Brussels, 31 August 2020

EACB Answer to Joint consultation paper of the European Supervisory Authorities (ESAs) on ESG Disclosures

31 August 2020

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Introduction

The EACB welcomes the opportunity to provide feedback on the ESA's joint consultation on draft RTS regarding ESG disclosures as mandated by Article 2a, Article 4(6) and (7), Article 8(3), Article 9(5), Article 10(2) and Article 11(4) of Regulation (EU) 2019/2088. We sincerely appreciate that the ESAs put a lot of thought into their proposals, and also a serious effort was made in answering as many queries from the various financial industries during the public hearing that was held by the ESAs on 2 July with respect to this consultation. Notwithstanding the efforts made, we still have an important number of concerns regarding the draft RTS which are outlined below.

General comments

- **the SFDR Level 1 text contains many elements that hold back the Draft RTS from being as useful and effective as they could possibly be**, namely:-
    - the mandate granted to the ESAs to elaborate on adverse sustainability impact is at entity level (Article 4 SFDR) which for our members, whose business as credit institutions and distributors of financial products extends beyond portfolio management and investment advice, is not as relevant as information to the end-client who is more interested in the product level. An entity level approach paints a negative picture of the company to the client, and is disproportionate compared to financial market participants whose core business is, for example, portfolio management;
    - further to the above, consideration of adverse sustainability impacts at entity level does not work without an understanding of the same disclosures at product level. Unfortunately, Article 7 SFDR which relates to adverse sustainability impacts at product level does not require the ESAs to draft RTS, and also becomes applicable on 30 December 2022, way after implementation date of Article 4. This makes it harder to report at entity level without guidance for product level application of "risks" i.e. adverse sustainability impacts;
    - Articles 8 to 11 SFDR with respect to the powers of the ESAs to draft RTS at least give consideration to the types of financial products. Therefore, the ESAs may propose different levels of pre-contractual disclosures, website disclosures and periodic reporting depending on product type. This should also be considered for disclosure of adverse sustainability impacts at product level (Article 7 SFDR), which then by extension, would also apply at entity level (Article 4 SFDR);
    - with the introduction of the ESAs mandate brought about by the Taxonomy, the ESAs must develop RTS on the principle of "do not significantly harm" but since the SFDR does not require alignment with the "minimum safeguards" principle under the Taxonomy, it is difficult for financial market participants to determine if an Article 8 or 9 product is Taxonomy compliant in this sense. Further to that, the DNSH criteria under both the Taxonomy and SFDR differ in scope; and

Article 8 and 9 products are not properly distinguished under Level 1, and there is no required mandate for the ESAs to elaborate on their definition. The same goes for particular definitions such as "environmental and social characteristics". This makes it harder to categorise compliance of the different products under the various requirements. It is even more confusing whether the interpretation of a "sustainable investment" under SFDR is solely referring to Article 9 products.

- **this creates a situation where our members who initially thought that their timing issues of compliance with the SFDR's implementation deadline of 10 March 2021 could at least be counteracted by starting to update their systems and documentation based on the Draft RTS, now actually realise that they are farther away from being able to meet the implementation deadline.** This is exacerbated by the fact that a major part of the templates to be proposed in the draft RTS have still not been published for consultation. During the public hearing it was indicated that the public survey with respect to Annex II to V templates would be published in September 2020, but it is unclear if the final proposal by the ESAs will be delivered in time with the current consultation of which final ESAs report has been delayed to end of January 2021 at the earliest. We completely understand that given this complex topic and the operational changes caused by the COVID-19 pandemic that the ESAs have had to reshuffle their deadlines to deliver on the above mandates. In this context, we fully welcome the ESAs' comments in their letter to the Commission (JC 2020 43) dated 28 April 2020: *"…we would like to encourage the European Commission to consider re-visiting the application deadline in SFDR, 10 March 2021, to allow financial market participants sufficient time to properly implement the provisions in the technical standards."*;
- **We also have concerns regarding inconsistency between the timing and content of the ESG-related amendments to the product governance and suitability rules under MiFID II delegated acts.** Regarding timing, it is expected that the SFDR will become effective before the MiFID amendments which will impact certain requirements, such as periodic reporting. For example, ESG preferences of the client have not yet been integrated, yet the SFDR already requires periodic reporting on how ESG preferences have been incorporated. The MiFID amendments are also proposing the definition of "sustainability preferences" which impacts the definition of Article 8 and 9 products. This is confusing and misleading for clients. Indeed, the EACB has co-signed a joint industry letter in this regard which can be found HERE;
- **Furthermore, we are concerned with the different interpretations of similar concepts: adverse impact assessment, ESG risk, Do not significantly harm (DNSH) etc. between the Level 2 RTS and the Taxonomy,** and would urge the ESAs to further align the Level 2 to the Taxonomy. This would help avoid situations of multiple disclosures for a similar concept (e.g. the various levels of DNSH which are foreseen as per our interpretation under Question 22); and
- **Cost versus return on investment**
  In a recent report, ESMA stressed high impact of cost on retail investor returns. The implementation of ESG considerations into the retail investment process will increase these costs especially in the start-up phase when processes have not yet been standardised. At a time when economic recovery and drawing retail investors back to financial markets is a political priority, it is thus of utmost important that implementation

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costs are kept to a minimum. This requires a careful alignment of implementation timelines of different obligations and an extremely close alignment of concepts between different pieces of legislation as mentioned in the relevant bullet points above.

