Frankfurt am Main,
1 September 2020

BVI's response to the Joint Consultation Paper by the ESAs on ESG disclosures (JC 2020 16)

Please make your introductory comments below, if any:

BVI[1] fully supports the EU Action Plan on financing sustainable growth. Our members (fund and asset management companies) are committed to contributing to the goal of reorienting capital flows towards sustainable investments by developing investment strategies and issuing products that serve different sustainability preferences of clients. The market for sustainable investments is already experiencing a rapid growth in Germany[2] and the industry is actively taking part in the evolution of the regulatory frameworks to ensure that they will create an environment in which sustainable investing can thrive and grow.

Against this background, we welcome the opportunity to comment on the ESA consultation paper on ESG disclosures. By specifying the material concepts of SFDR and providing detailed guidance in terms of investor information, the results of the ESAs' work will amount to an essential centrepiece of the new EU framework for sustainable finance. In the meantime, however, the work on developing this guidance is very challenging and **many underlying concepts are still not fit for purpose**. This pertains in particular to the following elements of the ESA consultation:

- The proposed **warning for investors in products with environmental and social characteristics** and a **lack of clear delineation of those products** in relation to both, non-ESG products and products qualifying as sustainable investments under Article 9 SFDR (cf. our response to Q16 and Q23),
- The general **approach to identification of principal adverse impacts** that results in a uniform treatment of all investments and does not allow for prioritisation in line with the Level 1 text (cf. our response to Q1-2),
- A long **list of mandatory PAI indicators** that are neither relevant to all investments/sectors nor covered by publicly available, comparable and reliable data (cf. our response to Q4-6),
- Extremely **cumbersome approach to calculation of average indicators** at the entity level that is disproportionate to the expected benefits in terms of new insights (cf. our response to Q11),
- **Delayed consultation of mandatory templates** for pre-contractual information that aggravates the temporal challenges with implementation as well as their **sweeping application to all financial products** (cf. our response to Q12-14).

These major inconsistencies and ambiguities further add to the challenges of SFDR implementation. As the ESAs are aware, in case of submission of the draft RTS to the Commission by end January 2021,

[1] BVI represents the interests of the German fund industry at national and international level. The association promotes sensible regulation of the fund business as well as fair competition vis-à-vis policy makers and regulators. Asset Managers act as trustees in the sole interest of the investor and are subject to strict regulation. Funds match funding investors and the capital demands of companies and governments, thus fulfilling an important macro-economic function. BVI's 114 members manage assets more than 3 trillion euros for retail investors, insurance companies, pension and retirement schemes, banks, churches and foundations. With a share of 22%, Germany represents the largest fund market in the EU. BVI's ID number in the EU Transparency Register is 96816064173-47. For more information, please visit www.bvi.de/en.

[2] E.g. the proportion of retail investment funds that follow dedicated ESG strategies and are offered as „ESG", „sustainable", "green" or similar in terms of total net sales in Germany has increased from 5 to 40 percent since 2017 (source: BVI statistics).

market participants will be left with **no more than five weeks** for the legal assessment and the subsequent operational and technical implementation of the new rules. This short deadline is clearly not feasible for the practical application of an entirely new and complex legal framework.

Therefore, **we fully back the ESAs' suggestion in the joint letter to the Commission to revisit the application date of SFDR**. In order to avoid distortions of marketing and distribution of sustainable products, we advocate a **postponement of the application date to 1 January 2022.** This moderate extension would give market participants 11 months for practical implementation which is still an ambitious but manageable timeline. It would also **align the general SFDR implementation with the application of Taxonomy-related disclosures** that shall lead to further adaptations of the RTS and will also become effective by 1 January 2022. Moreover, in view of the fact that the **substantive requirements for integrating sustainability risk and considering principal adverse impact will become effective probably by end 2021** (based on the current draft Level 2 texts under UCITS and AIFM Directives, and Solvency II that include a transitional period of 11 respectively 12 months), such postponement would avoid that disclosure requirements under SFDR come into force before the application of the substantive rules and thus help to restore coherence of the EU sustainable finance rules.

Q1 : Do you agree with the approach proposed in Chapter II and Annex I – where the indicators in Table 1 always lead to principal adverse impacts irrespective of the value of the metrics, requiring consistent disclosure, and the indicators in Table 2 and 3 are subject to an "opt-in" regime for disclosure?

We disagree with the general approach to identification of principal adverse impact (PAI) as proposed by the ESAs and do not deem it compatible with the Level 1 texts.

Recital 20 SFDR refers to principal adverse impact as "impacts of investment decisions (…) that result in negative effects on sustainability factors." This implies an evaluation of whether the identified impact is negative and material, or at least is likely to become material. However, the approach proposed by the ESAs will **always result in disclosures on principal adverse impact, regardless of materiality** of the underlying calculation values. For instance:

- **Indicators on carbon emissions (KPI 1) and carbon footprint (KPI 2) will always result in positive values**, and hence in disclosures of principal adverse impact, since there are yet virtually no investments that would qualify as carbon neutral. This means that even investments that would overall comply with the Taxonomy criteria with regard to climate change mitigation and thus be considered as delivering significant positive contribution to reducing carbon emissions would still need to disclose adverse impact under KPIs 1 and 2. Such outcome is **not acceptable for consistency reasons** and is likely to **create confusion among distributors and investors**.
- **Many indicators are not relevant for all companies and sectors**, but depend on the context in which a company operates. This applies for instance to indicators on biodiversity and ecosystem change controls (KPI 9) and deforestation policy (KPI 11). If those topic are not relevant to the business operations of a company (e.g. from the IT or finance sector), then the fact that there is no relevant policy in place does not effectively create an adverse impact, but according to the ESAs' proposal, shall be disclosed as such. A detailed evaluation of the relevance in terms of the proposed KPIs can be found in the **annex** to our reply (column C).

The ESAs themselves anticipate that financial market participants shall be able to prioritise adverse impacts by considering their scope, severity, probability of occurrence and potentially irremediable character on sustainability factors (cf. recital 5 and 6 of the draft RTS). However, the **blunt approach proposed by the ESAs does not allow for such prioritisation**, since it requires calculation of 32 mandatory indicators with regard to all investments across all managed portfolios. Prioritisation is effectively allowed only for the two (or more) optional KPIs to be chosen from tables 2 and 3 of Annex I. We are not convinced that this approach is helpful for the understanding of the principal adverse impact by investors and distributors. On the contrary, as soon as a positive value is being provided in the template, investors will assume that there is an adverse impact (even in case the positive value e.g. on carbon emissions is very low in absolute terms or when considering the main focus of investments). As soon as PAI disclosures will be provided at the product level in accordance with Art. 7 (1) SFDR, such approach will definitely **prompt many questions and might undermine investors' confidence especially in sustainable products** under Art. 9 SFDR that will inevitably also need to disclose PAI under the ESAs' approach.

In addition, the **proposed approach is not appropriate in terms of costs and benefit ratio**. For a management company with many hundreds of funds and managed portfolios, it implies **consideration of several thousands of investments and calculation of at least 34 indicators for each of them**, regardless of the potential in which cases adverse impacts may actually materialise. The value chain in the asset management industry that often involves delegation of portfolio management to specialised providers around the globe in order to provide best quality management expertise to investors makes such consideration across all investments barely possible. Given the huge challenges with the availability of relevant data as indicated in our replies to Q2 and Q5 below, the operational burden entailed by the proposed approach cannot in our view be sufficiently justified by benefits in terms of outcome for investors. As explained above, disclosure of a long list of quantitative KPIs is generally not helpful especially for retail investors.

For all these reasons, we are strongly in favour of an overhaul of the proposed approach to PAI reporting. A balanced regulatory approach should entail more flexibility and allow for qualitative evaluation of PAI indicators that should be considered relevant for a specific investment. This could be facilitated by the following measures:

- **Significantly reducing the number of mandatory indicators.** Only indicators that are of general importance for all assets and sectors and with satisfactory data coverage should be included in the final list.
- **Allowing for a qualitative, risk-based assessment of the other indicators in line with recitals 4 and 5 of the draft RTS**. Such assessment should be primarily based on scope, severity and probability of occurrence of principal adverse impacts as well as their potentially irremediable character.

Q2: Does the approach laid out in Chapter II and Annex I, take sufficiently into account the size, nature, and scale of financial market participants activities and the type of products they make available?

