RESPONSE TO THE ESA’s CONSULTATION ON THE DRAFT RTS UNDER THE SUSTAINABLE FINANCE DISCLOSURES REGULATION

1 September 2020
EFAMA, the voice of the European investment management industry, considers the Sustainable Finance Disclosure Regulation (SFDR) and its accompanying technical standards essential pieces in a strong and ambitious framework for sustainable investing. Our feedback aims at improving the effectiveness and feasibility of the ESAs’ proposal, as well as strengthening this regulation’s synergies with existing and upcoming rules.

We renew our full support to this initiative’s objectives to enhance comparability for end-investors, hold market participants accountable and avoid greenwashing. At the same time, disclosures should provide users with meaningful and reliable information, backed by solid data, and preserve ease of access to such information. Transparency on how sustainability is integrated into investment decisions should not become a mere box-ticking exercise. Instead, metrics and indicators should ensure enough flexibility to capture an extensive range of ESG products, strategies and objectives.

We hope our recommendations herein will help European authorities strike the right balance between enhanced transparency for sustainability-minded investors and a practical framework for the industry.

This response has been drafted by EFAMA and endorsed by the Association for Financial Markets in Europe (AFME). We remain available to discuss and clarify any views reported below.
OUR KEY RECOMMENDATIONS

Strike the balance between comparability and meaningful disclosures

While harmonised templates may enhance consistency and comparability, we believe that the proposed reporting against 32+2 mandatory indicators would limit the relevance of disclosures across different sectors and strategies. The proposed template might not appropriately capture the materiality of the principal adverse impacts (PAI). Besides, the proposed metrics for PAI refer to underlying investments. As such, they would be more appropriate for investee companies, who control funds allocation towards investment, rather than asset managers, responsible for portfolio composition instead.

The ESA’s proposed approach may run counter to the objectives set out in the SFDR. It risks resulting in a “one-size-fits-all” disclosure, failing to reflect the materiality considerations or the concept of “significant harm”. Moreover, existing methodologies to measure and aggregate data at the entity level lack depth and consistency. As a result, disclosures would greatly risk misleading end-investors. We thus recommend to substantially reduce the number of mandatory, uniform indicators, adding emphasis on proportionality and materiality considerations.

Take into account the gaps in ESG data

The lack of relevant, comparable, reliable and publicly available data on investee companies remains a key impediment to the mandatory reporting against the proposed indicators, as well as to the realisation of the full potential of sustainable finance. Disclosures based on insufficient and unreliable data would be unfeasible and lead to misleading results. The revision of the NFRD and the establishment of an EU-wide public ESG database should bring about long-term solutions to narrow down the ESG data gap. In the meantime, however, we recommend adopting a phased approach to disclosure requirements, with a focus on optional indicators, narrative disclosures, and qualitative information.

Adopt a more principle-based approach to entity-level disclosures

To improve comparability, the relevance and consistency of underlying data are essential, especially when investing outside the EU. Hence, we propose to limit the number of mandatory indicators to a smaller subset of more generic metrics that are meaningful, relevant across different sectors and asset classes, and measurable with available data. Meanwhile, asset managers would favour the flexibility to choose from optional indicators based on materiality for each underlying investee company, asset class and investment strategy. This approach could be revised and tightened over time, subject to enhanced availability of data and standardised disclosure frameworks.

We also note that the approach to calculating a weighted average of PAI indicators over the entire reference period, regarding all investments at the entity level, would be disproportionate. Many investment firms manage several hundreds of funds and mandates with a wide range of investment assets, strategies and geographical or sectoral focuses. We would suggest providing for specific reference date(s) instead. We believe that ‘the year-end’ would be a sensible reference date for the calculation of the composition of holdings, for example, given that investee companies disclose ESG data on an annual basis and PAI indicators are also to be disclosed annually.

Ensure flexibility for pre-contractual, website and periodic product disclosures

Pre-contractual and periodic templates for financial products require sufficient flexibility to capture ESG considerations in a way that accurately reflects the funds’ characteristics, assets and strategies. We recommend developing such templates in a manner coherent with already existing
client disclosure requirements and making it easy to include them in existing documentation for pre-contractual and periodic disclosures. We recommend a twofold approach, whereby standardised templates are mandatory for products made available to retail investors and optional for products intended exclusively for professional investors. EFAMA champions a well-balanced information disclosure approach that would provide end-investors with valuable information to guide their initial investment decisions in the pre-contractual documents (e.g. the prospectus) while allowing to provide all information that has elements of uncertainty and/or requires frequent updates on the website.

Clarify the distinction between Article 8 and Article 9 products

More clarity is needed on what products will qualify as Art. 8 and Art. 9 products. The definition of Art. 8 products should capture a broader range of investments, integrating environmental and social (ESG) characteristics with different approaches and levels of ambition, as originally outlined in the SFDR. In our detailed response we provide a list of recommendations that we believe will help capture the differences between Art. 8 and Art. 9 products and enhance investors’ choice of ESG investment products while avoiding misleading disclosures or greenwashing.

Ensure a realistic timeline for the implementation of the new rules

Our most critical concern is the extremely tight and practically unrealistic deadline to implement the new rules. In case the draft RTSs are published by the end of January 2021, market participants will be faced with only around five to nine weeks for the legal assessment and the subsequent operational and technical implementation of the new rules. Such a short timeline makes it very hard or even impossible to properly implement this entirely new and complex legal framework. Therefore, we fully back the ESAs’ suggestion in their joint letter to the Commission to revisit the application date of SFDR and we call for a postponement of the application date to at least 1 January 2022.

This postponement would provide market participants with 11 months for the implementation of the new framework. This is still a challenging, yet manageable timeline, coherent with the application date for the disclosure requirements under the EU Taxonomy Regulation. The new SFDR application date would also be better aligned with the application timeline for the upcoming rules on the integration of sustainability risk and the consideration of principal adverse impacts in investment decisions. The postponement would help restore the consistency and coherence within the EU sustainable finance regulatory framework.
RESPONSE TO THE ESAS’ QUESTIONNAIRE

Question 1: 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?

While we see the merits of reporting against some of the indicators included in Table 1 of the draft RTS to disclose principal adverse impact at the entity level, we disagree with the proposed approach whereby any positive value for any adverse impact indicator would automatically result in a “principal” adverse impact. In some cases having carbon emissions in one sector can offset or reduce emissions in another sector (e.g. the CO₂ emissions of a manufacturer of solar panels). Positive metrics associated with the indicators in Table 1 do not provide the context regarding the nature of the adverse impacts of investments.

We believe the proposed approach is too prescriptive and it goes beyond the requirements set out in the Level 1 text of SFDR. When requiring the publication of “a statement on due diligence policies with respect to adverse impact, taking due account of size, nature and scale of their activities and the types of financial products they make available” and to disclose “information about their policies on the identification and prioritisation of principal adverse sustainability impacts and indicators”, Art. 4 SFDR takes into account proportionality considerations and leaves flexibility on which indicators to use. In our understanding, Level 1 provisions focus on those issues which are strictly under the asset managers’ control. That is, investment policies and the identification and management of potential adverse impacts based on their activities and products made available.

While we understand, and embrace, the objective to enhance comparability for end-investors with a harmonised, mandatory template, we have strong reservations on the choice of the indicators listed in Table 1, their number and the overall benefits of such disclosures, as limited conclusions can be drawn after aggregating all positions held in all the asset manager’s portfolios. We would favour a more principle-based approach to entity-level disclosures, as it would be closer to our reading of Level 1 text and more likely to provide fit-for-purpose, proportionate and relevant information to clients and other stakeholders.

