Frankfurt,
13 August 2021

BVI response to the IOSCO consultation on sustainability-related practices, policies, procedures and disclosure in asset management (CR01/21)

BVI[1] and its members are committed to the goals of the EU Action Plan on facilitating sustainable growth, i.e. to shifting capital flows in order to accelerate transition to a more sustainable economy. The market for sustainable funds in Germany has experienced fulminant growth and nearly doubled in size during six months until the end of Q1 2021. Funds that are classified as sustainable account now for EUR 254 trillion of assets under management; this positive development is driven to a large extent by net inflows in retail funds.

Against this background, we welcome the opportunity to comment on the IOSCO consultation in relation to ESG practices, policies and disclosures and their potential alignment at the global level. Indeed, in view of the rapidly growing investors' interest in ESG products, there is indisputably a practical need for internationally valid guidance on these matters. Nonetheless, from the EU perspective, we must point out that there is an unprecedented wave of regulations underway that relates to many different aspects of sustainable finance. The regulatory standards for ESG disclosures at both entity and product level just entered into force on 10 March 2021 under the SFDR framework. While implementation of SFDR has been principle-based at the first stage, it will entail regulatory technical standards that will prescribe details of the content and presentation of ESG information. Those standards still need to be supplemented by disclosure requirements in relation to the EU Taxonomy framework that will introduce common criteria for sustainable economic activities. It is expected that a combined set of disclosure requirements under SFDR and EU Taxonomy will become mandatory by 1 July 2022. Sustainability-related rules are also being developed under other pieces of EU law, such as the UCITS and AIFM Directives that will introduce the obligation to integrate sustainability risk and in parts also principal adverse impacts in the investment due diligence, risk management and the internal organisation of asset managers. In addition, sustainability issues in terms of distribution are covered by MiFID II and IDD that provide for a regulatory understanding of sustainability preferences of clients.

In light of this rapid progress in the area of sustainable finance in Europe, we would welcome if equivalent and as far as possible consistent standards were introduced also in other jurisdictions in order to warrant investor protection and to facilitate operations of globally active asset managers. In this regard, the initiatives undertaken so far at the EU level could work as possible models for international ESG standards to be developed by IOSCO, potentially by using a building block approach in order to match the level of development of sustainable investing in the relevant markets.

[1] BVI represents the interests of the German fund industry at national and international level. The association promotes sensible regulation of the fund business as well as fair competition vis-à-vis policy makers and regulators. Asset Managers act as trustees in the sole interest of the investor and are subject to strict regulation. Funds match funding investors and the capital demands of companies and governments, thus fulfilling an important macro-economic function. BVI's 116 members manage assets some EUR 4 trillion for retail investors, insurance companies, pension and retirement schemes, banks, churches and foundations. With a share of 27%, Germany represents the largest fund market in the EU. BVI's ID number in the EU Transparency Register is 96816064173-47. For more information, please visit www.bvi.de/en.

BVI
Bundesverband Investment und Asset Management e.V.

Contact
Phone +49 69 15 40 90 0
www.bvi.de

BVI Berlin
Unter den Linden 42
10117 Berlin

BVI Brussels
Rue du Trône 14–16
1000 Bruxelles

BVI Frankfurt
Bockenheimer Anlage 15
60322 Frankfurt am Main

Executive Board
Thomas Richter CEO
Rudolf Siebel MD

We would also like to point to the announcement by the International Platform on Sustainable Finance (IPSF)[2] to work on international alignment of standards for sustainability-related disclosures. In its preliminary workplan for 2021, the IPSF notes that there are still significant gaps in the quality and comparability of information disclosed to meet the needs of investors. In this light, the IPSF has set up a working group, co-chaired by the EU, Japan and Switzerland, that shall facilitate the exchange of views on national and international policy and regulatory developments regarding sustainability-related reporting, with the aim of supporting the further alignment of disclosure requirements across IPSF member jurisdictions. A public report that shall describe commonalities and differences in existing disclosure requirements has been announced for October 2021. **For the sake of effective regulatory convergence, it would be very helpful for IOSCO to coordinate further regulatory initiatives at international level having regard to the outcomes of the IPSF report and in close collaboration with the IPSF where possible.**

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?*

The expectations upon sustainability-related practices, policies, procedures and disclosures by investors, supervisory and the wider public are manyfold and rapidly growing. Our impression is, however, that stakeholders often raise claims for greenwashing if a specific approach or product does not meet their specific idea of sustainability. We agree with IOSCO that in order to bring the debate to an issue-oriented level, greenwashing should refer to practices of misrepresenting sustainability-related practices or outcomes, either at the asset manager or product level.

