DDV Comments

On the EC Consultation on the Renewed Sustainable Finance Strategy

Executive Summary

- We advocate a regulatory pause and recommend waiting for a practical test of the relevant regulatory measures such as the Taxonomy Regulation and the SFDR. We fear regulatory overload for market participants, regulators, and supervisors alike.
- The structural disadvantages for structured products in the current sustainability-driven regulatory initiatives have to be addressed. Structured investment products have significant potential to contribute to the sustainable finance agenda.
- Publicly available data is urgently needed in order to comply with regulatory requirements.
- There should be further reflection on the usefulness of minimum standards in comparison with labels. We question the utility of labels. Minimum standards should be based on current regulatory concepts and – aside from general, principle-based guidance – based on market initiatives.
- We advocate a practical approach regarding the legal documentation of sustainability aspects in prospectuses. Reference to the Green Bond Framework should be sufficient.
- The assessment of sustainability preferences goes hand in hand with product governance requirements. The introduction of additional product standards “through the backdoor” should be avoided.

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The DDV welcomes the opportunity to provide comment on the present consultation on the Renewed Sustainable Finance Strategy. The DDV recognises that aligning the real economy with sustainability is one of the most important and demanding challenges facing today's international community. Given the central role of financial markets, it is understandable that they have been identified as a potentially effective mechanism to reach this objective. The members of the DDV are willing to contribute to this objective and have been actively involved in setting standards for sustainable investment products for almost two years.

The DDV would like to take this opportunity to respond to selected questions of particular importance for structured products.

Question 1: With the increased ambition of the European Green Deal and the urgency with which we need to act to tackle the climate and environmental-related challenges, do you think that (please select one of the following):

- Major additional policy actions are needed to accelerate the systematic sustainability transition of the EU financial sector.
- **Incremental additional actions may be needed in targeted areas, but existing actions implemented under the Action Plan on Financing Sustainable Growth are largely sufficient.**
- No further policy action is needed for the time being.

We highly appreciate that the European Commission Action Plan on Financing Sustainable Financial Growth provides for a comprehensive catalogue of supervisory measures intended to give greater weight to sustainability in the European financial sector than has been the case to date. Given the massive threat of uncontrolled global warming, the initiative is certainly called for. However, it should be borne in mind that all the measures envisaged in the Action Plan are uncharted territory for supervisors, market participants, and the real economy. The measures go far beyond what market participants have had to take account of with the implementation of MiFID I and MiFID II. Added to this are the extraordinarily tight deadlines within which implementation has to take place. No one – neither the European legislator, nor the supervisory authorities, nor the market participants – can currently reliably estimate what impact the regulation will have in practice on the acceptance and further expansion of sustainable investments. Against this background, we recommend waiting for a practical test of the relevant regulatory measures, such as the Taxonomy Regulation and the SFDR, before taking further regulatory steps. As such, we strongly advocate a regulatory pause. A level playing field for all financial products potentially contributing to the objectives of the sustainable finance agenda also needs to be maintained. This is not yet the case for structured products.

Question 7: Overall, can you identify specific obstacles in current EU policies and regulations that hinder the development of sustainable finance and the integration and management of climate, environmental and social risks into financial decision-making?

- Please provide a maximum of three examples [BOX max. 2000 characters].

When we look at the current sustainability-driven regulatory initiatives, structured products are faced with structural disadvantages compared with funds and insurance-based products. The risk of unequal treatment is particularly evident in at least two regards:

1. Although bond-based structured products embedding a derivative (hereinafter "**structured products**") are not formally financial products within the meaning of the SFDR, nevertheless, it seems that, de facto, they have to meet certain requirements of Articles 8 and 9 of the SFDR in order to have access to the investment advice and portfolio management services of distributors and asset managers. This is as (following the amendment to the Delegated Regulation (EU) 2017/565 proposed by the Commission), clients with an ESG preference can only be offered financial instruments that comply with the requirements set out in Articles 8 or 9 of the SFDR. However, the SFDR requirements at Level 1 and Level 2 (cf. the draft of the ESG Disclosure RTS currently under consultation) give the impression of being one-sidedly based on features typical of investment funds and insurance-based products. For the manufacturers of structured products, it will be an uphill battle to adapt to SFDR disclosure requirements on a quasi-voluntary basis.

