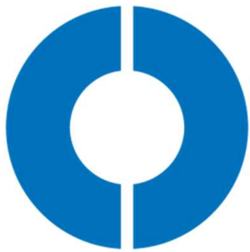
Schroders



Joint ESA Consultation Paper on ESG Disclosures

Response by Schroders plc

1 September 2020

About Schroders

As a global asset and wealth manager, Schroders delivers a broad range of investments designed to meet the diverse needs of institutions, intermediaries and high net worth individuals. We manage over EUR 550bn globally across a wide range of asset classes, regions and strategies. We have a long history of commitment to sustainable investment, having established a dedicated team over 20 years ago, which has grown to over 20 focused sustainable investment professionals today.

Summary

We believe that the disclosure elements of the EU Sustainable Finance package are particularly vital. By making ESG integration mandatory across the EU and by calling for more granularity on the process of due diligence, this regulation is an important step for embedding sustainability into all activities.

It is also vital that end-investors are provided with clear, comparable information on which to base comparisons. We recognise that many of the requirements are at an entity rather than fund level, but nonetheless expect that they will ultimately provide a template for fund level reporting, not least as building an entity level view will require the amalgamation of portfolio level measures.

We are concerned that elements of the disclosure requirement represent a tick box approach to adverse impacts which might lead many in the financial chain to consider that adverse impacts only need to be considered for a small proportion of their assets and only in relation to the factors identified. Sustainable investment is a large but still-growing field, in which innovation and new ideas must be encouraged, rather than choked by an overly-expansive framework that risks restraining rather than promoting the innovation this industry needs. If this is ignored, **there's a real risk that ESG considerations become a compliance exercise, rather than part of the "DNA" of financial market participants.**

For example, in recent years, we have developed our proprietary tool SustainEx model which quantifies around 40 areas of social or environmental impacts, including a number that are not covered in the template ranging from arms production, prescription drug abuse, employee stress and plastics manufacturing.

Our proprietary tool for conducting company level due diligence looks at over 250 data points using both conventional and unconventional data from over 70 sources to build up a picture of a company's **material** impacts, exposures and management before investing. Yet despite having invested significantly in this we still struggle to find credible information sources for many of the data fields identified in Table 1.

This makes it even more obvious that aggregating the data bottom-up from portfolio/product to entity level, we need to concentrate on indicators which make sense across the (product board) as well as across asset classes and hence provide meaningful, material and comparable information to investors at entity level.

Public company disclosure simply isn't granular enough, let alone private company or asset disclosure. We think it is therefore inevitable that the data for much of this will be estimated, likely by the 3rd party ESG rating agencies, given the task will be too great for any one fund management house to do itself. We have already noted that in relation to the Taxonomy and Benchmarks that it

is highly likely that **outsourced solutions** will be used. We are concerned that this will create **market distortions** and certainly create risk and an **anti competitive environment** in that we suspect only two of the existing ESG rating agencies will be in a positon to build the data sets. **We strongly advocate for a much slimmed down template based on widely reported data to avoid this issue. Over time as the NFRD encourages better company disclosure this could be built out. We would also suggest to allow disclosures per asset class for a more meaningful analysis.**

However we do believe that there is real merit in surfacing more data on the ESG performance of investments. We also think that there is real merit in using "raw" ESG data points, rather than the black box aggregated scores that are in use, but are difficult for even expert investors to understand.

We would also advocate a **greater role for Asset Management companies to describe their own methods for conducting due diligence** and the outcomes of their in house tools. We feel that this would enable clients to conduct their own analysis on the differentiated approaches and come to their own conclusions. By creating a market that encourages innovation we believe that ultimately in this still nascent area of investment better solutions will ultimately be found.

Own experience of performing due diligence on ESG issues for many years now have taught us that **materiality is key**. Many of the issues that are in the suggested template are material, but with the exception of the corporate governance issues, few are for all sectors, the only practical solution to which is more flexibility to encourage investment firms to detail how they assess materiality and the performances of investee companies in those areas.

