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| 23 April 2020 |

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| Response form for the Joint Consultation Paper concerning ESG disclosures |
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| Date: 23 April 2020ESMA 34-45-904 |

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:

* contain a clear rationale; and
* 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:

1. Insert your responses to the questions in the Consultation Paper in the present response form.
2. 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.
3. 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.
4. 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.
5. 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](https://www.esma.europa.eu/press-news/consultations) under the heading ‘Your input - Consultations’ by 1 September 2020.
6. 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]](#footnote-2). Further information on data protection can be found under the [Legal notice](http://www.eba.europa.eu/legal-notice) section of the EBA website and under the [Legal notice](https://eiopa.europa.eu/Pages/Links/Legal-notice.aspx) section of the EIOPA website and under the [Legal notice](https://www.esma.europa.eu/legal-notice) section of the ESMA website.

# General information about respondent

|  |  |
| --- | --- |
| Name of the company / organisation | Invesco |
| Activity | Investment Services |
| Are you representing an association? |[ ]
| Country/Region | International |

# Introduction

Please make your introductory comments below, if any:

<ESA\_COMMENT\_ESG\_1>

Invesco welcomes the opportunity to comment on the ESAs draft regulatory technical standards under the Sustainable Finance Disclosure Regulation. Invesco has the privilege to just under $1.2 trillion of assets on behalf of our clients (as at August 2020). Our investment teams and clients increasingly view sustainability issues as important factors in driving long-term value of the companies we invest in. Invesco broadly support the objectives of the EU Sustainable Finance Action Plan and the Sustainable Finance Disclosures Regulation. In particular, we fully support the aim to ensure that clients are provide with relevant and meaningful information to enable them to make an informed investment decision. Such information should be concise, clear and understandable to clients and appropriate to the products and services they use.

 ***Principal adverse impact***

The introduction of new rules regarding the consideration of principal adverse impact by financial firms marks a sea change in the legal frameworks for financial market participants. The focus by firms to date has been on managing financially material ESG risks, with consideration of non-financial sustainability considerations being traditionally confined to dedicated ESG solutions. However, we have seen a marked increase in the appetite for investors and asset managers to make use of their role as stewards of the assets in which they invest in order to manage adverse impacts, such as climate change, supported by the introduction of Stewardship Codes in various jurisdictions, which seek to place a greater emphasis on purposeful engagement and stewardship on ESG issues. We would see the introduction of the new principal adverse impact disclosure framework as supporting this evolution.

The genesis of the Level 1 requirements, and set out in the recitals, is the OECD guidelines for institutional investors. Under these guidelines, institutional investors are encouraged to undertake risk-based due diligence on universally applicable issues (environment, human rights, etc) in order to promote more responsible business practices by investee firms. The OECD guidelines are primarily process-based, i.e. they do not focus on specific outcomes but on the processes and procedures that financial firms should have in place in order to identify and manage adverse impacts. The guidelines are also risk-based, considering both the materiality of the adverse impact but also the materiality of the investment. The OECD framework recognises that the most salient adverse impacts are likely to vary by company based on sector and/or geography and therefore institutional investors will be required to exercise judgement when undertaking due diligence on the OECD principles. The framework also recognises that in order to mitigate adverse impacts, firms should focus on those investee companies where they have the most ability to exert influence, which is likely to be reflective of the size of their shareholding in the company.

By centring the approach primarily on the disclosure of standardised sustainability indicators, we fear that the ESAs’ proposal departs from the intent and spirit of the Level 1 requirements but would, more importantly, not meaningfully further the consideration of sustainability by financial firms. In particular, the proposed approach, in our view, is likely to lead to a tick-box approach and boilerplate disclosures which will focus more on gathering and reporting on the various indicators and less on how firms identify, prioritise and manage adverse impact. In recital 5, the ESAs, in our view rightly, consider that the identification and prioritisation of principal adverse sustainability impact should be based on “their scope, severity, probability of occurrence and potentially irremediable character on sustainability factors”. However, we do not see this principle reflected in the 32 indicators proposed in Annex 1. Ultimately, we believe that the approach proposed by the ESAs will be unlikely to provide meaningful information to clients about a firm’s approach to sustainability and ultimately, could lead to misleading disclosures to clients regarding adverse impacts.

We believe that a more principles-based approach based on universal principles enshrined in the UN Global Compact and the OECD multinational guidelines, which places a greater emphasis on the due diligence processes and actions taken by the firms to manage such adverse impacts would better suit the needs of investors, would be internationally relevant and would be more faithful to the intent and letter of the Level 1 requirements, while allowing for a sufficient degree of consistency between firms. We believe that our suggested approach would also have the added benefit of being sufficiently simple to allow a broad range of financial market participants to comply with the rules, reflects the current availability of data and provides sufficient flexibility to create a “race to the top” when it comes to the consideration of adverse sustainability impact. Our proposal is set out in response to question 1.

***Product disclosures***

We broadly welcome the proposals set out by the ESAs in relation to the product disclosures to ensure that investors are provided with more detailed and consistent disclosures regarding the sustainability features of the products made available. As recognised in the Level 1, products with varying degrees of ambition have been developed to date. While the aim of the Disclosure Regulation is not to limit the choice for investors or create a product label, it is important that investors are able to understand the sustainability features of the products available so that they can make an informed choice and thereby mitigate any risk of greenwashing. Our responses to the questions are therefore primarily aimed at fine-tuning the proposals set out by the ESAs in order to better reflect the very broad array of products and strategies that will be subject to these new disclosure rules.

In particular, we fully support the view that disclosures by product providers should be proportionate to the ESG strategy of the product to ensure that products don’t under-disclose but equally don’t over-disclose. Striking the right balance will therefore require a certain degree of flexibility given the wide range of ESG strategies covered by Article 8 in particular. We agree that only the binding elements of the strategy should be disclosed in pre-contractual documents, with further complementary or more detailed information provided on the websites. In our responses below, we make specific recommendations with regards to which elements we feel might be better suited to the website to ensure that pre-contractual disclosures are concise and easy to understand, and that detailed information can be updated on a regular basis on the website.

**Use of templates**

As a general principle, we believe that ensuring integrated disclosures where the information regarding the ESG characteristics are seamlessly integrated into existing pre-contractual product disclosures would be the most useful to aid the comprehension by investors. For this reason, we believe that the mandatory use of templates, or even specific headings, which might require product providers to set out the information in a separate section of the pre-contractual disclosures, could run against this approach.

In particular, we believe that a degree of flexibility is necessary given the divergence between different types of pre-contractual documents (prospectuses, KIDs, etc) and a template might be challenging in certain circumstances. While we believe that the level of detail provide by the RTS should by themselves provide sufficient comparability, should the regulators feel that a template is necessary, we believe that it might be more appropriate to provide this on the website instead of the 2-page summary.

**Scope of Article 8 and Article 9**

As set out in in recital 21 of SFDR, financial products with varying level of ambition have been developed to date. The purpose of Articles 8 and 9, therefore, was to ensure that product providers were transparent about the level of materiality of the ESG strategy where the firm made claims about the sustainability of their products.

