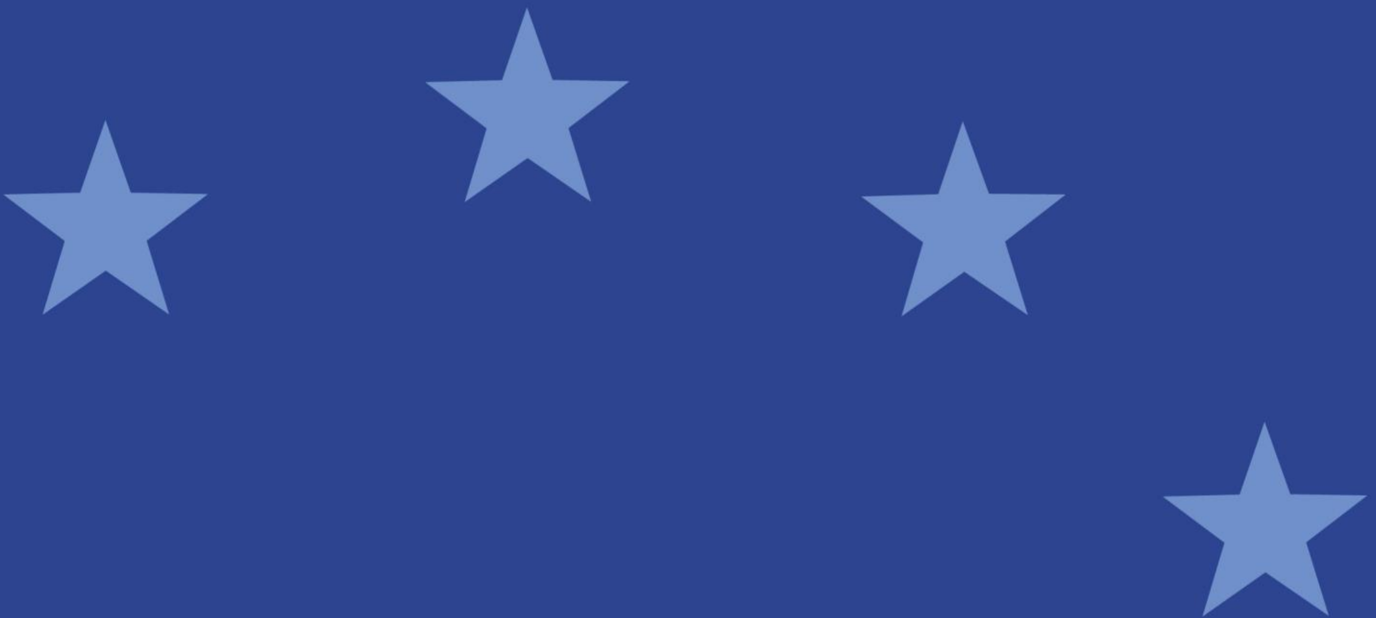
European Securities and Markets Authority

EBA European Banking Authority

EIOPA European Insurance and Occupational Pensions Authority

JOINT COMMITTEE OF THE EUROPEAN SUPERVISORY AUTHORITIES

Response form for the Joint Consultation Paper concerning ESG disclosures



23 April 2020

Date: 23 April 2020
ESMA 34-45-904

JOINT COMMITTEE OF THE EUROPEAN SUPERVISORY AUTHORITIES

Responding to this paper

The European Supervisory Authorities (ESAs) invite comments on all matters in this consultation paper on ESG disclosures under Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial sector (hereinafter "SFDR") and in particular on the specific questions summarised in Section 3 of the consultation paper under "Questions to stakeholders".

Comments are most helpful if they:

1. contain a clear rationale; and
2. describe any alternatives the ESAs should consider.

When describing alternative approaches the ESAs encourage stakeholders to consider how the approach would achieve the aims of SFDR.

Instructions

In order to facilitate analysis of responses to the Consultation Paper, respondents are requested to follow the below steps when preparing and submitting their response:

Q1 Insert your responses to the questions in the Consultation Paper in the present response form.

Q2 Please do not remove tags of the type <ESA_QUESTION_ESG_1>. Your response to each question has to be framed by the two tags corresponding to the question.

Q3 If you do not wish to respond to a given question, please do not delete it but simply leave the text "TYPE YOUR TEXT HERE" between the tags.

Q4 When you have drafted your response, name your response form according to the following convention: ESA_ESG_nameofrespondent_RESPONSEFORM. For example, for a respondent named ABCD, the response form would be entitled ESA_ESG_ABCD_RESPONSEFORM.

Q5 The consultation paper is available on the websites of the three ESAs and the Joint Committee. Comments on this consultation paper can be sent using the response form, via the ESMA website under the heading 'Your input - Consultations' by **1 September 2020**.

Q6 Contributions not provided in the template for comments, or after the deadline will not be processed.

Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise in the respective field in the template for comments. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESAs rules on public access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESAs Board of Appeal and the European Ombudsman.

Data protection

The protection of individuals with regard to the processing of personal data by the ESAs is based on Regulation (EU) 2018/1725[1]. Further information on data protection can be found under the Legal notice section of the EBA website and under the Legal notice section of the EIOPA website and under the Legal notice section of the ESMA website.

[1] Regulation (EU) 2018/1725 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 23 October 2018 on the protection of natural persons with regard to the processing of personal data by the Union institutions, bodies, offices and agencies and on the free movement of such data, and repealing Regulation (EC) No 45/2001 and Decision No 1247/2002/EC, OJ L 295, 21.11.2018, p. 39.

General information about respondent

Name of the company / organisation	2° Investing Initiative
Activity	Civil society
Are you representing an association?	☐
Country/Region	France

Introduction

Please make your introductory comments below, if any:

<ESA_COMMENT_ESG_1>
2DII's research (see 2DII paper: *A Large Majority of Retail Clients Want to Invest Sustainably* on our website) details the results of our survey programme and behavioural science research. This shows that, on the demand side, 65% to 85% of retail investors in Germany and France say they want to invest more sustainably. In terms of concrete outcomes (i.e. beyond just having an interest in sustainable financial products) *having an impact in the real economy* seems to be the main end goal for consumers. However, the supply side does not match this profile of retail investor demand with a corresponding array of suitable financial products.