In our view, the proposed approach to PAI disclosures does not sufficiently take into account the size, nature and scale of financial market participants, nor the types of products they make available. We see the following major issues:

(1) **No added value from entity-level disclosures:** For fund and asset management companies, aggregated quantitative disclosures at the entity level are of hardly any value for investors. Large asset managers manage several hundreds of funds and mandates with different investment assets, strategies and geographical or sectoral focuses. Most of them offer traditional investment funds alongside ESG investments, but also plenty of other investment strategies suiting different investors' needs. **Calculations of PAI indicators over the entire range of investment decisions undertaken for all managed portfolios will thus allow no insights into the principal adverse impacts relevant in terms of investments in a specific fund**. Since the PAI values averaged out at the management company level will be no valuable guidance for investment decisions, the corresponding efforts should be kept to a reasonable extent.

(2) **PAI indicators are largely not relevant for other than investments in companies:** The proposed approach involves the calculation of at minimum 34 PAI indicators, including 32 mandatory indicators listed in Table 1 of Annex I of the draft RTS. However, the proposed indicators address issues that are primarily relevant to investments in companies (shares or bonds). Most of them are not relevant or even not applicable to investments in other assets such as sovereign papers, real estate, commodities or other alternative asset classes. In case of large asset managers with a wide-ranging offer of investments, aggregation of such partially relevant indicators at the entity level over all asset classes will thus present additional challenges. The results will likely be distorted and not allow for any kind of meaningful comparisons by investors.

(3) **Disproportionate burden for small and middle-sized firms:** The ESAs acknowledge that ESG data for assessing investments against the proposed PAI indicators is in most cases not readily available, but must be obtained from issuers or purchased from commercial vendors. Notwithstanding the quality issues with such ESG data that is currently not generated based on a common standard, the **necessary data collection will pose a huge challenge for small and middle-sized market participants** in both operational and financial terms. It is important to bear in mind that even commercial data vendors are often not able to obtain relevant data, especially for investments outside the EU. At this point, we disagree with the statement made by the ESAs at the open hearing on 2 July 2020 that proportionality considerations are already reflected by the "comply or explain" mechanism under Article 4 (1) SFDR that does not require consideration of PAI from all firms. At least in case of firms that offer sustainable products, there seems to be a regulatory, but also commercial expectation that the product provider will also account for PAI in the due diligence process. This understanding has been lately confirmed by the proposed Level 2 measures to MiFID II and IDD relating to the definition of sustainability preferences that, if confirmed, would effectively require PAI consideration in Article 8 products. Therefore, it is important to bear in mind that the **leeway for smaller market participants to make use of the "explain" option under Article 4 (1) SFDR is rather limited**. The Level 2 standards in terms of PAI consideration should thus be fairly balanced and not only manageable for large market players.

On balance, we call therefore for an overhaul of the proposed approach to PAI reporting. A balanced regulatory approach should entail more flexibility and allow for qualitative evaluation of PAI indicators that should be considered relevant for a specific investment. This could be facilitated by the following measures:

- **Significantly reducing the number of mandatory indicators.** Only indicators that are of general importance for all assets and sectors and with satisfactory data coverage should be included in the final list.
- **Allowing for a qualitative, risk-based assessment of the other indicators in line with recitals 4 and 5 of the draft RTS**. Such assessment should be thus primarily based on scope, severity and

probability of occurrence of principal adverse impacts as well as their potentially irremediable character.

Q3: If you do not agree with the approach in Chapter II and Annex I, is there another way to ensure sufficiently comparable disclosure against key indicators?

Sufficiently comparable disclosures could be accommodated by defining indicators for identification of principal adverse impact. However, contrary to the current proposal, **only a small set of key indicators that are (1) universally applicable to all assets and sectors and (2) already subject to sufficient data coverage should be prescribed as mandatory**. Based on a detailed analysis of the ESAs' proposal (cf. the **annex** to our reply), we have identified a short list of indicators that collectively meet those requirements and thus would qualify for mandatory disclosures. These indicators are presented in our response to Q4 and Q5 below.

All remaining indicators should be made optional and a list of indicators to choose from should be provided. Similar to the current approach with regard to tables 2 and 3, a minimum number of indicators could be required, while leaving market participants the flexibility as to which indicators they deem relevant in view of the asset mix at the entity level. Market participants could be requested to explain their selection of indicators and especially why they choose not to apply certain indicators for PAI considerations.

Reduction of mandatory indicators to KPIs that are universally relevant would also help avoiding misinterpretations of the calculation outcomes aggregated at the entity level. Indeed, the issue of aggregation in relation to such complex indicators with high numbers of variables is extremely important. The multiple open questions arising in this regard need to be clearly answered before the first reporting date in order to avoid divergent results simply due to differences in calculation that would lead to misinterpretations and confusion among investors.

We deem it also very important to provide further clarity on the following points:

(1) Which indicators are applicable to which categories of assets: Currently, many indicators seem to apply to investee companies, i.e. corporations, which raises the question of how to deal with those indicators in case of partial investments in sovereign papers or real estate at the entity level. This is particularly relevant in case of large asset managers that manage several hundreds of portfolios involving different investment assets. **Our suggestion would be to calculate those indicators only upon the share of portfolios that corresponds to investments in companies**.

(2) How to calculate PAI indicators in case of partially missing data: It is very likely that not all investments will be capable of assessment against the relevant indicators due to either the lack of relevant data or to the data being incomplete or insufficiently reliable. In order to obtain consistent calculation outcomes, it is important to clarify how to deal with this situation. **Our suggestion would be to disregard the investments with lacking/insufficient data for the purpose of calculations while providing corresponding explanations to investors. In order to enhance investors' understanding, firms could be specifically required to supplement disclosures by a "coverage rate" that would inform investors about the percentage of all relevant assets used as the basis for calculations.**

Q4: Do you have any views on the reporting template provided in Table 1 of Annex I?

The asset managers' ability to assess additional PAI indicators is largely dependent upon disclosure of the relevant KPIs by companies and will hopefully increase following the NFRD review. However, it is clear that the review process in terms of non-financial disclosures by companies will take several years in order to take effect. At the current stage, we cannot assess whether and to what extent it will improve the current situation in terms of corporate data. A huge data gap will anyway remain with regard to investments outside the EU that represent a large proportion of the European fund assets[3].

Therefore, we **disagree with the proposed approach involving 32 mandatory indicators** for the assessment of each and every investment. For the reasons explained in our replies to Q1 and Q2 above, we are **strongly in favour of defining a small set of key indicators that are (1) universally applicable to all assets and sectors and (2) already subject to sufficient data coverage**. Only indicators that cumulatively meet those conditions should be prescribed as mandatory. According to our analysis of the ESA proposal (cf. the **annex** to our reply), the following indicators could on that basis qualify for mandatory disclosures:

Environmental indicators:

- **KPI 1 (carbon emissions, broken down by scope 1 and 2):** Generally considered relevant for all assets. According to the unequivocal feedback from our members, data for scope 3 emissions is largely not available. Data providers offer assumptions on scope 3 emissions that vary greatly and do not represent a suitable basis for calculation of indicators that shall be compared by investors. Moreover, the issue of double-counting within scope 3 and between scope 2 and scope 3 emissions is not yet sufficiently addressed.
- **KPI 3 (weighted average carbon intensity for scope 1 and 2 emissions):** Generally considered relevant for all assets. This metric is established in the market and recommended by the TCFD. Due to the calculation based on revenues, it is not linked to a company's market capitalisation and not exposed to variations due to changes in the share price. Therefore, it is preferable to KPI 2 (carbon footprint) in terms of mandatory disclosures.
  Scope 3 data is not available and as such any calculation based on Scope 3 would be detrimental, since not comparable. The issue of double counting within Scope 3 and between Scope 2 and Scope 3 is not addressed.
- **KPI 5 (total energy consumption from non-renewable sources and share of non-renewable energy consumption):** Generally considered relevant for all assets, even though data is not readily available across all sectors. Data on GWh consumption is less available than percentages and would require further costs and efforts to be obtained.
- **KPI 7 (energy consumption intensity):** Generally considered relevant for all assets, even though data is not readily available across all sectors. Data on GWh consumption is less available than percentages and would require further costs and efforts to be obtained.

Social and employee, respect for human rights, anti-corruption and anti-bribery indicators:

It is important to stress that all indicators proposed in this section are generally **only applicable to investments in companies (shares or bonds)** and should therefore be considered and disclosed only in this regard. Firms that do not make company investments (e.g. specialised real estate management companies) should not be obliged to report upon these indicators.

---

[3] Around 43% of the equity assets held by German retail funds are invested outside the EU; for institutional funds the share of non-EU investments is even higher with 53% (as of January 2020, source: German Bundesbank statistics). According to the research by Morgan Stanley, approximately 30% of European ESG funds accounting for approximately 40% of AuM are global[3]. Non-European countries, such as the United States, Japan and Canada, represent more than 70% weight of the MSCI World Index.