Regulation (EU) 2019/2088 only foresees the objective of comparability of product-level disclosures, seeming to acknowledge that achieving comparability of aggregated, entity-level disclosures is an extremely complex task and the use of sufficiently flexible templates is more appropriate at the product-level. Nevertheless, we do see potential merits in the approach proposed in Chapter II and Annex I and, to get closer to the ESAs’ objectives, we recommend limiting the number of mandatory indicators to a smaller subset of more generic metrics that are meaningful, relevant across different sectors and asset classes, and measurable with available data. We also maintain that any indicators chosen should be aligned with the “Do No Significant Harm” (DNSH) criteria and social safeguards already provided under the EU Taxonomy Regulation, as well as the information to be reported under the revised NFRD. Only indicators that cumulatively meet those conditions should be prescribed as mandatory.

According to a detailed analysis of the ESA’s proposal performed by our members, we would recommend limiting any mandatory disclosures to no more than six key indicators (e.g. four on environmental matters and two on social and employee matters), while all other indicators currently included in Table 1 should be made optional and moved to tables 2 and 3, respectively. The ESAs could consider the use of the following indicators on environmental matters:

- KPI 1 (carbon emissions, broken down by scope 1 and 2): Generally considered relevant for all assets. According to the feedback from our members, data for scope 3 emissions is often unavailable. Data providers offer assumptions on scope 3 emissions that vary greatly and do not
represent a suitable basis for the calculation of indicators to be compared by investors. Moreover, the issue of double-counting within scope 3 and between scope 2 and scope 3 emissions has not been sufficiently addressed yet.

• **KPI 2 (carbon footprint for scope 1 and 2 emissions):** Generally considered relevant for all assets. Calculation methodologies for scope 1 and 2 are established in the market but are asset class-specific. The suggested methodology, based on the investee company’s enterprise value, is not fully adequate for direct equity investments.

• **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.

With regards to social and employee matters, human rights, anti-corruption and anti-bribery matters, we note that the indicators proposed by the ESAs in this section are generally only applicable to investments in companies (cf. our remarks below), and are too granular to be assessed based on currently available ESG data. Therefore, as an alternative, we suggest using high-level mandatory KPIs to report on the relevant aspects of portfolio investments in companies, such as the following:

• **Non-signatories to the UN Global Compact:** share of investments in investee companies that have not committed to the UNGC principles.

• **Severe controversies/breaches of the UN Global Compact:** share of investments in investee companies that have been involved in severe violations of the UNGC principles.

To enhance the alignment between SFDR and the EU Taxonomy Regulation we would welcome reporting of breaches to the OECD Guidelines for Multinational Enterprises and UNGP on Business and Human Rights, including the ILO Declaration on Fundamental Principles and Rights at Work and the International Bill of Human Rights. However, breaches of the UNGC principles may effectively act as a proxy for many of these frameworks and the adherence to (or severe violations of) UNGC has been already measured by several ESG data providers since many years. Data on these aspects are therefore readily available on the market, although the interpretation of severe violations is not fully aligned yet.

**A reduced number of mandatory indicators would bring substantial benefits to end-investors,** who could otherwise be overwhelmed by too much information. The concept of PAI is entirely new to most market participants, including retail investors. A long list of quantitative indicators, presenting percentages and figures with regards to very specific aspects of investments, will likely place excessive strain on investors who will be struggling to understand the implications of entity-level disclosures and their individual investment in a fund. Consumer testing, in the context of UCITS KIID or the PRIIPs KID, demonstrates that investors tend to attach high importance to quantitative elements of disclosures while disregarding explanations. Any clarifications (e.g. on the limited relevance of certain indicators) is unlikely to be considered unless investors are already familiar with these general concepts. For these and other reasons mentioned above, it is highly preferable to start with a small number of generally relevant KPIs that are less prone to misinterpretations by investors.

This approach would be helpful for investee companies as well. Our members have already initiated discussions with European companies, to assess their preparedness in light of the upcoming need to gather data for screening in line with the provisions under SFDR. Companies seem unaware of the new
regulatory requirements and currently do not have the necessary data. For these reasons, we believe it is crucial to follow a phased approach, giving time to the markets to adjust and develop the necessary tools.

Finally, we would like to flag potential knock-on effects that the proposed PAI indicators would have on the manufacturers of financial products that are not in the scope of the SFDR. Although the indicators listed in Tables 2 and 3 are optional, the proposal requiring financial market participants (FMPs) to report on two indicators of choice might result in a situation where for all products that the product manufacturer sells to an FMP (even those that are not in the scope of SFDR, such as green bonds) the manufacturer will need to make available an analysis on all 50 principal adverse impact indicators, so that the FMP can choose among the 18 optional PAI indicators that they want to disclose. For example, product manufacturers usually do not know who is the end-investor for their structured products. Therefore, they will need to implement adequate systems and processes to retrieve the data from the investee companies for all types of products (even those outside of the scope of SFDR) and all 50 indicators, in case an FMP would buy them and require that information. Given the issues with ESG data availability, highlighted in this response, we think having to report on 50 indicators would be disproportionate and needs clarification from the ESAs on how the process would work from the manufacturing of a product to its distribution.

Question 2: 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?

We do not believe that the proposed approach is sufficiently proportionate, as not all financial market participants have the tools and resources to directly perform full due diligence on investee companies and they may have to obtain this information from third-party providers (who, in turn, rely on publicly available data). Similar proportionality concerns remain relevant even for larger companies, which must carry out this assessment on hundreds of funds and holdings, without being able to rely on automation or a scalable approach.

We also believe that the “Description of actions and engagement policies to address principal adverse sustainability impacts” and the section on “Engagement policies” in Arts. 8 and 9 RTS, respectively, go beyond the principles reflected in Art. 7(2) SFDR and lack proportionality. The draft RTS require an explanation of the reduction in principal adverse impacts achieved by the actions taken during the reference period and there is no corresponding requirement in the Level 1 text. We would like this requirement to be removed because it lacks proportionality and could prove highly unfeasible. We note it is based on the assumption that financial market participants are able to engage with all investee companies directly, before relying on third parties to obtain data on the PAI indicators listed. An asset manager’s holdings may span across thousands of investee companies. Fund managers do not have the resources to engage individually with all investee company on each of these PAI indicators. A manager may also be unable to assign specific outcomes to specific engagement activities.

The proposed approach also disregards different types of financial products and different investment strategies. In this regard, we note that the references to money market instruments in the draft RTS – beginning from Recital 20 – tend to exclude the latter as underlying assets for financial products intended to promote environmental or social objectives. We question this approach as such instruments should not be penalised only due to their shorter maturities. Money market instruments remain a vital source of short-term funding for corporate entities of all types, including those pursuing ambitious environmental or social objectives.

Finally, we highlight that the disclosure of adverse impacts is in principle on a comply-or-explain approach for smaller financial markets participants. We also note that many of the proposed indicators are not relevant for assets other than equities and corporate bonds (e.g. infrastructure, real estate).
Question 3: 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?

As mentioned in our response to Question 1, we strongly believe that the proposed indicators should be revised and reduced in number, while the focus to develop harmonised templates should be shifted to product-level disclosures.

In addition, some datapoints in Annex 1 are still subject to different interpretations. Different data providers are likely to use diverging definitions or ones that remain open to interpretation. This might especially be true for several social indicators. Moreover, it will not be possible to have the data properly audited.

