On behalf of the Public Affairs Executive (PAE) of the EUROPEAN PRIVATE EQUITY AND VENTURE CAPITAL INDUSTRY

16 October 2020

Response to the ESAs Survey on templates for Environmental and/or Social financial products under SFDR

<u>Question 1</u>: How useful is the highly standardised presentation of the information in this format? Choose between: (i) Useless; (ii) Fairly useless; (iii) Neither useless nor useful; (iv) Fairly useful; and (v) Very useful. Please explain.

<u>Answer</u>:

Fairly useless.

The template as presented is geared towards investments in **<u>publicly listed assets</u>** and/or **<u>open-ended products</u>** and hence not all elements are applicable in a private equity and venture capital setting. In the private equity and venture capital context, sophisticated investors are generally committing to a blind pool, closed-ended product following extensive disclosures and, often, due diligence.

In that light, we do not believe that the **<u>one-size-fits-all</u>** standardised presentation suggested by the examples is useful. A standardized template *can* be helpful in facilitating comparability between products offered. However, if one template is to be used for *all* types of products, there is a significant risk that the information will not be specific enough and hence it will be difficult to compare between products. It is also difficult to complete the disclosures in a way that it is not misleading to investors and gives rise to a need to provide supplementary information to investors (outside of the standardised template) in order to ensure they have the information that they need to make a fully informed decision.

Generally, this lack of tailoring could be addressed by including a number of **<u>selection options</u>** (e.g. passive vs active, asset class type(s), specific themes), as well as more **<u>specific instructions</u>** on the information that should be provided and **<u>more discretion</u>** given to promoters on the information to be included. In addition, in appropriate cases, it should be possible to indicate that a particular question is not applicable (including because the answer is not yet known – for example, allocation to sectors).

It is important that firms be given the opportunity to clarify their disclosures, with further text, as otherwise there is a risk of them making misrepresentations. In particular, some of the required items relate to future intentions, e.g. portfolio construction, in relation to which firms should be allowed to clarify that the actual investments made may not be precisely consistent with the stated intent.

See our answer to Question 6 below for some specific concerns relating to private equity and venture capital.

Finally, the qualitative, long and rather prescriptive format should be reconsidered.

Question 2: More specifically, how useful is the presentation of the information with the use of **icons** as visual aids (in mock-ups 1 and 3)? Choose between: (i) Useless; (ii) Fairly useless; (iii) Neither useless nor useful; (iv) Fairly useful; and (v) Very useful. Please explain.

The pictures below show examples of the icons used in the templates (mock-ups 1 and 3).

Answer:

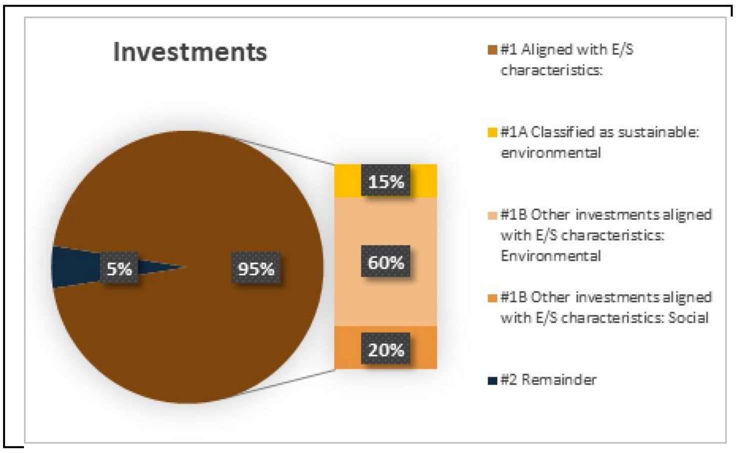
Fairly useless. And particularly not useful for institutional / professional investors.

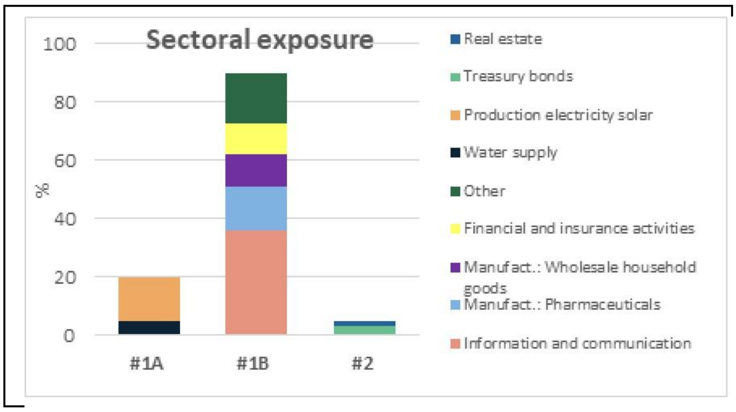
We imagine that the icons are designed to facilitate the understanding of retail investors. We do not think the icons will be particularly useful for institutional investors in private equity and venture capital funds, who will engage in detail with firms offering these products and often negotiate with firms on the products' design. If icons are deemed necessary, we suggest it be made clear that the choice for firms is a binary one of using all of the icons or none of them.