Given the fact that there is no universal sustainability concept so far, it is essential to enhance transparency about the relevant ESG commitments and deliverables, and to do so in a comparable and comprehensible manner. The EU framework on sustainability related disclosures (SFRD) that entered into force in March 2021 follows this approach and requires a common set of disclosures relating to the treatment of sustainability risk at the entity level as well as potential consideration of principal adverse impacts of investment decisions (PAIs). With regard to the latter, it is planned to introduce an obligation for a standardised PAI statement to be mandatory for large asset managers (with more than 500 employees) and applicable to smaller asset managers on a “comply or explain” basis. This standardised statement shall comprise disclosure of specific quantitative indicators on a number of ESG issues relating to GHG emissions, water, waste and biodiversity as well as social issues and human rights. The PAI statement is also meant to include a description of actions undertaken or planned by the asset manager to avoid or reduce the identified PAIs.

At the product level, the SFDR introduces detailed descriptions of ESG strategies, objectives and attainments for individual products. In particular, it is planned to introduce standardised templates for disclosure of ESG information that shall be included as annexes to the sales prospectuses and annual reports. Such standardised annexes will allow investors to easily locate the relevant information and to compare details of e.g. elements of ESG strategy, potential sustainable objectives, planned and actual asset allocation, sustainability indicators used to measure the ESG performance etc.

[2] https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/international-platform-sustainable-finance_en

In light of this rapid progress in the area of ESG disclosures in Europe, we would welcome if equivalent and as far as possible consistent standards were introduced also in other jurisdictions in order to warrant investor protection and to facilitate operations of globally active asset managers. In this regard, the initiatives undertaken so far at the EU level could work as possible models for international ESG standards to be developed by IOSCO, potentially by using a building block approach in order to match the level of development of sustainable investing in the relevant markets.

The EU is currently working very intensively on developing a **sustainable Taxonomy for classification of sustainable economic activities**. Some other jurisdiction are also determined to undertake similar initiatives and the IPSF is analysing the progress made so far in order to lay the foundations for a Common Ground Taxonomy that shall display the commonalities between the frameworks existing so far and provide a reference point for international investors. This work will provide an important basis for developing a common classification tool for green and sustainable investments. With products starting to disclose their commitments towards the Taxonomy and their actual share of Taxonomy-aligned investments, as foreseen in the EU, the quality of sustainability-related information and comparability of sustainable investment concepts for investors should further improve.

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

We agree with using the TCFD framework as the basis for disclosures of sustainability-related risks at the entity level. It is important to bear in mind, however, that in the sphere of asset management, sustainability risk derives primarily from the exposures to assets in the managed portfolios. **The focus of sustainability risk management should be therefore at the product level** and closely intertwined with the investment strategy as well as metrics and targets agreed with investors.

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?*

In the European market, all fund and asset managers are required to take into account sustainability-related risks in their investment process and need to provide information on the relevant internal procedures both on their websites and in the sales prospectuses for individual funds. Therefore, systematic integration of ESG risks and opportunities can already be considered a relevant market standard in the EU.

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?*

In Europe the SFDR framework distinguishes between products that promote environmental or social characteristics (so-called Art. 8 products) and those having sustainable investments as their objective (so-called Art. 9 products). However, the distinction between these two categories of ESG products becomes somehow blurred due to the implementing regulations that introduce elements of sustainable investments also in Art. 8 products and the lack of clear guidance from regulators.

In an ideal world, products with sustainable investment objectives should aim at achieving measurable sustainability contribution that should be regularly reported to investors by way of quantitative and qualitative metrics. Moreover, such products should be committed to invest the predominant part of the portfolio, i.e. more than 50 percent, in line with sustainability objectives on a continuous basis. In contrast, products with environmental or social characteristics should encompass funds that incorporate ESG factors in their investment process in particular by selecting investments based on certain environmental or social considerations, applying exclusion filters and/or engagement strategies in order to improve the ESG performance of investee companies. Obviously, such products can also define sustainable investment objectives and report on their attainment, albeit at a lower level.

Against this background, we do not see many differences in the disclosure requirements relevant for both product categories. Indeed, under SFDR the disclosure standards for Art. 8 and 9 products are very similar and differ only in respect of sustainable investment objectives that are required to be specified in the pre-contractual documents for Art. 9 products and used as the basis for regular reporting on the “overall sustainability impacts”. With regard to Art. 8 products, information on the attainment of sustainable objectives is optional and pertains only to a subset of such products that make a commitment for partial sustainable investments.

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

The SFDR framework does not include a naming convention which leads to some uncertainty in practice. The following observations should be key in this regard:

- **There is currently no clear market practice for distinguishing the terms “sustainable”, “responsible”, “ESG” or “SRI”.** All these terms are being used in an equivalent manner and often depend on the marketing preferences in certain markets or regions.
- **The use of such terms should be understood as marking 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.
- **Naming of a fund as sustainable, ESG or similar should not necessarily imply any specific level of ambition in ESG terms.** Given the currently different levels of development and diverging expectations of investors, we believe that such naming should be associated with the general idea of commitment to sustainability as part of the investments strategy as explained above. Further details of the sustainability objectives and the criteria/strategies used for their attainment and relevant at the fund level should be explained to investors as part of the pre-contractual and periodic disclosures in line with the principle “do what you say and say what you do”.
- Investors and distributors seeking more guidance on sustainability can refer to relevant ESG product labels that ensure compliance with certain sustainability standards (cf. our reply to Q6 below).

