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Response to ESAs Survey on Templates for Environmental and/or Social Financial Products under SFDR

Submitted via online survey on 16 October 2020.

Q1. How useful is the highly standardised presentation of the information in this format?

- [ ] Useless
- [ ] Fairly useless
- [x] Neither useless nor useful
- [ ] Fairly useful
- [ ] Very useful

Please explain:

We are supportive of the goal of the ESAs to improve the consistency and comparability of product-level disclosures and make them simple and easy to understand by consumers. Therefore, in our response to the Joint Consultation Paper, we agreed in principle with the use of standardised templates, subject to certain comments we made about striking the right balance in terms of how and where different types of information can be best disclosed. Those comments remain relevant in responding to this consultation also. We welcome the release by the ESAs of the draft disclosure templates and have the following considerations relating to their use in practice:

- The Level 1 text requires the pre-contractual disclosures to be made in the prospectus / offering document of the UCITS / AIF. However, we consider the template that the ESAs have produced to be more akin to a standalone factsheet type document on sustainability, with its own colour-coded graphs, tables and supporting commentary. Careful consideration needs to be given as to how this document would fit within the prospectus, a document that is narrative, qualitative and static in nature. A factsheet type disclosure may be better situated on a website, as that would also allow for the information to be updated more frequently and could increase accessibility for consumers.

- However, the legislative requirement is to include this disclosure in the prospectus. A balance therefore needs to be struck in terms of information that is disclosed in the prospectus under this template versus via a website. We suggest that links could be provided in the prospectus to information that is graphical and / or quantitative in nature, where this information could be more readily updated. Providing an ex-ante portfolio breakdown in the prospectus could also potentially be misleading for certain funds that may vary their portfolio allocations significantly over time.
- The mock prospectus template runs to six pages and in keeping with the ESAs' stated aim of making disclosures concise (particularly for consumers) we think that the level of disclosure could be further condensed (to three pages, for example). This could be done by removing multiple repetitions and overly detailed or technical explanations and linking to website disclosures as appropriate. We have included our suggestions in that regard under our response to Question 6.
- The length of the pre-contractual disclosure will be an issue particularly in the case of PEPPs. The Level 1 text mandates the inclusion of the pre-contractual disclosures in the PEPP KID. However, the PEPP KID is required to have a maximum length of three pages whereas the mocked-up template is six pages long. This challenge further points to the preferability of housing the sustainability factsheet on a website and providing a link to it in the pre-contractual documentation.
- In relation to the periodic reporting template, standardisation of the template is to be welcomed but, as with the pre-contractual disclosure template, the variety of disclosures make it difficult to slot this into one document or the annual report. Some aspects, such as 'top 25 investments' overlap with the schedule of investments (SOI) included in the audited financial statement section. We suggest that this periodic disclosure template could also be simplified in order to prevent duplication, overlap and confusion arising. Again, we have included our suggestion in that regard under our response to Question 6.
- Assuming the ESAs proceed with the proposed format of pre-contractual disclosure, while it may seem best to include it as an annex to the prospectus, information contained in it relating to the investment objectives and policies would typically be presented in the body of the prospectus rather than separately in an appendix type of disclosure. This could create internal incoherence in the prospectus and confusion for investors in terms of the flow and relative importance of different parts of the prospectus.
- We consider that formatting items such as icons and graphs into the body of a prospectus will be inconsistent with the layout of this document and will not add value. This points again to simplification of the presentation and format. We would

be concerned that NCAs may take different approaches in terms of how this template should be integrated into the prospectus and would welcome guidance and a consistent view in relation to that.

