Swiss Sustainable Finance

Swiss Sustainable Finance response to ESA consultation on the Regulatory Technical Standards (RTS) of Disclosure Regulation (SFDR)

1. Introduction and background

In the absence of harmonised EU rules on sustainability-related disclosures, it is likely that diverging measures will continue to be adopted at national level and different approaches in different financial services sectors might persist. The EU Action Plan makes an attempt to address this problematic and led to the drafting of regulations, such as the Sustainable Finance Disclosure Regulation (SFDR).

On 23 April 2020, the European Supervisory Authorities (ESAs) therefore published draft Regulatory Technical Standards (RTS) related to the content, methodologies and presentation of sustainability-related disclosures. The draft is expected to be sent to the EU before the end of 2020.

The RTS applies to the SFDR, which is in essence trying to harmonise ESG disclosure standards for disclosures of different types of information complexity, granularity and consumer-friendliness, ranging from detailed fund prospectuses to, for example, the concise "key information documents" for pan-European pension products (PEPPs).

These Joint Committee draft RTS on ESG disclosures have been developed by the three European Supervisory Authorities (EBA, EIOPA and ESMA) under SFDR, which aims to strengthen protection for end-investors and improve the disclosures that they receive from a broad range of financial market participants and financial advisers, as well as regarding financial products. It is our understanding that these RTS apply to any company that falls under the Non-Financial Disclosure Directive OR to investments promoting an environmental or social characteristic OR investments pursuing a sustainable investment objective.

The RTS defines mandatory reporting requirements and provides a suggested template for reporting and covers the following topics:

- Principal adverse impact disclosure – Article 4(6) and 4(7) SFDR
- Product pre-contractual disclosure – Article 8 and 9 SFDR, including "Do not significantly harm" – Article 2a SFDR
- Product website disclosure – Article 10 SFDR, including "Do not significantly harm" – Article 2a SFDR
- Product periodic disclosure – Article 11 SFDR, including "Do not significantly harm" – Article 2a SFDR

The ESAs collected feedback through a consultation, which was open until **1 September 2020**. SSF consolidated feedback from its members to the 27 separate questions. The consolidated answers are listed below.

Swiss Sustainable Finance

2. SSF consolidate feedback to consultation

<table>
<tr><th>Question</th><th>SSF response</th></tr>
<tr><td colspan="2">Questions on the topic of adverse impact indicators
The ESAs have developed a set of 32 mandatory indicators covering 8 areas (Greenhouse gas emissions, Energy performance, Biodiversity, Water, Waste, Social and employee matters, Human rights, and Anti-corruption and anti-bribery) which are considered to always lead to principal adverse impacts as any positive value for the assessment of the indicators is classified as having a principal adverse impact. Also included in the mandatory indicators is one regarding exposure to the manufacture and selling of controversial weapons, based on the baseline exclusions for EU climate transition benchmarks (CTB) and EU Paris aligned benchmarks (PABs).
This set is complemented by additional opt-in indicators (table 2 and 3). ESAs have proposed a reporting template found in Table 1 of the consultation documentation and in ANNEX 1.</td></tr>
<tr><td>Q1 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?</td><td>We find that this approach could lead to confusing results for investors. For example, indicators on carbon emission and carbon footprint will always result in positive values and trigger a PAI; however, such an investment could be Taxonomy aligned (regarding climate mitigation). This may be misleading for retail investors.

Additionally, our members feel that the list of mandatory indicators is too long and should be simplified to ones for which data is likely already available, as a starting point. The materiality of the indicators for specific investments/sectors should also be reflected, as some indicators may be immaterial depending on the underlying investments (see for example the SASB framework, which identifies sector relevant KPIs).

Another point that will be very challenging is that non-EU companies are not yet required to report on these indicators. Therefore the data availability could be problematic and lead to very low coverage ratios for portfolios.</td></tr>
<tr><td>Q2 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?</td><td>Smaller asset managers will be at a disadvantage, as they will not have the same resources to collect and also repot on the data.</td></tr>
</table>

