Frankfurt am Main,
23 August 2018

European Commission's Sustainable Finance Initiative – Regulation on disclosures relating to sustainable investments and risks

Encouraging investments in sustainable products is a core element in the strive towards a more sustainable environment. Therefore, BVI[1] is supportive of the European Commission's Action Plan and the legislative proposals on Financing Sustainable Growth. A coherent disclosure how market participants integrate sustainability risks in their investment decisions and what strategies they apply to sustainable products will foster a more sustainable environment. A comprehensive Taxonomy taking the different approaches towards sustainability into account will be a welcomed tool.[2] German asset managers are happy to share their expertise and experience in dealing with ESG considerations and ESG risks in the investment process and related disclosure.

Key messages

- **Meaningful accessible disclosure covering all strategies will foster Sustainable Finance ("SF").** We support a disclosure regime that provides both investors and financial advisors with meaningful information regarding asset managers' approach towards sustainability. Hence, we appreciate the distinction between disclosure requirements for all asset managers and disclosure requirements for products "targeting sustainable investments". However, the proposal should take into account all different strategies which are applied to sustainable products. In order to do so, the disclosure requirements should comprise all products that are marketed as sustainable. This would also solve the duplication of disclosure requirements for sustainable products as it is unfortunately proposed with the disclosure for "marketing products as sustainable" in the Regulation on establishing a framework to facilitate sustainable investments ("Taxonomy Regulation") and the disclosure for products "targeting sustainable investments" in the Regulation on disclosures relating to sustainable investments and risks ("Disclosure Regulation"). Moreover, we question whether the disclosure requirements relevant also for all asset managers will provide investors and financial advisors with the relevant information in an easily accessible manner.
- **Disclosure requirements need to be coherent throughout the investment chain and should not only cover a selection of market participants.** Only a framework requiring all market participants including corporates and governments or other public entities seeking financing from the capital markets to disclose relevant information will allow investors to fully understand their investment and provide comparability and a level-playing-field also on a cross-border basis. As the proposal stands, we are concerned about the consistency and the scope in this respect. Furthermore, the content, place and timing of information to be disclosed needs to be consistent with the overall objective of

[1] BVI represents the interests of the German fund industry at national and international level. The association promotes sensible regulation of the fund business as well as fair competition vis-à-vis policy makers and regulators. Fund companies act as trustees in the sole interest of the investor and are subject to strict regulation. Funds match funding investors and the capital demands of companies and governments, thus fulfilling an important macro-economic function. BVI's over 100 members manage assets of more than 3 trillion euros for private investors, insurance companies, pension and retirement schemes, banks, churches and foundations. BVI's ID number in the EU Transparency Register is 96816064173-47. For more information, please visit www.bvi.de/en.
[2] See in detail our position paper on the proposed Regulation regarding the Establishment of a framework to facilitate sustainable investments.

facilitating SF. Fragmented disclosure requirements will at best not achieve the full potential of SF. In the worst case scenario it will be to the detriment of sustainable growth.

- **Content of disclosure should be built on the Taxonomy and aligned to market dynamics.** The content of the disclosure regarding sustainable products should be clearly linked to the Taxonomy. Furthermore, disclosure regarding impact of investments should at the most be on a best effort basis since metrics measuring such impact are not yet well-developed. The Commission‘s understanding of sustainable products seems to give a preference to impact and thematic investing, thereby bearing the risk of creating more confusion for investors and raising barriers to the already low growth of sustainable products.
- **Fragmentation of regulation leads to inefficiencies and additional costs.** The approach to use a Regulation for specific disclosure, e.g. regarding sustainability, might be understandable from a legislator’s point of view since it allows for a focussed political negotiation process. However, the number of regulatory measures regarding disclosure for asset managers has increased significantly. These rules often overlap or are inconsistent, which leads to less targeted and more confusing disclosure to the detriment of the investor. Disclosure requirements should be integrated in existing regulation.