Overall, as long as data is not normalized and formatted as a result of the forthcoming review of NFRD, and as long as there is a weak coverage of these indicators, the approach proposed in Chapter II is likely to result in inaccurate and potentially misleading information.

Question 4: Do you have any views on the reporting template provided in Table 1 of Annex I?

As mentioned above, we fear that the proposed approach would result in a box-ticking exercise and boilerplate disclosures, rather than providing meaningful information to clients. In our members’ approach, reporting is a dialogue with investors, where the goal should be to help them understand the underlying investment process, not a mere disclosure against a standardised list. In principle, our recommendations are intended to ensure that any proposed template meets the requirements of feasibility, ease of access, clarity, and comparability.

We also disagree with an obligation to use all the proposed indicators to every direct and indirect holding. In our view, entity-level disclosure of adverse impact on sustainability factors should focus on the disclosure of FMPs’ policies and practices in relation to adverse impact, following a more principle-based approach.

A more flexible approach would also allow a parent company to issue a single statement for all the subsidiaries within the group that apply the same due diligence process, as well as avoid duplication for entities that have both portfolio management and investment advice authorisation (thus falling under the requirements for both investors and advisers). Please refer to our response to Question 1 for more details.

With regards to the timing for reporting against the template, we note that, in a group of companies, our understanding is that subsidiaries with less than 500 employees will need to disclose their principal adverse impact statement (or their non-consideration of adverse impact) by 10 March 2021, while their parent companies with more than 500 employees are not required to do so until 30 June 2021. Generally, however, the subsidiaries will just adopt the policy implemented by the parent. We thus believe that financial market participants that are part of the group and are subject to Article 4 on a comply-or-explain basis, should have a deadline aligned with the timing of the disclosure of the rest of the group. It will not be proportionate to expect smaller subsidiaries to disclose ahead of their parent. We recommend adopting a flexible approach whereby parent companies are able to publish a single statement on the due diligence policies adopted by all subsidiaries in the group.

Question 5: 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 do not think that all indicators included in Annex I are equally relevant or meaningful metrics. For this reason, in our response to Question 1, we put forward a proposal to review the suggested indicators and reduce their number to a smaller subset of more generic metrics that are meaningful, relevant across different sectors and asset classes and measurable with available data.
We would also advise against the inclusion of forward-looking indicators. Although indicators such as emission reduction pathways or scope 4 emissions would help bring a future-oriented perspective to the entity level assessment, they fall outside of the scope of "principal adverse impact" reporting, which is limited to negative environmental impact. Moreover, credible and meaningful methodologies for a forward-looking analysis are not yet available; asset managers are striving to develop and implement these methodologies, but they are still facing the challenges to obtaining meaningful historical data and note that forward-looking indicators would risk being mostly speculative.

We would also like to share with the ESAs more general considerations associated with the choice of indicators. Generally speaking, "principal adverse impact" must include a concept of materiality ("principal") and a notion of “significant harm”. In our view, neither of these principles are properly reflected in the proposed indicators. They fail to establish a link with the concept of “Do No Significant Harm” as defined by the Technical Expert Group under the EU Taxonomy Regulation.

The main issue remains the lack of ESG disclosures by investee companies. Even after the review of NFRD takes effect (it will take at least two to three years before enhanced disclosures under NFRD can be reasonably expected) the challenge will remain to obtain data on non-EU holdings. To cope with the ESG data gap, and limit the reliance on third-party providers, we would welcome more clarity and flexibility on the use of qualitative information and estimations. As a first step, we would recommend the EC to perform a survey to identify, for each indicator (i) whether it is available, (ii) whether it is based on direct company disclosures or estimates and (iii) what information is considered useful by financial market participants and end-investors. We would suggest prioritising climate-related indicators (i.e., GHG emissions). Other indicators (e.g. on biodiversity) could be phased-in once the EU Taxonomy is finalised and once the corresponding information is publicly available.

Some of the proposed indicators are useful as a standard (e.g. the existence of social policies) but they would not be relevant from an adverse impact assessment perspective. For an asset manager, the relevant consideration is not whether a company has a certain policy in place but to understand the way the policy is implemented and how effective it is. The risks, for instance, of corruption or slavery depend to a large extent on the context in which a company operates, including the geographic location and the type of industry. Therefore, indicators cannot be applied to all companies in the same manner in the way that the RTS propose. For instance, the absence of a certain policy may not automatically mean an adverse impact is caused – let alone be sufficient to constitute a "principal" adverse impact. Conversely, even if there is a policy in place, not all possible adverse impacts can be excluded. The outcome of the assessment of some indicators could be misleading and depend on factors which are beyond the investee company's actual practices. For instance, the indicator of a “number of convictions and amount of fines for violation of anti-corruption and anti-bribery laws” will also be determined by the robustness of the judiciary system in a country and not necessarily only by the practice of a company.

Finally, we note that other indicators may be useful – depending on the type of company and the context – to capture the nuances of companies’ sustainability practices. For instance, some asset managers engage with companies on their advocacy campaign in relation to their government’s climate change policies. While we do not suggest adding advocacy practices to the list, we aim at demonstrating that flexibility is needed, that the use of indicators should be optional, and that the indicators’ list should not be exclusive.

Question 6: 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?

While the inclusion of more ambitious carbon emissions indicators than those currently disclosed may encourage enhanced reporting, we would refrain from 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.

In particular, we note that the proposed formula includes scope 3 emissions, while, at this stage, the corresponding data reported by companies is largely missing. The inclusion of scope 3 emissions into the formula may result in a flawed outcome. Rather than including an overly restrictive formula, we strongly suggest having a formula in place which refers to international market standards on the calculation of carbon footprint, such as TCFD, PCAF etc., at least at the beginning of the application of SFDR. Subject to market developments, a tighter formula for calculating carbon footprint may evolve.

Question 7: 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?

We fear that this proposal would duplicate metrics on the same factors, making disclosures unnecessarily complex and potentially misleading end-investors. The concept of PAI is new to market participants, including retail investors. A long list of quantitative indicators on specific aspects of the investments would likely overwhelm end-investors, already struggling to understand the implications of entity-level disclosures for their individual investment in a fund. This problem will only be further exacerbated if two different percentages (regarding different reference values) are disclosed for one KPI.

To provide meaningful disclosures for end-investors, we do not agree with the proposal to require 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. In the latter case, it is unclear whether there is a requirement to look through indirect investments when making the disclosures, although this might be difficult for funds of funds (particularly if one of the underlying funds is not subject to the same EU regulation). One consistent metric should be prescribed for the calculations of mandatory and optional KPIs.

We believe that one measurement is sufficient, to be performed, depending on the indicators, either as a percentage of the aggregate investments or the share of the investee companies (the latter to be preferred in cases where the policies in place are to be considered).

Question 8: 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?

Given the insufficient availability of ESG data on investee companies, necessary for preparing disclosures by financial market participants, it appears premature to mandate the use of more advanced indicators or metrics. We also note that metrics such as “avoided emissions” are largely a theoretical concept and their calculation is heavily dependent on the assumptions used in that calculation. Hence, these advanced metrics are prone to greenwashing if not backed by solid data.

Instead, we suggest starting with the inclusion of fewer indicators associated with more widely available information (i.e. carbon footprint) and only include more advanced indicators subject to the availability of underlying data. Such indicators and metrics could be kept optional, and used by financial market participants who wish to provide more context to any adverse impact.