2. With a view to their de facto "financial product" feature, we strongly advocate including structured products in the scope of the forthcoming **EU Ecolabel** – as will probably be the case with investment funds and insurance-based products. Structured products have the same ability to allocate capital to sustainable projects and activities as investment funds or insurance-based products. For example, the issuer of a bond-based structured product can use the proceeds of the structured product to finance green projects. Hence, there is no reason for unequal treatment of structured products and investment funds/insurance-based products under the EU Ecolabel regime. Should the Commission identify any impediments to this approach due to restrictions under the EU Ecolabel Regulation (Regulation (EU) No. 66/2020), we ask the Commission to call for an expedient amendment of the EU Ecolabel Regulation (for instance, consideration could be given to extending the limited scope of the Regulation, currently confined to "goods" and "services", to "financial products").

The DDV is convinced that structured products can make a valuable contribution to the objectives of the sustainable finance agenda (see also our answer to Question 53).

Question 10: Should institutional investors and credit institutions be required to estimate and disclose which temperature scenario their portfolios are financing (e.g. 2°C, 3°C, 4°C), in comparison with the goals of the Paris Agreement, and on the basis of a common EU-wide methodology?

- Yes, institutional investors
- Yes, credit institutions
- Yes, both
- **No**
- Do not know

No. Institutional investors already (i.e., based on the existing regulatory framework) face a major challenge in obtaining sufficient information to determine the degree of taxonomy compliance of the target companies they finance. While the extension of non-financial reporting obligations in the NFRD (Non-Financial Reporting Directive) will help in this respect, it will not be sufficient to precisely measure the temperature scenario financed by a portfolio. Moreover, any miscalculation may result in unmanageable civil liability risks for investors vis-à-vis their clients/shareholders.

Question 14: In your opinion, should the EU take action to support the development of a common, publicly accessible, free-of-cost environmental data space for companies' ESG information, including data reported under the NFRD and other relevant ESG data?

- **Yes**/No/Do not know.
- If yes, please explain how it should be structured and what type of ESG information should feature therein. [BOX, 2000 characters]

The recent regulatory developments in the context of the EU sustainable finance agenda create an urgent need for publicly available ESG data. In particular, compliance with the new disclosure obligations introduced by the SFDR requires financial market participants to have access to comparable, robust, and reliable ESG data at the company level. Companies subject to the NFRD will have to disclose how and to what extent their activities qualify as environmentally sustainable as defined in the Regulation. Unfortunately, the availability of comparable, reliable, and public ESG data of high quality is currently rather limited and insufficient to comply with the new regulatory requirements.

We therefore encourage the EU to create an EU data space for ESG data. The primary focus should be on the development of a minimum set of standardised and reliable data based on regulatory requirements. Later on, based on market needs, further data points might be included in order to promote informed decision making. The reliability of data is of particular importance here, so that users of that data do not need to manually verify the information.

Question 17: Do you have concerns on the level of concentration in the market for ESG ratings and data?

- Please express your view by using a scale of 1 (not concerned at all) to 5 (very concerned): **2**
- If necessary, please explain the reasons for your answer. [BOX, 2000 characters]

The DDV is of the opinion that there is sound competition in the markets for ESG data and rating providers. However, concentration might become an issue in the future. Consolidation of ESG rating agencies and data providers has already taken place in recent years.

Question 18: How would you rate the comparability, quality and reliability of ESG **data** from sustainability providers currently available in the market?

- Please express your view by using a scale of 1 (very poor) to 5 (very good): **3**
- If necessary, please explain the reasons for your answer. [BOX, 2000 characters]

ESG data from different providers is only comparable to a limited extent. This due to factors including differing investor preferences with regard to sustainable investment products and the history of individual data providers and rating agencies. Hence, in addition to commercial data providers, we see merit in developing a public data space with a limited set of regulatory data (see also our answer to Question 14).

Question 19: How would you rate the quality and relevance of ESG **research** material currently available in the market?

- Please express your view by using a scale of 1 (very poor) to 5 (very good): **2**
- If necessary, please explain the reasons for your answer. [BOX, 2000 characters]

While there is a wide range of ESG data available, there is a lack of the relevant data needed to comply with the regulatory requirements (see also our answer to Question 14).

Question 21: In your opinion, should the EU take action in this area?

- **Yes**/No/Do not know.
- If yes, please explain why and what kind of action you consider would address the identified problems. In particular, do you think the EU should consider regulatory intervention? [BOX, 2000 characters]

The DDV is of the opinion that any regulatory intervention in the market for ESG data providers and rating agencies should be limited. Nevertheless, some rules, particularly for basic organisational requirements (e.g., having internal conflict of interest policies in place), would be desirable.

