FINANCE FINLAND

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Finance Finland's (FFI) response to the joint ESA consultation on ESG disclosures

Draft regulatory technical standards with regard to the content, methodologies and presentation of disclosures pursuant to Article 2a, Article 4(6) and (7), Article 8(3), Article 9(5), Article 10(2) and Article 11(4) of Regulation (EU) 2019/2088

Question 1: *Do you agree with the approach proposed in Chapter II and Annex I – where the indicators in Table 1 always lead to principal adverse impacts irrespective of the value of the metrics, requiring consistent disclosure, and the indicators in Table 2 and 3 are subject to an "opt-in" regime for disclosure?*

We don't agree with the approach where financial market participants would be required to seek all the information needed to fill the PAI template regardless of which companies/business sectors are represented in their investment portfolios. The approach leads to a lot of unnecessary burden for both companies and financial market participants. Firstly, there is a significant problem in data availability, and secondly, not all of these indicators are relevant to all business sectors.

An example of an indicator which is irrelevant for many business sectors is indicator no. 11, which concerns the company's deforestation strategy. Any investment to a company without a deforestation strategy would look like an adverse impact company, regardless of whether that company actually represents land use sectors.

Some indicators, such as no. 26 on child labour, are subject to individual estimations of what constitutes a "significant risk of incidents to child labour". Company and investor evaluations of this are likely to vary, so we would need a harmonized methodology to define this risk. It would also be important to report discovered child labour violations, not only the risks.

We also think that the proposed RTS goes beyond level 1, which requires financial market participants to disclose "their policies on identification of and prioritization of PAI and indicators". The proposed template model does not allow financial market participants to do their own identification and justification of PAIs, which we think is the level 1 text's purpose.

The result of this template model, if it is chosen in the end, is that companies would be forced to disclose indicators for which they don't have enough verified data. This leads to a situation where reporting doesn't reflect reality but is a vague estimation at best. For example, for data relating to water use, the coverage ratio from companies is now less than 50%. Some data service providers are making assumptions based on average consumption levels of each business sector. Is this allowed when a portfolio company does not disclose that information? This would be misleading. Our members do not want to be forced to report numbers they can't back up with data.

And what to do when part of the portfolio companies disclose the data and part of them don't? Is the regulator's objective that FMPs would not invest in companies that do not report these indicators? If that is the case, it should be carefully considered what the impact is on diversification, which is a key risk management tool and generally considered an important feature in low-risk investment products that are offered to retail clients. If the investment universe for article 8 and 9 products becomes very limited, these products will be riskier, and consequently can be offered to fewer investors. Now, investee companies don't have any obligation to report these indicators. Even if we create such a mandatory framework via NFRD review, the finance sector will still face at least a few years' gap before any new NFRD requirements become effective, and even then the problem of data availability

remains with companies outside the EU. Disclosures requirements should be phased in according to what data is available and when.

The indicators themselves are contradictory. The ESAs have said that these indicators were selected because they always lead to significant adverse impacts. However, especially the social indicators look strange against this reasoning. How is an executive CEO pay ratio a principal adverse impact stemming from an investment? Does the indicator imply that in every company all employees should have the exact same pay, or otherwise it is a serious negative sign of the investment? This does not reflect the reality at all and puts companies in an impossible situation if the goal is to avoid principle adverse impacts.

We strongly advocate for **more qualitative, principles-based and risk-based** indicators. Only indicators which are **relevant to each respective business sector** should be mandatory to report on. This kind of framework is built e.g. by the Sustainability Accounting Standards Board (SASB). Some indicators are relevant to the energy sector, some to the building sector; some are more relevant to the IT services sector or agriculture, etc. The injury rate for employees, for example, is not relevant for a company that is entirely internet-based.

Question 2: Does the approach laid out in Chapter II and Annex I, take sufficiently into account the size, nature, and scale of financial market participants activities and the type of products they make available?

See our answer to Q1 above. The suggested approach seems to favour big asset management companies, especially due to the insufficient availability of ESG data (and especially in terms of indicators) and the cost of acquiring impact indicators. For smaller FMPs, disclosure of the adverse impact is, in principle, on comply-or-explain. However, MiFID II DAs may effectively require any manager who wants to distribute an ESG fund to comply with the adverse impact disclosure, regardless of size.

