EFAMA

European Fund and Asset Management Association

CONSULTATION RESPONSE

Brussels, 4 July 2023

Joint Consultation Paper – Review of SFDR Delegated Regulation regarding PAI and financial product disclosures

Foreword

EFAMA, the voice of the European investment management industry, considers the Sustainable Finance Disclosure Regulation (SFDR) and its accompanying technical standards essential elements in a strong and ambitious framework for sustainable investing. Our feedback aims at improving the effectiveness and feasibility of the ESAs' proposal, as well as strengthening the regulation's synergies with existing and upcoming rules.

We underline our full support to enhance comparability for end investors, hold market participants accountable, and avoid greenwashing. At the same time, disclosures should provide investors with meaningful and reliable information, backed by solid data, and preserve ease of access to such information. Thereby, it is of utmost importance that the proposed amendments are carefully calibrated and compatible with the end investors' needs while being both proportionate and feasible for financial market participants (FMPs) to produce.

We hope our recommendations herein will help European authorities strike the right balance between enhanced transparency for sustainability-minded investors and a practical framework for the industry.

Key Recommendations

A pragmatic approach between the SFDR Level 2 Review and its interaction with SFDR Level 1

The Level 2 review should leverage the outcome of the upcoming SFDR assessment. If the Commission concludes that changes to the SFDR Level 1 are necessary, then the current Level 2 review should rather focus on providing additional clarity and simplicity which must ultimately benefit end investors in their understanding of financial products.

However, it is crucial to ensure that **any proposed amendments to L2 measures should be able to withstand any future review of the Level 1 framework** as we need to address the fundamental issues within SFDR rather than "tinker around the edges". As such, additional requirements would not only create an unnecessary burden with limited added value but also confuse end investors who are already grappling with information overload and constantly changing disclosures.

For example, we generally support the clarification of formulas for Principal Adverse Impacts (PAIs) and the simplification of disclosures through the use of a dashboard. We also agree with the inclusion of disclosures on decarbonization targets. We believe that these products play a significant role in financing the transition and should have transparent disclosures that enable comparisons and promote common understanding.

On the other hand, we fail to see the added value of expanding disclosures on the Do No Significant Harm (DNSH) assessment of sustainable investments (SIs). A SI encompasses three subcomponents: contributions, DNSH, and good governance. Expanding the existing disclosures by introducing quantitative thresholds for only one subcomponent will not effectively resolve the issue of meaningful comparisons of SI. Keeping in mind that the Commission is not only considering a possible SFDR Level 1 review to enhance legal clarity for key definitions, including SI, but also the integral role of DNSH in SIs and the potential inclusion of this concept in the SFDR Level 1 review, we firmly believe that **the current timing does not help address additional changes and requirements, as the scope and application of the DNSH test might completely change** in the foreseeable future. Thus, discussions around SI (including its components) should be left out of level 2 consideration until decisions regarding these fundamental elements have been decided upon.

Alignment between the PAIs in SFDR and in CSRD Delegated Acts (ESRS standards)

We strongly advocate for the SFDR Level 2 review to prioritize the alignment of PAIs between SFDR and the delegated acts of the Corporate Sustainability Reporting Directive (CSRD) - related to the European Sustainable Reporting Standards (ESRS). This alignment should encompass the following key aspects:

1. ***Scope:*** We propose that all disclosure requirements and data points (e.g. PAIs) included in SFDR should be mandated under CSRD/ESRS. If certain data points are made voluntary in the ESRS, the PAI should be removed from SFDR. If certain data points are being subject to materiality assessment, then PAI entity-level disclosure requirements should appropriately be recalibrated to reflect this incoherence (see (3) below).

2. ***Definition:*** It is essential to ensure that the definition of PAIs is consistent across SFDR and CSRD/ESRS. Harmonizing the definitions will provide clarity and avoid confusion for FMPs and end investors.
3. ***Materiality:*** If the Commission proceeds as proposed in the ESRS draft delegated acts (e.g. disclosures and datapoint within each standard will undergo a materiality assessment), then reflections need to take place under SFDR. Indeed, the ESAs and the European Commission must provide clear guidance on how FMPs should handle missing data points resulting from this materiality assessment. This guidance should cover aspects such as entity reporting and the DNSH assessment.
4. ***Timing:*** Subject to our comments regarding scope and materiality, it is of utmost importance not to aggravate the already existing data gaps for FMPs by ensuring that:

    - the application date for any additions to the PAI list under SFDR aligns with the date of publication of the reporting under CSRD/ESRS, by all in-scope undertakings, including any potential additional 1 to 2-year phasing period that the Commission would introduce as per the ESRS draft delegated acts. Should new PAIs be introduced before that date, it should then be acknowledged by regulators that FMP's proxies of the missing data will likely not be reliable.

    - as far as current PAIs are concerned: If the Commission proceeds as proposed in the ESRS draft delegated acts with an additional phase-in period, then a suspension of some existing PAIs from the SFDR list (where data coverage is very low for example) must also be considered.

Consumer Testing & Cost-Benefit Analysis

We commend the ESAs for intending to conduct **consumer testing scenarios** on the possible changes. However, we are disappointed that the ESAs have not already done so ahead of this consultation. Our strong preference was for the ESAs to consult only on those areas that have been deemed to facilitate a better understanding of disclosures following extensive and conclusive consumer testing.

We also emphasize the challenges involved in altering the current Annexes in the prospectus. Such changes necessitate substantial modifications to the underlying operating models of FMPs. Therefore, a **comprehensive cost-benefit analysis should be conducted before implementing any modifications to the templates**. This analysis should prioritize the identification of the most advantageous and impactful changes to ensure an **optimal balance between costs and benefits.**

Sufficient implementation time

We greatly appreciate the ESAs' recognition, as mentioned in one of the recitals, to ensure the smooth functioning of the financial services sector and sustainability disclosures. In line with this acknowledgment, we firmly believe that FMPs should be afforded ample time to implement the required amendments. It is crucial to avoid frequent changes to disclosures, as such instability undermines consumer confidence in sustainable products and hinders progress in the broader sustainable finance agenda.

Therefore, we strongly recommend establishing **a minimum one-year gap between the publication of Regulatory Technical Standards (RTS) and their entry into effect.** This timeframe will allow sufficient preparation and adaptation for FMPs, ensuring a smooth transition without undue disruption. In addition, we propose that **the Regulation be applicable with a one-year gap, between changes affecting pre-contractual and website disclosures, and the changes impacting periodic reporting disclosures.** As periodic reporting disclosures are intended to report on the achievement during the reporting period, the one-year gap between implementation dates will be key. As far as the date of application of any new PAI, please refer to the comment on "timing" above. As far as changes in existing PAIs, we believe they should occur on the 1st of January to avoid complex recalculations in the course of the year.

PAI Entity Level Statement

By the time this consultation closes, relevant financial market participants have already published their first PAI statements. Whilst we understand the importance of ensuring there is transparency in relation to how PAIs are considered in the investment process, we do not believe their disclosures at an entity level are useful. Consumers invest in products. As such, this is where the disclosure of relevant PAIs will have the most impact and will be more decision-useful. The rigid nature of the template required to be used for entity-level PAI statements leads the disclosure of indicator values to be misinterpreted particularly in the absence of contextual information like comparison against an index. We have significant concerns that these values might be accepted unquestioningly, which could severely tarnish the reputation of FMPs.

Response to the ESAs' Questionnaire

Statement on Principal Adverse Impacts of investment decisions on sustainability factors

Question 1: **Do you agree with the newly proposed mandatory social indicators in Annex I, Table I (amount of accumulated earnings in non-cooperative tax jurisdictions for undertakings whose turnover exceeds € 750 million, exposure to companies involved in the cultivation and production of tobacco, interference with the formation of trade unions or election worker representatives, share of employees earning less than the adequate wage)?**
We are generally supportive of introducing some social-related PAIs. Nevertheless, we believe it is important to consider the following principles before implementing the proposed social indicators. ***1. Relying on available data through ESRS/CSRD or by defining guiding rules to enable necessary calculations and disclosures*** We acknowledge and appreciate the efforts made by the ESAs to align PAIs with mandatory ESRS indicators under CSRD. This alignment will facilitate the implementation and reporting of these indicators. However, it is worth noting that the European Commission in its DA on CSRD, ESRS, publicly considers applying materiality assessments to the majority of the indicators that FMPs are required to disclose within their PAI statements and use in their DNSH test. Undertakings' internal materiality assessment could result in data points for PAIs not being reported at all. **Our strong preference is that there needs to be complete alignment between FMP disclosure requirements and the disclosure requirements of companies under the scope of CSRD/ESRS.** Only if the Commission proceeds as proposed in relation to data points required under CSRD/ESRS being made subject to materiality assessment, we emphasize the imperative to reflect this accordingly through the recalibration of SFDR PAI requirements and get fair, feasible, and clear guidance for all the industry to deal with this issue. Moreover, it is important to recognise that a very significant portion of the investable universe falls outside the scope of the CSRD, as investments are global in nature. Without proper recalibration and clear guidance on the manner to treat this lack of data, obtaining meaningful data on these new indicators will pose substantial challenges. Non-CSRD investments often involve investments in developing countries for which data retrieval may prove to be difficult or even impossible. Introducing additional mandatory PAIs at this stage would only exacerbate the existing data deficit and necessitate the use of additional wider-reaching estimations, again leading to a reduction in comparability and thus adversely impacting investors. Additionally, for certain strategies, for example, index tracking funds, it is **not feasible for an investment manager to fill data gaps** as the data either needs to be embedded in the index rules or there is a significant cost to obtain the data. This would likely impact performance and potentially have the effect of restricting investor choice and increasing costs for end investors. For this reason, **we strongly disagree with the introduction of any new (social) PAI which lacks clear corresponding reporting requirements in the CSRD and ESRS.** Any

decision to add further mandatory indicators must be based on a comprehensive analysis of the sustainability-relation information already reported or expected to be reported by companies. Introducing additional indicators and front-running regulatory requirements, such as the ESRS, which address contentious issues like “trade unions” and "fair wage," may instead result in fragmented data and reliance on data providers' interpretations and complex models. **New indicators should rely on available data** to enable necessary calculations and disclosures by FMPs. To mitigate any potential issues with sequencing and to guarantee alignment and data availability, **the final version of RTS 2.0 should align with the initial set of ESRS standards, both in terms of content and timing.** This assumes the ESRS retain mandatory requirements for social indicators. Thus, the RTS 2.0 should not come into application before 2027 or 2028 at the earliest depending on the additional phasing, for any newly proposed indicators (the time to be in a position to obtain the relevant data from, at least, large companies subject to CSRD and have clear guidance in the way managing the absence of disclosure of others and to deal with materiality assessment).