From a more practical perspective, there is a risk that the use of icons will complicate disclosures and design. To make it easier for readers, the different sections may be better complemented by indicators or alike so that the answers can be tagged and compared.

Question 3: More specifically, how useful is the presentation of the information with the use of **graphs** as visual aids? Choose between: (i) Useless; (ii) Fairly useless; (iii) Neither useless nor useful; (iv) Fairly useful; and (v) Very useful. Please explain.

Examples of the graphs used in the templates:





Answer:

Neither useless nor useful. This will depend on the information that is being presented.

We believe that in principle graphs *could* be useful, particularly for retail investors. However, we feel that they should track the draft RTS more closely and should be **simpler** than the examples provided in the survey (which we think may be over complicated and possibly misleading, and should return to the simpler approach suggested in the draft RTS). A simple pie chart with narrative included seems more useful and appropriate for a largely retail audience. Again, we believe that institutional investors in private equity and venture capital funds are unlikely to rely on these in making their investment decisions, preferring instead to discuss their expectations and the sustainability strategy of the fund with the fund manager.

We think that promoters should have the option to omit graphs and pie charts when they reasonably conclude that they are not useful to help investors to understand the information. For example, where the pie chart will simply demonstrate that 100% of a fund's assets are in a particular category, we think that the pie chart may confuse investors and will certainly add nothing to their understanding.

Finally, we would like to stress that the templates need to be complemented with different alternatives depending on the type of financial institution. The current mock-ups are not fully suited to the specificities of, and are therefore not helpful for, private equity and venture capital funds (investing in non-listed companies, mainly SMEs).

<u>Question 4</u>: More specifically, how useful is the presentation of the information with the use of **explanatory notes**, in the column at the right side of the document, which are presented on a grey background? Choose between: (i) Useless; (ii) Fairly useless; (iii) Neither useless nor useful; (iv) Fairly useful; and (v) Very useful. Please explain.

The picture below shows an example of one of the explanatory notes used in the templates.

> *The category* ***#1 Aligned with E/S characteristics*** *includes any investment that is aligned with the characteristic:*
>
> *- The* ***Subcategory #1A*** *covers investments that are qualified as sustainable. A sustainable investment means an investment in an economic activity that contributes to an environmental objective, measured for example by key resource efficiency indicators such as CO2 emissions, or the use of water, or an investment that contributes to a social objective, such as tackling inequality or that fosters social cohesion.*
>
> *- The* ***sub-category*** **#1B Other E/S characteristics** *covers investments aligned with the environmental or social characteristics that* ***do not*** *meet the criteria of 'sustainable investment'.*

Answer:

It is useful to have clarity on the information that needs to be presented.

That said, we believe that if lengthy notes are required to explain the graphs, the usefulness of using graphical representations is reduced. Notes should only be relied upon where they are necessary, and we would urge the ESAs to consider whether the data presentation and direction is clear enough in the first place.

In that respect, the question is whether some of the detail in the table (explanatory notes) can be formulated in a **more concise** and **succinct** manner and, for example, provide the rest at the end of the document (e.g. in an end note). In addition, it is a bit unclear now whether the explanatory notes aim to explain key concepts / definitions or more.

In line with the comment above, we would also suggest developing **specific templates** for private equity.

Question 5: Are there any **presentational** aspects that might make it hard to understand the sustainability aspects of products? For example, with regard to the distinction between the sub-categories of investments, namely between #1A and #1B? Choose between: (i) Yes; (ii) No; (iii) Other. Please explain.

Answer:

Yes.

First, it needs to be clarified if this is the way that the disclosures *can* be made or *should* be made.

As indicated above, we consider graphical representations to be helpful in principle, but these should be **simpler** to understand and not require extraneous information or understanding to decipher. It is sometimes unclear, even for ESG experts, what the graphs attempt to show. This suggests that a retail audience might also be confused.

In general, the purpose of the template is to lend **credibility** to the products. In order to achieve that, we think there should be more clarity, including on when a product qualifies, and more specific guidance on information that needs to be provided. For example, the template does not require to show how an investment/portfolio performed and/or improved on certain E/S characteristics or what impact was actually created. We believe this could also be considered to lend credibility to the template.

