European Securities and Markets Authority

16 December 2022
ESMA22-106-4248

SUMMARY OF CONCLUSIONS

Securities and Markets Stakeholder Group

Date:	5 October 2022
Time:	09:00 – 16:45h
Location:	ESMA, 201-203 rue de Bercy, 75012 Paris
Contact:	federica.briganti@esma.europa.eu

1. Report from the Steering Committee

The SMSG Chair reported on the SMSG activities since the last meeting. On the basis of the SMSG advice to ESMA on sustainability reporting, the rapporteur of that working group, Florence Bindelle, has submitted the SMSG position to the EFRAG consultation. The SMSG has moreover been working on its advice on MIFID II Product Governance Guidelines which will be discussed and hopefully adopted today.

2. Adoption of summary of conclusions from 8 July 2022

The summary of conclusions from 8 July 2022 was adopted.

3. Recent market developments

ESMA staff presented the ESMA Report on Trends, Risks and Vulnerabilities and provided an update regarding emerging risks in energy derivatives markets. ESMA staff explained that the impact of the war on commodity prices is the main driver of current events such as the inflationary pressure, the high level of volatility across many markets, including those related to energy, the massive drop in US equities, and the meltdown in crypto markets. Overall, the outlook is negative, and all the main risk categories are very high with the exception of credit risk, which is on the rise as well. There are also drastic rises in interest rates on the European side and in non-EU jurisdictions, including the UK and the United States, which may result in further portfolio rebalancing and rising corporate financing costs. This is linked to the uncertainty related to a further escalation of the Russian-Ukrainian war. From both the EU and national perspectives, there is now a raft of extraordinary measures to mitigate the impact that this has had on energy prices.

Tanguy van de Werve (SMSG member) gave a presentation on the impact of the current economic situation on the fund industry (with a special focus on UCITS, including ETF). He gave an overview of the long-term evolutions in the UCITS and alternative investment funds markets, by showing that net sales in UCITS have been increasing for the last 10 years until the end of 2021. Also assets under management have increased over that period (40%) and their value has appreciated (55%). The costs of funds have decreased over time, due to increased transparency, pressure from passive funds and pressure from consumer organisations. For most of 2022, redemptions have been higher than subscriptions, contrary to what has happened over the last 10 years. Fixed-income funds, such as bond funds and money market funds faced substantial net outflows so far this year, mainly due to increasing interest rates and the resulting impact on the valuation of debt. In relation to equity UCITS, net sales started positively in January and February and then they went down substantially, despite the market rebound. Also, the asset growth was negative for most of 2022, because influenced by market depreciation. For money market funds market depreciation plays a lesser role. MMFs nevertheless experienced severe outflows at the start of the year. ETFs have attracted net inflows during most of 2022 and so far; outflows were mainly concentrated in actively managed funds. The net sales of AIFs are negative so far. He concluded that the industry has proven to be efficiently using liquidity management tools.

Pieter Schuurs (SMSG member) gave a presentation on the impact of the efficiency and stability of energy markets. He raised concerns about the complexity of the situation of energy markets, with a high interdependence between gas and electricity prices and limited demand flexibility. Less gas is being delivered from Russia with price increases as a natural effect; therefore, several large trading companies are leaving the market or are less active because of liquidity constraints. There has been less OTC trading and a very large increase in prices on the power markets over the summer. He described the regulatory and political response and raised the question of whether the electricity market is functioning properly, especially derivatives markets. He concluded that, although there is severe pressure, the market has proven to function properly thanks to the liquidity support that has been provided by central banks and governments. He posited that the pressure does not depend on a default in the market design, but it is due to a supply crisis and that the full overhaul of European energy markets, that in principle function well, may prove counterproductive.

