ICI Global

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Filed 1 September 2020

ICI Global Response to the ESAs' Consultation on Proposed Regulatory Technical Standards (RTS) for the EU's Sustainable Finance Disclosure Regulation (SFDR)

[Please note that the consultation utilized a template with each consultation question (including an opportunity for introductory comments) followed by a text box for the response. We used the template to file the below responses on 1 September 2020.]

Introductory comments

We are responding to this consultation on behalf of the members of ICI Global, which carries out the international work of the Investment Company Institute, the leading association representing regulated funds globally. ICI's membership includes regulated funds publicly offered to investors in jurisdictions worldwide, with total assets of US$33.9 trillion. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of regulated investment funds, their managers, and investors. ICI Global has offices in London, Hong Kong, and Washington, DC.

We appreciate the opportunity to provide feedback to the European Supervisory Authorities (ESAs) on the proposed regulatory technical standards (RTS) for the sustainable finance Disclosure Regulation (SFDR). We acknowledge the challenges the ESAs face in drafting the RTS, including the novelty of the subject matter, the compressed timeline mandated by level 1, ambiguity in the level 1 text, and lack of certainty given other pieces of related legislation that are not yet final. We appreciate the efforts the ESAs have put into this proposal, and we support the objectives of ensuring end investors receive meaningful information about their investments.

Timeline. As an initial matter, we reiterate our concerns about the extremely compressed implementation timeline and urge moving the SFDR's 10 March 2021 application date to 1 January 2022. This timeline would allow for more well-considered implementation of the new disclosure requirements and better coordination across other important pieces of sustainable finance legislation. For Europe's sustainable finance action plan to succeed, the SFDR's framework for sustainability-related disclosures must connect seamlessly to other building blocks of the European Union's sustainable finance legislation, including the Taxonomy Regulation and the Non-Financial Reporting Directive (NFRD).

An application date of 1 January 2022 would align with the Taxonomy's first set of product disclosure requirements, as well as the likely application timeline for the delegated acts under the UCITS Directive, which will integrate consideration of sustainability risk into the investment process. It also would provide time for the European Commission to complete its review of ESG-related corporate disclosure requirements under the NFRD. We discuss our specific concerns with the current timeline throughout our response.

Manager-level disclosure. As a starting point, we do not believe that the proposed firm-level aggregate quantitative disclosure will provide investors with meaningful information about the sustainability impacts of their investment. The proposal would require a manager to disclose to investors a list of

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metrics (i.e., 'principal adverse impact' indicators) that represent aggregated information for tens of thousands of investments made across all of the funds and client mandates that a manager manages. This would not provide any useful information to an end investor about the specific products in which they are invested or considering investing.

We also strongly disagree with the proposed treatment of any positive value of an indicator as representing a 'principal adverse impact.' This 'one-size-fits-all' approach fails to take into account whether an indicator is relevant across sectors, asset classes, geographies, and investment strategies. The proposal's overly strict approach further exacerbates these issues, as it will force managers to obtain and disclose 'bad' data, without providing needed flexibility for managers to navigate issues with data availability, quality, and relevance.

We are deeply concerned that the proposed entity-level disclosure requirements will create an enormous operational challenge, with huge, uncertain costs and intensive use of resources in exchange for (at best) questionable benefit to investors. In our view, the proposed approach also goes significantly beyond what is contemplated in the level 1 text, lacks proportionality, and fails to achieve much-needed coherence with other key pieces of sustainable finance legislation.

We therefore urge the ESAs to take a proportional, measured approach that focuses on the principles-based elements of SFDR Art. 4 and allows managers to undertake optional disclosure of the Table 1 indicators, with the discretion to disclose information that the manager determines is sufficiently meaningful, available, and reliable for a sector, industry, or investment. If the ESAs determine that some mandatory indicators are necessary, we then recommend that the ESAs prioritise disclosure of an initial subset of indicators that have broader relevance across sectors and asset classes and where data is both more widely available and reliable. Regardless, it is essential that managers be able to use 'reasonable efforts' or 'good faith efforts' to obtain data from investee companies and have flexibility to explain where they have not included data from all investments. These reasons would include where the data is not available (e.g., for certain asset classes), where the data is not reliable (e.g., no methodological consensus), or where the data is not relevant (e.g., for a particular sector or asset class).

We note the SFDR's evaluation provision (Art. 19) provides an opportunity to begin with less prescriptive requirements after which the Commission will assess if and when additional disclosure should become mandatory. During this evaluation window, we recommend that the Commission perform a study of sustainability impact data to inform any subsequent legislative proposal.

Product-level disclosure for ESG funds. We recommend shifting the proposed balance of information between pre-contractual and website information requirements to make the information more useful for investors. To ensure that the pre-contractual information is meaningful to end investors, it must be focused on information that will help investors make decisions about which product to invest in, while reserving technical details for the 'Sustainability-related disclosures' section of the website.

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We also urge flexibility in the timeline for the 10 March 2021 compliance date for product-level disclosure requirements, given that the product disclosure templates will not be released for consultation until September 2020. The RTS will not likely be completed until end of January 2021, and the pre-contractual disclosure then will need to go through the approval process at the NCA level. In addition to the issues with timing and sequencing, we discuss specific areas where we have particular concerns about the lack of substantive coherency or consistency among the SFDR, the Taxonomy Regulation, and the NFRD, such as the disclosure requirements around 'sustainable investments' and the principle of 'do no significant harm' (DNSH).

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

No, we do not agree with the proposed approach, for the following reasons:

1. Firm-level aggregate quantitative disclosure does not provide meaningful information to investors about their investments.
2. The proposed 'one-size-fits-all' approach, where the indicators in Table 1 always lead to 'per se' principal adverse impacts irrespective of the value of the metrics, fails to take into account whether an indicator is relevant across sectors, asset classes, geographies, and investment strategies.
3. The proposed approach will force managers to obtain and disclose 'bad' data, without providing needed flexibility for managers to navigate issues with data availability, quality, and relevance.
4. The proposed approach goes significantly beyond what is contemplated in the level 1 text.
5. The proposed requirement to calculate continuously aggregate PAI indicators over a reference period is needlessly onerous.
6. The proposed approach creates an enormous operational challenge and corresponding cost burden, with (at best) questionable benefit to investors.
7. The proposed approach lacks coherence with other key pieces of sustainable finance legislation—namely, the Taxonomy Regulation and the Non-Financial Reporting Directive (NFRD).
8. The proposed approach to PAI creates uncertain legal liability for asset managers.
9. The proposed approach is not proportional.

We explain in more detail below.

1. Firm-level aggregate quantitative disclosure does not provide meaningful information to investors about their investments.

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Firm-level aggregate quantitative disclosure does not provide investors with any meaningful or decision-useful information about the sustainability impacts of their investment. SFDR aims to provide end-investors with information about the sustainability impact of their investments. More specifically, SFDR 'aims to reduce information asymmetries in principal-agent relationships with regard to the integration of sustainability risks, the consideration of adverse sustainability impacts, the promotion of environmental or social characteristics, and sustainable investment, by requiring financial market participants and financial advisers to make pre-contractual and ongoing disclosures to end investors when they act as agents of those end investors (principals).' (See SFDR Recital 10). The proposed approach, however, would require a manager to disclose to investors a list of metrics (i.e., PAI indicators) that represent aggregated information about tens of thousands of investments made across all of the funds and client mandates that a manager manages.

Manager-level, quantitative disclosure of sustainability impact does not provide useful information to end investors about the specific products in which they are invested or considering investing. A fund investor would review this information either in the context of an ongoing fund investment or to obtain information about funds in which they are considering investing. In either case, fund-level information is what is most relevant to the investor. We recognise that the level 1 text requires entity-level disclosure, but an investor would be better served by the qualitative entity-level disclosure outlined in SFDR Article 4(2)(a) and (b), which can be tailored to the size of an asset manager, the nature and scale of its activities, and the types of financial products it makes available.

The proposed list of indicators provides little information on substantive sustainability impact and instead indicates only the size of the asset manager and the spectrum of investment strategies that it manages. For example, an asset manager with a large amount of assets under management will show a higher adverse impact than a smaller asset manager merely because of greater amount of activity engaged in by the larger manager. A manager with a significant focus on broad index strategies or emerging markets is likely to show a higher adverse impact than a manager that focuses on tech sector investments. Managers' entity-level PAI indicators will differ based on their size and the types of investment strategies they manage, but those metrics do not provide any meaningful information to an investor about the differences in those managers' approaches to adverse sustainability impact.

2. <u>The proposed 'one-size-fits-all' approach, where the indicators in Table 1 always lead to 'per se' principal adverse impacts irrespective of the value of the metrics, fails to take into account whether an indicator is relevant across sectors, asset classes, geographies, and investment strategies.</u>

We strongly disagree with the proposed approach's treatment of any positive value of an indicator as representing a 'principal adverse impact.' This approach ignores that analysis of adverse sustainability impact is not one-size-fits all and that relative performance and directionality matter.

Both the Taxonomy Regulation and NFRD recognise that adverse sustainability impact analysis must be tailored to different sectors and industries. For example, the Taxonomy's 'do no significant harm'

(DNSH) analysis is not identical for each economic activity; rather, it includes tailored, sector-specific thresholds. In the context of the NFRD, the Commission has proposed encouraging companies to disclose principal adverse impacts (PAI) based on whether the metrics are relevant to the company based on sector, activities, etc. As another example, one of the proposed indicators—the share of investments or investee companies without a deforestation policy—may be highly relevant in the context of extractives and mineral processing but may be much less relevant for a company in the financial sector.

Relative performance and directionality are more meaningful measures of sustainability impact than an absolute metric without context. For example, comparing the carbon emissions of a cement company to a healthcare company is not a useful exercise. When analysing sustainability impact, a manager instead would seek to understand how the cement company performs on carbon emissions relative to other companies in that sector and whether its performance is improving over time.

The proposed approach creates a 'tick-the-box' compliance exercise rather than meaningful disclosure of adverse sustainability impact. Rather than providing managers with the flexibility and discretion to account for differences in strategies, sectors, and investments, this approach substitutes managers' expertise with a laundry list of metrics that may bear no relation to the actual sustainability impact of a company in which a manager invests. The result is a 'tick-the-box' compliance exercise that does not provide end-investors with meaningful or decision-useful information about the products in which they are invested or considering investing.

