EUROPEAN ASSOCIATION OF CO-OPERATIVE BANKS
The Co-operative Difference : Sustainability, Proximity, Governance

Brussels, 15 September 2023

EACB Answer to

ESMA's call for evidence on the integration of sustainability preferences in the suitability assessment and product governance arrangements

September 2023

The **European Association of Co-operative Banks** (EACB) is the voice of the co-operative banks in Europe. It represents, promotes and defends the common interests of its 27 member institutions and of co-operative banks in general. Co-operative banks form decentralised networks which are subject to banking as well as co-operative legislation. Democracy, transparency and proximity are the three key characteristics of the co-operative banks' business model. With 2,700 locally operating banks and 52,000 outlets co-operative banks are widely represented throughout the enlarged European Union, playing a major role in the financial and economic system. They have a long tradition in serving 223 million customers, consumers, retailers and communities. The co-operative banks in Europe represent 87 million members and 705,000 employees and have a total average market share of about 20%.

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Introduction

The EACB welcomes the opportunity to provide feedback to the call for evidence (CfE) of the European Securities and Markets Authority (ESMA) on the integration of sustainability preferences in the suitability assessment and product governance arrangements. Considering that such requirements directly impact the distribution services provided to clients, then as co-operative banks, our members and their clients are directly impacted by the "sustainability preferences" regime.

General comments

In general, the EACB would like to point out that the regulatory requirements are too granular and too complex from the perspective of clients and our co-operative banking members. Therefore, the EACB takes a critical view of ESMA's possible considerations on further interpretations (see paragraph 8 of Section 2 'Background' of the CfE). Further interpretations would be counterproductive against the above background. There is more a need for simplification. The goal of encouraging clients to invest more in financial instruments that take sustainability factors into account, and which is also supported by our co-operative banking members would rather be made more difficult. For more details, see our responses to the CfE below.

Responses

Sustainable finance and financial education

Q1: What actions did firms implement within their organisation to take into account the new requirements related to sustainability preferences? Please elaborate especially on the following:

- **What proportion of firms' employees (differentiating between client facing staff and the other staff) have received training on sustainability topics? What these trainings consisted of? Was any test or exam put in place?**
- **Which conflicts of interest relating to the integration of clients' sustainability preferences did firms identify and which measures did firms take to ensure that these conflicts of interest do not damage the interest of clients?**

We would like to share an anonymised, non-exhaustive list of actions taken by our co-operative banking members, in order to implement within their organisation the new sustainability preferences regime:

- Introduction of lengthy sustainability preferences questionnaire to carry out the suitability assessment on the client;

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- Whether F2F or online, most co-operative banks introduced a "digital tool" which includes the newly introduced sustainability preferences questionnaire mentioned in the previous point. This could be a third-party product or a proprietary tool;
- The new "digital tool" allows various possibilities for the advisor, including in some cases the use of information buttons/boxes to explain each sustainability preference to the client;
- We have also noted that in some digital tools but also in F2F advice, the client is asked if certain ecological aspects, social aspects or criteria of good corporate governance (sustainability aspects) should be taken into account when investing. If yes, the client is asked whether the following sustainability aspects should be taken into account: a) Avoiding significant negative impacts on sustainability (PAIs); b) Positive contribution to sustainability (SFDR); c) Significant positive contribution to the environment (Taxonomy);
- The questions in each "digital tool" varies slightly across the co-operative banks, in line with the Level 2 and Level 3 requirements. But we note that it is common that a "best efforts" approach had to be taken for the new questionnaire and tools, due to pending issues with the sustainable finance regulatory framework. And in the case of co-operative banks, the advice given to clients is mainly F2F (as preferred by the client base) even if use of digital tools is required. This is also prevalent in Nordic countries like Finland; and
- Investment in adequate ESG trainings in line with already existing requirements under MiFID II. Co-operative banks have organized comprehensive training both for all investment advisors in the co-operative bank or group (e.g. by an external supplier and the related degree, or with in-house training), as well as, general staff training on how to discuss sustainability issues with customers. In addition, various materials and content for both personal assistance and digital channels has been produced (e.g. in some cases even customers' self-studies were published).

Q2: Are there specific aspects of sustainable finance that retail investors struggle to understand? For example:

- **Understanding of general aspects such as why it is important to consider sustainability risks and factors when investing?**
- **Understanding differences between sustainable products and products without sustainability features?**
- **Understanding that sustainability characteristics and (expected) return are two separate issues?**
- **Understanding the new legal definition of "sustainability preferences" and its components (e.g., categories a), b) and c), minimum proportion, principal adverse impact indicators (PAIs), etc)?**

Retail investors in cooperative banks have certainly reported - according to data collected to compare client behaviour towards sustainable finance between 2021 and 2022 – that the new questionnaires with respect to the "sustainability preferences" regime are too complex to understand and too granular. Too many decisions are demanded of the client. And with regard to the sustainability preferences, references are made to sustainability regulation and terms in these regulations (SFDR and Taxonomy) which are not understandable for the average client. Consequently, clients often feel "overwhelmed" by the sustainability preferences questionnaire.

