



NSA comments on the European Commission draft delegated regulation amending Regulation (EU) 2017/565 as regards the suitability assessment of investment instruments

The Nordic Securities Association (NSA) supports the European Commission's objective to integrate sustainability targets into the European financial markets. One of the legislative proposals published on May 24th concerns the suitability assessment process of investment firms, amending regulation 2017/565 (MiFID II). The NSA regrets the short period of time allowed to give feedback to this draft delegated act, even though its impact on companies' investment advisory processes is so substantial. Please note that the NSA may respond separately to the Commission's other sustainable finance proposals.

Providing clients with more information about investment instruments' sustainability impacts can have the positive influence of more investments being directed to actions that support sustainable development goals. So far, it has been up to the companies themselves to consider how to offer and sell sustainable instruments. Adjusting to new regulation and potentially building capabilities in this area requires sufficient lead time, and **the NSA is pleased that the Commission's proposal includes 18 months transitional period. It is important to give companies this time to modify their investment service processes.** Legislators need to ensure also that any future guidelines and Q&As are prepared well in time ahead of the entry into force of the legislation. However, we see a need for the proposal to be further clarified before it's ready for implementation and usable from both an operational and a client perspective.

In terms of sequencing we recommend first putting in place **a common EU taxonomy covering at least some essential elements of all E, S and G, before attempting to suggest and/or implement provisions on sustainability in the MiFID suitability assessment process.** This would support disclosure of instrument level information in a relevant and uniform way. We would also like to question whether it is appropriate to implement some of the suitability rules through ESMA guidelines already before the adoption of the delegated act - and in two steps (Q 2 and Q 4 2018). In our view this will only increase the complexity for firms and create unnecessary legal uncertainty.

Secondly, in its final report from 31st January 2018, the HLEG recommended to *"require investment advisers to ask about, and then respond to, retail investors' preferences about the sustainable impact of their investments, as a routine component of financial advice"*. However, the legislative proposal doesn't reflect the HLEG recommendation to (only) apply the regulation to retail clients, which means the provisions potentially also apply to professional clients and eligible counterparties. In our experience, eligible counterparties and professional clients are generally sufficiently sophisticated to take relevant considerations – including ESG – into their investment decisions. We therefore propose the HLEG recommendation is followed and the requirement is **limited to apply only to retail customers.** In addition, the principle of proportionality must apply so

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that e.g. the obligation to collect information does not create unnecessary administrative burdens and information overload for investment firms and their clients.

And finally, we ask for clarification of which financial instruments are to be covered by the proposed sustainability assessment. The MiFID II Directive covers a wide range of financial instruments and services in accordance with Annex I to Directive 2014/65/EU. In our opinion, the intended instrument targets for sustainable investments will be "traditional" investment instruments – e.g. equities, bonds, funds, etc. The definition of financial instruments under MiFID II is broader than these types of investment instruments described above and in many cases, we do not think it is meaningful nor appropriate to extend the requirement for all financial instruments as defined by MiFID II. In particular, this applies to instruments often used to hedge risks arising from companies' normal commercial activities, such as interest rate and currency derivatives. In our opinion, it is not relevant to consider sustainability preferences when advising customers on these financial instruments - and it may even be impossible in the sense that it is difficult to see how a currency transaction¹ or an interest rate swap should be ESG classified.

Many definitions about ESG will still be open when the MiFID II proposals come into force. **When the work starts to define sustainability, the process must be as open and transparent as possible, so that companies know what will be expected of them.** Financial companies depend on the underlying companies to get the information that is required of them, so the EU should ensure that reporting is developed in all industries to improve investors' possibilities to get sustainability data.

The taxonomy to be developed by the Commission must be flexible and dynamic. Otherwise there is a risk that issuers no longer want to issue ESG instruments. The reason for this is that if the rules are too detailed and strict, issuers do not want to take the risk of not being compliant with the rules during the lifetime of a bond. This would be contrary to the goal of the Commission's Sustainability Action Plan. In this connection we would like to underline the importance that the taxonomy is based on existing market practices such as the Green Bond Principles.

in addition, it is vital that the taxonomy can be adjusted over time to encourage market participants to continue innovations in many directions to help solve the future energy supply situation. There are 5 billion people in developing economies which are entering the most energy intensive phase of their economic growth and new solutions are needed for these economies to develop cost efficient, clean, energy supply. This process has only just started and the technology to secure this is not in place currently. The taxonomy must foster an innovation-friendly setting in the environmental area.

Finally, we support an approach that is based on incentives and free choice of the consumer. The EU should keep fostering sustainability by means of increasing information and transparency in the market, and by removing any subsidies for unsustainable action.

¹ As an example: How should a currency like USD or EUR be ESG classified? And how should a currency transaction involving two currencies – for example where a (Retail) customer buy USD and pay with EUR – be ESG classified?