AMIC response
ESAs consultation: Disclosure Regulation draft RTS
1 September 2020

Adverse impact indicators

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

From an investor perspective, quantitative disclosure of principal adverse impacts at firm/AUM level is not relevant. Disclosure at firm level as the sum of products' principal adverse impacts has little added value to investors who invest via funds and mandates and not in an asset management company. In addition there are today no aggregation guidelines suggested by the ESAs to calculate these indicators in a homogeneous way. As a result indicators at entity level could be misleading for end-investors.

Table 1 type of disclosures at firm level would not only be of little relevance to investors, it will give them an inaccurate picture of the ESG footprint of assets under management (AUM), especially as many asset classes (sovereign bonds, money markets and cash equivalents, currency, some commodities) cannot be evaluated against these KPIs. One asset manager may provide via his products only a limited equity or corporate bond exposure but be performing very well against these KPIs while some may have via their products larger exposure to equity or corporate bonds but with only an average performance against these KPIs. The proposal may lead to a misrepresentation of the principal adverse impacts of AUM as in the second case the consideration for principal adverse impacts may be far greater in absolute terms.

Furthermore the performance against these KPIs does not consider the sectorial exposure of AUM. For example, the significance of the absence of deforestation and biodiversity policies won't be the same if AUM are not exposed to agricultural expansion, cattle breeding, timber extraction, mining, oil extraction and infrastructure development (ie concept of materiality which is missing in the ESAs' approach). The sectorial bias of AUM would in theory need to be considered when assessing principal adverse impacts, leading to over/underweighting the importance of certain KPIs. Therefore a poor performance against some of these KPIs does not lead necessarily to principal adverse impacts.

There are also important implementation challenges with the current proposal for green bonds as these indicators are not adapted for this type of asset. It is unclear how asset managers for example should account for the social and governance KPIs (eg Excessive CEO pay ratio), which make little sense in the context of green bonds as they are (re) financing specific projects or assets and not investing in a company. Even for environmental KPIs, asset managers may face challenges as for instance the scope 1 and 2 emissions of a specific project/asset level are not always available especially when green bonds are focused on environmental objectives other than climate change mitigation. For green bonds it would be preferable to allow asset managers to use freely KPIs adapted to the variety of environmental objectives they pursue (ie climate change mitigation, climate change adaptation, natural resource conservation, biodiversity conservation, and pollution prevention and control). If the ESAs decide to opt for a list of mandatory KPIs at AUM level, we would suggest including at least two seperate KPIs adapted to green bonds and for which we know that data is to some extent available:

- Carbon emission avoided
- Energy mix for power generation

We are also concerned to see the ESAs dismissing the issue of data availability at the very beginning of the consultation paper. The ESAs seem to rely on the existence of ESG data providers as a justification for mandatory granular reporting by financial market participants (such as the KPIs proposed in Table 1) while acknowledging that ESG data and scores are yet very heterogeneous due to the lack of standardized and verifiable disclosure by issuers. Combining and interpreting these different ESG rating approaches, asset managers have often developed their own methodology and scoring systems. But if these analyses contribute to enrich data they only partially overcome the lack of reporting on principal adverse impacts by issuers.
The ESAs need to align disclosure requirements between issuers and financial market participants: **the list of KPIs proposed should therefore at least take the form of non-mandatory guidelines as it is the case for NFRD guidelines on reporting climate-related information and general guidelines on non-financial reporting**. In the EU, companies are required to comply with NFRD when they meet the scoping requirements, the fact that each company must ultimately determine which disclosures are most relevant to its own stakeholders and can rely on a "comply or explain" provision, has led to a lack of comparability and quality of the information reported. It also needs to be remembered that asset managers invest across the globe and that in other jurisdictions ESG disclosures by issuers can be even less advanced.

<u>Given the methodological flaws and implementation challenges described above, we would therefore suggest applying the list of KPIs at fund/portfolio level only and on a best efforts/non-mandatory basis.</u> This approach should allow fund/portfolio managers to use sectorial averages/estimates in absence of data disclosed by issuers and clarify that that some asset classes like sovereign bonds, money markets and cash equivalents, currency, some commodities are excluded from this assessment.

If the ESAs were to go ahead with its draft proposal on disclosure at firm level, we would recommend to limit the list of compulsory quantitative indicators to a handful of meaningful and matured ones taken into account:

- Availability and maturity of data
- Availability of a standardised methodology applied to companies
- Availability of a methodology to aggregate performance – and in their absence, disclosures

We propose the following list of indicators:

Environment:

- Carbon emissions scope 1 and 2
- Carbon footprint
- Share of green investments (following the EU Taxonomy)
- KPIs for Green Bonds exclusively:
  - Carbon emission avoided
  - Energy mix for power generation

Social and Governance:

- Non-signatories to UN Global Compact: share of investments in investee companies that have not committed to the UNGC principles.
- Severe controversies/breaches of UN Global Compact: share of investments in investee companies that have been involved in severe violations of the UNGC principles.