The SMSG discussed the presentations. First, contagion risk was discussed, in view of three significant liquidity concerns in the markets over the past 3 years (margin calls due to the COVID-crisis; margin tensions linked to the energy prices last summer; downturn in the gilt market accelerated by pension funds over the last 10 days), whereas we should at best face such a crisis only once every 10 years. Liquidity stress inevitable increases stress in the market and may lead to contagion. Second, inflation was indicated as the main investor protection concern of 2022, and it was suggested that ESMA should increase its focus on inflation in its TRV reports. Third, it was considered that overall markets have functioned well to bridge offer-demand-gaps, and circuit-breakers did what they had to. The question was raised how ESMA monitors this. Moreover, SMSG members saw a role for ESMA and the Commission to emphasise the fact that markets are well-functioning even in times of crisis, in order to re-gain trust of retail investors. ESMA staff highlighted that market surveillance activity is being conducted by the national competent authorities in relation to the trading venues and any potential manipulation in the markets. The ESMA chair confirmed that markets and infrastructures have worked. In view of the enormous price spikes in the energy markets, she suggested that ESMA should consider whether in those limited circumstances, pauses should be introduced to get the immediate panic out of the markets. She stressed the importance of not transferring the crisis in the energy markets into the other markets.

Christiane Hölz (SMSG member) and Rainer Riess (SMSG member) gave a presentation on the impact of EU sanctions on private investors holding depository receipts of Russian issuers. They expressed concerns in relation to the application of sanctions to depository receipts (DR). They called for further clarity on whether the issuers or participants in the Russian market would potentially pay indirect fees to a CSD. Furthermore, several deposit banks have now informed their clients that according to a decision of the Russian central bank, dividends on Russian shares are only paid in Rubel and if shareholders do not manage to open such an account within the set deadline, they will suffer a compulsory sale, without there being information on when the sale will take place, and with severe price lumps. The situation of retail investors is opaque, changing weekly, with instructions that are difficult to understand, and differing from bank to bank. They highlighted that while institutional investors can navigate these problems with the help of advisors, retail investors are heavily penalised and “sanctioned”. They found that sanctions are important but should ideally not be harmful to the EU. They are of the opinion that the European Commission should liaise with the US Treasury to have a common process in place since most of the depository banks that have launched these depositary receipts are US entities. They asked what ESMA can do, for instance to increase transparency.

SMSG members expressed their concerns about the issue. ESMA staff highlighted that, while being aware of the problems regarding the depository receipts, the interpretation of the legislation is in the remit of the European Commission. ESMA deems it important to leave the power in this regard in one hand. In this respect, in the last months, ESMA has been collecting questions raised directly to ESMA or through National Competent Authorities (NCAs), channelling them to the Commission and sharing replies with all NCAs, to support the consistent interpretation across the EU.

The SMSG agreed to set up a working group on the EU Sanctions and effects on financial markets.

4. Discussion on Suitability issues

Lubomir Christov (SMSG member) presented a study on suitability issues, entitled “Towards upgrading the suitability requirement”, highlighting certain concerns such as weak enforcement, consumer complaints, difficulties to comply because of the lack of clear, consistent guidance by regulators, and inconsistent implementation. He gave several recommendations, including: (i) to replicate the South-African study on the variance of investment recommendations in one or more major European markets; (ii) to require that risk tolerance assessments be always valid and reliable, taking into account psychometrics, ensuring that at least 10 questions are asked (since the reliability of suitability tests increases with the number of questions), and ensuring that at least 5 risk groups are distinguished; (iii) to provide ‘negative’ guidelines for risk profiling; (iv) to review the scope of the regulated investment service and recommend to the EC that the service of “financial planning” be brought under the regulatory umbrella.

ESMA staff presented the Final Report on the guidelines on certain aspects of the MiFID II suitability requirements. They highlighted the main changes to the guidelines, following the input given by stakeholders in relation to the date of application of guidelines, the use of a portfolio approach, and recommendations in regard of clients’ sustainability preferences. The guidelines have also been better aligned with pre-existing EIOPA guidance on the matter. ESMA staff confirmed that the majority of SMSG comments and suggestions had been taken on board in the Final Report.