Whether or not the corresponding requirement exists within CSRD and ESRS should also be the gauge in determining whether existing PAIs should be kept as mandatory. As noted above, **our strong preference is to ensure that all disclosure requirements and data points that are included in SFDR (e.g. PAI) are made mandatory under CSRD, ESRS, without being subject to a materiality assessment.** However, if the Commission proceeds as proposed and the evaluation of materiality applies to CSRD and ESRS, it is essential to accurately align this assessment within SFDR to ensure consistent treatment. It would be inconsistent if CSRD permits investee companies to disclose PAIs only when they are deemed material, while SFDR mandates financial institutions to disclose all PAIs**.** Reconciling the concepts of materiality between SFDR and CSRD is crucial to ensure consistent and meaningful reporting across the investment chain.

In the event that the European Commission proceeds with its proposed course of action, it will be necessary to recalibrate the treatment PAIs at the moment. However, we would prefer to have a separate discussion on this matter as we do not want to pre-empt the outcome of the European Commission’s consultation on ESRS.

2. Focusing on achieving relevance and simplification

We urge for a shift in focus away from the mere addition of indicators and towards **prioritizing relevance and simplification.** This is especially crucial given the current limitations in data quality, which first and foremost necessitates improvements in data coverage to ensure more reliable results.

Based on this overall principle we need to consider the risks of a long list of indicators that are not necessarily of direct relevance and may dilute the overall understanding of the PAIs of a product. In addition, it is imperative for investors not to receive an excessive amount of information. We, therefore, **recommend minimizing the number of PAIs, focusing on only the most relevant ones.**

For instance, in the case of Real Estate PAI Indicators: We believe that examining management companies in detail does not add any added value, whereas refining existing indicators specific to the sector would be more beneficial.

The priority should, therefore, be placed on a selected few indicators that are universally relevant to all assets and strategies to make them aligned with ESRS/CSRD, providing investors with a clear and robust understanding of the material negative impacts investments have on various sustainability factors.

Additionally, the costs of reporting and disclosing by non-financial undertakings and FMPs should be carefully weighed against the benefits they offer to users. It is essential to evaluate whether retail investors genuinely need this information to make well-informed investment decisions. Thus, emphasis should be placed on investor-centric disclosures of relevant principal adverse impacts.

Furthermore, whilst we understand the importance of ensuring there is transparency in relation to how PAIs are considered in the investment process, we do not believe the disclosure of principal adverse impacts at an entity level is useful. Consumers invest in products. As such, this is where the disclosure of relevant PAIs will have the most impact and will be more decision-useful.

The rigid nature of the template required to be used for entity-level PAI statements lends to the disclosure of indicator values to be misinterpreted particularly in the absence of contextual information like comparison against an index. We are extremely concerned that these values will be taken at face value and will put FMPs in a very bad light.

3. Specific issues related to the proposed additional social-related PAI

There are a number of challenges related to the proposed mandatory social indicators, which should be carefully considered as prerequisites before any implementation of the proposed indicators. These include:

- **PAI 14. Amount of accumulated earnings in non-cooperative tax jurisdictions:** This PAI refers to a new reporting introduced in the Accounting Directive 2013/34/EU for EU companies with a turnover greater than 750 million. We understand that in-scope undertakings may report for the first time in the course of 2026 for FY 2025. However, we still have concerns about the data availability and would like to raise the following points that need to be addressed before any addition to the SFDR PAI list:

  Given the above, the implementation of this PAI can only be on 31.12.2026 at the earliest.

  Non-EU undertakings do not have this reporting obligation and it will be quite challenging to get the accumulated earnings information in any country-by-country report from a multinational; To this extent "**net profits"** would be an information that is more likely to be obtained (and which is also covered by the EU reporting) and that is still relevant.

  The threshold of € 750 million is that of the EU directive. Applying the same threshold to non-EU entities can be challenging in mapping and identifying entities, due to the complexity of corporate structures.

  Entities below the threshold do not report. It should therefore be considered that investments in entities below the threshold can be put at zero in the PAI calculation.

Furthermore, even if the information regarding (a) the amount of accumulated earnings and (b) the list of non-cooperative tax jurisdictions would be presented in the annual reports of underlying undertakings, it is important to clarify that this **information** will remain unchanged or **"frozen" as per the management report** until the subsequent annual report is published.

Lastly, it is crucial to understand that residency/earnings from such jurisdictions do not necessarily imply poor governance but rather suggest the **potential** for it.

- **PAI 16. Exposure to companies involved in the cultivation and production of tobacco:** We are in favour of introducing a social indicator for companies involved in the cultivation and production of tobacco, but we suggest limiting it to these specific entities. Consequently, we believe the wording should be revised to explicitly state "Exposure to companies directly involved in the cultivation and production of tobacco products." This clarification is necessary to differentiate between individuals growing tobacco plants and corporations manufacturing cigarettes or tobacco products. Distribution of these products should not be included in the indicator as it would encompass a wide range of entities with only a tangential connection to the tobacco industry.

- **PAI 17. Interference in the formation of trade unions or election of worker representatives:**
  We doubt the significance of the indicator. A policy commitment to non-interference in the formation of trade unions or election of worker representatives may not always equate to non-interference. It is highly improbable for companies to willingly disclose their involvement in such behaviors and while external data might still exist, it would likely be exceptionally limited and primarily derived from illegal activities, which would already be flagged under the United Nations Global Compact (UNGC). Moreover, the underlying data may not be sufficient in terms of data coverage, as **it is not a mandatory indicator as part of ESRS S1. Therefore, in line with our introduction, we believe this PAI should not be introduced in the SFDR list.**

  Moreover, the indicator exhibits variations across different countries and cultures. For instance, Europe and the US adopt different approaches, and worker unionization is less prevalent in the US. In the latter, “union breaking” seems much more prevalent. Consequently, such an indicator would inherently favour or disadvantage certain markets based on their prevailing practices.

  Therefore, there may be a need for clarification either in the terminology/definition employed or in the methodology utilized.

  As it is in practice difficult to assess whether companies interfere with union formation, a possible solution might be to refer to “**formal commitment** to non-interference in the formation of trade unions or election of worker representatives”. This approach would involve a binary assessment, allowing for a clearer distinction between companies with and without such policies (true/false approach), potentially increasing the availability of data.

Additionally, an indicator measuring the number of workdays lost to strike actions could be considered a meaningful indicator with readily available data. This metric could provide valuable insights into labor relations and their impact on corporate operations.

- **PAI 18. Share of employees of investee companies earning less than the adequate wage:** The concept of adequate wages unfortunately remains insufficiently defined. Determining what qualifies as an "adequate wage" is influenced by numerous factors, including jurisdiction, supply and demand, and the qualifications and experience of employees. Ultimately, the assessment of an adequate wage is subjective and varies among financial market participants. As a result, measuring the proportion of employees earning less than an adequate wage becomes challenging. This raises the question of who should be responsible for determining and evaluating their adequacy. Rather than relying on financial market participants, we question whether the determination of wages and their judgment should be left to national labour markets or their regulatory frameworks.

  In addition, we stress the importance of receiving this data point through the ESRS standards. Also, it is crucial to establish a calibration and clear definition of "adequate wages" before adopting the corresponding PAI. Specifically, clarifying the relationship between an "adequate" wage and the ESRS-defined living wage would be beneficial. Furthermore, we strongly recommend seeking clarification regarding the definition of "employees" in the formula, particularly whether it encompasses permanent employees exclusively or includes other categories as well.

Question 3: Do you agree with the newly proposed opt-in social indicators in Annex I, Table III (excessive use of non-guaranteed-hour employees in investee companies, excessive use of temporary contract employees in investee companies, excessive use of non-employee workers in investee companies, insufficient employment of persons with disabilities in the workforce, lack of grievance/complaints handling mechanism for stakeholders materially affected by the operations of investee companies, lack of grievance/complaints handling mechanism for consumers/ end-users of the investee companies)?

We have concerns regarding the proposed opt-in social indicators due to their definition and quantification, which could negatively impact socio-economically disadvantaged groups.

The precise interpretation of phrases like *"insufficient employment of individuals with disabilities within the workforce," "excessive use of non-employee workers,"* and *"excessive use of temporary contract employees"* is highly complex. Financial market participants may apply these indicators in different ways, depending on the jurisdiction, sector (considerations varying based on economic activities, including seasonal and non-seasonal), and company, resulting in decreased comparability among them and potentially putting investors at a disadvantage.