- We are weary that the **principle adverse indicators shall not undergo consumer testing** considering the sheer amount of information that will have to be published. **Clients (particularly retail) have already experienced the situation of information overload under MiFID II,** where the information presented was not always easy to understand or useful, compared to the costs faced by the clients.
- In addition, the fact that most of the PAIs are mandatory without consideration of business sectors and other proportionality factors, gives a one-fit-for-all approach towards ESG risks which **underestimates the financial risk and return** normally analysed under MiFID II product governance and suitability assessment rules.
- The consideration of client objectives and preferences in MiFID II is also done on a **"financial instruments" basis and not "financial products"** basis as defined under the SFDR. This may cause some issues in terms of applicability of product governance and suitability assessment rules in MiFID II.

Adverse Impact Indicators

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?

The EACB can appreciate the ambitious aim of the proposal but notes that it does not work in all aspects:

General

- Data issues: Our members indicate that it will be difficult as financial market participants to obtain such granular level of data from investee companies and ESG data providers. In fact, some ESG data providers have advised our members that they will only be able to provide data for some of the PAIs. The lack of data can be illustrated using the coverage ratio which will also be low for raw data when the RTS enters into force. By way of example, the coverage ratio now from companies relating to water use/emissions is less than 50%. Some data service providers are making assumptions based on average consumption levels of each business sectors which are misleading on an individual company level. On top of that, there is lack of data due to extraterritoriality of investee companies, in that even if the RTS and the NFRD eventually are in line with each other, non-EU companies are not obliged to provide the necessary information. This also impacts the coverage ratio. In this context, we believe that if the RTS would eventually require such data then there should be no requirements for the coverage ratio. Furthermore, there is a restricted number of data providers, with the three largest in size being controlled by US capital. This means that many FMPs will not be able to report on indicators and will make use of the "best-

efforts" basis under Article 7(2) for a long time until the situation improves. This situation is certainly not desirable and this is why we support the creation of an EU data register whereby non-financial corporates can upload raw ESG data in electronic form on a voluntary basis. The EACB has recently launched a joint call for EU action in this regard through the publication of a joint letter;

- Alignment with NFRD: Furthermore, if the volume (32 mandatory PAIs and 18 opt-in PAIs) together with the level of detail is approved as being proposed, this shall create a situation where there is too much information being mandatorily requested from financial institutions as opposed to what could be obtained from investee companies under the non-financial reporting directive (NFRD) particularly with respect to environmental criteria. This is particularly important as the review of NFRD will not be completed in time for the implementation date of the SFRD RTS. Financial market participants and financial advisers would be faced with at least a year gap between when they should be making PAI disclosures to their clients and the information required from investee companies in order to fulfil these disclosures obligations under SFDR. Therefore, we would support simplification of the PAIs and metrics in the SFDR RTS so that the NFRD would be able to provide for the information gap; and
- Consumer testing: The numbers themselves will have little meaning for the (retail) customer because their interest is primarily in the portfolio or their holding within the portfolio. This shall lead to a situation of information overload for the client. Furthermore, the ESAs confirmed that they will not carry out any consumer testing of the template under Annex I, and thus, it is difficult to assess the effectiveness of disclosing additional detailed informaiton. If MiFID II has shown us anything, it is that clients get overwhelmed with excess information especially if it not specific to their investment. And besides the unclear benefits to clients, there may also experience costs increases due to lack of data, updating of systems, etc.

Table 1 – Mandatory PAIs

- Materiality: We do not agree that the mandatory PAIs always lead to adverse impacts because this depends on the 'materiality' or 'relevancy' for each business sector. An example of a framework that defines and includes the relevancy per sector is the one set up by the Sustainability Accounting Standards Board, where one can see which kind of indicators are relevant to which business sector, i.e. some indicators are relevant to the energy sector, some to the building sector, IT services sector, agriculture sector and so on. To further illustrate, it is asked whether a company has a Deforestation Policy (indicator 11) but this will not be relevant to all companies. According to Table 1, any figure (or even no figure followed up with a comment in the 'Explanation Box' would still make the company qualify this as a principal adverse impact. This concept of materiality is particularly important for SMEs who would require a proportional approach relevant to their business sector due to their size, nature and scale of activities;
- Comparibility: It is hard to compare the numbers across various business sectors. If we take indicator 1 as an example, let us say that both a utility company and a gym chain report their carbon emissions. The utility company could reduce its emissions from 200 to 100 units and thus be compliant with the Paris Agreement Reduction Pathway (positive). But on the other hand, the gym chain has a lower carbon emission of 100 but might have higher underlying risk. There is already

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a notable incomparibility problem here. On top of that, the indicator is related to the invested capital and thus, large financial market participants will show higher emissions. In general, the impact of application of PAI should lead to comparable results (absolute versus relative figures): it should be ensured that the size of an investment/fund does not affect the numbers reported i.e. the outcome of the application of the PAI should not be that a small fund appears more sustainable then a big fund purely as a result of the size of the fund. This should be particularly checked for PAIs 5 and 14.; and

- Transition: In order to promote the transition, investments must also be made in "polluting" sectors that then reduce their emissions over time. This transition element is not reflected in this proposal.
- PAI 26: a methodology needs to be provided for PAI 26 in order to ensure comparability.

Table 2 and 3 – Opt-in PAIs

We fail to see the usefulness of an opt-in regime for the end-client. The first issue is that the underlying methodologies of the table fields are not identical and thus cannot be compared. Second, most firms will not disclose the same indicators from table 2 and 3 because they are required to pick minimum one social and one environmental indicator from the list of 18 opt-in PAIs. We fail to see how the aggregate figure will lead to better comparibility for the end-client, particularlyy since it is not considering the impact at product level (which is the client's main concern).

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?

In our answer to Q1 we already bring up the issue of proportionality and materiality particularly in the area of SMEs.

