BAI Diversifikation zählt.

Preliminary and general remarks

The Bundesverband Alternative Investments e.V. (BAI) is the asset class- and product-spanning representation of interest for Alternative Investments in Germany. BAI, welcomes the opportunity to comment and participate to IOSCO's consultation paper regarding the Recommendations on Sustainability-Related Practices, Policies, Procedures and Disclosure in Asset Management.

For years now, BAI has participated and commented on various consultations to sustainability- and ESG-related regulatory topics on all regulatory levels: Global, European and national, i.e., German, level. As you know, European Union's ambitious Sustainable Finance Action Plan from 2018 as well as the renewed Sustainable Finance Strategy from this year and the many regulatory initiatives therein, addressed sustainability as a topic and greenwashing as a problem. BAI is committed to working towards the objectives of the EU Action Plan for addressing (material) sustainability-related for financial products, for financing sustainable growth and to supporting the transition of Europe's economy. In order to effectively contribute to these goals, the asset management industry needs a clear and coherent regulatory framework for sustainable investments and reliable, realistic timelines for implementation. The financial and asset management industry needs also a logical sequence for implementing sustainability requirements and the most catchy, simple regulation possible rather than complicated, complex bureaucracy. All this, where possible, on a global basis as the financial and asset management industry is global itself.

Most of the problems identified and addressed in IOSCO's recommendations are identified and addressed in EU's Sustainable Finance Initiative(s), too. The Taxonomy Regulation aims to unify and harmonize the common understanding of what is "sustainable" or what are sustainability risks and factors by defining and classifying, and the Sustainable Finance Disclosure Regulation (SFDR) requires asset managers to disclose sustainability-related information on both entity and product level, inter alia to prevent greenwashing.

When responding and commenting to the different consultations, we usually argued guided by the following high-level principles and convictions:

- There should be alignment of regulatory requirements with industry practice, initiatives and broadly and well-established standards;
- We plea for a pragmatic approach for sustainability-related disclosures in the financial services sector instead of too granular and bureaucratic prescriptions;
- Fundamental aspects such as materiality, proportionality and necessity orientation should be respected (no one-size-fits-all approach, for instance, and proportionality considerations for example with regard to criteria as size, nature, complexity, etc.);
- The need for standards which can be globally aligned;
- To ensure the availability, sufficiency, reliability and comparability of ESG data; and
- To ensure that financial market participants are only required to report and disclose on data they are able to get from investee companies, i.e., to ensure that there is a logical sequence in introducing reporting and disclosure obligations.

When commenting on planned European regulatory acts, BAI consequently pleaded for the consideration of global standards and initiatives, when commenting on planned national (German) regulatory measures, we asked German legislator or supervisory authorities to align planned acts with the European legal framework. Same here: We welcome in IOSCO's Consultation Paper taking into account the developments on European level; the many referrals to the Taxonomy Regulation and the SFDR proof of it. The current multitude of regulatory initiatives worldwide, often not well coordinated, with relevance to sustainable finance significantly increases the complexity of the regulatory environment and has the potential of impeding, instead of facilitating, sustainable investments. IOSCO as an international organization is predestined to coordinate a worldwide approach with regard to practice, policies, procedures and disclosures for sustainable investments. Seeming being EU's Sustainable Finance Initiative the most sophisticated, comprehensive and coherent regulatory framework with regard to sustainability worldwide, we would like to invite IOSCO also to consider further regulatory developments in the European Union.

Having said that, we answer the following specific questions:

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?

From a purely European perspective, IOSCO's recommendations with regard to sustainability-related practices, policies, procedures and disclosure in the asset management industry aiming to address the issue of greenwashing are appropriate and sufficiently detailed. It is for a long time BAI's deep conviction that taking into account ESG risks is and has to be part of a contemporary "state of the art" risk management – and that this does not depend of any regulatory prescription for asset managers. Asset managers have and have to have in their genes to act in the best interest of their clients and to fulfil their fiduciary duties towards them. From a purely European (regulatory) perspective, the areas of addressed practices is already covered by the different regulatory measures of the Sustainable Finance Initiative, primarily by the SFDR, the Taxonomy Regulation, but also by integration risk management rules in the legal framework for asset managers, i.e., the AIFMD, the UCITS Directive and MiFID II.