We broadly agree with the rationale set out in the narrative provided by the ESAs regarding how they understand Article 8, i.e. that ESG integration should not qualify but sectoral inclusions, for example, could be considered as Article 8 products. However, the formulation of recital 21 of the draft RTS may inadvertently cast the net regarding what should be considered the promotion of an environmental/social characteristic much wider than intended since it sets out that the mere reference of a sustainability factor in information provide to clients **should** (as opposed to **could**)be considered to be promotion of a sustainability characteristic. We fear that this may create confusion for the following reasons:

* All products are required to include information regarding the providers approach to the integration of sustainability risks under Article 6 of SFDR, which will therefore require references to sustainability risks in their pre-contractual documents.
* Some firms will also be subject to the requirements on principal adverse impact, which will require them to include information in their product’s pre-contractual documents about how their products take into account principal adverse impact on sustainability factors under Article 7 of SFDR.
* Many firms will also have in place certain basic exclusions which they consider to be based on financial, legal or reputational risks, for example relating to controversial weapons or significant ESG controversies but are not intended to be promoting a sustainability characteristic.
* Products may include limited exclusions at the request of clients without the exclusion materially altering the investment strategy of the product (i.e. the product does not promote that characteristic). Such exclusions, however, may still be referenced in pre-contractual documents.

In our view, therefore, environmental and social characteristics should be understood to be where a product-specific sustainability characteristic is presented as a key feature of the product. We believe that firms should be allowed to include proportionate references in the information they provide to clients regarding how they take into account financially material ESG considerations, any policies relating to legal risks pertaining to ESG issues or other limited references to sustainability factors without triggering Article 8 disclosures. In such cases, firms may wish to include a disclaimer stating that such references to sustainability factors are not promoting an environmental or social characteristic.

The aim of the rules is to counter greenwashing and, ultimately, any risk of mis-selling that may arise as a result. We believe that, since the new MiFID rules shall clarify that only products that have made Article 8 and 9 disclosures can be considered as satisfying a client’s sustainability preference, firms will be cautious to ensure that they do no over-disclose under Article 8 and therefore we believe that the RTS should not seek to make Article 8 disclosures a requirement where firms are not seeking to market or distribute their products as sustainable products.

We would suggest reformulating recital 21 as follows:

Financial products with environmental or social characteristics should be considered to be promoting, among other characteristics, environmental or social characteristics, or a combination thereof, when information provided to clients, in marketing communications or in mandatory investor disclosures or as part of a process of automatic enrolment in an IORP, ***presents sustainability considerations as a key feature of the product. Proportionate references to the consideration of sustainability risks or sustainability factors in pre-contractual documents should not be considered to be promoting an environmental or social characteristic so long as financial market participants include a statement to that effect.***

In relation to Article 9, we would understand the Level 1 as defining Article 9 products as products which has as their **investment** objective to **primarily** invest in sustainable investments (as defined by Article 2(17) of the SFDR), which seems to have been confirmed by the ESAs during the public hearing when discussing the extent to which a fund following the proposed eco-label rules for equity should be classed as Article 8 rather than Article 9. While the definition of “primarily” varies by regulator, we believe that including a recital to provide further clarity might be helpful to provide guidance to firms as to when they should be disclosing under Article 9 rather than Article 8.

We welcome the recognition by the ESAs that Article 8 products may also invest in sustainable investments as part of the attainment of their environmental or social characteristics (including where such products invest predominantly but not primarily in sustainable investments). However, many Article 8 products will not invest in sustainable investments and therefore we believe that Article 8 products should only disclose the planned proportion of sustainable investments where this is a binding element of the fund. We would therefore suggest that such disclosures under Article 15 of the RTS should only be “where relevant”. Even in cases where Article 8 products plan to allocate capital to sustainable investments, this may vary depending on investment opportunities and market conditions and therefore may not necessarily be expressed as a planned proportion.

In addition to clearer guidance on the scope of Articles 8 and 9, we understand the desire from the ESAs to ensure that investors are clear as to whether the product they are investing in falls under Article 8 or Article 9. However, we believe that the formulation of Article 16 might lead to confusion amongst investors. Most investors will understand the term “sustainable investment objective” to also include Article 8 products whose investment strategy includes the consideration of sustainability factors, rather than as a legally defined term under the SFDR. We believe that the drafting also seems to confuse the investment strategy of the fund (i.e. where an Article 9 product has as its investment objective to invest in sustainable investments) and the environmental and social objectives to which a sustainable investment must make a significant contribution to (such as climate change or diversity). As set out above, we believe that to reduce the risk of confusion, it might be helpful to clarify that an Article 9 product is one where the objective is to **primarily** invest in sustainable investments (as defined by SFDR) so as not to exclude approaches under Article 8 where a product might invest a portion of the assets in sustainable investments. We suggest a revised wording under question 16 that we feel might be clearer in this regard.

**Level of granularity in defining environmental and social characteristics**

Many sustainable investment products will define the sustainability characteristics of a product at a high-level since the strategy may consider a range of sustainability factors. For example, a fund may seek to reduce exposure to adverse sustainability impacts by reducing its exposure to harmful activities or it may wish to seek increased exposure to companies with better sustainability performance using an ESG rating that is based on a variety of underlying sustainability indicators.

We are concerned about the language of Article 18 where it refers to “**each** of the environmental or social characteristics”. The Level 1 text in Article 8(1) refers to “a combination of” environmental and social characteristics, which would therefore allow firms to use aggregate ESG ratings. Requiring firms to define each of the environmental or social characteristics at a more granular level would therefore be going beyond the Level 1 text. We therefore suggest reformulating this to refer to **“the attainment of the environmental or social characteristics, or combination thereof”**.

Furthermore, as set out above, we believe that the Level 1 clearly sets out that information regarding sustainability indicators is only necessary for the websites, not pre-contractual disclosures, to the extent they are relevant as part of the methodologies and criteria used in the investment process. Including this level of granularity in pre-contractual disclosures might not only overload investors with information but may constrain providers in updating their methodologies on a regular basis, for example as new data sources become available.

**Use of benchmarks**

Recital 27 sets out that the purpose of Article 21 is to ensure that products that are designed to match an index, i.e. a passive fund, are transparent about the benchmark or index they are using and how it is aligned with the environmental and/social characteristics of the fund. However, Article 14 (g) refers to cases where “an index has been designated for the financial product as a reference benchmark”. However, according to the ESMA Q&A relating to the use of benchmarks under UCITS, a UCITS managed in reference to a benchmark is one where the benchmark plays a role in the management of the UCITS, for example, in the explicit or implicit definition of its portfolio composition and/or performance objectives and measures, i.e. it would encompass not only passively managed funds that are designed to match a benchmark but also actively managed benchmarks that merely use the benchmark to define the investment universe or as a comparator. We would recommend that Article 14(g) refers to cases where a financial product tracks an index in order to align with the ESMA Q&A wording and ensure that the scope of Article 14(g) is consistent with the intent set out in recital 27.

If our understanding regarding the scope of reference benchmarks is correct, then we believe that the disclosures set out in Articles 21, 36(d), 40 and 47 may need to be modified as a result, since where a passive fund tracks a benchmark, the characteristics of the product and the benchmark are one and the same. Furthermore, we believe that the disclosures that product providers are required to make under SFDR should be aligned with the disclosures of Benchmark administrators, since product providers will rely on this information in order to undertake their own disclosures. The link to the information provided by Benchmark Administrators is specifically referenced in Article 40 and we believe should also be clearly referenced in Article 21 as well. Furthermore, under the new ESG Benchmark Disclosures, Benchmark Administrators are not mandated to set out how their ESG benchmarks differ from a broad market index but rather to set out how the benchmark methodology takes into account various sustainability factors. Instead, we believe that product providers should provide a description of the benchmark’s key features and where more detailed information regarding the methodology can be found in pre-contractual disclosures and report on the sustainability performance of the benchmark in periodic reporting, based on the Benchmark Administrator’s annual ESG disclosures. We would also like to highlight that there seems to be an error in Article 40 since it seems to refer to the “sustainable investment objective” instead of the “environmental and social characteristics”. We would also find it helpful, for the sake of clarity to specify that “performance” in this context is the sustainability performance not financial performance of the product and/or benchmark.

