

EFAMA's RESPONSE TO IOSCO's "RECOMMENDATIONS ON SUSTAINABILITY-RELATED PRACTICES, POLICIES, PROCEDURES AND DISCLOSURE IN ASSET MANAGEMENT"

11 August 2021

EFAMA's RESPONSE TO IOSCO's "RECOMMENDATIONS ON SUSTAINABILITY-RELATED PRACTICES, POLICIES, PROCEDURES AND DISCLOSURE IN ASSET MANAGEMENT"

EXECUTIVE SUMMARY

EFAMA welcomes IOSCO's enhanced attention to transparency efforts supporting informed and qualified investment decisions in sustainability-related products. We support the adoption of such recommendations at the international level and believe IOSCO should leverage the experience with SFDR and Taxonomy in Europe to help establish consistent international standards, definitions and best practices.

In this response, we would like to highlight three pressing challenges deserving greater attention in the report from asset managers' perspective.

First, the industry faces dozens of new ESG compliance requirements in the form of new disclosure regimes, taxonomies and voluntary labels. As a result, the uncoordinated proliferation of such frameworks, rules and standards in different jurisdictions can inhibit the cross-border distribution of funds that match investors' sustainability preferences. In such an unduly complex regulatory environment with heightened risk of market fragmentation, the goal must be to drive global consistency. For example, whereas the recently adopted SFDR provides an-EU wide disclosure framework, some jurisdictions consider adopting additional disclosure requirements or minimum standards when applying SFDR or ESG amendments to MiFID II on clients' sustainability preferences. Moreover, while the EU is opting for a comprehensive approach covering aspects beyond climate change, other jurisdictions are considering a more restricted scope of disclosures targeted primarily at climate change.

To address this challenge, EFAMA recommends that IOSCO and its members should proactively support initiatives aimed at ensuring greater international consistency between disclosure regimes, definitions and taxonomies and thereby prevent fragmentation. EFAMA also endorses initiatives resulting from the recommendation no.4 for common sustainable finance-related terms at the international level to ensure that key concepts are applied in the same way and therefore contribute to avoiding greenwashing and mis-selling to end-investors.

Second, the lack of high-quality ESG data on investee companies hinders robust and clear information provision to investors, and hence global ESG capital flows. Therefore, to answer investors' growing expectations, EFAMA would support mandatory sustainability reporting standards by non-financial undertakings. These should also incorporate information requirements on companies' ESG factors that are material for their business decisions and which are being increasingly integrated into asset managers' disclosure requirements (e.g. SFDR, Taxonomy, EU Ecolabel).

Nonetheless, until the ISSB of the IFRS makes headway in improving the global availability of disclosures, the use of proxies by asset managers should be permitted when relevant data is not available. In such cases, it needs to be clarified that the reporting for asset managers should take place on a best effort basis as any further requirement will entail liability issues that go beyond a portfolio manager's capacity to demonstrate the reliability of the disclosures. In this context, EFAMA also recommends that regulators work in parallel on harmonised methodologies for calculating and aggregating such proxies. We also recommend that due attention is given to the growing dependency on third party ESG data providers of which there are a limited number, leading to costs implications that are ultimately borne by the investors.

Third, we are concerned by the approach suggested in question 6 of the consultation report. Labelling schemes with specific sustainability parameters should remain strictly voluntary for sustainability products. While we see an added value in adopting transparency regimes for ESG products, mandatory

labels in different jurisdictions would hinder the cross-border selling of funds and fragment the ESG market with diverging minimum standards for such products.

Finally, we express our strong support for the recommendation no.5. We strongly support efforts targeted at the promotion of financial and investor education initiatives by regulators and policymakers. We highlight that financial advisory should be supported in its explanation of different ESG integration approaches to investors. In Europe, such support should be targeted at the operationalisation of the recently introduced clients' sustainability preferences under the MiFID II.

QUESTIONS AND ANSWERS

Question 1: Will the recommendations outlined below sufficiently improve sustainability-related practices, policies, procedures and disclosure in the asset management industry and address the issue of greenwashing? Are there other areas of sustainability-related practices, policies, procedures and disclosure in the asset management industry not mentioned in this consultation report that should be addressed as separate recommendations?