Question 25: In those cases where a prospectus has to be published, do you believe that requiring the disclosure of specific information on green bonds in the prospectus, which is a single binding document, would improve the consistency and comparability of information for such instruments and help fight greenwashing?

- Please express your view by using a scale of 1 (strongly disagree) to 5 (strongly agree): **1 (strongly disagree)**
- If necessary, please specify the reasons for your answer [BOX, 2000 characters]

Currently, the prospectus describes the Green Bond Framework (GBF) in general terms and then refers to it via an external link. However, the GBF is not part of the prospectus. This does not greatly detract from the usability of the prospectus from an investor´s perspective. However, were the GBF to become part of the prospectus, it would complicate the approval process and the liability risk for the issuer would significantly increase.

Question 26: In those cases where a prospectus has to be published, to what extent do you agree with the following statement:
"Issuers that adopt the EU GBS should include a link to that standard in the prospectus instead of being subject to specific disclosure requirements on green bonds in the prospectus"

- Please express your view by using a scale of 1 (strongly disagree) to 5 (strongly agree): **5 (strongly agree)**
- If necessary, please specify the reasons for your answer [BOX]

Please see our answer to Question 25.

Question 28: In its final report, the High-Level Expert Group on Sustainable Finance recommended to establish a minimum standard for sustainably denominated investment funds (commonly referred to as ESG or SRI funds, despite having diverse methodologies), aimed at retail investors. What actions would you consider necessary to standardise investment funds that have broader sustainability denominations?

- No regulatory intervention is needed.
- **The Commission or the ESAs should issue guidance on minimum standards.**
- Regulatory intervention is needed to enshrine minimum standards in law.
- Regulatory intervention is needed to create a label.

The DDV is of the opinion that Articles 8 and 9 of the SFDR together with the Taxonomy Regulation provide a sufficient regulatory framework for the categorisation of sustainable financial products. In addition, we invite the Commission to further reflect on the comparative usefulness of minimum standards and labels. While we believe that there is merit for minimum standards, we question the additional benefit of labels. We can already see a diverse landscape of different labels, and any additional label has the potential to create confusion rather than clarity. Furthermore, labels always come with a price that not all retail clients might want to bear.

However, the DDV sees merit in minimum regulatory standards at the product level in the form of a definition how assets / asset classes are evaluated with regards to their sustainability-related qualities. Here, existing market initiatives have to be thoroughly taken into account. Furthermore, the DDV considers transparency to be the most effective approach to fostering sustainable financial products without hampering innovation.

Question 29: Should the EU establish a label for investment funds (e.g. ESG funds or green funds aimed at professional investors)?

- Yes/**No**/Do not know.
- If necessary, please explain your answer [BOX, 2000 characters]
- If yes, regarding green funds aimed at professional investors, should this be in the context of the EU Ecolabel?

The DDV does not generally support the introduction of further labels (see our answer to Question 7 above). In addition, we are concerned that further regulatory measures, such as the introduction of a specific ecolabel for ESG funds, could further destabilise the already limited level playing field that exists between funds and structured products. In particular, it seems unreasonable that issuers of structured products have to effectively meet the requirements for financial products under MiFID II, PRIIPs and (to a certain extent) the SFDR, yet are excluded from making use of the EU Ecolabel.

Product/Regulation	SFDR	ECOLABEL	MiFID II/IDD	PRIIPs
AIF/UCIT	yes	yes	yes	yes
Insurance-based product with an investment component	yes	yes	yes	yes
Structured product	Formally no, but effectively yes	no	yes	yes
Savings account	no	yes	no	no

Furthermore, Articles 8 and 9 of the SFDR together with the Taxonomy Regulation provide a sufficient regulatory framework, at least for environmentally sustainable investments, to also categorise "ESG funds" (and make them transparent for the retail investor). As such, there is no need to create a further label.

Question 30: The market has recently seen the development of sustainability-linked bonds and loans, whose interest rates or returns are dependent on the company meeting pre-determined sustainability targets. This approach is different from regular green bonds, which have a green use-of-proceeds approach. Should the EU develop standards for these types of sustainability-linked bonds or loans?

- Please express your view by using a scale of 1 (strongly disagree) to 5 (strongly agree): **1 (strongly disagree)**
- If necessary, please explain. [BOX, 2000 characters]

Sustainability objectives vary greatly from industry to industry and also from business model to business model within the same industry. Standardisation in this area will fall short of capturing this variety and thus take away flexibility from both issuers and investors, especially with regards to bilaterally negotiated loan agreements. Furthermore, market standards are just starting to evolve (e.g., the newly published ICMA principles for sustainability-linked bonds). Hence, we suggest letting market practice to settle first before thinking about additional regulatory measures. Nevertheless, we encourage the Commission to closely study the markets' best-practices for sustainability-linked bonds and loans and make the results available to the market.