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One of the contradicting factors leading to this complexity is that labelling of products is unclear with respect to SFDR Article 8 and 9 SFDR funds, especially because the definition of "sustainable investments" remains open according to the consolidated questions and answers of the European Supervisory Authorities (ESAs) published on 17 May 2023 (JC 2023 18). Indeed, the SFDR does not set out minimum requirements on what qualifies as a "contribution", "do not significant harm" or "good governance". However, the Q&As at least clarify that the definition of "sustainable investment" can be measured at company level and not necessarily at the level of a specific project or activity. As a consequence we note among co-operative banking clients, that equity UCITS funds are the most popular ESG product (even with high-risk client who is interested in sustainability) as they most commonly reflect real economy activities and are easier to link with a positive impact preference.

Missing or inadequate ESG data also means, in addition to the lack of a common "sustainable investment" definition, that our cooperative banks have mostly increased their sustainable product supply to Article 9 funds which are easier to classify. We see a mismatch between the data needed to match with clients' sustainability preferences which leads to a decline in ESG product supply. In turn, clients interpret this product mismatch as misleading claims from the financial sector ("greenwashing risk"). The latter is particularly complicated because consumers might adapt their sustainability preferences and end up investing in an Article 8 SFDR fund for example, and then find out it might still have fossil fuels in its portfolio. On the other hand, it was noted that even if the investor is offered an Article 9 SFDR fund which is suitable for them, it might not necessarily be an "ESG impact fund". Taxonomy alignment also still remains very low due to data issues, which is hard to explain to clients. And regarding PAI impacts, we see a divergence happening in the European Sustainability Reporting Standards (ESRS) mandated under the Corporate Sustainability Reporting Directive (CSDR) because these contain requirements for less reporting on mandatory PAI data points as compared to the SFDR RTS. This once again creates an ESG data issue. These issues seem to put off clients who then withdraw from investing in sustainability altogether after dealing with the questionnaire. But we believe that the mismatch of client expectations with the product supply mainly comes down to the design of the sustainable finance regulation, rather than financial institutions' implementation processes.

Furthermore, it is surprising that the ESMA guidelines on certain aspects of the MiFID II suitability requirements (ESMA35-43-3006) provide for the obligation that in order to help clients understanding the concept of "sustainability preferences" and the choices to be made in this context, firms should explain the terms and the distinctions between the different elements of the definition of sustainability preferences and also between these products and products without such sustainability features in a clear manner, avoiding technical language and that firms should also explain terms and concepts used when referring to environmental, social and governance aspects (ESMA35-43-3006, General guideline 1, Supporting guideline, Paragraph 16, page 42). According to the principle of certainty, laws must be understandable in themselves. The cooperative banks try and explain and educate in a simplified language, but the use of technical terms is unavoidable unless the European Commission or the ESAs provide a sort of non-binding "common consumer dictionary" of simplified terms. ESMA in its final report on suitability of May 2022, explicitly stated that technical terms and distinctions of the sustainability preferences must be used and explained (page 42/43, Guideline 1 point 17, page 45/ 46, point 26).

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One particular cooperative banking group carried out a customer survey in this regard. It is interesting to note that their clients mainly commented on the complexity for retail investors to understand what a single term means in practice, but another common complaint is the struggle to comprehend what actual effects the choice of a single sustainability preference has on the investment advice they receive. In addition, the survey delivered the feedback that sustainability preferences are seen as issues related only to the environment, not other elements of sustainability.

The outcomes of work on "greenwashing", "funds' names using ESG or sustainability-related terms" and "the SFDR RTS and Level 1 reviews" will also impact the client understanding of "suitability preferences".

Q3: Are there specific financial education initiatives on sustainable finance developed by consumer associations, trade associations or other organisations and that are used by investment firms that you can bring to ESMA's attention? Please accompany your reply with any relevant background information on the initiative and/or with details on its effectiveness/usefulness.

We are aware that cooperative banks do several outreach activities to train SMEs specifically on how to transition their business to sustainable practices aiming at low carbon measures/ sustainable energy use and so on. Clients of cooperative banks also often are united by various social objectives in their projects. The EACB had participated in the United Nations Climate Change Conference COP26 in 2021, to provide the experience of its clients in this context (LINK).

Q4: What is the main way firms currently provide information to retail clients about sustainable finance? For example:

- **Orally during the meetings with clients**
- **Through educational brochures or other (paper) documents**
- **Through dedicated website and apps**
- **A combination of the above**
- **Other**

In your opinion, are these approaches effective? Please provide details. Are retail clients satisfied with the quality of information provided?

Recent information collected from our members during 2022 suggests that the majority of cooperative bank clients presently take face-to-face advice for their investment choices, with numbers going as high as 95-100 % in countries like Spain and Italy, to 80 % in Finland. In the Netherlands, online advice is very common (still can be considered F2F) but robo-advice is not so popular. Therefore, the main way for communication with retail clients is through their investment advisor when it comes to sustainable finance in co-operative banking, even if the use of online tools is used in conjunction. For "digital tools" as a support in informing clients, see our answer to Q1, the second bullet point.