SMSG members highlighted the importance of financial education, but also “non-financial” (sustainability) education for investors. They suggested that NCAs should monitor and increase transparency on the algorithms used by financial institutions to match investors with products, and suggested that ESMA should monitor this. SMSG members also agreed on the importance of both monitoring and regulating financial planning.

5. SMSG advice on MIFID II Product Governance Guidelines

The SMSG Chair presented the SMSG's advice on MIFID II Product Governance Guidelines. First, it was highlighted that the SMSG is of the opinion that the revised guidelines are balanced, fairly reflect and elaborate on the changes in Level 1 and Level 2 texts, and adequately deal with the results of the 2021 Common Supervisory Action on MiFID II Product Governance Requirements. The SMSG advice stresses the need for consistency in terminology and processes between the product governance guidelines and industry standards that are generally used in the market; between the terminology used by manufacturers and distributors; between the product governance guidelines on the one hand and the suitability and appropriateness guidelines on the other hand; between the product governance guidelines and the PRIIPs framework; and between the product governance guidelines and existing market standards. The SMSG Chair also mentioned that ESMA should ensure consistency in and between its own guidelines, as well as between the terminology and processes of the PRIIPs framework and the product governance framework, so as to avoid confusion and duplication of work. Moreover, the SMSG advice suggests that ESMA could stimulate industry associations to further develop market standards in light of the revised product governance, suitability and appropriateness guidelines. The SMSG advice also calls for a need to strike a balance between sufficient granularity and practicability, efficiency, and open-architecture requirements. Several problems were raised in regard of product governance, leading to a reduced product offer for retail investors. Finally, additional changes were suggested in relation to individual guidelines for both distributors and manufacturers.

The ESMA Chair thanked the SMSG for the interesting insights provided and for the advice that will be valuable in finalising the guidelines in the coming months.

The SMSG advice on MIFID II Product Governance Guidelines was discussed and adopted.

6. SMSG role in the breach of Union law procedure ("BUL")

Guillaume Prache (SMSG member) gave a presentation on the SMSG's role in the breach of Union law procedure. He highlighted that the BUL procedure has been very rarely used by ESMA, even less for investor protection issues. He mentioned that ESMA has recently advertised the BUL procedure on social media and that this can also be a tool to better inform ESMA about compliance with EU Law, and to increase awareness on some issues even at national level. He noted that the SMSG has never incited ESMA to start a BUL procedure and the SMSG has only twice discussed potential BUL issues. He gave a number of recommendations in order to make better use of the BUL procedure as a tool to improve compliance with EU Law, supervisory convergence and investor protection, such as including a BUL section in ESMA's annual report, ensuring strict confidentiality on the identity of individual authors (natural persons) of BUL-related complaints, unless they give express consent for disclosure of their identities, and publicly disclosing when the SMSG discusses a BUL potential case and the reasons why it was pursued or not.

ESMA staff highlighted that the complaints received by ESMA are not public because of confidentiality concerns. ESMA staff also highlighted that BUL represents a last resort and extreme measure. ESMA recently developed a new BUL strategy and launched a campaign to explain the BUL and complaint-handling process on social media. ESMA provided more information on these matters in the last ESMA annual reports and welcomes SMSG input, not only on potential breaches of Union law, but also on lack of convergence.

The SMSG agreed to set up a working group on the SMSG's role in the breach of Union law procedure.

7. DORA and MICA proposals

ESMA staff provided an overview of the timeline regarding the adoption of DORA and MICA proposals, highlighting the key dimensions for their implementations and ESMA's tasks and responsibilities.

The SMSG discussed the topic, pointing out that DORA is a horizontal issue, with many complexities. There are, on the one hand, user-side concerns, including with regard to legal certainty. On the other hand, there are supply-side concerns, such as compliance costs.

The SMSG agreed to set up a working group on DORA and to reach out to other stakeholder groups on this topic in due time.

8. Sustainable finance developments

a) Evolution of the market for sustainable products

Adina Gurau Audibert (SMSG member) presented the findings of the AFG survey on sustainable investment in France in 2021, highlighting the overall rise in asset under management and a different distribution of assets between article 8 and Article 9 of the SFDR regulation.