We also note that indicators capturing activities by investee companies to reduce GHG emissions would measure the positive contribution of a company’s activities. While this seems to go beyond the scope and general concept of principal adverse impact, and should not be linked with it, we do believe that some indicators could be formulated positively and used as sustainability indicators (i.e. for Article 9 products under Art. 27 of the draft RTS).
Question 9: 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 share the ESAs and the Commission’s goal to enhance the reporting of social and employee matters, respect for human rights, anti-corruption, and anti-bribery matters. However, asset managers still face a lack of information needed to produce such disclosures, and the ESG data gap is especially acute concerning ‘social’ matters.

The analysis conducted by our members indicates the scarcity of ESG data associated with the detailed indicators currently proposed, since such indicators are not reported separately by companies. On the other hand, most issues deemed relevant in this respect are already covered by the UN Global Compact Principles, on which data are widely available. Therefore, we recommend starting with the following high-level mandatory KPIs to report on the relevant aspects of portfolio investments in companies:

- **Non-signatories to the UN Global Compact**: share of investments in investee companies that have not committed to the UNGC principles.

- **Severe controversies/breaches of the UN Global Compact**: share of investments in investee companies that have been involved in severe violations of the UNGC principles.

Accordingly, we suggest that the indicators proposed by the ESAs in table 1 (KPIs 17 to 32) should be made optional and moved to tables 2 and 3, respectively. This list of mandatory indicators could be subject to a review in a couple of years, after the implementation of a reviewed NFRD. Meanwhile, the ESAs could envisage that market participants will have to explain their choice of indicators.

Question 10: 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 do not agree with the proposed timeframe for the historical comparison: we question its usefulness and we believe it would go beyond the provisions in the Level 1 text. Given the significance of this proposal, it cannot be considered a purely technical specification within the remit of what the RTS can prescribe.

This is also relevant to the historical comparisons in periodic reports for Article 8 and 9 products as proposed by the ESAs in Art. 51 of the draft RTS. Also, in this respect, we believe that the approach taken by the ESAs in the consultation paper goes beyond the mandate under SFDR.

As they are associated with the performance of funds, we believe that historical comparisons should cover a maximum period of either three or five years. This would better reflect the ESG profile of companies, especially those in transition. In a rapidly evolving ESG space, we also note that a ten-years’ period would require to draw a comparison of data that are not comparable, due to potential differences in the context in which they were gathered or the methodology used to analyse them.

In particular, we would recommend removing the reference to an “average” in reporting performance, unless the RTS establish a methodology for calculation of such an “average”. We also note that the reporting on charges and fees seems to go beyond the remits of Level 1 provisions and introduces cost reporting methodology considerations which are not addressed in the RTS.

Moreover, absolute historical figures do not provide any information to investors about the actual impact of investments. For instance, if the carbon footprint of investments decreases but overall AUM increases, the impact disclosed will increase year-over-year.
Question 11: 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 believe that the approach proposed by ESAs is already overly prescriptive and might result in confusing disclosures to end-investors. We strongly suggest providing a more flexible approach. We do not agree with the approach suggested by the ESAs to calculate PAI over the entire reference period with regards to all investments at the entity level. Such approach prescribing for a continuous calculation of indicators across the aggregated holdings would not only be too onerous, but we question its practical feasibility.

Many asset managers manage 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 several 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). Calculation of the PAI indicators across all the aggregated holdings cannot be reasonably required on a daily, weekly, or even monthly basis. Moreover, the entity-level PAI disclosures will not provide meaningful insights on how it affects a fund that a client may be considering. Given this limited added-value to support investment decisions, it is even more important that the entity-level disclosures minimise the resulting compliance burdens.

Instead, we would suggest providing for specific reference date(s). We believe that the ‘year-end’ would be a sensible reference date for the calculations on the composition of holdings, given that investee companies disclose ESG data on annual basis and as the PAI indicators are to be disclosed once a year for the preceding calendar year. Since the relevant ESG data for calculation of PAI indicators is scarce, often outdated and unlikely to be reported more frequently than once a year even following the envisaged NFRD review, annual calculations should be considered sufficient.

In case the ESAs would nevertheless see the necessity for more frequent calculations, we would suggest that they are 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 more than sufficient to address any “window dressing” concerns, as any reallocation of portfolio holdings entails transaction costs and directly reduces the net performance of financial products. Quarterly aggregation of portfolio holdings should be considered the maximum requirement for proportionality reasons. Should the ESAs take up this suggestion, we recommend clarifying that quarterly calculations only apply to determine portfolio composition, while the calculation of PAI indicators can be performed once a year based on the weighted average holdings using the most recent data.

Question 12: Do you agree with the approach to have mandatory (1) pre-contractual and (2) periodic templates for financial products?

While for retail investors, we see some merits in having mandatory pre-contractual and periodic templates to enhance the comparability of financial products, we highlight the need for sufficient flexibility to capture ESG considerations in a way that accurately reflects the funds’ characteristics, assets and strategies. Moreover, as the templates have not been developed yet, we are unable to provide a clear yes/no reply to this question.

Shall the ESAs decide to launch the development of such templates, we believe they should be coherent with client disclosures under other EU rules, like PRIIPs (e.g. its space constraints). We suggest to carefully consider how to best fit this proposal within the existing EU framework for disclosures and provide for a simple and practical solution. In this regard, we would support the inclusion of a template in the existing documentation as perhaps this is the easiest approach to meet the requirements (rather than
making changes to the existing disclosures within the investment objective/policy sections of the fund documentation).

We would also like to highlight that while mandatory templates can be useful for retail investors, they are not needed and unlikely to respond to the needs of institutional clients. Professional clients need tailored information (including in the way they are presented). This information, in turn, is processed to fulfil their own reporting requirements, such as those of insurance providers and pension funds. Standardised templates, developed with retail investors in mind, would not be valuable to professional investors, who would still need to request specific ESG information directly from asset managers. Therefore, we recommend that the use of mandatory templates for pre-contractual and periodic disclosures be limited to products foreseen for public distribution (i.e. to retail investors). For other products, especially those targeted to professional investors only (as defined in MiFID II and IDD), disclosures in accordance with the templates should be optional. In any case, the content of regulatory disclosures should be provided in the RTS to enable their implementation without the templates.

We would also like to take this opportunity to highlight some of the timeline issues associated with product disclosures. While there is a major challenge regarding the overall application timeline due to Level 1 application dates, there is another timeline challenge associated with the reporting of periodic information. While we very much support the approach reflected in Art 51 or the draft RTS, we have received some mixed signals during the ESAs public hearing on ESG disclosures held on 2 July 2020. Therefore, we seek clarification as to whether our understanding is correct, with particular reference to funds with specific year-end. In case of a fund with a year-end on 31 December, the report issued beginning of 2022 will cover the period from 1 January 2021 to 31 December 2021, covering a period prior to the SFDR implementation. The situation is even more difficult for funds with a year-end 30/09 issuing its 30/09/21 annual report beginning of 2022. Based on Recital 32 SFDR, we understand that Art. 20(3) has foreseen a different start date for the periodic reporting to ensure that the periodic report requirements will apply to a full year after the SFDR implementation date. We thus suggest clarifying this in the final draft RTS using some commonly used language e.g. as in the Accounting Directive “Articles 36 to 52 shall apply to periodic reports covering reporting periods starting on or after 1 January 2022”.

Regarding the general timeline issues, we understand that the ESAs will publish the final draft RTS by the end of 2020 at the earliest. Depending on whether this can be expected by the end of 2020 or by the end of January 2021, market participants will have only 5 to 9 weeks to carry out a legal assessment and operational and technical implementation of the new rules. This is a very challenging situation not only for financial market participants, who are unlikely to be able to provide properly adapted pre-contractual disclosures by 10 March 2021, but also for:

- National Competent Authorities (NCAs), who will need to approve hundreds or even thousands for prospectuses over 2-3 weeks; and

- End-investors, who will face at least three rounds of adjustments to pre-contractual information. This is likely to result in information overload, and possibly confuse especially retail investors.