Moreover, all data related to non-employee workers are not part of the mandatory ESRS standards.

While we do not oppose the inclusion of additional opt-in indicators, we believe that adding more disclosures will not contribute to simplification efforts or provide tangible benefits to the end investor.

Question 4: Would you recommend any other social indicator or adjust any of the ones proposed?

We strongly advise the ESAs to carefully consider the formulation and measurement of any new indicators to ensure their meaningfulness and usefulness in multiple aspects. First and foremost, the indicators should provide valuable insights for **decision-making by end investors**, enabling them to make informed choices aligned with their sustainability preferences and goals, without overloading them with highly complex and diverse information.

Second, the indicators should contribute to enhancing the **investment process of financial market participants**, facilitating their analysis, risk assessment, and integration of the due diligence process in relation to principal adverse impacts into their strategies. Last, the indicators should **assist investee companies in effectively managing and addressing any adverse impacts** they may have, promoting responsible and sustainable practices. In this context, we would like to emphasise once more that FMPs should not be required to disclose information that does not correspond to or is aligned with a mandatory reporting requirement in ESRS.

By prioritizing these objectives, the development and implementation of new indicators can deliver value and drive positive change in the investment landscape.

Question 5: Do you agree with the changes proposed to the existing mandatory and opt-in social indicators in Annex I, Table I and III (i.e. replacing the UN Global Compact Principles with the UN Guiding Principles and ILO Declaration on Fundamental Principles and Rights at Work) ? Do you have any additional suggestions for changes to other indicators not considered by the ESAs?

In principle, we welcome the proposal to ensure **consistency with the Taxonomy and Climate Benchmark Regulation** by replacing the UN Global Compact principles within PAI indicators 10 (Violations of UN Global Compact principles and Organisation for Economic Cooperation and Development (OECD) Guidelines for Multinational Enterprises) and 11 (Lack of processes and compliance mechanisms to monitor compliance with UN Global Compact principles and OECD Guidelines for Multinational Enterprises) in Table 1 of Annex I with UN Guiding Principles on Business and Human Rights, including the principles and rights set out in the eight fundamental conventions identified in the Declaration of the International Labour Organisation on Fundamental Principles and Rights at Work and the International Bill of

Human Rights to align with Article 18 (Minimum safeguards) of Taxonomy Regulation.

That being said, we have concerns regarding the proposed formulae for both violations of the UN Guiding Principles and "policies to monitor compliance with or avoidable grievances and complaints handling mechanisms to address violations of at least one international guideline or principle" that require **additional clarification.** This is necessary to avoid confusion about what is considered compliant with the UN Guiding Principles and, consequently, the appropriate monitoring policies, processes, and consequences for violating these principles.

To ensure clarity, it is important to define acceptable monitoring policies and processes, as well as establish a clear understanding of what constitutes a violation of the UN Guiding Principles. For instance, entities should demonstrate ongoing human rights due diligence, monitoring of human rights risks, and a formal commitment to providing access to remedy as a minimum requirement. However, defining the parameters of a violation presents a greater challenge.

Drawing from the experience of UN Global Compact violations, it is evident that the burden of evidence is substantial, and there are discrepancies among third-party data sources in the absence of a global consensus on defining violations. Therefore, **we strongly encourage further consultation to establish the definition of relevant metrics and criteria for determining violations.**

Question 6: For real estate assets, do you consider relevant to apply any PAI indicator related to social matters to the entity in charge of the management of the real estate assets the FMP invested in?

We do not consider it relevant to apply any PAI indicator related to social matters to the entity in charge of the real estate assets the financial market participant has invested in. The Taxonomy Regulation already addresses these matters for real estate assets, so applying PAI indicators related to social issues would only duplicate the work.

The purpose of the real estate asset is what provides any social benefit. The social characteristics of the fund’s management company are irrelevant to the real estate funds’ sustainability objectives.

Adding such PAI indicators would contribute to the existing information overload that the existing disclosures constitute for the investors, especially the retail investors.

Question 7: For real estate assets, do you see any merit in adjusting the definition of PAI indicator 22 of Table 1 in order to align it with the EU Taxonomy criteria applicable to the DNSH of the climate change mitigation objective under the climate change adaptation objective?

In general, the change makes sense, permitting that the below two main challenges are considered.

- The current lack of a European homogeneous EPC rating system based on letters (A/B/C).
  This leads to an unequal definition and quality of the regional EPC which may penalize

or favor some buildings according to their locations.

- Existence of very few detailed and relevant pan-European benchmarks that help to define the top 30%, which may exclude from the top 30% high energy efficiency and ESG quality buildings.

Question 8: Do you see any challenges in the interaction between the definition "enterprise value" and "current value of investment" for the calculation of PAI?

We see a challenge in estimating the detention percentage (current value of the investment/investee company's enterprise value) as the delegated regulation does not include any indication on how to determine the detention percentage for periods other than year-end. The detention percentages during the year also have to be consistent with the impact figures published at year end-end by the company.

The approach described in the ESAs' Q&A consists in calculating the detention percentage from the number of securities held by investors at the end of each quarter with the current value of investment calculated by taking as reference the ones included in the calculation of the enterprise value for the fiscal year-end. This is to ensure that the change in the current value of investment represents a change in the number of investments held and not a change in the valuation of that investment.

However, this:

- does not solve the consistency issue: as it focuses on how to manage the impact of financial market fluctuations, it does not resolve issues regarding changes in debt profile, activity perimeter of the company, credit event, etc., but introduces significant impact in case of changes in the capital structure of the company (stock split, capital increase, corporate action).

- introduces unwelcome complexity on the calculation approaches for only a limited number of PAIs while the others can be calculated based on quarterly market valuations, increasing operational risks.

- introduces a huge additional workload for reporting and is contrary to common practices for portfolio analysis (presentation of asset allocations, performance and risk calculations, look-through analysis for prudential reports), which are based on market valuations and this may at product level lead to breach of regulatory ratio in case the PAI indicator is part of the product binding objectives.

Consequently, it will be virtually impossible to reconcile financial, risk and PAI assessments for portfolios, or provide look-through analysis for investments in funds.

To reduce the bias in the PAI impact calculation, we recommend that the existing Q&A be modified to allow an approach that relies **on a quarterly estimation of the enterprise value based on market prices at each calculation point (e.g. quarterly) to calculate the detention percentage.**

Lastly, we ask regulators to **ensure that the estimation of enterprise value aligns with CSRD and is readily accessible for FMPs to make use of**, particularly considering the requirement to determine PAI on at least four specific dates during the reference period.

Question 9: Do you have any comments or proposed adjustments to the new formulae suggested in Annex I?

As a preliminary comment, we highlight, once more, the essential need to ensure that **the new formulas and definitions of PAI under the SFDR align entirely with the standards set by CSRD and ESRS.** The ESAs must ensure consistency, as the forthcoming delegated regulation from the European Commission will adopt these standards.

It is useful to provide calculation formulas for the individual indicators to avoid diverging interpretations. However, complexity should not be increased by the new calculation formulas. The ESAs should also not introduce additional requirements or change how the industry has already implemented the calculation of indicators. Below we highlight specific issues with the newly proposed formulas.

Threshold versus Transparency

"**Exposure to companies active in the coal sector" indicator:** the coal sector is not clearly defined and there is currently no requirement to disclose this information at the investee company level. It remains unclear if it is related to coal power plants, trading, transportation, or mining. Financial market participants should be given flexibility in defining a threshold to determine whether a company is active in the coal sector provided that this is disclosed as part of the PAI statement.

"Exposure to companies active in the fossil fuel sector" indicator: As per companies' activities in the coal sector, financial market participants should be given flexibility in defining a revenue threshold to avoid treating companies with varying levels of exposure equally, provided that any threshold is disclosed as part of the PAI statement.

The complexity of the data to be collected

"Energy consumption intensity per high impact climate sector" indicator: obtaining the information needed for the nominator and denominator can be difficult, especially for conglomerates operating in multiple NACE sectors. We suggest that as long as there is no reporting obligation of this indicator per NACE sector applicable to the underlying investee company, then the overall energy consumption intensity is allocated to the NACE sector with the highest share in the company's revenues.

"Share of non-renewable energy consumption and production" indicator: the current wording in the RTS does not indicate a requirement to split between consumption and production. As per energy consumption intensity per high-impact climate sector, we are unsure whether the split between consumption and production is actually available or will be required as part of CSRD and ESRS.

Formula inconsistent with industry understanding or with the narrative

Board gender diversity indicator: current description is the average ratio of female to male board members in investee companies, expressed as a percentage of all board members. However, this is not aligned with the formula included in the consultation which has male board members as the numerator. Whilst using male board members as the numerator is consistent with showing the ‘negative’ impact, the current wording will have to be updated to ensure this indicator cannot be misinterpreted. Although our preference is for the ESAs to retain the industry’s current understanding (i.e. female board members as numerator) to avoid any need for restatement.

Number of identified cases of severe human rights issues and indicators (number of cases of severe human rights issues and incidents connected to investee companies on **a weighted average basis**)**:** Reference to weighted average basis has been removed in the consultation. As per the board gender diversity indicator, the narrative for the indicator must match the proposed formula to calculate the indicator.

“Investee countries subject to social violations” indicator: We welcome the formula based on exposures and propose to amend the narrative and description of PAI 20 “Number of investee countries subject to social violations...” to “exposure to investee countries subject to...).

