

Interview with Michael Maldener, Managing Director and Conducting Officer of Nordea Investment Funds S.A., and Cecilia Siegbahn, Regulatory Expert

EU ESG Regulation

Please note that the conference call occurred on the 28th of October 2020. All market commentary and information refers to the period before then.

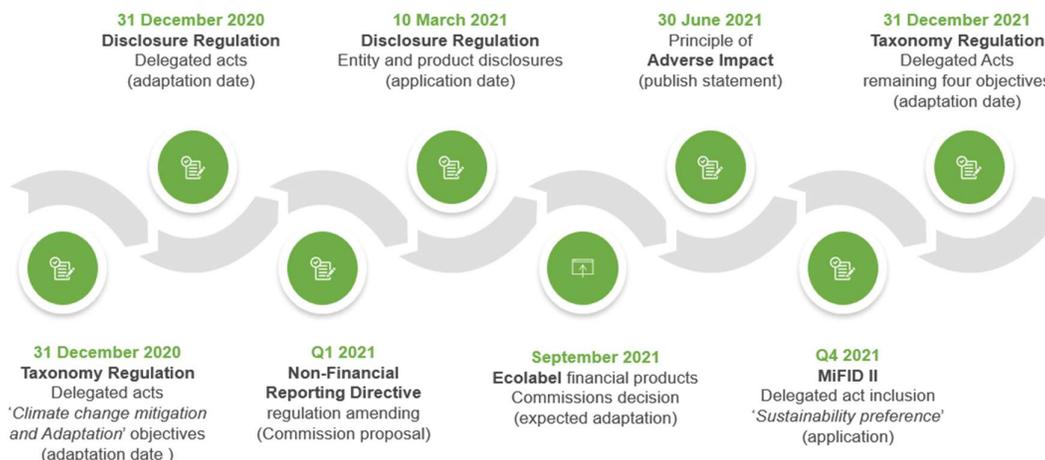
Key takeaways

- Even though the “Level 2” regulation of the SFDR has been delayed, the deadlines for the initial higher level (Level 1) regulations must still be met by the 10th of March 2021
- Sustainability preferences in the MiFID II update must be considered at every single suitability assessment and have far-reach implications on advisors and distributors (e.g. training, documentation)
- Documentation will be an important “proof point” and will be easier with robust processes
- Product classification remains a key question

We’ve seen some delays of expected regulation: what are the implications of this?

The Disclosure regulation was adopted by the EU in 2019 (coming into force in 2021), setting out the broad expectations, but we do not yet have many details of how to meet these requirements. For example, the Disclosure regulation states in article 8 that Financial Market Participants need to disclose “How Environmental and/or Social characteristics are met”. We will need to comply with this by 10 March 2021. However, we are still waiting for details on how we disclose, which will be part of the level 2 regulations. Despite the delay in the detail, we must still comply with the level 1 regulation, so we cannot sit and wait for the details to be published. We have to continue working on how our own businesses will meet the requirements of the regulation as it stands, knowing that we may have to change things after the publication of the level 2 regulations.

In the case of the details behind the disclosure regulation, these “delegated acts” were expected to be published in December 2020 (as per the image below). We now expect them in the first quarter of 2021, but we are still waiting final confirmation from the EU Commission.



Where are some implications of sustainability preferences in suitability assessments?

We know that the changes to MiFID II will require sustainability preferences to be included in every suitability assessment. This will be across asset classes, geographies and risk levels. It's going to have to feature in every piece of advice distributors give. Two implications of this are the need to for training – advisors need a good grasp of the subject to give a good client experience – and documentation. Documentation of the suitability assessment will have to be given to the retail customer, and good documentation will be a strong “proof point” that advisors followed the requirements of the legislation. This will be easier if an advisor has robust assessment and selection processes.