- We welcome the mock-up of the template with a fictitious fund, as this gives a good indication of ESAs' expectations regarding the level of detail to be included in the template. The example provided is in relation an index tracking ETF, but we would welcome further examples to cover all types of financial products, including actively managed funds and both Article 8 and 9 products. It would also be helpful to have an example of a fund which uses derivatives and an explanation of how that use is aligned with environmental and social characteristics.
- We understand that the ESAs are approaching this exercise from the perspective of the consumer and agree with this approach. We also note that SFDR does not distinguish between professional and retail clients in terms of the disclosures being made. However, in responding to Question 1 on the usefulness of these standardised templates, the ESAs should be aware that there is a widespread recognition that these templates will not be of any use to professional investors, who conduct their own extensive due diligence and request bespoke information. Similar to ongoing discussions in relation to the provisions of costs and charges information under MiFID, we believe that it may, therefore, make sense to exempt the use of these templates for professional clients.
- If the ESAs determine that the templates for pre-contractual and periodic reporting must be provided to both retail and professional clients, we suggest that the templates are simplified in presentation and format and condensed in length in the interests of all investors, both retail and professional.

Q2. More specifically, how useful is the presentation of the information with the use of icons as visual aids (in mock-up 1 and 3)?

- [x] Useless
- [ ] Fairly useless
- [ ] Neither useless nor useful
- [ ] Fairly useful
- [ ] Very useful

Please explain:

We do not think the icons will add any value to the disclosure, not all of them are self-explanatory and they will more likely distract the users from the important elements of the financial product being described. Furthermore, as per our response to Question 1, their inclusion would complicate integration into the prospectus and stylistically, icons would sit quite oddly in the prospectus in terms of the flow and cohesion of that document. This underscores the point that if icons are to be used that they form part of a standalone document that can be referenced in the prospectus with a link to the relevant webpage provided. It has also been pointed out that the use of icons may reduce the machine readability of the documents and therefore accessibility for the visually impaired. We suggest that organisations for the visually impaired are consulted in that regard.

Q3. More specifically, how useful is the presentation of the information with the use of graphs as visual aids?

- ☐ Useless
- ☐ Fairly useless
- ☑ Neither useless nor useful
- ☐ Fairly useful
- ☐ Very useful

Please explain:

While graphs can serve a meaningful purpose to aid presentation and understanding of information that is data related, as per our previous comments, we would suggest transferring sections with dynamic data onto the website. It would make such information both easily accessible and ensure it can be kept up to date. As stated in our response to the Joint Consultation Paper, pre-contractual disclosures should predominantly be qualitative in nature to reflect the general nature of documents in which the proposed template will be inserted. As such, we do not agree with the requirement to disclose a graphical representation in the prospectus.

We also wish to highlight some issues with the proposed graphical representations that could lead to confusion:

- **Minimum asset allocation planned**
  - As noted in our response to the Joint Consultation Paper, an Article 8 product may not necessarily invest in “sustainable investments” as defined under the

SFDR so requiring it to specify an exact percentage of "sustainable investments" may not make sense. We note that in the example provided by the ESAs the stated investment strategy makes no reference to "sustainable investments". Therefore, there is an inconsistency with the graph which could cause investor confusion.

- We also think that the further breakdown of "sustainable investments" (#1A Classified as sustainable: environmental; #1B Other investments aligned with E/S characteristics: Environmental; #1B Other investments aligned with E/S characteristics: Social) is likely to cause confusion. We agreed with the ESAs in our response to the Joint Consultation Paper that such breakdowns could be misleading for the end-investor who will need to be able to distinguish how different investments relate to the overall strategy of the fund. The approach to ESG integration is holistic and undertaken at the level of the portfolio and all assets of the product contribute to the overall objective and strategy. The stated strategy will address how ESG investments are assessed and selected for the portfolio.
- As mentioned previously, a graph could also be misleading since product manufacturers, particularly for actively managed funds, are likely to retain a certain level of discretion and would typically provide an indicative range in terms of investments, while the exact percentages could vary significantly over time.

- **Allocation of the investments according to economic sector**
  - This graph will be relevant for certain strategies (e.g. exclusionary strategies), but not for others and therefore we think its inclusion should be optional if it is relevant. As per our previous comments, we think that breaking down the portfolio ESG sub-categories labelled #1A, #1B, #2 is not helpful and overcomplicates the graph. When such sectoral breakdowns are provided, this is best done as a pie chart that represents the portfolio as whole.
  - For most products, sector allocations are not a binding characteristic of the product and it would be misleading to present such information as a planned allocation that will always be adhered to. Therefore, if such a graph is to be used, it should be made clear that it is for illustration purposes only, is not a binding characteristic of the fund and therefore is subject to change over the life of the fund. We would suggest therefore that the information in the graph should be a snapshot as at a given date.
  - We believe that sectoral descriptions should be based on financial market participants' existing reporting to clients. In particular, financial market

participants should be given the flexibility to choose the appropriate sectoral headings which correspond to their regular reporting.