Swiss Sustainable Finance

Question	SSF response
	In addition, entity level reporting will be very difficult for larger asset managers with products based on many different asset classes. The PAIs are not easily applied to asset classes, such as commodities and sovereign bonds.
Q3 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?	Amongst our members, there is a call for a much more simplified set of mandatory indicators with all other indicators being voluntary. It was also proposed that a better method of reporting may be on a product-level (rather than entity level) for financial market players.
Q4 Do you have any views on the reporting template provided in Table 1 of Annex I?	As mentioned in our previous responses, the template outlines too many indicators, which will make it very difficult for market participants to come to a meaningful, representative aggregated value which retail investors can easily understand.
Q5 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 recommend any further KPIs as we already think the current 32 are too extensive based on data availability and the resources of market players to obtain the data. We fear the indicators will be very difficult to obtain from non-EU companies that do not fall under the same reporting requirements.
Q6 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 pre-vailing carbon price?	We recommend refraining from adding further mandatory indicators. If these indicators are to be considered, we feel this should be on a purely voluntary basis.
Q7 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?	We are concerned that this double metric may confuse investors. We would advise to avoid a double metric.
Q8 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 – we believe the aim should be to reduce the proposed indicators. Additionally, it is likely a better approach to first see if the data is available for the already proposed indicators before implementing new indicators.

Swiss Sustainable Finance

Question	SSF response
Q9 Do you agree with the goal of trying to deliver indicators for social and employee matters, respect for human rights, anti-corruption and anti-bribery matters at the same time as the environmental indicators?	We agree that indicators for social and employee matters can be delivered simultaneously to environmental indicators. However, we stress here that the list of indicators is long and detailed and that data may be more difficult to obtain than for Environmental indicators. In a first step, such indicators could perhaps be voluntary until we achieve better data availability and/or once the taxonomy has concretely defined social indicators.
Q10 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?	We do not agree. We feel this goes far beyond what the SFDR (level 1 regulation) requires.
Q11 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?	Yes, we would highly recommend to harmonize methodology and timing with other required reporting. Regarding "window dressing", we feel perhaps the concept of materiality should be more strongly reflected within the SFDR as this topic was part of the proposed NFDR. We feel information is only of use if it can be justified to be material to the company, its stakeholders, as well as to society and the environment.
Questions on the topic of templates *ESA has delayed the drafting of templates for pre-contractual and periodic product disclosure for Article 8 and 9 SFDR products. The feedback given here will give input for developing these templates.*	
Q12 : Do you agree with the approach to have mandatory (1) pre-contractual and (2) periodic templates for financial products?	We agree that providing reasonable templates with only a select number of mandatory indicators (see answers above) is advisable in order to produce consistency amongst market players. We note that such templates would need to be adapted to the various asset classes. Such templates may only be applied to retail products/clients, as professional/institutional clients require tailor-made information and have the internal capacity to question and compare the provided information.

Swiss Sustainable Finance

Question	SSF response
	In addition, at this point in time, if such new templates are developed, market players will need ample time to implement them within their systems, which normally take some time to adjust.
Q13 If the ESAs develop such pre-contractual and periodic templates, what elements should the ESAs include and how should they be formatted?	Clear, pre-defined templates for investee companies and product manufacturers can ensure proper data flow between all parties in the value chain. These templates must focus on a limited number of material indicators so as to keep the reporting burden low.
Q14 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.	N/A
Questions on the topic of product disclosure at pre-contractual, website and periodic level	
Q15 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 any-thing you would add or subtract from these proposals?	We feel if this clause is retained, then, especially for publically available information on company websites, reporting should only be required for retail products. Professional/institutional clients require tailor-made information and have the internal capacity to question and compare the provided information. All website disclosures for not publicly distributed products may only get published in a password protected space of the website. Otherwise such information may qualify as marketing material and this will lead to conflicts with compulsory distribution restrictions for products and services which are not suitable for retail investors. In particular for asset management products and services provided to a single client, such website disclosure creates issues with confidentiality of contractual agreements. Therefore for single investor funds as well as managed accounts, the required website disclosure (in particular on the level of the product) does not make sense and should be shifted to a disclosure requirements which has to be provided directly to the investor/client.
Q16 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.	We feel there is still considerable confusion between Article 8 and Article 9 products. The main conceptual difference is that while Article 9 products strive to achieve specific sustainability objectives alongside financial yield, Article 8 products define only financial