Even with regard to investee companies, the proposed KPIs are too granular to be assessed based on ESG data as currently available. Therefore, as an alternative we suggest using the **following high-level mandatory KPIs** in order to report on the relevant aspects of portfolio investments in companies:

- **No signatories to UN Global Compact** (share of investments in investee companies that have not committed to the UNGC principles)
- **Severe controversies/breaches of UN Global Compact** (share of investments in investee companies that have been involved in severe violations of the UNGC principles)

Adherence to and severe violations of UNGC is already measured by a number of ESG data providers since many years. Data on these aspects is therefore readily available to the market, even though the interpretation of severe violations is not fully aligned.

These high-level KPIs could be further supplemented by mandatory disclosure of **KPI 29 (exposure to controversial weapons)** given that such exposures are generally considered relevant as an indicator for ESG controversies and the relevant data is available in the market.

All remaining indicators currently included in table 1 should be made optional and moved to tables 2 and 3 respectively. With regard to each table, a minimum number of indicators could be required to be applied, while leaving market participants the flexibility as to which indicators they deem relevant in view of the asset mix at the entity level. Market participants could be requested to explain their selection of indicators and especially why they choose not to apply certain indicators for PAI considerations. A reassessment of the mandatory list of indicators could be foreseen in the Level 2 texts, e.g. by means of a recital, on the basis of the NFDR framework after its revision has taken place.

For the time being, in view of the difficulties with obtaining the relevant data points, it should also be considered allowing the use of “proxy indicators” in case a metric is not exactly available from a data vendor who nonetheless provides for a related KPI (for instance, while KPIs 31 and 32 on anti-corruption and anti-bribery matters are often not exactly available, data vendors provide for metrics identifying companies with severe and very severe controversies relating to bribery and corruption).

Reduction of mandatory indicators to a small set of KPIs would also be **highly beneficial for the general understanding by distributors and end-investors**. The ESAs should bear in mind that the concept of PAI is entirely new not only to most market participants and financial advisers, but especially to retail investors. A long list of quantitative indicators showing percentages and figures with regard to very specific aspects of investments will very likely overstrain investors who will be anyway struggling to relate entity-level disclosures, e.g. by a fund manager, to their individual investment in a fund. Consumer testing, e.g. in the context of UCITS KIID or the PRIIPs KID, demonstrates quite clearly that investors tend to attach high importance to quantitative elements of disclosures while disregarding explanations. Any clarifications, e.g. in terms of limited relevance of certain indicators, will very likely not be taken into account unless investors are familiar with the general concept. Also for these reasons, it is highly preferable to **start with a small number of generally relevant KPIs that are less prone to misinterpretations** by investors.

Q5: Do you agree with the indicators? Would you recommend any other indicators? Do you see merit in including forward-looking indicators such as emission reduction pathways, or scope 4 emissions (saving other companies´ GHG emissions)?

We disagree with the proposed approach involving 32 mandatory indicators for the assessment of each and every investment. For the reasons explained in our replies to Q1 and Q2 above, we are strongly in favour of defining a small set of key indicators that are (1) universally applicable to all assets and sectors and (2) already subject to sufficient data coverage. Only indicators that cumulatively meet those conditions should be prescribed as mandatory.

Starting with these prerogatives, we have analysed the proposed KPIs based on our members' feedback and data availability from leading vendors. The details of our evaluation can be found in the **annex to this question**. On this basis, the following indicators would qualify for mandatory disclosures:

Environmental indicators:

- **KPI 1 (carbon emissions, broken down by scope 1 and 2):** Generally considered relevant for all assets. According to the unequivocal feedback from our members, data for scope 3 emissions is largely not available. Data providers offer assumptions on scope 3 emissions that vary greatly and are definitely not a suitable basis for calculation of indicators that shall be compared by investors. Moreover, the issue of double-counting within scope 3 and between scope 2 and scope 3 emissions is not yet sufficiently addressed.
- **KPI 3 (weighted average carbon intensity for scope 1 and 2 emissions):** Generally considered relevant for all assets. This metric is established in the market and recommended by the TCFD. Due to the calculation based on revenues, it is not linked to a company's market capitalisation and not exposed to variations due to changes in the share price. Therefore, it is preferable to KPI 2 (carbon footprint) in terms of mandatory disclosures.
  Scope 3 is data is not available and as such any calculation based on Scope 3 would be detrimental, since not comparable. The issue of double counting within Scope 3 and between Scope 2 and Scope 3 is not addressed.
- **KPI 5 (total energy consumption from non-renewable sources and share of non-renewable energy consumption):** Generally considered relevant for all assets, even though data is not readily available across all sectors. Data on GWh consumption is less available than percentages and would require further costs and efforts to be obtained.
- **KPI 7 (energy consumption intensity):** Generally considered relevant for all assets, even though data is not readily available across all sectors. Data on GWh consumption is less available than percentages and would require further costs and efforts to be obtained.

Social and employee, respect for human rights, anti-corruption and anti-bribery indicators:

It is important to clarify that all indicators proposed in this section are generally only applicable to investments in companies **(shares or bonds)** and should therefore be considered and disclosed only in this regard. Firms that do not make company investments (e.g. specialised real estate management companies) should not be obliged to report upon these indicators.
Even with regard to investee companies, the proposed KPIs are too granular to be assessed based on ESG data as currently available. Therefore, as an alternative we suggest using the **following high-level mandatory KPIs** in order to report on the relevant aspects of portfolio investments in companies:

- **No signatories to UN Global Compact** (share of investments in investee companies that have not committed to the UNGC principles)
- **Severe controversies/breaches of UN Global Compact** (share of investments in investee companies that have been involved in severe violations of the UNGC principles)

Adherence to and severe violations of UNGC is already measured by a number of ESG data providers since many years. Data on these aspects is therefore readily available to the market, even though the interpretation of severe violations is not fully aligned.

These high-level KPIs could be further supplemented by mandatory disclosure of **KPI 29 (exposure to controversial weapons)** given that such exposures are generally considered relevant as an indicator for ESG controversies and the relevant data is available in the market.

With regard to the remaining indicators, **our analysis shows that**

- **many KPIs are relevant only to selected business sectors**: For instance, issues relating to deforestation (KPI 10) or biodiversity (KPI 8 and 9) are not relevant to IT enterprises or companies from the financial sector. Requiring calculation of average indicators across all portfolio holdings would mean that the absence of policies with regard to deforestation or preservation of ecosystems in those investments would negatively impact the average KPI value, even though such absence does not effectively result in an adverse impact. Similar issues arise with regard to KPI 25 on measures for preventing trafficking in human beings for companies that operate in an environment where human trafficking is not present. To put it differently: **Not having a policy/not taking measures on certain issues cannot be always considered a deficiency, but must be seen in the specific business context in which a company operates.**

- as stressed above, **many KPIs can only be applied to investments in companies:** Even though such limited applicability is already acknowledged in the metric column of some KPIs, there are many other instances in which general applicability is being erroneously assumed. For instance, KPIs on social and employee matters with regard to whistleblower protection (KPI 21) or human rights policy (KPI 23) can only be reasonably applied to companies, not to sovereign or sub-sovereign issuers. Extension of such KPIs to sovereigns would raise many unresolved questions (especially about the scope of consideration) and effectively not work due to the lack of data. Moreover, social and employee indicators are generally not relevant with regard to investments in other assets such as commodities or real estate.

- **the relevant data points are in most cases not available:** While the ESAs seem to be aware of the fact that comparable, good quality data on the relevant KPIs are largely not available in the market, even not from commercial vendors, they seem not fully cognisant of the associated challenges especially for small and middle-sizes market participants. In this context, we would like to refer the Eurosystem reply[4] from the ECB to the European Commission's public consultations on the Renewed Sustainable Finance Strategy and the revision of the Non-Financial Reporting Directive which clearly acknowledges need to improve the quality of sustainability and climate-related information. In particular, the ECB emphasises that available sustainability and climate-related data and scores suffer from a lack of standardisation and comparability. Moreover, in the absence of a consistent set of publicly available corporate-level information, the metrics developed by market data providers seek to consolidate the (limited) quantitative and qualitative environmental information provided by companies. The ECB highlights that situation as **an impediment to the consistent use of ESG data by financial institutions and market participants and stresses that unreliable ESG data and ratings limit users in their capacity to conduct granular financial risk analyses.**

  These findings are fully applicable to the evaluation of principal adverse impact: The asset managers' ability to assess the PAI indicators is largely dependent upon disclosure of the relevant KPIs by companies and will hopefully increase following the NFRD review. **It should indeed be**

[4] Available under the following link: https://www.ecb.europa.eu/pub/pdf/other/ecb.eurosystemreplyeuropeancommissionpublicconsultations_20200608~cf01a984aa.en.pdf.

considered a regulatory prerogative for the NFRD review that any ESG information to be taken into account by investors must be first reported by companies in an easily accessible and standardised manner. However, it is clear that the review process in terms of non-financial disclosures by companies has been just initiated and will take several years in order to take effect. At the current stage, we also cannot assess whether and to what extent it will improve the current situation in terms of corporate data.