We also question the language of Article 31 that seems to require that products that have carbon emissions reduction as their objective, that they are mandated to use an EU Climate Benchmark. While the language of the Level 1 text is rather ambiguous, we do not believe that Article 9(3) has the effect of mandating the use of a particular type of benchmark. Our reading of Article 9(1) leaves the choice of benchmark to the product provider whereas Article 9(2) applies where no such benchmark has been designated. Since Article 9(3) sublinea 2 is a derogation from Article 9(2), it does not override Article 9(1) and therefore it should not be read as mandating the use of EU Climate Benchmarks. This reading is supported by recital 21 which says that “financial market participants should disclose sustainability benchmark they use to measure the sustainability performance or where no benchmark is used, how the sustainability objective is met” and recital 24 which says that “where an appropriate index has been designated as a reference benchmark”.

This is important since the EU Climate Benchmarks may not be appropriate for all investment strategies. The EU Climate Benchmarks are based on the concept of investing in a universal benchmark and where carbon emissions must decrease by 7% every year. As such, such benchmarks may not be relevant where product providers seek to reduce carbon emissions by investing in clean technologies. In fact, the TEG, in its report, has highlighted that the methodology cannot be applied to green benchmarks such as CleanTech indices.

Therefore, we believe that it would disproportionate to require product providers to use a benchmark that would not be relevant to its investment approach. We would suggest that Article 31 should instead require product providers to set out ***whether*** the reference benchmark qualified as an EU Climate Transition Benchmark and, if not, an explanation as to why the reference benchmark has been selected instead. Such a “comply or explain” approach would incentivise product providers to use an EU Climate Benchmark where relevant while ensuring that product providers can use other approaches where this would be more suitable for the strategy in question.

**Periodic reporting**

We believe that the requirements regarding periodic reporting should mirror those with regards to pre-contractual disclosures. As set out above and in the detailed responses that follow, we have made suggestions in particularly on the pre-contractual disclosures, which would need to also be reflected in the requirements in relation to periodic reporting. This would include: information on the planned proportions of sustainable investments, the disclosures relation to Do No Significant Harm and information regarding the use of benchmarks.

In addition, we would like to raise the question relating to Article 51(2)(a): we understand this section to be relating to the ***sustainability*** performance of the product and therefore as we are unclear what it would mean for a product provider to disclose on the sustainability performance (for example a reduction in carbon emissions) of a **product net of fees**. We believe that this provision should be either clarified or removed.

Finally, in relation to the historical comparisons in periodic reports, we would like to seek clarity regarding timing of the first reporting. Article 51 seems to imply that the first reference period starts on 1 January 2022 and therefore that the first reports would be published in 2023. It would helpful if the ESAs could provide clarity that this is indeed their understanding. This is without prejudice to our broader comments regarding the issues with the timelines for implementation.

***Implementation timeline***

We welcome the recognition by the ESAs that the current implementation timeline under the SFDR is challenging, in particular for the funds industry where prospectuses require regulatory approval. Beyond the practical challenges for firms and regulators to re-approve all prospectuses by March, which in all likelihood will be before the RTS are finalised and published in the Official Journal, we are concerned that, together with the other regulatory changes foreseen, the current timetable would lead to multiple changes in prospectuses and periodic reporting, which is likely to be confusing to investors.

Further changes to policies and prospectuses are likely to be needed in light of the following regulatory changes that have yet to be finalised:

* Changes to UCITS and AIFMD will mandate the integration of sustainability risks into governance, due diligence and risk management policies. Firms may, as a consequence, need to amend their sustainability risk policies under Article 4 and the disclosures under Article 6. These rules are not yet final and therefore we have no precise timeline for the introduction of these rules.
* Changes to the MiFID Delegated Acts on product governance and suitability may lead to changes to disclosures for Article 8 and 9 products to ensure that the requisite information to enable distributors to define the target market for these funds is available. As with the UCITS and AIFMD rules, these rules are not yet final.
* The introduction of the Taxonomy will again require changes to prospectuses for all products, which need to take place by 1 January 2022.

We believe that aligning the timetable so that all of the above changes enter into effect simultaneously would ensure better outcomes for clients so as to limit any confusion that might be created if they were to receive multiple new pre-contractual documents over a short period of time. We would therefore like to propose the following revised timetable:

1 January 2022:

* Entry into effect product and entity-level website disclosures and pre-contractual disclosures under SFDR (Articles 3, 4, 5, 6, 7, 8, 9 and 10 of SFDR), including Taxonomy changes.
* Entry into effect of changes to UCITS, AIFMD and MiFID Level 2 regarding sustainability risks and sustainability preferences
* Start of 1st reference period for periodic reports and principal adverse impact annual reporting.

1 January 2023

* Entry into effect of periodic reporting under Article 11 of SFDR
* Entry into effect of annual reporting for entity-level principal adverse impact, with the first reports due within 6 months, i.e. by 30 June 2023.

<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>

While we understand the desire expressed by the ESAs for more consistent disclosures, we fear that the proposed approach would lead to a tick-box approach that would not make a meaningful contribution to improving the consideration of adverse sustainability by firms and therefore departs from the intent of the Level 1 text.

In our view, the Level 1 text rightly places the focus on firms undertaking their own due diligence on principal adverse impact and reporting on those policies and procedures, as well as any action taken. In doing so, firms should consider to what extent principal adverse impacts are material or likely to be material. We would highlight recital 18 of the Level 1 text which places the emphasis on such due diligence procedures and sets out how the ESAs should have regard to the OECD multinational guidelines (which are based on a risk-based approach to due diligence) as well as Article 4(2)(a) that states that the responsibility for the identification and prioritisation of principal adverse impacts and indicators sits with the financial market participants as part of their policies.

Ultimately, the intent of these disclosures is to inform investors about which adverse impacts financial market participants consider the most material and the actions they take to address such impacts. In many cases, firms may want to target action on those companies and issues that they consider to be the most significant in order to have the most impact. For example, firms have significantly ramped up activity in relation to climate risk over recent years, in particular under the banner of Climate Action 100+ where asset owners and asset managers campaign for change by the 100+ highest emitters.

We therefore believe that the proposed approach by the ESAs departs from the intent of the Level 1 and risks moving the industry away from the original intent towards more boilerplate disclosures that are unlikely to be meaningful to investors. In particular, by mandating for 32 indicators to always be considered principal, the approach fails to take sufficient account of the principle of materiality. This would seem to conflict with the intent set out in recital 5 of the draft RTS, which we fully support, that sets out that in defining what they consider “principal”, financial market participants should have regard to “*scope, severity, probability of occurrence and potentially irremediable character on sustainability factors. Scope concerns the reach of the effects of the impact, for example the number of individuals that could be affected or the extent of environmental damage such as the volume of water polluted or melting glaciers that could lead to floods, loss of water power capacity, decrease of revenues from tourism and agriculture and thus higher unemployment and non-performing loans. Probability of occurrence refers to the likelihood of adverse impacts to materialise.”*

For example, the proposed approach would consider any company without a policy regarding deforestation to lead to a principal adverse impact, regardless of whether the company in question operates in a sector that would have a material impact on deforestation (for example an IT company with offices in urban areas is unlikely to represent a material risk for deforestation). Similarly, we question considering carbon emissions and carbon footprint as a principal adverse impact without any materiality threshold as this would lead to a conflict with the Taxonomy. Under the EU Taxonomy, the definition of an activity that is considered to be making a significant contribution to climate goals includes transition and enabling activities, both of which would lead to some (albeit lower compared to other companies) carbon emissions and could lead to such activities being considered an adverse impact. Furthermore, the definition of significant harm to climate under Article 17 of the Taxonomy refers to any activity that leads to a significant increase in carbon emissions.