Regarding the type of products, the most pertinent issue is definitely the application of the PAIs on a product level. Currently, the proposals made are restrained by the mandate under Article 4 SFDR which is only for entity level disclosures. However, it would have been more useful to report on product level based on Article 8 and 9 SFDR products, and with the possibility of some key PAIs for products outside the scope of Article 8 and 9.

For large financial market participants (over 500 employees) these will automatically have to disclose all PAIs under Table 1 even if they do not offer ESG products or services. Normally, one would assume that the more ESG products one has, or ESG objectives one pursues, then the more detailed the PAI disclosures would be. However, the focus is on the entity aggregate figure and not the actual product in this case. Moreover, SMEs who still decide to disclose or just about pass the 500 employees mark, will find it extremely difficult to gather all the information required.

Furthermore, our view that the approach laid out in Chapter II and Annex I does not take sufficiently into account the type of products FMPs make available, can be illustrated with the following example: According to Art. 5 Para. 2 RTS the adverse sustainability impacts statement shall include a summary, which shall be provided in, as a minimum, at least one of the official languages of the home Member State of the

financial market participant and, if different, in a language customary in the sphere of international finance. According to this provision financial market participants or financial market advisors must provide an English version of the summary even if their website only addresses investors in their home Member State and therefore all information available on their website is provided in the language of their home Member State. Since most UCITS management companies restrict access to their website in order to avoid (unauthorized) worldwide distribution of their funds, the obligation to include an English version of the summary in any case seems disproportionate.

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?

Ideally it would have been more useful to report at product level, in accordance with Article 8 and 9 SFDR products. We understand that this is not within mandate of the ESAs but perhaps the current proposal can still be linked to Art 7 SFDR without over-stepping the entity-level requirement. This would allow for a more proportional and comparable result particularly for the end-client.

We would propose simplification of the number of indicators under Table 1 (by reducing the number and defining which indicators are relevant to each sector).

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

Reference is made to our answers to Questions 1 to 3 which highlight the materiality and proportionality issues in relation to Table 1, as well as the issue of there being too many indicators in general of which aggregate figure is not so helpful to the end-client, who is more interested in the product level risk or impact.

Further to the above, we are weary of the PAI indicators going over and above what is set in the Taxonomy Regulation. In the case that a FMP invests only in taxonomy-compliant companies as it satisfies the thresholds for carbon neutrality, it would still have to disclose for all PAIs under Table 1 as these indicators always classify that there is a principal adverse impact for any positive value identified in the FMP's assessment. The environmental objectives under the Taxonomy will also not be effective in time for the application of the SFDR and its RTS, whereas a proposal for social objectives under the Taxonomy does not even exist to-date. This is an important argument in advocating for simplification of Table 1 since there is a mis-alignment in timing between the SFDR and the Taxonomy.

Finally we wish to comment on the narrow definition of "fossil fuel sectors" in Article 1(1) of the draft RTS, which seems to exempt non-solid fossil fuels. In our opinion, the definition should be in line with Eurostat: *"Fossil fuel is a generic term for non-renewable energy sources such as coal, coal products, natural gas, derived gas, crude oil, petroleum products and non-renewable wastes. These fuels originate from plants and animals that existed in the geological past (for example, millions of years ago). Fossil fuels can be also made by industrial processes from other fossil fuels."*

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Any deviation from commonly used definitions in the European Union would be highly confusing, for investors, for companies that would be required to report two different costly sets of information, and for monitoring the EU's environmental footprint in statistics.

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)?

We do not agree with the current list of indicators, so adding any more would be counterintuitive to our comments. As mentioned above, we believe it is important that the measurement of a principle adverse impact considers the materiality or relevance of an adverse impact for a business sector, same for the concept of "significant harm". The proposed indicators donot reflect these ideas, nor do they reflect the "do no significant harm" principle brought in by the amendment the Taxonomy Regulation brings to SFDR. The existence of a social policy for example in itself is not sufficiently indicative from an adverse impact assessment perspective. It is rather the implementation of such policy and it's effectiveness that would have to be looked at. As another example, the absence of an anti-slavery policy does not have to mean that an adverse impact is caused. This will very much depend of the context in which a certain company operates (country, sector of industry).

Therefore, we do not support additional indicators to the ones already proposed.

The best solution would be to start with a business-specific list of indicators that would at the very minimum align with the Taxonomy regulation. Then additional indicators could be introduced over time particularly with a link to the product level which is the most meaningful for transparency reasons. The key goals should be alignment with sustainable finance workstreams (and Taxonomy being the standard) and consideration of materiality and proportionality.

To establish such list of indicators we would propose to research, based on company disclosure or estimates, if and what data is available for the different indicators and which are considered useful by FMP and end-investors.

To add to our argument, we reiterate the issue with data collection. At the moment there is no consolidated EU database available and the NFRD is not yet updated in order to obtain the necessary ESG data metrics. And even when the NFRD is revised, it may not necessarily apply to companies outside the EU.

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?

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Further to our answer to Q5 which indicates an aversion to additional indicators, we also think it is premature to ask for (a) at this stage, whereas we do not understand what is meant by "relative to the prevailing carbon price" under (b).

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?

Our members have advised that both measurements could be used but may generally lead to an outcome that may be too complex for most clients to understand. Furthermore, the lack of ESG data (see issues highlighted in our answers to Q1 and Q2) will make it difficult to provide reliable quantitative figures. This information would be based on a low coverage ratio from companies during the first years of this regulation entering into force. The requirement for financial market participants to disclose real shares of indicators could be too demanding, and thus, it should be possible to disclose this also based on a lower coverage ratio of PAIs.

In this context, option 1 (the amount of instruments or percentage of NAV without particular issue) could be more relevant to be disclosed to clients, as opposed to the share of companies (option 2).

