Frankfurt,
4 July 2023

BVI's[1] response to the ESAs' Joint Consultation Paper on the review of SFDR Delegated Regulation regarding PAI and financial product disclosures

Questions

Q1: 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 sceptical about introducing new mandatory social indicators at the current point of time, without a clear link to the ESRS and the prospect to obtain the corresponding information from investee companies.

While understanding the EU's endeavours to expand the evaluation of socially adverse impacts of investment decisions, we must point out that such evaluation cannot take place without reliable and comparable reporting by companies. As it stands, with the first quantitative PAI reports due by 30 June 2023, asset managers are struggling with poor data quality resulting from the widespread use of estimations and extrapolations by commercial ESG data vendors and with significant data gaps that still remain. Given that PAI indicators are meant to be integrated into the investment due diligence and shall complement the information basis for investment decisions, it is inappropriate to rely on non-reported, estimated data in this regard.

Therefore, in the context of the CSRD implementation, we have argued from the outset in favour of reporting obligations on at least mandatory PAI indicators that should apply to CSRD issuers regardless of an individual materiality assessment and would enable EU asset managers and investors to obtain the necessary information basis for PAI consideration. We are disappointed to see that the technical advice by EFRAG that catered for the information needs of investors has been significantly weakened in the draft ESRS delegated act published by the EU Commission on 9 June 2023. By subjecting nearly all substantive requirements to the materiality assessment by reporting companies, the Commission's draft fails to ensure that EU asset managers obtain all sustainability-related information necessary for their investment and reporting purposes, including data on the mandatory PAIs.

In the current setting, it seems that introduction of CSRD and application of the ESRS will not solve the ESG data problems in relation to EU companies, not talking about non-EU issuers which represent a large proportion of fund portfolios managed on behalf of European investors. Nonetheless, inclusion of PAI relevant information items in the ESRS might send some positive signals and potentially create leverage opportunities for asset managers to engage with non-EU undertakings in favour of voluntary reporting according to the ESRS.

[1] BVI represents the interests of the German fund industry at national and international level. The association promotes sensible regulation of the fund business as well as fair competition vis-à-vis policy makers and regulators. Asset managers act as trustees in the sole interest of the investor and are subject to strict regulation. Funds match funding investors and the capital demands of companies and governments, thus fulfilling an important macro-economic function. BVI's 115 members manage assets of some EUR 4 trillion for retail investors, insurance companies, pension and retirement schemes, banks, churches and foundations. With a share of 28%, Germany represents the largest fund market in the EU. BVI's ID number in the EU Transparency Register is 96816064173-47. For more information, please visit www.bvi.de/en.

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For these reasons, we cannot support introduction of new mandatory PAI indicators without a clear reference to the ESRS that would allow for direct sourcing of the underlying data from companies' reports. This applies even more in the anticipated ESRS environment where investors will probably need first to engage with companies in order to convince them about the materiality of reporting on the PAI indicators included in the ESRS framework. One can easily anticipate that in these circumstances hardly any company will be willing to provide information on additional ESG aspects that are even not covered by the ESRS.

Therefore, we urge the ESAs to waive the idea of introducing new mandatory social indicators under SFDR without corresponding reporting standards being applicable for EU investee companies under the final ESRS. Instead, in the face of the reporting landscape not having evolved as expected, the ESAs should look for alternative solutions for expanding the range of social indicators.

A possible solution could be inserting the suggested new mandatory PAI indicators #14, 16-18 in Table 3 rather than Table 1 and requiring financial market participants (FMPs) under Art. 6(1)(b) SFDR DR to select not only one, but five additional social indicators from the list of optional KPIs in order to ensure that a sufficiently broad range of social issues is being considered. The advantage of this solution would be that asset managers could select social indicators with the best data coverage that is available for the purpose of PAI reporting based on the reports from investee companies. Given that under the Commission's proposal, companies should focus on reporting those adverse impacts that are material based on their severity and likelihood, higher data coverage could be considered an indicator for higher relevance from the impact perspective. **Thus, such flexible approach would enable asset managers and other FMPs to select PAI indicators on those social issues where the need for action is particularly urgent.**

Q2: Would you recommend any other mandatory social indicator or adjust any of the ones proposed?

As stated above, **we disagree with the idea of introducing new mandatory social indicators under SFDR without corresponding reporting standards being applicable for EU investee companies under the final ESRS**. Instead, in the face of the reporting landscape not having evolved as expected, the ESAs should look for alternative solutions for expanding the range of social indicators.