Q4. More specifically, how useful is the presentation of the information with the use of explanatory notes, in the column at the right side of the document, which are presented on a grey background)?

- [ ] Useless
- [ ] Fairly useless
- [x] Neither useless nor useful
- [ ] Fairly useful
- [ ] Very useful

Please explain:

We believe that a better approach would be to ensure that the templates use plain language that can be readily understood by consumers. This should dispense with the need for explanatory notes and be consistent with a focus on clear and jargon free information for consumers. Furthermore, to reinforce this perspective, we suggest that these templates undergo consumer testing for understandability.

We would also have a concern about the potential for conflicts between the explanatory notes and explanations included in other sections of the prospectus, for example those relating to derivatives, governance, asset allocation, etc. this point underscores the benefit of focussing on plain langue explanations linked to the prospectus, rather than including separate explanatory notes.

If the concept of explanatory notes is to be retained then we believe that it would be more useful if they were used to further clarify a financial market participant's approach and truly operate as an "explanation" rather than a "glossary". For example, when a financial market participant excludes weapons, the explanatory note could explain the scope of the exclusion.

Finally, we have also identified challenges with some of the existing wording in the explanatory notes:

- Binding elements are defined as "commitments that cannot be amended during the life of the financial product". However, it is possible that an investment strategy can be amended during the life of the product with shareholder approval or notification. Therefore, we suggest clarifying this.

- A "reference benchmark" is defined as "an index against which it can be measured whether the financial product is meeting its sustainable investment objective". However, reference benchmarks may serve a variety of roles and, in this case, it is used to determine the allocation of the fund since the fund tracks the index.
- Finally, given the mocked-up example relates to an Article 8 product, the explanatory notes should reference sustainable "environmental and social characteristics" rather than "sustainable investments".

Q5. Are there any presentational aspects that might make it hard to understand the sustainability-aspects of products?

For example, with regard to the distinction between the sub-categories of investments, namely between #1A and #1B?

- [x] Yes
- [ ] No
- [ ] Other

Please explain:

Yes, further to our comments under Q.3 in relation to the graphical representations, we think that the use of such sub-categories is likely to be confusing to investors. Such breakdowns will overcomplicate matters for consumers seeking to understand the approach to ESG in terms of the overall strategy and portfolio.

Q6. Do you have any other suggestions or comments to improve the presentation of these disclosure documents?

As highlighted previously, we consider the pre-contractual temple too long in running to six pages, particularly when for example the UCITS KIID must be limited to two pages and the PEPP KID to three pages (a document into which this template is supposed to fit). In keeping with the ESAs' stated aim of making disclosures concise (particularly for consumers) we propose condensing the template to no more than three pages. This could be done by removing duplication and overly detailed or technical explanations. For example, the description of ESG characteristics overlaps with the description of the strategy, with the same core information repeated several times in the subsections. We recommend a single section setting out the investment policy, as is the case in a KID, as this would simplify the disclosure and therefore aid comprehension The section on ‘do no significant harm’ also appears overly technical for consumers and we would suggest that a link to a policy on a website (similar to what has been done in relation to the good governance section) would suffice.

Similarly, we believe that the periodic reporting template could be simplified to aid investor understanding and avoid confusion. Building on our concern over consistency and interaction with the financial statements, we view some of the disclosures as supplementary and not necessarily adding value in the context of the periodic reporting template on ESG, for example duplicated information such as ‘top 25 investments’, which is part of the condensed SOI in the audited financial statements. If this template were to be separately disclosed as part of the annual report, there would be challenges with consistency with other parts of the annual report. Cross-referencing the template to the equivalent existing disclosure presented elsewhere in the annual report would be preferable.