While we recognise that setting materiality thresholds risks making the process unwieldy, we believe that a more principles-based approach that could be applied universally across sectors would be simpler. Taken together with the guidance of recital 5 of the draft RTS on when adverse impacts should be considered “principal”, we believe that our proposed approach would be more intelligible for clients and routed in how market-leading best practice is evolving in this area.

In our experience, investors increasingly want to understand what actions financial market participants are taking in order to manage and mitigate environmental or social harm, for example through engagement and proxy voting, advocacy, etc. We have seen a clear push globally for asset managers and institutional investors to be more purposeful in their engagement and voting, moving beyond simply reporting on the number of AGMs they voted in or the number of meetings they had towards reporting on the outcomes of such activities. We have also seen a significant increase in collaborative engagement initiatives where investors seek to use their combined voice to effect change, for example through Climate Action 100+. We believe that the disclosures for principal adverse impact should be targeted towards adding further momentum to this trend.

For this reason, we would like to propose an alternative approach that we believe would better align with the intent of the Level 1 while also achieving a sufficient level of consistency for investors. Our approach is centred on the OECD guidelines and UN Global Compact, which can be universally applied to all companies (thus removing the need for thresholds or materiality considerations) and would create continuity between the principal adverse impacts identified (both ex-ante in the form of the presence of adequate policies as well as ex-post in the form of any controversies) with the actions taken by the financial market participant to mitigate such impacts. We believe that our proposed approach would provide sufficient detail to investors without overwhelming them and would suit the broad diversity of market participants, taking into account their size and the nature of the products they offer.

The concept of adverse impact is new and we believe that the intent of the Level 1 is to encourage as many financial market participants to opt-in as possible. However, a very ambitious approach from day 1 could deter financial market participants from doing so, meaning that only those subject to the derogation would comply with these disclosures. Therefore, we believe that it makes sense to start with a more principles-based approach, which could be refined over time as firms become more sophisticated in their approach and as improved data becomes available.

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| **Issue**  | **Percentage of assets covered by data** | **Indicator** | **Percentage** | **Commentary and actions taken\*** |
| **Climate change and Environment**1. Support the transition to net zero and reduce climate risk
2. Support a precautionary approach to environmental challenges
3. Undertake initiatives to promote greater environmental responsibility; and
4. Encourage the development and diffusion of environmentally friendly technologies.
 | 80% | Percentage of assets invested in investee companies that do not report on climate risks (aligned with TCFD recommendations) | 60% | Active role as a lead investor and active participant in collaborative engagements on CA100+. Supports minimum expectations of companies sign up to and report on TCFD (e.g. feedback to FCA consultation) |
| Percentage of assets invested in investee companies that have not set climate reduction targets (covering Scope 1, 2 and 3) |  |
| Percentage of assets invested in investee companies without an environmental policy in place |  |
| Percentage of assets invested in investee companies with exposure to significant environmental violations | 25% |
| **Social and Labour Relations**1. Uphold the freedom of association and the effective recognition of the right to collective bargaining
2. Eliminate of all forms of forced and compulsory labour
3. Effectively abolish child labour;
4. Eliminate discrimination in respect of employment and occupation.
 | 80% | Percentage of assets invested in investee companies without a labour policy in place | 60% | Joined the Investor Forum collaboration to engage with the company that was assessed as violating labour standard in their supply chain and actively monitoring the progress of the company.  |
| Percentage of assets invested in investee companies with exposure to significant social and labour violations  | 5% |
| **Human Rights**1. Support and respect the protection of internationally proclaimed human rights
2. Avoid complicity in human rights abuses.
 | 80% | Percentage of assets invested in investee companies without a human rights policy in place | 80% | Support minimum expectations of companies to report on their policy and actions (e.g. NFRD consultations) |
| Percentage of assets invested in investee companies with exposure to significant human rights violations  | 0% |
| **Business Ethics** 1. Work against corruption in all its forms, including extortion and bribery.
2. Support fair business practices, including in relation to consumer interest, competition, taxation and innovation.
 | 80% | Percentage of assets invested in investee companies without a business ethics policy in place | 60% | Active managers and ESG team have engaged the company identified as violating and consider that the company has put in place measures to avoid reoccurrence. |
| Percentage of assets invested in investee companies with exposure to significant bribery or corruption violations | 5% |

<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>

As set out in our comments above, we believe that the proposed approach may act as a disincentivise to smaller financial market participants to opt-in to the regime, given that the proposed approach would entail significant new data and reporting requirements. We found that we could readily access data on less than half of the indicators proposed by the ESAs, and a handful of others where data is available but not following the calculation methodology proposed by the ESAs. Even then, significant infrastructure would be needed in order to be able extract the relevant information and provide the breakdown in the format required in the Annex.

The proposed approach is centred on direct investments in investee companies and may not be relevant to other asset classes (e.g. government bonds, real estate, derivatives). However, we believe that designing a consistent methodology that could work across asset classes would be very complex and therefore we believe focusing on equity and corporate bonds is a proportionate approach but would welcome clarification from the ESAs that this is what is intended by “investment”.

The approach laid out also raises questions with regards to how indirect investments (for example investments in fund-of-funds) would comply. Since the Level 1 concerns the “investment decision”, the decision in question would be the selection of the underlying funds. Since product-level disclosures on principal adverse impact are not due to take effect until 31 December 2022, we question how an investor could comply with principal adverse impact reporting for fund-of-funds until such time as those disclosures came into effect.

<ESA\_QUESTION\_ESG\_2>

* : 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>

As set out above, we believe that the disclosures need to strike a better balance between comparability and how meaningful the disclosures will ultimately be. Focusing too heavily on comparability is likely to lead to a tick-box exercise and boilerplate disclosures that would be inconsistent with the aims and spirit of the Level 1. As set out above, we would propose an alternative approach that seeks to refocus on key principles derived from the UN Global Compact and OECD multinational guidelines, while still ensuring sufficient consistency and comparability.

<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 above, we believe that the disclosures need to strike a better balance between comparability and how meaningful the disclosures will ultimately be. Focusing too heavily on comparability is likely to lead to a tick-box exercise and boilerplate disclosures that would be inconsistent with the aims and spirit of the Level 1. As set out above, we would propose an alternative approach that seeks to refocus on key principles derived from the UN Global Compact and OECD multinational guidelines, while still ensuring sufficient consistency and comparability.

In particular, we believe that the reporting template places too much emphasis on the indicators, with information relating to the policies and any action taken relegated to the end of the template when in fact, it is this information that is supposed to be the focus of the disclosures under the Level 1.

<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>

As per out comments above, we believe that many of the indicators proposed fail to consider materiality and therefore could lead to unintended consequences by giving the impression that the scale of adverse impact is much larger than it truly is or conversely, by aggregating the numbers could mask the existence of adverse impacts.