Our concern is that drafting in the SFDR contains differing conceptions of *the impact of investment decisions* and inadequate articulation of key concepts - which hinders the ability of the SFDR regulatory framework to contribute to its policy objectives and bring about actual environmental improvements.

This problem (differing conceptions of the impact of investment decisions and inadequate articulation of key concepts) is apparent in the interpretation of principal adverse impacts.

Recital 20 of the SFDR states that '[p]rincipal adverse impacts should be understood as those impacts of investment decisions and advice that result in negative effects on sustainability factors.'

Art 2(24) SFDR defines 'sustainability factors' as 'environmental, social and employee matters, respect for human rights, anti-corruption and anti-bribery matters.' Therefore environmental matters are actual tangible, real world matters.

In the environmental context, a consistent approach to these definitions would require the notion of principal adverse impacts to be understood as the negative effects of investment decisions on the real world. Put another way this would imply that the notion of principal adverse impacts should be understood as the negative change in an environmental matter (the delta) brought about by an investment decision.

However, the set of indicators proposed in the delegated regulation to assess principal adverse impacts are metrics for environmental matters *associated with* a financial product, but they do not say anything about environmental matters *brought about by* investment decisions of that financial product. These metrics do not say anything demonstrable about the consequences that investment decisions might have in the real economy (although note that the concept of investment decision is crucial here - is the investment decision to be understood as the initial portfolio construction (for example), or subsequent decisions in respect of portfolio holdings (such as voting and other stewardship activities, selling or holding stock etc.) or both?)

As such, the description of principal adverse impacts and the table in Annex I appear to be as inconsistent as the criteria recently proposed by the EC regarding the Ecolabel on Financial Products (see 2DII's paper providing feedback on the second version of the Ecolabel criteria for financial products on our website). In both cases, the legislation is saying one thing but doing another as the criteria which is used are simply not relevant for the stated purpose.

It could even be stated that these pieces of regulation may contribute to establishing an erroneous understanding of the notion of impact in the financial field, which could lead to an increase in misleading statements regarding this particular issue and jeopardize the policy objectives of the SFDR and the Ecolabel regulation.

This problem (differing conceptions of the impact of investment decisions and inadequate articulation of key concepts) also means that the drafting in the SFDR fails to adequately cater for genuine impact related financial products (namely those that aim to generate an impact through the specific and measurable contribution of the investor to changes in the investee's behaviour/activities/capital expenditures etc.).

There is already a broad range of financial products integrating sustainability-related criteria, pursuing very different objectives and mobilizing very different approaches. An overwhelming majority of these are not associated with sustainability impacts (i.e. they have not been designed with the objective of influencing the decisions of the players in the real economy). Rather they are primarily designed to marginally integrate financial risks related to sustainability factors, by reducing the exposure to risky sectors and increasing the exposure to green sectors of the real economy.

Our reading of the definition for 'sustainable investment' in Art 2(17) SFDR is that it fails to distinguish between the actions of the investor as opposed to the actions of the investee company. This creates additional confusion and fails to demarcate between financial products which are designed to have an impact in the real economy versus financial products which are merely exposed to green sectors of the real economy.

Meanwhile the category of financial instruments defined by Art 8 SFDR is extremely broad (and would likely be unsuitable for impact-oriented end investors). As the consultation notes '[t]he scope of the products with environmental and social characteristics (Article 8) was intentionally drafted as a catch all category to cover all financial products with different environmental or social ambitions that do not qualify as sustainable investments according to Article 9 SFDR.'

Of the related recitals in the draft RTS (e.g. recitals 18, 19, 20 and 21) we do not consider these are sufficient to properly distinguish between financial products which are designed to have an impact in the real economy versus financial products which are merely exposed to green sectors of the real economy or properly clarify where to draw the line between the two categories of financial product articulated in Article 8 and 9 SFDR.

We consider that without clarity in this area, this will lead to lower observable demand for genuine impact related financial products and corresponding reduced supply of these financial products by financial market participants – therefore working against the policy objectives of the SFDR and more broadly.

We note that '[t]he ESAs discussed the necessity and possibility to define terms crucial for the application of the level 1 text. While the ESAs see merit in specifying terms that are currently not defined in level 1 legislation ("promotion of environmental or social characteristics" / "follow good governance practices"), the ESAs concluded that possibilities for defining terms at level 2 are limited, instead chose to provide context for the level 2 articles in the recitals to this RTS.' However, for the reasons set out in the preceding paragraphs we urge the ESAs to rethink this position. As we see it, this draft RTS is the only opportunity to provide much needed clarity in this area – without which there is significant possibility of vastly divergent interpretation of these requirements by financial market participants and national financial regulators alike.

The related issue of greenwashing is a further factor which hinders achieving the policy objectives of the SFDR and more broadly. By way of example, the above lack of clarity could lead to mis selling of financial products to impact oriented end investors (e.g. by selling financial products which are exposed to green sectors of the real economy but otherwise do not bring about any demonstrable additional impact to impact oriented end investors) but there are multiple other circumstances in which mis selling can arise.

In the second half of 2019, 2DII reviewed 230 sustainability-themed European retail funds, representing 139 billion in assets under management explicitly presented as having a link to environmental characteristics through the implementation of socially responsible investing (SRI), green thematic and green bond approaches. Our analysis concluded that 52 of the funds in our sample made environmental impact claims, almost all of which were misaligned with the EU consumer protection regulatory guidance applicable to environmental claims (based on the Unfair Commercial Practices Directive). Please refer to our paper *EU Retail Funds' Environmental Impact Claims Do Not Comply with Regulatory Guidance* on our website.

We note that there are various mentions of the problem of greenwashing in the consultation and that the ESAs are aware of this problem and its consequences for achieving the policy objectives of the SFDR and more broadly.

