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Nordea ASSET MANAGEMENT

Interview with Michael Maldener, Managing Director and Conducting Officer of Nordea Investment Funds

EU ESG Regulation

Please note that the conference call occurred on the 29th of July 2020. All market commentary and information refers to the period before then

Key takeaways

- The upcoming EU initiatives aim at redirecting capital flows into sustainable investment while ensuring the end investor can understand clearly what he is buying
- The Taxonomy regulation and Disclosure regulation are two of the first parts being developed: they will provide a common vocabulary and increase the transparency and comparability of sustainable investments between products
- The Delegated acts of the new regulations are still being developed and will not come into force until next year
- This has led to some unclarity as asset managers and advisors work towards meeting the first stage requirements while waiting for the details in the delegated acts to be published

With the investor spotlight undoubtedly fixed on ESG in recent times, can you give us an idea into this from a regulatory perspective?

No matter what term you used to describe it – whether it is ESG, responsibility or sustainability – this has become a megatrend in the investment industry. It has moved from niche into the mainstream. Regulation is now being overlaid to bring structure and ensure a level of consistency to sustainable investing. The EU has been developing its Action Plan on Sustainable Finance both to redirect capital flows towards sustainable investing (which is needed to enable Europe to meet the targets set by the Paris Agreement of 2015) and to provide a framework for sustainability within the asset management space. We can simplify the first regulatory initiatives into three points. First, the Disclosure regulation will clarify the duties and responsibilities investment managers and distributors have. Second, the Taxonomy regulation will provide an aligned vocabulary – which is aimed at avoiding potential occurrences of greenwashing. The final point is to lay the foundations for the longer lasting goals by updating and amending existing legislations, such as MiFID II . We are still somewhat at the beginning of this process, which means there will be a lot of clarification and alignment to come.

You mentioned the Taxonomy. ESG labelling can be quite confusing for some investors, are you pleased this a focus for regulators?

Yes. There is a vast number of different terms – some describe similar aspects, while others can be quite distinct. Sometimes it feels like you do not see the entire forest because of all the different trees. Current regulatory initiatives aim to bring structure to this. The Taxonomy has taken the first steps towards a common set of environmental definitions to be used across the industry.

What do Distributors and Financial Advisors need to be aware of in terms of regulation?

The Disclosure regulation targets distributors and financial advisors as well as asset managers, so no matter where you are in the value chain, you will have to disclose how you classify the products and how sustainable the underlying investments are.

The Disclosure regulation additionally requires the entities to disclose how they deal with sustainability risks in areas such as the investment decision-making process and product classification.

How does MiFID II relate to all this?

In June 2020, drafts to the updated Delegated acts of MiFID II were published and they created some noise in the industry. Some elements in the published drafts were not aligned with the Disclosure regulation and as a consequence the product classification might be challenging to set. One key aspect to mention is the requirement within MiFID II to integrate sustainability preferences into the suitability assessment when providing investment advice or discretionary portfolio management. Sustainability preferences need to be assessed alongside the usual aspects of financial risk suitability. Right now, there are gaps between the different regulatory sets and drafts we see, which hopefully will be adjusted in the final version of the Delegated acts which will be published later this year.

What challenges does the industry face as we move forward?

ESG or sustainability has been an active part of investment management industry for some time, but it has been largely unregulated. There are certainly major challenges to put this activity into a framework to meet targets in the wider EU Sustainable Finance Action Plan context, especially around ensuring the end investor understands what he or she is buying while redirecting capital flows into sustainable finance. The current situation is similar to the process of moving. As an industry, we have lived in our house for quite some time and we are now moving into something new. However, the boxes to put our belongings do not fit with the stuff we have, or the boxes have not arrived yet. In other words, this current guidance will be elaborated on in the months and years to come. In the meantime, it is important for advisers to start thinking about their offering and internal processes in relation to sustainable investing. Sustainability offers a potentially huge opportunity to advisors who are early in recalibrating their business model to meet the ESG assessment requirements and offer a good range of sustainable funds.