Meaningful accessible disclosure covering all strategies will foster SF

In order to achieve relevant disclosure for investors as well as for financial advisors, the Disclosure Regulation should take into account the existing different approaches which are relevant for sustainable investments today. It should provide for a consistent approach which provides for meaningful and accessible disclosure.

- **Taking into account the different approaches towards sustainable investments.** We are in particular concerned that the European Commission’s definition of what constitutes a sustainable investment would focus only on a specific segment of the sustainable market, namely thematic and impact funds.

Approaches toward sustainable investments

Asset managers incorporate ESG factors into investment decisions with the aim to better manage ESG risks and to generate sustainable, long-term, risk-adjusted returns.[3] Sustainable products seek to combine financial return with a moral or ethical return. Both of the aforementioned approaches are based on ESG data and one or more of the following or similar strategies:

- ESG integration: Integration of material ESG factors into fundamental analysis to enhance investment decision making
- Positive/best-in-class screening: Investment in sectors, companies or projects selected for positive ESG performance relative to industry peers
- Negative/exclusion screening: Negative screening or exclusion
- Norms-based screening: Screening of investments against minimum standards of business practice based on international norms

[3] See also PRI, “What is Responsible investment?”, https://www.unpri.org/pri/what-is-responsible-investment.

o Engagement: Encouraging positive change of a company's strategy contributes to its long-term value by using so-called Engagement as strategy[4]

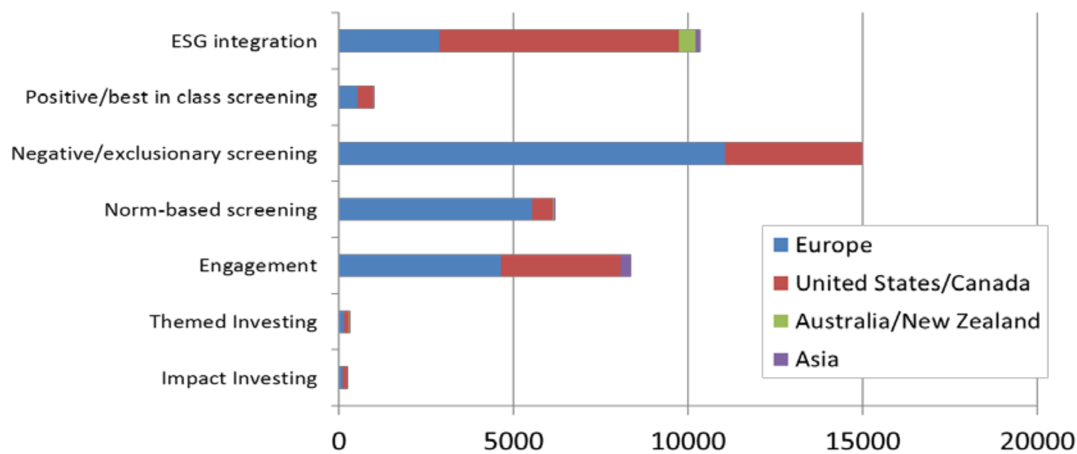
The following two approaches are in practice only relevant for sustainable products:

o Themed investing: selection of assets that contribute to addressing one or more sustainability challenges such as climate change or water scarcity

o Impact investing: investments made into companies, organizations, and funds with the intention to generate social and environmental impact alongside a financial return

In particular impact or thematic funds are a small niche though the market has been grown in the past. Furthermore, the definition seems to disregard one of the most powerful; tools available to investors: Engagement. Likewise, the text does not recognise the existing disclosure requirements under the revised Shareholder Rights Directive.

Strategies by Region (in US $ billions)



Source: Global Sustainable Investment Alliance, Global Sustainable Investment Review 2016, p. 8, 27.

