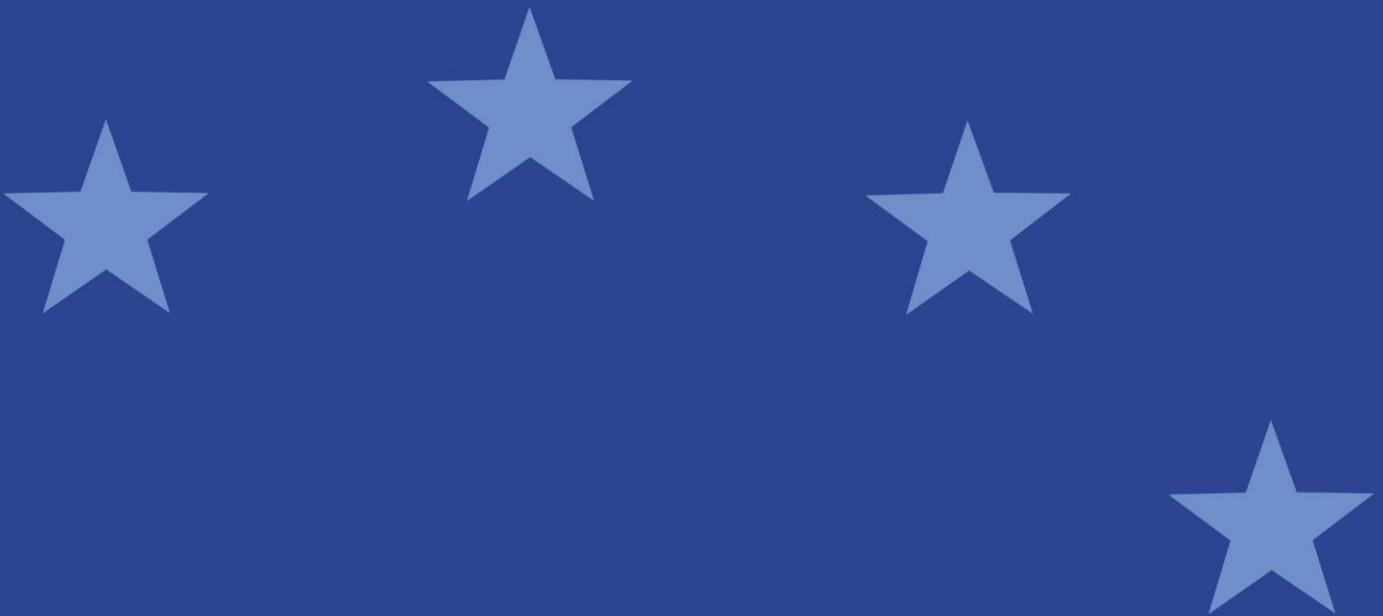


Response form for the Joint Consultation Paper concerning ESG disclosures





Responding to this paper

The European Supervisory Authorities (ESAs) invite comments on all matters in this consultation paper on ESG disclosures under Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial sector (hereinafter “SFDR”) and in particular on the specific questions summarised in Section 3 of the consultation paper under “Questions to stakeholders”.

Comments are most helpful if they:

1. contain a clear rationale; and
2. describe any alternatives the ESAs should consider.

When describing alternative approaches the ESAs encourage stakeholders to consider how the approach would achieve the aims of SFDR.

Instructions

In order to facilitate analysis of responses to the Consultation Paper, respondents are requested to follow the below steps when preparing and submitting their response:

- Q1** Insert your responses to the questions in the Consultation Paper in the present response form.
- Q2** Please do not remove tags of the type <ESA_QUESTION_ESG_1>. Your response to each question has to be framed by the two tags corresponding to the question.
- Q3** If you do not wish to respond to a given question, please do not delete it but simply leave the text “TYPE YOUR TEXT HERE” between the tags.
- Q4** When you have drafted your response, name your response form according to the following convention: ESA_ESG_nameofrespondent_RESPONSEFORM. For example, for a respondent named ABCD, the response form would be entitled ESA_ESG_ABCD_RESPONSEFORM.
- Q5** The consultation paper is available on the websites of the three ESAs and the Joint Committee. Comments on this consultation paper can be sent using the response form, via the [ESMA website](#) under the heading ‘Your input - Consultations’ by **1 September 2020**.
- Q6** Contributions not provided in the template for comments, or after the deadline will not be processed.

Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise in the respective field in the template for comments. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESAs rules on public access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESAs Board of Appeal and the European Ombudsman.

Data protection

The protection of individuals with regard to the processing of personal data by the ESAs is based on Regulation (EU) 2018/1725¹. Further information on data protection can be found under the [Legal notice](#) section of the EBA website and under the [Legal notice](#) section of the EIOPA website and under the [Legal notice](#) section of the ESMA website.

¹ Regulation (EU) 2018/1725 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 23 October 2018 on the protection of natural persons with regard to the processing of personal data by the Union institutions, bodies, offices and agencies and on the free movement of such data, and repealing Regulation (EC) No 45/2001 and Decision No 1247/2002/EC, OJ L 295, 21.11.2018, p. 39.

General information about respondent

Name of the company / organisation	Morningstar
Activity	Other Financial service providers
Are you representing an association?	<input type="checkbox"/>
Country/Region	International

Introduction

Please make your introductory comments below, if any:

<ESA_COMMENT_ESG_1>

Morningstar and Sustainalytics welcome the opportunity to comment on the consultation concerning ESG disclosures. Morningstar's mission is to help investors reach their financial goals. Because we offer an extensive line of products for individual investors, professional financial advisors, and institutional clients, we bring several perspectives in this response. First, we have a track record of categorizing and rating mutual funds that pursue different sustainability strategies. Second, our equity analysts use environmental, social, and governance (or ESG) analysis as part of their approach to assessing investments. Third, for more than five years Morningstar has partnered with Sustainalytics, a leading provider of ESG ratings and data, and used that data in the analysis of issuers and investment funds. <ESA_COMMENT_ESG_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??**

<ESA_QUESTION_ESG_1>

We agree with the principle of a mandatory set of disclosures, supplemented with further self-elected disclosures that are directly relevant to the aims of a financial market participant and its financial products.

However, it is not clear to us what criteria have been used in selecting the proposed mandatory items in table 1, versus the voluntary items in tables 2 and 3, or indeed, the value of requiring one indicator to be elected from tables 2 and 3. It seems likely that at a minimum, products with similar objectives will choose different indicators, limiting comparability for investors, and further, allow the election of indicators where a product has the least adverse impact. It is also not clear that the metrics always lead to adverse impacts regardless of their value. Considering the social indicators in particular, a positive value does not necessarily indicate an adverse impact, for example indicator 19 (CEO pay ratio) and 20 (board gender diversity).

We are conducting ongoing detailed analysis of each of the proposed indicators and will be happy to engage in further discussion with the ESAs and share further views.

Our recommendation is to focus on a limited set of mandatory (negative impact) indicators. This facilitates comparability. While some indicators may not be relevant for certain investments, this should then be up to the fund manager to explain and provide context. Providing room to leave out reporting on certain indicators in certain circumstances, introduces complexity and may be gamed.

<ESA_QUESTION_ESG_1>

- **: 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?**

<ESA_QUESTION_ESG_2>

We have concerns that the approach blends too much together and will not enable investors to discern which factors are material by product. Additionally, a firm whose business comprises a significant amount of private mandates will not be directly comparable to a firm that largely defines and manages its own products.

<ESA_QUESTION_ESG_2>

- **: 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?**

<ESA_QUESTION_ESG_3>

In our view a better balance is needed between meaningful indicators and practicality, in terms of data availability. For many of the proposed indicators there is currently no or very scarce data available, and while this can reasonably be expected to improve over time it will limit the quality and comparability of reporting in the nearer term. For example, we question the value of having 8 distinct indicators that capture some form of climate impact and would advocate for a few very central metrics e.g. Scope 1,2 and 3 emissions.

The disclosure requirements should also align more with existing disclosure requirements for corporations or current corporate disclosure best-practice (e.g. as reflected by SASB, GRI, CDP).