However, members are more concerned that weighted measurements are not required for all the PAIs which creates confusion and inconsistency because the method of calculation is unclear. Examples of non-weighted indicators include PAIs 18 (gender pay gap), 20 (board gender diversity), 28 (number and nature of severe human rights cases and incidents), and 29 (exposure to controversial weapons). It would be useful to provide clarification on the calculation of the measurement for non-weighted indicators.

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?

We have indicated in our answers to other questions, that we do not see merit in additional indicators. However, this could be possible if assessed by business sector. For example, under SASB there are more advanced indicators for GHG emissions applicable to each business sector which is reviewed separately in this regard.

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?

Hard data is difficult to come by with respect to social (and also governance) objectives, but there seems to be available access to S & G policies at the very least, according to some data providers. Therefore, it may be possible to report on social and employee matters, respect for human rights, anti-corruption and anti-bribery matters together with environmental indicators at a policy level, if the information is available and material.

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Issues might occur once the Taxonomy Regulation will define S and G more into detail, leading to multiple rounds of implementation for FMPs. However, the development of social objectives under the Taxonomy is still to be decided. In addition, the minimum safeguards for social matters are advised in order to determine environmental objectives under the Taxonomy, which is also designed with a sector-by-sector and activity based dimension. The intention of the social indicators is different under the SFDR as opposed to the goals of the Taxonomy. That said, we would expect alignment under the Taxonomy should social objectives be defined in the future.

The NFRD should also, in the future, be designed as a tool to gather appropriate hard data on social indicators as based on the SFDR and the Taxonomy.

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?

Our members honestly feel that it will be impossible to even have this kind of backward-looking information at this stage. However, the understanding of the proposed draft proposal is that such reporting can also start from 10 March 2021 as a kick-off date, with previous reporting periods as from this date going forward. The 10-year timespan could then be phased-in after such length of data would be finally available. If our interpretation of Article 6(2) is equivalent to the above, then our members could be able to comply with this ten-year horizon.
However, we fail to see the usefullness of this proposal. To further illustrate our skepticism, we make reference to the ESAs publication of 2018 (Joint Consultation Paper concerning amendments to the PRIIPs KID, JC 2018 60), in which the following statement under the section on "Extend the historical period used to measure performance" was made:-

"Another option considered has been to ***extend the historical period used to measure performance from 5 years to 10 years****. This would entail a change to the time periods specified in various points in Annex II of the Delegated Regulation (e.g. Points 5 and 6). Such an approach, if introduced now, is expected to reduce current expectations for returns, in particular under the moderate scenario. This is due to the inclusion of the performance during the financial crisis (2008-2009). However, it does not resolve the issues described above in Section 4.1.3 related to potentially overly positive expectations as to future returns, or undue 'pro-cyclicality' since market cycles can also last 10 years or more. In particular, were this change to be introduced in 2020 and in the absence of a significant downturn in financial markets prior to that, the impact is likely to be limited since the crisis period would no longer be included in the 10 year historical period. A lengthening of the historical period used also reduces the number of products for which data will be available for the whole period.* ***Overall, this option was not considered to bring material improvements to the methodology that outweigh its drawbacks."***

Based on the above, it would be more useful to propose a 5 year time horizon since relevance of ESG past performance over a 10 year period is difficult to justify.

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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?

From a general timing viewpoint, we would suggest to align reference periods with other reporting which is required on a yearly basis. At the moment, the current proposal leads to an undesirable scenario whereby service providers report different periods (e.g. January to December, July to June etc.). This would create a standard in reporting and reduce the risk of "window dressing". It would also help maintain a legal playing field by preventing competition issues between different sectors, who would be able to report before others on ESG information.

Furthermore, the timing of reporting requires better clarification. During the ESAs public hearing of 2 July on SFDR Draft RTS, participants queried about reference periods and first reporting dates with respect to Article 4 RTS. The ESAs confirmed that the first disclosure reference period for entity-level PAIs is to be made by 30 June 2022, which would cover the period starting on or after 10 March 2021, until 31 Dec 2021. However, after the hearing some of our members have been advised by the ESAs that (i) Art. 5, 7, 8, 9 and 10 RTS disclosures would have to be done from the time that the financial market participant starts considering principal adverse impacts or from 30 June 2021 (for entities with 500+ employees); and (ii) whereas disclosures required under Article 6 RTS would have to be made by 30 June 2022. This begs the question whether the first PAI reporting at entity level is due by 30 June 2022, which would make sense according to Article 4(3). On the other hand, the reporting as from 30 June 2021 seems to align with Art. 4(3) and (4), but this is confusing to FMPs. Logically, we would prefer the first reporting to cover a full 6 or 12 month period and to be aligned with other reporting periods as mentioned in our above general statement. Reporting as from 30 June 2021 would not be helpful in this case. Therefore, we would appreciate clarification from the ESAs and the Commission in this regard.