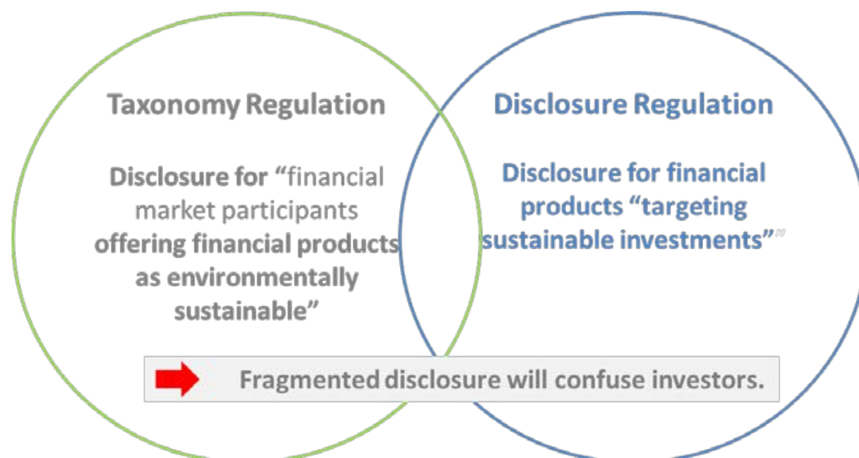
Since the available assets for impact and themed investing are limited or often too small in order to become viable investments interesting for institutional investors without a specific investing focus on impact and themed investing, we doubt that these specific approaches will in future provide for more than a limited market share. We fear that the Disclosure Regulation which suggests a rather limited understanding of sustainable products would lead to a decrease of the number of sustainable products. Today the term "sustainable" is also applied to products that provide for other ESG strategies. For such products national labels have been developed.[5]

In order to foster sustainable investments on a broader basis, the disclosure regime focusing on products needs to be relevant for all sustainable products, not only products which apply a specific impact or themed strategy. Therefore, the relevant criterion should not be the fact that a product has as its target sustainable investments but whether a product is "marketed as sustainable".

[4] See e.g. EuroSIF SRI Study 2016, p. 22; http://www.eurosif.org/wp-content/uploads/2017/11/SRI-study-2016-LR-.pdf
[5] See e.g. the label of the German SIF "Forum Nachhaltige Geldanlagen", http://www.fng-siegel.org/en/, or the label of the Luxembourg Finance Labelling Agency (LuxFLAG), https://www.luxflag.org.

Transparency on all of the respective products will allow investors to assess whether the products are sustainable in their view. This will be compatible with different beliefs of investors.

- **Only one set of rules for sustainable products.** Both the Taxonomy Regulation as well as the Disclosure Regulation feature specific disclosure requirements for sustainable products. In both Regulations, delegated acts are foreseen. The Taxonomy Regulation seems to focus on products that will be able to measure investments in economic activities. The Disclosure Regulation, on the other hand, seems to focus on products targeting sustainable investments, hence suggesting the strategy of impact investing. Though we understand that the disclosure requirements according to the Taxonomy Regulation only enter into force once the Taxonomy is built, there is no clarity on how that will affect the disclosure requirements under the Disclosure Regulation. As a solution, the Disclosure Regulation should apply to products marketed as sustainable and any disclosure requirement in the Taxonomy Regulation should be deleted.



- **Clear link between disclosure for sustainable products and Taxonomy.** The Disclosure Regulation should provide for a clear link to the Taxonomy – as far as it is established. We generally see the merit of disclosure on how financial market participants deal with sustainability issues even before the Taxonomy is established. We understand that absent the Taxonomy, the intention is that Level 2 rules provide for the necessary disclosure. However, we are concerned that Level 2 measures will require detailed disclosure which will be different from a disclosure based on the developed Taxonomy. The changes will be confusing for investors, financial advisors and asset managers. We therefore advocate for a principle based disclosure absent the Taxonomy.