Question 3: If you do not agree with the approach in Chapter II and Annex I, is there another way to ensure sufficiently comparable disclosure against key indicators?

At this stage, without a reliable ESG reporting framework in place in the EU, the number of mandatory PAIs needs to be reduced. We propose that a few key indicators – such as those on GHG emissions (1–4) for scope 1 and 2, on which data availability is relatively easier – could be made mandatory for reporting, and the others would be voluntary. Ideally, the list should not be exclusive, either, meaning that an FMP could also use other indicator(s) if considered material or more appropriate. FMPs should be requested to disclose what indicators they are focussing on and why they might not be considering certain indicators for certain types of companies. This would be in line with our interpretation of the level 1 text.

Overall, as long as data is not normalized/formatted, which is the aim of the NFRD revision, and as long as there is a weak coverage ratio combined with ambiguity, the ESAs' proposals are likely to result in a lot of very approximative and possibly inaccurate information, which could actually mislead end-investors. Especially with regards to some of the proposed social indicators, we risk having different data providers and investors using slightly different definitions or ones that are open to interpretation.

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

We should keep in mind that the aim of this regulation is to improve the end-investor's possibilities to choose more sustainable investments, and we advocate for the ESAs to conduct a consumer test to see if this proposed reporting model actually helps the retail clients to understand their portfolios better. We worry that the proposed table is too detailed and includes too many indicators for the end investor to understand.

The proposed approach would result in box-ticking compliance and boilerplate disclosures, not in meaningful information to clients. Reporting should serve dialogue and increase understanding about sustainability throughout the investment chain from the investee company to the end investor. The goal should be to help all these parties understand processes, not create a standardized list to disclose against.

We need a materiality assessment and possibilities for clients to differentiate the information according to their personal sustainability preferences, instead of overburdening them with a load of data.

Question 5: Do you agree with the indicators? Would you recommend any other indicators? Do you see merit in including forward-looking indicators such as emission reduction pathways, or scope 4 emissions (saving other companies´ GHG emissions)?

"Principal adverse impact" must include a concept of materiality ("principal") and a notion of "significant harm". Neither of these aspects are reflected in the proposed indicators. They also conflict with the concept of "Do No Significant Harm" as defined by the Technical Expert Group under the Taxonomy, which, as per the Taxonomy amendment, are intended to be linked. Alignment between the different sustainable finance legislations should be a priority.

We would suggest a survey to identify the availability of data for each indicator. This should be based on company disclosures or estimates and the FMPs and end-investors' views on what data is considered useful. Sequencing of the required indicators should follow the reporting that will become effective via taxonomy regulation and the NFRD.

We would like to stress that some of the proposed indicators have limited value:

- Commentary mentions "scope, severity, probability of occurrence and potentially irremediable character on sustainability factors", but none of these are reflected in the actual indicators.
- Some of the proposed indicators are useful as a standard (for instance, existence of social policies) but wouldn't actually be relevant from an adverse impact assessment perspective. **For an asset manager the relevant consideration is not whether a company has a certain policy in place but to understand the way the policy is implemented and how effective it is.**
- The risks of corruption or slavery, for instance, largely depend on the context in which a company operates, including the geographic location and the type of industry. Therefore, **indicators cannot be applied to all companies in the same manner in the way that the RTS propose**. For instance, the absence of a certain policy may not automatically mean adverse impact is caused.

- The outcome of the assessment of some indicators could be misleading and depend on factors which are beyond the investee company's actual practices. For instance, the indicator of "number of convictions and amount of fines for violation of anti-corruption and anti-bribery laws" will also be determined by the robustness of the country's judiciary system and not necessarily only by the company's practices.

- The ESAs have said that these indicators were selected because they always lead to significant adverse impacts. However, especially the social indicators look strange against this reasoning. How is an executive CEO pay ratio a principal adverse impact stemming from an investment? Does the indicator imply that in every company, all employees should have the exact same pay, or otherwise it is a serious negative sign of the investment? This does not reflect the reality at all and puts companies in an impossible situation if the goal is to avoid principle adverse impacts.

- On the contrary, we do see merit in creating harmonized indicators and can support mandatory status for those that report GHG emissions (1–4, for scope 1 and 2). Also, indicator 11 (deforestation policy) is relevant for land use sectors but should not be mandatory for portfolio companies which don't have impacts on forests.