Finally we would welcome some more **guidance of the characteristics of Article 8 and 9 products and** where the line is drawn **between Article 8 products and the disclosure of how sustainability risks are integrated into investment decisions** of all products in scope (Article 6). Against the granularity of the Taxonomy we find the lack of definition between characteristics and objectives potentially confusing. We welcome the suggestion that the ESA might provide mapping against widely used investment terms in this area.

Questions

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?*

We agree that clear quantification and disclosure of the most significant dimensions of investment impacts – both on a positive and a negative side - is important. Our concerns with the approach outlined are twofold:

- Firstly, the disclosures described ignore any necessary materiality assessment: not all of the indicators will always lead to principal adverse impact, while in some instances indicators not covered by the template will be material (e.g. tobacco production or gambling activities). Hence, the proprietary framework we have developed to assess corporate externalities,

SustainEx[1], includes around 40 impacts of which less than half are included in Table 1 Translating this process from product to entity level will only provide meaningful, material and comparable information to investors if we focus on indicators which make sense across the (product) board as well as across asset classes.

- Second, while we agree with the statement in the impact assessment that it is important that firms do not just make statements about due diligence policies, we do not believe that the proposed approach actually provides as per Article 4(2)(a) adequate "information about ….**policies**." Successful due diligence requires not only data, but an understanding of the relevance and materiality of that data to the underlying investment. The proposed template provides no room for this judgement to come through.

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

While the qualitative disclosures contained in Chapter II are helpful, the metrics suggested in Annex I create some issues; in particular for a diversified asset manager investing across public and private markets, such as us. Most of the metrics appear to be based on the implicit assumption that they refer to investee companies. It is not clear how we should account for individual assets, such a building or infrastructure asset. Nor is it clear how holdings in sovereign bonds should be accounted for. These non-corporate asset classes (i.e. non-equity or non-credit) are a significant share of the assets managed, either directly or through multi-asset portfolios, which will create significant compliance problems without further guidance.

Similarly, the disclosures described are relatively widely disclosed by large, public companies but the availability of that information drops rapidly among smaller companies or those without public equity securities. That disclosure shortfall partly reflects disclosure limitations by those companies and partly reflects the failure of conventional ESG data aggregators to collect information from those companies.

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

We would recommend that the **number of required indicators is significantly reduced to focus on those which can be reliably and consistently measured, and those which are most relevant and material to entity assessment**.

In particular, we expect most organisations to use ESG data aggregators to source the data required, rather than gathering data directly from companies' reporting. We believe Refinitiv and Bloomberg are the two most widely used sources of that company level data. We have undertaken an initial

[1] For more information on SustainEx: https://www.schroders.com/en/ch/asset-management/insights/thought-leadership/sustainex-quantifying-the-hidden-costs-of-companies-social-impacts/

assessment of global companies using the proposed template, sourcing data from both of those sources.

Over three quarters of the companies included in the global MSCI ACWI IMI index are included in one or both of those data sources. However, our preliminary analysis indicates that those aggregators find very different information for the same companies. Focusing on 23 indicators for which data is included in both sources, we find that those sources reach inconsistent conclusions in a majority of cases. As a result, fund managers using one source will report very different conclusions to a manager with similar underlying exposures but which has opted to use another source. It is vital that we recognise the inherent weaknesses and inconsistencies in the data on which the template is based. Limiting the number of metrics to those which are most consistently reported will mitigate the impacts of those inconsistencies and improve transparency and comparability.

In particular, the following are both widely relevant and relatively consistently reported, where available:

- Carbon emissions (broken down by scope 1, 2 and 3 carbon emissions - including agriculture, forestry and other land use (AFOLU) emissions - and in total)
- Carbon footprint
- Weighted average carbon intensity
- Biodiversity and ecosystem preservation practices
- Number/rate of accidents, injuries, fatalities, frequency
- Gender pay gap
- Anti -corruption and anti -bribery policies

An alternative to an approach that requires every investment management firm to calculate its own exposure would be to **create or support a central "clearing house" which would compute these exposures from holding information provided by each firm**. In addition to mitigating the inefficiency of every organisation developing parallel processes, it would also ensure more consistency and comparability in the resulting measures as well as avoid market distortions and an anti competitive environment (see above in our summary).