This situation is **particularly precarious for small and middle-sized asset managers that are not able to compete with large market participants as regards operational efforts and costs** for collecting ESG data. In this context, **we strongly disagree with the approach proposed by the ESAs in Article 7(2) of the draft RTS** that would first require financial market participants to undertake best efforts in order to obtain the data directly from investee companies before being able to use in-house research or turning to commercial data vendors. The requirement to approach each and every portfolio company with a data request would certainly overstrain smaller asset managers and could act as an impediment to consideration of PAI on a voluntary compliance basis. In case PAI consideration will amount to a precondition for the offering of sustainable products (cf. our comments to Q2 above), it **might generally discriminate against ESG product offerings by small and middle-sized firms**, thus making it an exclusive domain for large globally operating firms with more spare resources. This cannot be the desired outcome of the EU sustainable finance initiatives.

Against the background of these considerations, **all remaining indicators currently included in table 1 should be made optional** and moved to tables 2 and 3 respectively. With regard to each table, a minimum number of indicators could be required to be applied, while leaving market participants the flexibility as to which indicators they deem relevant in view of the asset mix at the entity level. Market participants could be requested to explain their selection of indicators and especially why they choose not to apply certain indicators for PAI considerations, A reassessment of the mandatory list of indicators could be foreseen in the Level 2 texts, e.g. by means of a recital, on the basis of the NFRD framework after its revision has taken place.

Q6: In addition to the proposed indicators on carbon emissions in Annex I, do you see merit in also requesting a) a relative measure of carbon emissions relative to the EU 2030 climate and energy framework target and b) a relative measure of carbon emissions relative to the prevailing carbon price?

As explained above, we consider the current set of proposed indicators far too complex and onerous in its implementation and are strongly in favour of reducing to a small set of basic, universally applicable KPIs. Therefore, at this stage, the complexity should not be further increased by extending the list of indicators, especially given that

- the EU 2030 climate targets are currently under review and cannot be used for assessment of portfolio investments in the near future,
- reference to “prevailing carbon price” would be entirely ambiguous and hardly feasible for standardised consideration in the context of ESG data, especially for financial market participants investing on a global scale.

Q7: The ESAs saw merit in requiring measurement of both (1) the share of the investments in companies without a particular issue required by the indicator and (2) the share of all companies in the investments without that issue. Do you have any feedback on this proposal?

In our view, the use of a double metric for displaying information on the same issue will only **add complexity** and might **further confuse (retail) investors**. As explained above, the concept of PAI is entirely new especially to retail investors. A long list of quantitative indicators with regard to very specific aspects of investments will very likely overstrain investors who will be anyway struggling to relate entity-level disclosures, e.g. by a fund manager, to their individual investment in a fund. This problem will be only increased if two different percentages (with regard to different reference values) will be shown for one KPI.

In order to enhance investors' understanding and not to deter them from engaging with PAI disclosures, it is highly **preferable to start with a small number of generally relevant KPIs that are less prone to misinterpretations and to reduce the general complexity of disclosures**. For this reason, we disagree with the double measurement approach as proposed by the ESAs with regard to some PAI indicators. One consistent metric should be prescribed for the calculations of mandatory and optional KPIs.

Q8: Would you see merit in including more advanced indicators or metrics to allow financial market participants to capture activities by investee companies to reduce GHG emissions? If yes, how would such advanced metrics capture adverse impacts?

Indicators capturing activities by investee companies to reduce GHG emissions would rather measure the **positive contribution of a company's activities**. Hence, such indicators could be used as sustainability indicators especially for Article 9 products under Art. 27 of the draft RTS, but **should go beyond the scope and general concept of PAI**. Moreover, in view of the anyway insufficient availability of ESG data and the considerable challenges with implementing the proposed KPIs, it appears premature to work on more advanced indicators or metrics at the current stage.

Q9: Do you agree with the goal of trying to deliver indicators for social and employee matters, respect for human rights, anti-corruption and anti-bribery matters at the same time as the environmental indicators?

We agree with the general goal of delivering all relevant PAI indicators at the same time as the environmental indicators. Given that the reporting requirements under Art. 4 (1)(a), (3) and (4) SFDR will apply at Level 1 simultaneously in terms of PAI on all sustainability factors, it makes sense to develop one consistent set of indicators to be taken into account in the SFDR implementation projects currently underway.

This being said, **we do not support the long list of mandatory indicators** on social and employee matters respect for human rights, anti-corruption and anti-bribery. The analysis conducted with our members' help (cf. the **annex** to our reply) clearly shows that ESG data in relation to the detailed indicators is scarce, since such indicators are not reported separately by companies. On the other hand, most issues deemed relevant in this respect are anyway covered by the UN Global Compact Principles on which data is widely available. Our suggestion is therefore **to start with the following**

high-level mandatory KPIs in order to report on the relevant aspects of portfolio investments in companies:

- **No signatories to UN Global Compact** (share of investments in investee companies that have not committed to the UNGC principles),
- **Severe controversies/breaches of UN Global Compact** (share of investments in investee companies that have been involved in severe violations of the UNGC principles).

These high-level KPIs could be further supplemented by mandatory disclosure of **KPI 29 (exposure to controversial weapons)** given that such exposures are generally considered relevant as an indicator for ESG controversies and the relevant data is available in the market.

All the other **granular indicators currently included in table 1 (KPIs 17 to 32) should be made optional** and moved to tables 2 and 3 respectively. Market participants could be requested to explain their selection of indicators and especially why they choose not to apply certain indicators for PAI considerations. A reassessment of the mandatory list of indicators could be foreseen in the Level 2 texts, e.g. by means of a recital, on the basis of the NFDR framework after its revision has taken place. However, it should indeed be considered a regulatory prerogative that any ESG information to be taken into account by investors must be first reported by companies in an easily accessible and standardised manner.

Q10: Do you agree with the proposal that financial market participants should provide a historical comparison of principal adverse impact disclosures up to ten years? If not, what timespan would you suggest?

We disagree with the proposed historical comparisons of PAI disclosures for the following reasons:

- Historical comparisons proposed by the ESAs **exceed the boundaries of regulatory technical standards** as defined in Art. 10 (1), second paragraph of the ESA Regulations. The proposed comparison of identified PAI over the period of 10 years would be a material element of the proposed PAI statement and thus cannot be considered a purely technical specification. Given that historical comparisons are not foreseen by the mandate given to the ESAs under Art. 4 (5) and (6) SFDR, the respective proposal by the ESAs goes beyond the Level 1 entitlement. This interpretation is also **relevant with regard to the historical comparisons for periodic reports for Article 8 and 9 products** as proposed by the ESAs in Art. 51 of the draft RTS. Also in these terms, the approach taken by ESAs in the consultation paper goes beyond the mandate provided by the EU legislators.

- Disclosures based on historical comparisons imply that there is **a legislative expectation in terms of reducing the identified principal adverse impac**t over a certain period of time. However, such expectation **is not enshrined in the Level 1 text** of SFDR. Art. 4 (2)(b) SFDR that shall be relevant in this regard requires only a description of the identified principal adverse impacts and any actions in relation thereto. Given that Article 4 disclosures are to be made at the entity level and pertain at least to all large financial market participants regardless of whether they commit to invest in line with ESG strategies or to offer sustainable products, it is **essential that the Level 2 requirements do not introduce a de-facto anticipation of applying ESG investment strategies in order to reduce PAI**. Such anticipation would definitely amount to a policy choice that needs to be made at Level 1 by the EU legislators.

Q11: Are there any ways to discourage potential "window dressing" techniques in the principal adverse impact reporting? Should the ESAs consider harmonising the methodology and timing of reporting across the reference period, e.g. on what dates the composition of investments must be taken into account? If not, what alternative would you suggest to curtail window dressing techniques?

We strictly reject the approach indicated by the ESAs at the open hearing, i.e. **to calculate PAI indicators over the entire reference period with regard to all investments at the entity level**. For fund managers, such **continuous aggregation of holdings over all managed portfolios would be entirely disproportionate.** Large management companies manage several hundreds of funds and mandates with a wide range of investment assets, strategies and geographical or sectoral focuses. At the entity level, such set-up results in many thousands of different holdings, whereby economic exposure to one issuer is often due to investments in a range of instruments (shares, bonds, single title or index derivatives). Aggregation of such holdings for the purpose of calculating PAI indicators cannot be reasonably required on a daily basis. This applies even more given that such aggregated calculations at the entity level will allow no insights into the principal adverse impacts relevant in terms of investments in a specific fund. Since the PAI values calculated at the management company level will be no valuable guidance for investment decisions, the corresponding efforts should be kept to a reasonable extent.