A possible solution could be inserting the suggested new mandatory PAI indicators #14, 16-18 in Table 3 rather than Table 1 and requiring FMPs under Art. 6(1)(b) SFDR DR to select not only one, but five additional social indicators from the list of optional KPIs in order to ensure that a sufficiently broad range of social issues is being considered. The advantage of this solution would be that asset managers could select social indicators with the best data coverage that is available for the purpose of PAI reporting based on the reports from investee companies. Given that under Commission's proposal, companies should focus on reporting those adverse impacts that are material based on their severity and likelihood, higher data coverage could be considered an indicator for higher relevance from the impact perspective. **Thus, such flexible approach would enable asset managers and other FMPs to select PAI indicators on those social issues where the need for action is particularly urgent.**

In more technical terms, we suggest further specification of the proposed indicators. Especially the new indicator 18 is not feasible, since the evaluation of what is "earning less than the adequate wage" must obviously take into account the circumstances in the local markets and requires extensive research that would likely result in diverging outcomes for each financial market participant (or rather each ESG data vendor it works with). A reference to an internationally acknowledged benchmark or standard should be considered a precondition for assessing inadequateness of wages.

Q3: 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 no reservations against introducing new optional social indicators in Annex I Table 3 in line with the ESAs' suggestions, since this measure would broaden the range of social issues to be considered on a voluntary basis without resulting in binding reporting obligations. Information on optional indicators must likewise be derivable from the sustainability reporting under ESRS. Assuming that companies will focus in their CSRD reports on those adverse impacts that are material based on their severity and likelihood, higher data coverage could be considered an indicator for higher relevance from the impact perspective. **Thus, asset managers and other FMPs would be able to select PAI indicators on those social issues where the need for action is particularly urgent.**

Q4: Would you recommend any other social indicator or adjust any of the ones proposed?

We recommend further specifications of the proposed social indicators. The use of indeterminate legal concepts such as "excessive use of" for the proposed indicators 9-11 and "insufficient employment" for the proposed indicator 12 in Table 2 will pose huge problems for the practical application and likely result in diverging outcomes for each financial market participant (or rather each ESG data vendor it works with). References to internationally acknowledged benchmarks or standard should be considered a precondition for assessing such concepts in practice. Otherwise, adaptation of the proposed metrics would be necessary.

Q5: 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 see merit in replacing the reference to UN Global Compact with the UN Guiding Principles and ILO Declaration especially as regards indicators 10 and 11 in Annex I Table 1 SFDR DR. Such adjustment would align the measure for social adverse impact with the minimum social safeguards applicable under the EU Taxonomy.

Q6: 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?

It seems unclear to us how the mandatory indicators designed for securities investments can be used in the real estate sector. It is possible that social aspects could not play any role at all conceptually in relation to real estate. Moreover, such data might not even be available on a regular basis. It might be possible that social PAI indicators could be applied at least at the "first level", i.e. in the direct service relationship with service providers, especially since it cannot be assumed that EU regulation in this area actually does not apply to real estate investments. Possible regulatory proposals should definitely take into account the actual circumstances and give preference to practical solutions.

Q7: 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?

We consider this proposal to be very workable.

Q8: Do you see any challenges in the interaction between the definition 'enterprise value' and 'current value of investment' for the calculation of the PAI indicators?

We are very concerned by the implications of the ESAs' Q&As II.6 and II.7 on SFDR DR published in November 2022. There the ESAs indicate that for the purpose of PAI calculations, the enterprise value shall be fixed at fiscal year-end of the investee company which leads to multiple problems in practice, especially in case of subsequent capital events (stock splits, increases/decreases of issued capital, corporate actions) or liquidation.

Therefore, we welcome the clarification provided by the ESAs in the open hearing on 6 June 2023 that the calculation approach outlined in the Q&As is to be seen as recommendation and that other approaches are equally admissible as long as they are adequately described in the PAI statement. Our members have a clear preference for PAI calculations by reference to estimations of the enterprise value based on (dirty) market prices at the end of each quarter for both equity and debt. We would support a respective modification of the ESA Q&As II.6 and II.7 in order to clarify the legitimacy of such approach in line with the request submitted by EFAMA on 24 March 2023.

Q9: Do you have any comments or proposed adjustments to the new formulae suggested in Annex I?

We welcome the introduction of calculation formulae for all PAI indicators in Annex I as an important step towards standardising the quantitative reporting on PAIs. Our methodical concerns with regard to the proposed new social indicators are highlighted in our responses to Q1 and Q4.

With regard to the formula for PAI indicator 20 in Table 1 (investee countries subject to social violations), we believe there is a wording mistake, since the proposed nominator captures "investee countries under investigation". Cleary, it must not be assumed that mere investigations of potential breaches would be sufficient to generate a principal adverse impact, especially since the equivalent indicator for investee companies (PAI indicator 10 in Table 1) refers to "investee companies in violation of at least one international guidelines or principles". We recommend adapting the wording of the formula for PAII 20 accordingly.

