The European Securities and Markets Authority
103 rue de Grenelle
Paris 75007
France

(submitted online at www.esma.europa.eu)

19 February 2019

Dear Sirs,

Consultation paper on integrating sustainability risks and factors in MiFID II (ESMA35-43-1210)

The International Capital Market Association (ICMA)[1] is submitting its response to certain aspects of the above consultation.

ICMA is a membership association, headquartered in Switzerland, committed to serving the needs of its wide range of members. These include private and public sector issuers, financial intermediaries, asset managers and other investors, capital market infrastructure providers, central banks, law firms and others worldwide. ICMA currently has 550 members located in over 60 countries. See: www.icmagroup.org.

ICMA has a long-standing engagement on sustainability issues through running the secretariat for the Green Bond Principles Executive Committee, which coordinates the Green Bond Principles, the Social Bond Principles and the Sustainability Bond Guidelines. However, this response is primarily drafted on behalf of ICMA's primary market constituency comprised of banks that lead-manage syndicated debt securities issues throughout Europe. This constituency deliberates principally through:

- the ICMA Primary Market Practices Committee, which gathers the heads and senior members of the syndicate desks of a number of ICMA member banks active in lead-managing syndicated debt securities issues in Europe; and
- the ICMA Legal and Documentation Committee, which gathers the heads and senior members of the legal transaction management teams of a number of ICMA member banks active in lead-managing syndicated debt securities issues in Europe.

We set out our response in the Annex to this letter and would be pleased to discuss it at your convenience.

Yours faithfully,

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[1] European Transparency Register #0223480577-59

Annex

1. **Response scope** – This response addresses the use of terminology under the consultation paper, Q5 and Q10 on existing market standards and labels and the proposal regarding product governance rules under Q6 and Q7.

2. **ESMA's use of terminology –** The terms "ESG" and "sustainability" are both used in the text in a manner which can be interpreted as implying that they are interchangeable. This is subject to debate and clearly "ESG" can be read as putting greater emphasis for example on "governance". We understand that the immediate priority of the implementation of the EU Action Plan on sustainable finance to be climate change mitigation and adaptation. This is illustrated by the publication of the work to date of the EU TEG on sustainable finance in relation to the EU Taxonomy and to Climate-related Disclosures. Accordingly, we believe that "sustainability" is preferable as a term (i) to avoid confusion about the EU's priorities in the proposed amendments under MIFID II, (ii) to avoid the risk of any premature regulatory burden on firms, and (iii) not to divert the focus of the firms' regulatory implementation.

Q5: Which existing market standards or "labels" are you intending to take into account or already taking into account for the consideration of ESG factors? Do you see any issues when relying on current market standards or "labels"? Please describe.

Q10: What current market standards or "labels" are you intending to take into account or already taking into account for the consideration of ESG factors? Do you see any issues when relying on current market standards or "labels"? Please describe.

3. **Existing labels and market standards** – Q5 and Q10 seek information on existing market standards or "labels" that firms intend to take into account or are already taking into account for the consideration of ESG factors. In this respect, we would like to draw ESMA's attention on the Green Bond Principles ("**GBP**"), Social Bond Principles ("**SBP**") and Sustainability Bond Guidelines ("**SBG**") which are globally used market standards and developed by market participants (i.e. issuers, underwriters and investors) and for which ICMA provides the Secretariat. See below more specifically.

   (a) "Green Bonds" enable capital-raising and investment for new and existing projects with environmental benefits. The GBP, updated as of June 2018, are voluntary process guidelines that recommend transparency and disclosure and promote integrity in the development of the Green Bond market by clarifying the approach for issuance of a Green Bond. The GBP are intended for broad use by the market: they provide issuers guidance on the key components involved in launching a credible Green Bond; they aid investors by ensuring availability of information necessary to evaluate the environmental impact of their Green Bond investments; and they assist underwriters by moving the market towards standard disclosures which will facilitate transactions.

   (b) "Social Bonds" are use of proceeds bonds that raise funds for new and existing projects with positive social outcomes. The SBP updated as of June 2018 promote integrity in the Social Bond market through guidelines that recommend transparency, disclosure and reporting. They are intended for use by market participants and are designed to drive the provision of information needed to increase capital allocation to social projects.

   (c) "Sustainability Bonds" are bonds where the proceeds will be exclusively applied to finance or re-finance a combination of both Green and Social Projects. The SBG as of June 2018 have been published to confirm the relevance of the GBP/SBP in this context and facilitate the application of their guidance on transparency and disclosure to the Sustainability Bond

market. The common four core components of the GBP/SBP and their recommendations on the use of external reviews and impact reporting therefore also apply to Sustainability Bonds.

Q6: Do you agree with the suggested approach and the proposed amendments to the MiFID II Delegated Directive Articles on 'product governance'? If not, please explain.