We further caution that the proposed approach would fail to account for investments in transition activities—for example, high-emissions companies that are working toward lowering their emissions. We do not believe that the EU's climate objectives are well-served by penalising transition investments.

3. <u>The proposed approach will force managers to obtain and disclose 'bad' data, without providing needed flexibility for managers to navigate issues with data availability, quality, and relevance.</u>

The 'best efforts' language in RTS Art. 7 requires a manager to obtain 100% data coverage for each indicator for tens of thousands of investments—regardless of data availability, quality, or cost. If the data is not available from an investee company, RTS Art. 7.2(b) requires the use of 'best efforts' to obtain the data from elsewhere, whether a data provider or internal modelling or research. We are strongly concerned that this 'best efforts' language effectively requires a manager to achieve 100% data coverage for each indicator across tens of thousands of investments, ignoring issues with availability, quality, relevance, and cost of that data. We explain in our response to Question 2 why this 'best efforts' requirement lacks proportionality, and we recommend an alternative approach in our response to Question 3.

The proposed approach does not provide managers with the necessary flexibility to address gaps in data availability or quality. This approach fails to account for differences in data availability or quality by region, asset class, size of company, and many other factors. Rather, it assumes that managers will be

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able to obtain quality data on 32+2 indicators from investee companies across tens of thousands of securities. This assumption is not valid. As we discuss further in our response to Question 5, many of these indicators are based on data that is not yet widely available from investee companies or across all asset classes. Corporate issuers are not required to disclose the vast majority of this data, even in the EU. Although the EC aims to address this shortcoming in the upcoming NFRD review, the lack of data availability will not be resolved before the compliance date for the aggregate entity-level disclosure requirement. The revised NFRD will be applicable at least two years after the application of SFDR, and the NFRD will capture large companies based in the EU or at the maximum with some presence in the EU, but not the broader range of investee companies.

Without more flexibility, the proposed approach effectively will create a legal obligation for managers to purchase expensive data from third party service providers without regard for data quality and with questionable benefit to investors. Given the requirement for 100% coverage across tens of thousands of investments, asset managers will be forced to obtain data from service providers that is based on modelled information with significant variations in inputs and assumptions. Legally mandating disclosure of this modelled information is tantamount to requiring managers to purchase this data from providers, even though the reliability of this data is unlikely to be consistent across providers given that they obtain data from different sources, make different assumptions, and frequently estimate data using different methodologies. This requirement is not proportionate to the pursued objectives. In addition, these costs are not justified by a corresponding significant benefit to investors given the current availability and reliability of data.

We caution that requiring 100% data coverage for an indicator will result in the inclusion of low quality data, which in turn will reduce the quality of the aggregate metric. Providing managers with flexibility to navigate lack of data availability or concerns about data reliability will improve the quality of the final aggregate indicator disclosures.

We therefore urge the ESAs to allow managers to use 'reasonable efforts' or 'good faith efforts,' which would provide managers with needed flexibility to navigate scenarios where 100% data coverage does not exist, or where the manager has concerns about the quality of the data. This will result in more meaningful disclosure to investors, as we explain further in our response to Question 3.

4. <u>The proposed approach goes significantly beyond what is contemplated in the level 1 text.</u>

In proposing a process that requires aggregating adverse impact indicators of tens of thousands of different holdings across thousands of funds and accounts, the ESAs are imposing highly prescriptive requirements for which there is no mandate in the level 1 text (and, as we noted above, this approach also is inconsistent with the Taxonomy Regulation's and the NFRD's approaches). Rather, the level 1 text describes an approach where principles-based entity-level disclosure focuses on disclosure of firms' policies and firms' own means of identifying, prioritising, and engaging with companies on adverse sustainability impacts.

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Although we recognise the level 1 reference to sustainability indicators and that the ESAs must put forward a draft that references sustainability indicators in some way, the level 1 text does not direct the ESAs to dictate a mandatory list of sustainability indicators. The level 1 text instead focuses on importance of website disclosure of 'procedures and descriptions of the principal adverse impacts' (see Recital 18), and we encourage the ESAs to implement the principles-based approach taken in SFDR Art. 4, which requires a description of adverse impacts, policies to identify and prioritise principal adverse sustainability impacts, actions to address them and engagement policies, as well as references to international standards.

We are concerned that the RTS Arts. 8 and 9 disclosure requirements on 'Description of actions and engagement policies to address principal adverse sustainability impacts' and 'Engagement policies' unnecessarily go beyond the level 1 disclosure requirement, and we recommend specific changes to the language to address this concern. The level 1 disclosure requires 'a description of the principal adverse sustainability impacts and of any actions in relation thereto taken or, where relevant, planned' and 'brief summaries of engagement policies in accordance with Article 3g of [SRD II], where applicable.' RTS Art. 8, however, requires a description of the actions taken and planned to avoid or reduce the principal adverse impacts identified; and RTS Art. 9 requires an explanation of the reduction in principal adverse impacts achieved by the actions taken during the reference period.

We have three specific comments to better align the RTS with the level 1 text:

1) The level 1 text requires a description of the actions planned, *where relevant*. *See* SFDR Art. 4.2(b). The draft RTS should include this relevance language. Without this relevance language, the RTS effectively would require managers to generate forward-looking assumptions about their actions with respect to PAI.
2) The level 1 text requires a description of actions taken (or planned, where relevant) in relation to PAIs. *See* SFDR Art. 4.2(b). The draft RTS goes beyond this to require a description of actions taken *to avoid or reduce* the principal adverse impacts identified. The draft RTS should mirror the level 1 language for consistency.
3) The draft RTS requires an explanation of the reduction in principal adverse impacts achieved by the actions taken during the reference period. There is no corresponding requirement in the level 1 text. We urge the ESAs to remove this requirement. This requirement assumes that all asset managers are able to engage with all investee companies on all of the PAI indicators listed. An asset manager may invest in tens of thousands of investee companies, however, and is also engaging with these companies on issues that are not related to sustainability impact. Fund managers do not have the resources to engage with each investee company on each of these PAI indicators. A manager also is not able to assign specific outcomes to specific engagement activities.

We have similar concerns about the Art. 10 provision that requires a description that specifies the adverse impact indicators used in the assessment of PAI to measure adherence to international standards or alignment with the Paris Agreement, and we urge the ESAs to remove it. The level 1 text requires 'a reference to their adherence to responsible business conduct codes and internationally recognised standards for due diligence and reporting and, where relevant, the degree of their alignment with the objectives of the Paris Agreement.' RTS Art. 10 goes beyond the level 1 text and further requires this disclosure to 'specify the [] indicators used in the assessment of principal adverse sustainability impacts referred to in Article 6 to measure that adherence or alignment.' As discussed above, we have significant concerns about the proposed approach to the PAI indicators. This provision imports the list of already problematic indicators into yet another context.

5. <u>The proposed requirement to calculate continuously aggregate PAI indicators over a reference period is needlessly onerous.</u>

We urge the ESAs to reconsider the proposed approach to tracking PAI indicators over a reference period for all of the investment decisions made during that timeframe. Obtaining the data is not the only concern. Once a manager has obtained the data, it must build systems to analyse, aggregate, and disclose the data according to the proposed continuous tracking methodology. This raises a number of questions on how this would work in practice.

- How would this apply to purchases and sales? E.g., subtracting carbon footprint of an investment when it is sold? What if the carbon footprint has increased or decreased over the holding period?
- How would this work for binary data points (e.g., proportion of companies with a biodiversity policy)?
- How to account for use of derivatives, short exposures, non-equity securities?
- How to aggregate for a subset of companies where data is available and differentiate where part of the data is not available for the aggregation?
- Will the ESAs publish additional formulas or methodologies?

We raise these questions to highlight how technically and operationally challenging this undertaking will be to track these indicators over a reference period, for each purchase or sale for thousands of different investee companies (and other exposures), and we urge the ESAs to reconsider this approach.

Concerns about 'window dressing' of PAI disclosure are unfounded. The ESAs raise concerns about window dressing as the reason for choosing an approach that requires continuous calculation rather than a point-in-time snapshot. These concerns appear to contemplate that managers are likely to compromise their fiduciary duty and investment returns to improve the optics of their PAI disclosure. We assert that concerns about window dressing are unfounded and do not justify such an onerous requirement. As we discuss in our response to Question 2, a point-in-time calculation methodology would be more proportionate and would allow the ESAs and the Commission to first review managers' actual disclosure and determine whether any window dressing is in fact occurring. Further, the RTS Art. 2 requirement to ensure that the disclosure is 'clear and not misleading' is the proper and sufficient check on any disclosure statements.

6. <u>The proposed approach creates an enormous operational challenge and corresponding cost burden, with (at best) questionable benefit to investors.</u>

We are deeply concerned that the proposed disclosure requirements will pose huge, uncertain costs and intensive use of resources in exchange for very little benefit to end investors. As we discuss further in our response to Question 27, the proposal does not recognise the enormity of the operational challenges and costs for a manager to create the infrastructure to gather, analyse, aggregate, and disclosure 32+2 indicators across tens of thousands of securities. We expect this new disclosure to pose significant costs—obtaining data from investee companies or data providers, developing in-house analytical capabilities, implementing new systems to track PAI indicators across aggregate investments, among other elements. Unfortunately, the preliminary impact assessment did not address the PAI disclosure requirements, even though it is the most costly and resource-intensive element of the proposal.

7. <u>The proposed approach lacks needed coherence with other key pieces of sustainable finance legislation—namely, the Taxonomy Regulation and the Non-Financial Reporting Directive (NFRD).</u>

We note that the proposed PAI indicators are not aligned with the Taxonomy Regulation's technical screening criteria for significant contribution to environmental objectives, the 'do no significant harm' (DNSH) criteria, or the 'minimum social safeguards.' We discuss this aspect further in our response to Question 22 on the DNSH product-level disclosure. Although a 'social' Taxonomy is slated for development, it is unclear whether or how it will be consistent with the proposed PAI indicators. Similarly, the PAI indicators are not aligned with the NFRD's disclosure requirements for corporate issuers.

8. <u>The proposed approach to PAI creates uncertain legal liability for asset managers.</u>

It is unclear whether or how managers will be liable for the data they are disclosing on the PAI indicators. It is also unclear whether deeming any positive value for a PAI indicator as a 'per se' principal adverse impacts on sustainability will create liability for managers. We caution that an environment of uncertain liability is not conducive to encouraging disclosure, particularly in the case of data that has questionable meaningfulness, availability, or reliability.