We also consider other potential occurrences of "window dressing" under the current PAI reporting proposal:

- **The granularity of disclosures** could in itself lead to window dressing due to the practice of excluding a section of the population from the sample analysis due to unavailability of data. This eliminates the randomness quality of such analsyis because the exclusion of a certain data class is similar to data collection from a subset of the population. This would mean that the result would not be representative of the population as a whole. Proposals on this issue are addressed in our answers to questions 1-3;
- **The lack of data** could also lead to portfolio managers putting specific focus on investment styles or sectors that are in favour or at a disadvantage under the SFDR (e.g. thematic investors). This could manifest in unintended investor behaviour for certain investment styles of asset managers/portfolio managers. The insufficient data could also lead to disclosures being based on estimates and assumptions which does not give certainty to the end-investor about the adverse sustainability impacts of the entity/product. Proposals on the data issues are addressed in our answer to question 1;

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- **Taxonomy Regulation:** Another challenge is that many investors and data rating agencies use a different classification system than the NACE nomenclature of macro-sectors and economic activities used in the Taxonomy Regulation. Company reporting is often not done according to NACE. Most data providers assess companies, not their economic activities and therefore the Taxonomy does not align very well with the practical reality of data providers and rating agencies. Window dressing may occur here due to this misalingment;
- **The double materiality standard** (i.e. impact on both financial performance and 'societal' performance) is also relevant when it comes to "window dressing". Most ESG scores include determining which factors are material to a company's financial performance. This double materiality is also part of the proposed NFDR, and we do not see why the SFDR does not make any reference to the materiality of adverse impacts to specific companies. Information is only of use when it is material to the company, to its shareholders, to society and the environment. We believe disclosing Table 1 on an entity level does not qualify to all the above-mentioned requirements;
- **ESG ratings:** Research from several think-tanks shows significant differences in results of ESG data rating agencies on the ESG performance of a company. Since the methodologies and processes of rating agencies appear to be subjective, then the reporting of impacts is more complicated than it seems and can lead to window-dressing due to incomprability. Since the SFDR is aimed at FMPs and not at rating agencies, the issue of incomparability is not solved as FMPs are still free to chose what data provider or rating agency they prefer; and
- **Venue shopping:** This refers to the idea that financial market participants might seek to avoid obstacles to the realisation of their requirements by looking for new rating agencies that, given the alternative data and methods, align better with the FMP's preferences (for example, regarding costs or availability and not per se quality). As most SFDR data points require very detailed information, they can only be retrieved at very high costs and at the same time this data will still turn out to be unreliable and incomparable. Some market leaders in the data-rating industry have declared recently, that there are no 'end-to-end solutions with respect to the Taxonomy'. As the SFDR requirements impose even more data fields (i.e. broader scope, not only environmental but also social and governance indicators) and has a far more stringent timeline that has no phases (in contrast to the Taxonomy), this makes March 2021 an impossible deadline for FMPs throughout Europe with more risk of venue shopping.

Templates

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

Our members note that templates could help financial service providers facilitate the necessary disclosures and reporting but would rather prefer a non-binding option since the granularity of the information required [e.g. RTS Article 14(a)-(g) or Article 23 (a)-(h)] makes it challenging to define such template in practice. Furthermore, there is some

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clarity required on whether the reporting must be done on a common basis of the investment product or specific to each client. The understanding from the ESAs public hearing is that this is for each product (e.g. portfolio). The issue with this is that clients currently already receive their own client-based disclosures and reporting on a mostly quarterly basis (with some product reports based on yearly frequency).

Templates for pre-contractual information and periodic reporting already exist for PRIIPs and UCITS products, for example, under the KIID and KID. Ideally we would prefer ESG information to be reported as a supplement to these documents. However, it is a bit unclear how these disclosures and reporting would function. To illustrate, clients of a bank or investment company may have one or two SFRD Article 8 or Article 9 ESG UCITS funds in their larger portfolio. Based on Article 11 (2) SFDR these disclosures should be reported at UCITS product level (Article 69 UCITS Directive). This is a logical reasoning. However, the bank or investment company must report also periodically relating to the client portfolio according to Article 25(6) of MiFID II. It is unclear if the client will have the same reporting twice at fund or portfolio level, and if it is possuble to choose one or the other.

Therefore, the other solution would be to report only on websites relating to these specific two ESG UCITS funds in this case.

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

If these templates were to be created and made mandatory we would prefer an electronic format (e.g. XBRL files).

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.

First of all comparability would make sense on a product-by-product basis rather than the whole aggregate portfolio. That said, there may still be issues of comparability between products of different suppliers as this depends on the methodology behind the metrics and the data provider used.

Product disclosure at pre-contractual, website and periodic level

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?

It is important to note that there are currently two overriding issues in disclosures to clients within securities markets legislation: (i) information overload; and (ii) lack of harmonisation between regulations. Clients already receive a lot of pre-contractual information followed up by even more ex-post and periodic reporting. On top of this, if

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the client invests in a UCITS, PRIIPs and MiFID product they are faced with different methods of disclosure. Therefore, clients may not be able to easily digest an additional layer of ESG-related information. We would thus strongly propose that the pre-contractual information is available on the relevant website except in the case of private wealth management clients/ discretionary portfolio management due to GDPR issues. This is especially relevant if the information will be based on aggregate product level and not specifically to the client holding.

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.

Our members do not find that the proposals clearly distinguish between Article 8 and 9 products for the following reasons:-

- During the ESAs public hearing it was clarified that an Article 9 product falls under the definition of 'sustainable investment' under Article 2(17) SFDR:

  > "…an investment in an economic activity that contributes to an environmental objective... or an investment in an economic activity that contributes to a social objective… provided that such investments do not significantly harm any of those objectives and that the investee companies follow good governance practices." However, this is not clearly stated in the recitals or articles of the draft RTS. And even if it were, the definition of a sustainable investment is still rather vague and not linked to the Taxonomy Regulation. The link between sustainable investments in SFRD and taxonomy should be better explained and it would be useful to have a clear indication of what impact indicators article 9 products would need to influence or target.

