



Integration of sustainability into MIFID-II product governance regulation

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Agenda

1. Legal requirements

2. Product data flow from manufacturer to distributor

3. Considerations about implementation

MiFID II

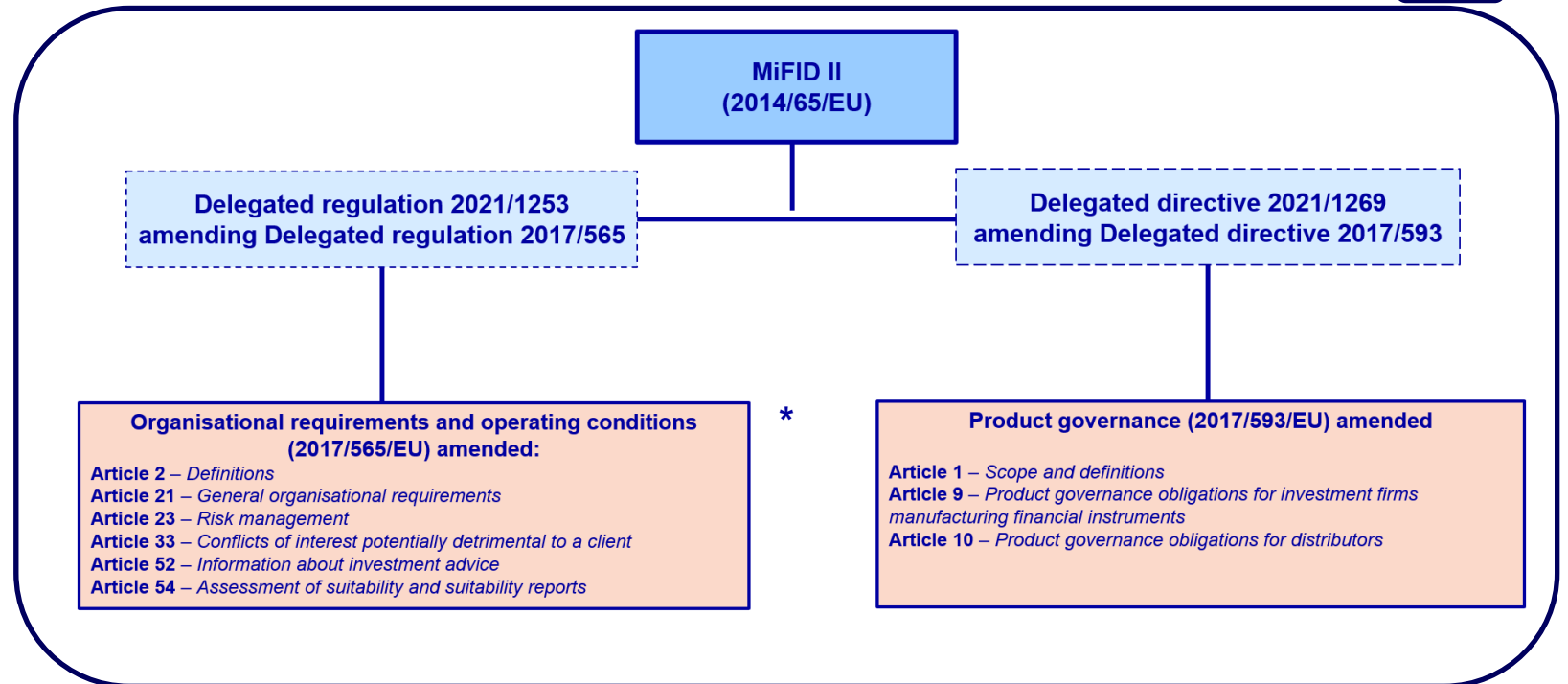
From August 2022, MiFID II requires advisers to start assessing customers sustainability preference as part of the suitability assessments.

From November 2022, MiFID II requires investment firms manufacturing and distributing financial instruments to consider sustainability factors in the 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.