9. <u>Finally, the proposed approach is not proportional.</u>

See response to Question 2.

<u>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?</u>

No, the proposed approach does not adequately take into account the need for proportionality as mandated in the level 1 text, where SFDR Article 4(1)(a) requires a financial market participant to publish a statement on due diligence policies with respect to principal adverse sustainability impacts, 'taking due account of their size, the nature and scale of their activities and the types of financial products they make available.' Proportionality is also consistent with the EU's focus on encouraging SME growth in Europe. We explain below why the proposed PAI indicator disclosure lacks proportionality, and then we make recommendations in our response to Question 3 on an alternative approach.

1. <u>The proposed approach to PAI indicator disclosure does not take due account of an asset manager's size.</u>

The proposed template takes a very strict approach, where all 32+2 indicators must be disclosed at an aggregate firm-level for all investments. This approach is extremely resource-intensive, favours scale, and does not provide any flexibility for smaller managers to comply with SFDR Art. 4(1).

Although we understand that RTS Art. 7.2 is intended to provide proportionality, this 'best efforts' language creates a disproportional requirement for a manager to obtain 100% data coverage for each indicator for tens of thousands of investments—regardless of data availability, quality, or cost—and without providing the manager with any discretion or flexibility. If the data is not available from an investee company, RTS Art. 7.2(b) requires the use of 'best efforts' to obtain the data from elsewhere, whether a data provider or internal modelling or research. We are strongly concerned that this 'best efforts' language effectively requires a manager to achieve 100% data coverage for each indicator across tens of thousands of investments, ignoring issues with availability, quality, relevance, and cost of that data.

The proposed approach does not provide managers with the necessary flexibility to address gaps in data availability or quality. This approach fails to account for differences in data availability or quality by region, asset class, size of company, and many other factors. Rather, it assumes that managers will be able to obtain quality data on 32+2 indicators from investee companies across tens of thousands of securities. This assumption is not valid. As we discuss further in our response to Question 5, many of these indicators are based on data that is not yet widely available from investee companies or across all asset classes. Corporate issuers are not required to disclose the vast majority of this data, even in the EU. Although the EC aims to address this shortcoming in the upcoming NFRD review, the lack of data availability will not be resolved before the compliance date for the aggregate entity-level disclosure requirement. The revised NFRD will be applicable at least two years after the application of SFDR, and the NFRD will capture large companies based in the EU or at the maximum with some presence in the EU, but not the broader range of investee companies.

Without more flexibility, the proposed approach effectively will create a disproportionate legal obligation for managers to purchase expensive data from third party service providers without regard for data quality and with questionable benefit to investors. Given the requirement for 100% coverage across tens of thousands of investments, asset managers will be forced to obtain data from service providers that is based on modelled information with significant variations in inputs and assumptions. Legally mandating disclosure of this modelled information is tantamount to requiring managers to purchase this data from providers, even though the reliability of this data is unlikely to be consistent across providers given that they obtain data from different sources, make different assumptions, and frequently estimate data using different methodologies. This requirement is not proportionate to the pursued objectives. In addition, these costs are not justified by a corresponding significant benefit to investors given the current availability and reliability of data.

We therefore urge the ESAs to allow managers to use 'reasonable efforts' or 'good faith efforts,' which would provide managers with needed flexibility to navigate scenarios where 100% data coverage does not exist, or where the manager has concerns about the quality of the data. This will result in a more proportional approach that also provides more meaningful disclosure to investors.

The sheer number of mandatory indicators is not proportional. The long list of indicators is not workable for any asset manager, much less SMEs. As discussed in our responses to Questions 1 and 5, we have significant concerns about whether investors will find aggregate firm-level disclosure of a long list of metrics to be helpful in choosing their investments. ESG data is expensive and resource-intensive to obtain, analyse, and disclose, and the ESAs should carefully consider the cost-benefit of these indicators before requiring their disclosure.

The proposed requirement to continuously calculate aggregate PAI indicators over a reference period is needlessly onerous and not proportional. As we also explain in our response to Question 1, we understand that the ESAs' proposal would require managers to track PAI indicators over a reference period for all of the investment decisions made during that timeframe and then disclose the aggregate values. Obtaining the data is not the only concern. Once a manager has obtained the data, it must build systems to analyse, aggregate, and disclose the data according to the proposed continuous tracking methodology. This raises a number of questions on how this would work in practice.

- How would this apply to purchases and sales? E.g., subtracting carbon footprint of an investment when it is sold? What if the carbon footprint has increased or decreased over the holding period?
- How would this work for binary data points (e.g., proportion of companies with a biodiversity policy)?
- How to account for use of derivatives, short exposures, non-equity securities?
- How to aggregate for a subset of companies where data is available and differentiate where part of the data is not available for the aggregation?
- Will the ESAs publish additional formulas or methodologies?

We raise these questions to highlight how technically and operationally challenging this undertaking will be to track these indicators over a reference period, for each purchase or sale for thousands of different investee companies (and other exposures), and we urge the ESAs to reconsider this approach.

A point-in-time calculation methodology would be proportional and would allow the ESAs and the Commission to first review managers' actual disclosure and determine whether any window dressing is in fact occurring. The ESAs raise concerns about window dressing as the reason for choosing an approach that requires continuous calculation rather than a point-in-time snapshot. These concerns appear to contemplate that managers are likely to compromise their fiduciary duty and investment returns to improve the optics of their PAI disclosure. We assert that concerns about window dressing are unfounded and do not justify such an onerous requirement. A point-in-time calculation methodology would be more proportionate and would allow the ESAs and the Commission to first review managers' actual disclosure and determine whether any window dressing is in fact occurring. Further, the RTS Art. 2 requirement to ensure that the disclosure is 'clear and not misleading' is the proper and sufficient check on any disclosure statements.

The proposed approach creates an enormous operational challenge and corresponding cost burden, which lacks proportionality and provides (at best) questionable benefit to investors. As we discuss further in our response to Question 27, the proposal does not recognise the enormity of the operational challenges and costs for a manager to create the infrastructure to gather, analyse, aggregate, and disclose 32+2 indicators across tens of thousands of securities. We expect this new disclosure to pose significant costs—obtaining data from investee companies or data providers, developing in-house analytical capabilities, implementing new systems to track PAI indicators across aggregate investments, among other elements. Unfortunately, the preliminary impact assessment did not address the PAI disclosure requirements, even though it is the most costly and resource-intensive element of the proposal. We are deeply concerned that the proposed disclosure requirements will pose huge, uncertain costs and intensive use of resources in exchange for very little benefit to end investors.

2. <u>The proposed PAI indicator disclosure does not take due account of the nature and scale of managers' activities and the types of financial products they make available.</u>

Different asset managers may specialise in different investment strategies, some of which will be disproportionately disadvantaged by the proposed approach. For example, the proposed approach contemplates that managers will be able to obtain the PAI indicators from investee companies. This may be more likely to be possible for large investee companies based in the EU. Managers invest globally, however, and many companies in non-EU countries will be less willing or able to report this data. Further, some managers may focus geographically, investing in areas where this data may be less available or reliable (e.g., emerging markets). Given the importance of emerging markets and transition investments to achieving the EU's climate objectives, we caution the EU from inadvertently penalising investment in transitioning sectors. In addition, some of the PAI indicator methodology refer to existing EU regulatory standards, but it is unclear how this analysis would apply to the significant universe of non-EU investments.

Other managers may focus on mid-cap or small-cap companies that do not have the resources to report all of these indicators. Similarly, managers may have more difficulty obtaining data for these asset classes or for other asset classes such as fixed income. If the data is less available from investee companies, then those managers will have to spend more to purchase that data from providers—assuming the data is available at all.

The proposed approach does not consider the types of strategies and products in which a manager may specialise (e.g., index strategies vs. impact strategies). The proposed approach also does not consider the sectorial exposure of asset managers. A technology sector strategy would be likely to outperform an emerging markets strategy on the list of PAI indicators, but this does not provide an accurate picture of their respective sustainability impact. As mentioned earlier, the data for the emerging markets strategy also would likely be much more difficult to obtain and probably more expensive.

Lastly, the proposed approach does not account for how different investment strategies may emphasise different asset classes. Many asset classes (sovereign bonds, securitisations, money markets and cash equivalents, currency, some commodities) cannot be evaluated against these indicators. This is likely to skew a manager's aggregate PAI indicators based on whether that managers' clients are invested in certain asset classes versus others.

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?

We believe that the focus on comparability of Art. 4 entity-level disclosure is misplaced. SFDR aims to improve comparability of financial products (see Recital 9), but there is no level 1 discussion of comparability of Art. 4 entity-level disclosure. In fact, it is not possible to compare accurately two financial market participants at the entity-level. Comparing the value of one asset manager's PAI indicator to another's may create the illusion of comparability but any sense of comparability is ultimately meaningless and even misleading to investors. As we explain our response to Question 1, an asset manager's aggregate PAI metrics will reflect its size and the investment strategies that it offers, rather than any meaningful information about the sustainability impact of its investments.

It is essential that managers be able to use 'reasonable efforts' or 'good faith efforts' to obtain data from investee companies and have flexibility to explain where they have not included data from all investments, including where the data is not available (e.g., for certain investee companies or asset classes), where the data is not reliable, or where the data is not relevant (e.g., for a particular sector or asset class). Managers need this flexibility to navigate the significant challenges with availability and quality of sustainability impact data. As we explain our response to Question 1, we have serious concerns that the proposed 'best efforts' language effectively requires a manager to achieve 100% data coverage for each indicator across tens of thousands of investments, ignoring issues with availability, quality, and cost of that data. Requiring 100% data coverage for an indicator will mandate the inclusion of low quality data, which in turn will reduce the quality of the aggregate metric.

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Given the questions around the meaningfulness of entity-level quantitative disclosure and the immense operational and cost challenges involved, we urge the ESAs to take a proportional, measured approach that focuses on the principles-based elements of SFDR Art. 4. Although we recognise the level 1 reference to sustainability indicators and that the ESAs must put forward a draft that references sustainability indicators in some way, the level 1 text does not direct the ESAs to dictate a mandatory list of sustainability indicators. The level 1 text instead focuses on importance of website disclosure of 'procedures and descriptions of the principal adverse impacts' (see Recital 18), and we encourage the ESAs to implement the principles-based approach taken in SFDR Art. 4, which requires a description of adverse impacts, policies to identify and prioritise principal adverse sustainability impacts, actions to address them and engagement policies, as well as references to international standards. This would allow managers to undertake optional disclosure of the Table 1 indicators, with the discretion to disclose information that the manager determines is sufficiently meaningful, available, and reliable for a sector, industry, or investment.