To give a couple of examples:

* Considering all companies without a deforestation policy regardless of whether such companies are at risk of contributing to deforestation is likely to overstate the significance of this risk, which is likely to be most prevalent in a certain number of industries and countries.
* Aggregating the ratio of highest to lowest paid employees is likely to mask cases where there is excessive CEO pay (which is more significant in certain industries than others).

We therefore believe that, in order to achieve comparability, there is a need to focus on more universal principles that can be applied to all companies across sectors, as set out above.

With regards to more forward-looking indicators, in principle we would agree that the use of forward-looking metrics for climate risk would allow firms to identify companies that are not aligned with the Paris Agreement. Significant work is currently ongoing across the industry (for example by the IIGCC Paris-Aligned Investing working group and the Net Zero Asset Owners Alliance) to define methodologies that might enable investors to identify which companies are aligned with the Paris Agreement. However, the methodologies to undertake such assessments are still in the early stages of development and not yet ready for mass deployment. They also imply a very significant resource commitment for financial market participants and therefore we believe that it is too early to consider using such detailed forward-looking measures.

We believe that a simpler approach would be to focus on measuring the percentage of companies not yet disclosing against the TCFD and not yet having set carbon reduction targets (including Scope 1, 2 and 3 targets), since this would reinforce the policy objective to encourage companies to disclose on climate risk and to transition towards lower-carbon business models, while being simple to measure and report on.

<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 per our comments above, while we recognise that such relative metrics would be more meaningful in identifying companies at risk of having a significant adverse impact on climate change, calibrating such a relative measure may be overly onerous for firms. As set out above in question 5, we believe that a simpler approach could focus on TCFD reporting and the setting of carbon reduction targets, which would be relatively easy to measure and would reinforce the broader policy objective of encouraging companies to report on their climate risk and set carbon reduction targets.

<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>

We believe that presenting two different methodologies is likely to be confusing for investors. Of the two approaches, we believe that measuring the share of investments in companies would be more meaningful since it would allow investors to gauge the level of exposure to such companies. For example, 20 companies may flag on a particular indicator but only represent 0.1% of the investments whereas only 1 company could flag on an indicator but represent 20% of the portfolio.

Focusing on the share of investment would also be consistent with the OECD guidelines, which emphasis that the materiality of the exposure (as well as the materiality of the risk) should be taken into account when firms undertake their due diligence.

This is why our proposed approach focuses on the share of the assets exposed to the relevant risk indicators, rather than the number of entities.

<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>

As set out above, our preferred approach would be to focus on companies that are not reporting against TCFD and have not set a carbon reduction target. Such metrics would be a better measure of adverse impact that carbon intensity, would align with the EU’s policy objectives under the Green Deal and EU Taxonomy and would be relatively easy to measure.

<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>

Yes, we agree that environmental and social issues are equally important to investors and ideally should be presented holistically, as set out in our proposed approach.

<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 agree that some historical comparison would be helpful since principal adverse impacts and the actions taken by firms may take place over a period of time and would enable investors to understand whether the actions taken by firms are leading to meaningful improvements. We also welcome the proposal by the ESAs to ensure that such an obligation is not retroactive, and therefore should only begin from the point in time when a firm first starts reporting on principle adverse impact. That said, we believe that 10 years may be too long, particularly as the data and approaches in this area are evolving at pace. We would suggest that 5 years would be a more realistic timeframe.

<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 question the extent to which “window dressing” is likely to be a significant issue. Asset managers have a duty of care to their clients to act in their best interest. Selling assets in order to “game” their principal adverse impact disclosures would clearly run contrary to that duty of care since it would lead to increase transaction costs and could lead to financial detriment of investors.

We are concerned by the proposal set out during the public hearing that firms should be measuring adverse impact daily, since such an approach would be hugely resource intensive and unlikely to add much value to investors given that average portfolio turnover rates are, in most cases, fairly low. To the extent that the ESAs would like to harmonise the timing of reporting across the reference period, we would suggest either a single snapshot at year end (which would be consistent with existing product-level periodic reporting) or alternatively quarterly snapshots to capture changes in the composition of the portfolio during the year.

<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>

In the absence of any examples of the proposed templates, it is difficult to give a concrete answer. However, in principle we have reservations about the proposal to have mandatory templates for pre-contractual and periodic reporting for financial products. We recognise the desire of the ESAs to ensure comparability of the information presented to clients, but we question whether the mandatory use of templates in pre-contractual disclosures and period reporting is the right way to achieve this objective. We believe that the level of detail set out in the RTS themselves should be sufficiently detailed to ensure that investors can access consistent information.

Firstly, we believe that the information relating to the environmental and social characteristics or sustainable investment objective should be integrated into the core information already provided to investors. We believe that such an approach would improve investor understanding about the product they are investing in and its key features. Mandating the use of a template would run contrary to this aim since it may require firms to present the ESG information separately from the rest of the investment policy rather than presenting it as part and parcel of the product’s investment strategy. It may also constrain innovation in this space, particularly since approaches to presenting sustainability information to clients are still evolving.

Secondly, the use of templates could undermine the principle set out in the ESAs commentary regarding the need to ensure that the disclosures are proportionate to the ESG approach of the fund. We fully endorse this principle to ensure that firms do not underdisclose but also don’t overdisclose. Article 8 products, in particular, will include products pursuing very different approaches. A one-size-fits-all template is unlikely to achieve meaningful transparency and could limit the ability of firms to ensure that their disclosures are proportionate and lead to product providers disclosing information that is not meaningful or relevant to the strategy.

Linked to this is the practical challenge of designing a template that would work across product types but also the different types of pre-contractual disclosures. For example, while the Level 1 text specifies that for portfolio management, the disclosures shall take place in the Article 24 disclosures, where the form and length of such disclosures is unconstrained. On the other hand, for a PEPP, the pre-contractual disclosures are aimed to be integrated into the PEPP KID, where the format and length is highly constrained. In order to cater to such variety of products, approaches and pre-contractual document types, we believe that a more flexible approach is needed that is ill-suited to a template.

As set out in more detail in further questions, we would suggest that in order to cater for these different needs, the information provide in pre-contractual disclosures should focus on the key features and binding elements of the investment strategy that an investor would need to understand the approach on offer, with further complementary or more detailed information available on the website. Should the ESAs feel that a template would be of value to clients to ensure a greater level of comparability than is possible within the confines of disparate pre-contractual disclosures, we would suggest that such a template might be better suited to disclosure on the website rather than in the pre-contractual disclosures themselves (for example replacing the proposed 2-page summary on the website).

We would also suggest that the ESAs consider developing such templates under the empowerment under Article 13 to develop implementing technical standards since such an approach would enable the templates to be updated more frequently as approaches to disclosing such information evolve rather than including them as part of the RTS themselves, which can be time-consuming to amend and update.

<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>

As per our comments above, we have reservations about whether such templates would be the best way to ensure consistency of disclosures to end clients. To the extent that the ESAs do pursue the introduction of templates, we believe that the templates should be focused on the core information that will aid investors in making an investment choice, i.e. the key features of the fund. Given the diversity of approaches that will fall under Article 8 in particular, we believe that going beyond this may prove challenging since many of the additional elements suggested by the ESAs may not be relevant to all investment approaches or asset classes.

Furthermore, we would urge the ESAs to undertake consumer testing to ensure that the information facilitates the comprehension of investors and provides them with meaningful and decision-useful information.

<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 above, we believe that the detail contained in the RTS, which specify the contents of the information to be disclosed should ensure adequate comparability between products while allowing sufficient flexibility to be able to integrate the information into existing documents.