In light of this problem and the fact that the SFDR and the draft RTS introduce new disclosure requirements, we consider that a further useful measure would be to clarify the link between the various heads of information required to be disclosed under the SFDR and the draft RTS with the legal provisions which relate to misleading information. This should in theory help ensure that this information is subjected to a higher level of scrutiny by financial market participants and therefore reduce the risk of greenwashing and mis selling.

In this regard, we note that the ESAs will consider the opportunity to further develop the optional ITS contained in Art 13 SFDR subject to developments in marketing communications for the relevant financial products and would urge the ESAs to ensure this takes place.

Regulatory oversight of these disclosures is also going to be a key determinant of market behaviour. Currently we see a divergence in relation to the extent to which sustainable finance, climate risk etc. is understood to form part of national financial regulators' oversight mandate (or at least the extent to which these considerations practically form part of the oversight mandate in light of organisational capacity and expertise of national financial regulators). Harmonisation here would be useful in relation to SFDR considerations and more broadly and should also seek to ensure that national financial regulators develop sufficient organisational expertise and capacity to discharge their responsibilities effectively.
<ESA_COMMENT_ESG_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??**

<ESA_QUESTION_ESG_1>
We are generally supportive of reporting a mandatory set of indicators which are considered to always lead to principal adverse impacts (i.e. Table 1). In principal this should lead to more consistency and harmonisation in reported information (as compared to the current NFRD reporting framework for example – which is being amended to address this problem). However, the devil is in the detail in the sense that this approach will only work if the mandatory set of indicators are comprehensive and designed to reveal the right information, and disclosures made by financial market participants in relation to these indicators are accurate and not misleading (please see our response to Question 5 in this regard).

However, from a consistency and harmonisation perspective, it is it is difficult to see the rationale for simply reporting against at least one additional principal adverse impact from Table 2 and at least one additional principal adverse impact from Table 3 and any other adverse impact which qualifies as principal (Art 6(1)(b)-(d) of the draft RTS). Leaving aside the notion of whether 'principal adverse impacts' has been adequately defined (see later in this response), either the financial market participant has a principal adverse impact (or several principal adverse impacts) which should be reported or it does not. We suspect that the requirements as they are currently designed in Art 6(1) of the draft RTS will permit an element of cherry picking as to which adverse impacts to report – which will work against any consistency or harmonisation objective.

On the subject of how to interpret principal adverse impacts, please refer to our introductory comments where we articulate our concerns in relation to the drafting in the SFDR containing differing conceptions of the impact of investment decisions and how this problem is apparent in the interpretation of principal adverse impacts. In addition, a further problem which is apparent in the approach proposed in Chapter II and Annex I is that there is no further description or clarification as to when an adverse impact qualifies as a principal adverse impact.

In light of the above (and leaving aside our concerns in the introductory comments as to the drafting in the SFDR) we suggest that there needs to be further clarification of when an adverse impact qualifies as a principal adverse impact (e.g. is this analogous to how materiality considerations operate) and that the references to 'at least one' in Art 6(1)(b)&(c) of the draft RTS are reframed to refer to all principal adverse impacts articulated in the corresponding tables.
<ESA_QUESTION_ESG_1>

- **: 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?**

<ESA_QUESTION_ESG_2>
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- **: 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?**

<ESA_QUESTION_ESG_3>
Leaving aside our concerns in the introductory comments as to the drafting in the SFDR, generally speaking we are supportive of the approach in Chapter II and Annex I. However we would also make the following points.

For the reasons set out in our response to Question 1, we suggest that there needs to be further clarification of when an adverse impact qualifies as a principal adverse impact (e.g. is this analogous to how materiality considerations operate) and that the references to 'at least one' in Art 6(1)(b)&(c) of the draft RTS are reframed to refer to all principal adverse impacts articulated in the corresponding tables.

There is currently a problem in relation to data availability for many key indicators. To be clear, we are not seeking to water down the disclosure requirements in any way. Rather we are fully supportive of disclosure requirements being as comprehensive as possible – as this is the key lever to increase data availability and bring about a shift in market behaviour. However, the current extent of data availability does in our opinion necessitate further provisions in the draft RTS setting out constraints in respect of data quality and error minimization to ensure that data gaps are not simply estimated away using imprecise estimates.

Currently we consider that the website disclosures in respect of methodologies, data sources and processing, limitations to methodologies and data etc. (as per Art 34 and 35 of the draft RTS and Art 10(1)(b) SFDR for example) do not sufficiently recognise the extent of this problem of data availability (i.e. they treat it as an ordinary situation rather than possibly the single most important issue and constraint affecting the utility of the information).

Please also see our responses to Question 10 in relation to further provisions or guidance in relation to rebaselining etc. being necessary to enable meaningful comparisons between current and previous reference periods and Question 25 in relation to the disclosures in respect of methodologies, data sources etc. needing to be very clearly subject to legal safeguards, regulatory oversight etc. and should therefore be contained in the pre-contractual documentation (as opposed to website disclosures).
<ESA_QUESTION_ESG_3>

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

<ESA_QUESTION_ESG_4>
As set out in our response to Question 1, we are supportive of reporting a mandatory set of indicators. We are similarly supportive of a mandatory reporting template to further assist with a consistency and harmonisation objective.

However we do have a number of concerns about the indicators currently articulated in Table 1 (please refer to our introductory comments and see our response to Question 5 in this regard).
<ESA_QUESTION_ESG_4>

- **: 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)?**

<ESA_QUESTION_ESG_5>
We have a number of concerns with the indicators which include the following:

Enterprise value: This is suggested as a reference point in relation to GHG calculations. However it is a highly volatile and not always available data point, even for listed companies, on financial databases.

In relation to *availability* of this data point, our research revealed that over 100 companies out of a sample of 1574 companies represented in the MSCI World did not have an enterprise value datapoint in Bloomberg. While this datapoint should in theory be identifiable and verifiable through further analysis, it shows that even for listed companies, it is not readily processed in all cases. Moreover, enterprise value is not a datapoint that exists for non-listed bond issuers.