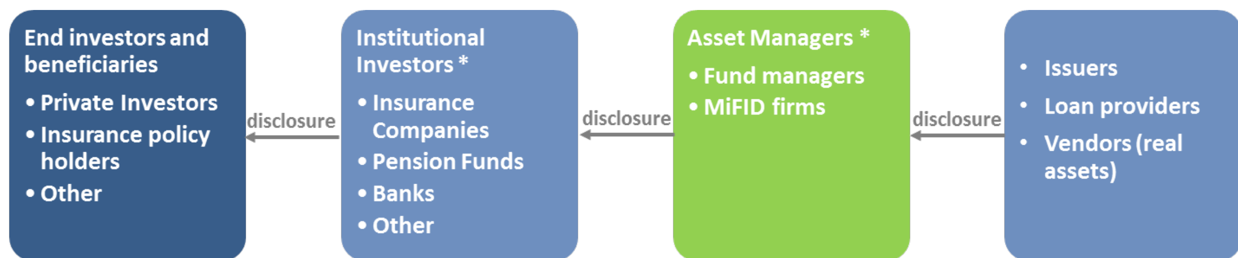
- **Place of disclosure should be consistent and accessible.** We fully support the idea of consistent disclosure regarding ESG risks and integration. In this respect, it is worth mentioning that many institutional investors and asset managers in practice use different or a combination of methods of selecting investments taking also material extra-financial considerations into account – an approach which (though different from specific sustainable products) fosters SF. However, we do not believe that the disclosure in pre-contractual documents will indeed facilitate investors' understanding of how the asset managers take ESG risks into account. In particular, investors usually do not take notice of the information in a prospectus. In addition, including the information in legal documentation will make the disclosure a pure compliance exercise. Finally, an investor who is interested in the information on both the asset manager's general ESG risk policy and how it is applied to the product would have to access two different sets of information, i.e. the website and the prospectus. We therefore recommend a requirement for asset managers to disclose their approach towards ESG risks on the website and include a short reference in the prospectus.

- **Meaningful disclosure regarding integration of sustainability risks.** We appreciate the generic wording for the pre-contractual disclosure regarding the integration of sustainability risks which allows compatibility with different approaches in the industry. However, we are concerned that the pre-contractual disclosure on the extent to which ESG risks are expected to have a relevant impact on the returns of a financial product (see Article 4(1)(b)) will not be meaningful. Forward-looking statements are subject to a variety of risks, uncertainties and speculation. Actual events or results will very likely differ from such statements and their value for investors will be limited.

- **Interaction with existing standards and approaches.** The revised Shareholder Rights Directive provides measures for long-term and non-financial transparency of asset managers on their stewardship activities. The rules will have to be implemented by 10 June 2019 and are therefore not yet in force. They should be taken into account in the disclosure requirements. Furthermore, asset managers publicly disclose different reports such as Engagement Reports, Corporate Responsibility Reports, UN PRI Transparency Reports, responses to the EuroSIF Transparency Code or even specific ESG fund reports. Moreover, they provide tailored reports on how they consider sustainability factors in their investment decision making according to institutional investors' requests and needs. For such reporting, asset managers rely on sustainability ratings. While the general requirement to provide for transparency on risk policies seems to be compatible with these disclosures, this is not the case for the disclosure requirements for sustainable products (Art. 5 et seq. of the Disclosure Regulation).

Disclosure requirements need to be consistent throughout the investment chain and should not only cover a selection of market participants

Disclosure is only as reliable as the underlying data provided. Asset managers need information relevant for the respective asset class, i.e. investments in equity, fixed income including sovereign as well as alternatives like real estate. While we strongly believe that the Taxonomy Regulation should itself not provide for disclosure requirements, we do not see a consistent approach for disclosure throughout the investment chain. In this respect, the legislative package falls short of facilitating such disclosure of information for all investments.



* Depending on the specific investment not all intermediaries might be part of the investment chain.