Evolving list

As a general observation, we note that the last available data to calculate the PAIs can lead to distortions in effective exposure. This is because the data used for calculation may not have been available or may have changed since the moment the PAI indicator was initially determined. It is especially crucial to consider this aspect given that most indicators are based on evolving factors.

For the aforementioned "**amount of accumulated earnings in non-cooperative tax jurisdictions**" indicator, the EU revised list of non-cooperative jurisdictions for tax purposes is a dynamic list with changing jurisdictions. Therefore, it should be specified at what time point the list should be used in the calculation. Please also refer to the comments in Q1.

Others (clarifications required)

“Sovereign GHG intensity” indicator: we would welcome clarifications on the scope of a country’s GHG intensity, focusing in particular on territorial emissions, treatment of agencies, treatment of imported emissions, and treatment of exported emissions. Reference to a country’s GDP should be clear that this should be the PPP-adjusted GDP as recommended by PCAF. The PPP adjustment of GDP allows for comparing the real sizes of the economies and the output by subtracting the exchange rate effect and mitigates the negative effect for countries where production and emissions are concentrated. We also identify the possible issue of double counting for indirect investments (fund of funds).

"**Gender pay gap" indicator**: the formula floors the gender pay gap at 0 which may not be the case in the related ESRS. To address the gender gap, companies, where females are paid more than males, should also be taken into consideration. Thus, the formula should allow for negative values in cases where women are paid more.

Overall, these modifications may introduce **operational challenges as the market transitions simultaneously to the new calculation formula and adjusts disclosures accordingly.** It would therefore be highly beneficial to receive **comprehensive guidance and allow sufficient time for implementation**.

Furthermore, these changes must be **implemented only on January 1st** to minimize their impact on the average PAI calculation within the reporting year. Clarification is required on how FMPs should treat year-on-year changes to certain indicators. This becomes relevant when the ESAs change formulas resulting in previously disclosed indicators no longer being comparable. We, therefore, believe it best not to restate the prior year's values and rather provide an explanation within the explanation column.

Question 10: Do you have any comments on the further clarifications or technical changes to the current list of indicators? Did you encounter any issues in the calculation of the adverse impact for any of the other existing indicators in Annex I?

PAI indicators should be designed to **effectively capture and quantify adverse impacts**, providing valuable insights for the investment process. This is of paramount importance, as these indicators are instrumental in evaluating whether sustainable investments cause no significant harm. However, it is worth noting that certain metrics may fall short of accurately measuring the actual adverse impacts. Presented below are a few illustrative examples:

PAI 09. Hazardous waste (and radioactive waste ratio): The adverse impact of hazardous waste is not solely determined by its volume, but rather by the extent of inadequate or unregulated disposal into the environment. Also, nuclear waste and other hazardous waste, although both calculated in metric tonnes have very different levels of magnitude. To facilitate an effective assessment in relation to nuclear waste, it would be appropriate to separate it from hazardous waste with two separate indicators.

PAI 20. Investee countries subject to social violations: Certain metrics may be overly generalised, such as an indicator assessing social violations across countries, which could categorise around 75% of all countries as causing significant harm.

PAI 22. Exposure to energy-inefficient real estate assets: Some indicators that rely on EU regulations, which limits their usefulness for investments outside the EU. Incorporating globally recognised science-based methodologies would greatly enhance their applicability to investments on a global scale.

The **current misalignment of timelines between SFDR and CSRD** creates a **data gap** that significantly impacts the accuracy and reliability of the results, even when diligent efforts are made to collect or estimate the data. The use of different frameworks, reporting standards, and methodologies by investee companies makes it challenging to consistently compare and aggregate data. As was shown by the above examples, data availability, and quality can vary greatly across different companies, industries, and regions, introducing potential biases. Assessing and estimating qualitative information, such as company policies, management practices, processes, and compliance mechanisms, becomes particularly challenging in the absence of reporting obligations. It requires judgment and expertise assessments, which may yield different results from data providers or FMPs. For certain PAIs, the collection of raw data is so limited that assessing or estimating the missing data becomes a significant challenge as it could lead to data being misleading due to the risk of missing data being understated.

In addition, the ESAs could also consider **establishing thresholds of coverage** (considering both raw data and estimates) below which the PAI becomes optional, or inapplicable for extrapolation on investments with missing/insufficient data (recognizing that it may not be meaningful for all underlying investments). This would be particularly crucial in case PAIs are not made fully mandatory by CSRD/ESRS or are postponed due to additional phasing.

Question 11: Do you agree with the proposal to require the disclosure of the share of information for the PAI indicators for which the financial market participant relies on information directly from investee companies?

We suggest, for the sake of clarity and to enable investors to assess the robustness of the disclosed indicators in the PAI report to keep it as **a good practice** rather than a mandatory disclosure, as the effort required outweighs the insignificant value it provides for a number of reasons.

Firstly, it is challenging to determine the share of information for the PAI indicators that financial market participants rely on from investee companies, as this data is complex. Implementing the proposal would require advanced and costly IT solutions, which may not be practical or cost-efficient. Second, there are doubts about the value of this information for the end investor, especially retail investors.

This would be coherent with what the ESAs outlined in Question II.1 in the November 2022 Q&As, identifying as a *"**good practice, but not obligatory,** for financial market participants to include, where relevant as part of the disclosures required by Article 7(1)€ of the Delegated Regulation and for each PAI considered by the financial market participant: [..]the proportion of investments for which the financial market participant has relied on data obtained directly from investee companies, in order to calculate the corresponding indicator."*

However, it is important to emphasize that the ESAs need to provide a clear specification regarding **what qualifies as "information collected directly from the investee company."** This specification should clarify that this category includes data gathered through and reported by data providers which in turn have been reported by investee companies. To manage the reporting burden, investment managers should be allowed to rely on third-party sources for reported information rather than sourcing it directly from investee companies or issuers. As described above this could have the effect of restricting certain strategies' adoption of sustainability, impacting performance, reducing investor choice, and increasing cost.

If the ESAs consider adopting this amendment, it is crucial to resolve the ambiguity surrounding the **source of the data.**

By distinguishing between data directly collected from investee companies and data reported by information providers, there is a potential risk of creating an unjustified hierarchy between the two sources. Many financial market participants opt to obtain data for PAI calculations from data providers who specialize in collecting and enhancing data usability. The ability to utilize data providers is an essential aspect of market efficiency, resulting from a rigorous selection process and supplier due diligence, ensuring the equivalence of directly collected and provider-sourced data. Furthermore, taking into account the establishment of ESAP, we believe that differentiating between data collected directly by FMPs from investee companies or through a provider (or in the case of ESAP, platform) should not be a particular significant information, worthy of disclosure.

The relevant difference, worthy of disclosure, should be between **reported data** (regardless of collection method) and **estimated data**. Estimated data refers to information obtained through additional research and internal or third-party estimation processes.

Question 12: What is your view on the approach taken in this consultation paper to define 'all investments'? What are the advantages and drawbacks you identify? Would a change in the approach adopted for the treatment of 'all investments' be necessary in your view?

The approach of considering all investments encompass all assets invested by financial market participants has a significant drawback. By including "irrelevant" assets in the **denominator** while excluding them from the numerator, as demonstrated in the ESAs' example, the PAI value is effectively diluted.

Instead, we propose that **the category of "all investments" only includes the eligible assets**, such as corporates (for a corporate-related PAI), sovereigns and supranationals (for a sovereign PAI), or real estate assets.

Nonetheless, to ensure that the end investor understands the impact of their investment for each 1 euro invested in a product, it is particularly crucial to additionally disclose the **eligibility ratio.** This ratio represents the **proportion of eligible asset exposure over the Net Asset Value**. This is preferred over using Assets under Management, as it may not precisely reflect the volume of investments made by end investors in the financial products. It also facilitates the aggregation of PAIs for their portfolio's direct and indirect eligible investments (including through funds, fund of funds, and other means).

Within this question, we would like to take the opportunity to raise the **calculation issues due to insufficient coverage** i.e. due to the absence of reported data and the absence of reasonably reliable estimates. There are multiple ways to deal with this, this can among others be:

- **Reporting on a full basis, extrapolating uncovered data on eligible assets in the numerator based on the average of covered data (which is similar to adjusting the denominator to investments with covered data).** This offsets the lack of data and allows for some comparability.
- **Only reporting the covered data (reported or reliably estimated) in the numerator.** This option disregards missing data (in the numerator) as if they were equal to zero which is a misleading understatement and hinders comparability. However, the issue of attributing zero adverse impact to non-reporting companies will be resolved by adjusting the denominator to only include companies where data have been reported or estimated.

A **precautionary approach** should be adopted to adjust the denominator to "covered" data or extrapolate missing data in the numerator.

Including the eligible assets in the category of "all investments" promotes consistency and enables the measurement and comparison (at a specific moment and over time) of the impact on the relevant assets where investment decisions can be made to consider the PAIs. It facilitates the comparison of how PAIs are managed by the entity (or in a product) and prevents the dilution effect of a denominator based on the total assets under management.

As such, if based on assets under management, allocating more cash or government bonds in a fund could artificially "enhance" or "diminish" the PAI associated with investee companies.

Furthermore, in order to ensure understanding by retail investors, we would like to stress the significance of having a clear and preferably standardized disclosure developed by the ESAs. We see merit in presenting the coverage figure alongside this disclosure, accompanied by an appropriate explanation (to be determined by the ESAs).