This would be further exacerbated in case of mandatory templates, as they are likely to add complexity to the process. For example, to meet the 10 March 2021 deadline, asset managers will need to submit the updated prospectuses to respective authorities by September-November 2020. Meanwhile, our understanding is that the final draft RTS will not be available at that time yet.

In many Member States, amendments to fund prospectuses and, in some Member States, also marketing materials, need to be submitted to the NCAs for approval before they can be used at the point of sale. Such approval usually takes several weeks. However, as in this case the NCAs are likely to be overloaded with hundreds or even thousands of fund prospectuses, this process may take much longer. Moreover,
we expect most regulators will not approve a prospectus until the RTS are in force – which is unlikely to happen before June or July 2021. As a result, prospectuses approvals are likely to be halted and the sale of products interrupted for several months.

We therefore **strongly support the ESAs’ recommendation to revise the Level 1 application date**. An extension of the application date to, at least, 1 January 2022 would give market participants a much more manageable timeline and would provide for alignment with the application date of the first set of the EU Taxonomy-related disclosures. It would also result in more consistency with other sustainable finance rules, such as the integration of sustainability considerations in the UCITS/AIFMD and Solvency II frameworks (expected to become effective by the end 2021, with a transitional period of 11 and 12 months, respectively). This way we would ensure that the requirement to provide for the disclosures does not pre-empt the actual requirement to consider sustainability risks and principal adverse impact.

If a Level 1 timeline adjustment was however not possible, as a minimum we suggest that the ESAs start involving NCAs already at this stage of finalisation of the RTS to reduce to a minimum any backlogs and delays in approvals of prospectuses and other regulated documents.

**Question 13: If the ESAs develop such pre-contractual and periodic templates, what elements should the ESAs include and how should they be formatted?**

To ensure that pre-contractual and periodic disclosures provide for comparable information on a wide range of products and investment strategies, we would recommend avoiding a prescriptive list. We also note that sustainable investment objectives, strategies and indicators closely relate to each other. Presenting them under different headings could make the description overly complex and too difficult to be understood by retail investors. We would therefore appreciate more flexibility with respect to the presentation of the required information in the templates. Instead, we believe that pre-contractual and periodic disclosures should:

- Ensure enough flexibility to capture investment products’ broad range of different strategies, underlying assets, investment horizons, etc.
- Contain information on the strategy adopted to promote ESG characteristics or to pursue sustainable investment objectives.
- Refer to the investment process. That is, whether products integrate ESG considerations, make use of exclusions, set investment constraints, adopt best-in-class strategies, etc.

As we indicate in our reply to the previous question, we suggest that the templates are developed as part of the existing funds’ documentation, rather than as new documents. However, the provisions should be practically thought-through and well-aligned with other key client disclosures, such as the UCITS KIID and its space constraints. More generally, for information requested in templates for pre-contractual disclosures, more guidance would be useful with respect to whether and to what extent references to websites containing the required information will be accepted.

We also believe that money market instruments (MMI) should not be singled out in the disclosure and that the reference to money market instruments should be removed from Recital 20 and Arts. 15, 24, 41 and 49. Indeed, the text seems to suggest that MMI cannot contribute to the specific environmental or social characteristics promoted by the product as any other instrument. We believe, instead, that all instruments can allocate capital to sustainable projects even though all don’t have the same type of impact. As an example, the French state SRI label recognises this and numerous money market funds (who invest in MMI in compliance with the European Money Market Fund Regulation) are SRI labelled. It would be counterproductive and inefficient from an economic perspective to leave some aside, as they all play a role in financing a more sustainable economy. Diversification of instruments is of utmost
importance to accompany the transition. In the case of MMI, we highlight that they play a very important part to finance on, over the long term, the short end of the curve. It should be recognised that these instruments are held perpetually in money market funds (by being repeatedly rolled over) so that they continuously finance the economy (corporates and banks for instance). Therefore, we propose to delete the reference to MMI and to replace it by “or are cash held as ancillary liquidity”.

**Question 14:** 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.

To ensure that pre-contractual and periodic templates provide for comparable information on a wide range of products and investment strategies, we would recommend avoiding a prescriptive list. Instead, we believe that the templates should ensure enough flexibility to capture investment products’ broad range of different strategies, underlying assets, investment horizons, etc.

We would also propose a twofold approach, whereby standardised templates are mandatory for products made available to retail investors and optional for products exclusively intended to professional investors. As outlined in our response to Question 12, this approach would ensure that retail investors can easily compare products, while professional investors can prioritise access to tailored information suited to their specific needs.

**Question 15:** 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?

We believe that pre-contractual disclosures should provide valuable information to guide investors’ choices and initial decisions. Pre-contractual disclosures include information relevant at the time of distribution of the financial product. Website disclosures, on the other hand, can be adapted more easily. Therefore, websites are much better suited to include information that has elements of uncertainty and/or requires frequent updates. This would avoid too frequent changes of pre-contractual documents and thus would result in more reliable and up-to-date information on the portfolio composition for end-investors and avoid unnecessary costs.

To improve the balance of information between pre-contractual and website information requirements, we recommend moving the graphical representation of the investments of the product, proposed under Art. 15 (2) and Art. 24 (2) of the draft RTS, to website disclosures, while providing only a general description in the pre-contractual information. Fund managers would find it challenging to determine in advance the exact proportion of investments allocated to specific assets across different sectors and sub-sectors, especially considering changes to portfolio composition over time.

With regards to website disclosures, we would advise against the requirement to publish a summary document in the format of maximum two sides of A4-sized paper, effectively creating an “ESG KIID”. Article 10(1) SFDR already states that information shall be provided in a clear, succinct, and understandable manner. To ensure that the transparency requirements for website disclosures are not overly complex, the ESAs should remove this proposal that would result in a duplication of information in an additional summary. To be useful, disclosures for retail investors should be simple, concise, and easily accessible. We would rather advise reducing the complexity of the contents of website disclosures, instead of providing for yet another document to come on top of the existing disclosures. In case the ESAs were to keep the obligation to provide a summary, we would suggest to 1) restrict the obligation to provide the “summary” for products that are sold to retail investors only (professional investors rely on differently tailored information and would not find such a summary valuable), and 2) remove the obligation to publish the summary in a language customary in the sphere of international finance in case products are distributed only in one country.
Article 8 and Article 9 products also include tailor-made private funds and portfolios managed on a discretionary basis set up under bilateral agreements protected by confidentiality requirements. These products are not widely distributed, and disclosures should not be available publicly. Therefore, we believe that disclosures under Article 33 RTS, in the case of products that are not publicly distributed, shall be provided directly to investors.

Question 16: 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.

While we acknowledge the limitations of the ESAs mandate, we strongly believe that more clarity is needed on the delineation between Article 8 and Article 9 products. Moreover, we fear that the draft delegated regulation on the integration of sustainability considerations under MiFID II and IDD may further contribute to the ambiguity. Such ambiguity creates major operational concerns for fund managers and distributors, which are likely to result in an uneven application of the new rules. This would undermine the objective to enhance comparability for end-investors. Instead, it risks confusing, or even misleading, end-investors. Our understanding is that, while the distinct feature of Art. 9 products is that they have sustainable investment objectives (defined under SFDR as whose with a particular environmental or social impact), SFDR intentionally framed a wider scope for Art. 8 products, to capture investments with broader environmental and social characteristics and different level of ambition.