We agree with the outlined recommendations for the asset management sector. At the same time, we wish to stress that asset managers are relying on companies' reporting. Without such reporting, asset managers will find it difficult to adjust their internal investment policies and processes and disclose ESG factors related to their investments to end investors. In this regard, it remains critical that the timelines for introducing new ESG disclosure requirements for asset managers take effect only after a reporting regime is already in place and effective for issuing companies. Ensuring appropriate regulatory sequencing is therefore of equal importance as the regulatory commitments themselves.

Question 2: The key areas identified are based on the key pillars of the TCFD Framework. Do you agree with this approach?

Yes, EFAMA supports the categorisation into four pillars based on the TCFD framework, given the extensive use and recognition of these standards at global level. At the same time, there are other ESG considerations such as water risk, biodiversity, and/or human capital for which no consistent metrics and targets exist. Given that such considerations are also linked to sustainability reporting and demands for information from investors, further guidance can help with the comparability of such disclosures.

We are also concerned by the significant data gaps for underlying holdings outside the large listed issuers where reporting is more progressed. Nonetheless, even within the disclosures from large publicly listed companies, there are significant challenges concerning the comparability, consistency and assurance of sustainability related information.

Question 3: Should the scope of this recommendation cover all asset managers or be limited to only those asset managers that take sustainability-related risks and opportunities into consideration in their investment process?

We believe that ESG risk integration in internal processes and organisation is relevant for all asset managers and is not linked only to specific investment strategies. Therefore, we support that these recommendations cover all asset managers.

Question 4: Should securities regulators and/or policymakers, as applicable, consider setting out different disclosure requirements for products with sustainability-related investment objectives as compared to products that promote sustainability-related characteristics? If so, for which of the different areas of disclosure listed above should the requirements vary, and how should they vary? In addition, if so, should securities regulators and/or policymakers, as applicable, consider specifying thresholds or other criteria for determining whether a product has sustainability-related investment objectives as compared to sustainability-related characteristics, and what should those thresholds or criteria be?

To ensure consistency and avoid unnecessary complexity by differentiating products' transparency requirements based on their "level" of greenness, EFAMA supports the same high-level transparency requirements for products with sustainability-related characteristics and products with sustainability-related objectives. The distinction between 'objectives' and 'characteristics' is not always entirely evident. After all, differentiating between these two types of ESG products proved challenging also under the SFDR Article 8 and 9 products.

In principle, we support greater transparency – especially with regard to how assets perform across a spectrum of measurements, including both financial and non-financial information. In this context, our members are supportive of minimum disclosure standards that inform investors about the sustainability strategy of each product without imposing unclear distinctions between products that have sustainability-related investment objectives and those with sustainability-related characteristics. We rather recommend empowering the investors by providing them with the opportunity to choose the suitable products based on the products' sustainability parameters disclosed under the relevant transparency regime. On the other hand, specific criteria or thresholds for investments thresholds should apply only to ESG labelled products, such as the EU Ecolabel.

Question 5: Should naming parameters permit the product name to reference sustainability only if the investment objectives refer to sustainability?

Currently, there is no clear market practice distinguishing between the terms "sustainable", "responsible", "ESG" or "SRI", resulting in an interchangeable use of these terms stemming from the marketing preferences in certain markets or regions.

Nonetheless, we believe that the use of such terms in product names should be interpreted as making a commitment in terms of sustainability. Therefore, it should be legitimate under the condition that a product commits in a binding manner to pursue sustainability objectives or at least to apply ESG criteria in the investment process. In either case, sustainability factors must amount to binding elements of the investment strategy relevant at the fund level and must not be left to the discretion of the asset manager.

Should investors or distributors seek more guidance and guarantees on sustainability, they can refer to the relevant voluntary ESG product labels that ensure compliance with certain sustainability standards.

Question 6: Should a product need to have an ESG, SRI or similar label in order to be marketed as a sustainability-related product?