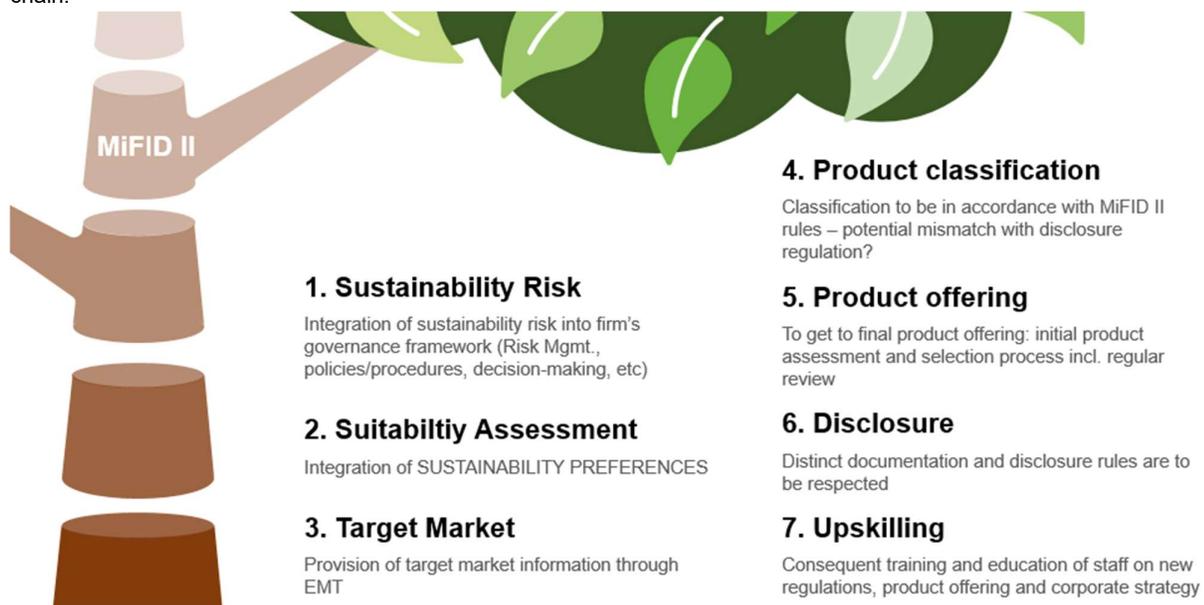
How will advisors meet sustainability preferences?

Although there has been nothing concrete, a leaked draft of the MiFID II proposals indicated some aspects of how to define “sustainable” products that raised several concerns throughout the industry. This leak suggested that Article 8 products (“light green” ESG products) need to integrate the Principle Adverse Impact (PAI) in the investment decision or have a minimum amount invested in sustainable investments. This product classification differs from the classification in the SFDR (Disclosure regulation), which only requires Article 9 (“dark green” sustainable) products to have sustainable investments as its objective. If MiFID rules result in a distributors not being able to sell a straight Article 8 product (as per SFDR) as an ESG or light green product under MiFID, distributors’ product assessment and selection process would have to go beyond what is actually disclosed by asset managers under SFDR. In addition, PAI is still very much in the air because the SFDR Level 2 requirements have not yet been published, and there remains a lack of adequate and concise data available from the underlying companies.

Another very concerning suggestion was that MiFID II could expect the investor, at the individual level, to determine the “minimum proportion of sustainable investments” for a product to meet his suitability criteria. If this responsibility is put on the investor it becomes nearly impossible for asset managers or distributors to categorise products themselves.

What key points do distributors and advisors need to think about now in relation to MiFID II?

There are 7 key aspects we believe our clients need to be considering, as shown below, but these can broadly be grouped into clusters. 1) How to integrate sustainability risk into your governance, which potentially includes adjusting or establishing KPIs, how to document your approach and how to manage potential conflicts of interest; 2) Suitability assessment, discussed above; 3-5) Target market and products requires a process at distributor level for assessing, classifying and selling the different types of product; 6) Ensuring your processes support strong documentation and 7) Training and education throughout your value chain.



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