The SMSG discussed those findings, referring, among other things, to the SEC requirement to align the name of the fund with investor expectations.

ESMA staff thanked for the interesting analysis provided, confirmed its commitment to ensure that investors receive fair information, and welcomed any further broader European research aimed to monitor and capture the evolution of the market for sustainable products.

b) ESG Ratings:

Giovanni Petrella (SMSG member) presented a study exploring both the divergence between ESG ratings and the relationship between ESG scores and stock returns. He highlighted that ESG scores have improved over time in the EU and US between 2010 and 2020, reflecting greater awareness of ESG issues and improved information availability. However, divergence in ratings has been widely documented. It reflects differences in data sources, choice of criteria, risk factors identified and methodology. The divergence in ESG ratings and E, S and G-pillar scores is broadly stable over time but tends to be higher for governance issues. While this has adverse consequences on ESG risk pricing, differences in opinion also enrich the information set and reduce the risk of rating over-reliance. Divergence between ratings is, as such, not problematic, on the condition that each rating is transparent on what it measures. ESG ratings measure to some extent prospective risks and ESG performance. Stock returns are not affected by ESG scores once other key aspects are factored in. The absence of ESG risk pricing can discourage investors and reduces company incentives to invest in ESG projects.

SMSG members raised the need for greater attention to how the data underlying ESG ratings are being generated and for transparency on measurement metrics and methodology. The importance for asset managers to understand the source of the data used by ESG data providers was also highlighted. SMSG members also discussed the possible reasons why large companies tend to have higher ESG scores.

ESMA staff highlighted that the divergence in ESG ratings also feeds into better information of the markets. In the call for evidence that ESMA published at the beginning of the year, ESMA staff noticed that users of ESG ratings typically rely on one large data provider and that there was quite a high concentration on the market. In addition to this, most users additionally rely on smaller ESG rating providers, with more specialised products in order to gain additional insight and to feed their investment process. In this sense, ESMA confirmed that ESG rating divergence can also have beneficial aspects, despite the main concerns related to data quality transparency. ESMA staff informed the SMSG that the European Commission would propose a new initiative to foster the reliability, trust and comparability of ESG ratings by early 2023.

c) Taxonomy

Piotr Biernacki (SMSG member) gave a presentation on the requirement of art. 3 (c) of the Taxonomy Regulation, that stipulates that an activity can only be considered environmentally sustainable, if it is carried out in accordance with “minimum safeguards”. Art. 18 of the Taxonomy Regulation briefly explains what this means. However, this provision has not been developed by Level 2 or Level 3 standards. The future CSRD reporting should include all relevant information to verify compliance with the “minimum safeguards” requirement. However, it is unclear how reporting should be done on this matter in 2022 and 2023 reports. He concludes that the Taxonomy Regulation has introduced a de facto legal obligation to comply with due diligence several years before the draft Corporate Sustainability Due Diligence Directive comes into force. He also highlighted that the process of verification whether a company complies with minimum safeguards is a time-consuming and difficult one. He asked whether any potential guidance or Q&A’s could be obtained from ESMA in this regard.

SMSG members highlighted the lack of guidance on these issues.

ESMA staff acknowledged the complexity of the minimum safeguards assessment and indicated that it has worked in the past months to assist the European Commission with the collection of application questions in relation to the Article 8 reporting regime and their discussion with national authorities and with the audit profession. However, ESMA staff indicated that interpretation issues relating to the Taxonomy Regulation are a responsibility of the Commission and concluded to not be in the position to issue interpretative material addressing the application of the Minimum Safeguards requirements.

d) SFDR

ESMA staff presented the main changes in the Final Report on the RTS on investments in gas and nuclear taxonomy-aligned activities published on 30 September, containing changes to the disclosure templates for the information provided in pre-contractual documents, on websites, and in periodic reports about the exposure of financial products to investments in fossil gas and nuclear energy activities. ESMA staff also presented the key findings of the Report published on the 28 July on the extent of voluntary disclosure of principle adverse impacts of investment decisions under SFDR.