In case of very low PAI coverage, please refer to our response to Q10.

Question 13: Should information on investee companies' value chains in the PAI calculations only be included where the investee company reports them?

Requiring the inclusion of information on investee companies' value chains in PAI calculations poses practical challenges due to a **significant lack of data.**

Therefore, we **support the proposal to consider information on investee companies' value chains to the PAIs where the investee company is reporting impacts in its value chain according to the ESRS under its own materiality assessment performed in accordance with the ESRS.** If the investee company is not reporting its value chain's adverse impacts under the ESRS or this is disclosed in other reporting, then those do not need to be taken into account for the PAI calculations.

DERIVATIVES

Question 14: Do you agree with the proposed treatment of derivatives in the PAI indicators or would you suggest any other method?

Question 15: What are your views with regard to the treatment of derivatives in general (Taxonomy alignment, share of sustainable investments and PAI calculations)? Should the netting provision of Article 17(1)(g) be applied to sustainable investment calculations?

Derivatives are an integral part of asset management in the best interest of investors. We, therefore, appreciate that the topic of derivatives in being discussed in this Consultation Paper, as it rightly emphasizes the role of derivatives in investment decisions while seeking to provide clarity on how to incorporate them into investors' ESG disclosures.

Overall, we must ensure a **streamlined approach to the PAI indicators compared to taxonomy alignment and sustainable investments.** To incorporate derivatives solely based on the risk of greenwashing would contradict their treatment in the UCITS/AIFMD Guidelines and fail to align with management objectives and actual market practices. It is, thus, crucial to ensure a consistent approach for all three concepts: PAI, SI, and taxonomy.

It is also crucial to provide further clarification on **how derivatives' exposures might be assessed**, particularly in the context of PAIs, due to various differentiating factors and **data challenges.** In principle, derivatives may (or may not) be included in the calculation of PAIs at both the entity and fund levels, as they are indeed part of the Assets under Management.

However, it is important to differentiate between **the purpose of the derivative** (for example promotion of E/S characteristics or temporary exposure for technical issues) and the **different types of derivatives** when setting the calculation methodology. Different types of derivatives require a nuanced and targeted treatment, depending on their specific characteristics. Below are some important guiding principles to consider:

- In the case of **currency or interest rate derivatives** and **inflation derivatives or insignificant and/or temporary derivatives,** there are no investments in economic activities and no investment decision as meant for the PAI.

- If the derivative serves to attain the ESG objective, like a **derivative with an equity or corporate underlying,** it should be considered.

- The same would apply for **derivatives with exposures to a single sovereign issuer**, which can be captured under the sovereign PAIs 15/16.

- For **synthetically-replicated passive funds and structured products,** it should be made clear that the focus, if any, should be on the exposure of the fund, rather than physical investments.

  Therefore, for structured products and passive management using synthetical replication of an index :

  - The "physical" portfolio swapped against the performance should be disregarded
  - The performance leg of the swap, if considered for PAIs as well as for sustainable investments + taxonomy alignment, would need a look-through "delta" approach. We recognise that a look-through exercise might be very complex (especially in the case of broad indices).
  - A closed-end product such as a structured fund or note should be allowed to freeze the delta at launch for the lifetime of the product.

- For specific portfolio techniques, the portfolio manager may need to specifically disclose their methodology.

Regarding the principle put forward to consider the end physical investment information, as this is not an available data for the industry, we will not be able to take into consideration the value chain principle and the end physical investment.

Within EFAMA, we explored the five below options for the treatment of derivatives:

- Denominator is NAV; numerator for both PAIs, SIs and Taxonomy alignments includes derivatives at market value.
- Denominator is NAV; numerator for both PAIs, SIs and Taxonomy alignments do not include any derivatives.
- Denominator is NAV; numerator for both PAIs, SIs and Taxonomy alignments include derivatives on a delta notional (AIFMD approach).
- Numerator and denominator include derivatives in delta exposure; for both PAIs, SIs

and Taxonomy alignments.

- ESMA current proposal for derivatives.

Due to the intricate nature of the subject, despite the efforts made by our Working Group, we have currently been unable to achieve a unanimous agreement. Therefore, we kindly request that the ESAs allow the industry additional time to reach a consensus on the treatment of derivatives. We are also willing to engage in further discussions with regulators regarding this matter. It is important to note that an alternative outcome could potentially subject market participants and underlying investors to various methodologies for determining the minimum investment proportion in derivatives transactions. This would lead to greater inconsistency and would contradict ESAs' objectives.

In the meantime, in line with the SFDR disclosure regime, we favour that FMP remain transparent about the extend of the use of derivatives, the way they use those for the achievement of the E/S profile of the managed product, and the calculation methodology applied for the different impacted metrics.

DNSH DISCLOSURE DESIGN OPTIONS

Question 17: Do you agree with the ESAs' assessment of the DNSH framework under SFDR?

A sustainable investment encompasses three subcomponents: contributions, DNSH, and good governance. Expanding the existing disclosures by introducing quantitative thresholds for only one subcomponent (i.e. DNSH), will not effectively resolve the issue of meaningful comparisons of the overall assessment of SI. The lack of a clear definition of sustainable investment in SFDR Level 1 poses challenges for conducting accurate comparisons of the sustainability assessment, even for professional investors. Keeping in mind (i) that the EC is considering a possible SFDR Level 1 review to enhance legal clarity for key definitions, including SI and (ii) the integral role of DNSH in SIs and the potential inclusion of this concept in the SFDR Level 1 review, we firmly believe that **the current timing is not conducive to addressing additional changes and requirements, given that the significance and application of the DNSH test might completely change.**

The constant changes are a risk not only in relation to consistent implementation of the rules but also and beyond that to the credibility and robustness of the overall SF framework. In this respect, **we strongly recommend aligning the timeline of the review on topics, such as DNSH, so that the Level 1 rules are assessed** and reviewed before bringing further and detailed changes at Level 2. Similarly, making relevant responses regarding the long-term outlook becomes very difficult, as they depend on the forthcoming developments arising from the Level 1 review and the market's ability to adjust to the new Taxonomy and SFDR concepts.

Also, we do not agree that moving to a Taxonomy-based system would solve the issue. At the moment, there is: i) insufficient data available under the Taxonomy ii) the Taxonomy works by reference to activities rather than entities iii) the Taxonomy thresholds are too stringent for many valid sustainable strategies and iv) the Taxonomy does not cover all economic activities. Moreover, the DNSH criterion within Taxonomy is largely qualitative rather than quantitative, primarily focused on assessing alignment with EU environmental regulations using a binary approach.

Question 18: With regard to the DNSH disclosures in the SFDR Delegated Regulation, do you consider it relevant to make disclosures about the quantitative thresholds FMPs use to take into account the PAI indicators for DNSH purposes mandatory? Please explain your reasoning.

As a disclosure framework, we do **not support** the idea of requiring financial market participants to set **quantitative thresholds** across mandatory indicators as part of the DNSH assessments. We strongly believe that expanding the disclosures on the DNSH assessment of SI does not provide any additional value. The publication of thresholds used for DNSH does not guarantee comparability between financial market participants as different PAIs consideration methodologies can be used in the DNSH analysis, leading to further confusion for investors.

Moreover, a sustainable investment encompasses not only DNSH but also contribution and good governance. Focusing solely on one component of SI in the disclosure requirements fails to capture all aspects of the overall SI assessment.

Furthermore, it is imperative to consider the following points:

- Thresholds for specific PAIs should be evaluated in a nuanced manner, such as taking into account sector-specific variations and also the direction of travel (i.e. focussing on more forward-looking thresholds).
- Instead of quantitative thresholds, binary tests (Y/N) can be a valuable alternative, as is the case with the Taxonomy DNSH criteria. A qualitative approach might better capture the complexity of assessing certain impacts.
- The availability of data is a crucial factor to consider as meaningful thresholds for PAIs may be limited by the lack of accessible data.
- While we understand that the goal is to give the market access to information on compliance with the DNSH criteria, there is a real risk of "disclosure overload", especially if this would have to occur across quantitative thresholds. For example, the publication of quantitative thresholds implies that, for each change or adjustment made in the methodology, all the relevant documents must be modified which creates a huge administrative burden.

In light of these circumstances, we urge policymakers to prioritise excluding the SI topic from Level 2 considerations for the short to medium term.

Question 19: Do you support the introduction of an optional "safe harbour" for environmental DNSH for taxonomy-aligned activities? Please explain your reasoning.

Based on the recent European Commission FAQ of 12 June 2023 for taxonomy-aligned activities, we have understood that those are automatically qualified as sustainable investments. Therefore, the optional "safe harbour" is not required.

Question 20: Do you agree with the longer term view of the ESAs that if two parallel concepts of sustainability are retained that the Taxonomy TSCs should form the basis of DNSH assessments? Please explain your reasoning.

The inherent inconsistencies between the two parallel concepts of sustainability (SFDR – investment level and Taxonomy – activity level) would be best addressed by a Level 1 SFDR review in combination with further development of the EU Taxonomy. A more complete Taxonomy that covers social sustainability and more activities could help resolve issues within SFDR.

Furthermore, as a basis for DNSH assessment, the Taxonomy DNSH criteria should cater to assessing entities. This requires adequate data and thresholds that cover all economic activities. Any criteria and guidance on estimates should also account for markets and assets that are not required to disclose taxonomy alignment to avoid discouraging investments in, for example, emerging markets and unlisted companies.