Only a framework requiring all market participants seeking financing from the capital markets to disclose relevant information will allow asset managers to apply SF throughout all investments and enhance the possibility to offer sustainable products. Only if such information is available to asset managers, they will be able to disclose the information in an understandable and meaningful way to the benefit of end investors and financial advisors. Only if all institutional investors are required to report to their end investors, will they take ESG considerations into account. Furthermore, consistent reporting requirements provide comparability and a level playing field also on a cross-border basis. Fragmented disclosure requirements will at best not achieve the full potential of SF. In the worst case scenario it will be to the detriment of sustainable growth. Sustainability reporting should – if possible – cover all types of assets and be used by all financial market participants in order to provide a complete picture. We would therefore advocate for a respective alignment on corporate disclosure.

Content of disclosure should be built on the Taxonomy and aligned to market dynamics

In order to provide investors with the right choice, the content of required disclosure should be compatible with existing strategies and standards:

- **Principle based disclosure will foster SF.** The Taxonomy will serve as the basis for a consistent reporting throughout the investment chain in the mid-run. Mandatory disclosure by asset managers prior to a developed Taxonomy should be based on principles and should be consistent with existing regulation whether already applicable or not. Prescriptive disclosure will (i) likely not allow taking market developments into account quickly, (ii) probably not be compatible with the Taxonomy (at least not immediately) and (iii) possibly be limited since not all data will be available throughout the investment chain and all asset classes. Consequently, prior to any robust development of the Taxonomy, we appeal to refrain from detailed regulation regarding reporting requirements for asset managers. Rules, if any, should be based on principles and should not provide for a detailed framework regarding content and format and should take into account that the impact of the rules under the revised Shareholder Rights Directive cannot yet be assessed. We are in this respect concerned that Level 2 measures will indeed stipulate prescriptive disclosure requirements. In order to allow sustainable investments to grow, we therefore call on the legislator to refrain from delegated acts for the time being.

- **Impact measurement is at early stages.** The disclosure rules require measurement and monitoring of the impact and respective disclosure (see. Art. 6 (1) (b) and Art. 7 (1) (b)). Products which allow for a measurable impact are very limited. So far, measurement of impact is at a very early development

stage. For project-based investments (e.g. private market infrastructure) this is much easier than for listed assets. While some initiatives are developing impact metric standards[6], by far no reliable standard has been established. Furthermore, the impact focus solely looks at non-financial criteria. For a financial investment, however, non-financial criteria are relevant where they can have a material impact on the return. Taking non-financial criteria into account which are not material will be difficult for asset managers unless specifically agreed with the investor, in particular if it comes at a cost or if it has a negative impact on the return. Given the development in this respect, the rules should at the very least include a reference to best effort and should not provide for prescriptive Level 2 measures at least until the methods on measuring impact have been further developed.

Fragmented Regulation will be detrimental to the market dynamics

To be effective, disclosures need to be read and understood by their target audience – the investor. In addition, market participants need to comply with the disclosure requirements. We are very much concerned that the project will not be successful unless there will be consistent legislation which applies to each part of the investment chain, allows for enough flexibility in order to address investors' needs and provides for clear but principle based rules.

The reason for our concern is that investors are provided with numerous diverging disclosures under various different pieces of regulation (PRIIPs, UCITS, MIFID, Shareholder Rights, etc) with respect to the same investment. Likewise market participants have to understand and apply different pieces of legislation and try to provide meaningful information to investors. This is becoming increasingly difficult. For instance asset managers have not only to comply with the disclosure requirements stipulated by the UCITS Directive and AIFMD framework. In addition, disclosure requirements are included in the MiFID II framework for some services, in the Shareholder Rights Directive II, the Securities Financing Transaction Regulation, the Benchmark Regulation, the Money Market Funds Regulation and in future possibly also under the proposed Regulation on facilitating cross-border distribution of investment funds – just to name the most obvious ones. While a focused regulation might be easier to handle in the legislative process, this is not the case in practical application. Adding an additional layer of disclosure without diligently considering its target audience and how it may interact or complement existing disclosures will lead to confusion and sub-optimal outcomes. We urge the Commission to closely observe any developments which could further facilitate inconsistent disclosure regimes and ensure that all the pieces of legislation are consistent.