- As for social indicators, indicators 17, 20, 22 and 23 are the most important ones. For indicator 17, investee companies' supplier level would also be important to note.

Question 6: In addition to the proposed indicators on carbon emissions in Annex I, do you see merit in also requesting a) a relative measure of carbon emissions relative to the EU 2030 climate and energy framework target and b) a relative measure of carbon emissions relative to the prevailing carbon price?

Yes, for the purpose of being able to track towards the target of EU 2030.

Question 7: The ESAs saw merit in requiring measurement of both (1) the share of the investments in companies without a particular issue required by the indicator and (2) the share of all companies in the investments without that issue. Do you have any feedback on this proposal?

Out of these options, option 1 would be more relevant. The amount of investments (percentage of NAV) without particular issue could be more relevant to disclose. The share of companies (amount of companies) is not that relevant. However, there are problems in lacking ESG data – please see our answers to Q1 and Q2. During the first years on this regulation entering into force, this information would be based on a low coverage ratio from companies. Requirement for financial market participants to disclose real shares of indicators is too much. It should be possible to disclose this also based on lower coverage ratio of PAIs.

Question 8: Would you see merit in including more advanced indicators or metrics to allow financial market participants to capture activities by investee companies to reduce GHG emissions? If yes, how would such advanced metrics capture adverse impacts?

Given the insufficient availability of ESG data on investee companies, which is necessary for disclosures by FMP against the indicators, it appears premature to mandate the use of more

advanced indicators or metrics. We suggest starting with a few indicators for information that is more widely available (e.g. carbon footprint) and then wait on actual availability of more advanced metrics.

Question 9: Do you agree with the goal of trying to deliver indicators for social and employee matters, respect for human rights, anti-corruption and anti-bribery matters at the same time as the environmental indicators?

We understand that social aspects need to be considered also in PAI assessment, but we recommend keeping the social indicators more limited at this stage compared to environmental indicators. Firstly, we should ensure that social PAI indicators in the SFDR reflect and are aligned with the taxonomy regulation's minimum social safeguards. We haven't started to work on social taxonomy yet, so it would be wise to wait for it before making far-reaching definitions in the SFDR.

Secondly, the compliance timeline is very short while data on social aspects is largely unavailable, so FMPs don't have the means to report very detailed information on social aspects yet.

Question 10: Do you agree with the proposal that financial market participants should provide a historical comparison of principal adverse impact disclosures up to ten years? If not, what timespan would you suggest?

We would like to point out that this goes beyond the Level 1 text as it does not provide any reference to historical indicators. Moreover, absolute historical figures do not provide any information to investors about actual impact of investments. For example, if the carbon footprint of investments decreases but overall AUM increases, disclosed impact will increase year over year.

Possible compromise could be a three-year timeframe for historical comparison. This would better reflect especially the ESG profile of companies in transition. Any changes in key personnel and investment style/process should also be disclosed, as these can have impact. If there have been major changes over the years, historical data may prove irrelevant. We think that historical data from up to ten years is too much also for retail clients, who won't get any additional value from it.

Question 11: Are there any ways to discourage potential "window dressing" techniques in the principal adverse impact reporting? Should the ESAs consider harmonising the methodology and timing of reporting across the reference period, e.g. on what dates the composition of investments must be taken into account? If not, what alternative would you suggest to curtail window dressing techniques?

The timing of reporting could be done yearly at the same time as other reporting, and there should be set reference periods. It is not desirable that some service providers report from Jan-Dec and some from July-June. Basic standards could be used in this regard.

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

Templates could help financial service providers make these reports and disclosures, but these templates should not be mandatory. We hope that these templates do not mean more manual work for service providers. We would prefer electronic templates that automatically acquire information.

Because of the granularity of the information required, e.g. in RTS article 14 (a–g) on pre-contractual information or in article 23 (a–h), presentations will be challenging to define and make in practice.

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

Electronic format (e.g. XBRL files) could be used.

Question 14: If you do not agree with harmonised reporting templates for financial products, please suggest what other approach you would propose that would ensure comparability between products.