Should the ESAs consider the use of templates as necessary to achieve a higher level of comparability, we would suggest that the templates might instead be published on the websites (replacing the 2-page summary section).

<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>

As per our comments above, these disclosure rules will apply to a very broad range of products, spanning different product structures, different asset classes and different sustainable investment approaches. We believe that some of the proposed disclosures might only be relevant to certain types of investments and may lead to many funds providing nil returns. For example, we believe that many Article 8 products will not plan to allocate a proportion of their investments to sustainable investments.

We therefore believe that the requirements for the pre-contractual disclosures should be more targeted with a focus only the binding characteristics of the investment strategy, with complementary or more detailed information available on the website. We believe that some of the information currently suggested to be include in the pre-contractual documents might sit better on the website where that information, in particular information regarding planned proportions where such proportions are not a binding characteristic of the fund and therefore is likely to change; or implies a level of detail that would be better suited to website disclosures. Furthermore, graphical representations are atypical in fund prospectuses. Instead, we would limit pre-contractual disclosures to narrative descriptions only, with graphical representations being reserved for the website.

In particular, we believe that the information regarding sectoral exposures (Article 15(b)(iii)) should only be provided in pre-contractual disclosures where this is a binding characteristic of the strategy and would only apply in the case of equity and corporate bonds (i.e. in the case of sectoral exclusions). Even funds based on sectoral exclusions are likely to reference the sectors they do not plan to allocate capital to and even then, it may not take the form of a proportion or percentage but rather some other rules-based approach to the exclusion. For example, a fund may seek to exclude any company deriving more than 10% of its revenues from tobacco but this may not manifest as a binding proportion of the fund being invested in that sector. Therefore, we would suggest that the ESAs might wish to refer to the planned “allocation” rather than “proportion” in order to cater for the different approaches that product providers may take.

For other approaches (e.g. real estate funds, best-in-class) we believe that such information may be provided for illustration purposes but in such circumstances, it should be optional and should feature on the website rather than pre-contractual documents. For fund-of-funds, we would welcome clarification that no look-through to the underlying funds’ holdings is necessary. Instead, we would suggest that the FoF links to the constituent funds’ own disclosures.

From a practical perspective, it is also challenging for funds since the pre-contractual documents in question are the prospectuses that require regulatory approval, which can take several months to update, and therefore the information may become stale and would be a burden to update regularly. We believe that an alternative approach would be to include only a narrative description of any binding characteristics in terms of constraints or targets for investing in particular sectors, with a detailed breakdown or a graphical illustration of the sectoral allocation for information purposes only provided on the website, where such information can be updated regularly and presented in a more engaging manner to clients.

We also believe that Article 18 relating to sustainability indicators should also be on the website rather than the prospectus. Firstly, the Level 1 text (Article 10(1)(b)) only refers to information relating to sustainability indicators in relation to website disclosures, whereas pre-contractual disclosures are to be focused on the environmental and/or social characteristics of the product. Secondly, including such information in pre-contractual disclosures may be overly detailed. For example, where a product uses an ESG rating to measure the environmental and social characteristics for the fund, the ESG rating may rely on a significant number of different indicators that may be applied differently to each company depending on the industry and geography of the activities of the company. This is likely to entail a level of detail that is unnecessary in pre-contractual disclosures and again would entail significant burdens both on market participants and regulators every time the methodology of the rating were to change.

Finally, in relation to website disclosures, we would recommend removing the requirement for a 2-page limit for the summary. Since such disclosures are to appear online rather than as paper documents, we see no reason to impose such a constraint which would run against the current policy objective to ensure that client disclosures are digital and more interactive. As per above, this may be where the proposed templates could be used instead.

<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>

We therefore believe that the main difference between Article 8 and Article 9 products are sufficiently well captured by the proposed provisions and we do not believe that there is a need to further distinguish between them.

As set out in recital 21 of the Level 1 text, Article 8 and Article 9 seek to capture the breadth of sustainable products on the market, catering to the different degrees of ambition that underpin these strategies while recognising that Article 9 products will go beyond an Article 8 product by having as an objective a positive impact on the environment and society.

The difference between Article 8 and Article 9, therefore, is that an Article 9 will seek to deliver a positive and measurable environmental or social impact by primarily investing in sustainable investments (as defined by Article 2(17) of the Level 1) whereas an Article 8 product will promote an environmental and/or social characteristic. As part of attaining their environmental or social characteristics, a subset of Article 8 products may also wish to invest in sustainable investments alongside other types of investments in order to attain the environmental and/or social characteristics of the product but need only meet a lower bar of demonstrating how the characteristics have been met.

However, as per our introductory comments, we believe that it may be helpful to provide further guidance on the scope of Article 8 and Article 9. In particular, we have concerns that recital 21 may inadvertently scope in a number of products that are not intended to promote environmental or social characteristics.

We would suggest reformulating recital 21 as follows:

Financial products with environmental or social characteristics should be considered to be promoting, among other characteristics, environmental or social characteristics, or a combination thereof, when information provided to clients, in marketing communications or in mandatory investor disclosures or as part of a process of automatic enrolment in an IORP, ***presents sustainability considerations as a key feature of the product. Proportionate references to the consideration of sustainability risks or sustainability factors in pre-contractual documents should not be considered to be promoting an environmental or social characteristic so long as financial market participants include a statement to that effect.***

In relation to Article 9, we would understand the Level 1 as defining Article 9 products as products which has as their **investment** objective to **primarily** invest in sustainable investments (as defined by Article 2(17) of the SFDR), which seems to have been confirmed by the ESAs during the public hearing when discussing the extent to which a fund following the proposed eco-label rules for equity should be classed as Article 8 rather than Article 9. While the definition of “primarily” varies by regulator, we believe that including a recital to provide further clarity might be helpful to provide guidance to firms as to when they should be disclosing under Article 9 rather than Article 8.

To avoid any doubt as to whether a product provider considers a product to be Article 8 or Article 9, we agree that it makes sense to include a statement to this effect. We believe that the disclaimer under Article 16 which requires providers to state that Article 8 products are not aiming to have sustainable investments as their investment objective should be sufficient to ensure that clients are clear as to whether product providers consider the product to be Article 8 or Article 9, recalling that the purpose of these rules is to ensure transparency rather than introducing a form of product-label.

However, we would recommend reformulating Article 16 to ensure clarity for investors for the following reasons:

* Many investors will interpret “sustainable investment objective” in a broader sense, i.e. to mean that the fund follows a sustainable investing strategy, rather than the legal definition of sustainable investment under Article 2(17) of SFDR, and therefore may be confused by this language.
* Article 8 products may also invest in sustainable investments as defined by Article 2(17) of SFDR (as recognised under Article 15 of the draft RTS) but it will form part of the environmental and social characteristics rather than the investment objective. Again, it may cause confusion to investors who may not appreciate the legal nuances between an objective and a characteristic.

For these reasons we would propose the following alternative drafting:

**No environmental or social objective**

The section referred to in point (b) of Article 14 shall contain the following statement: This product does not have as its objective to invest primarily in sustainable investments as defined in Article 2(17) of the Sustainable Finance Disclosures Regulation.

Where a financial product invests in sustainable investments as part of the attainment of the environmental and/or social characteristics of the product, the section shall also contain an description of the financial market participant’s policies regarding the “do no significant harm” principle and its application in relation to the planned proportion of sustainable investments.