Q7: Do you agree with the proposed changes to the ESMA Guidelines on MiFID II product governance requirements and the addition of an additional case study? If not, please explain what changes should be made and why.

4. **ESMA proposal on product governance rules** (Q6 and Q7) – The consultation proposes to amend Article 9 and 10 of the MiFID II Delegated Directive and the ESMA Guidelines, by notably confirming in various places the inclusion of ESG preference consideration where relevant. It is worth bearing in mind that the ESMA Guidelines on MiFID II product governance requirements (ESMA35-43-620) already contemplate (at #18(e)) that a product may be designed to achieve specific investment objectives such as "green investment", "ethical investment", etc., as relevant.

5. **Ability to resell bonds and liquidity impact** – It is worth bearing in mind that an intrinsic value point common to all bonds (certainly those larger syndicated issues[2]) is the technical ability of investors to resell them (bonds unlike bilateral loans are transferable by simple delivery), albeit subject to market liquidity conditions in terms of immediacy. In this respect one needs to be wary of unduly restricting the potential investor base for individual bonds, as all investors (including dedicated sustainable or green investors) periodically seek to rebalance their portfolio exposures (notably in terms of optimising exposure diversification). They could be significantly hindered from doing so if disproportionate[3] application of, e.g. product governance rules, meant that a particular type of sustainable or green investor would only be able to sell some of its bond holdings if the same type of sustainable or green investor could be found as a buyer.

6. **Other appropriate ESG accountability mechanisms** – It is also worth bearing in mind that other existing oversight/accountability concepts should focus responsibility appropriately and proportionately in terms of the policy objective of promoting sustainable finance: (i) specific disclosure in the form of dedicated third party review and reporting/certification (established specifically for confirming alignment with green or sustainable standards) and (ii) general disclosure in the form of periodic corporate reporting regimes (such as under the Transparency Directive).

7. **Unintended consequences for sustainable finance –** Lastly, it is worth underlining that creating specific and potentially elaborate procedures for sustainable finance products in the debt markets could prove counterproductive if market participation were deterred as a result.

8. **But no concerns in the context of ICMA1/ICMA2** – That said, no concerns have been raised regarding the consultation proposal in the specific context of either the ICMA1 approach[4] ('all bonds / professional investors only') or the ICMA2 approach[5] ('simple listed bonds / retail investor inclusive') that have been developed as possible options for use in the context of cross-border syndicated bond issuance.

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[2] Ranging in size from several hundred million euros to several billion.

[3] See MiFID II Delegated Directive (EU/2017/593), Recital 18 and Art.9.1 and Art.10.1 in relation to the concept of proportionality

[4] https://www.icmagroup.org/assets/documents/Regulatory/Primary-Markets/PG-PRIIPs-2018---An-approach-for-the-Eurobond-markets-v13bis-CLEAN-230518.pdf.

[5] https://www.icmagroup.org/assets/documents/Regulatory/Primary-Markets/PG-Gen-Retail-ICMA2-v8bis-CLEAN-230518.pdf.

9. **Rationale / ICMA1** – The proportionate ICMA1 approach *inter alia*, in terms of clients' objectives and needs, notes that professional investors have carefully considered and developed investment objectives (which may have multiple elements and strands and which may vary from time to time) as well as a sufficient ability to determine their own bond investment objectives and the role of individual bonds within them; they also have a sufficient understanding of all specifications of an investment in bonds and how such an investment would fit within their needs and expectations. In this respect, the ICMA1 approach already addresses not just the financial, but also (as already contemplated in the ESMA Guidelines noted above) the extra-financial aspects of bonds – including any preferences related to ESG, Sharia-compliance, etc.

10. **Rationale / ICMA2** – The proportionate ICMA2 approach *inter alia*, in terms of clients' objectives and needs, notes that, given the nature of listed bonds which are not ESMA complex[6] (including those of EEA-related official borrowers) and the amount of information available through mandatory and market-standard disclosures and otherwise generally available, a typical retail investor has sufficient ability to determine its investment objectives regarding such bonds, how such an investment would fit within that investor's needs and expectations and access to the extent it requires or wishes to IFAs and other independent advisers, who can advise their clients on, amongst other things, investment horizon and the compatibility of such bonds with the needs of clients who seek a contracted repayment of the amount invested and a predictable return profile. Similarly, certain ESMA complex bonds (including those of EEA-related official borrowers), though technically ESMA complex, do not include any additional risks relating to the expected return that are difficult to understand. In this respect, the ICMA2 approach also already addresses not just the financial, but also (as already contemplated in the ESMA Guidelines noted above) the extra-financial aspects of such bonds – including any preferences related to ESG Sharia-compliance, etc.

[6] For MiFID II purposes, and the purposes of the ICMA2 approach, *"ESMA complex"* bonds are those *"that embed a derivative or incorporate a structure which makes it difficult for the client to understand the risk involved"*.