European Financial Market Participants (FMPs), such as asset managers, have to disclose on ESG risks and strategies, have to classify their funds, have to disclose on the identification, assessment and management of sustainability-related risks. However, a duty of disclosure also encourages asset managers to consider these issues materially beforehand.

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

Referencing the TCFD Framework is a supportable approach, because of the international character of this framework, because of its acceptance and principles-based approach. The core elements of how organizations operate, i.e., governance, strategy, risk management, and metrics and targets are covered by TCFD's four key pillars. As we have stated above, the consideration of ESG risks, or risk management as such, is key function in managing assets for clients. We therefore agree with this approach, as TCFD's key pillars put the lever in the right places.

In our view, the TCFD Framework is useful to address some of the main problems of ESG disclosure: the availability, reliability and comparability of ESG data. So, disclosures based on the key pillars of the TCFD Framework could lead to more comparability among companies within a sector industry or portfolio and to more reliable, verifiable and objective data when using the TCFD metrics and targets.

The TCFD Framework focuses primarily on climate-related risks, as the European (Green) Taxonomy Regulation and the SFDR do either. We also support this approach because of the more urgent nature of climate-related risks and the risks resulting from climate change. But from a holistic perspective, (good) governance matters have to be considered as well as social risks. It is the E&S&G that have to be considered; over time, focusing only on "E" risks will not be a sufficient approach.

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?

All asset managers should be covered by IOSCO's recommendations. It is not a question of doing "green" business or following sustainability strategies or not, but a question that has to be answered by any asset manager. Of course, addressing greenwashing problems is primarily a problem of asset managers pretending doing sustainable or green investing, but not really do in fact. But the consideration of (ESG or sustainability-related) risks, for instance, concerns everyone as it is, and we have mentioned it already above, pure and simple risk management.

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?

The question whether securities regulators and/or policymakers should consider setting out different disclosure requirements for products with sustainability-related investment objectives as compared to products that promote sustainability-related characteristics seems to be inspired by the classification in so-called Article 8 or 9 products under European SFDR which also differs in products only "promoting" sustainability-related characteristics (Article 8) and products with sustainability-related investment objectives (Article 9). Yes, regulators or policymakers should consider different disclosure requirements as the requirements for products with a sustainability-related objectives are or should be stricter. The focus of products with a sustainability-related objectives should be on the investment objectives disclosure (iv.) and the investment strategies disclosure (v.).

Differentiation between sustainability-related products is quite complicated. Specific threshold might help to achieve a more schematic differentiation, but if specific thresholds are introduced, they should not be unrealistically high. The lower limit might be 51%, the higher limit in an area around 75% probably (a threshold introduced by German BaFin's Draft Guidelines on Sustainable Investment Funds; feedback from our members and form the market rather signals that this threshold is unrealistically high).

The European legislator has already adopted a normative framework for ESG funds, as we have noticed before. Through the new rules introduced by the SFDR, the European legislator intends to harmonise the rules for the disclosure of ESG information by fund managers. This will enable investors to be in a position to compare products and thus to make informed investment decisions. From a fund manager's perspective, the legislative package makes clear that AIFMs need to account for sustainability risks and factors as part of their ordinary course duties and reporting obligations toward investors, both at their management company level and at the level of the investment funds they are manufacturing or selling (product level).

While the integration of sustainability risks into the fund's management process does not come as a completely new concept, the complexity of the new SFDR provisions and underlying concepts will oblige fund managers to drastically enhance their investment management processes and investor disclosures to be compliant.

One of the first challenges for fund managers is to clearly understand the double materiality concept so here. In SFDR, sustainability has a two-tier meaning and covers (i) integration of sustainability risks and the impact of such risks on the returns of the fund (Art. 6 of SFDR) and (ii) adverse sustainability impacts of investment decisions on sustainability factors (Art 4 and Art 7 of SFDR). These aspects are relevant both (i) at the management company level (i.e. the AIFM) and (ii) at the product level (i.e. the AIF).

