

RESPONSE TO THE EUROPEAN COMMISSION CONSULTATION ON MIFID II SUITABILITY REQUIREMENTS

21 June 2018

PRI'S POSITION

The Principles for Responsible Investment (PRI) believes that dialogue between investors and clients on ESG interests and preferences is a necessary element of a sustainable financial system and we welcome policy initiatives to encourage this dialogue.

The PRI has traditionally focussed on ESG in investment rather than the point of sale dialogue on client ESG interests, we nevertheless have signatory data on asset consulting services and disclosure of ESG related investment information to individual beneficiaries and clients of investment funds that is relevant to the proposed changes to MiFID II.

The PRI is a membership organisation of over 2000 global institutional investors, (including, insurers, investment managers and advisors) with approximately US \$90 trillion in assets under management. Over 1000 of these signatories are based in the Europe. PRI members are required to report on an annual basis on their responsible investment activity, which creates a public disclosure of their policy, process and approach to environmental, social and governance (ESG) issues across asset classes.

Our data indicates that many European asset owners have made considerable efforts to integrate ESG factors in their investment processes, however, the PRI finds that the depth and scale of implementation can vary. In addition, the PRI's data indicates that a minority of investment advisors and asset managers disclose to how they take client preferences on ESG issues into account.

For example, while 95% of global investors reporting to the PRI have an investment policy that covers their approach to responsible investment, approximately half (52%) consider ESG issues in their economic analysis. When it comes to disclosure of the approach to ESG integration – only just over half of PRI signatories (55%) with internally managed listed equity assets indicate that they disclose their ESG integration approach publicly, in any form, including to clients and beneficiaries.

In relation to investment consultants, our data also shows that only 41% of asset consultants incorporate ESG issues when developing investment policies for clients. Even fewer consultants assess the ESG risk profile, materiality or time horizon of ESG objectives of their client.

The PRI's view is that weak implementation of ESG sends signals to the market that ESG factors are not requisite for investment decision-making and advice, which in turn limits the willingness and ability of investment advisors and portfolio managers to consider ESG factors in their advice and products.

The PRI believes that client and beneficiary preferences on ESG issues should be clearly understood and taken into account by those investing on their behalf. Consideration of ESG preferences is necessary to address a societal need for capital flows into assets that will support sustainable economic development, such as that envisaged by the Paris Climate Agreement and the UN Sustainable Development Goals. It is our view that dialogue between investors and clients is a necessary step to influence the sustainability of capital flows.

The PRI notes that under the existing MiFID II framework, firms providing investment advice and portfolio management are required to obtain information about the client ... to provide services and products that are suitable for the client (suitability assessment). Without considering the client's ESG preference, this process is incomplete.

More broadly, the PRI also welcomes the full suite of reinforcing reforms released by the Commission, including: clarification of investors duties to act in the best interests of clients and beneficiaries; and the development of a taxonomy to clarify sustainable economic activities.

We note that the duty to pay attention to the preferences of clients is separate from the duty to consider ESG issues that can be material to investment risk and return. We support the requirement for investment advisors and portfolio managers to provide clear information about the potential benefits and risks of taking client and beneficiary preferences, including ESG issues, into account, as stated in the proposed wording of articles 48 and 54.

If the investment entity is unable to reflect the sustainability preferences of members or clients with a positive or neutral investment outcome, they should clearly disclose to those members or beneficiaries the investment implications of including their preferences and ensure that the member or client can provide their consent on the investment strategy undertaken on their behalf. If the investment entity chooses not to reflect those preferences, this should also be disclosed, including the rationale for the approach taken.

We believe a taxonomy will provide greater clarity and consistency to enable investors to determine how their portfolios can be better aligned with client and beneficiary preferences on environmental and social issues in due course.