

Response by FNG to ESMA Consultation Paper on integrating sustainability risks and factors in MIFID II

General remark:

As industry association promoting sustainable investment in Germany, Austria and Switzerland with 190 members from banks, asset managers, financial advisors and rating agencies among others FNG greatly supports the general intention of the EU legislative package to explicitly require the integration of sustainability risks and factors (i.e. environmental, social and governance risks) in the investment decision or client advisory processes.

This initiative could lead to significant growth of the sustainable and responsible investment market as empiric evidence shows that the increasingly high interest of private investors in sustainable products is currently not addressed properly in the client advisory process.¹ There are several reasons for this. One is the still persisting prejudice that sustainable and responsible investments have lesser returns compared to conventional investments which has been empirically discarded.² Furthermore, financial advisors lack the knowledge and the incentives to address sustainable investments. This gap has to be addressed through relevant education programs.

In the following, FNG responds to a few selected questions raised in the consultation paper:

Q1: Do you agree with the suggested approach and the changes to the Article 21 of the MiFID II Delegated Regulation on ‘general organisational requirements’? Please state the reasons for your answer.

FNG agrees with ESMA that the integration of sustainability risks within the MiFID II requirements is better done through a high-level principle-based approach. Due to the dynamic nature of sustainable and responsible investments and the different approaches that exist in the market - reflecting different investor motivations and applying different investment strategies - it is important that the general dynamics of the market are supported, but that the variety is not limited too early.

FNG welcomes requirements that mandate financial institutions to incorporate ESG considerations in their risk management processes, systems and controls in order to ensure

¹ [Schroders Global Investor Study 2018](#); [Gutsche, Gunnar and Zwergel, Bernhard: Information barriers and SRI market participation– Can sustainability and transparency labels help?](#); [Heinemann, Kristin, Zwergel, Bernhard, Gold, Stefan, Seuring, Stefan and Klein, Christian; Exploring the Supply-Demand-Discrepancy of Sustainable Financial Products in Germany from a Financial Advisor’s Point of View.](#)

² [Friede, Gunnar, Busch, Timo & Bassen, Alexander: ESG and financial performance: aggregated evidence from more than 2000 empirical studies.](#)

the investment and advisory process correctly takes them into account. Therefore, FNG supports introducing sustainability risks in Art. 21 of the MiFID II Delegated Regulation on “general organizational requirements”. Considering sustainability risks in portfolio management should be a requirement with regards to fiduciary duty in line with the legislative package on sustainability duties of institutional investors and asset managers. For example, this is already part of the best practice guidance of the German industrial association (BVI).³

FNG welcomes the ESMA analysis 7 on organizational requirements that firms will be expected to ensure that staff involved in the advisory process possess skills, knowledge and expertise for the assessment of sustainability risks. Various surveys have shown that there is significant unmet demand from investors on ESG products⁴ and that financial advisors are reluctant to address sustainability issues with their clients due to lack of knowledge on sustainable investments.

Together with ÖGUT and other European Social Investment Fora (SIFs) and supported by the European Commission FNG has developed a [Sustainable Investment Training Course](#) in 2015 that comprises e-learning, webinars and in some countries also classroom-based workshops. Furthermore, relevant training modules have been developed by academics and asset managers.

In addition to professional executive trainings FNG calls for a systematic integration of ESG topics in standard curriculums of banking and financial advisors’ education. Financial advisors should be able to prove a certain level of advanced training on sustainability issues in order to be enabled to discuss the issue with their clients.

Q5: Which existing market standards or “labels” are you intending to take into account or already taking into account for the consideration of ESG factors?

FNG supports ESMA’s view that before the final taxonomy has been defined by the Commission, the categorization of ESG-related products should take into account existing market standards. There are already many ESG standards that have been widely accepted by the market. FNG has always supported initiatives to increase market transparency and ensure high product quality in the sustainable investing market. For example, FNG has developed the transparency codex in 2008 together with its European umbrella organization Eurosif. Since

³ [BVI Rules of Conduct](#)

⁴ [Schroders Global Investor Study 2018; Gutsche, Gunnar and Zwergel, Bernhard: Information barriers and SRI market participation– Can sustainability and transparency labels help?; Heinemann, Kristin, Zwergel, Bernhard, Gold, Stefan, Seuring, Stefan and Klein, Christian; Exploring the Supply-Demand-Discrepancy of Sustainable Financial Products in Germany from a Financial Advisor’s Point of View.](#)

2012 FNG is publishing the FNG sustainability profiles which are a good point of orientation for financial advisors and clients alike.