In relation to *volatility* of this datapoint, we analysed year on year volatility of enterprise value for 1,396 companies over a 4-year time span (total observations 5,584). Year on year enterprise value volatility exceeds 10% in more than half (60%) of cases.

Emissions data availability: Scope 1 and Scope 2 data does not exist comprehensively for non-listed companies. Even for listed companies, data gaps can make meaningful discrimination of companies based on their carbon footprint impossible. In a study from 2016, the Institutional Investors Group on Climate Change conducted a systematic review of the carbon footprint profiles across four major data providers. Across the profiles, not only did results differ dramatically, the headline result was not consistent as to which of two portfolios had a lower carbon footprint. While there have been significant further developments in the models and methodologies by data providers since, there is no evidence that the actual underlying comparability between data providers has improved. Moreover, such high degree of divergence for listed companies is likely to be even more pronounced for non-listed companies. The variations in estimates matter since over 50% of listed companies still do not report their Scope 1 and Scope 2 emissions, with an even lower percentage reporting Scope 3.

Notion of Paris-alignment: Art 4(2)(d) SFDR refers to 'the degree of their alignment with the objectives of the Paris Agreement.' We do not consider the current indicators in Table 1 give any indication of the degree of alignment with the objectives of the Paris Agreement. In particular, the current indicators are based on carbon footprinting and associated financial intensity – this is a backward looking metric (i.e. it does not have a forward looking component about what emissions will be released in the future) and does not provide any indication of whether the result is Paris-aligned or not.

We are aware that the methodology for the EU Climate Benchmarks is based on a carbon footprinting approach and have set out our concerns in our *EU Climate Benchmarks Factsheet* (available on our website). However, the problem is worse in relation to the indicators in Table 1 because there are no additional criteria (in relation to an annual 7% reduction for example) which gets us closer to the notion of Paris-alignment.

Various methodologies exist which provide forward looking metrics for Paris-alignment. Since 2015, the EU has funded a number of research projects led by 2DII under the H2020 and LIFE Action grants, as well as more broadly through the LIFE NGO Operating Grant. These projects are still funded by the EU with over €4 million in R&D invested to date. The EU has recently agreed to extend funding by another three years. The outcome of these projects – the PACTA model – is designed to measure consistency of financial portfolios with climate scenarios. It is the leading model used by the private sector worldwide, road-tested by over 800 financial institutions around the world, applied by major financial supervisors in Europe and abroad (e.g. EIOPA, Sweden Finansinspektionen, Japanese Financial Services Agency) and supported by large industry associations (e.g. UN Principles for Responsible Investment). It underpins a major European climate alignment initiative supported by a range of European governments (e.g. Austria, Sweden, Luxembourg). The model is endorsed by a group of leading European banks (ING, BNP Paribas, Societe General, BBVA, StandardChartered), and supported by significant NGOs (WWF, InfluenceMap).

The PACTA model is therefore one of several methodologies which has developed forward looking Paris-alignment metrics. We would be happy to share the research expertise and knowledge which 2DII has acquired during the development of the PACTA model in order to address this missing category of indicators in Table 1.

Engagement Policies: We are aware that the requirement in Art 4(2)(c) SFDR relates to providing the summary of the engagement policy in accordance with Art 3g of Directive 2007/36/EC. Art 3g of that directive does not have any particular emphasis on engagement for the purposes of stewardship of environmental or social matters. Nevertheless current market practice by investors, as evidenced by a number of coalitions and initiatives (e.g. CA100+ etc.) uses investor stewardship activities in furtherance of an environmental objective. This is particularly evident in relation to climate change considerations. It may be useful to articulate that stewardship activities – beyond what is required to be reported under Art 3g – may be relevant for other heads of information (such as degree of alignment with the objectives of the Paris Agreement).

<ESA_QUESTION_ESG_5>

- **: 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?**

<ESA_QUESTION_ESG_6>
As set out in our response to Question 5, the current metrics are based on carbon footprinting and associated financial intensity. This is a backward looking metric (i.e. it does not have a forward looking component about what emissions will be released in the future) and does not provide any indication of whether the result is Paris-aligned or not. Table 1 has no additional criteria (in relation to an annual 7% reduction for example) which gets us closer to the notion of Paris-alignment.

Therefore a measure of carbon emissions relative to the EU 2030 climate and energy framework target could be a useful additional methodological step. However this still falls short of being a true forward looking component which relates to the notion of Paris-alignment which we advocate in the PACTA model for example.

It is unclear what is meant by ‘a relative measure of carbon emissions relative to the prevailing carbon price’?
<ESA_QUESTION_ESG_6>

- **: 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?**

<ESA_QUESTION_ESG_7>
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<ESA_QUESTION_ESG_7>

- : **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?**

<ESA_QUESTION_ESG_8>
We are in favour of requiring disclosure of metrics on spend and other activities relating to low carbon research and innovation. We also note that (as indicated in the recent consultation for the renewed Sustainable Finance Strategy), the Commission is currently examining options to increase financing of research and innovation activities and whether to include relevant research and innovation metrics as a new category in the EU Taxonomy. In light of this apparent direction of travel, it would be beneficial to accommodate this information in the requirements set out in the draft RTS. However, whether Table 1 is the right place to do this is another matter (as it is not clear how these metrics would capture adverse impacts).
<ESA_QUESTION_ESG_8>

- **: 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?**

<ESA_QUESTION_ESG_9>
In general we agree with this goal for efficiency purposes and the fact that the sooner these indicators are established the better.