IDD

Quite similar requirements in 2017/2358 and 2017/2359



Regulatory requirements: MiFID II PRODUCT GOVERNANCE | MANUFACTURERS

Article 9 is amended as follows:

(a) in paragraph 9, the first subparagraph is replaced by the following:

'9. Member States shall require investment firms to identify at a sufficiently granular level the potential target market for each financial instrument and specify the type(s) of client with whose needs, characteristics and objectives, including any sustainability related objectives, the financial instrument is compatible. As part of this process, the firm shall identify any group(s) of clients with whose needs, characteristics and objectives the financial instrument is not compatible, except where financial instruments consider sustainability factors. Where firms collaborate to manufacture a financial instrument, only one target market needs to be identified.;

in paragraph 13, the following second subparagraph is added:

'The sustainability factors of the financial instrument shall be presented in a transparent manner and provide distributors with the relevant information to duly consider any sustainability related objectives of the client or potential client.;

(b) paragraph 11 is replaced by the following:

'11. Member States shall require investment firms to determine whether a financial instrument meets the identified needs, characteristics and objectives of the target market, including by examining the following elements:

- (a) the financial instrument's risk/reward profile is consistent with the target market;
- (b) the financial instrument's sustainability factors, where relevant, are consistent with the target market;
- (c) the financial instrument design is driven by features that benefit the client and not by a business model that relies on poor client outcomes to be profitable.;

(d) paragraph 14 is replaced by the following:

'14. Member States shall require investment firms to review the financial instruments they manufacture on a regular basis, taking into account any event that could materially affect the potential risk to the identified target market. Investment firms shall consider whether the financial instrument remains consistent with the needs, characteristics and objectives, including any sustainability related objectives, of the target market and if it is distributed to the target market, or reaches clients with whose needs, characteristics and objectives the financial instrument is not compatible.;

Identify at a sufficiently granular level the potential target market for each financial instrument and specify the type of clients with **sustainability related objectives** the product is compatible

Review consistency with **sustainability related objectives**

Examine **sustainability factors**

Regulatory requirements: MiFID II PRODUCT GOVERNANCE | DISTRIBUTORS

(3) Article 10 is amended as follows:

(a) in paragraph 2, the first subparagraph is replaced by the following:

'2. Member States shall require investment firms to have in place adequate product governance arrangements to ensure that products and services they intend to offer or recommend are compatible with the needs, characteristics, and objectives, including any sustainability related objectives, of an identified target market and that the intended distribution strategy is consistent with the identified target market. Investment firms shall appropriately identify and assess the circumstances and needs of the clients they intend to focus on, so as to ensure that clients' interests are not compromised as a result of commercial or funding pressures. As part of this process, investment firms shall identify any group of clients with whose needs, characteristics and objectives the product or service is not compatible except where financial instruments consider sustainability factors.'

Ensure consistency with **sustainability related objectives** of an identified target market



To be noted: according to recital 52-53 of the ESMA Product Governance Guidelines (ESMA35-43-620) products can be sold outside of the positive target market provided that the portfolio as a whole is suitable for the client.

Considering that the target market should be set at a sufficient granular level, a general statement that a financial instrument has a sustainability-related profile should not be sufficient. Investment firms manufacturing and distributing financial instruments should rather specify to which group of clients with sustainability related objectives the financial instrument is supposed to be distributed.

Requirement to take **sustainability related objectives** into considerations when *reviewing*



(b) paragraph 5 is replaced by the following:

'5. Member States shall require investment firms to review the investment products they offer or recommend and the services they provide on a regular basis, taking into account any event that could materially affect the potential risk to the identified target market. Firms shall assess at least whether the product or service remains consistent with the needs, characteristics and objectives, including any sustainability related objectives, of the identified target market and whether the intended distribution strategy remains appropriate. Firms shall reconsider the target market and/or update the product governance arrangements if they become aware that they have wrongly identified the target market for a specific product or service or that the product or service no longer meets the circumstances of the identified target market, such as where the product becomes illiquid or very volatile due to market changes.'

Defined and undefined sustainability terminology

Advisory regulation : Investment firms should reveal clients **sustainability preferences in the suitability assessment**

When revealing **'sustainability preferences'** the client should make a choice as to whether, and if so to what extent, one or more of the following financial instruments (FI) shall be integrated into his or her investment:

- (a) FI with minimum proportion of environmentally sustainable investments (**Taxonomy** aligned)
- (b) FI with minimum proportion of **sustainable investments (SFDR aligned)**
- (c) FI that considers **Principal Adverse Impacts (PAI)** on sustainability factors where qualitative or quantitative elements demonstrating that consideration are determined by the client

No obligation to use percentage %

ESMA: firms could collect information on the client's preferences in terms of the "minimum proportion" as mentioned in a) and b) if the client requested to include these financial instruments in the investment. Where a firm decides to collect this information not in terms of particular percentage but by ranges or sizes, these ranges should be presented in a neutral way to the client and should be sufficiently granular.