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

We believe the proposal retained in the draft RTS goes far beyond the level 1 text and is not in line with the proportionality principle set out in SFDR. This proposal loses sight of the end purpose, which is two-fold: to provide meaningful information to end investors to make informed decisions and to mitigate potential adverse impacts of investments on the environment and society. Financial participants offer many different types of investment products with quite different characteristics and investment strategies. Aggregation at the entity (asset manager) level provides no real added-value for end-investors that will select individual products aligned with their own expectations and interests, and in many ways obfuscates the information most necessary for them to make decisions. They are interested in priority by disclosure on the specific product(s) in which they invest their money. Similarly, financial advisors need to get access to information at product level as their duty is to advise their clients on products, which are suitable to their specific profile, and not to recommend one specific entity compared to another. This is why, without contextualisation – as to nature of economic activity, location, nature of the environmental or social issue – or complete information, following principles should prevail:

- The principle of proportionality needs to prevail across the board;
- Testing the indicators link to real world impacts should be strongly encouraged;
- Not all indicators can or should be applied to all sectors/companies and asset classes.

The fact that issuers are not required to report against the indicators proposed by the ESAs is a challenge for all asset managers but in particular the smaller ones. They will have to allocate proportionally more resources to ESG data providers and/or build expertise internally to assess how investee companies perform against KPIs (but this won't be enough to bridge the data gap). Smaller fund managers are likely exposed to specific sectors or local companies, which means that they will have to report against KPIs, which are not necessarily relevant to them. Some of these new resources could therefore be mis-allocated.

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

Setting a mandatory list of KPIs applicable to the buy-side will not considerably enhance comparability unless all issuers are subject to similar disclosure obligations. At this stage, the ESAs should opt for an indicative list of KPIs based on information available and should refrain from pre-empting the NFRD review, which is supposed to adopt cross-sectorial and sectorial KPIs for issuers. An alternative option would be to opt for a phasing approach and start with a restricted list of indicators based on:

- Availability and maturity of data
- Availability of a standardised methodology applicable by companies
- Availability of a methodology to aggregate ESG performance

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

Please refer to response to question 1

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

The fact that some investee companies set themselves forward-looking objectives (eg increase of renewable energy consumption over fossil fuels or emission reduction targets) might be a motive to include it in a fund/portfolio and there may therefore be some merit in encouraging financial market participants to submit (on top of past data) forward looking data if they feel that they are equipped to do so (on an optional basis).

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

Fund managers are already struggling to get data on Scope 1, 2 and 3 emissions from all issuers. This proposal seems therefore premature on a mandatory basis but could be explored on a non-mandatory/best efforts basis.

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

Having two measurement approaches per KPI is likely to confuse investors. The share of investee companies is not a meaningful way to measure the ESG footprint of an asset manager as they may have small investments in many companies. The share of investments in investee companies is preferable especially when considering companies' compliance with certain policies (eg UN Global Compact).

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

No answer

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

Yes, we do agree with that approach if it is based on non-mandatory/best efforts basis and at fund level. If the ESAs were to go ahead with mandatory disclosures at firm level, we would suggest the following quantitative indicators:

- Signatories to UN Global Compact: share of investments in investee companies that have not committed to the UNGC principles.
- Severe controversies/breaches of UN Global Compact: share of investments in investee companies that have been involved in severe violations of the UNGC principles.

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

As explained above we believe reporting against these KPIs should be non-mandatory/on a best effort basis and at fund level. Under this approach, the data disclosed could mirror the recommended holding period, which is usually five years for PRIIPS.

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

We believe "window dressing" should be addressed by making sure that the investors are presented with clear and synthetic and not misleading information as to what the <u>stategies/products</u> intend to do and the type of exposure that result from it on average. As explained in our response to question 1, we believe firm disclosures, as currently proposed, are far less relevant and potentially misleading.

Templates

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

Although mandatory templates could bring clarity on reporting obligations for financial market participants, we know by experience (eg PRIIPS KID) that this type of exercise has proven to be extremely difficult and lengthy. Furthermore, because this would involve the prospectus and periodic reports, we are not sure that this is will be achievable in the timeframe allowed (RTS due in December). Finally, we would argue that the draft RTS are already prescriptive enough to ensure a certain level of comparability and that a principles-based approach could foster innovation and competition. Whatever the decision the ESAs make, this needs to be communicated as soon as possible to financial market participants.

