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DIRECTORATE-GENERAL FOR FINANCIAL STABILITY, FINANCIAL SERVICES AND CAPITAL
MARKETS UNION

The Director-General

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Subject: Draft definition of sustainability preferences

Dear Madam, Sirs,

Thank you for your letter dated 23 July 2020 (Ares(2020)3894521) regarding the proposed definition of ‘sustainability preferences’.

Given the scale and challenge of the risks posed by climate change and the degradation of the environment and other sustainability matters, strong action and increased effort from all actors, including the financial services sector, are urgently required. In order to mobilise the necessary financial capital, it is essential that the credibility of sustainable investments and general awareness of sustainability risks are improved while making it easier for end investors to identify the potential adverse impacts of their investments.

Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector (hereinafter referred to as ‘the Disclosure Regulation’), Regulation (EU) 2020/852 on the establishment of a framework to facilitate sustainable investment (hereinafter referred to as ‘the Taxonomy Regulation’) and the rules on client sustainability preferences are crucial elements in achieving these objectives.

The Disclosure and Taxonomy Regulations will bring greater accountability, discipline, efficiency and comparability to financial markets by improving the disclosure of sustainability-related information and this information will be available to end-investors, financial advisers, supervisors and broader civil society.

The Disclosure Regulation requires that a financial product's documentation describe how its stated levels of sustainability are achieved. As it is not a labelling regime, different sustainability-related ambitions can be set. While financial products qualifying under Article must pursue the objective of sustainable investment and do no significant harm, financial products that fall under Article 8 can integrate different strategies. These strategies can include those that, despite claims of pursuing ESG, SRI or sustainability oriented purposes, may lack real sustainability-related materiality. Clearly, such financial products should not be eligible for recommendation to end-investors who express clear sustainability-related preferences.

This is the reason why the draft rules on sustainability preferences, which were the subject of a public consultation from 8 June to 6 July 2020, require that such preferences should only apply to those financial instruments or insurance-based investment products that are at least to some extent invested in sustainable investments, including taxonomy-compliant activities, or that consider principal adverse impacts on sustainability.

The draft rules are intended to stimulate the interest of end-investors and incentivize the financial sector to engage in positive impact investing or at least to reduce negative externalities, with no thresholds. The draft text is in line with, and further strengthens the policy objective of reducing the occurrence of greenwashing and mis-selling. It also encourages the financial system to support businesses on the transition path towards sustainability, as well as continuing to support existing sustainable businesses.

Since the product scopes of the MiFID II framework and the Disclosure and Taxonomy Regulations are different, the draft rules are not restricted to financial products of those Regulations, but are based on their sustainability-related concepts. This has the potential to allow MiFID investment firms to recommend not only investment funds, but also other relevant financial instruments.

The draft rules on client sustainability preferences ensure consistency with the Disclosure and the Taxonomy Regulations and strengthen the effectiveness of sustainability-related disclosures under these Regulations. The European Supervisory Authorities draft regulatory standards under the Disclosure Regulation lay down the disclosure of the proportions of investments that are sustainable and develop categories for principal adverse impacts, while the Taxonomy Regulation requires disclosure of the degree to which investments align with the taxonomy. This information also forms part of the draft rules on client's sustainability preferences.

I hope the above information addresses the concerns expressed in your letter. However, if you require any further clarification please do not hesitate to contact my services.

I look forward to continuing to work with you on this important issue.

Yours sincerely,

(e-signed)

John BERRIGAN

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