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

The name of a product and its naming parameters should make clear what is "in" the product. Sustainable products with naming parameters should permit the product name to reference sustainability only if the investment objectives refer to sustainability, yes. The naming parameters are probably the most important pieces of information for a (retail) investor. Therefore, the requirements for a fund's name to reference sustainability should be clear and not misleading at all.

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

Although labels are probably under the most efficient measures for investors to decide whether an investment is sustainable or not, there are, so far, no worldwide accepted labels or criteria for such labels. The German Sustainable Finance Advisory Council, for instance, an advisory group of the German Federal Government, suggests a system of "labels" like traffic lights: green, orange and red colors to classify the degree of sustainability of a financial product. Within the European Union, the Commission develops labels such as an Ecolabel for financial products or a framework for a EU Green Bond Standards. Such labels are useful, but still under development. So, our answer is not principally "no" to the question, if a product needs to have an ESG, SRI or similar label in order to be marketed as a sustainability-related product, but in the current situation we do not see any possibility for the use of such labels due to the lack of accepted labels.

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

Yes, we agree with the areas of investment strategies disclosure specified in IOSCO's recommendations. Product offering documents such as PPMs, marketing materials, key investor documents, prospectuses etc. are the main areas for the disclosure of investment strategies. The various investment strategies existing is the main feature for differentiation between asset classes or within an asset class, and potential investors should know before what they probably invest in. So, the sustainability-related investment strategies (investment universe, investment selection process, criteria used and extent of the portfolio's focus on sustainability are important for investors' decisions, and therefore these disclosures should be part of all offering documents.

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?

As an association with a focus on alternative investments and rather on private markets than on public markets (besides liquid alternatives, of course), we do not have a specific answer to this question. But in general, yes, what an investment fund "does", how it votes or engages as a shareholder should be aligned with the investment objectives or characteristics.

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?

Standardization is useful for comparability. But the more standardized formats and presentation of marketing materials are, the less flexibility results from it. We would support certain harmonization and standardization, especially for retail investment products. But the more investment funds are customized and structured for professional and sophisticated (institutional) investors, the less standardization and harmonization of contents are needed. So, on a rather high level, regulators could address the format and presentation of marketing materials and website disclosure for sustainability-related products without address them in a too granular manner to provide the needed flexibility.

As IOSCO commented itself, the recommendation regarding marketing materials and website disclosure is primarily focused on the content of marketing materials and website disclosure rather than the format. To compare sustainability-related products, the content is far more important than the format.

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?

Our answer with regard to the use of specific metrics or key performance indicators is also given from a European perspective: The European Sustainable Finance Initiative already knows key performance indicators such as a green investment ratio for funds, a green asset ratio for banks, etc.:

Non-financial companies shall, under Art. 8 of the Taxonomy Regulation, disclose the proportion of environmentally sustainable activities that align with the EU Taxonomy criteria. The translation of environmental performance into financial variables (turnover, Capital Expenditures (CapEx) and Operational Expenditures (OpEx) should allow in turn investors and financial institutions to have clear and comparable data to help them with their investment and financing decisions.

The main KPIs for financial companies such as banks, investment firms, asset managers, insurers/reinsurers relate to the proportion of taxonomy-aligned economic activities in their financial activities, such as lending, investment and insurance.

Asset managers should report the proportion of taxonomy-aligned investments managed by an asset manager in the value of all assets under management from both its collective and individual portfolio management activities, the so-called green investment ratio.

We acknowledge that metrics and KPIs as being introduced in the European Union might be very useful to specify the degree of sustainability of products or asset managers. We therefore support, in principle, the use of metrics and KPIs and encourage regulators to introduce them. But with regard to the experiences and challenges we have made and we face with the European approach, we plea for rather few and simple metrics and KPIs to not hinder sustainable investments because of an over-bureaucratic approach and too granular prescriptions and templates.