Revision of delegated acts of AIFMD and UCITS Directive

We understand that the Commission has requested ESMA to provide advice to clarify the duties of management companies in the delegated acts of the AIFMD and UCITS Directive. In this respect, we would like to point out that existing rules within the regulatory framework appropriately reflect the asset managers' role as intermediaries and their strict obligation to follow the investment strategy as agreed with the investor. The rules also provide for sufficient flexibility to tailor the mandate or product according to investors' specific ESG needs. ESG considerations depend on a specific person's view regarding standards, ethical or social beliefs. For instance, investors have a very different

[6] For instance https://www.worldbenchmarkingalliance.org/

understanding regarding sustainability of nuclear energy depending whether they focus on carbon dioxide emissions or nuclear waste.

As outlined above, the ESG strategies applied in practice vary. Since it is difficult to capture and properly weigh all benefits and disadvantages of those strategies in respect to all assets in a regulatory framework, the decision on ESG considerations and strategies should remain with the investor. Only the investor will be able to assess which strategy is in his or the end investors' interest. Otherwise, there is a potential risk that the current growth of SF will be constrained. **Therefore, any further specification of investors' duty in EU legislation should not jeopardise the flexibility to allow for different beliefs and different ESG strategies.**

Technical comments

The following comments suggest specific changes to the Disclosure Regulation.

Article	Comment
Art. 1 (2)	"Financial products" as defined in the Disclosures proposal include portfolio management. Portfolio management, however, is not a product but a service according to Annex I Section A (4) of MiFID II. It must therefore be described as such in order to avoid regulatory confusion.
Art. 4 (1) (b)	The provision should be deleted. Forward-looking statements are subject to a variety of risks, uncertainties and speculation. Actual events or results will very likely differ from such statements and their value for investors will be limited. In particular, the requirement to include information about the extent of the impact on the return seems to be inappropriate.
Art. 4 (3)	Financial market participants should have the choice where to disclose the information or information should be displayed on the website. In particular prospectuses are often not read by investors. If information is scattered in different sources, it is less accessible for investors.
Art. 5	This Article requires disclosure in the legal documentation, whereas Art. 6 requires disclosure of some of the same but also other information on the website. We do not believe that the disclosure of the same information at several places will indeed improve investors' insight. Already investors' are complaining about information overload. We therefore suggest merging Article 5 and 6 and allow for disclosure only at the website.
Art. 5 (1)	The term "has as its target sustainable investments" appears to have a quantifiable connotation and suggests the niche of impact investments. It should be replaced by the term "is marketed as sustainable". Otherwise there is a risk that sustainable products applying accepted ESG-strategies will not be considered as sustainable. This could ultimately be to the detriment of fostering SF.
Art. 5 (1)	Paragraphs (a) and (b) should only apply to indices which have been replicated (i.e. passive strategies). The sole use of a benchmark as a basis for building a portfolio, reference for tracking past performance or for fee calculation should not require compliance with (a) and (b). For such use of benchmarks, a disclosure requirement on the general strategy and how a benchmark is used in this respect should suffice.
Art. 5 (3)	The reference in subparagraph 2 to paragraph 2 seems to be incorrect.

Art. 5 (5) and (6)	Detailed disclosure requirements can facilitate consistency. It is decisive, however, that Level 2 measures do not discourage existing market dynamics.
Art. 6 (1) (a)	The term "sustainable investment target" appears to have a quantifiable connotation and suggests impact investments. It should be replaced by the term "marketed as sustainable".
Art. 6 (1) (b)	The term "assess, measure and monitor the impact" appears to have a quantifiable connotation and suggests impact investments. Furthermore, metrics on measuring impact are not yet well developed. The term should in total be replaced by the term "monitor the impact on a best effort basis". General monitoring and a general description could be feasible.
Art. 7 (1) (a)	The term "sustainable-related impact" appears to have a quantifiable connotation and suggests impact investments. Furthermore, metrics on measuring impact are not yet well developed. The term should be replaced by "results of monitoring the impact on a best effort basis". General monitoring and a general description could be feasible.