Question 31: Should such a potential standard for target-setting sustainability-linked bonds or loans make use of the EU Taxonomy as one of the key performance indicators?

- Please express your view by using a scale of 1 (strongly disagree) to 5 (strongly agree).
- If necessary, please explain. [BOX, 2000 characters]

See our answer to Question 30.

Question 33: The Climate Benchmarks Regulation creates two types of EU climate benchmarks - 'EU Climate Transition' and 'EU Paris-aligned' - aimed at investors with climate-conscious investment strategies. The regulation also requires the Commission to assess the feasibility of a broader 'ESG benchmark'. Should the EU take action to create an ESG benchmark?

- Yes/**No**/Do not know.
- If no, please explain the reasons for your answer, if necessary. [BOX, 2000 characters]

- If yes, please explain what the key elements of such a benchmark should be. [BOX max. 2000 characters]

We are sceptical as to the creation of a broader ESG benchmark.

What is currently lacking is a consistent overall regulatory concept at the EU level that facilitates unbureaucratic access to a broad ESG product universe for retail and institutional investors. A prerequisite for such a concept would be that the product categories (pursuant to Articles 8 and 9 of the SFDR) are clearly defined and market participants and financial advisors are not overburdened by excessive transparency requirements that cannot be met on the basis of current data.

None of these requirements are currently fulfilled. In particular, the consultation document of the ESAs on the Disclosure RTS gives rise to the concern that, on the basis of opaque product categories, market participants will be required to provide a large number of transparency details without any idea from the ESAs as to how this information should be obtained. An "ESG benchmark" could theoretically contribute to the provision of information for market participants, for example by means of the benchmark statement (cf. Article 27(2a) of Regulation 2019/2089).

Given the current absence of a comprehensive regulatory concept, we believe, however, that the creation of a broader ESG Benchmark would most likely impair the current ESG index landscape. This landscape is a highly dynamic area whose constant evolution follows and also drives the ESG topic's further development in its individual subdomains of environmental, social, and governance evaluation criteria. Within the business landscape of index providers, many private sector actors, both traditional as well as specialised firms, have today established their business model competing under free-market conditions for the best solutions that satisfy specific investor demands. An ESG benchmark created selectively and not embedded in an integrated regulatory concept would heavily impact this business landscape without any clear added value.

Question 34: Beyond the possible standards and labels mentioned above (for bonds, retail investment products, investment funds for professional investors, loans and mortgages, benchmarks), do you see the need for any other kinds of standards or labels for sustainable finance?

- Yes/**No**/Do not know.
- If yes, what should they cover thematically and for what types of financial products? [box max. 2000 characters]

See our answer to Question 28.

Question 49: In order to ensure that retail investors are asked about their sustainability preferences in a simple, adequate and sufficiently granular way, would detailed guidance for financial advisers be useful when they ask questions to retail investors seeking financial advice?

- Yes/**No**/Do not know.

- If necessary, please provide an explanation of your answer. [box max. 2000 characters] 21

We question the use of guidance in assessing client sustainability preferences. We would like to draw particular attention to the retroactive effects on product governance implementations. These two set of rules need be synchronised to a certain extent and should not be addressed independently.

In any case, the introduction of indirect product regulation through the "back door" by formulating requirements for financial advisers should be avoided. This would have an impact on the content of financial products beyond the existing provisions under Articles 8 and 9 of the SFDR. In this respect, the draft amendment of Regulation (EU) 2017/565 which requires that an “Article 8 financial product” has to meet additional requirements to be eligible for investors with ESG preferences, goes in to the opposite (and wrong) direction.

Question 50: Do you think that retail investors should be systematically offered sustainable investment products as one of the default options, when the provider has them available, at a comparable cost and if those products meet the suitability test?

- Yes/**No**/Do not know.

The DDV believes that demand for sustainable investment products will increase steadily under the regime that is planned to come into force in the near future. We do not see any merit in being overly prescriptive in this regard and leaving clients with no choice at all with regard to their sustainability preferences. According to our understanding, the MIFID rules do not (and should not) allow for a preference regarding specific financial products.