Product governance regulation: Distributors should in the product governance processes - based on **sustainability factors** of the financial instrument – duly consider **sustainability related objectives** of the client.

'sustainability factors' mean environmental, social and employee matters, respect for human rights, anti-corruption and anti-bribery matters

Key undefined terms

'sustainability-related objectives'

'sustainability-related profile'



Target market must describe 'sustainability-related objectives' (SRO) in a sufficiently granular manner.

The undefined term SRO could be seen as a broader term than sustainability preferences.

In practice there is a need to translate SRO's into a manageable concept in order to match the right products to the right clients.

ESMA Consultation Paper Guidelines on certain aspects of the MiFID II suitability requirements

Consultation Paper

Guidelines on certain aspects of the MiFID II suitability requirements

Guideline 7 - arrangements necessary to understand investment products

Guideline 7 – no. 71.

“When considering the sustainability factors of products in view of the subsequent matching with the client’s sustainability preferences, firms **could**, for example, **rank and group the financial instruments** included in their product range in terms of:

- i) the proportion invested in economic activities that qualify as environmentally sustainable as defined in Article 2, point (1), of **Taxonomy** Regulation);
- ii) the proportion of **sustainable investments** (as defined in Article 2, point (17), of **SFDR**);
- iii) the consideration of **principal adverse impacts**

ESMA

Such grouping should also be consistent with the firm’s analysis conducted for the purposes of product governance obligations

The European Securities and Markets Authority (ESMA), the EU’s securities markets regulator, is **consulting** on certain aspects of suitability requirements under the Markets in Financial Instruments Directive (MiFID II), in order to update its guidelines following amendments to MiFID II relating to sustainability.

The assessment of suitability is one of the most important protections for investors under MiFID II and applies to the provision of all types of investment advice (whether independent or not) and portfolio management.

Proposed Guidelines on certain aspects of the MiFID II suitability requirements

The main amendments introduced to the MiFID II Delegated Regulation and reflected in the guidelines on the topic of sustainability are:

- *Collection of information from clients on sustainability preferences* – Firms will need to collect information from clients on their preferences in relation to the different types of sustainable investment products to what extent they want to invest in these products;
- *Assessment of sustainability preferences* – Once the firm has identified a range of suitable products for client, in accordance with the criteria of knowledge and experience, financial situation and other investment objectives, it shall identify - in a second step - the product(s) that fulfil the client’s sustainability preferences; and

27 January 2022 | ESMA35-43-2998

Complex regulation to be translated into an easy understandable concept?

PRODUCT GOVERNANCE IMPLEMENTATION TO BE ALIGNED WITH ADVISORY IMPLEMENTATION

A need **to “translate”** complex sustainability regulation and sustainability product data into

- Easy understandable **categorizations of different products** with sustainability characteristics (“bucketing” of products)
- Easy understandable **sustainability preference profiles** (“segmenting” of clients into client profiles)



**TO BE
ALIGNED**

European Environmental Template (EET) - data

Manufacturer commitment to responsible investment

Main criterias used for a first screening of ESG related products SFDR - fx

- E.g. Financial instrument SFDR product type (article 6, 8, 9)

Art. 8 & Art. 9 Product Specific Information - fx

- Scoping according to SFDR annex template
 - Minimal_Proportion_Of_Sustainable_Investments_
- ESG thematic investing description
- Minimum/planned Sustainable investment and taxonomy assets allocation breakdown

MiFID/IDD Target Market - Manufacturer angle (from a client perspective)

- Does This Financial Instrument Consider End Client Sustainability Preferences (Yes, Neutral)

Taxonomy aligned investments (for definitions please refer to the RTS)

Screening Criteria (O)

- Negative based screening/exclusions
- Sector Based Exclusions

Principle Adverse Indicators (PAIs) - 18 -e.g.