<ESA_QUESTION_ESG_3>

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

<ESA_QUESTION_ESG_4>

We are very supportive of the standard template approach and would just caution that it should be kept under regular review to ensure that it continues to reflect the most useful indicators as markets develop over time.

<ESA_QUESTION_ESG_4>

- : **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)?**

<ESA_QUESTION_ESG_5>

An increasing focus on forward-looking metrics is to be welcomed, but is highly dependent on issuer disclosures. Work to align and standardize the Non-Financial Reporting obligations is important in this regard.

We don't fully understand the selection process for the proposed metrics. They appear to be a blend of input indicators (e.g. energy consumption), output indicators (e.g. hazardous waste produced), and management indicators (many on the social side), where one could argue that neither input nor output nor management indicators are complete. Also, it is important to note that not all indicators are relevant or material for all companies, or all products. Further, current corporate reporting on scope 3 carbon emissions is scarce and unreliable, often leading to data that is not meaningful – adding scope 4 would only worsen that.

In summary, our recommendation is as follows:

- Focus on a few but important indicators
- Select and define indicators to align closely with existing reporting best practice and for which disclosure is relatively consistent and comparable
- Include benchmark figures which allows users to put figures in context. In isolation, most of the figures will not mean anything to an investor.

<ESA_QUESTION_ESG_5>

- : **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?**

<ESA_QUESTION_ESG_6>

As stated above, we think there are already too many and overlapping carbon indicators in the proposal. That said, proposal a) is attractive because the metric illustrates how far a company is away from where it needs to go. In contrast, all of the other proposed indicators do not lend themselves to easy interpretation whether a certain performance is "good" or "bad". However, without a clear methodology and a consistent approach of defining company level targets that align with EU 2030 targets this is not a good idea and could significantly add to the reporting burden and cost of financial market participants.

<ESA_QUESTION_ESG_6>

- : **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?**

<ESA_QUESTION_ESG_7>

As above, we would continue to advocate for simplicity and focus only on option (1) – there is limited to no value in knowing that 10% of companies are “involved” when their share in the portfolio is 1%.

An aspect that would benefit from further clarification is the reference to ‘companies’. Many financial products will also be holding securities in other forms – derivatives, short positions, bonds and other funds – so does the measurement requirement only apply to the holdings in company shares?

If not, guidance on how the measurement of other securities should be undertaken. For example,

1. In the case of a corporate bond, should metrics be based upon the corporate entity level data or on analysis of the bonds’ use of proceeds statement?
2. In the case of investment in another fund, is look-through to the underlying portfolio required - if so, would that be needed throughout the reference period, effectively requiring the underlying fund to disclose its holdings on a daily basis?
3. If advisors who offer a ‘model portfolio’ solutions (under a discretionary portfolio mandate) are required to look through to the holdings of each fund, every time a position in that model portfolio changed would likely incur significant complexity and additional costs that would potentially be passed on to the end investor.
4. Without guidance on how to treat short positions and derivatives positions in the calculations, market participants will likely utilise different methodologies reducing comparability.

<ESA_QUESTION_ESG_7>

- : **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?**

<ESA_QUESTION_ESG_8>

We can see some merit in including these metrics but only once they have been included in relevant ESG best practice reporting frameworks.

<ESA_QUESTION_ESG_8>

- : **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?**

<ESA_QUESTION_ESG_9>

We agree it is helpful to address these indicators at the same time, so that firms can prepare for them, and investors will see them, concurrently.

<ESA_QUESTION_ESG_9>

- : **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?**

<ESA_QUESTION_ESG_10>

In light of the evolving nature of many metrics (and the availability thereof), their consistency (or lack of) over time may either render them incomparable or require costly historical re-adjustment for minimal value.

From the perspective of investors, it is easy to become overloaded with data and find it difficult to identify the most useful information. Coupling this with patchy and incomplete data will make such disclosures even more difficult to interpret and compare. Further, the requisite information will be available in each annual report over the period and therefore accessible to those investors who want to make historic comparisons.