A default offering of ESG products could further lead to a highly uneven investment landscape in which unduly high risk exposure (in ESG assets) is allocated over time to a large part of the retail investor clientele. At least in case of a rather narrow thematic ESG focus (e.g., with a very high degree of Taxonomy-compliant activities), this could be expected to be a realistic scenario. This danger (of ill-allocated risk) would be further aggravated if any such default option were to be built into the automated (robo) advice algorithms that are used to a growing degree by retail clients in today’s markets.

Question 52: In your view, is it important to better measure the impact of financial products on sustainability factors?

The DDV does not see a need for fundamental improvement of the impact measurement of financial products. Standards used within the EU on assessing the effectiveness of specific instruments allocating investments based on their impact (such as Green bonds) are already very advanced and sophisticated, often establishing the framework for the international ESG landscape. However, the DDV does see merit in developing a unified, standardised set of publicly available data (see our answer to Question 14).

Question 53: Do you think that all financial products / instruments (e.g. shares, bonds, ETFs, money market funds) have the same ability to allocate capital to sustainable projects and activities?

- **Yes**/No/Do not know.
- If no, please explain what you would consider to be the most impactful products/instruments to reallocate capital in this way.[box max. 2000 characters]

Structured products are particularly effective in this regard. Structured products have been an important part of the investment landscape in recent decades. They are issued by financial institutions and are in most cases essentially bond-based and embed a derivative. A significant portion of them function by providing a fixed regular pay-out (interest) until maturity, with the repayment level of the principal amount depending on the condition of certain market features. Structured products often come in a fully or partially capital-protected form. Very importantly, they are passive investment products, so there is no active management and hence no such fee. They exist for all sorts of market expectations, and are purchased by investors either at issuance or on the secondary market, where they can also be sold before maturity.

Their packaged structure (e.g., the combination of bond and option) makes them a more sophisticated type of financial product. This, however, is necessary to create their features (regular interest payments and principal repayment on certain conditions).

The DDV strongly believes that all elements of a structured product can be assessed on their ESG quality. With respect to the derivative component, the underlying reference value (e.g., equity, basket, or index) can be assessed according to the provisions of the EU Taxonomy and Benchmark Regulations. As for the non-derivative (bond or funding) component, where the bond serves the financing of a sustainable asset (e.g. in the form of a green bond), the ESG quality can be assessed based on its investment purpose. Alternatively, the ESG quality can be assessed based on the general ESG quality of the issuing financial institution that holds the bond/funding component on its general balance sheet. Since a lot of the financing for sustainable economic activities is and will be based on debt financing – including bank loans, which, for instance are of particular importance in the German context – the potential contribution of these products to the sustainable finance agenda should not be underestimated, either from a retail client perspective or from a banking perspective.

Question 82: In particular, do you think that existing actions need to be complemented by the development of a taxonomy for economic activities that are most exposed to the transition due to their current negative environmental impacts (the so-called "brown taxonomy") at EU level, in line with the review clause of the political agreement on the Taxonomy Regulation?

- Yes/**No**/Do not know.
- If no, please explain why you disagree [BOX max. 2000 characters]
- If yes, what would be the purpose of such a brown taxonomy? (select all that apply)
  - Help supervisors to identify and manage climate and environmental risks.
  - Create new prudential tools, such as for exposures to carbon-intensive industries.
  - Make it easier for investors and financial institutions to voluntarily lower their exposure to these activities. o Identify and stop environmentally harmful subsidies.
  - Other, please specify. [box max. 2000 characters]

A specific "brown taxonomy" could have the effect of explicitly restricting investment decisions for banks and investors. This would not be in line with indirect steering approach ("nudging") pursued by the EU so far: market participants and companies should not be directly forced to invest in or carry out environmentally sustainable economic activities, however, they have to provide transparent information on the respective share of environmentally sustainable economic activities. This approach should not be hastily abandoned before its effectiveness has been tested in practice.

Question 83: Beyond a sustainable and a brown taxonomy, do you see the need for a taxonomy which would cover all other economic activities that lie in between the two ends of the spectrum, and which may have a more limited negative or positive impact, in line with the review clause of the political agreement on the Taxonomy Regulation?

- Yes/**No**/Do not know.
- If yes, what should be the purpose of such a taxonomy? Please specify. [BOX max. 2000 characters]

See our answer to Question 1. Prior to a "practice test" of the current taxonomy concept, which has not even reached the status of (draft) Level 2 delegated acts, it is far too early to judge whether a more detailed taxonomy is required. Once again, we would remind the European Commission not to overburden itself, supervisory authorities, or market participants. Hastily adding new layers of taxonomy regulation before the current one is even implemented could lead to administrative collapse for both regulators and market participants.

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