An explicit reference to sustainable investment into Art. 8 products will blur the lines between the two categories and drastically reduce the likelihood that non-impact funds (that do however integrate ESG considerations) will be able to qualify under Art. 8. Ultimately, this will limit investors’ choice for sustainable investments, undermining the objectives of SFDR and, possibly, the Sustainable Finance Action Plan’s goal to redirect financial flows into more sustainable activities. For these reasons, we would like to highlight some of the challenges related to the definition of Art. 8 and Art. 9 products that are linked to, or could be remedied in the RTS:

1. Introduce amendments to Recital 21 to ensure clarity and avoid green-washing

While it is useful for Art. 8 to provide for a broader category that could capture various existing industry ESG-related strategies it is not helpful, neither to end-investors nor the industry, to end up in a situation where a simple ESG integration or a firm-wide exclusion would result in categorising all funds of a particular FMP as Art. 8 products. While we appreciate the intention of Recital 21 to clarify what triggers Art. 8 disclosure obligations, we question whether linking it with the information on ESG characteristics provided in marketing and regulatory disclosures is the best way forward. Often, even firm-wide exclusions or simple ESG integration are required to be disclosed in the regulatory documents. Some firms choose to have certain firm-level exclusions and, if all funds of a particular FMP were to be considered Art. 8 or 9 products, disclosures could mislead end-investors and might be perceived as green-washing.

We would therefore recommend amending Recital 21 as follows:

- **Remove the direct link to the regulatory documents** and, instead, ensure flexibility by emphasising that Art. 8 disclosures should be triggered when a financial product is marketed as featuring the integration of discernible ESG characteristics affecting its strategy and

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1 It is also important to note a distinction between regulatory documents (e.g. prospectus) and marketing material. In some Member States, marketing material is pre-approved. While an explicit reference to ESG characteristics in a marketing material could possibly be considered the expression of an intent to promote the product as sustainable, this is not necessarily the case for regulated information subject to strict regulatory requirements. However, it should be noted that in some countries marketing materials also need to follow certain rules.
composition;

- Clarify that firm-wide ESG policies or exclusions should not by default qualify all of the entity’s products as an Art. 8 product.

2. Remove the provisions requiring to disclose the proportion of sustainable investments in case of Art. 8 products

Art. 15 (2)(a)(i) of draft RTS requires to illustrate the planned proportion of sustainable investments of Article 8 products in the pre-contractual information and to report on the proportion of sustainable investments in periodic reports. However, Level 1 refers only to sustainable investments in case of Art. 9 products. Therefore, we do not believe that Art. 8 products can commit to a certain proportion of sustainable investments in the pre-contractual disclosures. Moreover, given there is no requirement that the portfolios of Article 9 products should entirely consist of sustainable investments, the proposal by the ESAs would even further blur the distinction between Art.8 and Art. 9 products. We thus suggest removing this provision or, at least, to clarify that the proposed graphical representation of sustainable investments for Article 8 products should only apply “where relevant”.

Another inconsistency arises from the obligation to disclose the percentage of ‘sustainable investments’ in Art. 8 products. This is, a portfolio investment must either be disclosed as a sustainable investment or as an investment aligned with the environmental or social characteristic. Specifically, Art. 15(2) RTS states that (a) the planned proportion of investments that are sustainable investments must be provided; and, (b) the total investments, other than those that are sustainable investments, that contribute to the E/S characteristics, must be cited.

We think that this is misleading as the sustainable investments within an Art. 8 product may also be aligned with the environmental or social characteristics. As a result, an investor may consider that an Art. 8 product with a high proportion of sustainable investments is not well aligned with the environmental or social characteristics that the investor wants to invest in. As drafted, the current approach is binary. Instead, disclosures should be allowed under both categories where the investment fulfils both the environmental or social characteristics and the ‘sustainable investment’ criteria. We therefore highly recommend removing the provisions requiring to disclose the proportion of sustainable investments in case of Art. 8 products.

Another way forward would be for the ESAs to further explore (possibly through recitals) the concept of an ‘objective’ which lies at the core of both the definition of an article 9 product and that of a “sustainable investment” under SFDR. According to the Level 1, it seems that there is no such a thing as a “sustainable investment” per se: a sustainable investment is always defined in connection to an objective which needs to be set ex-ante and measured ex-post. Mandating Art. 8 products to disclose their share of “sustainable investment” is therefore counter-intuitive, as Art. 8 products are not defined as those that have a sustainable investment objective. We would also like to draw the ESAs’ attention to Art. 38 RTS which refers to “no significant harm to sustainable investment objectives” although it relates to Article 8 products which again does not seem in line with Level 1.

3. Remove the potentially misleading warning proposed in Art. 16 (1) of the draft RTS

Recital 18 to the draft RTS acknowledges that there is a wide variety of ESG investment strategies including “best in class” approaches, exclusions, engagement on ESG matters, and others that shall not be further restricted by the regulation.

Based on the draft RTS, all those strategies, which we understand would qualify as products under Art. 8, must include criteria for selecting investments to attain environmental or social characteristics (Art. 17a of the draft RTS) which shall be measured by sustainability indicators to be disclosed to investors as
part of pre-contractual information (Art. 18 of the draft RTS). Information about to what extent these characteristics were attained, including the performance of the sustainability indicators used, shall be disclosed to investors each year as part of the periodic reports (Art. 37(1)(a) of the draft RTS). Furthermore, historical comparisons about the level of attainment of environmental or social characteristics during the lifetime of a product should be provided (Art. 37(1)(b), (2) of the draft RTS).

Therefore, we believe that Art. 8 products, following such strict requirements and providing such detailed disclosures, should not be required to provide any kind of warning. While it is true that Art. 8 products are intended as products pursuing sustainable investment as their objective, any such warning is likely to be misunderstood by end-investors that are likely not to be familiar with the nuances of legal definitions.

4. Remove the requirement to reference EU Climate Benchmarks for Article 9 products that have carbon emissions reduction as their objective

Articles 31, 35 and 48 of the draft RTS suggest that, as long as an EU Climate Benchmark is available, its use for Art. 9 products having carbon emissions reduction as their objective is mandatory. As a limitation to this approach, we note that EU CTBs are only relevant when the portfolio is composed of a diversified pool of assets and companies. The TEG recognizes that the methodology would not work for cleantech benchmark and it would only apply to equities and bonds since there are no widely used benchmarks for most private assets that are likely to be included in Art. 9 products (e.g. infrastructure investment). Moreover, we also note that benchmarks are based on backwards-looking data, whereas our focus lies on future carbon emission reduction targets of investee companies. We, therefore, believe that the RTS should not mandate the use of specific benchmarks. Instead, we suggest that funds, which have a carbon reduction objective, should disclose whether they use an EU CTB and, if not, they should explain why they have chosen another benchmark or no benchmark at all.

The draft RTS further states that where EU Climate Benchmarks are not available, financial market participants “shall explain how the financial product complies with the methodological requirements set out in Articles 19a [EU Climate Transition Benchmarks and EU Paris-aligned Benchmarks], 19b [Requirements for EU Climate Transition Benchmarks] and 19c [Exclusions for Paris-aligned Benchmarks] of Regulation (EU) 2016/1011”. Recently adopted Delegated Regulation on minimum standards for EU Climate Transition benchmarks and EU Paris-aligned benchmarks, in Article 12, provide for exclusions for Paris-aligned Benchmarks. Thus, we understand that products qualifying under Article 9 SFDR, having carbon emissions reduction as their objective, shall exclude from their investments companies listed in paragraphs 1 and 2 of Article 12 of the Delegated Regulation on Climate Benchmarks.