For these reasons, our recommendation is to begin with three years historic disclosure, of as complete and material metrics as practical and/ or to allow the historic data to be presented graphically, making it easier to identify trends.

<ESA_QUESTION_ESG_10>

- **: 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?**

<ESA_QUESTION_ESG_11>

Our reading of the proposed rules was that FMPs will need to disclose the measures referred to in Annex I tables 1, 2 and 3 for a given reference period (normally a calendar year) which would limit the scope for ‘window dressing’. However, clarity on the reporting requirement will maximise comparability and minimize ‘window dressing’. For example, basing the reporting on average holdings over the period or the averages of the four end of quarter figures would make window-dressing more difficult than being based on positions at the end of the reference period.

<ESA_QUESTION_ESG_11>

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

<ESA_QUESTION_ESG_12>

Yes, we are fully supportive of the approach to have mandatory templates because it will put peer products on a level-playing field regarding the information that they make available to investors.

<ESA_QUESTION_ESG_12>

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

<ESA_QUESTION_ESG_13>

We would envisage a standardized list of indicators that would serve as a way of profiling products. The indicators should be meaningful to and understandable by investors and in machine readable format to aid deeper analysis. The onus would be on products to justify why some indicators “are not relevant”.

<ESA_QUESTION_ESG_13>

- **: 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.**

<ESA_QUESTION_ESG_14>

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<ESA_QUESTION_ESG_14>

- **: 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?**

<ESA_QUESTION_ESG_15>

We agree with the objective of keeping the pre-contractual information concise and applicable, with signposting to further information on the website. However, it is not clear about how certain products, like fund of funds or those running model portfolios such as discretionary fund managers, will be able to practically control or access the data to report on, some of the disclosures. For example, the planned percentage in sustainable investments or the actual proportions invested in different sectors will be challenging if it is to reflect the experience over a reference period, as will the planned percentage in sustainable investments in cases where a range of financial products are used as the underlying investments.

<ESA_QUESTION_ESG_15>

- : **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.**

<ESA_QUESTION_ESG_16>

We think that the definitions of Article 8 and 9 products need further clarity, particularly in terms of clarifying what is meant by 'promote'. Our assumption is that 'promote' is analogous to making or marketing claims to have environmental or social characteristics in any product literature, including unregulated documents.

It is unclear what criteria should be used to assess whether a product is an Article 9 product and how this may differ from a fund that has an 'environmental or social' characteristic. It is further clouded by the reference to 'guarantee' in Recital 6 of the draft amendments to Delegated Regulation (EU) 2017/565 as regards the integration of sustainability factors, risks and preferences into certain organisational requirements and operating conditions for investment firms – *'To enable clients to better understand those products, investment firms that provide investment advice and portfolio management services should clearly explain the distinction between financial products that promote environmental or social characteristics and financial products that pursue sustainable investment objectives. Whilst financial products that pursue sustainable investment objectives **guarantee** the attainment of certain level of sustainability, financial products that promote environmental or social characteristics do not necessarily achieve that.*

Both the industry and investors would benefit from clarity and consistency in the way that this important demarcation between different product types is determined. This should include clarification that in the case of a product meeting the criteria for both Article 8 and Article 9 it would be considered an Article 9 product only and would disclose under those rules only and not additionally have to fulfil Article 8 requirements.

<ESA_QUESTION_ESG_16>

- : **Do the graphical and narrative descriptions of investment proportions capture indirect investments sufficiently?**

<ESA_QUESTION_ESG_17>

We think that more guidance is needed on the definition of indirect investments and whether that includes bonds, fund of funds and derivatives. Shorting is a broader topic where more guidance would also be helpful, for example, whether the practice would infer any credits for the emissions of companies that have been shorted by an FMP.

<ESA_QUESTION_ESG_17>

- : **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?**

<ESA_QUESTION_ESG_18>

As referenced in previous answers, we favour uniformity. Given the potential different characteristics across products, potentially the graphical representation could usefully be supplemented by a check-list of environmental characteristics to provide easily accessible further drilldown about the specific areas of focus of a product.