None of these points address the template's inherent focus on large, listed companies. We would suggest that similar templates, focusing on key measures, are required for other asset classes, allowing disclosures per asset class and more meaningful analysis.

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

As discussed before, the approach outlined in the Table and Annex runs the risk of reducing what are currently sophisticated approaches on due diligence on ESG into a tick box exercise, undermining investment managers' focus on interpreting and assimilating that information to form considered conclusions reflecting the most important issues.

In our experience one of the challenges around ESG is that new issues are always emerging, reflecting the increasing pace of change and growing environmental and social pressures on companies. A rigid framework, to which investment firms have little incentive to add further information, risks de-emphasising or distracting from the most important issues or newly emerging issues.

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

Some of the metrics have extremely low reporting levels. Their granular nature – for indicator 10 (Natural species and protected areas) for example covers investee companies that might have operations sites owned, leased or managed in or adjacent to protected areas and areas of high biodiversity areas. Current company disclosure does not enable us to even extrapolate an approximate value for this.

Many of the indicators are actually multi layered which could create confusions. For example indicator 10 refers to species, protected areas and biodiversity, despite indicator 9 already covering biodiversity.

There is an overt focus on our underlying investments having polices in areas, when we view that the actual performance of the company is more important. Often, the existence of policies will reflect local norms or legal requirements, more than reflecting underlying corporate commitments or behaviour.

By applying a single framework across diverse groups of companies, the template loses its ability to identify the most material issues for particular companies or sectors. For example, deforestation policies are not particularly relevant for technology companies but very important for paper companies. On the other hand, strong data security practices are very important for technology companies, but are not included in the template.

Many metrics are not well defined. For example severe human rights abuses - we suggest seeking the United Nations Guiding Principles on Human Rights (UNGP) guidance on establishing a framework. Our own analysis of controversies, including reviews of a wide range of third party data providers, underlines the inconsistencies in the ways they are defined and recorded, undermining comparability across managers using different definitions or different providers.

Similarly, other measures require judgements that are likely to be inconsistent across investment firms. For example, point 13 (Exposure to areas or high water stress) does not provide a definition of areas of high water stress, which would lead to inconsistent interpretations, even if investors were able to source information on the location of companies' assets (which is very difficult).

As outlined above, we therefore **recommend focusing on a smaller list of mandatory indicators** and encouraging investment managers to augment that information with other measures they consider important.

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

Assessing carbon emissions relative to widely used emissions pathways, such as the EU 2030 climate and energy framework target, is an increasing focus for many investors and would be valuable information for many. However, we note that the industry is a long way from agreement on ways that alignment should be measured and in the absence of any consensus, it is hard to see how this can be included in a disclosure framework.

We do not understand how carbon emissions could be measured relative to prevailing carbon prices.

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

In principle, it would be valuable to provide a "reference" point to gauge the extent to which the share of investments is above or below the share of all companies without an issue. However, in practice, the data for many of those data points makes this practically impossible. For many of the data points listed, disclosure levels are very low, and the absence of evidence that an issue exists will necessarily be interpreted as meaning that company does not have an issue. When looking across all companies, that lack of information will become more pronounced, meaning that in many cases, interpreting a lack of information to assume the company has no issue will be incorrect and misleading.

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

Given the overarching desire to see Paris Alignment across Europe it would make sense to have metrics calibrated to this. For example if the company has made a commitment to Science Based targets or other emissions reductions.