<ESA\_QUESTION\_ESG\_16>

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

<ESA\_QUESTION\_ESG\_17>

In relation to indirect investments, for example in the case of fund-of-funds, a core question will be whether product providers are required to undertake a “look-through” to the underlying fund holdings in order to comply with these rules, which would significantly increase the complexity of these disclosures. In keeping with our comments in response to other questions, we believe that only the binding elements of the investment strategy should be required under the RTS, with complementary information regarding sectoral allocations, minimum reduction rates, etc. only disclosed where relevant and on the website. In the case of indirect investments such as fund-of-funds, the focus would therefore be on how the underlying funds are selected rather than looking-through to the holdings of the underlying funds.

<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>

We question whether a graphical representation would be additive to investors since, in most cases, we believe that the vast majority of investments would be screened against the environmental and/or social characteristics (except any cash or other assets in the fund, which would in most cases be a relatively small percentage of the assets).

If we consider some of the typical approaches that Article 8 products are likely to pursue:

* **Exclusions**: where a fund sets out as its approach to exclude certain types of assets (for example companies whose revenues are derived from certain activities such as tobacco, weapons, fossil fuels, etc), then one would expect all of the funds assets to be screened for these characteristics. It is the absence of such investments that contribute to the environmental or social characteristics and therefore any further subdivision would not make sense.
* **Best-in-class**: where a fund uses a best-in-class screen to select assets, again one would expect that almost all of the fund’s assets would have been screened and any assets where such screening was not possible would likely to be excluded. Since such screens are typically done using aggregate ESG scores, a further subdivision between environmental and social characteristics would again not be meaningful here.
* **Thematic***:* as with a best-in-class fund, the ESG screen would be used to select investments for the portfolio and therefore we would expect all of the investments to have been screened. Such funds typically focus on single themes and therefore a further subdivision is unlikely to be relevant.
* **Fund-of-fund:** in the case of fund-of-funds, the product will invest in other funds that are themselves Article 8 or, in some cases, Article 9 products. In such cases, the investment in question would be the underlying funds and we think it would be disproportionate to require such products to undertake a look-through to the holdings of each underlying fund.

We would therefore suggest that such disclosures on planned proportions may only be relevant where a product has as part of its investment strategy to invest in sustainable investments or Taxonomy-aligned investments and therefore may wish to highlight the percentage of investments that fulfil such criteria. However, we believe that a narrative disclosure would be better suited for presenting this information since many funds will include some level of discretion (for example the investment policy may indicate that the fund will invest up to x% of the assets) which may be difficult to convey in a graphical representation.

<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>

In our experience, investors are interested in understanding the sectoral exposure of the product for in order to understand what sectors may have been excluded (rather than included) from the product. However, in many cases, exclusions will be done at industry or sub-industry level (for example tobacco, controversial weapons, etc) and therefore this is unlikely to be visible from a sectoral breakdown. In particular, such funds may not make the proportion invested a binding characteristic but rather the outcome of applying an exclusion to companies exhibiting certain characteristics (for example, a common approach is to exclude companies with more than x% of revenues derived from certain activities). The application of this binding characteristic may not translate into a planned proportion of the fund invested in that sector but rather the fund may display information at a point in time regarding the proportion of assets in such sectors for information purposes.

Where this is relevant, we would suggest that product providers should set out which sectors/activities have been excluded in the form of a table, if that is relevant to the strategy of the product. We would caution against attempts to mandate in detail which sectors/sub-industries should be shown in such a table since such preferences vary by market and asset class and it is therefore difficult to standardise such information. That said, we believe most investors increasingly would want to understand their exposure to all fossil fuels, not only solid fossil fuels.

Sectoral breakdowns may also be of interest to investors to understand whether the characteristic is achieved by underweighting certain sectors rather than using a best-in-class approach. For example, a fund that seeks to reduce the carbon intensity of the fund could achieve this by not investing in high emitting sectors, which might limit diversification of the fund or increase tracking error, or by only investing in companies with the lowest carbon emissions in each sector in order to maintain diversification of the fund and limit tracking error. A sectoral breakdown may assist investors to better understand the approach taken but this would be for information purposes only rather than a binding characteristic of the fund and therefore, where relevant, would be more appropriate on the website.

<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>

As set out above, we believe that greater flexibility may be warranted to cater for the different product types and approaches that will fall under Article 8, in particular.

An area where attention is required will relate to portfolio management, in particular in relation to information made available on websites. In particular, since portfolio management is specific to the needs of an individual client, we believe that making information relating to their investments publicly available on websites could breach the client’s right to privacy. We believe that this issue could be addressed in one of two ways. Firstly, where the portfolio management service follows the same investment strategy as a UCITS or AIF, financial market participants may provide information on the website at the investment strategy level, which would cover all products that follow that strategy, rather than individual website disclosures for each product. Secondly, where the portfolio management service follows a bespoke investment strategy made available only to that client, information provided on the website can be provide in a password-protected part of the website, which only the client has access to.

<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>

We agree with the ESAs that the “good governance practices” should be seen through the prism of a policy to manage governance issues. However, we would suggest that RTS should not seek to gold-plate the Level 1 text by standardising the definition of “good governance practices” across Article 8 and Article 9 products.

While from a practical perspective, firms that offer products that invest in sustainable investments (either Article 9 products or Article 8 that invest a portion of the assets in sustainable investments) are likely to apply the same policy across its range of products and therefore may apply the higher standard to Article 8 products regardless of whether these products invest a portion of their assets in sustainable investments, we believe it would be disproportionate for those providers that do not offer Article 9 products or Article 8 products investing in sustainable investments to be required to meet this higher standard.

<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>

We are concerned that the proposed rules regarding the “do no significant harm” principle will create a significant burden on funds and could have the effect of significantly constraining such investments.

Under Article 2(17), a sustainable investment is defined as an investment that makes a significant contribution to an environmental or social objective without doing harm to other objectives. However, there is no exhaustive definition of environmental or social objectives nor further clarity on what is means to do no significant harm.

Similar to adverse impact, the concept of do no significant harm is primarily seen as a process-driven due diligence requirement, whereby firms undertake risk-based assessments to ensure that their investments do not cause significant harm to sustainability that may be relevant to the investment. We therefore believe that the language of Articles 16, 25, 38 and 45 should rather focus on the due diligence processes undertaken by the firms to ensure that the investments do not do any harm, rather than on any quantitative disclosures based on the ESAs concept of adverse impact or exclusions applied.

Furthermore, we believe that the definition of do no significant harm under the Taxonomy and SFDR should be consistent. As recognised in the Taxonomy Regulation, the principle of do no significant harm and adverse impact should be made consistent by the ESAs. However, as set out in our views in earlier questions on adverse impact, we have concerns that the proposal principal adverse impact indicators conflict with the spirit of the Taxonomy. To give a few examples:

* Article 17 of the Taxonomy defines significant harm to climate change mitigation being where the activity leads to significant greenhouse gas emissions. In contrast, the adverse impact indicator considers any level of greenhouse gas emissions (including where a transition or enabling activity meets the substantial contribution threshold) to be an adverse impact, which would include activities deemed to be making a significant contribution to climate change mitigation (in particular transition and enabling activities).
* Article 17 defines significant harm to pollution as being where there is a significant increase in generation of waste (excluding non-recyclable waste) whereas the adverse impact indicator considers all non-recycled waste as creating an adverse impact.

The definition of principal adverse impact as proposed by the ESAs is therefore inconsistent and much more expansive (it covers over 32 different indicators and 4 different indicators for greenhouse gas emissions whereas the Taxonomy DNSH is only one indicator), setting a much higher bar for sustainable investments than is provided for by the Taxonomy, which would seem inconsistent since the Taxonomy is designed to represent the gold standard when it comes to ascertaining the sustainability of an investment.