However the question relates principally to feasibility – is the 'state of the art' in relation to indicators for social and employee matters, respect of human rights, anti-corruption and anti-bribery the same as for climate change (and broader environmental matters). Provided the state of the art is sufficient to enable a science based approach to the development of these indicators then we agree with the goal. If the state of the art is not yet as this stage, then strict adherence to this goal could lead to indicators which are counterproductive and hinder the overall objective of the SFDR.
<ESA_QUESTION_ESG_9>

- **: 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?**

<ESA_QUESTION_ESG_10>
We consider that the drafting of Art 6(2) of the draft RTS could be improved to make it clearer whether the current reference period should be compared to one or several previous reference periods.

Based on our interpretation of Art 6(2) the requirement to compare a current reference period to a previous reference period which is 10 years previous will not kick in until 10 years in the future. In light of the fact that financial market participant disclosures in this area are just beginning, and our comments elsewhere about the current extent of data availability, we consider that market practice (in terms of methodologies, data etc.) will significantly change over this period.

Therefore we think that further provisions or guidance in relation to re-baselining etc. are necessary to enable meaningful comparisons between current and previous reference periods. Absent these further provisions, a comparison between a current reference period and a previous reference period which is 10 years previous may not be particularly useful.
<ESA_QUESTION_ESG_10>

- **: 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?**

<ESA_QUESTION_ESG_11>
We are generally supportive of measures which can prevent "gaming" disclosure requirements (whether in relation to principal adverse impact reporting or otherwise). This is a widespread problem in sustainability reporting outside of any legal framework, and is likely to be evident in sustainability reporting which is subject to legal requirements also.

In addition to harmonising the methodology and timing of reporting across the reference period, a further useful measure would be to clarify the link between the various heads of information required to be disclosed under the SFDR and the draft RTS with the legal provisions which relate to misleading information. This should in theory help ensure that this information is subjected to a higher level of scrutiny by financial market participants and therefore reduce the risk of greenwashing and mis selling.

In this regard, we note that the ESAs will consider the opportunity to further develop the optional ITS contained in Art 13 SFDR subject to developments in marketing communications for the relevant financial products and would urge the ESAs to ensure this takes place.

Regulatory oversight of these disclosures is also going to be a key determinant of market behaviour. Currently we see a divergence in relation to the extent to which sustainable finance, climate risk etc. is understood to form part of national financial regulator's oversight mandate (or at least the extent to which these considerations practically form part of the oversight mandate in light of organisational capacity and expertise of national financial regulators). Harmonisation here would be useful in relation to SFDR considerations and more broadly and should also seek to ensure that national financial regulators develop sufficient organisational expertise and capacity to discharge their responsibilities effectively.
<ESA_QUESTION_ESG_11>

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

<ESA_QUESTION_ESG_12>
Yes. For similar reasons to as set out in Question 1 we are supportive of mandatory pre-contractual and periodic templates for financial products.
<ESA_QUESTION_ESG_12>

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

<ESA_QUESTION_ESG_13>
Our research programme in Germany (*2020: working group report* (in German language) on our website) has focussed on the inclusion of sustainability preferences in the suitability assessment. This has revealed that in the context of retail investor decision making:
- it is crucial to have information on impacts and potential exclusion criteria alike; and
- a major hurdle against using more ambitious frameworks to determine suitability is a lack of data. This point was raised by banking representatives in the Working Group (and was backed by our experience building a platform to link suitability assessment results with matching financial products).

We consider that the above observations will be similarly applicable and relevant to the design of pre-contractual and periodic templates.

We also raise the following points which are not necessarily related to ESG issues but are nevertheless relevant for the design of these templates:
- 2DII research reveals that retail investors are often overwhelmed with the amount of information that needs to be digested ahead of an investment decision. Specific, tailored, easily digestible information designed for communicating information to an average retail investor is necessary to avoid this.
- The template needs to present a full theory of change - objectives need to be explained, a methodology established to work towards those objectives and indicators/metrics created to track success in working towards the objective.
- If a benchmark is used, it would be useful to explain how this supports the theory of change.
- The template should disclose methods as well as data providers, metrics and strategies.
- For the end investor, it has to be clear what a financial product tries to achieve, how this goal should be achieved in the future and how successful it has been to do so in the past.
- Potential impacts on risk and returns should be explained and reasoned.

In terms of format, we consider that the pre-contractual template needs to be designed with two purposes in mind:
- First, it needs to be readable by individuals for the purposes of their investment decision making. Simple language must be a requirement as well as other considerations around length, information content etc. (e.g. analogous thinking to the design of key information documents); and
- Second, it also needs to be readable by machine applications. We strongly recommend collecting and presenting this information in a public database (please see our response to Question 14).

Finally, these requirements in relation to pre-contractual templates need to operate in synergy with the changes which are taking place in relation to the suitability assessment required under MiFID. For example, both the above formats would improve the link to a non-financial suitability assessment (e.g. the second to determine a list of suitable products and the first to make it possible for end users to compare the products on this list with regards to their characteristics – our research under the NKI financed project "KlifinScanner" leads us to conclude that both of these steps are necessary).

Please also see our response to Question 14. While we agree with harmonised reporting templates for financial products, we also think an EU-wide database would be a further useful measure.
<ESA_QUESTION_ESG_13>

- **: 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.**

<ESA_QUESTION_ESG_14>
As set out in our responses to Questions 12 and 13, we agree with harmonised reporting templates for financial products.

In addition to harmonised reporting templates, we also support the development of an EU-wide database enabling comparison between different types of financial product accessible across the EU on the basis of a variety of financial and non-financial criteria. Our support for development of this database stems from our concerns about the deficiencies we have observed in the MiFID framework which inhibit the integration of ESG criteria – we set out the skeleton of our reasoning below.

As articulated elsewhere in this response, 2DII's research (see 2DII paper: *A Large Majority of Retail Clients Want to Invest Sustainably* on our website) details the results of our survey programme and behavioural science research. This shows that, on the demand side, 65% to 85% of retail investors in Germany and France say they want to invest more sustainably. In terms of concrete outcomes (i.e. beyond just having an interest in sustainable financial products) having an impact in the real economy seems to be the main end goal for consumers. However, the supply side does not match this profile of retail investor demand with a corresponding array of suitable financial products.