In many ways the question illustrates the challenge that exists around ESG measurement. We have been working on a methodology that allows us to capture avoided emissions and make enhancements to scope 3 calculations that are very helpful in evaluating the contributions that many industrial companies make. However it will take time to build and test the effectiveness of our nascent methodology. Any template should be flexible enough to allow for such methodologies to be included in the future. Indeed innovation should be encouraged, rather than hindered by overly-rigid or spuriously detailed frameworks.

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

We support the disclosures regime including social issues. We have been consistent in our feedback that the Taxonomy process has placed a focus on environmental issues to the determent of social ones.

However, once again we stress the importance of materiality. For some regions and sectors human rights are of particular importance and high risk, but they are much less material for a small cap European tech company for example.

We have made specific notes on the template at the end of this document.

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

At a firm level, given the nature of how business models and firms' portfolios change, we would not recommend this approach. It is likely that little meaningful analysis could be performed against a backdrop of asset growth, losses and acquisitions in different types of portfolios which will typically have a bigger impact on entity trends than organisations' underlying efforts.

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

Given that this legislation is aimed at the larger asset manager firms, window dressing of the type that this question implies (eg adjusting positions around year end to improve profiles) seems unlikely, given their fiduciary responsibilities and the practical challenges of implementing changes on the scale required.

However, an **over reliance of templates does create risks that investment firms place disproportionate reliance on indicators that do not reflect their views of risk or weaknesses but which improve the profile of their portfolios.** It would be far more effective is equal attention was placed on asset managers own due diligence processes on identifying and managing adverse impacts, possibly with some type of external assurance.

Templates

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

We think that mandatory and pre contractual templates for financial products are a good idea, provided they remain flexible and fit with other regulatory client disclosure documents.

To give an example, we developed a fund template for investors which is simpler than the proposed table 1, but has the advantage of reasonable data coverage over listed asset investments. You will see that we compare the metrics to a benchmark, which we consider essential for providing context to ESG data and has the added benefit of putting it on a par with other financial disclosures that investor are more familiar with. Feedback on this approach is good, and we hope to develop and improve it over time as the underlying data points improve. Indeed we have made a conscious decision to go for data points that had good coverage rather than those we believe are the perfect and we will of course use engagement to push for more corporate disclosure in key areas.

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Schroder International Selection Fund UK Equity

Internal use only

Data as at 31.12.2019

Environmental, Social and Governance Information Sheet

This report provides an "ESG snapshot" of this Schroders investment fund. It uses reported company data to identify or derive Environmental, Social and Governance (ESG) metrics on an objective basis. With this we compare a range of ESG metrics for the fund and its benchmark where applicable, and identify the measure coverage of the fund. The charts illustrate how the portfolio and benchmark compare for each metric, with stronger performance being further to the right on the chart's scale. The metrics are aligned to a number of the United Nations Sustainable Development Goals. These goals, ratified by UN member states, set forth ambitious global development goals as part of the 2030 Agenda for Sustainable Development. Schroders is a signatory to the UN Global Compact to support and advance these goals.
Relevant risks as associated with this fund are shown overleaf and should be carefully considered before making any investment. The value of investments and the income from them may go down as well as up and investors may not get back the amounts originally invested.

Ratings and accreditation

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Please refer to the Important information section for the disclosure.

Sustainability performance measures

● Fund ● FTSE All-Share (GBP)