Furthermore, in 2015, FNG developed the [FNG label for sustainable investment funds](#) in a two-year multi-stakeholder consultation to enhance credibility of different approaches in sustainable investment. The label respects various SRI investment styles and does not discriminate one or another approach. Furthermore, it is robust and able to adapt to different asset classes, like equities, corporate bonds, sovereign bonds, convertibles, ILS, mixed assets, etc. The focus of the label is not only on the investment process, but also on the activities of the funds vendor to assess institutional credibility, product standards and the selection process and engagement. The label enjoys an increasing acceptance in the market and has experienced growth rates of 25% and 40% during the last two years. Solid governance and independence are ensured through an external audit by the University of Hamburg a high-level committee with members of WWF and ÖGUT. As European SRI label provider, FNG is part of an ad-hoc working group of the European Commission (DG FISMA and DG ENV) to advise on the application of the EU Ecolabel to financial products.

In the current status it will be difficult to limit the range of ESG products only to the segment with an external label. Despite the market growth the choice of products for certain asset classes is still too low. On the other hand, a certain product categorization will be helpful for asset managers and advisors to identify and handle different investor preferences. The [Eurosif sustainable and responsible investment strategies](#) (e.g. norm-based screening and positive and negative screening) can be used as an established reference. In principle FNG recommends, that the level of detail in questions to identify preferences should correspond with the choice of available products, so that in the current market situation very specific questions should rather be avoided. FNG would therefore not recommend specific questions on a preference between E, S and G criteria, but the whole ESG set of criteria.

Regarding ESMA analysis 10 on product governance that the proposed amendments do not require that all investment products always need to have a reference, as to whether the products fulfils ESG preferences or not: In FNG's view it is important that there is market transparency and that the investor can assess the applied sustainability standard and method of a product in line with the EU legislative package on sustainability duties of institutional investors and asset managers.

The current market can be differentiated between sustainable investment (ESG criteria applied at product level), responsible investment (ESG criteria defined at institutional level) and products without systematic ESG integration.⁵ It would be consistent that disclosure requirements should at least give the affiliation to one of these categories.

⁵ [FNG 2018 Market Report on Sustainable Investments: Germany, Austria and Switzerland](#)

Q11: If not, do you have any suggestions for developing a more detailed approach with regard to (a) the collection of information from clients and (b) the assessment of ESG preferences with the assessment of suitability?

and

Q12: Please specify any approach you see to assess environmental, social and governance criteria separately from each other or as single preferences.

From FNG's perspective, it is not helpful to ask on client ESG preferences separately as the interdependencies between the three sustainability dimensions, in particular between environmental and social criteria have to be taken into account. The detailed analysis on ESG criteria has to be seen as a holistic analysis on the sustainability performance of companies. On the other hand, it is important to identify investor preferences on different sustainability strategies that are available on the market. The approach should be a step-by-step-process, starting with a general perspective to explore the level of interest and the motivations of the client and then diving deeper to identify the precise investment strategies that reflect the client preferences.

Specific questions to the client could be:

Would you like to invest in products that apply non-financial ESG criteria?

- Very important
- If possible, yes
- Rather, but it is not my main priority
- No specific preference or not a matter of priority

Which type of sustainable investment strategy⁶ would you like to apply?

- Investments, that avoid (as minimum requirement) controversial weapons like cluster bombs and screen investments according to their compliance with international standards and norms like UN Global Compact (**Norms-Based Screening**)
- Investments that exclude companies in controversial sectors like tobacco, weapons, pornography or alcohol or countries due to death penalty or corruption at country level) (**Exclusions**)
- Investments, that systematically analyze companies and countries according to environmental, social and governance (ESG) criteria and select the best performers. (**Best In Class**)

⁶ based on the [Eurosif definitions](#).

- Investments that apply an extensive set of positive- and negative criteria to define the sustainability level of investments and have been certified based on a quality label for the high level of transparency and traceable processes (**Certified Sustainability Funds**)
- Investments in companies, whose products and services represent environmental and/or social benefits (like renewable energies, water or microfinance) or support the sustainable development goals (**Thematic or Impact Investments**)
- Investments that use the systematic exercising of shareholder rights to motivate companies to improve their environmental, social and Corporate Governance performance (**either through Engagement or Voting**)