<ESA_QUESTION_ESG_18>

- : **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?**

<ESA_QUESTION_ESG_19>

In principle we agree with disclosing exposure to fossil-fuel sectors although it is not clear why it is confined to 'solid' fossil fuels. It can also be asked why fossil fuel exposure is deemed more important than other environmental issues, such as deforestation, or social characteristics, for example, child labour but we agree that with climate being such a key topic it is tangible information for any investor interested in climate and easy to collect.

<ESA_QUESTION_ESG_19>

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

<ESA_QUESTION_ESG_20>

We refer to our answer to Q15.

<ESA_QUESTION_ESG_20>

- : **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?**

<ESA_QUESTION_ESG_21>

We do not see a justification for differentiating between Article 8 and 9 products, given that Article 8 products may also have sustainable investments, and sometimes a significant proportion thereof.

<ESA_QUESTION_ESG_21>

- : **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?**

<ESA_QUESTION_ESG_22>

We think more clarity is needed in this area. Firstly, whether the PAI indicators are designed to be akin to the Taxonomy DNSH criteria in respect of environmental objectives and how DNSH should be considered for the social objectives listed in art 2(17) of SFDR. Further, if a product only has an Environmental OR a Social objective whether an investee company does no significant harm to both environmental and social objectives.

Secondly, the wording of article 16(2) appears circular and could be more clearly worded ('how the sustainable investment does not significantly harm the sustainable investment objective'). It also appears to

contradict the statement in 16(1) which compels the product to state 'this product does not have as its objective sustainable investment' but then has to describe how that non-existent sustainable objective is not harmed. We would recommend it be explicitly stated that for Article 8 products the DNSH criteria only apply to the part of the portfolio that has sustainable investments.

The provision for products to disclose 'how the indicators for adverse impacts in Annex I are taken into account' is also not sufficiently clear. Firstly, with regard to whether products can disclose that they only take into account some (or none) of the adverse impact indicators or if every Article 8 and 9 fund has to develop a policy for each of the indicators. Secondly, it is unclear whether, when products have to disclose how the impacts are taken into account, a textual statement is sufficient or if that has to be supplemented with calculated values for any of the indicators.

<ESA_QUESTION_ESG_22>

- : **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?**

<ESA_QUESTION_ESG_23>

We are conscious of multiple phrases, and definitions thereof. Standardised definitions for the purpose of communication to investors as well as efficient and consistent compliance with regulation would be beneficial. We would advocate coalescing around existing standards on responsible investment strategies, such as those defined by the UNPRI, for example [here](#). We would also point to the recently issued CFA consultation as another piece of work to be considered in reaching one harmonized set of terms and definitions without perpetuating multiple different sets of standards. Other more local and focused example of other frameworks to potentially reference are the ESG investment strategies of Febelfin or the UK Investment Association Responsible Investment Framework.

<ESA_QUESTION_ESG_23>

- : **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?**

<ESA_QUESTION_ESG_24>

The purpose of these disclosures is not clear to us and therefore makes the question difficult to answer. The articles specifically reference providing only the sector and location of each holding without any other data related to each holding to provide further context. Location particularly is of minimal value given the international nature of many businesses. Arguably, the full sector and geographic breakdown of a products' portfolio is more useful information for investors.

The requirements should also be considered against existing UCITS disclosure requirements about portfolio constituents in annual reports. While the proposals are to identify the top holdings over the reference period, rather than at a point in time, this different set of disclosure requirements are perhaps better dealt with by amending the UCITS disclosures to provide the full set of data in one place for investors.

<ESA_QUESTION_ESG_24>

- : **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.**
1. **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);**

2. 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);
3. 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
4. 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.

<ESA_QUESTION_ESG_25>

a. Pre-contractual – it is a specific aim and important to highlight to investors: b. website – most investors are probably unlikely to read so save the valuable space, especially for insurance and pension products key information documents : c. website : d. website

<ESA_QUESTION_ESG_25>

- : 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)?

<ESA_QUESTION_ESG_26>

Continuing our preference for simplicity we would advocate for the information being shown together in one place.

<ESA_QUESTION_ESG_26>

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

<ESA_QUESTION_ESG_27>

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<ESA_QUESTION_ESG_27>