Against this background, while rejecting PAI calculations over the reporting period, we would nevertheless see merit in clarifying which reference date(s) shall be relevant. Since the PAI indicators shall be disclosed once a year for the preceding calendar year, it **appears reasonable to require calculations based on the composition of holdings at the year end.** Given that the relevant ESG data for calculation of PAI indicators is anyway scarce, outdated and will not be reported more frequently than once a year even following the envisaged NFRD review, annual calculations should be considered sufficient.

Nonetheless, should the ESAs see the necessity for more frequent calculations, we would suggest that these calculations could be based on the overall portfolio composition at the end of each quarter (i.e. 31 March, 30 June, 30 September). These additional reference dates should be fully sufficient in order to address concerns of potential "window dressing", given that any reallocation of portfolio holdings entails transaction costs and directly reduces the net performance of financial products. As explained above, **quarterly aggregation of portfolio holdings should be considered the absolutely maximum requirement for proportionality reasons**. Should the ESAs take up this suggestion, it would be worth clarifying that quarterly calculations **apply only to the establishment of the relevant portfolio compositions**, whereby the calculation of PAI indicators can be performed once a year on the basis of the weighted average holdings while using the most recent data.

Q12: Do you agree with the approach to have mandatory (1) pre-contractual and (2) periodic templates for financial products?
Q13: If the ESAs develop such pre-contractual and periodic templates, what elements should the ESAs include and how should they be formatted?

While we do not generally oppose to the idea of using mandatory templates for the provision of pre-contractual and periodic information, we must point to the **significant challenges and important limitations** of such an approach:

- **Templates add to the complexity of implementation:** As the ESAs are aware, the timeline for implementing the SFDR requirements by 10 March 2021 is extremely ambitious and unlikely to be met by most financial market participants in view of the pending regulatory process. Assuming that the ESAs will submit the final draft RTS by end January 2021, market participants will have no more than five weeks for the legal assessment of the new provisions and the subsequent operational and technical implementation. Especially the IT implementation can only be fully effectuated once the mandatory templates (that will hopefully form part of the final ESA advice) have been finalised. On the other hand, in many EU Member States amendments of fund prospectuses need to be submitted to the competent authorities for approval before they can be used at the point of sale. Such approval generally also takes several weeks. In view of these circumstances, most fund managers will not be able to provide fully adapted pre-contractual disclosures by 10 March 2021.

  Against this background, we are strongly in favour of extending the application date of SFDR to 1 January 2022. This moderate extension would give market participants 11 months for practical implementation which is still an ambitious but manageable timeline. It would also **align the general SFDR implementation with the application of Taxonomy-related disclosures** that shall lead to further adaptations of the RTS and will also become effective by 1 January 2022. Moreover, in view of the fact that the **substantive requirements for integrating sustainability risk and considering principal adverse impact will become effective probably by end 2021** (based on the current draft Level 2 texts under UCITS and AIFM Directives, and Solvency II that include a transitional period of 11 respectively 12 months), such postponement would avoid that disclosure requirements under SFDR come into force before the application of the substantive rules.

- **Mandatory templates are only justifiable for information of retail investors:** With the intended development of standardised mandatory templates, the ESAs obviously target the information needs of retail investors that indeed have demand for simple, visualised and comparable disclosures. However, the scope of Art. 8 and 9 SFDR is wider and in general encompasses all products that promote environmental or social characteristics or have as objective sustainable investments, including products targeted specifically at professional investors and tailored to their specific demands. This type of investors requires customised information, including in presentation terms, in order to be able to use it for their own purposes, e.g. for regulatory reporting in case of insurance companies and pension funds. Standardised disclosures in accordance with templates that have been developed for the retail audience are of little value for professional investors who would then turn to the asset manager in order to obtain in addition data on ESG issues suiting their particular needs.

  Therefore, the use of mandatory templates for pre-contractual and periodic disclosures should be limited to products foreseen for public distribution, i.e. available to retail investors. For other products, especially those launched exclusively for professional investors in the sense of AIFMD, MiFID II and IDD, disclosures in accordance with the templates should be optional. In any case, the content of regulatory disclosures should be conclusively laid down in the RTS itself in order to allow for their implementation detached from the templates.

Q14: If you do not agree with harmonised reporting templates for financial products, please suggest what other approach you would propose that would ensure comparability between products.

As pointed out above, we see no added value in introducing harmonised reporting templates for products targeted specifically at professional investors who often require customised information, including in presentation terms, in order to be able to use it for their own purposes, e.g. for regulatory reporting in case of insurance companies and pension funds. Standardised disclosures in accordance with templates that have been developed for the retail audience are of little value for professional investors who would then turn to the asset manager in order to obtain in addition data on ESG issues suiting their particular needs.

Therefore, the use of mandatory templates for pre-contractual and periodic disclosures, if deemed necessary for comparability reasons, should be limited to products foreseen for public distribution, i.e. available to retail investors. For other product, especially those launched exclusively for professional investors in the sense of MiFID II and IDD, disclosures in accordance with the templates should be optional. In any case, the content of regulatory disclosures should be conclusively laid down in the RTS itself in order to allow for their implementation detached from the templates.

Moreover, the development of templates yet to come further adds to the complexity of SFDR implementation. In view of the challenges explained in our reply to Q12 and Q13 above, **we advocate an extension of the application date of SFDR to 1 January 2022**. This moderate extension would give market participants a manageable timeline of 11 months for practical implementation while **aligning the general SFDR implementation with the application of Taxonomy-related disclosures** as well as with the substantive requirements for integration of sustainability risk and consideration of principal adverse impact by fund managers and insurance companies.

Q15: Do you agree with the balance of information between pre-contractual and website information requirements? Apart from the items listed under Questions 25 and 26, is there anything you would add or subtract from these proposals?

Before responding to the specific question, we would like to point **to three important aspects** of the ESAs' proposal in terms of website disclosures:

- **"Summary" of website disclosures is not covered by Level 1:** We disagree with the proposal to publish a "summary" in the format of maximum two sides of A4-sized paper when printed as part of the website disclosures. Such summary that would effectively amount to an "ESG KID" is not mandated by the Level 1 requirements under Art. 10 SFDR. On the contrary, Art. 10 (1) second subparagraph SFDR requires that the disclosure of the required information items as such shall be clear, succinct and understandable and be published in a simple and concise manner. If the ESAs consider that the website disclosures are overall too sophisticated especially for retail investors, they should work towards reducing this complexity when selecting the relevant contents of website disclosures and providing for further details of their presentation in the final RTS, not by inventing another kind of summary document that would come on top of those disclosures.

  In any event, the following two adaptations should be made:

- Financial market participants must **not be obliged to publish the summary in a language customary in the sphere of international finance if the relevant product is distributed only in the domestic market**.
- **The "summary" should not be required to be provided for products that are sold exclusively to professional investors**. As pointed out in our reply to Q12 and Q13 above, professional investors require tailored information, including in presentation terms, in order to be able to use it for their own purposes, e.g. for regulatory reporting in case of insurance companies and pension funds. Standardised disclosures in summary format that have been developed for better understanding by the retail audience are of basically no value for professional investors and would only result in additional red tape.

- **Disclosures of products that are not publicly distributed shall be made in a password-protected area of the website:** The detailed disclosure requirements proposed by the ESAs are generally being developed with products in mind that are subject to public distribution in the retail market. However, the scope of Art. 8 and 9 SFDR is wider and in general encompasses all products that promote environmental or social characteristics or have as objective sustainable investments, including products offered exclusively to professional investors. These include investment funds set up for dedicated investors according to their specific needs, but also individual investment portfolios. Given that **information on those products is not publicly available on the product provider's website**, we assume that it shall be allowable under Art. 33 of the draft RTS to provide for sustainability-related disclosures in relation to such products in a password-protected area of the website. Any other understanding would lead to a different treatment of sustainability-related disclosures in comparison to the provision of other relevant information about non-publicly sold products. It would also be very **problematic in view of the general confidentiality of contractual agreements** with institutional investors, applicable to both tailored funds and individual mandates, to disclose the relevant details in the public domain of the website.

  In addition, we would also **invite the ESAs to explore the possibility of providing the information foreseen for website disclosures directly to investors**, especially in case of individual mandates and tailor-made private funds. In those cases, there are in general no established website disclosures that could be extended to include sustainability-related information in line with Art. 33 of the draft RTS.