Category	Measure	Measure coverage	Description	Fund	Benchmark	Summary (right indicates stronger performance)
Planet	Carbon intensity	81.2%	Scope 1&2 GHG emissions relative to each $1mn of sales **Units** Tonnes of CO2 per $mn sales	156.2	161.2	5,000 4,000 3,000 2,000 1,000 0
	Policy Energy Efficiency	83.3%	Does the company publish a policy to improve energy efficiency? **Units** % of companies with a policy on energy efficiency in place	88.4%	94.4%	0% 20% 40% 60% 80% 100%
	Policy Emissions Reduction	83.3%	Does the company publish a policy to reduce GHG emissions? **Units** % of companies with a policy on emission reduction in place	93.0%	95.4%	0% 20% 40% 60% 80% 100%
People	Policy Human Rights	83.3%	Does the company publish a policy governing human rights standards of its operations **Units** % of companies with a policy on human rights in place	93.2%	91.7%	0% 20% 40% 60% 80% 100%
	Board Gender Diversity	83.3%	Percentage of women on the Board **Units** Average percentage of women on the board	30.1%	31.8%	0% 20% 40% 60% 80% 100%
	Employee Fatalities	40.7%	Employees killed during the year while at work **Units** Annual number of employee fatalities resulting from operational accidents	0.59	0.75	10 8 6 4 2 0
Prosperity	Employees Community Work Program	83.3%	Is there a program for employees to volunteer with community initiatives? **Units** % of companies with Employees Community Work programs in place	90.4%	87.3%	0% 20% 40% 60% 80% 100%
Governance	Independent Board Members	83.3%	Percentage of independent directors on the Board **Units** % of total directors who are independent	69.4%	67.2%	0% 20% 40% 60% 80% 100%
	CEO-Chairman Separation	83.3%	Are the CEO and Chairman separate roles? **Units** % of companies with separate CEO and Chairman	4.9%	1.7%	0% 20% 40% 60% 80% 100%

Source: Refinitiv ESG data. Data represents the latest available data as at "Reporting Date". Note: All of the analysis shown is based on company disclosed information collected and provided by Refinitiv. We recognise that some judgement is applied in determining these specific datapoints (for

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

It is very important that the templates provide adequate opportunity for firms to describe their processes for identifying investments with sustainability characteristics and outcomes as well as including space for measurement of these.

Given that any product would have to disclose against the averse impacts template and the taxonomy it is important that any additional metrics can be product specific, reflecting the investment process being used.

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

As noted above the combination of having to report on adverse impacts and against the taxonomy means that there is a high degree of comparable ESG information that will already be available to any client. It would therefore make sense that the template focused more on the bespoke tools used on that fund and the outcomes that they generate over time.

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

We note the high degree of overlap between the requirements for website disclosure and pre-contractual requirements. Some pre-contractual documents, such as prospectuses, require pre-approval from regulators and, as such, are not a suitable document for frequent updating. They set out the broad investment powers and limitations and, because they are not updated frequently, are couched in language such as "at least xxx%", no more than "xx".

A requirement for a graphical representation of planned investment proportions of this would suggest there has been no consideration of what this would look like for investors. We therefore suggest the requirement in Article 15. 2. (a) be deleted.

The requirement for graphical representation on a website should also be reconsidered. The financial market participant will be naturally be seeking to attract investment in their product. Should a firm decide to represent planned investments by way of a graph, pie chart or other visual method (e.g. video), this should be up to the firm to decide taking into consideration the need for such information to be provided in a clear, fair and not misleading manner. Not all investors prefer graphical representation or find it easier to understand.

Furthermore, we do not understand why the regulators consider there needs to be a summary document. This just adds additional documentation to a prospective investor, more cost without any perceived benefit. Also, we doubt that such an additional document is covered by the Level 1 text. Generally, a proliferation of documents/location of information (website, prospectus, KID, summary document) would seriously undermine the policy objective set by legislators and regulators to provide investors with a central and singular information sheet (KID). Finally, And how would this work for a PEPP key investor document?

Finally, we would like to highlight what seems to be some editing flaws in the draft:

- Article 34 (1)(d) draft RTS has an incorrect cross reference (should be to paragraph 3)
- For Article 8 SFDR products, the report requirements of Article 36(d) draft RTS do not make sense when read with Article 40 1 (a) draft RTS. It would seem that the word "not" is at fault. We note that there's similar wording in Article 43(d) draft RTS for Article 9 SFDR products which reference an index directed at sustainable performance.
- Article 8 SFDR products only have sustainable characteristics as defining criteria but for those products referring to a benchmark they should use a benchmark that reflects the sustainable characteristics. So 'not' should be deleted.