SFDR indicates that information on financial products falling under the scope of Article 8 and Article 9 should be located in pre-contractual information as well as on websites, without further specifying the precise scope of each disclosure. The ESAs have set out a proposal for pre-contractual information requirements in Chapter III of the draft RTS, taking into account the differences of the various financial products and the differences between the types of pre-contractual documentation set out in Article 6(3) SFDR. This proposal tries to strike a balance between comprehensiveness and comprehensibility of information. This pre-contractual information is complemented by website information under Chapter IV of the draft RTS. The periodic product disclosure focus on the success of the product in achieving its environmental or social characteristic (or combination thereof) or sustainable investment objective.

Question 15: Do you agree with the balance of information between pre-contractual and website information requirements? Apart from the items listed under Questions 25 and 26, is there anything you would add or subtract from these proposals?

Pre-contractual information is now excessively detailed. We strongly favour the option that most of the sustainability information given to clients about the product could be given on website. The material given to clients pre-contractually is now too detailed without further sustainability information. Too much information to clients is less information understood by clients.

We should learn from our experiences with PRIIPs and avoid creating another reporting framework that is overly complex and fails to give accurate, reliable, and material information to a client.

Question 16: Do you think the differences between Article 8 and Article 9 products are sufficiently well captured by the proposed provisions? If not, please suggest how the disclosures could be further distinguished.

It is not at all clear which products are SFDR Article 8 or Article 9 products and which are other products. This should be made clear to avoid product classification errors by financial service providers. It is unclear which product only “promotes sustainability” or “has sustainable investment as its objective”. What is needed for a financial product to be regarded as Article 8 or Article 9 product? Is it enough that you take out certain companies or investments from the portfolio? How do you need to engage? It is not defined in this RTS at all. It is difficult to classify the ESG funds or other financial products based on disclosure regulation and this draft RTS. If there is no clarification

in this regard, we may see different interpretations in the EU financial markets, and that is not a desirable outcome.

We would also like to point out that the proposed requirement for article 8 products to include the disclaimer "*This product does not have as its objective sustainable investment"* (article 16(1) and article 34(3)) is very counterproductive if the purpose of this regulation is to promote ESG investments. The disclaimer would confuse retail clients, because article 8 products are marketed as promoting environmental and/or social characteristics. To mainstream ESG investments, different kinds of products and investment strategies are needed to serve different needs, and it is not feasible to endeavour to direct customers interested in sustainability only to select article 9 products. We interpret this kind of a disclaimer text to practically downplay article 8 products.

We also need to keep in mind that, depending on the eventual requirements that need to be filled to classify a product as a "sustainable investment", it might not be possible for all market participants to provide these products to the desired extent. The investment universe might not be wide enough for this in the next few years, until sustainable economic activities become more widespread and are scaled up.

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

Regarding indirect investment, we prefer the numeric approach compared to graphical.

Question 18: The draft RTS require in Article 15(2) that for Article 8 products graphical representations illustrate the proportion of investments screened against the environmental or social characteristics of the financial product. However, as 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?

It is ok to use the same graphical representation, but it is important to make good use of the narrative description to explain differences.

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

It might be reasonable to disclose exposure to solid fossil-fuel sectors. The tobacco industry, for example, is also something that investors may use or be interested in at this point. But nuclear energy is not a relevant sector to include here.

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

No, they do not. Multi-option products are products that offer several investment options in a wrapped structure – e.g. insurance-based or unit-linked investment products. The client can choose, for example, which investment funds are taken into the product. In this case, the situation can be that only some of the underlying funds may be Article 8 or Article 9 funds, and majority of the investments

in insurance-based investment can be other mainstream investments without any specific sustainability reporting. In this case it should be possible only to report on the level of each Article 8 or 9 investment fund. There might not be enough data or relevancy to report on the insurance-based product level relating to these sustainability disclosures. This insurance-based product can be one part of portfolio management of that client and there is the same multi-layered reporting problem present on what to choose (three layers of reporting): Investment Fund > Insurance-based investment > Client's whole portfolio (including e.g. insurance-based-investments, direct investments to funds and direct investment to equities, bonds and structured products).

Question 21: While Article 8 SFDR suggests investee companies should have "good governance practices", Article 2(17) SFDR includes specific details for good governance practices for sustainable investment investee companies including "sound management structures, employee relations, remuneration of staff and tax compliance". Should the requirements in the RTS for good governance practices for Article 8 products also capture these elements, bearing in mind Article 8 products may not be undertaking sustainable investments?