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

Definitely not. The use of ESG, SRI or similar labels is only one way of demonstrating compliance with certain sustainability standards. Other possibilities include minimum regulatory requirements in terms of ESG ambition as recently announced by the EU Commission with regard to Art. 8 products under SFDR or industry standards for products that are offered as sustainability-related at the point of sale. In Germany, the industry associations representing distributors, fund manufacturers and issuers of structured products are just in the process of agreeing on a common target market concept for sustainable products that includes common quality standards such as minimum exclusions that go beyond the current regulatory requirements.

In the end, reference to labels is only a symptom of the lacking guidance as regards the understanding of sustainable investments and products. The progressing development of the sustainable Taxonomy in the EU and similar initiatives in other jurisdictions will certainly help in closing this gap and providing objective reference points for investors and distributors (cf. our reply to Q1).

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

We agree. In light of the current developments at the EU level, it might be worth emphasising that investors need to be specifically informed about the binding elements of the investment strategy used to select investments in accordance with certain ESG characteristics. In addition, in case not all funds are allocated in accordance with the ESG strategy, investors might find it useful to receive information about the purpose of this “remainder of investment” (e.g. liquidity buffer, risk hedging etc.) and whether certain minimum ESG safeguards apply in this regard.

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?*

Shareholder engagement and voting are definitely important elements of ESG strategies especially in actively-managed funds and play an increasingly relevant role in financing transition. In our view, funds that commit to ESG engagement as part of their sustainable investment strategy should report on its application and attainment of specific goals at the product level. In other instances, 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.

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?*

The SFDR provides extensive requirements for sustainability-related information to be published as part of the website disclosures for Art. 8 and Art. 9 products. These comprise in addition to the information on investment objectives and strategy also description of 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 and the risk and reward profile.

Marketing communications under SFDR must not contradict the information provided in the sales prospectus, on the website and as part of the annual report according to the regulatory requirements. In our view, this represents a commensurate approach.

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?*

Metrics to measure compliance with the sustainability objectives or ESG characteristics of a product must reflect the specific product features and therefore cannot be standardised. For instance, if a product follows a broad ESG strategy and selects investments by applying an ESG scoring "best in class" approach with reference to multiple environmental, social and governance factors, reporting on specific standardised KPIs e.g. for carbon intensity or energy performance would be of little value for investors. Fund providers should be able to determine a set of KPIs that are relevant for measuring the attainment of the sustainability commitment at the product level.

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?*

We would caution against being too ambitious and requiring quantitative reporting in any case. While the development of climate-related metrics is quite advanced and the necessary data already widely available, this is certainly not true for all sustainability aspects such as e.g. 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?*

While increasing consistency is helpful in any case, we believe that the understanding of sustainability-related terms has already converged in the recent years. In summer 2020 the CFA Institute consulted on a common set of ESG disclosure standards and as part of the consultation made the effort for defining most commonly used ESG terms based on a review of work published by national industry associations or bodies.[3] The definitions relate to terms such as "ESG integration", "best-in-class", "ESG-related exclusions" or "impact objective" and correspond with the general understanding in the market.

There are certainly areas where agreeing on a common understanding is still difficult, e.g. in term of what constitutes impact investing from the strategy perspective. However, in view of the current market

[3] Cf. Consultation Paper on the Development of the CFA Institute ESG Disclosure Standards for Investment Products from August 2020, page 12 to 23.

.BVI

dynamics, we believe that clearer concepts will soon evolve and will be driven by a mixture of investors' expectations and growing regulatory influence.

Question 13: *Are there any sets of standardized 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.[4] It is also included in the mapping conducted by the CFA Institute as part of its above-mentioned consultation.

In addition, the work conducted by the International Platform on Sustainable Finance (IPSF) as regards international alignment of standards for sustainability-related disclosures could also bring additional insights in terms of standardising relevant definitions. A public report that shall describe commonalities and differences in existing disclosure requirements has been announced by IPSF for 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?*
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?*

We fully agree with IOSCO that promotion of investor education should be at the heart of any policy initiative aiming at strengthening sustainable finance. 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. It is also essential not to overstrain the financial advice process and to support advisors in explaining different ESG approaches to investors. In the end, investors still seek financial advice primarily for financial reasons, in order to build up old-age provision or for the purpose of general capital formation. While sustainability issues play an increasingly important role, especially for the younger generation of savers, they must not be given a disproportionate weight in the overall investment advice.

[4] Reporting Framework glossary | PRI Web Page | PRI (unpri.org)