EFAMA believes that the marketing of sustainability-related products should not be linked to labels, as the mandatory use of labels would be too restrictive. Therefore, while certain additional disclosure requirements may apply to ESG products, such as those imposed by the SFDR transparency regime, the application of labels (e.g. the EU Ecolabel for retail financial products) should remain strictly voluntary. Furthermore, due to the diverse nature of the green labels across jurisdictions, asset managers might face complications in selling funds with a national label in a jurisdiction that does not recognise the label.

Question 7: Do you agree with the specified areas of investment strategies disclosure?

We agree with the areas suggested. In addition, and as mentioned in response to question 4, what remains crucial for empowering the investors and driving informed decisions is providing them with consistent and accurate disclosures on the products' sustainability parameters. In this context, it is also important to allow for a variety of investment strategies to be used to make a product sustainability-related and ensure asset managers are transparent about the way ESG integration takes place rather than prioritising some strategies over others.

Question 8: Should the disclosures address how past proxy voting and shareholder engagement records align with the investment objectives or characteristics of a sustainability-related product?

Asset managers see shareholder engagement and voting as essential elements of ESG strategies which play an increasingly relevant role in financing transition, especially in actively managed funds.

In principle, for products that do not specifically follow engagement strategies, proxy voting and shareholder engagement disclosures should be done voluntarily. For example, references to the stewardship and/or engagement report issued at the asset manager's level that comprise details of the voting behaviour and votes cast at general meetings should be considered sufficient for products that do not follow engagement strategies. On the other hand, funds that commit to deploying such strategies should report on their application and the attainment of specific goals at the product level.

In the European regulatory context, Article 6 SFDR financial products that do not specifically follow engagement strategies, execute on proxy voting and do not have shareholder engagement, should disclose such information voluntarily.

On the other hand, for Article 8 and 9 financial products, it might be helpful to address in a concise way how Active Ownership activities (engagement and voting) align with the investment objectives or characteristics of a (sustainability-related) financial product.

It is also important to note that both voting policies and engagement strategies are usually pursued at the entity level. For example, in relation to engagement it becomes essential to mention the applicability of the engagement strategy for the product level, ensuring disclosures are aimed at alignment and not into too much detail, making such disclosures overly burdensome for financial products.

Question 9: Should securities regulators and/or policymakers, as applicable, also address the format and presentation of marketing materials and website disclosure for sustainability-related products?

We find the high-level principles on standardisation of disclosure templates as too prescriptive, potentially leading to operational problems and increased costs.

Pre-contractual and periodic templates for financial products require sufficient flexibility to capture ESG considerations in a way that accurately reflects the funds' characteristics, assets and strategies. Asset managers should have sufficient flexibility in choosing the most appropriate presentation formats for their products and investment strategies. To allow for different management techniques and approaches, disclosure requirements should be flexible enough to allow additional information to be shared or cross-referred, if such information is found relevant by the asset manager to explain its approach.

For example, SFDR provides extensive requirements for sustainability-related information to be published under the website disclosures for Art. 8 and Art. 9 products (information on relevant data sources and methodologies, applicable limitations, measures taken to ensure data quality and due diligence process for the underlying assets). In addition, the website disclosures under SFDR shall be accompanied by a summary of a maximum two pages length that needs to be provided in the language of each EU Member State where a fund is being marketed. In our view, there is a risk that this sort of an "ESG KID" will put too much emphasis on the ESG features of a product as compared to its financial investment objectives.

Therefore, marketing communications under regimes such as the SFDR should remain flexible and not contradict the information provided in the sales prospectus, on the website and as part of the annual report according to the regulatory requirements.

Question 10: Should securities regulators and/or policymakers, as applicable, encourage the use of specific metrics or key performance indicators to assess, measure and monitor the sustainability-related product's compliance with its investment objectives and/or characteristics? Should these metrics be subject to self-selection, or should there be a standardised approach?

A high-level guidance concerning the way indicators and metrics will be used to assess and measure the investment objectives and characteristics of a product can help with further consistency. On the other hand, a one-size-fits-all approach for the use of indicators cannot apply given the wide range and diversity of investment objectives, underlying assets and preferences of the investor base.