Another example, as explained in our response to the ESAs Joint Consultation Paper concerning ESG disclosures under Regulation (EU) 2019/2088, investors and managers also need further clarification as to what constitutes an Article 8 SFDR product. The template will be **impossible to complete**, and will result in **different approaches from different firms**, unless that clarity exists.

In summary, we think it is important that an investment fund or related product should **not** be brought within the scope of Article 8 by:

(i) disclosure of a firm's consideration of sustainability risks under the revisions to AIFMD and MiFID. Indeed, it is important to distinguish between (a) disclosure of the required processes for an investment product reflecting firms' sustainability obligations in respect of their investment processes, and (b) active promotion of environmental and/or social characteristics that form a qualification to an obligation to maximise risk-adjusted returns. Absent that distinction, most financial products would fall within Article 8 which seems contrary to the SFDR intention;

(ii) compliance with principal adverse impact requirements as contemplated by Article 4 SFDR; and

(iii) non-material investment exclusions. It is important to distinguish between (a) negative screening that is sufficiently material to amount to promoting environmental and/or social characteristics, and (b) limited exclusions that would not be material. In private equity or venture capital fundraising, it is common for investors to negotiate certain excluded investments, which may be implemented either through bilateral side letters, or as exclusions in the investment policy of the fund. These are often required by investors on principle (or to back-to-back an investor's own obligations to its investors) even where they are not material to the particular investment fund – for example, a prohibition on a fund that is focussed on artificial intelligence from investing in companies that extract coal or oil. Common examples include investments in companies that manufacture pornography, depleted uranium munitions, or that operate casinos. We would welcome clarification that **limited or non-material investment exclusions** would not on their own bring a financial product within Article 8. Otherwise, investor-specific ethical requirements would cause the majority of private equity and venture capital funds to be Article 8 funds, resulting in inappropriate and excessive disclosure on sustainability.

In addition:

(i) many of our members have subscribed to UNPRI, SASB, certain SDGs or other sustainability frameworks or standards - we would welcome clarification that a firm that refers in its marketing material to that framework or standard would not automatically be promoting an environmental or social characteristic, and would not automatically fall within Article 8;

(ii) it is important that the disclosures that are required for an Article 8 product are clear and relate specifically to the "characteristic(s)" that are promoted in relation to that product and do not require disclosure in relation to characteristics that are not; and

(iii) it would be helpful to have clear guidance that the Article 8 test is distinct from the EU Taxonomy; that an Article 8 product would not automatically be subject to Taxonomy obligations solely by becoming an Article 8 product. In particular, we believe that Article 6 of the Taxonomy Regulation only requires Article 8 products to report taxonomy compliance if they have, as part of their promoted objective, as intention to make "sustainable investments" as defined in Article 2(17) of the SFDR (and not only because part of their approach to ESG considers environmental factors in a more generic sense), but we would welcome clarification on that point.

For more information, please see the Introduction and our answer to Question 16 in the abovementioned consultation response.

Question 6: Do you have any other suggestions or comments to improve the **presentation** of these disclosure documents?

Answer:

Notwithstanding that the focus of the current survey is on the form rather than the substance of pre-contractual and periodic disclosures (which we think is a missed opportunity), we have set out a number of observations below that demonstrate how some of our concerns may play out in practice via the templates, and made suggestions as to how these might be dealt with in some cases. In most cases, the answer would be to allow some **discretion** as to how answers are formulated and opportunities to explain areas where a more formulaic answer would be misleading.

Pre-contractual disclosures

What environmental and/or social characteristics are promoted by this financial product?
What investment strategy does this financial product follow to meet the E/S characteristics?

As mentioned above, in order for firms to answer these questions accurately, there would need to be more clarity on what constitutes an "environmental and/or social characteristic" for the purposes of Article 8. Again, we refer back to Invest Europe's feedback to the ESAs' RTS consultation on this point (see also our response to Question 5 above).

What are the binding elements for the investment selection?
Guidance: Binding elements are commitments that cannot be amended during the life of the financial product.

Private equity or venture capital fund products differ from certain other financial products in that binding contractual commitments can be amended during the life of the product, with the agreed levels of investor and manager consent. Firms would need the opportunity to highlight this possibility (especially given the "guidance note") in order to avoid the statement being misleading.

Is there an amount of potential investments excluded, as a result of the implementation of the selection criteria?

The example answer gives a percentage. The template should make clear that this is not required, as most funds would find it impossible to quantify the excluded investments precisely in advance (rather than describe them in general or specific terms).

What is the policy to assess good governance practices of the investee companies?

Private equity and venture capital funds negotiate investment-by-investment arrangements with individual companies at the time they invest to ensure that, after the investment, the governance is appropriate. An answer that describes this process should be regarded as sufficient for this question.