Secondly, and perhaps more pressingly, mandatory templates would create significant implementation timing issues. As it stands, the time between the ESAs' expected delivery date for the final RTS (January 2021) and the implementation date in Level 1 (March 2021) is extremely short. Delivering final mandatory templates with the expectation that the industry could operationalise these in the space of roughly 6 weeks' time is unrealistic. Furthermore, given many pre-contractual disclosures are subject to supervisory approvals in both home (e.g. product prospectuses) and in many host (e.g. countries that require local authorisation of marketing materials) jurisdictions, the burden that would be placed on supervisors to review the body of outstanding materials across their entire market in such a short time window is not to be underestimated.

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

Please refer to our response to question 12

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

Please refer to our response to question 12

Product disclosure at pre-contractual, website and periodic level

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

We believe retail investors should not be overloaded with information in pre-contractual document and that website references should be used as much as possible. For example, for Article 8 products, a brief description of the environmental or social characteristics could be in the pre-contractual document (RTS Art. 15(1)(a)), while any elaboration—as proposed by RTS Art. 15 (2)—should be on the website. We would suggest a similar approach for Article 9 products and the corresponding RTS Art. 25. For instance, websites are better suited for the disclosure of graphical representation of investments of the financial products: they allow more frequent and continuous updating than the pre-contractual documents. The need for flexibility in updating this type of information is important as there is still uncertainty as to what would qualify as a "sustainable investment" under SFDR/Taxonomy and as the ESG footprint of investee companies will evolve over time. We also suggest deleting the reference to use of derivatives in pre-contractual documents: this specific disclosure requirement, which is not required by the level 1 text, should not be prioritized in pre-contractual documents.

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

As many asset managers apply firm-wide exclusions or ESG integration, we need to avoid a situation where all funds end up falling in the scope of article 8. It should be clarified that only products marketed as ESG should be subject to article 8 requirements.

We are strongly opposed the warning statement included in article 16.1 of the draft RTS: "This product does not have as its objective sustainable investment". This could potentially lead to discriminate ESG products (article 8) and is not required under the level 1 text. The statement

obligation comes from article 4 (1) (b) and article 7 (2) of SFDR level 1 text. According to these articles, the warning statement should be made on the website (and not in pre-contractual documents) and should apply to a product "that does not consider the adverse impacts of investment decisions on sustainability factors and the reasons therefor." It clearly excludes ESG products which do "consider" adverse impacts in different ways (best-in class, exclusions…). We believe that the ESAs are going beyond the level 1 text by extending the warning to article 8 products and to pre-contractual disclosure requirement.
We would like to remind the ESAs that the EU Taxonomy regulation already requires for article 8 products to make the following statement in pre-contractual documents: "The "do no significant harm" principle applies only to those investments underlying the financial product that take into account the EU criteria for environmentally sustainable economic activities. The investments underlying the remaining portion of this financial product do not take into account the EU criteria for environmentally sustainable economic activities." We believe this warning statement for article 8 products is an unfair and potentially misleading qualification for investors as article 9 products also need to invest in other assets for diversification and hedging purposes. Green bond funds need to diversify their allocation and for risk management purposes can usually invest up to 30-40% of the assets in corporate bonds or sovereign bonds.
In this context, we believe the ESAs' proposal would further discriminate against ESG investment solutions and confuse investors even more and should therefore be dropped.

The proposed requirement for article 8 product to disclose in pre-contractual documents the proportion of sustainable investments is not only likely to blur the distinction between article 8 and article 9 products, it is also premature at this stage as we are not yet certain what would qualify as a "sustainable investment" under SFDR and the Taxonomy. This disclosure requirement is also likely to confuse investors as the draft RTS require to have separate disclosure of the proportion of ESG assets and sustainable assets, despite the fact underlying sustainable investments may well participate positively to the overall ESG characteristics of the product. We would therefore suggest dropping this provision, which is not required by the level 1 text.

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

No answer

Question 18: The draft RTS require in Article 15(2) that for Article 8 products graphical representations illustrate the proportion of investments screened against the environmental or social characteristics of the financial product. However, as characteristics can widely vary from product to product do you think using the same graphical representation for very different types of 17 products could be misleading to end-investors? If yes, how should such graphic representation be adapted?

We fear this approach would not provide relevant and comparative metrics to retail investors as some asset managers may apply firm-wide exclusions or ESG integration and given that ESG characteristics may widely vary from product to product and according to strategies.

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

Yes, we agree with solid fossil fuel disclosure.

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

No answer

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

We don't believe specifications at level 2 are needed.