If the ESAs determine that some disclosure of mandatory indicators is necessary, we then urge the ESAs to prioritise disclosure of an initial subset of indicators that have broader relevance across sectors and asset classes and where data is both widely available and reliable. We recommend keeping the remaining Table 1 indicators as optional until the Taxonomy work is complete, the NFRD is reviewed and implemented, and corresponding data is made publicly available by companies. We lay out our recommendations around specific indicators in our response to Question 5.

We note that the SFDR's evaluation provision (Art. 19) provides an opportunity to begin with less prescriptive requirements and assess if and when additional disclosure should become mandatory. SFDR Art. 19 directs the EC to evaluate the quality of disclosures and whether the functioning of SFDR is inhibited by the lack of data or their suboptimal quality, including indicators on adverse impacts on sustainability factors by investee companies. This provision then authorises the EC to put forward a subsequent legislative proposal. This provision provides an opportunity to begin with less prescriptive requirements that focus on optional rather than mandatory disclosure. The EC then will have a window to evaluate how the market implements the disclosure in advance of the 30 December 2022 review date after which the EC can propose new legislation to address any issues.

During this evaluation window, we urge the EC to perform a study of sustainability impact data to inform any subsequent legislative proposal. A data review is sorely needed, including availability across geography, asset classes, and size of company; quality and reliability of data; and which indicators provide the most meaningful measures of sustainability impact, including sector-specific and across a broad spectrum of investments. At this point, more of the data may be available, and the study also could focus more heavily on cost-benefit of mandating disclosure of certain indicators.

In the context of the NFRD, it would be beneficial for the Commission to further consult on whether companies can disclose the indicators in Table 1. If companies are not able to provide that data, then we do not see how managers would be able to disclose it. If the only data available is third party estimates based on assumptions, then we question how managers would verify the accuracy of that data.

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

We do not agree with the proposed reporting template.

Boilerplate, tick-the-box disclosure will not achieve the SFDR's objective of providing meaningful information to end investors on the sustainability impact of their investments. The ultimate goal should be to help investors understand processes, rather than boilerplate information in a template that does not provide managers with the flexibility and discretion to account for differences in strategies, sectors, and investments. The template, as currently drafted, is not consumer-friendly and is more likely to confuse investors given the significant amount of quantitative data reported without any context around how the indicators are relevant to a particular fund in which an investor is interested.

Although we understand the template is intended to create comparability, we believe that the focus on comparability of Art. 4 entity-level disclosure is misplaced (see also our response to Question 3). SFDR aims to improve comparability of financial products (see Recital 9), but there is no level 1 discussion of comparability of Art. 4 entity-level disclosure. In fact, it is not possible to compare accurately two financial market participants at the entity-level. Comparing the value of one asset manager's PAI indicator to another's may create the illusion of comparability but any sense of comparability is ultimately meaningless and even misleading to investors. As we explain our response to Question 1, an asset manager's aggregate PAI metrics will reflect its size and the investment strategies that it offers, rather than any meaningful information about the sustainability impact of its investments.

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)?

As an initial comment, we reiterate our view that investors would be best-served by the ESAs initially taking a proportional, measured approach that focuses on the principles-based elements of SFDR Art. 4 rather than focusing on mandatory indicator disclosure. This would allow managers to undertake optional disclosure of the Table 1 indicators, with the ability to disclose information that the manager determines is sufficiently meaningful, available, and reliable for a sector, industry, or investment.

We surveyed member firms on the draft proposed indicators. Most of the proposed mandatory indicators in Table 1 do not meet the following criteria that we believe are necessary for any mandatory indicator:

- **Provide a meaningful measure of adverse sustainability impact across a broad spectrum of investments.** Any mandatory indicators should provide a meaningful measure of sustainability impact when applied across thousands of investments (e.g., across sectors, asset classes, geographies, investment strategies). For example, an indicator may lack relevance for certain companies or sectors.

- **Based on widely available data**. Any mandatory indicators should be available from a significant portion of the investment universe (i.e., from investee companies and across asset classes).
- **Based on reliable data.** Any mandatory indicators should have methodological consensus around how to calculate the indicator and should not require third party service providers to model the data based on unverifiable assumptions.

We note that the information we provide below is from market participants that will implement SFDR in practice.

Regardless of our deep concerns, if the ESAs determine to require mandatory indicators, we then urge the ESAs to prioritise disclosure of an initial subset of indicators that have broader relevance across sectors and asset classes and where data is both more widely available and reliable. We recommend keeping the remaining Table 1 indicators as optional until the Taxonomy work is complete, the NFRD is reviewed and implemented, and corresponding data is made publicly available by companies.

We recommend the following approach if the ESAs determine to require mandatory indicators:

- **As a first step, we recommend initially prioritising disclosure of four environmental and social indicators as listed below.** These indicators have broader relevance across sectors and certain asset classes (i.e., equities and corporate bonds), are more widely available, and are based on more reliable data (e.g., have a reasonable level of methodological consensus regarding their calculation).
- **We recommend keeping the remaining Table 1 indicators as optional until the Taxonomy work is complete, the NFRD is reviewed and implemented, and corresponding data is made publicly available by companies.** These indicators may be relevant for certain sectors or asset classes, may have some availability (but not be available for a significant portion of the investment universe), or may have some level of methodological consensus. Although they are not meaningful measures of sustainability impact across a broad range of investments, this would provide managers with the flexibility to disclose some indicators that they deem relevant for certain investments.
- **Finally, we recommend removing certain Table 1 indicators entirely.** Our members do not find these indicators to be meaningful measures of sustainability impact for various reasons, including lack of sufficient relevance or lack of data availability or reliability.

This approach would allow asset managers to prioritise indicators that will be most useful to investors, while providing flexibility for disclosure of optional indicators where appropriate. We lay out our recommendations around specific indicators in the below charts.

1) Recommended Priority Indicators

RECOMMENDED PRIORITY INDICATORS			
	Table 1 Indicator	**Recommendation**	**Explanation**
1	Scope 1 and 2 carbon emissions	Prioritise	These indicators are available for a significant portion of the investment universe, although methodologies are asset class specific. We note that members do not find these indicators equally useful as a measure of adverse impact across all sectors (e.g., more useful for carbon intensive industries but less so for others). We recommend applying these indicators only to equities and corporate bonds, since these indicators are much less available for other asset classes.
2	Carbon footprint	Prioritise	
	Severe controversies/ breaches of UN Global Compact (share of investments in investee companies that have been involved in severe violations of the UNGC principles).	Prioritise	We recommend using Indicator #28 (Number and nature of identified cases of severe human rights issues and incidents) as starting point, but then tying it to the UN Global Compact. This indicator comprehensively covers many of the social indicators listed relating to human rights, labour, and anti-bribery and anti-corruption. This indicator should apply only to equities and corporate bonds.
	Signatory to the UN Global Compact (share of investments in investee companies that have not committed to the UNGC principles).	Prioritise	This indicator is not included in the proposed Table 1 list of mandatory indicators, but, in combination with Indicator #28, it efficiently and effectively covers many of the adverse social impact areas referenced by the ESAs' proposed social indicators in Tables 1 and 3. This indicator should apply only to equities and corporate bonds.

2) Recommendations for Other Table 1 Indicators

GREENHOUSE GAS EMISSIONS			
	Table 1 Indicator	**Recommendation**	**Explanation**
1	Scope 3 carbon emissions	Optional	Data not available for a very large portion of the investment universe and not generally available for non-equity securities. Most importantly, this indicator lacks reliability or methodological consensus. We recognise the ESAs' interest in driving increased disclosure of scope 3 emissions, but it is our understanding that climate scientists and climate data experts that worked on Intergovernmental Panel on Climate Change (IPCC) papers and the Greenhouse Gas (GHG) Protocol do not believe this data is likely to be reliable for the near future. There also are significant issues with double-counting.

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3	Weighted average carbon intensity	Optional	Not equally useful across all sectors (e.g., more useful for carbon intensive industries but less so for others).
4	Solid fossil fuel sector exposure	Optional	Not equally useful across all sectors (e.g., more useful for carbon intensive industries but less so for others). Calculation methodology also is unclear, especially as to how to aggregate across companies that have diversified percentages of revenues from fossil fuels.

ENERGY PERFORMANCE			
	Table 1 Indicator	**Recommendation**	**Explanation**
5	Energy consumption from non-renewable	Optional	Lack of data availability for non-equities. Also significant dispersion by sector. Information on energy intensity can be a useful indicator for energy intensive sectors. However, the metrics defined here would not present the data in the way that is most useful for investors. Note that this information (on a granular level) would be reflected in the data provided in response to Indicator #1.
6	Breakdown of consumption by type of non-renewable	Optional	Lack of data availability for non-equities. Also significant dispersion by sector. Information on energy intensity can be a useful indicator for energy intensive sectors. However, the metrics defined here would not present the data in the way that is most useful for investors. Additionally, non-renewable energy consumption information for non-utility companies likely depends on assumptions based on broad utility data (rather than on a particular sector) and may not be reliable or useful.
7	Energy consumption intensity	Optional	Lack of data availability for non-equities. Also significant dispersion by sector. Information on energy intensity can be a useful indicator for energy intensive sectors. However, the metrics defined here would not present the data in the way that is most useful for investors. Breakdown per NACE sector would require a very resource-intensive process and would result in extremely detailed, dense disclosure that lacks utility to an investor.
8	Energy consumption intensity per sector	Optional	

BIODIVERSITY			
	Table 1 Indicator	**Recommendation**	**Explanation**

9	Companies monitoring pressure on biodiversity and ecosystem	Remove	Lacks relevance for most investee companies. Not available for a significant portion of the investment universe. Not easily measurable.
10	Companies affecting natural species and protected areas	Remove	Subjective terminology that could lead to bad data across issuers (for example, 'areas of high biodiversity value' and 'adjacent to' could be interpreted very differently by issuers). Not available for a significant portion of the investment universe.
11	Companies without deforestation policy	Remove	Lacks relevance for most investee companies (for example, issuers outside of the natural resource/agriculture/paper business likely do not have deforestation policies). Not available for a significant portion of the investment universe.