- As pointed out above, professional investors often require tailored information in order to be able to use it for their own purposes, e.g. for regulatory reporting in case of insurance companies and pension funds. They might demand more specifications on some aspects of the ESG strategy and its implementation, while being less interested in others. For instance, institutional investors will generally not be interested in further disclosures on the investment strategy that they have agreed upon, but might wish more information e.g. on results of engagement. Consequently, there should **be more flexibility also with regard to the content of website disclosures for individual mandates and customised products for professional investors**.

Since website disclosures can be more easily adapted, they should be generally deemed more appropriate for any elements of ESG information that are either uncertain in the pre-contractual context (especially at the time of a product launch) or subject to frequent variations. It appears particularly **advisable to move the graphical presentation of the planned proportions of investments proposed under Art. 15 (2) and Art. 24 (2) of the draft RTS in total to the website** while providing only a general description in the pre-contractual information. Otherwise, many investment funds applying qualitative ESG criteria in their asset selection process would have **significant difficulties to**

commit to certain planned levels of specific assets. This applies in particular to the requirement under Art. 15 (2)(b)(iii) and 24 (2)(b)(iii) to specify the proportion of investments in different sectors and sub-sectors. If a product applies a list of exclusions or normative screening criteria as the basis for its respective ESG strategy, it is very difficult to determine in advance in which sectors it will invest. Moreover, the portfolio composition will likely change over time, also with regard to the proportions of investments in certain sectors. Website disclosures would help to avoid too frequent adaptations of pre-contractual documents that entail additional costs and to provide investors with an up-to-date picture of the portfolio composition.

In this context, **further clarification is needed as regards the understanding of sectors and sub-sectors** under Art. 15 (2)(b)(iii) and 24 (2)(b)(iii) and how the ESAs intend to apply it to specific investments. The fossil fuel sector needs to be clearly defined in order to ensure comparability of related disclosures (cf. our response to Q19 below). Moreover, there is a number of other established classification schemes for economic activities around the world alongside the NACE system used for Taxonomy purposes. Companies headquartered outside of Europe generally use different metrics (such as ISIC or regional/national classification systems) and are often difficult to be assessed according to NACE. Practical difficulties also arise with regard to classification of multi-industry companies (such as Siemens, General Electric, Nestlé), but also in some other particular cases (e.g. with regard to Amazon, there is an ongoing debate on whether it belongs to the retail trade or the logistic sector).

In any case, an **investment should be assigned to a certain sector in total (preferably based on its business focus) and not sub-categorised with reference to different economic activities it may comprise**. Division into separate sub-sectors based on a look-through approach would significantly increase the complexity of implementation and might confuse investors who would then not be able to relate the information to the disclosed portfolio composition.

On a related point, use of website disclosures should also be considered for the presentation of the reference benchmark. Specifically, we suggest allowing a reference to the website of the benchmark administrator under Art. 21 (1)(a) and Art. 30 (a) of the draft RTS in order to supplement the explanations on how the benchmark is continuously aligned with the environmental or social characteristics or sustainable investment objectives of a product. This would provide investors with up-to-date information on the methodology underlying the relevant benchmark directly from the responsible provider.

Q16: Do you think the differences between Article 8 and Article 9 products are sufficiently well captured by the proposed provisions? If not, please suggest how the disclosures could be further distinguished.

We are very **concerned that the delineation between Article 8 and 9 products will be significantly blurred** by both the proposed RTS on product disclosures and the Level 2 measures under MiFID II and IDD currently being finalised by the EU Commission. In these terms, we see the following major problems:

- **Proportion of sustainable investments under Art. 15 (2)(a)(i):** For Article 8 products, it is proposed to illustrate the planned proportion of sustainable investments as part of the pre-contractual information and to report on the proportion of sustainable investments in periodic reports. However, sustainable investments according to Art. 2 (17) SFDR are foreseen by Level 1 only in the context of Article 9 products. Article 8 products, on the other hand, are supposed to apply dedicated ESG strategies for the selection of their investments and thus, to promote environmental or social characteristics. Since Article 8 products do not have as their objective sustainable investments, they **cannot commit to a certain proportion of sustainable investments** in the pre-contractual disclosures.

In addition to the **incompatibility with Level 1**, introducing sustainable investment into Article 8 products through the backdoor of the Level 2 measures would also pose **significant challenges to distributors and investors**. Since the portfolios of Article 9 products must not consist in total of sustainable investments as implied by Art. 24 (2)(b)(ii) of the draft RTS, it would be **hardly possible to determine when a product qualifies for Article 9 and Article 8** respectively. This would significantly impede comprehensibility at the point of sale. A clear delineation between the two categories of sustainable products, however, is key for distributors in order to be able to explain the underlying concepts to their clients, but also for the ultimate understanding especially by retail clients. It would thus facilitate well-informed investment decisions.

Moreover, it is important to recognise that impact investing that qualifies as sustainable investment under Article 9 is a relatively new and immature market segment. Practicability of sustainable investments cannot be taken for granted for all asset classes and investment styles. Requiring elements of sustainable investments in Article 8 products would thus very likely **limit the choice of investment solutions** available for clients with sustainability preferences and be **particularly obstructive for diversified multi-asset products** that from the risk-reward perspective are generally deemed suitable for retail investors.

On balance**, we urge the ESAs to clarify that the proposed graphical representation of sustainable investments for Article 8 products under Art. 15 (2)(a)(i) of the draft RTS is a "where applicable" provision. Alternatively, it should be possible to stipulate a planned proportion of zero percent without suffering from disadvantages at the point of sale.** In this context, we would like to stress that we disagree with the proposed approach at Level 2 of MiFID II and IDD to introduce further criteria for Article 8 products by narrowing down the understanding of sustainability preferences of clients. The understanding of products that are allowed to be offered as sustainable must be consistent alongside all relevant pieces of EU law. A situation whereby a product is issued in full conformity with Article 8 SFDR and hence entitled to be marketed as promoting environmental or social characteristics, but cannot be offered to clients with sustainability preferences in the first place, must be avoided by any means.

- **"Warning" on the lack of sustainable investment objectives under Art. 16 (1):** On this basis, we also strictly reject the "warning" in terms of the lack of sustainable investment objectives proposed for Article 8 products as well as any other insinuation that financial products promoting environmental or social characteristics "do not necessarily achieve" a certain level of sustainability (cf. recital 6 of the draft Commission Delegated Regulations amending Delegated Regulations under MiFID II and IDD). The ESAs acknowledge in recital 18 to the draft RTS that there is a wide variety of ESG investment strategies in use in the market, including in particular "best in class" approaches, exclusions and ESG engagement, that shall not be further restricted by regulation. What they miss to see, however, is that on the basis of the draft RTS those strategies must include binding criteria for selecting investments in order to attain environmental or social characteristics (Art. 17 (a) of the draft RTS). The attainment of those characteristics shall be measured by means of sustainability indicators that will be disclosed to investors as part of pre-contractual information (Art. 18 of the draft RTS). Information about the extent to which those characteristics were attained, including the <u>performance of the sustainability indicators</u> used, shall be disclosed to investors each year as part of the periodic reports (Art. 37 (1)(a) of the draft RTS). In addition, it is proposed to provide <u>historical comparisons</u> about the level of attainment of environmental or social characteristics during the lifetime of a product (Art. 37 (1)(b), (2) of the draft RTS).

Having regard to those requirements, **ESG strategy products under Article 8 SFDR must not be stigmatised as inferior, but should be recognised as a fully-fledged legitimate alternative to sustainable investments under Article 9**. They offer material added value to investors that are interested in achieving financial returns in the first place, but at the same time wish to ensure that their investments adhere to certain standards in sustainability terms.

Consequently, **we request a complete deletion of the "warning" proposed in Art. 16 (1) of the draft RTS**. From the viewpoint of retail investors, the proposed sentence is anyway not comprehensible without further explanations. Investors are not familiar with the legal meaning of the term "sustainable investment" and would be considerably irritated if products offered as ESG or SRI would include such warning.

Q17: Do the graphical and narrative descriptions of investment proportions capture indirect investments sufficiently?

Yes, we see no need for further descriptions in relation to indirect investments.

Q18: The draft RTS require in Article 15(2) that for Article 8 products graphical representations illustrate the proportion of investments screened against the environmental or social characteristics of the financial product. However, as characteristics can widely vary from product to product do you think using the same graphical representation for very different types of products could be misleading to end-investors? If yes, how should such graphic representation be adapted?

We agree with the general objective of comparable graphical representation as regard the proportion of assets screened against environmental or social criteria. For products using positive E/S/G criteria in their asset selection process, such comparable disclosures appear reasonable. Further clarification should be provided on how to apply the graphical illustration for products relying on negative screening (exclusions). In our view, given that exclusions are meant to warrant the attainment of certain environmental or social standards, portfolio investments selected in compliance with exclusion criteria should qualify for representation under Art. 17 (2)(a)(ii) of the draft RTS.

