clients, but also for the ultimate understanding especially by retail clients. It would thus facilitate well-informed investment decisions.

In this context, it is important to stress that Article 9 products providing for impact investing are not yet common in the retail market and generally offer thematic investments focusing on certain projects or sectors (e.g. renewable energy). Such products will likely not be relevant for most retail clients seeking for diversified investment opportunities. According to the understanding in recital 5, potential sustainability preferences of clients shall be explored at the end of the suitability testing. Therefore, the expectation upon distributors to provide clear explanations about the different categories of sustainable products as articulated in recital 6 of the draft Delegated Regulations can only apply in case both categories can be considered relevant for suiting a client's individual investment objectives and needs.

- 3. Should the proposal of additional requirements under MiFID II and IDD be retained, the consideration of principal adverse impact as a standard for sustainable products must be allowed before 30 December 2022:** As explained above, maintaining full consistency between the understanding of “sustainable products” under SFDR and the definition of “sustainability preferences” under MiFID II and IDD is of essential importance for the practicability of the EU frameworks. Nonetheless, on the basis of the draft RTS currently consulted by the ESAs at Level 2 SFDR and the proposed Level 2 amendments to the UCITS and AIFM Directives, it is to be assumed that the requirement to consider principal adverse impact in accordance with Article 7 (1) (a) SFDR will anyway apply to all investment funds promoting environmental or social characteristics. This is because all Article 8 products shall provide investors with a reference to an adverse sustainability impact statement at entity level in accordance with Article 4 (1)(a), (3) or (4) SFDR⁸. For UCITS and AIFs, consideration of principal adverse impact at entity level shall impact the investment process relevant to the management of individual funds and will thus result in a consideration at the product level⁹.

Therefore, the second alternative proposed under Article 2 (7)(b) MiFID II Delegated Regulation and Article 2 (4) (b) (ii) IDD Delegated Regulation will effectively not introduce additional requirements for investment funds promoting environmental or social characteristics going beyond the SFDR framework and thus, is acceptable in terms of substance. In our view it would be consistent to provide more clarity in this regard in the final RTS to SFDR instead of specifying respective standards in the MiFID II and IDD frameworks. Nonetheless, should this provision be retained, it is important to clarify that consideration of principal adverse impact at the product level shall be possible on a voluntary basis before 30 December 2022. The phasing-in date foreseen in Article 7 (1) SFDR must be understood as an “at the latest” requirement which is very clear from the German version of SFDR. In any case, product launched in conformity with Article 8 SFDR must be

⁷ Cf. Art. 24 (2)(b)(ii) of the draft RTS.

⁸ Art. 15 (1)(c) of the draft RTS.

⁹ Art. 23 (6) of the draft Commission Delegated Directive amending Directive 2010/43/EU for UCITS, Art. 18 (6) of the draft Commission Delegated Regulation amending Delegated Regulation (EU) No 231/2013 for AIFM.



able to be offered to clients with sustainability preferences from the outset if they comply with the requirements of Article 7 (1) SFDR before 30 December 2022.