- During the same hearing, it was clarified that there is no provision that stops Article 8 products from having sustainable investments in their portfolio or using ESG terminology in the name of the product (e.g. Ulysses Sustainabilty Fund). This is somewhat clarified in recitals 20 and 21 of the draft RTS, but not in the articles. The recitals also cast a wide net of Article 8 products in scope: from best-in-class to exclusion strategies. To add to this confusion, an Article 9 product does not necessarily have to designate an index as a reference benchmark according to Article 9(2) SFDR. Therefore, one could define many non-Article 9 products as Article 8 products (even the mainstream ones) by simply having, for example, an exclusion strategy such as cluster ammunition that has to be excluded by law (although recital 24 does provide some clarity in this regard). On the other hand, since Article 9 products do not need to follow an index as reference benchmark and Article 8 products can also invest in sustainable investments, then there is not much differentiation between the two. Despite some clarification in the recitals, there is a fear that many different interpretations will appear in EU financial markets on the classification of Article 8 and 9 products;

- It is still unclear what environmental or social characteristics represent in reality, and so this will be hard to define and compare across products. And it is also unclear what is meant by the "promoting" of an environmental and social

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characteristic since "promoting" is a non-defined qualification. For example, adhering to PRI or UN Global Compact on an entity level, could implicate that all products that the entity makes available, are Article 8 products (of which understanding seemed to be supported by the ESAs during the public hearing). The ESAs also clarified during the hearing that it is not so much the "promotion"but the objective/intention of the product that qualifies it as Article 8. Therefore, it appears that a product can be defined as Article 8 even if it does not promote itself as such. This is a bit confusing to FMPs, FIs and ultimately the end-investor;

- Article 8 and 9 products which include environmental objectives (in our opinion, all Article 8 and 9 products), are required to disclose in line with the Taxonomy. All other Article 8 products (in our opinion: none) and non-ESG products can opt to disclose in line with the Taxonomy or provide a disclaimer. In that sense, without guidance from the Taxonomy, disclosing for these products will prove to be almost impossible (not leading to any comparability). Measuring the environmental performance of an equity or bond fund, or other products, is one of the main goals of the Taxonomy. We believe alignment is key, and that is certainly not the case with current timelines and definitions; and

- The differences between Article 8 and Article 9 products are not well captured. The warning message required by Article 16 (1) and Article 34 (3) is, in our view, misleading and should be removed. It is highly unlikely that the average investor will know the legal meaning of "sustainable investment" as defined by Article 2 (17) SFDR. Neither will he be aware of the exact differentiation between Article 8 and 9 SFDR. As a result, the client may understand the warning as contradictory to the environmental or social characteristics promoted by the Art. 8-product. There is also no need for the warning. The client receives accurate information on the precise sustainability related characteristics of the product in accordance with the provisions of the RTS.

Overall, the different points raised above illustrate the complexity that the proposals will add to an already complex product categorisation process. We anticipate selective use of the definitions by FMPs, the unintended consequence of certain products falling under Article 8 and the intentional evasion of Article 8 and 9 disclosures whilst still pursuing ESG integration (without actively 'promoting' it).

From the perspective of a financial product distributor such as cooperative banks, it would be of added value that – if products are to be classified - they are classified based on similar logic across product manufacturers.

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

We prefer a numeric approach compared to graphical representation when it comes to indirect investments.

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

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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?

Graphical representation could be misleading to consumers as the underlying methodologies, reporting etc. are not standardised. Before asking if this would work, it should be tested with (retail) clients to determine what they are looking for, and what is comprehensible to them. Information overload should always be prioritised when analysing impact of transparency requirements on clients.

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

Although we would think it reasonable to disclose exposures to fossil fuel sectors (e.g. tobacco industry may be very interesting for investors), we reiterate our answer to Q4 explaining our issue regarding the definition of "fossil fuel sectors" (separation of solid and non-solid). On the other hand, we believe it is premature to capture other sectors like nuclear energy when the definition of fossil fuel is unclear. There is also much debate on nuclear energy, even within the EU, on whether this is considered sustainable or not. Therefore, we would refrain from adding nuclear energy as an additional exposure disclosure required by FMPs.

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

We understand that this question specifically relates to the pre-contractual, website and periodic reporting but we wish to reiterate our general comment in the 'Introduction' regarding the fact that the RTS proposal does not provide sufficient granularity at the product level in order to report at entity level. Therefore, any issues with the product disclosures in this section should be considered also with respect to the PAIs to be reported at entity level.

The EACB believes that these proposals do not take sufficient account of product differences in several ways:-

- Our main concern is that of managed portfolios (e.g. an individual tailor made wealth management portfolio). First of all, a managed portfolio would normally be made up of underlying funds and stocks (which could also be foreign securities) which do not fall under the definition of "financial product" under the SFDR. It would be difficult, and certainly require additional information to be gathered from the FMP, to determine if the underlying financial instruments integrate ESG characteristics, adverse sustainability impacts, sustainability objectives and so on. This is an issue as stocks are a critical component of such portfolios, and ruling them out of product scope leaves a huge information gap. Second, portfolio management which is considered as a "financial product" under the SFDR, is de facto an investment service provided to several individual

investors. Indeed, those products take the form of a contract signed between a financial institution and a client (the investor), in which a discretionary portfolio management mandate is given to the financial institution by the investor. Such a contract takes into account the specific investment preferences and objectives of the investor, as well as his risk profile and his financial knowledge: depending on the investor's profile built up from those information, the financial institution will be able to select an adequate portfolio that has been determined in advance according to different profiles (i.e. "model portfolios"). It is worth noting that because portfolio management contracts are signed on a discretionary basis, the investor cannot change portfolios whenever he wants to (in case of unexpected losses for example): the only way to change his investments would be to change his investor profile. This is the reason why in practice, the investments made on behalf of the investors correspond exactly to the model portfolios pre-established by the financial institutions. In case where financial institutions notice the underlying investments no longer fit the initial investor profile (due to market volatility for example), they are required to use an action plan to remediate the issue. Third, disclosing information on contracts that have been established between the financial institution and an individual client raises issues in terms of privacy and data protection.