In this context, however, it is crucial **to ensure that investors can relate the graphical illustration to the relevant investment strategy**. In order to enhance investors' understanding in this respect, information on the investment strategy and its specific implementation in the investment process should be provided in direct relationship to the graphical representation. In particular, we suggest including the information required under Article 17 of the draft RTS in one coherent section on "Environmental or social characteristics and their implementation in the investment strategy" that would combine the information elements currently foreseen under Art. 15 and 17.

Q19: Do you agree with always disclosing exposure to solid fossil-fuel sectors? Are there other sectors that should be captured in such a way, such as nuclear energy?

We agree in principle, but **only in relation to investee companies**. Reporting of exposure to solid fossil-fuel sector should not be required for sovereign investments since there is no established method to measure such exposure in relation to whole countries or even sub-sovereign issuers. Also for other assets such as real estate, this information should not be relevant.

Moreover, the **understanding of the fossil fuel sector needs to be clarified** for the purpose of mandatory disclosures. The definition proposed in Art. 1(1) of the draft RTS is so far insufficient, since it does not provide for specification of the relevant fuel categories.

In future, exposure to other sectors that are particularly relevant from ESG perspective could be reported. However, selection of such relevant sectors should be based on the consensual evaluation under the EU Taxonomy.

Q20: Do the product disclosure rules take sufficient account of the differences between products, such as multi-option products or portfolio management products?

We perceive the **following deficiencies** as regards appropriate differentiation of products:

- **Lack of differentiation according to the investor type:** Many detailed suggestions for product disclosures have been developed by the ESAs for the stereotype of a product widely distributed in the retail market. Consequently, they target the information needs of retail investors that indeed have demand for simple, visualised and comparable disclosures, but are not equally appropriate in relation to professionals. This pertains in particular to the following elements of the ESAs' draft:
    - Provision for mandatory disclosure templates in terms of pre-contractual and periodic information under Art. 14, 23, 36 and 43 of the draft RTS,
    - "Summary" website disclosure under Art. 34 (1)(a) and 35 (1)(a) of the draft RTS.

  However, professional investors generally require tailored information, including in presentation terms, in order to be able to use it for their own purposes, e.g. for regulatory reporting in case of insurance companies and pension funds. For products sold exclusively to professional investors and not subject to public distribution, such as German Spezialfonds or individual mandates, standardised disclosures in accordance with templates that have been developed for the retail audience should therefore be only optional and "summary" website disclosures waived altogether. There should be flexibility to adapt the content of website disclosures to the individual investor's demands. In addition, website disclosures should be allowed to be provided in a separate password-protected area.

- **Insufficient consideration of individual portfolios:** Classification of managed portfolios as financial products under Art. 2 (12)(a) SFDR poses huge challenges to financial market participants that offer portfolio management services. In our view, the ESAs have some leeway to improve the feasibility of disclosure standards in relation to managed portfolios at Level 2. For instance, in the retail market it is common to offer standardised portfolio management solutions based on model portfolios that suit clients with different risk tolerance profiles. In our view, it would be appropriate in such cases to provide e.g. for **general website disclosures based on the standardised portfolio solution** rather than with reference to each individual portfolio managed for a specific client. This could be clarified by the ESAs e.g. by means of a recital.

For individual portfolios managed in accordance with the needs and preferences of individual investors with the professional status, on the other hand, standardised disclosures developed for retail clients will be widely inappropriate. In this regard, we refer to our above request for further differentiation of the disclosures depending on the investor type.

Q21: While Article 8 SFDR suggests investee companies should have "good governance practices", Article 2(17) SFDR includes specific details for good governance practices for sustainable in-vestment investee companies including "sound management structures, employee relations, remuneration of staff and tax compliance". Should the requirements in the RTS for good governance practices for Article 8 products also capture these elements, bearing in mind Article 8 products may not be undertaking sustainable investments?

According to our understanding, standards of sustainable corporate governance shall be discussed and refined at the EU level in the coming years. Given the current lack of harmonisation as regards the understanding of "good governance practices", also against the background of the applicable national law, we do not deem it advisable to provide for further specifications at the current stage. Rather, the final RTS should anticipate that the future regulatory standards for sustainable corporate governance will be used as the basis for identifying good governance without causing major adaptations of the internal processes.

Q22: What are your views on the preliminary proposals on "do not significantly harm" principle disclosures in line with the new empowerment under the taxonomy regulation, which can be found in Recital (33), Articles 16(2), 25, 34(3), 35(3), 38 and 45 in the draft RTS?

We are concerned that the proposed approach to the "do no significant harm" (DNSH) principle under the draft RTS might lead to inconsistencies with the "do not significant harm" criteria embedded in the EU Taxonomy, especially in view of the progressing development of the technical criteria for further economic activities.

According to our understanding, the proposed consideration of DNSH based on the indicators for adverse impact shall **apply at the investment level**, i.e. in relation to the investee company. Indeed for company investments, such consideration would allow for a distinction from the DNSH under the Taxonomy Regulation that is relevant in relation to a specific economic activity that qualifies as environmentally sustainable. For example, when investing in an utility company that provides for 30% of power supply from regenerative sources and 70% from coal, the regenerative supply part could meet the DNSH criteria under the Taxonomy (because it is related solely to the relevant economic activities), while it is questionable whether the overall investment should pass the DNSH based on the consideration of the overall GHG emissions and carbon footprint of the company.

However, the **interlinkage between the DNSH tests becomes more complex in case of products directly financing economic activities in line with the Taxonomy**. This would apply e.g. to green bond funds that contribute to the financing of Taxonomy-compliant projects, but also to real estate funds in case they invest in "green" buildings in line with the Taxonomy. In these cases, **the DNSH test under the Taxonomy cannot be overlapped by additional DNSH criteria linked to PAI indicators**. To put it differently: direct investments in economic activities that qualify as environmentally sustainable under the Taxonomy, and thus pass the relevant DNSH test, cannot be subject to further requirements and testing under Article 2 (17) SFDR. This pertains in particular to the environmental DNSH criteria that form the basis for the Taxonomy classification, but should also be acknowledged with regard to the social criteria that are represented in the Taxonomy by applying the minimum social safeguards. Any other result would **contradict the very purpose of the Taxonomy to define a coherent set of criteria for environmentally sustainable investments**.

Therefore, while not disagreeing with the preliminary proposal in principle, **we urge the ESAs to ensure full consistency with the DNSH test under the Taxonomy**. This could be facilitated by specifying that **for direct investments in environmentally sustainable economic activities in line with the Taxonomy, consideration of DNSH is already part of the Taxonomy criteria and thus shall be exempted from further testing against the adverse impact indicators.**

Q23: Do you see merit in the ESAs defining widely used ESG investment strategies (such as best-in-class, best-in-universe, exclusions, etc.) and giving financial market participants an oppor-tunity to disclose the use of such strategies, where relevant? If yes, how would you define such widely used strategies?

We **do not see sufficient merit in defining the widely used ESG investment strategies**. Indeed, we believe that a potential added value of such an approach, i.e. to provide further guidance to financial market participants, would be significantly outweighted by its likely downsides. Regulatory definitions of market-driven solutions, even if declared indicative, entail the risk of being considered set in stone. Consequently, definition of the current market approach e.g. for best-in-class would **make it difficult to advance this strategy in line with the state-of-the-art methodologies** developed in the market. Moreover, a regulatory list of broadly recognised ESG investment strategies could **prevent new innovative approaches to ESG investing being developed and generally limit innovation** in this currently very dynamic market segment. In our view, it is important to allow for flexibility as regards the choice of appropriate ESG investment strategies, but also possible combinations of different approaches/strategies that are often considered complementary for the attainment of environmental or social characteristics.

That being said, however, **we would welcome further clarification as regards the relevance of ESG factors for the investment strategy of Article 8 products**. Based on the Level 1 wording, it should be assumed that only products that promote, i.e. put emphasis on, environmental or social characteristics in their disclosures to investors fall under Article 8 SFDR. This understanding is in line with the general objective of the Regulation to ensure comparable disclosures for products that are offered with those characteristics to investors[5]. From the overall context of the provisions in Art. 14 to 22 of the draft RTS, we further understand that Art. 8 products must provide for <u>binding elements</u> for selection of investments in line with environmental or social characteristics to be included in the investment strategy and that the attainment of those characteristics must be <u>measured by means of sustainability indicators</u>. In contrast, the description of Art. 8 products in recital 21 of the draft RTS is much more vague. According to this recital, any product that *"references sustainability factors that are taken into consideration when allocating the capital invested"* in either marketing communications or mandatory investor disclosures would potentially qualify for Art. 8 SFDR.