WATER			
	Table 1 Indicator	**Recommendation**	**Explanation**
12	Water emissions	Optional	Only relevant for water-intensive sectors.
13	Exposure to areas of high water stress	Remove	Only relevant for water-intensive sectors. Potential unintended consequence of discouraging investment in such regions.
14	Untreated discharged waste water	Optional	Only relevant for water-intensive sectors.

WASTE			
	Table 1 Indicator	**Recommendation**	**Explanation**
15	Hazardous waste ratio	Optional	Only relevant for a subset of sectors (e.g., manufacturing).
16	Non-recycled waste ratio	Remove	Only relevant for a subset of sectors (e.g., manufacturing).

SOCIAL AND EMPLOYEE MATTERS			
	Table 1 Indicator	**Recommendation**	**Explanation**
17	Implementation of ILO Conventions	Optional	This is effectively covered by the recommended priority indicators related to the UN Global Compact.
18	Gender pay gap	Optional	Although our members may use this indicator in their internal analysis, it is not useful in aggregated form given that analysis of this indicator for any given investee company is highly dependent on context and other factors.
19	Excessive CEO pay ratio	Optional	No widespread disclosure of this metric by companies. In Europe, while the salary of board members and some senior executives will be the subject of further mandatory disclosure under the SRD II, the median salary will not be subject to such disclosure. Sector context is also essential because this

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			indicator depends on composition of labour force which will skew the ratio—for example, CEO pay ratios for a retail company (where there are a large number of low wage positions) vs. a software company would not provide a useful comparison. Also methodological challenges (e.g., how and whether to value option grants). Not applicable for all asset classes (e.g., sovereigns or municipal bonds).
20	Board gender diversity	Optional	Not available for all asset classes.
21	Insufficient whistleblower protection	Remove	Whether a company does or does not have a workplace policy is not a meaningful indicator of adverse sustainability impact. More important to measure actual performance.
22	Investment in investee companies without workplace accident prevention policies	Remove	

HUMAN RIGHTS			
	Table 1 Indicator	**Recommendation**	**Explanation**
23	Human rights policy	Optional	These indicators are effectively covered by the recommended priority indicators related to the UN Global Compact.
24	Due diligence	Optional	
25	Processes and measures for preventing trafficking in human beings	Remove	
26	Operations and suppliers at significant risk of incidents of child labour	Remove	
27	Operations and suppliers at significant risk of incidents of forced or compulsory labour	Remove	
28	Number and nature of identified cases of severe human rights issues and incidents		We recommend using this indicator as a starting point, but then tying it to the UN Global Compact. See above table with recommended priority indicators.

29	Exposure to controversial weapons (land mines and cluster bombs)	Optional	This information is generally available. It is a subset of the information covered by the recommended priority indicators related to the UN Global Compact (which excludes companies with exposure to controversial weapons).

ANTI-CORRUPTION AND ANTI-BRIBERY			
	Table 1 Indicator	**Recommendation**	**Explanation**
30	Anti-corruption and anti-bribery policies	Optional	Not available for certain asset classes. This is effectively covered by the recommended priority indicators related to the UN Global Compact.
31	Cases of insufficient action taken to address breaches of standards of anti-corruption and anti-bribery	Remove	Subjective data point that lacks comparability. More effectively covered by the recommended priority indicators related to the UN Global Compact.
32	Number of convictions and amount of fines for violation of anti-corruption and anti-bribery laws	Optional	Not available for certain asset classes. This is effectively covered by the recommended priority indicators related to the UN Global Compact.

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?

No, we do not see merit in requiring this disclosure. As we discuss in our response to Questions 3 and 5, if the ESAs determine to require mandatory indicators, we recommend that they prioritise disclosure of certain climate-related indicators (i.e., scope 1 and 2 emissions and carbon footprint). We also note that benchmarks may change over time, making comparison difficult given that managers update their data at different times.

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?

Yes, our feedback is that requiring measurement of the share of investee companies is not a useful measure of sustainability impact. Asset managers may have small investments in tens of thousands of companies. This is particularly magnified for managers with significant broad index offerings (e.g., a total stock market index fund). For example, the percentage of investee companies that have a deforestation policy does not provide any meaningful information about the sustainability impact of the actual investments in those companies.

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, as we discuss in our response to Question 5, managers already have difficulty obtaining data on carbon emissions. As we discuss in our response to Question 3, we recommend that the ESAs prioritise disclosure of certain climate-related indicators (i.e., scope 1 and 2 emissions and carbon footprint) that have broader relevance across sectors and asset classes and are based on widely available and reliable data. We would recommend a phased and considered approach when introducing any additional indicators to allow sufficient time for the industry to source and report on those indicators in a consistent manner.

We also reiterate that any approach to reporting investee companies' GHG emissions should take into account the importance of relative performance and directionality. For example, comparing the carbon emissions of a cement company to a healthcare company is not a useful exercise. When analysing sustainability impact, a manager instead would seek to understand how the cement company performs on carbon emissions relative to other companies in that sector and whether its performance is improving over time. Given the importance of investments in transition activities to the EU's climate objectives, we also caution the EU from inadvertently penalising investment in transitioning sectors.

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?

As we discuss in our response to Question 5, if the ESAs determine that some disclosure of mandatory social indicators is necessary, we then urge the ESAs to prioritise disclosure of two social indicators tied to the UN Global Compact. These indicators comprehensively cover many of the Table 1 social indicators relating to human rights, labour, and anti-bribery and anti-corruption. We recommend keeping the remaining Table 1 social indicators as optional until the Taxonomy work is complete, the NFRD is reviewed and implemented, and corresponding data is made publicly available by companies.

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?

No, the proposed requirement to provide a historical comparison of PAI indicators up to 10 years goes beyond the level 1 text and does not provide any benefit to investors. As discussed in our response to Question 1, firm-level aggregate quantitative disclosure does not provide investors with any meaningful or decision-useful information about the sustainability impacts of their investment. Similarly, absolute historical figures do not provide any information to investors about actual impact of investments. In fact, the lack of value to investors becomes even clearer with comparison year-over-year. For example, if a manager's assets under management increase from one year to the next, the disclosed PAI indicators may increase even if the manager focuses more on sustainable investments. The increase in the indicators does not provide any meaningful information to end investors, however, on whether investee companies' adverse sustainability impacts increased or decreased. There is no level 1 requirement to provide historical reporting, and this provision would provide misleading information to investors.

<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 that concerns about 'window dressing' of PAI disclosure are unfounded. The ESAs raise concerns about window dressing as the reason for choosing an approach that requires daily calculation rather than a point-in-time snapshot. These concerns appear to contemplate that managers are likely to compromise their fiduciary duty and investment returns to improve the optics of their PAI disclosure. We believe concerns about window dressing are unfounded and do not justify such an onerous requirement. The RTS Art. 2 requirement to ensure that the disclosure is 'clear and not misleading' is the proper and sufficient check on any disclosure statements.

As we discuss in our response to Question 2, a point-in-time calculation methodology would be more proportional and would allow the ESAs and the EC to first review managers' actual disclosure and determine whether any window dressing is in fact occurring. We note that the SFDR's evaluation provision (Art. 19) provide the EC with the opportunity to consider the application of these requirements and the benefits and proportionality of the related administrative burden.

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

Our comments on product disclosures generally relate to disclosure for a UCITS or a pan-European personal pension product (PEPP), both of which fall within the SFDR's definition of 'financial products' (see SFDR Art. 2(12)(f) and (g)).

We reserve our judgment on whether mandating the templates is the right approach until we have a chance to review the proposed templates. We understand the ESAs are currently drafting templates and plan to share them with the public for comment in September 2020. Theoretically, templates may be helpful, as they may help standardise presentation of the information and facilitate comparability. The usefulness of any template, however, would depend on its content, and how the content fits within the current sectoral disclosure requirements.

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Importantly, we have very significant concerns about the feasibility of the 10 March 2021 compliance date for product disclosures, and the ESAs' ongoing development of templates will make this process even more challenging. The current compliance date for the pre-contractual and website disclosures is 10 March 2021 (see SFDR Art. 20 and RTS Art. 54), and the compliance date for periodic disclosures is 1 January 2022. To comply with the 10 March 2021 compliance date for these new, detailed disclosures, asset managers will need to see both the final templates and the final RTS requirements (which are not likely to be ready until end of January 2021), then develop processes to comply with the new requirements. Some disclosures must be based on the availability of, and access to, data that still needs to be sourced. The pre-contractual disclosure then will need to go through the approval process at the NCA level. Allowing 1 month for these steps is simply not realistic.

We therefore urge ESAs to clarify that any pre-contractual disclosure would not have to be updated with the RTS requirements until the next required revision period for the pre-contractual disclosure after March 2021, and not sooner than 1 January 2022. To provide a reasonable period for implementation irrespective of when the next revision date falls (which, for some, could be soon after the 10 March 2021 implementation date), the compliance date should not begin until after 1 January 2022, which is approximately 11 months after the final RTS are available. ESAs should also clarify that these dates are by which the pre-contractual disclosure should be submitted for the NCA approval, and not the date by which the approval should be received.

We urge flexibility in the implementation timeline to ensure that the SFDR legislation delivers on its objective to create meaningful sustainable finance disclosure to end investors, rather than resulting in a rushed implementation process that creates doubt about the utility of the entire SFDR legislation. The building blocks for the disclosure, including the methodologies, will first need to be developed and established to produce meaningful disclosure for end investors. We emphasise that our member firms are already devoting substantial resources to the implementation of several new ESG-related legal requirements; we urge the ESAs to recognise the enormity of the implementation work for these new rules.

We also have broader concerns about the current patchwork approach, where each of the key regimes under the new series of ESG-related requirements—disclosure, risk integration, taxonomy, and benchmarks—takes its own approach to certain methodologies and categorisations (of investments, products, and benchmarks). As we discuss in Questions 16 and 17, one of the examples of this patchwork approach is the methodology for determining whether and to what extent an investment is a 'sustainable investment.' As proposed, investors will be exposed to two side-by-side disclosures on 'sustainable investments'—one for the SFDR and the other for the Taxonomy Regulation—which is certain to confuse investors. We urge the ESAs to focus on adopting common methodologies and definitions, where possible, across the various pieces of sustainable finance legislation to promote consistent and coherent disclosures.