Due to these specificities, we would propose that the ESAs clarify in the RTS that: (i) the product disclosure requirements would be done on the basis of a model portfolio for the specific case of portfolio management: this approach is currently used in pre-contractual disclosure under other European Regulations like MiFID or PRIIPs. It should of course be disclosed to the clients that the documentation is based on a model. This will avoid GDPR issues related to website disclosures of sensitive information; and (ii) that clarification is required on treatment of underlying stocks and bonds which do not appear to be in scope with respect to the product disclosure requirements. It would make more sense to report on the products in scope within the managed portfolio rather than the portfolio as a whole, but it would be helpful is the ESAs and the Commission made this clear.

- Regarding multi-option products, we understand these as products that offer several investment options in a wrapped structure – e.g. insurance-based investment products. Most of the times only some of the underlying funds in such product may be Article 8 or Article 9 funds, and the majority of the investments in insurance-based investment may not require any specific sustainability reporting. In this case it should be possible only to report on the level of each Article 8 or 9 investment fund, because reporting at the level of the insurance-based product may not be enough in terms of sustainability disclosures. It would make more sense if such reporting is adjusted to the type of product, for example different disclosures for different products like funds-of-funds, multi-assets funds, government bond funds etc; and

In some cases, the above types of products have non-EU stocks or funds. Funds listed in the US, for example, do not provide a UCITS KIID or a PRIIPs KID, and foreign stocks, e.g. Australian stock, are not in scope of the NFRD. For both examples, the FMP that is subject to the SFDR legislation is thus liable of any mis-assumptions (by way of wrong information provided) and wrong estimations (carried out by third party ESG rating agencies) made on the underlying investee company. We would envisage either for the ESAs to limit scope to European issuers only, or else as an alternative provide a clear methdology to apply to all non-European issuers.

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?

If the difference between Article 8 and 9 products is in actual fact not clear, then we would argue that Article 8 products may as well capture the minimum good governance requirements even if the product would not be undertaking sustainable investments. However, this would make sense if the question is referring to these minimum requirements as the definition of "good governance" is sufficiently detailed in the RTS (and even in the SFDR the above are given as basic exmaples).

Furthermore, we believe the definition of good governance should be more aligned with (a) the Taxonomy Regulation; and (b) other EC initiatives regarding corporate governance. The European Commission classifies its governance policy activities in broad categories, including directors and board members, shareholder rights, employee share ownership, remuneration policies, transparency, and financial institutions. [Source: http://ec.europa.eu/justice/civil/company-law/corporate-governance/index_en.html]

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

Our main observation is that there is inconsistency between the Taxonomy principle of DNSH, and the DNSH integrated in the definition of Article 2(17) SFDR. The Taxonomy which is meant to lead in terms of identifying DNSH criteria, will not be expected to deliver the criteria before 2022. This has led to a situation of premature integration of disclosure requirements related to DNSH as proposed under the draft RTS, which uses the PAI indicators to establish the DNSH principle for Article 9 products. The Taxonomy DNSH is also different in the sense that it refers to "minimum safeguards" for social objectives over and above the six environmental objectives, which is a different process to the one via the PAIs under the SFDR. Essentially we see a situation of 3 types of DNSH: (i) activity level Taxonomy; (ii) entity level SFDR; and (iii) product level SFDR. The issue is whether this creates a situation where, for example, an entity or product does not significantly harm other ESG objectives but at the same time does not satisfy the "minimum safeguards" under the Taxonomy. This should never become a plausible scenario and for this reason we would expect to see further clarifications on the overlap between the Taxonomy's DNSH/minimum safeguards criteria and the DNSH/PAI approach under the SFDR Draft RTS.

Further to this confusion, it appears that Article 8 products could also invest in sustainable investments and technically speaking this means that "some" Article 8 products must also apply the DNSH disclosure requirements. If this is the case, we

believe it should be clarified in the articles of the draft RTS as long as products that do not have sustainable investments as objectives are not required to disclose that they did not significantly harm other sustainable objectives. In addition, we do not think this statement under Article 16(1) is relevant to the investor when it comes to such products that do not have sustainable investments: "This product does not have as its objective sustainable investment." We strongly propose not to include these kinds of comments for such products.

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?

EACB members have advised that there is such a varying degree of investment strategies, that defining ESG-related ones would limit the development of new products/strategies. Ideally it would be up to the financial market participant to develop the ESG investment strategies to their clients. However, if a list is to be constructed, then it should simply advise that ESG investment strategies adhere to already existing international principles, in order to allow flexibility:

- Exclusionary screening (i.e. aligning with UN Global compact)
- ESG integration (i.e. aligning with PRI)
- Norms-based screening
- Active Ownership / Engagement (alignment with own FMP policies + SRDII)
- Positive best-in-class screening
- Positive thematics
- Impact investing.

That said, it would still be hard to determine a defined list because in many cases strategies are combined (e.g. an exclusion strategy also having active ownership). This is another reason why we do not see this happening.

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?

It is a good practice to disclose the top investments or investee companies of a fund e.g. in UCITS or AIF sustainable investment funds. However, we would advise the appropriate amount to be 5-15 top investments. This is because it is not always desirable that the fund manager openly discloses all or a significant part of the portfolio in the fund (except semianually). This has an impact also on multi-option products as insurance-based investments. In those investments, however, the client usually knows and decides which underlying investments are taken under that insurance so this is not an issue. In our view, it appears that Articles 39 to 46 are written more in terms of applicability of investment funds and do not work as well for different products such as derivatives and structured products. If the figure of 25 top investments shall be taken, it should be either the top 25 or representing 50% of the maximum amount invested (whichever comes first).