AMENDMENTS REGARDING GHG EMISSIONS REDUCTION TARGETS

Question 22: Do you agree that the proposed disclosures strike the right balance between the need for clear, reliable, decision-useful information for investors and the need to keep requirements feasible and proportional for FMPs? Please explain your answers.

Greenhouse gas emission reduction targets can be considered a transversal target across financial products, considering the existing variations in product types that encompass these targets and the diverse approaches employed by financial market participants to achieve them.

In line with this, we support the ESAs' expressed **need for transparency in disclosing greenhouse gas emission reduction targets** associated with financial products. This aligns with the overarching goal of the SFDR as a disclosure framework. The rationale behind this need primarily stems from the requirement to provide investors with high-quality disclosure at the product level, enabling them to compare financial products effectively and evaluate their potential contribution towards financial market participants' climate commitments.

However, to ensure the retail investor understands the information presented in the prospectuses, the **primary focus of the disclosures should center around i) the relevant commitments associated with the products in question and ii) their trajectory for reducing GHG emissions, if any.** We recommend that the ESAs allow **for simple explanations that enable investors to comprehend** the target and the financial product's intended approach to achieving it.

Thereby, we do not believe that only targets, as a measure of financed GHG emissions, should be disclosed. **As a disclosure framework, we do not agree that the ESAs should be mandating a specific approach to climate target-setting given the recognition that climate targets for investments may rely on a variety of different approaches.** For example, some EFAMA members take a 'bottom-up' approach to understand each holding

within their portfolios (as such their NZAMi portfolio targets) and are focused on the robust alignment of each company with a 1.5C pathway and strategy appropriate to its industry and regions of operation. The concepts of alignment and the pathways themselves are still evolving but their methodologies and assessments are rooted in the company-level criteria of the Paris Aligned Investment Initiative Net Zero Investment Framework. Whilst their research process requires them to monitor emissions performance, they do not consider the setting of a simple top-down portfolio or firmwide emissions pathway as a critical tool to direct their approach. Moreover, while environmental strategies can have targets, we would like to point out that social strategies may not necessarily require them. To allow asset managers to adopt different strategies and recognise the evolving nature of these strategies, **we urge the ESAs not to limit targets to finance emissions** in order not to stifle innovation. Further standardization (on the format and calculation methodologies) could be envisaged at a later stage to facilitate the comparability of products and avoid the risk of greenwashing. The industry should be involved in this subsequent standardization through relevant consultations. Indeed, for funds that include GHG targets in their strategy, we must ensure that the retail investor receives **consistent information from each FMP** regarding “how the fund intends to achieve the target”. Otherwise, clients would not be able to compare the robustness of different strategies, potentially putting FMPs with concise descriptions at a disadvantage compared to those with more detailed or marketing-oriented explanations. We believe that this approach better aligns with the disclosure framework and the current practice of providing explanations for "sustainable investment" in pre-contractual documents.

Question 23: Do you agree with the proposed approach of providing a hyperlink to the benchmark disclosures for products having GHG emissions reduction as their investment objective under Article 9(3) SFDR or would you prefer specific disclosures for such financial products? Do you believe the introduction of GHG emissions reduction target disclosures could lead to confusion between Article 9(3) and other Article 9 and 8 financial products? Please explain your answer.
Currently, prospectuses are already too long for investors to read. Therefore, we support the approach of providing a hyperlink to the benchmark disclosures for products with GHG emissions reduction as their investment objective under Article 9(3) of the SFDR. This allows to prevent further lengthening of prospectuses, as introducing hyperlinks can be an effective solution.

Question 24: The ESAs have introduced a distinction between a product-level commitment to achieve a reduction in financed emissions (through a strategy that possibly relies only on divestments and reallocations) and a commitment to achieve a reduction in investees’ emissions (through investment in companies that has adopted and duly executes a convincing transition plan or through active ownership). Do you find this distinction useful for investors and actionable for FMPs? Please explain your answer.
With the ESAs' specification that a combination of multiple strategies is permissible and mutually exclusive, financial market participants are granted some flexibility in determining the most appropriate means of achieving their targets. However, transparency regarding the

chosen approach remains essential. *Please refer to our answer in Q22.*

Recognising the usefulness for final investors, FMPs should disclose the relevant commitments associated with the products in question and their trajectory for reducing GHG emissions, if any, in a simple comprehensive manner. Again, excessive prescription concerning strategies that FMPs can employ to meet emission reduction targets should be avoided. Therefore, **the three strategies described should not be construed as mutually exclusive, but rather as examples among several possibilities that asset managers can adopt, either individually or in combination.**

Question 25: Do you find it useful to have a disclosure on the degree of Paris-Alignment of the Article 9 product's target(s)? Do you think that existing methodologies can provide sufficiently robust assessments of that aspect? If yes, please specify which methodology (or methodologies) would be relevant for that purpose and what are their most critical features? Please explain your answer.

We believe that setting ambitious climate targets should **not be limited to Article 9 products**, as it is not explicitly listed as one of the criteria for defining such products. Since the SFDR primarily functions as a disclosure regulation, it should be allowed to disclose the alignment of financial market participants' emission reduction targets with the objective of limiting global warming to 1.5°C, even for financial products that fall **under Article 8 of the SFDR.**

In addition, we have the following additional comments:

The wording of the question could be improved as follows: The question lacks clarity, as the term "Paris-Alignment" can be interpreted differently by different market participants. To address this issue, we recommend requesting more details about the scenario and methodologies used for the product, rather than using the current phrasing of the questions.

Regarding the **methodology**, there is currently a lack of standardized metrics to assess the Paris-aligned decarbonization pathway (cvar, carbon budget, and ITR,..). FMPs are utilizing various pathways to achieve Net Zero, which adds complexity to the situation. Given the absence of a universally accepted robust methodology for reaching Paris-aligned goals, it is important to focus on ensuring that FMPs are transparent in relation to their chosen methodology (e.g., commitment over time, intermediary targets) for meaningful comparability without overly prescribing specific methodologies.

Moreover, in the case of the **real estate sector,** measuring GHG emissions reduction at scale is a challenging task. There is no guidance on precisely what should be measured, such as whether it should include the entire building, scope 1 and 2 emissions, or emissions controlled by landlords or tenants. This emphasizes the need for a clear and consistent definition of "decarbonization" in disclosure. While the direction may be clear, it is also important to differentiate between absolute emissions and relative emissions (e.g., per square meter or square foot).

However, introducing the option of "not assessed" in the template can accommodate situations where existing methodologies may not adequately assess this particular aspect.

Lastly, the fact of having an objective of alignment with 1.5°C should not replace the disclosure

of quantitative targets.

<u>Question 27</u>: Do you agree with the proposed approach to require that, at product level, Financed GHG emissions reduction targets be set and disclosed based on the GHG accounting and reporting standard to be referenced in the forthcoming Delegated Act (DA) of the CSRD? Should the Global GHG Accounting and Reporting Standard for the Financial Industry developed by PCAF be required as the only standard to be used for the disclosures, or should any other standard be considered? Please justify your answer and provide the name of alternative standards you would suggest, if any.
We agree with the proposed approach to require that, at product level, Financed GHG emissions reduction targets be set and disclosed based on the GHG accounting and reporting standard to be referenced in the forthcoming Delegated Act (DA) of the CSRD. We understand that this is referencing PCAF. **We support the use of the PCAF Standards** as the basis for accounting for financed GHG emissions by financial institutions, which has been widely adopted by the investment industry. As such, we welcome the Commission's ongoing consultation on ESRS referencing PCAF. These standards have attained global acceptance and widespread adoption, making them valuable resources for FMPs in relation to accounting and reporting of GHG emissions. However, as detailed in our response to Q22, it is imperative to acknowledge the importance of maintaining a diverse landscape of decarbonisation target setting at this stage. This being said, we would like to raise that the financed emissions standard does not provide explicit guidance on methods to calculate financed emissions for every financial product including the following: private equity that refers to investment funds, green bonds, loans for securitization, exchange-traded funds, derivatives (e.g., futures, options, swaps), initial public offering (IPO) underwriting, and more. The focus should be on achieving harmonized data and reporting across all asset classes, which need to be considered further. **At the same time, it is important to consider the ongoing efforts by both EFRAG and IFRS, as they may result in the establishment of different rules or standards that need to be taken into account.**

<u>Question 28</u>: Do you agree with the approach taken to removals and the use of carbon credits and the alignment the ESAs have sought to achieve with the EFRAG Draft ESRS E1? Please explain your answer
Subject to our response to Q22, we support the proposal to set financed emission targets in gross terms. **Therefore, if financed emission targets are set in gross terms**, then **the separate target setting related to off-sets** of investee companies (in association with baseline, intermediate target, and final target), **is not proportionate and decision-useful**. It would be a considerable burden for FMPs to retrieve this information on a best-effort basis (also investing

in data providers and direct engagement), with little to no added value. We suggest the “progress on off-sets” template (e.g. in Annex IV for art8) is therefore removed.

Reporting on off-sets should be mandatory only when the FMP declares that either it will off-set residual emissions of the product, or that it will take into account the off-sets of investee companies.

Question 29: Do you find it useful to ask for disclosures regarding the consistency between the product targets and the financial market participants entity-level targets and transition plan for climate change mitigation? What could be the benefits of and challenges to making such disclosures available? Please explain you answer.

Disclosing the alignment between product targets and the entity-level targets and transition plan for climate change mitigation will not provide any significant additional value as the targets set at the entity level will cover not just financed emissions but also emissions from the entity’s operations, which will be different from product-level targets which will be by nature all related to financed emissions.