A prudent approach would be for the EU co-legislators to take a holistic view of the various ESG-related workstreams and revise the timetable considering the need to: a) provide a realistic amount of time between adoption and implementation of final rules; and b) sequence the adoption of risk integration, disclosure, the taxonomy, and the NFRD. However, if such an orderly and structured approach is not adopted, an alternative approach—as we suggest above—must be taken at a minimum to make it possible for firms to meet the requirements under the SFDR, in the meaningful way.

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

We look forward to making specific recommendations once we see the ESAs' draft templates.

Any new templates will have to fit within the legacy of the existing sectoral informational documents, which are already complex and contain numerous elements of information that were deemed important to the end investor under various sectoral rules. For example, the templates will have to work for different product requirements—for example, for UCITS, the pre-contractual disclosure template will be in the prospectus, while for a PEPP, the template will be in the Key Information Document (KID). Further, the new templates will also have to be consistent with any EU label that may be developed, as well as with applicable national labels.

We also urge ESAs to future-proof the format of disclosures by not specifying a format that memorialises or relies on the use of the existing technology or paper-based disclosure. This will be consistent with the aim of the European Commission's Digital Strategy Plan that calls for technology to make EU citizens' lives easier in all aspects, which we believe should translate into making the investment process easier for EU citizens.

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.

As we note in our responses to Questions 12 and 13, we reserve our views on the use of templates until we can comment on the draft templates. This notwithstanding, any new informational requirements will need to fit within the legacy of the existing sectoral informational documents, which are already complex and designed with the end investor in mind. Any new requirements also will need to be consistent and work coherently with any other EU-level or national level requirements for ESG products. Otherwise, despite the best intentions of EU and national policymakers to help end investors understand and differentiate among different kind of ESG products, the end result may have the opposite effect by creating an impenetrable wall of disjointed ESG-related information.

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?

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We do not agree with the proposed balance of information between the pre-contractual disclosure and the website based additional 'Sustainability-related disclosures'. As proposed, the RTS mandates excessive details for pre-contractual disclosure both for Article 8 and for Article 9 products. The draft RTS also includes elements that should not be included in either place, as we explain in more detail below.

To ensure that the pre-contractual information is meaningful to end investors, it must focus on information that will help investors make investment decisions, while reserving technical details for a separate communication, and in this case as required by SFDR Art. 10, for the website disclosure in a section titled 'Sustainability-related disclosures' (see RTS 33).

We recognise that the ESAs intend to help investors compare and differentiate among products, and we strongly believe that the target audience for the pre-contractual documents should be retail investors. Yet, the pre-contractual requirements call for a detail and depth of information that is likely to obscure the critical information that retail investors need to determine which products work best for them. For example, few retail investors can evaluate ESG features of a fund by looking at PAI indicators the fund manager takes into account (RTS Arts. 16 and 25).

Experience shows an overload of information increases the difficulty of comparing different ESG products and potentially deters retail investors from investing in an ESG product. This result would run counter to the objective of the SFDR and the more recent EU efforts for post-COVID-19 recovery to both direct more capital toward sustainable investments and support the continued effort to build a robust Capital Markets Union.

As we show in the charts below, the pre-contractual documents should include only the top-line information required in the level 1 text, allowing for more in-depth information to be delivered via a separate communication, on a website, in a section titled 'Sustainability-related disclosures.' 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 in the **'Sustainability-related disclosures' section** of the website. We would suggest a similar approach for Article 9 products and the corresponding RTS Art. 25. The following chart outlines our specific suggestions.

Recommended balance of information between pre-contractual disclosures and the web-site based additional 'Sustainability-related disclosures' for Article 8 and 9 products

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RTS Article	**RTS proposed pre-contractual disclosure**	**Recommended precontractual disclosure**	**Recommended website-based 'Sustainability-related disclosures'**	**Disclosure should not be required**
15(1)(a), 24(1)(a)	A description of the environmental or social characteristics promoted by [or sustainable investment objective of] the financial product	A brief description	Any detailed explanations	
15(1)(b), 24(1)(b)	A narrative and graphical representation of the investments of the financial product	Short-form graphical representation	Narrative explanation	
15(1)(c), 24(1)(c)	A reference to the webpage where the PAI Statement is published.	Agree with the proposed approach	--	
15(2)(a)(i), 24(2)(a)	A graphical representation that illustrates the planned proportions of the total investments that are sustainable investments and, where relevant, the subdivision of those sustainable investments between environmental or social objectives.	--	--	We do not think this should be required for Art. 8 funds and we question its utility for Art. 9 funds given the lack of coherency with the forthcoming Taxonomy disclosures. See our responses to Questions 16, 17 and 22.
15(2)(a)(ii), (iii)	**For Art. 8 products**, a graphical representation that illustrates the planned proportions of the total investments (other than those that are 'sustainable'), that contribute to the attainment of the environmental or social characteristics promoted by the financial product and, where relevant, the subdivision	See response to Question 18. Need flexibility to provide graphical representations that are useful to end investors.	--	

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RTS Article	**RTS proposed pre-contractual disclosure**	**Recommended precontractual disclosure**	**Recommended website-based 'Sustainability-related disclosures'**	**Disclosure should not be required**
	of those investments between environmental or social characteristics, and the remainder of the investments.			
15(2)(b)(i), 24(2)(b)(i)	A narrative explanation that explains the planned proportions shown as graphical explanations; distinguishing between direct holdings in investee companies and all other types of exposures to those companies [e.g., derivatives].	--	Too much detail for pre-contractual disclosure. See response to Question 17.	
15(2)(b)(ii), 24(2)(b)(ii)	A narrative explanation that explains the purpose of the planned remainder of the investments [that are not 'sustainable' or promoting E or S characteristics], including a description of any potential minimum environmental or social safeguards and whether those investments are used for hedging, relate to money market instruments or are investments for which there is insufficient data.	--	--	Goes beyond level 1 text. Reference to minimum environmental and social safeguards creates confusion with Taxonomy.
15(2)(b)(iii), 24(2)(b)(iii)	A narrative explanation that explains the planned proportions of investments in different sectors and sub-sectors, including the fossil fuel sectors.	--	Too much detail for pre-contractual disclosure.	
16(1)	**Art. 8 products** must disclose a statement: 'This product does not have as its objective sustainable investment.'	--	--	This statement is not meaningful to the end investor and should be removed.

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RTS Article	RTS proposed pre-contractual disclosure	Recommended precontractual disclosure	Recommended website-based 'Sustainability-related disclosures'	Disclosure should not be required
				Rather, the key information is what is required by RTS Art. 15(a) – explaining what this product does, rather than what it does not do.
16(2), 25	An explanation of how the sustainable investments in an Art. 9 product [or any sustainable investments in an Art. 8 product] does not significantly harm the sustainable investment objectives, including: (a) how the indicators for adverse impacts in Annex I are taken into account, and (b) how investments that significantly harm the sustainable investment objectives are excluded.	--	--	We do not think this should be required for Art. 8 funds and we question its utility for Art. 9 funds given the lack of coherency with the forthcoming Taxonomy disclosures. See our responses to Questions 16, 17 and 22.
17(a), 26(a)	A description of the type of investment strategy used to attain the environmental or social characteristics promoted by the financial product [or sustainable investment objective], the binding elements of that strategy to select the investments to attain each of those characteristics and how the strategy is implemented in the investment process on a continuous basis.	A brief description.	Any detailed explanation.	

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RTS Article	RTS proposed pre-contractual disclosure	Recommended precontractual disclosure	Recommended website-based 'Sustainability-related disclosures'	Disclosure should not be required
17(b), 26(b)	Where there is a commitment by the financial market participant to reduce by a minimum rate the scope of investment considered prior to the application of the investment strategy, an indication of that rate.	--	This information, with sufficient explanation, should be on the website.	
17(c), 26(c)	A short description of the policy to assess good governance practices of the investee companies and a reference to the website where to find more information	See our response to Question 21.	--	
18, 27	A list of the sustainability indicators used to measure the attainment of each of the environmental or social characteristics promoted by the financial product [or the attainment of the product's sustainable investment objective].	Short reference in prospectus with reference to additional disclosures in the 'Sustainability-related disclosures' section of the website.	Further details should go on the website.	
19, 28	Information on how the use of derivatives meets each of the environmental or social characteristics promoted by the financial product [or attains the product's sustainable investment objective].	--	--	See our response to Question 26.
21(a)	**For Art. 8 products**, an explanation of how the reference benchmark is continuously aligned with each	A brief explanation but clarified as suggested in our	Any detailed disclosure should be on the website.	

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RTS Article	**RTS proposed pre-contractual disclosure**	**Recommended precontractual disclosure**	**Recommended website-based 'Sustainability-related disclosures'**	**Disclosure should not be required**
	of the environmental or social characteristics promoted by the financial product and with the investment strategy.	response immediately following this chart.		
21(b)	**For Art. 8 products**, where an index is designated as a reference benchmark that is consistent with each of the environmental or social characteristics promoted by the financial product, an explanation of how the designated index differs from a broad market index.	A brief explanation but clarified as suggested in our response immediately following this chart.	Any detailed disclosure should be on the website.	
21(c)	**For Art. 8 products**, if the methodology of the reference benchmark is not aligned with an environmental or social characteristic promoted by the financial product, the section shall contain a prominent statement that the reference benchmark is not consistent with the environmental or social characteristics promoted by the financial product.	A brief explanation but clarified as suggested in our response immediately following this chart.	Any detailed disclosure should be on the website.	
30(a)	**For Art. 9 products** with a designated index for attaining sustainable investment objective, an explanation of how the taking into account of sustainability factors within the methodology of the reference benchmark is continuously aligned with the sustainable investment objective of the financial product.	A brief explanation but clarified as suggested in our response immediately following this chart.	Any detailed disclosure should be on the website.	