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

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

a) an indication of any commitment of a minimum reduction rate of the investments (sometimes referred to as the "investable universe") considered prior to the application of the investment strategy - in the draft RTS below it is in the pre-contractual disclosure Articles 17(b) and 26(b);	Website
b) a short description of the policy to assess good governance practices of the investee companies - in the draft RTS below it is in pre-contractual disclosure Articles 17(c) and 26(c);	Website
c) a description of the limitations to (1) methodologies and (2) data sources and how such limitations do not affect the attainment of any environmental or social characteristics or sustainable investment objective of the financial product - in the draft RTS below it is in the website disclosure under Article 34(1)(k) and Article 35(1)(k);	Website
d) a reference to whether data sources are external or internal and in what proportions - not currently reflected in the draft RTS	Website

but could complement the pre-contractual disclosures under Article 17.	

As explained in our answer to Question 15 we would prefer such information to be disclosed on the websites of the products rather than in pre-contractual disclosures. Our understanding is that pre-contractual would fall under retail information documents, such as the UCITS KIID and PRIIPS KID. However, there is no such documentation for discretionary portfolio management. The information obligations for discretionary portfolio management are set out in Article 24 (4) MiFID II, which is elaborated in, inter alia, Articles 46 - 51 Delegated Regulation 2017/565. For banks offering discretionary portfolio management, it could be beneficial to simply publish website disclosures. However, we would seek a different solution for discretionary/private wealth clients because of data privacy issues stemming from publication of information on their portfolio online.

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

We do not see a point to define separately how the use of derivatives meets each of the environmental or social characteristics or sustainable investment objectives promoted by the financial product. In investment funds, especially for retail clients, derivatives are mainly used to hedge against interest rate or currency changes. These should not be reported relating to sustainability at all. If the product (e.g. AIF fund or structured product) is based on an underlying derivative (e.g. an oil derivative), then this could make sense. In most cases it does not make sense because derivatives are mostly used for the above-mentioned reasons and there is no relevant relation to sustainability or something to report in this context.

Preliminary impact assessments

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

We note that this section carries out five impact analysis assessments for: (a) Article 4 SFDR; (ii) Article 8 and 9 SFDR; (iii) Article 10; (iv) Article 11; and (v) Do not significantly harm principle Draft RTS.

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We wish to first comment on the impact analysis on Article 4 on pages 74-75 of the cosnultation. In targeted interviews conducted by the Commission, only six firms provided numbers on the prospective costs of ESG integration which is not a significant analysis. The ranges of total costs are estimated between maximum 0.0001% to maximum 0.0003% of AuM. This can lead to an unrealistic and misleading statistics. Implementation of regulation borne by banks might change sales policies, for example, which in effect impacts clients. There is no data quantifying such burdens on a monetary scale, including for ESG impacts. It is therefore impossible to state that on a maximum the costs to integrate ESG consideration would amount to 0.0003% (pg. 74). Furthermore, the figures used are not comparable to this policy option because they do not correspond specifically to adverse impacts implementation. We do not see how the figures used have led the ESAs to conclude that:

"The majority of the ESAs' working group believes that the integration of ESG considerations to disclose adverse impacts and actions taken ***will not be disproportionately high****. The approach of* ***requiring mandatory indicators for the assessment and allowing the further tailoring of the assessment against an opt-in set of indicators strikes the right balance*** *between the need to create a harmonised regime and the ability to implement the new rules."*

We see that there are indeed lots of costs relating to implementation of SFDR and the accompinying RTS to financial markets participants. Documentation must be thoroughly reviewed to have more information for periodic reporting. Furthermore, financial market participants need more data from ESG data providers to comply with these new rules which will be costly to obtaine. The more detailed the rules are, the more costly it will be to implement them considering the lack of data and the fact that other workstreams are pending e.g. Taxonomy RTS.

Ongoing compliance costs will probably account for an even bigger burden. Since most of the EU Sustainable Finance Action Plan (e.g. NFRD, or Taxonomy) is far from complete, FMPs that are subject to the SFDR (and other regulations) will most likely face significant costs of re-implemention once EU policies change.

By way of example, below is the data provided by the Dutch Association of Banks with respect to the impact assessment of a medium-sized bank:

- Data costs: significant (i.e. 1 million €, depending on Annex I, II and III)
- Editing and publishing the data (1 FTE per year)
- Keeping the site up to date with all transparency obligations (0.5 FTE per year)
- Integrating climate risks into the analysis (1 FTE per year)
- Obligations as an asset manager (0.5 FTE per year)
- Compliance with regulations (0.5 FTE per year)

One-off costs for implementation:

- Adjusting processes (4 FTE)
- Coordination adjustments (2 FTE).
- Training client relationship managers

With respect to the impact assessments on the other articles: Article 8, 9, 10, 11 and DNSH principle. We note that specific costs are not provided but that during the public hearing the ESAs hinted that there may be consumer testing in this regard. We think

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the latter is very important to carry out for these articles but also Article 4. First of all, it will be very difficult for FMPs to provide cost data to contribute to an impact analysis because there are many pending regulatory issues to solve. One example is the unclear difference between Article 8 and 9 products which makes it hard for FMPs to classify which of their products must comply to which rules. If it is difficult to determine the appropriate requirements for compliance purposes, it is also difficult to estimate costs based on implementation. And finally, we would like to stress similar to our concerns in the 'Introduction' that when it comes to transparency regulation, the main focus when carrying out an impact assessment should be information overload and not costs. This is because impact should also be focused on the client and not just the company.

Contact:

The EACB trusts that its comments will be taken into account.

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