- We note that Article 16(2) and Article 38 draft RTS is intended to implement the taxonomy requirements. This causes an issue as the wording should be to "environmental objectives" as defined in the taxonomy regulation rather than suggesting that the sustainable investments of a fund promoting environmental or social characteristics has harmed "sustainable investment objectives" (i.e. for Article 8 SFDR there is no such objective).

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

It appears to us that environmental and social characteristics are not defined in Article 14 for Article 8 products nor is a sustainable investment objective in Article 24 for Article 9 products. We are encouraged that this is not defined as we believe that it will encourage innovation. However we are concerned that financial market participants could easily confuse the two product categories. For example would a product that sought to invest in low carbon companies fall into Article 8 or 9? Similarly how should a fund that sought to invest in businesses run by women be considered?

From our understanding of Article 24, we also believe that sustainable investment objectives effectively equate to Taxonomy compliant investment objectives. Given the currently narrow focus of the Taxonomy it is disappointing that funds that have a clear social objective would find it difficult to be included (for example, microfinance funds, which have a clear social focus but limited environmental criteria).

In Article 15, we believe that some of the intersection of the different areas of regulation are possibly confusing. Our reading of the Taxonomy leads us to believe that effectively sustainable investments are taxonomy compliant ones. At this stage in Article 15(2)(a)(i) we would find it difficult to the subdivide those "sustainable" investments between environmental and social objectives in a way that would be useful to a buyer of a fund, especially if the primary objective was social.

Finally we would welcome some more guidance of the characteristics of Article 8 and 9 products (mandatory investor disclosure vs. promotional or marketing material – see Recital 21, exclusion strategies, etc.) and where the line is drawn between Article 8 products and the disclosure of how sustainability risks are integrated into investment decisions of all products in scope (Article 6). Unfortunately, the public hearing in July seems to have increased confusion rather than provided clarity.

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

As we stated in answer to question 15, we do not agree with the proposed graphical representation, particularly in pre-contractual documentation. Such documentation should only be required to set out the general powers of investment, such as the proportion of the fund that will be invested in sustainable investment. It should be for the firm to decide how it would wish to represent its products on the website.

18. The draft RTS require in Article 15(2) that for Article 8 products graphical representations illustrate the proportion of investments screened against the environmental or social characteristics of the financial

product. However, as characteristics can widely vary from product to product do you think using the same graphical representation for very different types of products could be misleading to end-investors? If yes, how should such graphic representation be adapted?

Please see our responses to question 15 and 17.

We do not believe the draft RTS consider how retail investors engage with financial service providers. Should they require advice they will rely on an adviser to find a suitable product. The adviser will either sell their own products or search all, or a substantial part, of the market place and will rely on tools, such as the European MiFID Template, to filter out products they do not see as appropriate for their client before then comparing and contrasting a smaller sub set of products. To compare those products, advisers are unlikely to use pre-contractual information. Rather they will rely on factsheets, investment brochures, or other aides supplied by product manufacturers.

For investors who carry out their own research, it is much more likely that they will be using an investment platform. Such platforms attract investors to their offering by providing online tools that take the information provided by product manufacturers and present them in a way that is attractive for investors to compare and contrast investment propositions.

Requiring information to be graphically represented in a certain way will not aid comprehension and has the possibility of being misleading.

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

We are unclear why gas and oil has not been included in the fossil fuel exposure section. While coal is a major issue, ultimately a successful energy transition needs the phase out of more than just solid fossil fuels.

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

As noted above, the disclosure rules proposed do not reflect the different requirements of non-corporate asset classes and that lack of applicability should either be recognised or addressed through additional, asset class specific requirements

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

We would note that the current adverse impacts template covers many areas relevant to this, including the gender pay gap, and excessive CEO pay ratio, board diversity, whistle-blower

protection, and workplace accident prevention. It would make more sense to expand this section to include tax, which is the outstanding issue. For example we measure, for our investments, the paid tax rate against the statutory ones.

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

Please see the final bullet point in our reply to Question 15.

