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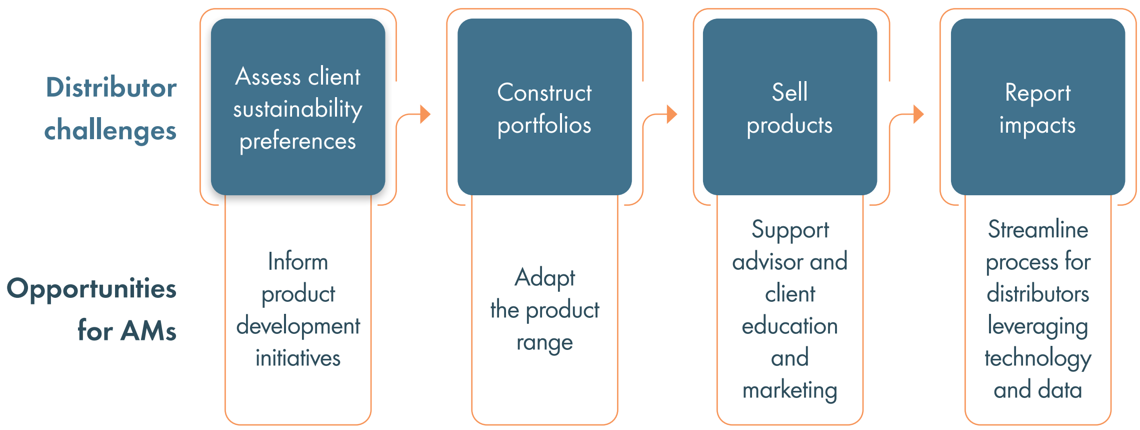
PERSPECTIVES

MIFID II AND SUSTAINABILITY: READY FOR THE AUGUST 2nd BIG BANG?

On August 2nd, changes to MiFID II will fundamentally alter the client suitability assessment process.[1] The addition of sustainability preferences to the latter will lead distributors to integrate sustainability at the core of the client investment journey and offer new opportunities for asset managers both at the service and product levels.

Indefi has identified four key areas in the product distribution value chain that asset managers should focus on in order to sustain their competitiveness in the European retail market.



1. See The Great Overhaul: How MiFID II Sustainability preferences will challenge the European fund management industry, Indefi (2022)

Inform product development initiatives

The new requirement to consider sustainability preferences necessitates changes to the product development process, particularly around investment impact assessment. Prior to the MiFID II amendments and SFDR, distributors' expectations focused on funds with ESG / sustainability labels. Labels benefit from independent granting organizations but offer a risk management-driven scoring-based approach to sustainability. This differs from MiFID II's individualized preference framework, which will likely materialize in a more specific set of product needs.

Asset managers must develop the ability to adjust product development according to diverse sustainability expectations. This can be accomplished via **enhanced engagement with distributors** in the client qualification process. Few distributors have defined how to turn sustainability preferences into a compelling product offering. This is an opportunity for asset managers to assist in the structuring of the sustainability preference assessment, ideally framing distributor and client thinking around the ESG themes that their own offering will address.

Adapt the product range

Reclassifying their product offering according to new sustainability dimensions will likely tax distributor resources and increase workloads. Asset managers who offer distributors with a **"ready-to-buy" framework** should gain a competitive advantage. By creating funds or investment solutions with specific sustainability preferences in mind, asset managers allow distributors to quickly determine which products are suitable for each client and help streamline the product matching process.

This will be especially favored by distributors who are not fully educated on the intricacies of sustainability. Asset managers can also leverage their asset allocation expertise and craft portfolios that address the most popular client preference combinations (e.g. a fund investing specifically in green technologies while considering the principal adverse impacts of GHG emissions) or even provide ESG-based individualized model portfolios.

Support advisor and client education and marketing

Asset managers are expected to assist advisors in their sustainability-based communication with clients via:

- **Sustainability-focused marketing materials**: Asset managers will need to complement the regulated and jargon-intensive pre-contractual documentation and reporting (e.g. EET Files) with **accessible marketing materials**. They should highlight tangible sustainability performance indicators, allowing advisors to show clients the impact of their investments.
- **Sustainable investment education**: Managers should proactively provide distributors with **education** on the complexities of sustainable portfolio management. This will allow advisors to then pass this education on to their clients (as required by MiFID II). This is another opportunity for asset managers to shape sustainability knowledge for advisors, and, in turn, clients, in a way that conforms to the manager's own product range.

Streamline process for distributors leveraging technology and data

While asset managers face their own challenges with respect to the procurement of sustainability data, they also serve as the *de facto* data providers for distributors. In this respect, the key expectation is for asset managers to effectively report on the extra-financial impact of their investments in a convincing and accurate way. This requires the definition of **clear and compelling sustainability KPIs** related to the genuine positive externalities of investments. Asset managers' support will have to extend to technology-based solutions that allow distributors to offer a higher level of service.

This should improve the "stickiness" of the capital invested in their funds and provide an additional barrier against greenwashing.

Under the renewed MIFID II framework, asset managers have an opportunity to capture new differentiation opportunities. This will be best accomplished by being **close and proactive in their engagement** with clients. Every step along the quest to the grail (avoiding greenwashing risk) matters. Presentable data on sustainability impacts that supports an asset manager's investment thesis will go a long way for their distribution clients while demonstrating their value to sustainability-focused investors.

Indefi, with headquarters in Paris and New York, is a leading strategy advisor for the global investment management business. Established in 2007, Indefi helps asset managers shape their business strategies and build a sustainable competitive advantage. The firm's expertise spans public and private markets, including infrastructure, private credit and equity, and real estate. A pioneer in advising asset managers on ESG development and integration strategies, Indefi is a PRI signatory. For more information, please visit www.indefi.com.