A contributing factor to this situation stems from the systemic problem in existing market practice related to the suitability assessment – financial advisors rarely ask about non-financial investment objectives of retail clients. As a result, many retail investors do not express these preferences. Even when prompted by clients, most advisors still offered them unsuitable products. A previous paper (see 2DII paper: *Non-Financial Message in a Bottle* on our website) identified this problem and 2DII will shortly release our results of mystery shopping visits on French bank networks.

A further contributing factor is a lack of credible information and definitional confusion in relation to the impact of a financial product or investment. Currently there is no clear definition nor methodological framework for measuring the impact of financial products in the real economy. And please see our introductory comments in relation to confusion created by drafting in the SFDR. Greenwashing is a further barrier to retail investors being able to access financial products which meet their non-financial investment objectives. (See 2DII paper: *EU Retail Funds' Environmental Impact Claims Do Not Comply with Regulatory Guidance* on our website).

The approach that we have discerned from the latest available drafts of the MiFID delegated legislation raises concerns as to what extent it fixes these two problem factors. We also consider that current indications of how the ESMA Guidelines will be amended (i.e. through continuing with high level principles based guidance as opposed to a more technical and granular approach) will contribute to widely divergent market practice in relation to the suitability assessment. In addition, variability of regulatory oversight and enforcement of suitability assessment and wider MiFID requirements by national financial regulators in Member States could similarly permit different market practice across the EU.

In light of these observations, the creation of an EU-wide database is a useful and cost-effective measure to increase the enabling environment for integration of ESG criteria in the MiFID framework and elevate average market practice in this area - even if problems with regulatory oversight and enforcement persist.

If properly designed, such a database should increase the level of awareness and retail investor ability to advocate effectively in relation to their non-financial investment objectives – which will of course mean that the market practice of financial advisors is subjected to increased scrutiny in this area.

The information content of the database is therefore critical. We reiterate the point made elsewhere that having an impact in the real economy seems to be the main end goal for consumers. Therefore, any EU-wide database must contain information on the impact of financial products as this information is central to a majority of retail investor investment decision making. In this regard however, the complicating factor is that (as noted above) there is no clear definition nor methodological framework for measuring the actual impact of financial products in the real economy.

In terms of final remarks:

- Making key information documents and the templates for pre-contractual and periodic reporting machine readable, to store information centrally and to make them accessible for registered users is a first step.
- It may be necessary to gather information beyond what is required to be disclosed under the current wider regulatory framework and anticipated changes thereto. 2DII has an established research programme which is developing a methodological approach to measuring impact.
- Developing the database should be aligned with the enhancements to the suitability assessment regarding non-financial preferences as well as other initiatives under the Sustainable Finance Action Plan and Sustainable Investment Strategy.

<ESA_QUESTION_ESG_14>

- **: 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?**

<ESA_QUESTION_ESG_15>
Please see our response to Question 25 where we articulate our reasoning as to why the preference should be for information to be included in pre-contractual disclosures where possible as opposed to website disclosures. In addition, in light of our responses to Questions 12-14 it is also worth remembering that if information is disclosed in pre-contractual templates (as opposed to websites) this will allow for better consistency, harmonisation and comparability.

The requirement(s) for website disclosure in the draft RTS could be improved (i.e. the actionability of this information by end investors could be enhanced) through:

- greater specificity in relation to where the sections of the website entitled ‘Adverse sustainability impacts statement’ (Art 4(1) of the draft RTS) or ‘Sustainability related disclosures’ (Art 33 of the draft RTS) etc. sit within the overall website structure of the financial market participant. This specificity could help ensure that all websites of financial market participants are easily navigable in order for end investors to locate the relevant information; and
- greater linking between a financial product’s pre-contractual disclosures and the associated website disclosures for that particular financial product (e.g. through hyperlink in the pre-contractual document to the relevant section of the website). At the moment the website disclosures will aggregate the disclosures for many different financial products offered by a financial market participant. Therefore in some cases, navigating through all of the disclosures to find the specific disclosures in respect of a specific financial product may be difficult.

<ESA_QUESTION_ESG_15>

- **: 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.**

<ESA_QUESTION_ESG_16>
Our concern here is not in relation to the proposed disclosure provisions *per se*, but rather how to interpret the different categories of financial product articulated in Article 8 and 9 SFDR (and hence which set of disclosure provisions any particular financial product is therefore subject to).

As articulated in our introductory comments, the problem of differing conceptions of impact and inadequate articulation of key concepts means that drafting in the SFDR fails to adequately cater for genuine impact related financial products (namely those that aim to generate an impact through the specific and measurable contribution of the investor to changes in the investee's behaviour/activities/capital expenditures etc.).

There is already a broad range of financial products integrating sustainability-related criteria, pursuing very different objectives and mobilizing very different approaches. An overwhelming majority of these are not associated with sustainability impacts (i.e. they have not been designed with the objective of influencing the decisions of the players in the real economy). Rather they are primarily designed to marginally integrate financial risks related to sustainability factors, by reducing the exposure to risky sectors and increasing the exposure to green sectors of the real economy.

Our reading of the definition for 'sustainable investment' in Art 2(17) SFDR is that it fails to distinguish between the actions of the investor as opposed to the actions of the investee company. This creates confusion and fails to demarcate between financial products which are designed to have an impact in the real economy versus financial products which are merely exposed to green sectors of the real economy.

Meanwhile the category of financial instruments defined by Art 8 SFDR is extremely broad (and would likely be unsuitable for impact-oriented end investors). As the consultation notes that '[t]he scope of the products with environmental and social characteristics (Article 8) was intentionally drafted as a catch all category to cover all financial products with different environmental or social ambitions that do not qualify as sustainable investments according to Article 9 SFDR.'

Of the related recitals in the proposed delegated regulaiton (e.g. recitals 18, 19, 20 and 21) we do not consider these are sufficient to properly distinguish between financial products which are designed to have an impact in the real economy versus financial products which are merely exposed to green sectors of the real economy or properly clarify where to draw the line between the two categories of financial product articulated in Article 8 and 9 SFDR.