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RTS Article	RTS proposed pre-contractual disclosure	Recommended precontractual disclosure	Recommended website-based 'Sustainability-related disclosures'	Disclosure should not be required
30(b)	**For Art. 9 products** with a designated index for attaining sustainable investment objective, an explanation as to why and how the designated index differs from a broad market index.	A brief explanation but clarified as suggested in our response immediately following this chart.	Any detailed disclosure should be on the website.	
30(c)	**For Art. 9 products** with a designated index for attaining sustainable investment objective, an explanation how the alignment of the investment strategy with the methodology of the index is ensured on a continuous basis.	A brief explanation but clarified as suggested in our response immediately following this chart.	Any detailed disclosure should be on the website.	
31	**For Art. 9 products** with objective of a reduction in carbon emissions, (1) an explanation that the reference benchmark qualifies as an EU Climate Transition Benchmark or an EU Paris-aligned Benchmark under [the Climate Benchmarks Regulation]. 2. By way of derogation from paragraph 1, where no [EU Climate Benchmark] is available, explain that fact and how the continued effort of attaining the objective of reducing carbon emissions is ensured in view of achieving the long-term global warming targets of the Paris Climate Agreement. In particular, explain how the financial	Yes, but revised as suggested in our response immediately following this chart.	Anything beyond what is required to be in the pre-contractual disclosure per the level 1 text should be on the website.	We recommend removing the obligation for the reference benchmark to qualify as an EU Climate Benchmark. See our response immediately following this chart.

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RTS Article	RTS proposed pre-contractual disclosure	Recommended precontractual disclosure	Recommended website-based 'Sustainability-related disclosures'	Disclosure should not be required
	product complies with the methodological requirements set out in Articles 19a, 19b and 19c of the [Benchmarks Regulation].			

<u>Additional comments</u>

As discussed in our responses to Questions 16 and 22, we recommend excluding the 'sustainable investments' (and DNSH) disclosure requirements for Art. 8 products.

We generally disagree with the forward-looking nature of the draft requirements in RTS Arts. 15 and 24 (which require disclosure of the 'planned proportion' of investments). Managers should be obliged to report on 'planned proportions' only to the extent relevant. Many products do not have such a planned proportion at the outset, particularly Art. 8. All of this reporting should be on the website (as it is quite complex and more suitable for institutional investors). Otherwise, any disclosure of investments should be a point-in-time snapshot of a fund's actual investments, not a forward-looking estimate.

We request clarification on RTS Arts. 21 and 30's specific disclosure requirements where a product uses an index as a reference benchmark. It appears that the intention of the SFDR text is to ensure that any product that uses indices for the purpose of attaining the product objective (whether Article 8 or Article 9) should explain whether and how that index helps the product achieve that objective. However, the wording of the proposed RTS disclosure is unclear in whether it captures *any* index that a product uses and for *any* purpose (e.g., an Art. 8 product theoretically may use a non-ESG index for the purpose of benchmarking its performance or just ESG-type index). We therefore recommend clarifying that, if the benchmark is not used to 'justify the attainment of environmental or social characteristics, or the delivery of the sustainable investment objective' (per RTS Recital 39), but for other purposes (*e.g.*, performance), then the disclosure should be limited to the statement that the benchmark is used for such a purpose and not for the purpose of meeting environmental or characteristics or the sustainable investment objective.

For RTS Art. 31, we do not agree that Art. 9 products with a climate objective should have an obligation to use an EU Climate Benchmark. This provision in RTS Art. 31(1) goes beyond the level 1 text (SFDR Art. 9(3)), which only requires disclosure of how the designated index is aligned with that objective and why and how the index differs from a broad market index. Rather than measuring the performance of an Art. 9 product with a climate objective against an EU Climate Benchmark, investors instead want to see how the product performs against a non-ESG benchmark. Generally speaking, investors look for asset managers to beat the risk/return characteristics offered by a 'regular' benchmark, not just a climate benchmark.

Similarly, we recommend removal of the provision in RTS Art. 31(2) that creates an obligation to explain how a financial product complies with requirements of the Benchmark Regulation. This requirement is not in the level 1 text and is more suited to benchmark administrators rather than asset managers.

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 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 it is in pre-contractual disclosure Articles 17(c) and 26(c);***
> ***c) a description of the limitations to (1) methodologies and (2) data sources and how such limitations do not affect the attainment of any environmental or social characteristics or sustainable investment objective of the financial product – in the draft RTS it is in the website disclosure under Article 34(1)(k) and Article 35(1)(k); and***
> ***d) a reference to whether data sources are external or internal and in what proportions – not currently reflected in the draft RTS but could complement the pre-contractual disclosures under Article 17.***

As we explain in our response to Question 15, to be helpful to retail investors, pre-contractual disclosure must strike the right balance between providing meaningful information and overloading consumers with technical detail. For this reason, **we recommend including above items A, B, and C in the website disclosure (in a section titled 'Sustainability-related disclosures'), and only including a reference to the availability of this information in the pre-contractual documents.** We do not believe that item D would provide useful information to an end investor, and we do not recommend requiring this information to be disclosed.

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.

No, the requirement for Art. 8 products to disclose 'sustainable investments' conflates Art. 8 and 9 products, running counter to the co-legislators' level 1 definitions of the two separate categories of product disclosure. The level 1 text defines Art. 8 products as products that 'promote an environmental or social objective,' while Art. 9 products 'have an objective of sustainable investments.' The level 1 text does not reference 'sustainable investments' for Art. 8 products, as that is not their objective.

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We recommend removing the reference to 'sustainable investments' in the draft RTS on pre-contractual disclosure, website disclosure, and periodic reports for Art. 8 products. The purpose of the product-level disclosure requirements is to inform investors on how the product meets its objectives, ensuring that end investors have the information they need to compare and select ESG financial products. Art. 8 disclosure therefore should focus on clear disclosure of the environmental and/or social characteristics that the product is promoting.

If the ESAs choose to retain the obligation for Art. 8 products to disclose the percentage of 'sustainable investments,' we urge the ESAs to clarify how to categorise a portfolio investment that is both a 'sustainable investment' and 'promotes environmental or social characteristics.' RTS Art. 15(2) requires disclosure of the portion of the product's investments that are either (1) sustainable or (2) promoting environmental or social characteristics. It is unclear how a manager would categorise an investment that meets both criteria.

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

The proposed approach to disclosure of 'sustainable investments' fails to take into account the Taxonomy Regulation's upcoming financial product disclosure requirements. This will result in an investor receiving a UCITS prospectus with two sets of side-by-side disclosure of 'sustainable investments'—one for the SFDR and one for the Taxonomy Regulation—that lack any consistency or coherency. The draft RTS propose to require pre-contractual and website disclosure of 'sustainable investments' according to the SFDR's definition of 'sustainable investment' (Article 2(17) SFDR). This disclosure, however, is not aligned with the disclosure requirements under the Taxonomy Regulation. Rather, the Taxonomy Regulation requires Art. 8 and 9 funds to disclose in the prospectus and annual report how and to what extent the fund is invested in 'environmentally sustainable' economic activities (as defined in the Taxonomy Regulation). This disclosure must include the percentage of the product's investments that are Taxonomy-aligned, including the respective proportions of 'enabling' and 'transition' activities. This disclosure for the Taxonomy's first two environmental objectives (climate change mitigation and adaptation) will apply from 31 December 2021, with requirements related to the other four objectives applying on 31 December 2022. We understand the EC intends to develop a 'social' Taxonomy, which will create even more confusion.

We caution that a lack of consistency or coherency between the SFDR and Taxonomy Regulation disclosure of 'sustainable investments' will result in disclosure that is incomprehensible to end investors.

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

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We agree with the ESAs' observation that ESG characteristics can vary widely from product to product. A prescriptive requirement to use the same graphical representation for very different types of products could be misleading to end-investors. **We instead recommend providing flexibility so that asset managers can provide graphical representations that are useful to end investors.**

We also disagree with the forward-looking nature of the draft requirement in RTS Art. 15 (which requires disclosure of the 'planned proportion' of investments). As we explain in our response to Question 15, any disclosure of investments should be a point-in-time snapshot of a fund's actual investments, not a forward-looking estimate.

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

The draft RTS proposes to define the term 'fossil fuel sectors' to include only solid fossil fuels. This is misleading. The term 'fossil fuels' is already widely understood to refer to all hydrocarbon-based fuel sources including oil and natural gas, as referenced under the definitions promoted by the Intergovernmental Panel on Climate Change. Unless the end investor is familiar with the regulatory definition, they are likely to assume that this refers to all fossil fuels.

We further disagree with the forward-looking nature of the draft requirement in RTS Art. 15 (which requires disclosure of the 'planned proportion' of investments). Any disclosure of investments should be a point-in-time snapshot of a fund's actual investments, not a forward-looking estimate.

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?

As discussed in our response to Question 17, SFDR Art. 8 does not contain any reference to the concept of 'sustainable investment,' and the RTS therefore should not link the Art. 8 product disclosure requirements to the definition of 'sustainable investment' in SFDR Art. 2(17).

To satisfy the level 1 requirement for Art. 8 disclosure around 'good governance practices', we strongly recommend taking a simple, streamlined approach to communicating information about 'good governance practices.' Many asset managers adhere to corporate governance stewardship codes, and we recommend requiring disclosure of stewardship codes onto which a manager has signed. This approach will provide valuable information to investors without adding further volume and complexity to the new disclosure requirements.

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<u>Question 22: What are your views on the preliminary proposals on 'do not significantly harm' [DNSH] 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?</u>

We were pleased to see the ESAs acknowledge the strong link between the concept of 'do not significantly harm' under SFDR and the same notion under the Taxonomy Regulation applied to environmental activities.

As we discuss in our response to Question 17, however, the proposal does not address the current gap in alignment between the SFDR and Taxonomy Regulation's definitions of 'sustainable investments' and the concept of 'do not significantly harm' (DNSH). This gap will result in an investor receiving a UCITS prospectus with two sets of side-by-side disclosure of 'sustainable investments'—one for the SFDR and one for the Taxonomy Regulation—that lack any consistency or coherency. To close this gap between the SFDR and the Taxonomy Regulation and create consistency and coherency in disclosures to investors, we urge the ESAs to clarify that economic activities defined as 'environmentally sustainable' under the Taxonomy Regulation will be deemed to satisfy the SFDR definition of 'sustainable investment.' We also make further clarifying recommendations on the analysis of 'sustainable investments' for Art. 8 and 9 products.

We explain further below.