However, the ESAs should bear in mind that investment funds and other financial products will be required by regulation to account for sustainability risks and in many cases also for principal adverse

[5] Cf. recitals 9 and 10 SFDR.

impacts on sustainability factors in their investment decisions[6] and to provide corresponding disclosures to investors. These requirements will apply to all funds regardless of their investments strategy and should be by no means sufficient to qualify a product for Article 8. Otherwise all EU funds would automatically become Art. 8 products which would result in a kind of decreed “green washing”. In these circumstances, investors would have significant difficulties to distinguish products that pursue dedicated ESG investment strategies which would also run counter to the regulatory intention. Similarly, application of an entity-wide policy or exclusion criteria, e.g. with regard to investments in controversial weapons, should not be relevant in this context.

Against this background, we suggest that **only products which reference binding sustainability factors in marketing materials, i.e. as elements for distinguishing from other products at the point of sale, should fall under Art. 8**. A by-catch of products that are not explicitly offered as sustainable must be avoided by any means, especially if based on regulatory information to be provided by all products e.g. in the sale prospectus for funds.

Therefore, in order to align the general description with the Level 1 concepts as well as the specific requirements for Art. 8 products under Art. 14 et seqq. of the draft RTS, we see the need for the following adaptation to recital 21:

> *“Financial products with environmental or social characteristics should be considered to be promoting, among other characteristics, environmental or social characteristics, or a combination thereof, when information provided to clients, in marketing communications or ~~**in mandatory investor disclosures or**~~ as a part of a process of automatic enrolment in an IORP, references **binding elements for the attainment of environmental or social characteristics that are applied as part of the investment strategy** when allocating the capital invested of the product.”*

Q24: Do you agree with the approach on the disclosure of financial products’ top investments in periodic disclosures as currently set out in Articles 39 and 46 of the draft RTS?

We have no specific suggestions in this regard. In the context of periodic disclosures, however, we would like to point to one **inconsistency in the draft RTS text**: Art. 36 (d) requires presentation of a section “sustainable performance of the index designated as a benchmark” for products with a reference benchmark that is not aligned with its environmental or social characteristics. Given that according to Art. 40 the relevant section of the periodic information shall contain details on performance of a reference benchmark that differs from a broad market index, it seems that the scope of application is erroneously referred to products without an ESG benchmark. Consequently, the word “not” as underlined above should be deleted from Art. 36 (d).

Q25: For each of the following four elements, please indicate whether you believe it is better to include the item in the pre-contractual or the website disclosures for financial products? Please explain your reasoning.

[6] Cf. the proposed amendments to Art. 23 (5) and (6) of the Commission Delegated Directive 2010/43/EU and Art. 18 (5) and (6) of the Commission Delegated Regulation (EU) No 231/2013 as regards sustainability risks and sustainability factors to be taken into account for UCITS and by AIFMs.

a) an indication of any commitment of a minimum reduction rate of the investments (sometimes referred to as the "investable universe") considered prior to the application of the investment strategy - in the draft RTS below it is in the pre-contractual dis-closure Articles 17(b) and 26(b);

b) a short description of the policy to assess good governance practices of the investee companies - in the draft RTS below it is in pre-contractual disclosure Articles 17(c) and 26(c);

c) a description of the limitations to (1) methodologies and (2) data sources and how such limitations do not affect the attainment of any environmental or social characteristics or sustainable investment objective of the financial product - in the draft RTS below it is in the website disclosure under Article 34(1)(k) and Article 35(1)(k); and

d) a reference to whether data sources are external or internal and in what proportions - not currently reflected in the draft RTS but could complement the pre-contractual dis-closures under Article 17.

As explained in our reply to Q15 above, we have a **general preference for website disclosures**, especially with regard to information elements that are that are either uncertain in the pre-contractual context (especially at the time of a product launch) or subject to frequent variations. In addition, lengthy descriptions of internal processes could be moved to the website in order to increase legibility of pre-contractual information for investors. Against this background, we would definitely see merit in providing information on the items mentioned in paragraphs b), c) and d) exclusively on the website as part of sustainability-related disclosures.

As regards information element a) – indication of any commitment of a minimum reduction rate of the investment – we first see the **need for clarification that such commitment is always voluntary** and depends on the offering terms of a product. While the proposed provision in Art. 17 (b) of the draft RTS is sufficiently clear, some ambiguity arises from the explanations in recital 24 where it is indicated that “disclosing of any commitment with regard to a minimum reduction (…) is necessary in order to give end-investors better visibility over the materiality of the offered strategy”. In particular, **we reject the assumption that any financial product relying on an exclusion strategy should have a minimum reduction commitment in place**. Most products apply exclusion criteria that are based on qualitative considerations of certain environmental or social factors, not on the effect in terms of investable assets. Reduction of the “scope of investments” that is assumed by the ESAs for an explicit commitment is in these cases rather a **by-product, not an explicit target, of an exclusion strategy**. Since such reduction of eligible investments would automatically reduce the risk diversification opportunities, it should be **treated with caution from the investor protection perspective**. Moreover, given that there is no uniform understanding of the “scope of investments” that would be relevant to certain investment strategies, stipulation of a minimum reduction rate with regard to the relevant investment universe would be rather arbitrary.

In this context, there is a need to revise the proposed wording in order to avoid misinterpretation of this provision. The regular case will be that exclusions are defined as part of the investment strategy from the outset, i.e. at a product launch, which means that there will be no scope of investments to be considered “prior to the application of the strategy [..]”. We suggest the following technical correction in this regard:

*(b) where there is a commitment by the financial market participant to reduce by a minimum rate the scope of investments **that would have been eligible without** the application of the strategy referred to in point (a), an indication of that rate;*

Q26: Is it better to include a separate section on information on how the use of derivatives meets each of the environmental or social characteristics or sustainable investment objectives promoted by the financial product, as in the below draft RTS under Article 19 and article 28, or would it be better to integrate this section with the graphical and narrative explanation of the investment proportions under Article 15(2) and 24(2)?

We would **prefer a narrative explanation** of the use of derivatives in order to keep the graphical representation simple and intuitively comprehensible for investors. As regards the location of such explanation, it would indeed make sense to integrate it in the narrative section provided for under Article 15 (2) and 24 (2) of the draft RTS in order to have a consistent depiction of the planned portfolio composition and the investable assets. In this context, we also advocate integration of the information on investment strategy in one coherent section on "environmental or social characteristics and their implementation in the investment strategy" that would combine the information elements currently foreseen under Art. 15 and 17 (cf. also our reply to Q18 above).

Q27: Do you have any views regarding the preliminary impact assessments? Can you provide more granular examples of costs associated with the policy options?

The proposals at hand will entail **high implementing and operating costs** for financial market participants. This pertains **in particular to the proposed approach to disclosure and calculations of PAI indicators**. As explained in our replies to Q1 to Q11, ESG data for calculating those indicators is widely not available and would need to be either obtained directly from issuers or purchased from commercial data vendors, even if of inferior quality. Both options represent **a high burden especially for small and medium-sized asset managers** who neither have the resources to approach each and every portfolio company with a request for data nor can easily afford additional data subscriptions.

In this context, it is important to point out to the **increasing market concentration in the area of ESG data providers that has significant implications for their pricing power**. All leading ESG data and research providers (MSCI, Morningstar – which acquired Sustainalytics earlier this year –, ISS-ESG and Vigeo-Eiris, the biggest according to market share) are now either headquartered in the US or owned by US company groups. In the last years, these data providers have overloaded the market with their products. The pricing frameworks remain opaque, depending largely on the combination of data modules and the size of (ESG) assets under management of the client. As it stands, a mid-sized to large fund manager will spend between EUR 200,000 and 400,000 per year for a comprehensive set of ESG data. However, these spendings will further increase in view of the new data requirements due to the ESG disclosure duties under SFDR and the Taxonomy.

The **complexity of PAI calculations at the entity level could emerge as another cost driver**. In order to keep this burden at a reasonable level, it appears **reasonable to require calculations based on the composition of holdings at the year end**. Should the ESAs deem it absolutely necessary to provide for more frequent calculations, we would suggest that the calculations should also reflect the overall portfolio composition at the end of each quarter (i.e. 31 March, 30 June, 30 September). These additional reference dates should be fully sufficient in order to address concerns of potential “window dressing”, while ensuring that the operational efforts are manageable for all market participants.

Implementation costs would be further pushed up by **the proposed blunt application of standardised disclosures to products targeted at professional investors** and not intended for public distribution. As explained above, standardised disclosures that have been developed for better understanding by the retail audience are of basically no value for professional investors and would only result in **additional red tape**. More flexibility should therefore be granted as regards presentation and content of ESG-related disclosures for professional investors.