In addition, entities typically manage both sustainable and non-sustainable products and have a fiduciary responsibility to all investors to manage products in accordance with their respective remits. It is not appropriate to link product-level objectives for sustainable products to entity-level objectives when at the entity level there may very well be a fiduciary responsibility to their non-sustainable product investors. Conflating the two creates a conflict of interest and/or risks which mislead investors that entities are targeting sustainable outcomes for their non-sustainable products.

What matters is the quality of the transition plan that the company has put in place as well as the progress to date (when available) and/or an explanation of why the targets have not been met with corrective actions planned to meet the targets and other commitments set out in the transition plan. In this context, financial market participants can consider a range of steps to take. These steps may include taking into account science-based targets, assessing the company's proposed approach to measuring transition, and using methods like the Net Zero Investment Framework to evaluate alignment with Net Zero.

To establish a clear and straightforward basis to compare entity-level targets, it is important for products to explicitly disclose their targets and demonstrate progress in achieving them. This expectation means that products with greenhouse gas emissions reduction targets will be included when calculating the entity's overall financed emissions reduction targets. Introducing additional disclosures only compounds the complexities that retail investors are already grappling.

SIMPLIFICATIONS OF TEMPLATES

Question 30: What are your views on the inclusion of a dashboard at the top of Annexes II-V of the SFDR Delegated Regulation as summary of the key information to complement the more detailed information in the pre-contractual and periodic disclosures ? Does it serve the purpose of helping consumers and less experienced

retail investors understand the essential information in a simpler and more visual way?
We emphasize the need for careful consideration of the challenges involved in altering the current Annexes in the prospectus. Such changes necessitate substantial modifications (and thus significant resources) to the underlying operating models of FMPs. Therefore, a **comprehensive cost-benefit analysis should be conducted before implementing any modifications to the templates**. This analysis should prioritize the identification of the most advantageous and impactful changes to ensure an **optimal balance between costs and benefits.** Furthermore, any revised templates or additional disclosures should be concluded only after the ESAs have conducted **consumer testing scenarios** involving retail investors. Subject to the positive results of the cost-benefit analysis and consumer testing, we in principle **support the introduction of the dashboard initiative**. It could offer a more transparent and succinct representation of the overall share of sustainable investments, thereby taking a significant step towards promoting sustainable investments and enhancing transparency for retail investors. Furthermore, it could serve as an effective summary in assessing the alignment of a product with a client's sustainability preferences.

Question 31: Do you agree that the current version of the templates capture all the information needed for retail investors to understand the characteristics of the products ? Do you have views on how to further simplify the language in the dashboard, or other sections of the templates, to make it more understandable to retail investors?
As an initial observation and reiterating our previous statement, we firmly support an investor-centric approach that reduces the number of disclosures and promotes standardization for the remaining ones. Nevertheless, a comprehensive evaluation of SFDR Level 1 is necessary to address this issue, and any standardization efforts should be focused solely on this issue. Even with the proposed "quick fixes" in the short to medium term, the SFDR disclosure requirements remain highly complex and are unlikely to be understood by retail investors. If the ESAs, nonetheless, intend to make interim changes before the SFDR L1 review, below are concrete proposals to further simplify the sections and the language of the dashboard. ***Simplifying the language of the dashboard*** To enhance the practical usefulness of the dashboard summary, we believe that **the current 250-character limit** for describing environmental and/or social features, as well as indicating the proportion of assets, is **insufficient.** We also question the additional box, considering that the first question in the template already asks for a description of the environmental and/or social characteristics of the product. Having two side-by-side narratives on the same topic may simply confuse the investor. Instead, we recommend an extended summary either by increasing the character limit or limiting the number of sentences within the box. Alternatively, one could include only a percentage, similar to the other boxes, which provides a detailed description of the features. Furthermore, we would like to point out an inconsistency within the core element (iv) of the dashboard, specifically regarding the phrasing of GHG emissions reduction (i.e. “This product

targets a reduction of ___% of greenhouse gas emissions in the **atmosphere** by ___"). The use of the word "atmosphere" could potentially be interpreted in two different ways: i) either as a general reduction of GHG emissions or ii) as the reduction of emissions already present in the atmosphere. In contrast, the GHG section of the template does not employ the term "atmosphere," but rather focuses on whether the product has a greenhouse gas emission reduction target.

We also propose to amend the sentence by adding "remove this statement, icon, **and box** where the product does not have a decarbonisation target".

Also, the wording in the first box of Article 8 products is misleading and should be revised. Instead of stating "this product has some sustainability characteristics, but does not have a sustainable investment objective," we suggest rephrasing it as "This product promotes environmental and/or social characteristics".

Simplifying other sections of the template

Pre-contractual disclosures

The current templates reveal a lack of **clarity** and logical **sequencing** in certain questions, leading to redundant or fragmented information that ultimately hampers investors' comprehension and overall understanding. To illustrate this issue, kindly consider the following examples:

- The questions concerning the binding elements of the investment strategy should be placed at the beginning of the template and closer to the section regarding sustainability indicators to underline that the binding elements of the investment strategy and sustainability indicators are intrinsically linked. We also appreciate a clearer explanation of what is meant by "binding elements." Are we expected to provide a list of these binding elements, or should we include the percentage mentioned in the "asset allocation" question, which was previously placed in the investment tree?

- Within Annex III, the questions "How do sustainable investments not cause significant harm to any environmental or social investment objective?" and the sub-question "How have the indicators for adverse impacts on sustainability factors been taken into account?" appear repetitive and could be merged into a single question.

- When describing the investment strategy, the focus should solely be on describing the ESG strategy rather than the general investment strategy. This aspect should be clarified.

- The question should be revised as follows: "If this product allocates a minimum investment of [x]% to sustainable investments, what are the objectives of these sustainable investments?" This modification is necessary as an Article 8 fund may not necessarily have sustainable investments.

- The box on page 126, which pertains to limiting global warming to 1.5 degrees Celsius, is confusing. We question why Article 8 products that have greenhouse gas reduction targets do not have to answer a subsequent question regarding the aim to limit global warming to 1.5° Celcius.

We also recommend streamlining the templates to improve readability for retail investors by **removing** the following questions:

- The question "What is the asset allocation and the minimum share of sustainable investments?" from Annex III confuses investors and creates misunderstanding. Our experience shows that distinguishing between the technical concepts of "asset allocation" and "minimum share of sustainable investments" is challenging for investors. Simplifying the template by removing this question would contribute to a clearer and more understandable presentation.

- Additionally, we strongly support reducing the number of categories of sustainable investment. This can be achieved by removing the concepts *of 'socially sustainable investments'* and *'other environmental sustainable investments',* as these ratios introduce additional complexity, which clearly outweighs any potential gains in clarity. We note that MiFID/IDD refers only to the proportion of sustainable investments. In addition, many FMPs do not differentiate between social and other environmental SI. Instead, commitments are made on the overall SI level, which may be a flexible combination of both. As such, reporting on sub-categories is impractical.

  When FMPs commit to split into social and environmental SIs, various methodologies are employed which are not comparable or/and transparent. In addition, the absence of data for these two categories further complicates matters for fund of fund structures in providing meaningful disclosure of social versus environmental on an aggregated product level.

  Finally, even if some FMPs choose to focus on a single sustainable investments theme - either social or environmental - they can already make use of the current SFDR Annex questions of SFDR (namely: 'What is the asset allocation planned for this financial product?' or 'What are the objectives of the sustainable investments that the financial product partially intends to make and how does the sustainable investment contribute to such objectives?')

- The questions 'To what minimum extent are sustainable investments with an environmental objective aligned with the EU Taxonomy?' and 'What is the minimum share of investments in transitional and enabling activities?' should be removed.

  If the ESAs insist on keeping the questions relating to the Taxonomy, they should still reflect on the following question: 'To what minimum extent are sustainable investments with an environmental objective aligned with the EU Taxonomy?' as it currently includes a graph. Firms that do not intend to allocate a minimum level of sustainable investments in taxonomy-aligned investments should be allowed to skip the graph and provide a brief explanation instead. This will further shorten the Annex.

- The template language should be updated to remove binary responses that are misleading for investors. The PCDs represent ex-ante commitments that a product makes not what it is currently invested in. For example:

  - It promotes E/S characteristics, but will not make any sustainable investments" suggests a product would actively avoid sustainable investments which is unrealistic. In reality, SIs may be part of a portfolio but there is no commitment to invest in them. We suggest this should be rephrased as "It promotes E/S characteristics, but does not commit to making any sustainable investments".

- "Does the financial product invest in fossil gas and/or nuclear energy-related activities that comply with the EU Taxonomy?" – similarly, most funds may invest in these activities but will not commit to investing a minimum % in such activities or avoid investing in them. Answering 'yes' may be interpreted as either a commitment or that it may invest in these activities. Similarly answering 'no' could be interpreted as the fund not committing to investing in these activities or the fund excluding these activities. We suggest this should be rephrased as "Does the financial product commit to investing a minimum proportion of its assets in fossil gas and/or nuclear energy-related activities that comply with the EU Taxonomy?"

Periodic reports

- The current version of SFDR L2 insufficiently considers specific characteristics relevant for funds of funds and discretionary portfolio management services (often investing in collective investment schemes) which represent a substantial part of the market. It is difficult to provide sector overviews of underlying funds ('look-through). Furthermore, indicating the domicile of funds in the 'country' section has questionable value for investors.