Greenhouse gas emission



Biodiversity



Water

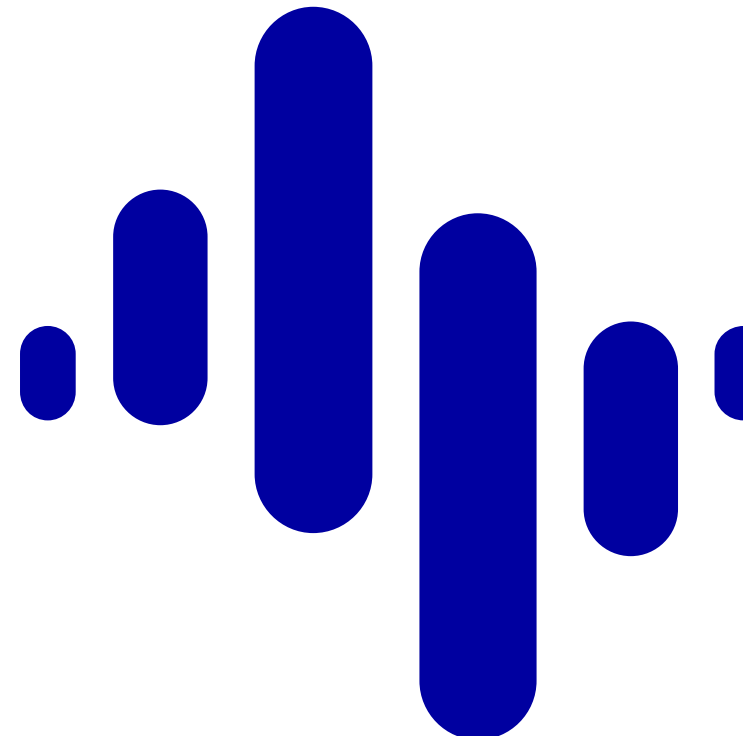


Social and employee matters

European Environmental Template (EET) is an (upcoming) industry solution standard excel-template to be used throughout the EU to facilitate the exchange of sustainability data about e.g. investment funds from fund companies (manufacturers) to distributors (banks). The EET supplement the current European MIFID Template (EMT).

In Nordea Bank, EET/EMT-data is used as part of the distribution approval of investment funds through the product governance processes

Manufacturers will fill in MIFID/IDD Target Market but only with a YES NEUTRAL



SFDR - precontractual template versus EET



SFDR precontractual template

ANNEX II

Template pre-contractual disclosure for the financial products referred to in Article 8, paragraphs 1, 2 and 2a, of Regulation (EU) 2019/2088 and Article 6, first paragraph, of Regulation (EU) 2020/852

Sustainable investment means an investment in an economic activity that contributes to an environmental or social objective, provided that the investment does not significantly harm any environmental or social objective and that the investee companies follow good governance practices.

The **EU Taxonomy** is a classification system laid down in Regulation (EU) 2020/852, establishing a list of **environmentally sustainable economic activities**. That Regulation does not lay down a list of socially sustainable economic activities. Sustainable investments with an environmental objective might be aligned with the

Product name: [complete]

Legal entity identifier: [complete]

Environmental and/or social characteristics

Does this financial product have a sustainable investment objective? *[tick and fill in as relevant, the percentage figure represents the minimum commitment to sustainable investments]*

Yes No

It will make a minimum of sustainable investments with an environmental objective: ___%

in economic activities that qualify as environmentally sustainable under the EU Taxonomy

in economic activities that do not qualify as environmentally sustainable under the EU Taxonomy

It will make a minimum of sustainable investments with a social objective: ___%

It promotes Environmental/Social (E/S) characteristics and while it does not have as its objective a sustainable investment, it will have a minimum proportion of ___% of sustainable investments

with an environmental objective in economic activities that qualify as environmentally sustainable under the EU Taxonomy

with an environmental objective in economic activities that do not qualify as environmentally sustainable under the EU Taxonomy