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

Although the definition of what "significant harm" means is left at the discretion of asset managers (recital 33), we are concern about the implementation challenges in relation to the DNSH assessment. It will be very difficult for fund managers to consider all 50 indicators when assessing the DNSH objective, as issuers are not required to disclose against these KPIs. But **even if issuers were to disclose these KPIs it is unclear how the DNSH test could be met or even performed in a relevant way (even by article 9 products).** For instance, green bond funds need to diversify their allocation and for risk management purposes can invest up to 30-40% of the assets in corporate bonds or sovereign bonds. Conducting the DNSH test for corporate bonds will be extremely burdensome especially for large companies given the breadth of their activities and their geographical footprint. Unless the fund is investing in green sovereign bonds, it will also be difficult to assess the sovereign bond part of the portfolio because the KPIs are not relevant for this asset class. More importantly we note that the KPIs are not necessarily adapted for green bond. For example, the DNSH test against Social and Governance KPIs (eg excessive CEO pay ratio) makes little sense in the context of green bonds, which are (re) funding specific projects or assets and not investing in the company as a whole.

We fear that Article 8 products, which are required to perform the DNSH assessment on their potential sustainable investments, are likely to face the same implementation challenges and that, even more importantly, disclosure requirements related to the DNSH principle are likely to confuse investors. The EU Taxonomy regulation requires indeed for article 8 products to make the following statement in pre-contractual documents: "The "do no significant harm" principle applies only to those investments underlying the financial product that take into account the EU criteria for environmentally sustainable economic activities. The investments underlying the remaining portion of this financial product do not take into account the EU criteria for environmentally sustainable economic activities." In that context, we urge the ESAs' to delete the warning statement as proposed under article 16 § 1 of the draft RTS which will add further confusion.

We note discrepancies between the approach under the EU Taxonomy TEG report, where the DNSH test is restricted to Environmental KPIs and tailored to specific activities (and therefore more appropriate for the EU GBS), and the ESAs' approach, with its 50 ESG KPIs. **This could lead to a duplication of DNSH tests and potentially contradicting outcomes.**

We therefore strongly recommend that at this stage the ESAs pursue "Policy option 1.1: High level policy commitment on assessment of significant harm" instead of singling out 50 KPIs to perform a detailed assessment of significant harm of investments.

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

No, we don't see merit in the ESAs attempting to define different ESG strategies and believe financial market participants can already provide relevant information to investors on this.

Question 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?

For confidentiality reasons and in line with industry practice for UCITS/Retail products, we would rather recommend disclosing the top 10 investments for each product. For many AIFs that are only marketed to a narrow segment of investors, granular disclosures around holdings probably shouldn't be public.

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

As highlighted in the background section above, the ESAs believe that finding the balance between pre-contractual and website disclosure is challenging given the different types of disclosure documents in Article 6(3) of Regulation (EU) 2019/2088. Therefore, specific feedback is sought from stakeholders in this regard.

Question 25: For each of the following four elements, please indicate whether you believe it is better to include the item in the pre-contractual or the website disclosures for financial products? Please explain your reasoning.
a) an indication of any commitment of a minimum reduction rate of the investments (sometimes referred to as the "investable universe") considered prior to the application of the investment strategy – in the draft RTS below it is in the pre-contractual disclosure Articles 17(b) and 26(b);
b) a short description of the policy to assess good governance practices of the investee companies – in the draft RTS below it is in pre-contractual disclosure Articles 17(c) and 26(c);
c) a description of the limitations to (1) methodologies and (2) data sources and how such limitations do not affect the attainment of any environmental or social characteristics or 18 sustainable investment objective of the financial product – in the draft RTS below it is in the website disclosure under Article 34(1)(k) and Article 35(1)(k); and
d) a reference to whether data sources are external or internal and in what proportions – not currently reflected in the draft RTS but could complement the pre-contractual disclosures under Article 17.

No answer

Question 26: Is it better to include a separate section on information on how the use of derivatives meets each of the environmental or social characteristics or sustainable investment objectives promoted by the financial product, as in the below draft RTS under Article 19 and

<u>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)?</u>

We do not understand the need to single out derivatives. They may simply be used for hedging purposes and are not necessarily meant to meet ESG characteristics. Other assets will also be used for diversification purposes and won't necessarily contribute to the ESG characteristics of the product. We therefore recommend removing the reference to the use of derivatives in draft RTS Articles 14(e), 23(e), 19 and 28, as well as in Recital 30.

Preliminary impact assessments

The ESAs have provided preliminary impact assessments for the empowerments in SFDR. Given the short time available for consideration of the empowerment in the not yet published Taxonomy Regulation, it has not been possible to provide a preliminary impact assessment on the empowerment related to "do not significantly harm".

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

Please refer to our responses to questions 1 and 2

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