It is also crucial to clarify when it is permissible to remove specific boxes or questions by using consistent wording throughout the templates. Currently, the template uses various phrases such as 'remove,' 'include only,' 'do not include,' 'include a section where,' and 'include section only' to express the same concept. This inconsistency in language has resulted in confusion and an inconsistent approach among regulators. Therefore, it is important to streamline the wording to ensure a clear and consistent understanding of when certain sections can be excluded or not.

Improvement on usability

The inclusion of SFDR templates into the prospectus has resulted in an already massive document becoming even longer, compromising its efficiency in delivering essential information. Presently, the templates remain complex and exceed the analytical capabilities of most retail investors. The mere addition of new templates to an existing lengthy document does not necessarily enhance information accessibility for investors.

This being said, during the consumer testing phase, it would be crucial to assess the extent to which investors proactively look at both the pre-contractual documents and website disclosures. This information could help in deciding whether separate locations for these information sources (website and pre-contractual disclosures) are beneficial, or whether a single consolidated platform encompassing both elements would be more helpful.

Furthermore, we support the incorporation of **external links**, such as a global responsible policy, to centralise certain elements and avoid the need to update numerous PCTs when a common exclusion level changes.

Simplifying PAI statement entity-level

Regarding **RTS Table 1**, it is extremely challenging to summarize actions planned or taken within the limited space provided. For the Article 4 PAI reporting, the table only allows for approximately 3 cm of width in a column to capture "actions taken," "actions planned," and "targets set for the next reference period."

Also, considering that a portfolio of 10 funds may encompass up to 5000 underlying investments, potentially involving actions with or planning actions with as many companies. Adopting a top 20 investment approach will not adequately address the issue, as the top 20 investments are typically less than 1% of the total portfolio. Meaningful targets regarding CO2 emissions, for example, must consider the sector and geographic context to provide accurate insights.

Question 33: Is the investment tree in the asset allocation section necessary if the dashboard shows the proportion of sustainable and taxonomy-aligned investments?

We strongly support the deletion of the asset allocation chart from the pre-contractual template. Its removal ensures greater clarity and avoids misleading/confusing investors. It is essential to prioritize simplicity and ease of understanding for retail investors when designing such targeted disclosure templates.

The current investment tree gives a misleading impression that the different SFDR ratios are interconnected when in reality, they are independent of each other. The structure also suggests that the denominator of SI is the E/S ratio, as 1-SI represents the remaining E/S that are not SI. However, regulatory requirements consistently state that the proportion of SI, both committed and reported, should be expressed as a proportion of the fund's assets, directly contradicting the asset allocation tree. This conflicting approach applies to all the indicators within the tree.

Moreover, there is no need to repeat the same information in a graphical manner. If the investment tree is removed, the same information is still covered in 'What is the asset allocation planned for this financial product?'.

Considering that the template is intended for retail investors, it is crucial to **limit the number of indicators** they need to comprehend and not overestimate their willingness and ability to perform extensive due diligence on the extra-financial characteristics of investment products.

Question 34: Do you agree with this approach of ensuring consistency in the use of colours in Annex II to V in the templates?

Mandating shades of green is not the appropriate way forward. The use of colors introduces potential challenges and can lead to possible misinterpretations. For instance, can a fund manager employ the green color even if only 1% of their fund consists of sustainable investments (thereby placing them in the same category as a fund manager with 70% of sustainable investments)? This fails to effectively communicate the level of sustainability to investors.

Additionally, further problems arise when these documents are printed on black-and-white documents and may pose difficulties for certain investors, such as those who are blind or color-blind. According to the EBU statistics, there are estimated to be over 30 million blind and partially sighted persons in geographical Europe with an average of 1 in 30 Europeans experiencing sight loss. It is important to align these issues with the already existing PRIIP

KID Regulation, to ensure that disclosures remain inclusive.

Question 36: Do you have any feedback with regard to the potential criteria for estimates?

We support the ESAs' proposal to align the definition of "equivalent information" with the wording of the Recital (21) of Regulation (EU) 202/852 and use the term "estimates" only. Clear guidance is necessary to ensure that (i) assessing taxonomy-alignment is possible for markets and assets that do not fall under CSRD, and (ii) estimating taxonomy-alignment is robust and comparable among market participants.

However, we provide below feedback on the possible criteria, as outlined by the Platform Usability Report on what can be accepted as estimates.

- The use of key environmental metrics to assess the positive contribution to one of the environmental objectives should not be limited to reported metrics because of standardization issues. Indeed, the lack of standardized reporting, especially for companies out of the scope of CSRD, prevents the direct use of reported data. Therefore, the use of data derived from reported metrics should be allowed in favor of developing estimates. But in the absence of reported data from investee companies, FMPs should be allowed to use other types of estimates, such as industry averages, provided that the estimation methodology is appropriately disclosed as part of the disclosure framework. Moreover, we would like to emphasize that the precautionary principle should always prevail.

- With regards to the criteria to verify alignment with the Taxonomy, in particular concerning compliance with the DNSH principle, for which the FMP or info provider will have to verify compliance with environmental laws and standards AND adhere to the quantitative tests set out in the technical screening criteria as set out in Art. 3(d) of the TR, we doubt whether providers can extrapolate this information, in particular, since it is difficult to verify compliance with environmental standards, especially for companies not in the scope of CSRD or Taxonomy, which to date remain a black box.

  Concerning verifying adherence to the quantitative tests set out in the TSC criteria (Art.3(d)), there is no real assurance as to how these tests are applied, as some jurisdictions may not require this information to be audited.

- On the estimation of compliance with minimum social safeguards, while the use of controversies should not be used to show compliance, it could be useful to demonstrate a misalignment with this criteria. As such, policies and/or controversies should be allowed as a form of qualitative assessment in relation to minimum safeguards.

Question 37: Do you perceive the need for a more specific definition of the concept of

“key environmental metrics” to prevent greenwashing? If so, how could those metrics be defined?
In order to address the concerns of greenwashing and promote the comparability of key environmental metrics, it is imperative to establish a more precise definition of the concept. These metrics should be restricted to those expressed in physical units to avoid comparability issues. Moreover, it is advisable to prioritize metrics that assess the entire value chain of an issuer, rather than focusing solely on specific scopes where positive performance can be measured while concealing negative performance in other scopes.

Question 38: Do you see the need to set out specific rules on the calculation of the proportion of sustainable investments of financial products? Please elaborate.
As already mentioned above, the lack of clarity surrounding the concept of sustainable investment and its associated implications should be addressed during level 1 discussions. At this stage, no specific calculation rules should be introduced. Should the ESAs, however, insist, we suggest leveraging the market value or net asset value as the basis for determining the proportion of sustainable investments. This approach aligns with established financial practices and ensures a more consistent assessment across products. Also, the EC’s response to the ESA questions in April 2023 clarified that a contribution could either be at the product or activity level. Therefore, we do not believe a calculation consistent with how the taxonomy alignment is calculated would be appropriate considering it deals with the taxonomy approach by activity.

Question 43: Do you have any views on the preliminary impact assessments? Can you provide estimates of costs associated with each of the policy options?
The proposed amendments to the templates and delegated regulation carry significant implications for FMPs. These changes demand extensive modifications to their IT systems, investment products, and operational processes, imposing a substantial implementation and monetary burden. We must not underestimate the costs associated with data gathering, validation, and calculation, as well as the technical challenges of adopting machine-readable formats and expandable paragraphs. These tasks cannot be rushed, as they require rigorous testing to ensure accuracy and reliability. Additionally, it is challenging to quantify the costs related to the loss of consumer confidence in sustainable products due to constant updates and clarifications. To maintain stability and prevent incessant changes, FMPs require a reasonable bedding-in period, avoiding a situation where the goalposts are constantly shifting. Furthermore, we cannot overlook the downstream impacts of template modifications, such as database connectivity adjustments, updates to industry data templates (such as the FinDatEx EET) changes in advisory processes in MiFID/IDD, and the ongoing monitoring of SFDR. To mitigate costs, it is crucial to grant FMPs sufficient time for the implementation of these amendments.

Insufficient implementation time will not only result in increased costs but also lead to compromised data quality. Diminished data quality adversely affects investors in several ways, weakening the transparency intended to benefit them. By allowing FMPs a reasonable timeframe for implementing these amendments, investors will ultimately benefit, as the costs incurred by FMPs are reflected in more expensive investment products.

Considering these vital considerations, we strongly advocate for maintaining the current status quo. Additionally, we propose that any revised templates or additional disclosures be finalized only after the ESAs have conducted consumer testing scenarios involving retail investors. This essential exercise will gather valuable feedback during the initial year of implementation and provide insights into whether retail investors truly require more than 20 PAIs to make informed investment decisions.

We urge you to carefully assess the far-reaching implications of these proposed amendments on financial stability and investor confidence. By supporting a reasonable implementation period and involving retail investors in the decision-making process, we can collectively uphold the integrity of the financial market while prioritizing the best interests of all stakeholders.

ABOUT EFAMA

EFAMA is the voice of the European investment management industry, which manages EUR 28.5 trillion of assets on behalf of its clients in Europe and around the world. We advocate for a regulatory environment that supports our industry's crucial role in steering capital towards investments for a sustainable future and providing long-term value for investors.

Besides fostering a Capital Markets Union, consumer empowerment and sustainable finance in Europe, we also support open and well-functioning global capital markets and engage with international standard setters and relevant third-country authorities. EFAMA is a primary source of industry statistical data and issues regular publications, including Market Insights and the EFAMA Fact Book. More information is available at www.efama.org

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