Metrics used to measure compliance with the sustainability objectives or ESG characteristics of a product must reflect the specific product features and therefore cannot be standardised. Therefore, we would disagree with a set list of indicators or a prescriptive approach as to how indicators can work at the product level. While transparency on the indicators used remains important, the selection of indicators and KPIs relevant for measuring the attainment of the sustainability commitment should remain at the discretion of asset managers who are best-suited to understand the investment strategy.

Question 11: Should periodic reporting include both quantitative and qualitative information about whether a sustainability-related product is meeting its sustainability-related investment objectives and/or characteristics?

Yes. Nonetheless, we caution against introducing too ambitious quantitative reporting requirements in any case. While the development of climate-related metrics is quite advanced and the necessary data is improving, this is certainly not the case for all other sustainability objectives, such as biodiversity or waste prevention. In order not to stifle innovation and to allow for progress in line with the state of the art, both quantitative and qualitative reporting should be possible, provided that the relevant sustainability indicators for measuring the attainment with the ESG characteristics or sustainability objectives of a product are clearly disclosed to investors.

Question 12: Do you agree that securities regulators and/or policymakers, as applicable, should encourage industry participants to coalesce around a set of consistent sustainability-related terms?

Yes, EFAMA would support a joint, coordinated approach in developing shared sustainability terminology and concepts in order to improve the accessibility of ESG investing for retail investors. Common definitions must be adopted at the international level to ensure that key concepts are applied in the same way and therefore help avoid greenwashing and mis-selling to end-investors.

The lack of common sustainability terminology definitions can contribute to greenwashing and a common set of global sustainability-related terms across all regions would help address this issue.

Question 13: Are there any sets of standardised sustainability-related terms being developed by international organisations that should be considered by securities regulators and/or policymakers, as applicable?

The glossary prepared by the UN PRI as part of its reporting framework is a very useful reference point for sustainability-related terms.

Furthermore, the foreseen work of the International Platform on Sustainable Finance (IPSF) on the international alignment of standards for sustainability-related disclosures could be also conducive to the standardisation of relevant definitions. Publication of a report that shall describe commonalities and differences in existing disclosure requirements by the IPSF is expected in October 2021.

Question 14: Do you agree that securities regulators and/or policymakers, as applicable, should promote financial and investor education initiatives relating to sustainability, or, where applicable, enhance existing sustainability-related financial and investor education initiatives?

Yes. Investor education initiatives are essential to improve financial literacy and in the case of ESG products, to empower citizens to contribute to mitigating climate change through their savings. Investors must be able to understand how and to which extent financial products can be helpful for promoting sustainability characteristics or attaining sustainability objectives and what is the likely relationship between the ESG dimension of a product and its risk and reward profile. The absence of basic knowledge of financial and ESG investing concepts and frameworks, such as diversification, the DNSH, Taxonomy or impact investing, may be detrimental to mobilising private investments in reaching net-zero by 2050.

At the same time, ESG information should not overstrain the financial advice process or be given a disproportionate weight in the overall investment advice compared to financial reasons. In this context, financial advisory should be supported in its explanation of different ESG integration approaches to investors. In Europe, such support should be targeted at the operationalisation of the recently introduced clients' sustainability preferences under the MiFID II.

Question 15: Are there any specific sustainability-related financial and investor education initiatives not mentioned in this consultation report that could be considered by securities regulators and/or policymakers, as applicable?

-



About EFAMA

EFAMA, the voice of the European investment management industry, represents 28 member associations, 58 corporate members and 24 associate members. At end Q1 2021, total net assets of European investment funds reached EUR 19.6 trillion. These assets were managed by more than 34,600 UCITS (Undertakings for Collective Investments in Transferable Securities) and almost 29,600 AIFs (Alternative Investment Funds). At the end of 2020, assets managed by European asset managers as investment funds and discretionary mandates amounted to an estimated EUR 27 trillion.

More information is available at www.efama.org.

Contact

Dominik Hatiar

Regulatory Policy Advisor

Dominik.hatiar@efama.org | +32 2 513 39 69 ..