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

No. As outlined above, sustainable investment is a large but still-growing field, in which innovation and new ideas must be encouraged, rather than choked by an overly-expansive framework that risks restraining rather than promoting the innovation this industry needs. Defining existing ESG investment strategies would ignore the constant development taking place and put ESG funds in a rigid corset. However, we welcome industry initiatives such as the EFAMA report on Responsible Investment of 2016[2] which explains different sustainable investment strategies. There are similar or even more elaborate initiatives / frameworks at national level e.g. IA Responsible Investment Framework[3].

Having said that, we would welcome some more guidance of the characteristics of Article 8 and 9 products and where the line is drawn between Article 8 products and the disclosure of how sustainability risks are integrated into investment decisions of all products in scope (Article 6).

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

We would point out that in factsheet and brochures (which are much more consumer friendly documents) fewer than 25 top holdings are provided. There may also be a question of cost where such holdings are to be provided by data vendors.

We do not agree that the disclosure in periodic reports should be "an average". Reporting for funds should be made at accounting year end. Similarly reporting for portfolio management should tie in with the end date that the report refers.

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[2] https://www.efama.org/Publications/EFAMA_Responsible%20Investment%20Report_September%202016.pdf
[3] https://www.theia.org/sites/default/files/2019-11/20191118-iaresponsibleinvestmentframework.pdf

Specific questions on pre-contractual disclosure items in light of differences between types of disclosure documents

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

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

As we stated in our answer to question 15, we favour website disclosure but where a product has, as part of its investment policy to screen out certain investments, then this would also naturally sit in pre-contractual disclosure documents.

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);

We are in favour of a description of the policies used to assess good governance practices. We note that some allowance may need to be made for different asset classes that because of their nature will follow different practices. For example the due diligence that we perform on a large cap listed company is different than a private equity fund investment.

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

We think it is very important that the limitations of the data sources used. In particular it is essential that users can easily distinguish between where estimates are being used.

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

We would support this distinction, but it should be clear that external is not necessarily better. As users of these data sources we frequently identify issues and shortcoming with them. We find that the data collection and rating agencies can be slow to rectify these.

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

We do not think derivatives should be singled out for separate disclosure. They are investments and may comprise a substantial part of a portfolio. Should such products fall within Article 8 or 9 then derivatives should be treated as any other type of investment for disclosure purposes.

Preliminary impact assessment

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

Insofar as we have developed data infrastructure and reporting tools to support our existing commitments, disentangling the incremental costs is challenging. However, we note that given we are committed to both continuous strengthening of our reporting and investment processes, the incremental costs will not be prohibitive.

Also, we note that on Page 71 of the preliminary impact assessment, (Policy option 2 the preferred approach) – the assessment assumes positively that the proposed rules being consulted on "allows for some tailoring of approach etc…."

We suggest that whilst this may be the case theoretically, what is being proposed in terms of the treatment of principal adverse sustainability impacts is too granular and therefore results in the disclosure of information that is not relevant to investors The result is confusing and misleading information being provided to investors – this being in conflict with the objective (page 69 last para) to "disclose relevant information…….to allow end investors to make informed decisions".

This is very similar to PRIIPs where the level 2 work resulted in the regulators eventually agreeing to a statement that the performance disclosures could mislead – directly contradicting the overarching requirement at the Level 1 for the KID to not be misleading.

Last but not least, we would also like to repeat our comments from the summary section:

Given the ESG data gap, we think it is inevitable that the data for much of the disclosure requirements will be estimated, likely by the 3rd party ESG rating agencies, given the task will be too great for any one fund management house to do itself. We have already noted that in relation to the Taxonomy and Benchmarks that it is highly likely that outsourced solutions will be used. We are concerned that this will create market distortions and certainly create risk and an anti competitive environment in that we suspect only two of the existing ESG rating agencies will be in a positon to build the data sets. We strongly advocate for a much slimmed down template based on widely reported data to avoid this issue. Over time as the NFRD encourages better company disclosure this could be built out.