with a social objective

It promotes E/S characteristics, but will not make any sustainable investments

EET - template

	A	B	C	D	E	F
53	Art. 8 & Art. 9 Product Specific Information					
54	Scoping according to SFDR annex template					
55	40	20170_Financial_Instrument_Sustainable_Investments_Art_8	Does the art 8 product invest in	Y / N	Conditionnal to product type in field 20040 or	C
56	41	20180_Financial_Instrument_Products_Minimal_Proportion_Of_Sustainable_Investments_Art_8	For art 8 products, the minimum proportion of sustainable	floating decimal (0.5 =	Conditionnal to product type in field 20040 or 20050	C
57	42	20190_Financial_Instrument_Sustainable_Investment_EU_Tax	Does the minimum specified in	Y / N	Conditionnal to answer in field 20170	C
58	43	20200_Financial_Instrument_Sustainable_Investment_Environmental_Not_EU_Taxonomy_Art_8	Does the minimum specified in field 20180 include Non EU	Y / N	Conditionnal to answer in field 20170	C
59	44	20210_Financial_Instrument_Sustainable_Investment_Social_Objective_Art_8	Does the minimum specified in field 20180 include sustainable	Y / N	Conditionnal to answer in field 20170	C
60	45	20220_Financial_Instrument_Minimum_Sustainable_Investment_With_Environmental_Objective_Art_9	For art 9 products, the minimum proportion of sustainable	floating decimal (0.5 =	Conditionnal to product type in field 20040 or 20050	C
61	46	20230_Financial_Instrument_Environmentally_Sustainable_Investment_EU_Taxonomy_Art_9	Does the minimum specified in field 20210 include EU Taxonomy	Y / N	Conditionnal to product type in field 20040 or 20050	C
62	47	20240_Financial_Instrument_Environmentally_Sustainable_Investment_Not_EU_Taxonomy_Art_9	Does the minimum specified in field 20210 include Non EU	Y / N	Conditionnal to product type in field 20040 or 20050	C
63	48	20250_Financial_Instrument_Minimum_Sustainable_Investment_Social_Objective_Art_9	For art 9 products, the minimum proportion of sustainable	floating decimal (0.5 =	Conditionnal to product type in field 20040 or 20050	O
64	ESG thematic investing description (This part describes investment strategy, and is not linked to Taxonomy)					
65	49	20260_Financial_Instrument_ESG_Existing_Thematic	Does this Financial Instrument have an ESG thematic	Y / N		O
			Description of the product			

Disclaimer:

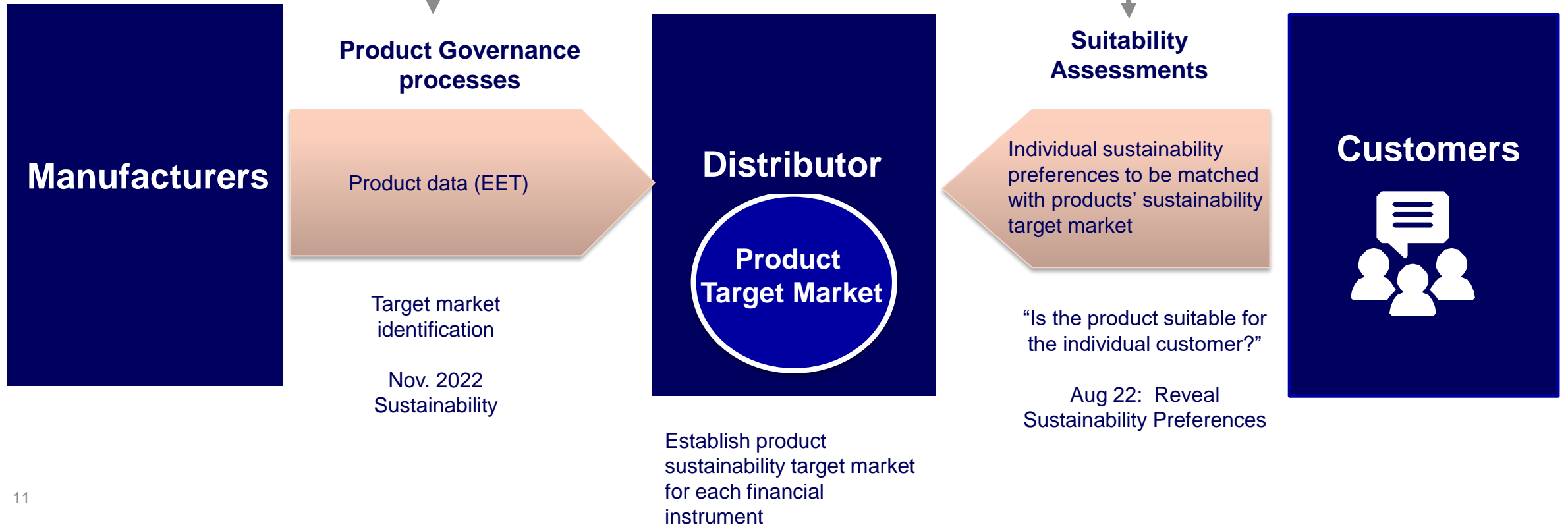
The use of this template is not compulsory. It is free of charge, intellectual property and copyrights. It has been designed by the FinDatEx platform which includes European asset data. This EET is the official FinDatEx data exchange template for ESG data. It references ESG data as defined by applicable EU regulation (SFDR, Taxonomy Regulation, IDD, MiFID). EET v1.0 provides mandatory / conditional information due to be delivered from 1 June 2022 to distributors and insurers for ESG MiFID/IDD start date as of 1/2 August 2022.