Furthermore, while we recognise that the SFDR pre-dates the Taxonomy and therefore makes no explicit mention of the do no significant harm rules under that legislation, we believe that funds which have Taxonomy-aligned investments as their investment objective should be able to rely on the “do no significant harm” assessment and minimum social safeguards under the Taxonomy in order to comply with the DNSH requirements under SFDR.

We would propose the following approach to developing the principle of do no significant harm under the Disclosure Regulation:

* The definition of principal adverse impact should be reviewed as per our recommendations above to better align with the minimum social safeguards in the Taxonomy, seeing as both principal adverse impact and the minimum social safeguards are based on the OECD guidelines.
* The disclosures provided by financial market participants should be focused on how firms define “do no significant harm” and their processes and procedures to ensure that the investments selected for the product do not cause significant harm, instead of focusing on what has been excluded.
* Financial market participants may leverage the definition of do no significant harm as set out in Article 17 of the Taxonomy when disclosing how the sustainable investments meet the DNSH criteria for environmentally sustainable investments. For social objectives, firms should set out their own approach in the absence of any defined social Taxonomy.

<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>

We do not see the need for the ESAs to define such strategies. Firstly, these terms are already well understood and we therefore see no need for them to be defined in law. Secondly, fixed definitions may hinder innovation in responsible investing.

<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>

While we broadly agree with the idea of including the top investments in periodic reports, and indeed this is already standard industry practice, we believe that the minimum should be the top 10 holdings rather than 25. This would align with current best practice in the industry.

More broadly, we believe that the requirements regarding periodic reporting should mirror those with regards to pre-contractual disclosures. As set out above and in the detailed responses that follow, we have made suggestions in particularly on the pre-contractual disclosures, which would need to also be reflected in the requirements in relation to periodic reporting. This would include: information on the planned proportions of sustainable investments, the disclosures relation to Do No Significant Harm and information regarding the use of benchmarks.

In addition, we would like to raise the question relating to Article 51(2)(a): we understand this section to be relating to the ***sustainability*** performance of the product and therefore as we are unclear what it would mean for a product provider to disclose on the sustainability performance (for example a reduction in carbon emissions) of a **product net of fees**. We believe that this provision should be either clarified or removed.

Finally, in relation to the historical comparisons in periodic reports, we would like to seek clarity regarding timing of the first reporting. Article 51 seems to imply that the first reference period starts on 1 January 2022 and therefore that the first reports would be published in 2023. It would helpful if the ESAs could provide clarity that this is indeed their understanding. This is without prejudice to our broader comments regarding the issues with the timelines for implementation.

<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.
* 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);
* 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);
* 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
* 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>

 ***Indication of any commitment of a minimum reduction rate***

Firstly, we believe that it is important to distinguish whether the reduction of the investment universe is a binding characteristic of the investment strategy (as under Article 17(a) of the draft RTS) or simply additional information provided to investors so that they may understand the materiality of the ESG approach. Where it is the former, then this information should form part of the pre-contractual disclosures but where it is the latter, it would make more sense to have this information on the website.

Secondly, we would suggest reformulating the language of Article 17(b) since funds that apply a best-in-class approach may not only adopt a relative approach where they rely on a percentage or rate but may define the threshold in relation to an absolute ESG score. For example, a fund may rate each company in the investment universe on a scale of A-E and exclude any company with a score of D or below. However, depending on the rating approach, it does not necessarily mean that each level A-E equates to 20% of the holdings and therefore the approach may mean that either more or less than 40% of the investable universe is excluded.

We would also recommend that the ESAs may wish to include some language with regards to what is meant by investment universe, particularly for products that do not have an index as a reference benchmark that is used to define the investment universe. In such cases, the investment universe could be defined in relation to the non-ESG version of the product, where one exists.

***Description of good governance policies***

We believe that information relating to policies, rather than product-specific characteristics would be better suited to website disclosures, in keeping with the requirements for sustainability risks and principal adverse impact policies.

***Limitations to methodologies and data sources***

We believe that such information is best suited to the website, consistent with the Level 1 requirements where Article 10(b) makes clear that information relating to data sources and methodologies should be disclosed on the website rather than in pre-contractual disclosures. It would be unhelpful to investors to have the information on methodology and data sources disclosed in a different place from the description of their limitations.

However, we would question the presumption in the above wording that such limitations do not affect the attainment of any environmental or social characteristics or sustainability objective. As recognised in the ESAs joint letter to the European Commission in response to the Sustainable Finance Strategy consultation, access to reliable and comparable sustainability data remains challenging. Firms will therefore wish to mitigate any legal or reputational risks by caveating any disclosures made by setting out any limitations, and the extent to which it may affect the attainment of any sustainability characteristics or objectives so as not to be held liable where such assessments were based on incomplete or erroneous data. Firms should instead set out any due diligence they have conducted in order to ensure the reliability of the data, on a best efforts’ basis.

***Reference to external or internal data sources***

As set out above, the Level 1 text (Article 10(b)) makes clear that information pertaining to data sources should be set out in website disclosures. We believe that the requirements set out in Article 34(j) of the draft RTS are sufficient.

<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>

We would suggest that some flexibility may be needed in relation to where this information is provided depending on the circumstances. While it is standard practice to include a separate section on the use of derivatives, it may not always be the case that their use will meet the environmental or social characteristics of the product (for example where used for hedging purposes) and there may be circumstances where the information would fit better within Article 17 regarding the investment strategy.

Derivatives may be used within a product for different reasons. In some cases, the derivative may form a core part of how the product meets its environmental and/or social characteristics. For example, where an a tracker fund replicating an ESG index using synthetic replication via a swap, the environmental and or social characteristics of the product and the swap are one and the same and therefore including this information in the investment strategy section may be more meaningful.

In other cases, derivatives may be used for risk mitigation purposes (for example to manage interest rate or currency risk) and therefore would be included in the “remainder” portion of the investment proportions and could be descripted in a separate section. However, in such circumstances, the use of derivatives cannot be said to “meet the environmental or social characteristics” or “sustainability objective” of the fund. We believe that the language of recital 30 referring to the compatibility with the sustainability characteristics or objectives of the product would be more appropriate.

<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>

As set out in our responses above, we are cautious about the use of templates for pre-contractual disclosures. In relation to the impact assessment, we note that the ESAs discounted the use of templates for website disclosures, considering them too rigid for financial market participants and yet came out in favour of such templates in pre-contractual disclosures, which we find to be inconsistent. Similarly, we find that the pros set out for not using a template for periodic reporting outweigh the cons (and would add that we see the ability to adjust the information to end-investor needs as a pro, not a con) whereas the cons for the ESAs preferred approach are considerable.

In relation to principal adverse impact, while we would broadly agree with the impact assessment, we see the approach set out by the ESAs as being based on option 3 (detailed rules) given that the vast majority of the identified indicators are mandatory and required very granular indicators to be reported following a prescribed methodology. Therefore, we would not consider this to be consistent with “minimum” standards.

In terms of cost, should the data required to comply with these rules not be available from a single source (as is currently the case), it could multiply the costs for product providers. For example, in order to ensure sufficient coverage of data, we currently use data from half a dozen providers totalling over $1m a year in subscription fees, much higher than the 200,000 EUR set out in the impact assessment. Added to this is the significant resources required to develop reporting systems and producing the relevant documents.

<ESA\_QUESTION\_ESG\_27>

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. [↑](#footnote-ref-2)