We consider that without clarity in this area, this will lead to lower observable demand for genuine impact related financial products and corresponding reduced supply of these financial products by financial market participants. Worse still this could lead to mis selling of financial products to impact oriented end investors (e.g. by selling financial products which are exposed to green sectors of the real economy but otherwise do not bring about any demonstrable additional impact to impact oriented end investors).

At the lower end of the scale, where to demarcate between which financial products which are caught by Article 8 and those which are not, is still potentially unclear. This means that it is also potentially unclear which financial products are subject to these disclosure requirements and which are not.

We note that '[t]he ESAs discussed the necessity and possibility to define terms crucial for the application of the level 1 text. While the ESAs see merit in specifying terms that are currently not defined in level 1 legislation ("promotion of environmental or social characteristics" / "follow good governance practices"), the ESAs concluded that possibilities for defining terms at level 2 are limited, instead chose to provide context for the level 2 articles in the recitals to this RTS.' However, for the reasons set out in the preceding paragraphs we urge the ESA to rethink this position. As we see it, this draft RTS is the only opportunity to

provide much needed clarity in this area – without which there is significant possibility of vastly divergent interpretation of these requirements by financial market participants and national financial regulators alike.
<ESA_QUESTION_ESG_16>

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

<ESA_QUESTION_ESG_17>
We note that the SFDR does not define investment and no further clarity is provided in either the recitals to the draft RTS or the articles of the draft RTS. On this basis there is nothing to indicate that a typical interpretation of the provisions of Art 15(2) of the draft RTS would extend to indirect investment.
<ESA_QUESTION_ESG_17>

- **: 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?**

<ESA_QUESTION_ESG_18>
Yes, while harmonisation of the graphical representation is beneficial, given that environmental and social characteristics can vary so widely, there is certainly the potential for these graphical representations to be misleading to end-investors.

We reiterate the point made in our response to Question 11, in that a useful measure would be to clarify the link between this information (and other information required to be disclosed under the SFDR and this draft RTS) and legal provisions which relate to misleading information. This should in theory help ensure that this information is subjected to a higher level of scrutiny by financial market participants (which should in theory reduce the risk of greenwashing and mis selling).

In this regard, we note that the ESAs will consider the opportunity to further develop the optional ITS contained in Art 13 SFDR subject to developments in marketing communications for the relevant financial products and would urge the ESAs to ensure this takes place.

A further point is that while 'environmental and social characteristics' is not defined (thereby leaving financial market participants the option to decide what qualifies), there are other areas of the regulatory framework which seek to promote a uniform interpretation of what is sustainable. We are of course referring to the Taxonomy Regulation (2020/852) here. This requirement in respect of a graphical representation should therefore bear in mind the developing classification of economic activities under the Taxonomy Regulation (2020/852) – although this classification is not currently of sufficient breadth to cover all environmental and social characteristics.
<ESA_QUESTION_ESG_18>

- **: 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?**

<ESA_QUESTION_ESG_19>
Yes, we agree with a requirement to disclose the planned proportion of investments in different sectors and sub-sectors (as per Art 15(2)(b) and Art 24(2)(b) of the draft RTS). This is a datapoint which is easily understandable by the end investor and has significant utility not just for the end investor but also other stakeholders such as civil society and financial regulators.

The current drafting (e.g. 'the planned proportion of investments in different sectors and sub-sectors, including the fossil fuel sectors') raises questions as to how this will be interpreted. By way of example, the question alludes to the fact that disclosing exposure to fossil fuel sectors is compulsory but for other sectors it is less clear. Therefore we think the drafting of this provision needs to be improved. In doing so, we strongly urge the ESAs to make clear that other high carbon sectors (beyond just the fossil fuel sector) should be included.

We have the following comments:

- Currently the requirement in Art 15(2)(b) and Art 24(2)(b) of the draft RTS only requires a narrative explanation in relation to the planned proportion of investments in different sectors and sub-sectors. We consider that there should be a graphical representation in relation to this information.
- As currently drafted, sectors and sub-sectors may be interpreted differently by different financial market participants – this may work against any harmonisation and consistency objective in respect of this information. Therefore there should be additional provisions to ensure that there is a uniform interpretation of sectors and sub-sectors (e.g. through referencing NACE codes or other classification system).
- This requirement may also need to bear in mind the developing classification of economic activities under the Taxonomy Regulation (2020/852) – although this classification is not currently of sufficient breadth to cover all sectors and sub sectors.

We also reiterate comments made by other stakeholders in various fora and events that fossil fuel sectors should be interpreted more widely than as currently defined in Art 1(1) of the draft RTS (i.e. more widely than solely sold fossil fuels). We can see no justification for the current definition of fossils fuel sectors excluding oil and gas.
<ESA_QUESTION_ESG_19>

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

<ESA_QUESTION_ESG_20>
We consider that the answer to this question will in large part be determined by the design of the Annex II and III templates which as far as we are aware are yet to be developed.

We note that, the ESAs are required to develop a single set of uniform pre-contractual disclosures which will be included in the wide range of documents articulated in Art 6(3) SFDR. And that in response and as referred to in the consultation, 'the policy approach chosen for the pre-contractual granularity of information is of minimum standardisation of requirements, which allows for some tailoring of approach to specificities of products.'

We urge the ESAs to focus on the issue of imparting sufficient information to end investors in a manner which ensures this information can be readily assimilated in their decision making. This should be the guiding rationale rather than having undue concern for disruption to the established market practices which have arisen in relation to preparing documents articulated by Art 6(3) SFDR. Yes, the documents articulated in Art 6(3) have varying levels of conciseness etc. But in our opinion it is not the starting point (i.e. the current state) of each Art 6(3) document which matters, but rather the end point of ensuring that all Art 6(3) documents contain the appropriate level of information about the environmental and social characteristics etc. of the financial product.
<ESA_QUESTION_ESG_20>

- **: 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?