The SMSG repeated its concern of “green-bleaching”, when private equity funds and alternative funds do not bother about sustainability disclosures, and discussed the timing of the adoption of the RTS by the European Commission.

9. AOB

ESMA staff updated the SMSG on the upcoming mandate to ESMA on the review of SRD II. ESMA and the SMSG agreed to discuss the topic at the next SMSG meeting after ESMA receives the mandate from the Commission. The SMSG agreed to set up a working group on the topic.

The SMSG Chair informed the group about the intended review of the group's rules of procedures and invited SMSG members to provide input in writing.

ESMA staff provided updates in relation to the next Joint Board of Supervisors and SMSG meeting, proposing to postpone it to January 2023 in order to allow for a physical meeting.

The SMSG Chair reminded the group about the overview of Consultation Papers.

PARTICIPANT LIST – SMSG 5 October 2022

Name	Organisation	
Alemanni, Barbara	University of Bocconi	present
Avgouleas, Emilios	University of Edinburgh	present
Balthasar, Stephan	Allianz SE	present
Bergmann, Henning	Deutscher Derivate Verband (German Derivatives Association)	present
Bezzina, Geoffrey	Head of the Arbitrer's office, Malta	absent
Biernacki, Piotr	Polish Association of Listed Companies	present
Bindelle, Florence	EuropeanIssuers AISBL	present
Christov, Lubomir	Advisor to the Bulgarian National Association "Active Consumers"	present
Colaert, Veerle	KU Leuven University	present
Funered, Urban	Swedish Securities Dealers Association	present
Gažić, Ivana	Zagreb Stock Exchange	present
Granjé, Ben	The Flemish Federation of Investors	present
Gurau Audibert, Adina	Association Française de la Gestion financière (AFG)	present
Hölz, Christiane	Deutsche Schutzvereinigung für Wertpapierbesitz e.V. (DSW)	present
Jewell, Dermott	Consumers' Association of Ireland	present
Litvack, Eric	Société Générale	present
Lounasmeri, Sari	Finnish Foundation for Share Promotion	present
Mandic, Stjepan	Concepto Ltd	present
Oberndorfer, Martha	Advisor to Austrian Public Sector Clients of ESG	present

Pedersen, Morten Bruun	Danish Consumer Council	present
Petrella, Giovanni	Università Cattolica	present
Prache, Guillaume	Better Finance	present
Riess, Rainer	Federation of European Securities Exchanges (FESE)	present
Saade, Virginie	Citadel	present
Santillán, Ignacio	Spanish Investors Compensation Scheme for investment firms (FOGAIN)	present
Scheck, Martin	International Capital Market Association (ICMA)	present
Schuurs, Pieter	Index	present
Stiefmüller, Christian Martin	Finance Watch AISBL	present
Van de Werve de Schilde, Tanguy	EFAMA	present
Vervliet, Chris	European Works Council at KBC Group	present

ESMA

Verena Ross	Chair
Jakub Michalik	Acting Head of Governance and External Affairs Department
Steffen Kern	Head of Risk Analysis and Economics Department
Evert van Walsum	Head of Investors and Issuer Department
Salvatore Gnoni	Head of Investor Protection and Intermediaries Unit
Claudia Guagliano	Head of Innovation, Products and Technologies Unit
Tania de Renzis	Senior Risk Analysis Officer of Innovation, Products and Technologies Unit
Patrik Karlsson	Senior Policy Officer of Investment Management Unit
Chiara Sandon	Policy Officer of Investment Management Unit
Julien Mazzacurati	Senior Economist

Amandine Zelenko	Team Leader of Enforcement Unit
Alessandro D’Eri	Senior Policy Officer of Corporate Reporting and Finance Unit
Valerio Novembre	Senior Policy Officer of Corporate Reporting and Finance Unit