Good governance is not sufficiently detailed in the RTS. Based on draft RTS we cannot define what is good governance and what is not. The definition of good governance should be aligned with the taxonomy regulation and other EU legislation.

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

As the taxonomy criteria, which will establish also the "do not significantly harm" criteria, is still at a very early stage, it is difficult to use it as a criteria for sustainable investments. How should companies that offer sustainable investment products according to article 9 interpret and comply with the "do not significantly harm" criteria in practice? Is the evaluation of "significant harm" left to financial companies themselves?

There are also two different kinds of definitions of "significant harm", one in the taxonomy regulation, which refers to the environmental objectives of article 9 in the mentioned regulation, and the one in the disclosures regulation's article 2(17), which relates "significant harm" to a different set of sustainability objectives.

Question 23: Do you see merit in the ESAs defining widely used ESG investment strategies (such as best-in-class, best-in-universe, exclusions, etc.) and giving financial market participants an opportunity to disclose the use of such strategies, where relevant? If yes, how would you define such widely used strategies?

Sustainable finance is in a fast development stage, and companies are innovating and trying new strategies and tools to do it. We are cautious of the idea of defining different investment strategies at this point because it would eventually also limit the possibilities for companies to innovate. We don't see the need for strict definitions. Instead, financial companies should be transparent about their ways of doing sustainable finance.

Question 24: Do you agree with the approach on the disclosure of financial products' top investments in periodic disclosures as currently set out in Articles 39 and 46 of the draft RTS?

It is a good practice to disclose the top investments or investee companies of e.g. a UCITS or AIF sustainable investment fund. However, the amount of 25 might be too high. The appropriate amount could be e.g. 10–15 top investments. It is not always desirable for a fund manager to openly disclose all or even a big part of the fund's portfolio.

This has an impact also on multi-option products as insurance-based investments. In those investments, however, the client usually knows and decides which underlying investments are taken under that insurance, and this is not an issue. This could apply also to derivatives and structured products, which are totally different in this regard. It seems like the articles 39 and 46 are considered to be and would be applicable only for investment funds.

As highlighted in the background section above, the ESAs believe that finding the balance between pre-contractual and website disclosure is challenging given the different types of disclosure documents in Article 6(3) of Regulation (EU) 2019/2088. Therefore, specific feedback is sought from stakeholders in this regard.

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

a) an indication of any commitment of a minimum reduction rate of the investments (sometimes referred to as the "investable universe") considered prior to the application of the investment strategy – in the draft RTS below it is in the pre-contractual disclosure Articles 17(b) and 26(b);

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 disclosures under Article 17.

All this information from (a) to (d) should be disclosed on webpages and not in pre-contractual information. The amount and detail of information given to clients pre-contractually is too high. We strongly propose that most of the information given to clients about sustainability could be given on website. Too much information to clients is less information understood by clients: the amount of information relating to sustainable finance disclosures is way too much for any client to really understand the detailed content.

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

We do not see a point to defining separately how the use of derivatives meets each of the environmental or social characteristics or sustainable investment objectives promoted by the financial product. In investment funds, derivatives are mainly used to e.g. hedge against interest rate or currency changes. These should not be reported in relation to sustainability at all. If the product is an AIF or a structured product and is based on an underlying derivative (e.g. an oil derivative), then this could make sense. In most cases it does not, however, because of the way investment funds utilise derivatives.

The ESAs have provided preliminary impact assessments for the empowerments in SFDR. Given the short time available for consideration of the empowerment in the not yet published Taxonomy Regulation, it has not been possible to provide a preliminary impact assessment on the empowerment related to “do not significantly harm”.

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

We can see lots of costs in the implementation of this regulation and the RTSs to financial markets participants. FMPs need to review their documentation thoroughly to include new information to their product reporting. Furthermore, FMPs need more data from ESG data providers to comply with these new rules and more ESG data analysts to cover this complex data. The more detailed the rules are, the more costly it will be.

Data costs are the biggest cost impact to FMPs, and their effect depends on how detailed reporting is required from the FMPs in the end. These costs also impact smaller companies relatively more. We also anticipate that companies will need significant employee resources to adjust processes and train their personnel.

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