Swiss Sustainable Finance

Question	SSF response
	return objectives, but in order to achieve those select their investments in accordance with a dedicated ESG strategy. We feel that many products falling under article 8 could be slightly altered to fall under article 9 and vice versa. Additionally, if stringent additional requirements apply to article 8 and 9 products, financial market players may avoid the use of these designations for products that still pursue ESG objectives, but will not "promote" this in the official product documentation, or worse, create new wording and definitions to indicate a sustainable product, so as not to be subject to the regulations.
Q17 Do the graphical and narrative descriptions of investment proportions capture indirect investments sufficiently?	N/A
Q18 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?	In general, a graphical representation of proportion of investments screened would be a valid option for retail investors to more easily be able to visualise the differences between products. There must, however, be a category for "not-screened" AS WELL as "not applicable" (i.e. commodities etc.) in order to provide true comparability. This is to make sure that products with a large share of "non-screenable" assets will not be unfairly represented by the mandatory reporting requirements.
Q19 Do you agree with always disclosing exposure to solid fossil-fuel sectors? Are there other sectors that should be captured in such a way, such as nuclear energy?	We do not agree, as this type of reporting is only relevant for certain asset classes. For example, government/sovereign investments may not be able to fulfil such disclosure requirements. Regarding nuclear energy, we acknowledge that there is still much debate around the role of nuclear energy in reaching a low-carbon economy. We would therefore refrain from adding nuclear energy as an additional exposure disclosure required by financial market participants.

Swiss Sustainable Finance

Question	SSF response
Q20 Do the product disclosure rules take sufficient account of the differences between products, such as multi-option products or portfolio management products?	We have some concerns that treating retail products similarly to professional/institutional products could be in conflict with contractual agreements. If we interpret the RTS to apply also to single investor products/portfolios, the website disclosure requirements may be in conflict with confidentiality duties. We feel it would be more practical to report consistently on underlying products (albeit products to which the reporting can be applied (i.e. equity/bond products), rather than on full diversified portfolios.
Q21 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?	N/A
Q22 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?	We feel the taxonomy DNSH may have been prematurely used for the RTS. To our understanding, DNSH criteria are not expected to be delivered in reporting until 2022 and are still subject to change. There must be a 100% overlap of the taxonomy DNSH/minimum safeguards and the DNSH/PAI approach. The RTS will need to ensure this is the case so as not to over burden financial market participants.
Q23 Do you see merit in the ESAs defining widely used ESG investment strategies (such as best-in-class, best-in-universe, exclusions, etc.) and giving financial market participants an opportunity to disclose the use of such strategies, where relevant? If yes, how would you define such widely used strategies?	No we would not support this. We would aim to allow for maximum flexibility and further development within the industry. Many market studies, including the annual SSF market study, do put a focus on the most commonly used strategies, however, we see that players are continuously striving to improve on these strategies, as well as looking to expand the currently available approaches.

Swiss Sustainable Finance

Question	SSF response
	See: https://www.sustainablefinance.ch/en/swiss-sustainable-investment-market-study-2020-_content---1--3037--35722.html
Q24 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?	Disclosing the top 25 holdings seems to be a lot. This would be disclosure of full portfolios for some managers, which is not always desirable for fund managers. Perhaps the RTS could consider the option to disclose the top 5-10 holdings OR holdings representing, for instance, 50% of the maximum amount invested.
Specific questions on pre-contractual disclosure items in light of differences between types of disclosure documents *These questions collect feedback to help the ESAs find the right balance between pre-contractual and website disclosures.*	
Q25 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 dis-closure Articles 17(b) and 26(b); b) a short description of the policy to assess good governance practices of the investee companies - in the draft RTS below it is in pre-contractual disclosure Articles 17(c) and 26(c); c) a description of the limitations to (1) methodologies and (2) data sources and how such limitations do not affect the attainment of any environmental or social characteristics or sustainable investment objective of the financial product - in the draft RTS below it is in the website disclosure under Article 34(1)(k) and Article 35(1)(k); and d) a reference to whether data sources are external or internal and in what proportions - not currently reflected in the draft RTS but could complement the pre-contractual dis-closures under Article 17.	For all four elements, we would recommend website disclosure. Of course contractual agreements with clients must be respected and, should this information be confidential, it would need to appear on a protected area of the website.

Swiss Sustainable Finance

Question	SSF response
Q26 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)?	Derivatives are mainly used to hedge against interest rate or currency changes, meaning their use is not related to sustainability. Therefore we feel this information is not necessary as the links to sustainability are not there. If anything, a short narrative could be included simply stating the fact that derivatives are used and for which reasons.
On the topic of preliminary impact assessments	
Q27 Do you have any views regarding the preliminary impact assessments? Can you provide more granular examples of costs associated with the policy options?	SSF member organisations predict that the fees for ESG data will significantly increase and additional ongoing compliance costs will also be higher.

3. Further information

Links to important documents

Documents linked to the consultation can be found at: https://www.esma.europa.eu/press-news/consultations/joint-esa-consultation-esg-disclosures#registration-form_consultation

Zurich, 30 August 2020