If metrics or KPIs are introduced, they should rather not be subject to self-selection in order to get standardized information from all financial market participants for better comparability. But if there are broadly accepted industry or market standards for metrics and KPIs, regulators should not "re-invent the world's formula", but refer or accept such standards as regulatory standards as well. We refer, for instance, to TCFD's Guidance on Climate-related Metrics, Targets, and Transition Plans.

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

Yes, in our view, periodic reporting should include both quantitative and qualitative information. Quantitative information is usually more appropriate to compare different sustainability-related products by comparing just some KPIs etc. But qualitative information often allows to get a good impression of how the management of a company or of an asset manager really thinks about relevant topics and how seriously the (senior) management pursues sustainable investing or how intensively senior management deals with questions of sustainable investment and consideration of ESG risks. Whether qualitative reporting or information is written with certain dedication or only serves the purpose of fulfilling regulatory requirements ("tick the box"), for example, can be read out quickly in this way.

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?

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?

<u>Question 12</u>: A common understanding and consistent sustainability-related terms and definitions around ESG, sustainability, sustainability risks etc. is essential. In principle, it is therefore highly welcome if securities regulators encourage the industry to get such a common understanding and to coalesce around a set of consistent sustainability-related terms. But if it were only national securities regulators or policymakers that develop or make develop common definitions, this would lead to just new problems and frictions. The financial industry as a whole, but also the asset management industry is a global industry; we plea therefore for a worldwide common understanding of what means "green", "sustainable", "ESG", "sustainability risks" etc. IOSCO or UNPRI are predestined to do so and to encourage the industry. As we have mentioned in our answers to other questions above, within the European Union, we have moved beyond the status in which regulators (only) encourage the industry to use uniform, consistent terms and definitions: With the Taxonomy Regulation, the European legislator establishes a classification system for what means sustainable activities etc.

<u>Question 13</u>: From a (purely) European perspective, references to the evolving Taxonomy Regulation and the definitions used in the SFDR would be the most useful approach also in global initiatives to not get other – and probably differing – definitions and terms. So, there is a set of standardized sustainability-related terms being developed – the various legal acts forming together EU's Sustainable Finance Initiative. There are not only "standards" within the EU, but legal requirements for any financial market participants. IOSCO should not disregard these requirements, developments and (both positive and negative) experiences in one of the most important asset management centers worldwide.

But from a global perspective, we would like to mention the "ISO 26000:2010 Guidance on social responsibility", for instance. This standard contributes to 16 from 17 Sustainable Development Goals, includes terms and definitions in its clause 2, identifies and provides the definition of key terms that are of fundamental importance for understanding social responsibility.

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?

n.a.

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?

n.a.

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The Bundesverband Alternative Investments e.V. (BAI) is the asset class- and product-spanning representation of interest for Alternative Investments in Germany. Our goals:

- We are improving the level of public awareness for alternative strategies and asset classes.
- We are creating internationally competitive and attractive (regulatory) conditions for the investment in Alternative Investments.
- We are representing the interests of the industry to politics and regulators.
- We are serving as a catalyst between professional German investors and recognized worldwide providers of Alternative Investments products and services.
- We are supporting scientific research in the field of Alternative Investments.

Founded 1997 in Bonn, Germany, the association's members are resident in any field of the professional Alternative Investments Business. Around 250 national and international companies are members of the BAI.

We advocate for a competitive environment for investments in AI, especially with a view to securing German old-age provision. It is our core responsibility to accomplish legal reforms and the development of case law on behalf of our members and their investors.

For that purpose, BAI is contributing to several legislative procedures and consultations on a national and European level, and is participating as expert in hearings. Discussions with representatives from industry and federal and state government are taking place on a regular basis in Berlin and Brussels. We are maintaining an intense dialogue with political institutions as well as supervisory bodies (German Supervisory Authority BaFin, German Central Bank Bundesbank, ESMA, EIOPA, IOSCO) and work towards a better understanding of our industry's concerns in legal and regulatory practice.