Apart from being very prescriptive, this would exclude companies in transition which need finance to carry out this process. Meanwhile, a fund that has the target to reduce carbon emissions by supporting the transition, may be invested in companies that do not yet meet the desired standards and therefore are likely to fall under the list of companies mentioned under Article 12 of the Delegated Regulation on minimum standards for EU Climate Transition benchmarks and EU Paris-aligned benchmarks. We think it would be counterproductive to the objectives of the EU Green Deal to exclude such companies. We also note that the EU Climate Benchmark could not be used by a fund that pursues social objectives, alongside climate objectives.

Question 17: Do the graphical and narrative descriptions of investment proportions capture indirect investments sufficiently?

We don’t agree with the suggested description of investment proportions via a graphical representation that splits total investments between the proportions that are sustainable (or contribute to the attainment of the environmental or social characteristics promoted by the financial product) and the rest of them. Such split risks being misleading for the investor that would need to further differentiate and understand
how different investments relate to the overall strategy of the fund. This would be particularly tricky for investments used for hedging, related to money market instruments, etc.

The description of investment proportions should specify what the fund intends to do (e.g. invest in 20% of sustainable assets), not necessarily what the fund will do. It is important to ensure enough flexibility to adapt this description to changing market conditions, as in the case of active funds. For indirect investments, we believe that disclosures should be limited to narrative descriptions, as preparers of disclosures would experience practical issues in generating look-through graphical representations. We also note that graphical representations could be misleading if interpreted as a binding commitment, rather than as an indicative parameter. We would also suggest including this field in website disclosures, which are much more easily adaptable.

Question 18: 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?

As we highlight in our replies to other questions of this consultation, graphical representations can be useful to illustrate only some investment strategies, for instance, to present a share of the sustainable investment in the portfolio of Art. 8 products. For products using positive ESG criteria in their asset selection process, such comparable disclosures may work well. However, for other strategies, it might be challenging, if not meaningless or misleading. In case of exclusions (negative screening), indicating the percentage reduction of the investable universe might be a more meaningful representation than a graphical one. Therefore, further clarification should be provided on how to apply the graphical illustration for products relying on negative screening (exclusions). Given that exclusions are meant to reach 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. When an integration or best in class approaches are applied, the share of the portfolio that promotes E&S characteristics could potentially be 100%, although this could confuse the investor and further blur the distinction between an Art. 8 from an Art. 9 product.

Therefore, we think a graphical representation should be optional: it should be at the discretion of the FMP to decide whether to use a graphical representation and what type. Moreover, investors should be able to relate the graphical illustration to the relevant investment strategy. To improve investors’ understanding, we recommend providing information on the investment strategy and its specific implementation in the investment process to accompany the graphical representation. We think it would be useful to provide 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.

Question 19: 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?

While we do not believe that fossil-fuel sectors should be singled out, we do see merits in the use of indicators capturing exposure to companies with a significant share of revenues from fossil fuels. However, this requirement should apply 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 to whole countries or even sub-sovereign issuers. Also, for other assets such as real estate, this information should not be relevant. We also note that the provisions in the RTS should not discourage investments needed by companies in fossil-fuel sectors to support their
transition towards more sustainable means of production, minimising the risk of stranded assets or unintended consequences on social and employee matters.

We have no further suggestions to include other sectors; we would leave any consideration related to nuclear energy to the scientific assessment being performed by the Commission.

**Question 20:** Do the product disclosure rules take sufficient account of the differences between products, such as multi-option products or portfolio management products?

We believe that product disclosure rules should better consider the following differences:

**Differences between investor type**

The ESAs proposals seem to primarily focus on products distributed in the retail market, and therefore corresponding to the retail investors' needs for simple, easy-to-visualise and comparable disclosures. However, such disclosures are inappropriate for professional investors. Professional investors usually need appropriately tailored information. This need is among others driven by their respective regulatory requirements (e.g. in case of insurance companies and pension funds).

We, therefore, recommend that in case of products sold exclusively to professional investors, not subject to public distribution, **standardised disclosures in accordance with templates** (Art. 14, 23, 36 and 43 of the draft RTS) **should be only optional and a requirement to provide a “summary” of the website disclosures** (Art. 34 (1)(a) and 35 (1)(a) of the draft RTS) **removed.** Moreover, providing website disclosures in a separate password-protected area of the website should be allowed.

**Differences between individual portfolios**

Art. 2 (12)(a) SFDR defines managed portfolios as financial products. This creates problems for financial market participants that offer portfolio management services. To reduce these challenges and make implementation feasible, we suggest to:

- When standardised portfolio management solutions, based on model portfolios that suit clients with different risk tolerance profiles, are offered to retail clients, we recommend providing e.g. general website disclosures based on the standardised portfolio solution instead of references to each portfolio managed for a specific client. This could be clarified through a recital in the RTS.

- For individual portfolios managed for professional investors, standardised disclosures developed for retail clients would be inappropriate. Please refer to our comments above requesting further differentiation of the disclosures depending on the investor type.

**Question 21:** 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 investment 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?

No, we do not agree that the requirements in the RTS for good governance practices for Article 8 products should capture the elements specified in Article 2(17) SFDR. Proposals at EU level for the development of sustainable governance standards are expected next year. Meanwhile, currently, there is no common reference about “good governance practices”, and rules regarding governance and company law are largely national. Also, quantifiable data in this area is still largely missing. Furthermore, such an approach would amount to “gold-plating” the definition of Art. 8 products and further blur the distinction between Art.
8 and Art. 9 products. We suggest the focus be placed on “sustainable investments” and, therefore, only products pursuing sustainable investments should meet a higher bar.

Question 22: 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?

In our view, the approach proposed by the ESAs in the draft RTS regarding the “do no significant harm” (DNSH) principle is likely to result in inconsistencies with the DNSH criteria in the EU Taxonomy and, in particular, the ongoing development of the screening criteria for the remaining economic activities.

We understand that the consideration of DNSH based on the indicators for adverse impact, proposed in the draft RTS, should apply at the investment, meaning the investee company, level. This is different than the approach taken by the EU Taxonomy Regulation where the consideration is at the level of the economic activity.

In case of products that invest directly in companies, meaning in all of their activities, the need to pass the EU Taxonomy test on specific economic activities is still understandable, while later on there has to be another test at the investee company level to see whether all its activities pass the DNSH test under Article 2(17) SFDR. However, we believe that such “double” test should not be applied in case of products directly financing economic activities in line with the EU Taxonomy, e.g. green bond funds that contribute to the financing of Taxonomy-compliant projects, or real estate funds investing in “green” buildings in line with the EU Taxonomy. This is particularly relevant for the environmental DNSH criteria under the EU Taxonomy. However, it should be also considered for the social criteria that under the EU Taxonomy exists in the form of the minimum social safeguards. Otherwise, the approach would defeat the purpose of the EU Taxonomy to define a classification system for environmentally sustainable investments.

Therefore, we recommend clarifying that for direct investments in environmentally sustainable economic activities in line with the EU Taxonomy, consideration of DNSH is already part of the EU Taxonomy criteria and such investments are exempted from further testing against the adverse impact indicators.