1. <u>We urge the ESAs to clarify that economic activities defined as 'environmentally sustainable' under the Taxonomy Regulation will be deemed to satisfy the SFDR definition of 'sustainable investment.'</u>

This clarification is needed to close the current gap in alignment between the SFDR and Taxonomy Regulation's definitions of 'sustainable investments' and the concept of 'do not significantly harm' (DNSH). The two definitions lack coherency in the following key areas:

- **Focus on environmental vs. social sustainability**. The SFDR definition references contribution to <u>any</u> environmental or social objective, while the Taxonomy definition requires 'significant contribution' to one of six specific environmental objectives, accompanied by a set of technical screening criteria with thresholds that define 'significant contribution.'
- **Application at investment level vs. economic activity level**. The SFDR defines a 'sustainable investment' at the investment level, while the Taxonomy defines it at the economic activity level. For an equity investment, the SFDR would appear to require a binary determination of whether the company is sustainable or not (100% sustainable or 0%), while the Taxonomy may deem an investment in that company to be a certain percentage (e.g. 5%) environmentally sustainable. Similarly, the RTS appear to require application of the DNSH analysis at the investment level, while the Taxonomy applies the DNSH analysis at the economic activity level.
- **Analysis of DNSH (environmental).** The Taxonomy's technical screening criteria provide thresholds for defining when an economic activity 'significantly harms' one of the environmental

objectives. The draft SFDR RTS instead use the Annex I PAI indicators (which are not aligned with the Taxonomy) to determine DNSH, and the DNSH analysis sweeps much more broadly than the Taxonomy.

- **Analysis of DNSH (social).** The Taxonomy Regulation applies certain 'minimum social safeguards' based on OECD principles. The draft SFDR RTS instead use the Annex I PAI indicators (which are not aligned with the Taxonomy) to determine DNSH, and the DNSH analysis sweeps much more broadly than the Taxonomy. The proposed SFDR RTS requirements do not contemplate the intended EU development of a 'social' Taxonomy.

This gap will result in an investor receiving a UCITS prospectus with two sets of side-by-side disclosure of 'sustainable investments'—one for the SFDR and one for the Taxonomy Regulation—that lack any consistency or coherency. The draft RTS propose to require pre-contractual and website disclosure of 'sustainable investments' according to the SFDR's definition of 'sustainable investment' (Article 2(17) SFDR). This disclosure, however, is not aligned with the disclosure requirements under the Taxonomy Regulation. Rather, the Taxonomy Regulation requires Art. 8 and 9 funds to disclose in the prospectus and annual report how and to what extent the fund is invested in 'environmentally sustainable' economic activities (as defined in the Taxonomy Regulation). This disclosure must include the percentage of the product's investments that are Taxonomy-aligned, including the respective proportions of 'enabling' and 'transition' activities. This disclosure for the Taxonomy's first two environmental objectives (climate change mitigation and adaptation) will apply from 31 December 2021, with requirements related to the other four objectives applying on 31 December 2022. We understand the EC intends to develop a 'social' Taxonomy, which will create even more confusion.

Under the proposed RTS, an investment could qualify as 'environmentally sustainable' under the Taxonomy Regulation, but not under the SFDR (and vice versa). This outcome would seem inconsistent with the co-legislators' intent since the Taxonomy is designed to represent the gold standard when it comes to ascertaining the environmental sustainability of an investment.

We therefore urge the ESAs to clarify that economic activities defined as 'environmentally sustainable' under the Taxonomy Regulation will be deemed to satisfy the SFDR definition of 'sustainable investment.' To provide consistency between the SFDR and Taxonomy definitions, we also recommend permitting firms to apply analysis of SFDR 'sustainable investments' and DNSH at the economic activity level, consistent with the approach under the Taxonomy Regulation. This will ensure that investors receive SFDR and Taxonomy disclosures that are consistent and coherent.

2. <u>We ask the ESAs to clarify that Art. 8 and 9 products are not expected to apply the DNSH analysis across their entire portfolio.</u>

The draft RTS potentially would require managers to apply the DNSH analysis across the entire product's portfolio. The language in RTS Arts. 16, 25, 38, and 48 requires Art. 8 and 9 pre-contractual and periodic report disclosure of 'how the sustainable investment does not significantly harm the sustainable investment objectives' and also 'how investments that significantly harm the sustainable

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investment objectives are excluded.' This language creates uncertainty around whether asset managers would be expected to apply the DNSH analysis to all of the product's investments or only to the investments disclosed as 'sustainable.'

We therefore ask the ESAs to clarify that Art. 8 and 9 products are expected to apply the DNSH analysis only to any investments disclosed as 'sustainable.' This would be consistent with the Taxonomy's approach to Art. 8 products, which clearly states that these products are not expected to apply the DNSH principle across their entire portfolio (Taxonomy Art. 6). There is no ground to believe that it was the intent of the co-legislators to require a different approach for the SFDR.

3. <u>We recommend that the ESAs take a more principles-based, proportional approach to the DNSH disclosure, particularly in light of the complexity of the information for end investors, link to the PAI indicators, and the lack of clarity around how DNSH and PAI relate.</u>

Instead of taking a prescriptive approach, we urge the ESAs to instead pursue 'Policy option 1.1: High level policy commitment on assessment of significant harm' as outlined in the consultation (p. 90). We agree with the ESAs' assessment that requiring disclosure of a high-level policy commitment on assessment of DNSH would be simpler, with lower implementation costs. The ESAs did not, however, propose this approach because they believe it will result in low comparability for investors and supervisors, and that not requiring disclosures of the levels of harm of investments will result in disclosures of little value.

We would assert that end investors can compare high-level policy commitments, especially if they are written 'in a manner that is easily accessible, . . . simple, concise, comprehensible, fair, clear and not misleading,' as required by RTS Art. 2. We do not believe that it is possible, however, to create comparable, useful *quantitative* disclosure of DNSH, given 1) the lack of coherence with the Taxonomy and 2) the likely inability of the end investor to understand the complex and confusing nature of this disclosure. We therefore urge the ESAs to consider a more principles-based approach, especially in light of the opportunity the EC will have to evaluate the application of the SFDR, including the functioning of the DNSH disclosure, and propose new legislation.

A high-level approach to DNSH is further necessary to avoid a disproportionately negative impact on investment strategies that pursue social characteristics or socially sustainable investment objectives. As one example, bonds issued by airports may have negative connotations from an environmental perspective, but there are significant social and economic benefits deriving from aviation and airports and airlines are deeply involved with initiatives which seek to mitigate the environmental impacts of air travel. A prescriptive approach to DNSH (where a sustainable investment must meet certain PAI indicator thresholds) would ignore the careful consideration that goes into managers' analysis of these types of positions and would disproportionately penalise strategies that target social impact.

Lastly, we expect the proposed approach to the DNSH analysis to be one of the most costly and resource-intensive elements of the proposal, and we note that it was not addressed in the preliminary

impact assessment (see our response to Question 27). Our recommendation to instead pursue policy option 1.1 would alleviate much of the concern around cost-benefit of this element.

<u>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?</u>

No, we do not see merit in the ESAs defining widely used ESG investment strategies such as best-in-class, best-in-universe, exclusions, etc. The ESG space is highly competitive, and managers continue to evolve their offerings of different ESG investment strategies in response to growing and changing investor demand. While industry-led initiatives from ICI and others have addressed common terminology around ESG investment strategies, we would caution the ESAs from codifying definitions that may not keep pace with and even inadvertently constrain the continued evolution of ESG product development.

We also note that the level 1 text already has defined two categories of products—Art. 8 and Art. 9. The proper and sufficient check on any disclosure statements is the RTS Art. 2 requirement to ensure that the disclosure is 'clear and not misleading.'

<u>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?</u>

As proposed, RTS Art. 39 and 46 require a list, in descending order of size, of the product's top 25 investments, including the sector and location of those investments, during the reference period. It is unclear how this requirement would align with the existing UCITS rules on disclosure of top investment holdings in periodic disclosures. Additionally, to be meaningful to investors, any reporting of top holdings should be at a point in time, and not over the reference period.

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

As we explain in our response to Question 15, any pre-contractual information should be designed to assist retail investors make an investment decision. Explaining derivatives and their use is a complex task, and any explanation in the pre-contractual materials should be concise and simple. Any narrative explanation should be included within the overall narrative explanation of how the fund achieves its objectives.

We do not believe that a graphical explanation would be helpful to investors. Additionally, it is not clear how investment proportions may be disclosed for derivatives or how the use of derivatives meets each of the environmental or social characteristics or sustainable investment objectives promoted by the financial product.

We therefore recommend removing draft RTS Arts. 14(e), 23(e), 19 and 28, as well as the reference to the use of derivatives in Recital 30.

<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>

The preliminary impact assessment does not address the most costly and resource-intensive elements of the proposal—specifically, the entity-level disclosure of PAI indicators and the DNSH analysis for 'sustainable investments.' The preliminary impact assessment only addresses the cost of ESG integration (i.e., integration of sustainability risk), referring to prior impact assessments that found that ESG integration would not be that costly.

We have serious questions around the benefit to investors of the proposed PAI and DNSH disclosure requirements. As we explain in our response to Question 1, entity-level disclosure of a long list of quantitative indicators across tens of thousands of investments does not provide any meaningful information to an investor about their particular investment. As we explain in our response to Question 22, the proposed DNSH disclosure lacks consistency or coherency with the corresponding Taxonomy product disclosure requirements and will result in two sets of side-by-side product disclosure that are incomprehensible to end investors.

We are deeply concerned that the proposed PAI and DNSH disclosure requirements will pose huge, uncertain costs and intensive use of resources in exchange for very little benefit to end investors. As we discuss in our response to Question 1, the proposal does not recognise the enormity of the operational challenges and costs for a manager to create the infrastructure to gather, analyse, aggregate, and disclosure PAI 32+2 indicators across tens of thousands of securities. The proposed DNSH requirements similarly would require managers to create additional infrastructure to screen ESG fund investments against pre-set thresholds for various PAI indicators (see also Question 22). We expect this new disclosure to pose significant costs—obtaining data from investee companies or data providers, developing in-house analytical capabilities, implementing new systems to track PAI indicators across aggregate investments, among other elements. We also note that the Taxonomy Regulation's new disclosure requirements will impose additional and significant burdens on resources.

This is why we urge the ESAs to use the SFDR's evaluation provision (Art. 19) as an opportunity to begin with less prescriptive requirements that focus on optional rather than mandatory disclosure. As we explain in our response to Question 3, the EC will have a window to evaluate how the market implements the disclosure in advance of the 30 December 2022 review date after which the EC can propose new legislation to address any issues. The EC will be able to use that window to review how investors are benefiting from the application of these requirements and the cost and proportionality of the related administrative burden.