<ESA_QUESTION_ESG_21>
Yes, good governance practices should be interpreted uniformly throughout the SFDR and the draft RTS. Governance practices are wider than solely sustainability issues and having competing notions of how to interpret good governance practices in relation to Art 8 and Art 9 will cause unnecessary confusion (particularly in light of our comments in response to Question 16).
<ESA_QUESTION_ESG_21>

- **: 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?**

<ESA_QUESTION_ESG_22>
The preliminary proposals are predicated on the concept of sustainable investment objectives. As far as we are aware this is a concept which is not defined in either the SFDR or the draft RTS – although of course Art 2(17) SFDR does define 'sustainable investment' which refers to the concept of sustainable investment objectives.

We consider that there is a possible problem of interpretation in the draft RTS, as sustainable investment objectives could refer to either:

- all of the possible environmental objectives and social objectives caught by the definition of 'sustainable investment' in Art 2(17) SFDR; or
- the specific environmental objective(s) or social objective(s) which determine that the financial product in question is a sustainable investment.

Where it is the former this is a potentially unending list and where it is the latter, this would not make sense conceptually.

However, we consider that the *structure* of the do no significant harm principle itself needs to be consistent in both the SFDR and Taxonomy Regulation (even if the underlying criteria are different). This is the case even though (as the consultation identifies) Art 2(17) SFDR does not explicitly link the concept of sustainable investments to the Taxonomy Regulation.

For the reasons set out above, we do not consider that the drafting of the preliminary proposals on do no significant harm in the draft RTS exactly mirror the structure of the do no significant harm principle established in the relevant provisions in the Taxonomy Regulation.

Therefore we consider that the drafting needs to be amended.
<ESA_QUESTION_ESG_22>

- **: 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?**

<ESA_QUESTION_ESG_23>
Yes, we see merit in the ESAs defining widely used investment strategies and giving financial market participants an opportunity to disclose the use of these strategies where relevant. These disclosures should also provide information about any departures from the normal investment strategy depicted in the definition (i.e. any unique characteristics of its own investment strategy).

In light of our comments made elsewhere in relation to the fact that having an impact in the real economy seems to be the main end goal for consumers, these definitions must clearly articulate a definition for genuine impact related investment strategies and should also clearly differentiate the link to Art 8 or 9 SFDR as appropriate.
<ESA_QUESTION_ESG_23>

- **: 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?**

<ESA_QUESTION_ESG_24>
We support having a list of the top investments of the financial product during the reference period. In a like manner to disclosures about the relative proportion of investments to different sectors (as per Question 19) this is a datapoint which is easily understandable by the end investor. However, we believe the following issues need to be considered.

Portfolio breadth: In light of the broad range of different financial products which this requirement might potentially apply to, and the broad range in terms of size of financial market participants offering these financial products, in some cases the top 25 investments could potentially cover only a very small proportion of the total investments of the financial product. Where this is the case, then disclosing the top 25 investments may not be sufficient to give an impression of the tilt or overall exposure. Therefore it may be worth incorporating an additional constraint such as either the top 25 investments **or** the investments comprising a minimum proportion of the total investments.

Levels of detail: The direct investments of a financial product may not always provide meaningful information for an end investor. This is the case for example when the financial product invests in a fund as the name of the fund may not give any indication of the underlying assets. Therefore it may be worth incorporating additional constraints in situations such as these to ensure that the information is more meaningful to the end investor.

Please also see our comments in our response to Question 19 about the need to achieve a uniform interpretation of how sectors are defined by different financial market participants.
<ESA_QUESTION_ESG_24>

- **: 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.**

1. **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);**
2. **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);**
3. **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**
4. **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.**

<ESA_QUESTION_ESG_25>
Generally speaking, our response here is dictated by the view that:

- detailed pre-contractual disclosures which are clearly available (as opposed to more peripheral or less immediately apparent information on websites) are more readily assimilated into decision making and enable potential investors to make better-informed investment decisions; and
- precontractual disclosures are more central to the oversight mandate of financial regulators and more subject to legal safeguards implies that information contained therein is potentially less susceptible to greenwashing.

Therefore we consider that where possible the preference should be for information to be included in pre-contractual disclosures as opposed to website disclosures.

We therefore agree that the investable universe (as per bullet 1) and the policy to assess governance practices of the investee companies (as per bullet 2) should be pre-contractual disclosures. Both of these pieces of information are highly product specific and central to the investment strategy of the financial product. This information should therefore be front and centre of the information which investors are presented with and upon which they make their investment decision.

In relation to the limitations to methodologies and data sources (bullet 3) and the reference to whether data sources are external or internal (bullet 4), we urge the ESAs to ensure this too is considered in pre-contractual disclosures.

We note that Art 10(1)(b) SFDR refers to disclosing methodologies and data sources on the website and that this information is potentially applicable across different financial products. However, mindful of our comments made elsewhere in this response (in relation to a current problem of data availability for key indicators and that in our opinion this necessitates further provisions in the draft RTS setting out constraints in respect of data quality and error minimisation to ensure data gaps are not simply estimated away using imprecise estimates) we consider that this information needs to be very clearly subject to legal safeguards, regulatory oversight etc. and should therefore be contained in the pre-contractual documentation (as opposed to website disclosures).
<ESA_QUESTION_ESG_25>

- **: 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)?**

<ESA_QUESTION_ESG_26>
Yes, derivatives are a complicated financial instrument and therefore it makes sense in our view to keep their associated disclosures separate from disclosures for more standard financial instruments.

This position is influenced by the belief that:

- the average retail investor may not have the financial expertise to properly understand the structure of derivatives; and
- derivatives' interaction with, or impact on the real economy is difficult to ascertain.

Therefore any information in relation to derivatives associated with a financial product should be clearly and separately identified (rather than combined in other disclosures) to enable proper and informed decision making. This will be particularly important for retail investors who are seeking to have a positive impact in the real economy.
<ESA_QUESTION_ESG_26>

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

<ESA_QUESTION_ESG_27>
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