



**FINANCE
DENMARK**

Finance Denmark's comments on the delegated acts integrating sustainability risks and factors into MIFID II

Finance Denmark welcomes the opportunity to comment on the European Commission's draft delegated acts integrating sustainability risks and factors into MIFID II.

Finance Denmark values the European Commission's continuous efforts to put sustainability considerations at the heart of the financial system to support transforming the European economy into a greener, more resilient and circular system.

We also support the Commission's work on integrating sustainability risks and factors into MIFID II, as it will further promote the distribution of sustainable investments in Europe and facilitate the necessary transition of the European economy. Please find our comments to the draft delegated acts amending Delegated Regulation (EU) 2017/565 and Delegated Directive (EU) 2017/593 below.

As a more general remark, we would like to highlight some of the challenges stemming from the sequencing and timing of the various regulatory initiatives under the sustainable finance agenda. Without disregard to the urgency for action to accelerate the transition to a more sustainable economy, it is important to bear in mind the need for consistency between the different legal acts to ensure an applicable EU sustainable finance framework and to avoid unnecessary burdens. Specific for this consultation is the need for consistency between the proposed requirements in MIFID II and the requirements already adopted in Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector (hereinafter "SFDR"). This is further elaborated on below.

Comments on the delegated act amending Delegated Regulation (EU) 2017/565

Definition of "sustainability preferences"

We support the proposal of integrating sustainability preferences into the suitability assessments of clients. We do, however, have concerns around the possible unintended consequences of the proposed definition of "sustainability preferences".

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At this time there still exists uncertainty as regards to what is required for a financial product to live up to Article 8 and Article 9 in the SFDR. This uncertainty impacts the understanding of the proposed definition of "sustainability preferences".

The proposed definition of "sustainability preferences" seems to exclude products that live up to Article 8 of the SFDR, but do not pursue sustainable investments or consider principal adverse impacts ("PAI") on sustainability factors. A subset of Article 8 products is hereby created that cannot be offered to clients under MIFID II as a sustainable investment product, even though it is viewed as a sustainable investment product in SFDR.

Our understanding is that Article 8 of the SFDR does not require a "characteristics" product to pursue sustainable investments or have PAI integration. Only products covered by Article 9 of the SFDR are required to pursue sustainability objectives. Article 8 and Article 9 products are meant to be complementing, alternative solutions for sustainable investments. Based on this, we suggest that Article 8 products per se are in scope of the definition on "sustainability preference" to ensure a proper alignment with the SFDR and to avoid an unnecessary restriction in investors' choice of sustainable investment products.

It is important to keep in mind that there is only a limited number of investment options on the market today that pursue sustainable objectives and/or have PAI integration. It seems more in line with the overall aim to promote sustainable investments that suitable Article 8 products are no limited to products with Article 9 characteristics.

The market for sustainable investments is still evolving and it is imperative that flexibility in the market is retained to draw on any one of several different and varied sustainability and responsible investment approaches, which cater to investors' multiple and varied investment objectives. It is not a given that investors wanting to invest in an Article 8 product automatically also wants to invest in an Article 9 product. It is therefore important to have a clear distinction between Article 8 and Article 9 products to suit different investor preferences.

Further guidance or examples on what constitutes an Article 8 and Article 9 product, respectively, would be beneficial for promoting the development of sustainable investment products. Guidance and/or examples should, however, be developed within the remits of the SFDR framework and should not be introduced through technical changes to MIFID II.

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More guidance is also needed as to how the assessment criteria in Article 8 ("promotes environmental and social characteristics") and Article 9 ("sustainable investment as its objective") of the SFDR should be applied to direct investments in shares and bonds. Such guidance should be in place well in advance of the entry into force of the delegated act to ensure correct implementation and adherence to the new requirements.

Financial preferences vs. sustainability preferences

With the proposed amendment to Article 54 investment firms' recommendations to clients should reflect both the financial objectives and any sustainability preferences expressed by those clients.

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The proposed recital 5 states that "investment firms providing investment advice should first assess the investor's investment objectives, time horizon and individual circumstances, before asking their clients for their potential sustainability preferences". This indicates that client's financial objectives should be given priority over sustainability preferences. This is, however, not reflected in the amendments made to Article 54. If financial objectives should be given priority over sustainability preferences, this should be clearly stated in Article 54.

Hedging objectives

If the inclusion of financial instruments in the definition of "sustainability preferences", is to be interpreted as all financial instruments as defined in section C of the MiFID II Directive, it would also include derivatives and other financial instruments used for the purpose of hedging.

It is of concern how the proposed regulation would be applied to derivative contracts, in particular OTC derivatives, if it is at all possible. Derivative contracts are bilateral agreements between counterparties, where each counterparty agrees to perform an obligation at a given point in time. Furthermore, OTC derivatives have no issuer and are not investment products. The characteristics of a derivative, as well as the purpose for entering into a derivative contract, differ from investment products. An interest rate swap for example, is not an investment but rather an exchange of commitments (e.g. fixed to floating rate). Consequently, it is unclear how sustainability preferences would be possible to apply when conducting a suitability assessment of OTC derivatives or in general for hedging purposes.

When hedging an exposure, the aim is to address a particular risk in the investor's portfolio. Applying sustainability preferences adds an additional layer which



might cause confusion as the purpose of hedging should solely be to manage the relevant risk.

We would suggest including “where relevant” in all new parts with sustainability preferences to cater for the specific issue around derivate contracts.

Comments on the delegated act amending Delegated Directive (EU) 2017/593

Target market

With the proposed amendment to Article 9(9) of the Delegated Directive (EU) 2017/593 investment firms are required to identify at a sufficiently granular level which sustainability preferences a financial instrument is compatible with.

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According to the proposed recitals a general statement that a financial instrument has a sustainability-related profile is not considered to be enough. Instead, investment firms should specify to which group of clients with specific sustainability preferences the financial instrument is supposed to be distributed.

We appreciate the clarification made in the recitals and suggest that the recitals are further elaborated on to provide further guidance on investment firms obligation to define which sustainability preferences a financial instrument is compatible with. Would it, as an example, be enough to identify that a financial instrument is dedicated to clients that have sustainable investments as their goal, or is it also necessary to define, whether a client should have an environmental or social investment objective?

Product governance requirements for distributors

With the proposed amendment to Article 10(2) of the Delegated Directive (EU) 2017/593 distributors are required to establish appropriate product governance arrangements to ensure that the products and services they intend to offer or recommend are compatible with the sustainability preferences of a specific target group.

The current availability of sustainable data on the market leaves distributors unable to assess the reliability of a manufacturer's assessment of a product's sustainability profile. It is important that the proposed delegated act clearly states that distributors are not required to validate the sustainability profile that distributors receive from the manufacturer. This should be part of the supervisory tasks of the competent authorities.



If distributors are to validate the sustainability profile, they will be made subject to a large administrative burden, which is difficult to comply with and not in line with the overall purpose of the proposed requirements. Large administrative costs can ultimately cause distributors to restrict their product range, which can hardly be in the interest of the client.

Definition of "sustainability preferences"

As for the proposed definition of "sustainability preferences" we refer to our comments above to the delegated act amending Delegated Regulation (EU) 2017/565.

Kind regards

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Ulrik Poulsen

Direct: +45 3016 1128

Mail: ulp@fida.dk