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Firm questionnaires

Q5: What are clients' experiences/reactions to the new questionnaires including questions on "sustainability preferences"? (e.g. do they require guidance to be able to answer to the questions? Do they show interest in the topic?)

Reference is made to the answer to question 2.

Q7: Which of the sustainable investment definitions do clients most often opt for? (EU Taxonomy alignment? Sustainable investment within the meaning of SFDR? Consideration of PAI? All of them?) Please provide any statistics, where available.

Currently the choice between a sustainability preference categorised as either (a) Taxonomy-aligned, (b) SFDR sustainable investment or (c) consideration of PAIs, is problematic for clients: On the one hand, it has been considered by our members that the PAI criteria under (c) to be the least conducive to investor impact as it aims at limiting negative impacts rather than contributing to positive sustainable or environmental impacts. On the other hand, it was noted that the PAI criteria under (c) is the easiest to explain to clients (), whilst (a) Taxonomy, and (b) SFDR preferences, are too complicated to explain. Regarding especially but not exclusively (a) Taxonomy, there are also barely any products to match the criteria at this stage. And regarding (b) SFDR ,, the classification of these products is unclear due to regulatory ambiguity.

In the case of assessment of a portfolio and not just a product, this is complicated further when there are non-EU investments in the client's portfolio. In Switzerland for example, the government has taken an approach similar to the current developing framework in the UK which is motivation based. The products are divided into categories of (a) value driven; (b) impact driven; (c) reducing negative impact. Therefore, our members sometimes note that the definition most opted for is often driven by discussing the clients' "motivations" further. Other clients feel "overwhelmed" by the sustainability preferences questionnaire, especially the demand of many decisions (see accordingly our answer to Q2).

Q10: Are firms currently able to satisfy the sustainability preferences expressed by clients (in particular in relation to the three categories (Taxonomy, SFDR, PAI))? If so, for which categories and/or types of financial instruments do firms find it most difficult to satisfy clients' preferences?

Reference is made to our answer to question 7.

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Adaptation of client sustainability preferences

Q11: How often has the adaptation of clients' sustainability preferences been necessary during these first months of application of the rules (e.g. in terms of percentage considering new clients and existing clients whose profiles have already been updated to include information on sustainability preferences)?

Current experience from our members shows that adaptation of client preferences to be very common. This is more complicated in the Netherlands whereby an additionality requirement by the AMF has added gold-plating issues. The AMF requires that firms prove that without the investment in one ESG fund, that another ESG fund would not have contributed to the sustainable investment objective. This is hard to evidence and also makes comparison of ESG funds in the EU harder to determine. In any case, the EACB is strongly opposed to such a requirement because it interferes in the business model of the investment firms and the missing legal basis for such a far reaching requirement at European level.

Q13: How were clients informed about the possibility to adapt their preferences?

We have noted examples from our members of questionnaires seeking consent if clients would be fine (Yes or No) to still receive recommendations for products based on their investor profile even if there are no products available that meet their sustainability preferences/ objectives.

Retail investors' demand of financial instruments with sustainability features and availability of product

Q34: Have firms noticed increased demand by clients of financial instruments with sustainability features? Please provide any relevant available statistics on this topic (e.g. percentage of clients asking information about these products; trends over time). Furthermore, please explain if factors such as age, gender, level of education or level of income/wealth play a role in the demand for financial instruments with sustainability features.

In general, it is noted that client demand for financial instruments has greatly increased from 2021 to 2022 because there is a client expectation of more ESG products with the new rules in place. However, the sustainable product supply has not managed to match client expectations for various reasons:

- Taxonomy still missing crucial information at the time when the "sustainability preferences" regime had to be implemented, and political debate on gas and nuclear created an added complication;
- Definition of sustainability/ sustainable investment remains vague;
- Data challenges dependent on upcoming CSRD, CSDD and the ESRS, which are inconsistent with other workstreams such as the SFDR PAIs being currently in the process of revision by end-2023; and

- SFDR created labelling regime without criteria but cannot be amended until next Commission term.

The above and the complicated new questionnaire thus shows that despite the higher general interest recorded, many cooperative banks recorded that when it comes to customer interest in actually defining their "sustainability preferences" a decrease in demand has been recorded by clients between 2021 and 2022 after they go through the new questionnaire.

In cases where our members have recorded an increased interest, it was noted that the figure does not seem realistic as complex definitions and lack of knowledge of sustainability issues probably understates the real interest by retail customers. It was also noted that due to the increasing interest rate environment generating interest in yield/return, some clients preferred safe haven products in their portfolio such as government bonds rather than ESG funds for example.

Q36: Are firms facing specific issues related to data availability/data quality with respect to financial instruments with sustainability features? If yes, how are firms dealing with these issues?

Data availability and quality remains a big issue when it comes to sustainable products supply.

Contact:

The EACB trusts that its comments will be taken into account.

For further information or questions on this paper, please contact:

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