What is the minimum asset allocation planned for this product?

In order to work for private equity and venture capital products, the templates need to cater for blind pool funds which do not have pre-defined asset allocation rules, and at the moment they do not. This question is one example of that problem.

In which economic sectors are the investments made?

In a pre-contractual context, managers of many sector agnostic or generalist funds will find it impossible to answer this question otherwise than in very general terms and in a way that signifies intention. As above, the templates need to cater for blind pool funds, and at the moment they do not.

Does this financial product make use of derivatives? If yes, how is the use of derivatives aligned with the E/S characteristics?

This question seems to envisage that a fund manager could answer "Yes" to the use of derivatives and then "No" to the supplementary question: "How is the use of derivatives aligned with the E/S characteristics?", which seems illogical. Perhaps this should read: "If yes, is the use of derivatives aligned with the E/S characteristics? If yes, explain how."

How will sustainable investments contribute to a sustainable objective and not significantly harm any other sustainable investment objectives during the reference period?

Many managers of private equity and venture capital funds that fall under Article 8 will not know at the outset whether the product in question will make "sustainable investments" and will not have made any binding intention to make such investments. For those funds, this question (and its sub-questions) does not seem possible to answer at pre-contractual stage, other than by explaining that it is not known whether sustainable investments will be made, or that the question is "n/a". We believe it should be clarified that these would be acceptable answers.

Periodic disclosures

How did the investments contribute to the sustainable characteristics and how did the sustainability indicators perform?

As above, this question can only be answered when the industry has greater clarity on what constitutes a "sustainability characteristic". As drafted, it will require all Article 8 funds which do not deliberately target "sustainable investments" to categorise all investments according to whether they are "sustainable" or not. This seems disproportionate for a fund that is not an Article 9 product, or does not commit at the outset to attain a certain level of "sustainable investments". It should be clear that managers of such funds are able to answer this question by stating that they have not committed to the relevant fund making any sustainable investments and they do not categorise their investments in that way.

How did sustainable investments contribute a sustainable objective and did not significantly harm any other sustainable investment objectives?
How were principal adverse impacts taken into account?
Were any investments excluded due to their significant harm to sustainable investment objectives?

These questions seem unnecessary unless the fund has committed to invest in sustainable investments or to report on how many of its investments are in that category.

On a separate note, we would also like to highlight the issue of availability of indices relevant to private equity funds. Any reference to a benchmark would most probably lead to the use of an index produced outside the EU as, even though some European providers are developing, leading index providers are located outside the EU, and an EU database is currently not available. More generally, this may be a concern from the perspective of EU data sovereignty.

Finally, we would like to make the following practical suggestions:

- To improve usability, more mock-ups should be made, illustrating not only passively managed products;

- To drive standardization, the use case should be set out more clearly, e.g. that the template, questions and explanatory notes are standardized – it is a bit unclear now if the questions and sub-questions directly link to the Regulation or if it is just an example of how to structure it;
- Key questions should be made more succinct (e.g. rewrite "Can I find on-line product-specific information") and have an indicator next to it to make comparisons easier;
- The background of the template and a link to more information on the Regulation should be added;
- The illustrative mock-ups send a signal that the explanations should be qualitative and lengthy, which should be reconsidered for a more clear and comparable reporting.

Question 7: When the templates are presented via **digital media**, can you foresee any particular challenges? Can you suggest how these particular challenges could be overcome while retaining the core aspects of the standardised template format?

Answer:

See previous responses.

Contact

For further information, please contact Martin Bresson (martin.bresson@investeurope.eu) or Erika Blanckaert (erika.blanckaert@investeurope.eu) at Invest Europe.

About the PAE

The Public Affairs Executive (PAE) consists of representatives from the venture capital, mid-market and large buyout parts of the private equity industry, as well as institutional investors and representatives of national private equity associations (NVCAs). The PAE represents the views of this industry in EU-level public affairs and aims to improve the understanding of its activities and its importance for the European economy.

About Invest Europe

Invest Europe is the association representing Europe's private equity, venture capital and infrastructure sectors, as well as their investors.

Our members take a long-term approach to investing in privately held companies, from start-ups to established firms. They inject not only capital but dynamism, innovation and expertise. This commitment helps deliver strong and sustainable growth, resulting in healthy returns for Europe's leading pension funds and insurers, to the benefit of the millions of European citizens who depend on them.

Invest Europe aims to make a constructive contribution to policy affecting private capital investment in Europe. We provide information to the public on our members' role in the economy. Our research provides the most authoritative source of data on trends and developments in our industry.

Invest Europe is the guardian of the industry's professional standards, demanding accountability, good governance and transparency from our members.

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