Overall, we believe it very important to ensure full consistency between DNSH under SFRD with the DNSH test under the EU Taxonomy. However, we note the difference between the definition of “DNSH” in the EU Taxonomy Level 1 text (Art. 17) – well-reflecting the principle of materiality – and the proposals provided in the screening criteria. The Level 1 definition is appropriate to cater for both activity- and entity-level disclosures.

At the same time, we would like to highlight that the PAI indicators proposed by the ESAs are not aligned with the approach provided for in the EU Taxonomy. This could result in regulatory incoherence and run counter to the objective of the EU Taxonomy to create a widely used classification system for defining environmentally sustainable activities.

We, therefore, strongly recommend that the ESAs pursue “Policy option 1.1: High level policy commitment on assessment of significant harm” instead of Policy option 1.2, providing for a detailed assessment of significant harm of investments including any own thresholds set.

Question 23: 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 opportunity to disclose the use of such strategies, where relevant? If yes, how would you define such widely used strategies?
No, we do not see merits in defining widely used ESG investment strategies, as market practices evolve rapidly and rigid definitions might have the unintended effect to limit innovative approaches to ESG investment. However, we would welcome more clarity on the relevance of ESG factors for the investment strategy of Art. 8 products and what can qualify as an ESG characteristic under SFRD.

To help firms consistently communicate what their strategy is and how they take into account sustainability considerations, the RTS could refer to the existing frameworks that have been formed through industry consensus-building. One such example is the EFAMA report on Responsible Investment of 2016 where, starting from page 18, we explain different sustainable investment strategies. There are similar or even more elaborate initiatives/frameworks at national level e.g. IAR Responsible Investment Framework.

Question 24: Do you agree with the approach on the disclosure of financial products’ top investments?

We agree in principle with the approach proposed in Articles 39 and 46 of the draft RTS on the disclosure of financial products’ top investments in periodic disclosures and in particular, regarding the number of lines to be disclosed. However, we question the choice of 25 top investments as, currently, the industry-standard practice is to disclose the top 10 investments in the case of retail products, while confidentiality requirements may prevent this disclosure altogether in the case of products intended to institutional investors. We are not convinced that the extra 15 investments would be helpful to investors or whether they would result in information overload.

Moreover, instead of disclosing an average, which would be burdensome, potentially misleading and with questionable merits for end-investors, we would rather suggest reporting on D-day, based on the relevant reporting period end-date, which is consistent with the requirements under UCITS and AIFMD. It is hard to imagine asset managers changing the composition of funds before the D-day to improve the disclosures. This would increase transaction costs and, in turn, drive down the financial performance and diverge from the agreed investment strategy, running counter to asset managers’ fiduciary duty.

Question 25: 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.

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 disclosure 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 disclosures under Article 17.

As explained in our response to Q 15, we have a general preference for website disclosures, especially in case of information that is subject to frequent changes or uncertain in the pre-contractual context (at

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2 https://www.efama.org/Publications/EFAMA_Responsible%20Investment%20Report_Sep%202016.pdf
the time of a product launch). Moreover, to provide investors with succinct pre-contractual information, lengthier descriptions of internal processes could be moved to the website.

a) This item can remain in pre-contractual disclosures, although we highlight that such a requirement should always be voluntary, as it depends on the specifications of the investment product.

b) This item should be disclosed on the website instead. As the work for the development and harmonisation of sustainable governance standards is still underway at the EU level, website disclosures could be more easily updated to reflect changes in the methodology to assess good governance practices of the investee companies.

c) This item should remain on the website, as this information may change frequently.

d) This item should be disclosed on the website instead. In addition to the possibility to update the information more frequently, website disclosures offer more space to elaborate on data sources.

As mentioned above, in the context of a), we see the need to clarify 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, recital 24 results in some ambiguity: “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”.

We object the assumption that any financial product relying on an exclusion strategy should have a minimum reduction commitment. 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 a result rather than an explicit objective 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.

Question 26: 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 think that a narrative explanation would be appropriate to provide information on how the use of derivatives meets each of the environmental or social characteristics or sustainable investment objectives promoted by the financial product only for derivatives that may be used to obtain exposure to these instruments. On the other hand, derivatives may also be used in ways not clearly linked to the sustainable objectives of the product (e.g. to hedge currency or interest rate risk). These types of derivatives would not be categorised as “sustainable investments” as they would not meet the environmental and sustainable characteristics of a product. Therefore, including them in the graphical and narrative explanations of the sustainable investment objective of the financial product would lead to confusion for investors.

Derivatives are an essential instrument of portfolio management and contribute heavily to the liquidity of a security and, in turn, its pricing. Potentially, if a very large percentage of the fund is comprised of derivatives for investment exposure purposes, it may be desirable to have the option to explain the use of such derivatives, if relevant, in the graphical and narrative explanations of the sustainable investment objective of the financial product. On the other hand, where derivatives are used in a product in a way that may qualify them as "sustainable investments", thought could be given to having 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, under Articles 19 and 28 of the RTS to give investors a complete picture and avoid misleading results. It would also be useful for the RTS to clearly indicate that derivatives should only be covered in one section (either in Articles 19 and 28, or in Articles 15(2) and 24(2), whichever approach the ESAs adopt in the final RTS).

**Question 27: Do you have any views regarding the preliminary impact assessments? Can you provide more granular examples of costs associated with the policy options?**

In the consultation paper, the ESAs rightly acknowledge the issue of data availability, raised repeatedly by EFAMA, and that this may complicate the assessment of the adverse impact of an investment decision against particular indicators. The costs associated with gathering and processing of the data remain high and are expected to increase even further with the application of the provisions under SFDR and the requirements specified in the draft RTS, also concerning the proposed frequency of the PAI indicators’ calculation. Although precise costs are difficult to quantify (and may also be commercially sensitive), the overall magnitude of the initial and on-going costs are extremely high.

Meanwhile, we only partially agree with the ESAs’ assessment that the situation is improving, as evidenced by the growing share of ESG data issued by data providers. As we also see an increasing concentration in the market for ESG data, research and ratings that is driving costs further up. While the ESG data situation may be improving for data which is currently frequently used by the industry, new regulatory requirements, including SFDR and the EU Taxonomy, will require the use of very specific indicators which are currently largely not available. This situation is unlikely to significantly change before 2-3 years, before new provisions stemming from the upcoming review of the NFRD, become effective.

Moreover, we do not agree with the ESAs’ conclusions that the integration of ESG considerations to disclose adverse impacts will not be disproportionately high. We also question the relevance of the results of a previous public consultation where stakeholders indicated that the integration of ESG considerations does not carry substantial additional costs. We welcome the ESAs’ intention to perform a more thorough cost-benefit analysis to accompany the final proposal.
This response has been drafted by EFAMA and endorsed by the Association for Financial Markets in Europe (AFME). We remain available to discuss and clarify any views reported below.

About EFAMA:
EFAMA, the voice of the European investment management industry, represents 28 Member Associations, 59 Corporate Members and 23 Associate Members. At end Q1 2020, total net assets of European investment funds reached EUR 15.7 trillion. These assets were managed by more than 34,250 UCITS (Undertakings for Collective Investments in Transferable Securities) and 29,000 AIFs (Alternative Investment Funds).
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About AFME:
AFME (Association for Financial Markets in Europe) advocates for deep and integrated European capital markets which serve the needs of companies and investors, supporting economic growth and benefiting society. AFME is the voice of all Europe’s wholesale financial markets, providing expertise across a broad range of regulatory and capital markets issues. AFME aims to act as a bridge between market participants and policy makers across Europe, drawing on its strong and long-standing relationships, its technical knowledge and fact-based work. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants.
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