Scope: Distributors and Insurers are working on the hypothesis that EET will be provided for all funds and structured products. Mandatory or Conditional status of the fields will change over time following regulations implementation timing.

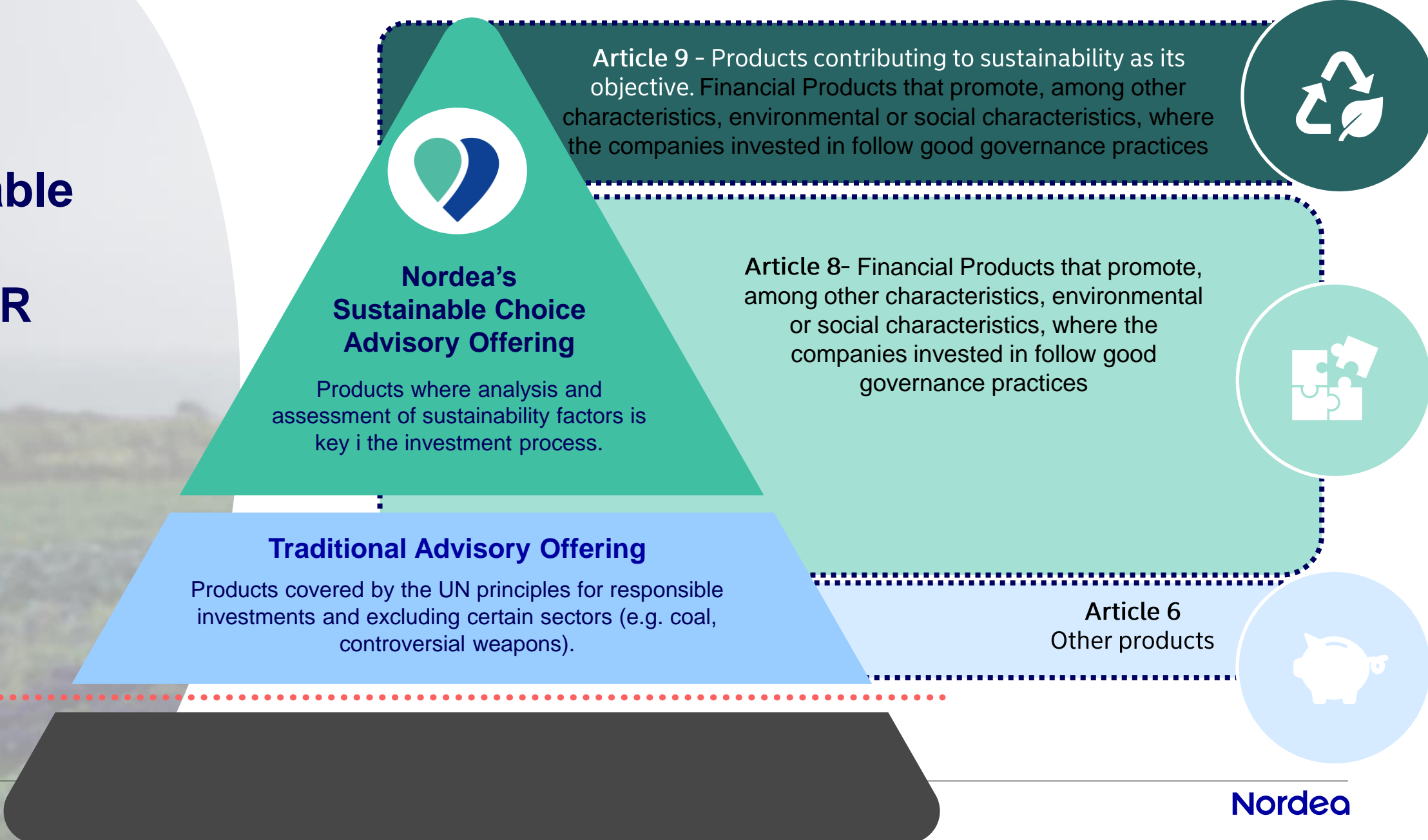
THE PRODUCT CHAIN|MANUFACTURER, DISTRIBUTOR AND END USERS



FSA (FI/DK/SE/NO) supervision/inspection: E.g. Compliant, well documented processes, honesty and loyalty towards clients and client's best interest.

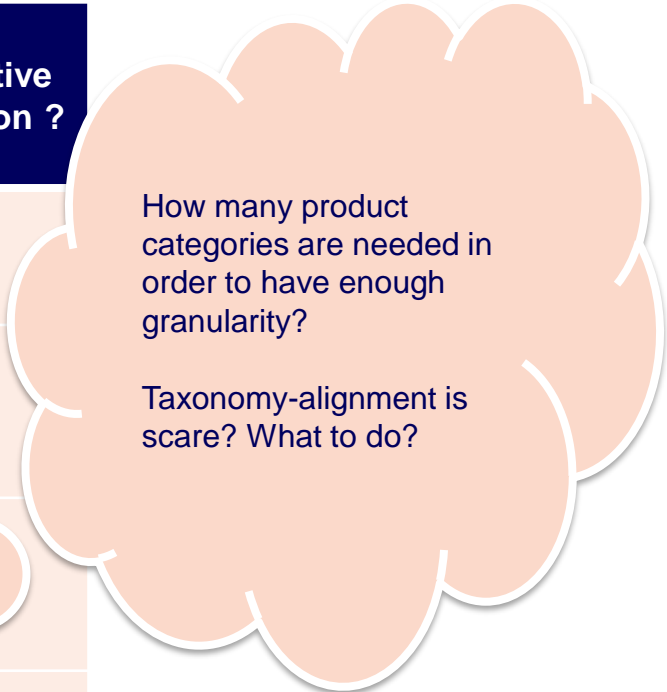


Sustainable Choice and SFDR



HOW TO REDUCE COMPLEXITY? | AN ISSUE IS TO CREATE A PRODUCT GOVERNANCE MATRIX

	Article as per SFDR	Criteria for SI ?	Criteria for PAI?	Taxonomy alignment?	Other Datapoints? E.g. minimum exclusions?	Qualitative evaluation ?
PRODUCT CATEGORY A	E.g. only article 9?					
PRODUCT CATEGORY B	Article 8?	E.g. requirement for min. SI commitment?				
PRODUCT CATEGORY C	Article 8?					
PRODUCT CATEGORY D	Article 8?					
PRODUCT CATEGORY E	Only article 6?					
MORE CATEGORIES?						



Decisions are to be made:
 Which product categorizations are to be used, how many product categorizations are to be used and based on which criteria should each category be defined ?

Grouping and wording for discussion and illustrative purposes only. Thus the illustration does not illustrate any decided Nordea Bank categorizations or criteria.

HOW TO REDUCE COMPLEXITY? | AN ISSUE IS TO CREATE A SUITABILITY MATRIX

1. Does client have preference for PAI'S?

	E.g. not particular important	e.g. somewhat important ?	E.g. more important?
E.g. Not particular important	<div style="border: 1px solid black; padding: 10px; transform: rotate(-5deg); background-color: #e0f0ff;"> <p>Decisions are to be made:</p> <p>How many profiles are needed ?</p> <p>How should each profile be defined ?</p> <p>How should questions to costumers be formulated ?</p> </div>		
E.g Somewhat important			
e.g. more important			
e.g. very much important			

2. Does the client have preference for Sustainable investments ? (and/or taxonomy alignment?)

How many profiles are needed ?

What to do about different risk profiles?

Which PAI's? (All 18 or some of them?)

Is it needed to split into different preferences for E or S - or E/S ?

...And what to do with taxonomy alignment?

Grouping and wording for discussion and illustrative purposes only. Thus the illustration does not illustrate any decided Nordea Bank segmentation.



Thank you!

Nordea