In the absence of a European reporting standard and related auditing standard, it would not currently be possible to provide assurance over the ‘do no significant harm’ requirement. We also suggest that this ESG disclosure template would be cross-referenced back to the information required by the Non-Financial Reporting Directive rather than duplicate the information.

Furthermore, in relation to the methodology for the calculations required to make the disclosures in the templates, we would again emphasise our proposal made in the response to the Joint Consultation Paper that these be based on a ‘snapshot’ of the investments at a point in time. Just as the financial year end is used as the appropriate reporting period for so many other purposes (e.g. balance sheets in the case of financial reports, holdings reports and valuation metrics, P/E, dividend yield, etc.), we believe it should be for these purposes also.

We would again emphasise the need for extensive consumer testing to be undertaken on these templates to ensure that they will be well understood by consumers and serve a meaningful purpose for them.

We would also like to highlight a number of inconsistencies we have identified between the draft RTS and the proposed templates, as well as points for further clarification:

- The sections, as included in the illustrations for both pre-contractual and periodic reports, do not always match the order in the RTS sections (e.g., no sustainable investment objective comes before environmental or social characteristics; sustainability indicators appear towards the end and after use of derivatives).

- There are sections that do not necessarily correspond with the proposed RTS (the question on potential investment excluded does not match the proposed RTS which refers to commitment).
- To our previous comments about addressing overlap and duplication, can the ESAs confirm if cross-referencing to other sections in the prospectus when filling out the template is possible? Or is it intended that investors should read the template entirely as a stand-alone document? If the answer is the latter, we think that the sub-fund description and the template would end up being quite repetitive and that disclosure on this aspect could be simplified.
- Article 24 of the draft RTS only refers to graphical presentations for planned allocation to sustainable investments, but a narrative (rather than a graphical) disclosure on sectoral breakdowns.
- The last question on reference benchmark refers to a benchmark used to determine whether a product meets its sustainable investment objective. As this is a template for an Article 8 fund, we understand that the question and description of a reference benchmark should be phrased differently to relate to meeting environmental or social characteristics.
- As per our previous comments above, we would stress again that mock-ups for an active fund as well as an Article 9 fund would be very beneficial in seeking to prepare for these disclosure templates.
- We are uncertain as to why there is another yes or no question once yes is selected in response to the question about the use of derivatives. Should this section simply explain how the use of derivatives is aligned with the environmental or social characteristics promoted? We suggest this could be section could be simplified accordingly in line with our previous comments.
- It is unclear in the template where the name of the financial product is to be included or is the expectation that as this will be inserted into in a prospectus, there is no need to include the name of the financial product? To our previous comments, the answer may depend on how the template is to be integrated into the pre-contractual documentation and whether it is intended that the pre-contractual disclosure template becomes a standalone document on a website (in which case we think the product name should be inserted).
- There are inconsistent references to the Taxonomy in the draft templates. On page 1 there is a reference to “a sustainable objective, for instance qualified as sustainable

according to the *EU classification*" while on page 3 "qualified as sustainable, some of which are classified as environmental investments under the *EU framework* to facilitate sustainable investment". We would also note that the Taxonomy is unlikely to be fully developed across investment categories depending on the timeframe for production of disclosures which reflect these templates.

- The draft template includes a reference to a prospectus section on Adverse Impacts. However, the relevant prospectus disclosures on principal adverse impacts are only required by 30 December 2022 and so there may be no section to which the cross-reference can be made prior to that date.

Q7. When the templates are presented via digital media, can you foresee any particular challenges? Can you suggest how these particular challenges could be overcome while retaining the core aspects of the standardised template format?

Further to our response under Question 1, we foresee challenges particularly with the integration of graphical representations and icons into a prospectus document that will take a narrative style and typically be published in black and white. Inclusion of the pre-contractual template in the main body of the prospectus may therefore not lend itself well to the best possible presentation of the template and could reduce its accessibility for consumers.

We therefore think that it would be useful for this form of product-level template to be housed on a website (as opposed to in a prospectus) and be a short-form document which cross-refers to supporting information whereby the template is a summary of the product and contains web-links to ancillary documents with more detailed and dynamic information. The prospectus could then refer, and provide a link, to the disclosure template.