Q10: 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?

The proposed formulae for PAI calculations will solve most technical problems encountered to date. The remaining challenges relate mostly to the limited availability of data and regulatory expectations for responsible approaches to closing data gaps. In this regard, we recommend reviewing the regulatory approach to sourcing PAI data under the current Article 7(2) and the proposed Art. 6(6) SFDR DR (cf. our response to Q11 below).

Q11: 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 that the ESAs review the regulatory approach to sourcing PAI data under the current Article 7(2) and the proposed Art. 6(6) SFDR DR.

Article 7(2) requires FMPs to use different methods for sourcing the relevant data on the best effort basis, ultimately by making reasonable assumptions. It is, however, questionable whether assumptions can be considered an appropriate basis for PAI considerations. UCITS management companies and AIFM that consider PAI under Article 4 SFDR are required by EU law to take into account the relevant PAI indicators in their investment process. This means effectively that PAI indicators need to be incorporated in the investment due diligence to complement the information basis for investment decisions. In case of financial products committed to considering PAIs at the product level under Article 7 SFDR, the general market approach is to treat the chosen PAIs as binding investment criteria for selecting/managing investment assets and/or engaging with investee companies on mitigating adverse impacts. However, founding investment decisions or engagement actions for funds and mandates managed for European investors on mere assumptions in terms of adverse impacts would be incompatible with the fiduciary duty owed by asset managers.

Some mandatory PAI indicators still show very low levels of coverage in the data sets offered by commercial ESG data vendors. This pertains for instance to PAI indicator 7 on activities negatively affecting biodiversity-sensitive areas and indicator 12 on unadjusted gender pay gap. As regards the latter, data is available so far only for UK domiciled companies that are obliged to report this KPI under their domestic law. FMPs cannot seriously be expected to extrapolate the gender pay gap reported by UK companies to investee companies located in other jurisdictions around the globe, with different corporate cultures and standards in terms of gender equality. Likewise, activities in biodiversity-sensitive areas under PAI indicator 7 must be assessed for the sites of individual companies and cannot be estimated based on reported data from competitors.

For these reasons, many asset managers currently refrain from using assumptions or estimates for the purpose of the first PAI reporting due by 30 June 2023. Instead, they calculate the PAIs based on information available from ESG data providers or obtained directly from companies/other assets and complement such reporting by disclosing a corresponding coverage ratio for each indicator. This approach is in our view preferable given the limitations explained above.

Given that the draft ESRS do not provide for mandatory reporting on PAI indicators, but require companies to report based on their internal materiality assessment, asset managers will actually be prevented from making reasonable assumptions in case of missing data. This is because non-reporting under ESRS will be equal with a company's statement that a given adverse impact is considered non-material which means that extrapolation from reported – material – data will not be reasonable anymore. In fact, the most obvious solution would be to treat non-reporting as a "reported zero" and to assume that an investment does not have a (material) adverse impact on a given environmental or social issue. However, this would entail a more fundamental change of the PAI reporting framework that would then focus on material adverse impacts in line with the ESRS evaluation.

In any case, under the new ESRS scenario, a clear guidance on how to deal with missing data for the purpose of PAI reporting will be even more relevant in order to prevent that the reported figures are meaningless and not at all comparable for investors. The current regulatory expectation that data gaps have to be filled under any circumstances does not pass the reality test and in particular, fails to provide for satisfactory data quality for founded investment decisions.

Therefore, we suggest in the first place to legitimate PAI reporting based on reliable data obtained by FMPs on a best effort basis that should be accompanied by disclosure of a coverage ratio. Under this scenario, disclosure of the share of information obtained directly from investee companies, sovereign issuers or real estate assets as suggested by the ESAs should be of less relevance. In practice, it is difficult for FMPs to establish such a proportion, given that most data used for PAI reporting is being sourced from ESG data vendors. This dependency on commercial data sources will remain unless the supply of relevant ESG data will be fundamentally improved, especially by the introduction of common reporting standards under CSRD and their availability in a machine-readable format with adequate technical interfaces via the European Single Access Point. So far, however, a proportion of information derived directly from the relevant source can only be established and reported if it is included in the data package offered by the ESG data provider. Given that the upcoming EU Regulation on ESG ratings does not aim at regulating mere ESG data provision, it will be difficult to introduce a regulatory obligation in this regard.

Q12: 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?

We agree with the ESAs that there are pros and cons to different approaches to defining the appropriate reference base for calculating PAI indicators.

It is clear that calculating PAIs with reference to all assets under management ("all investments" in the current understanding) results in indicators that are significantly driven by the composition of the portfolio in terms of asset allocation (such as sovereigns, corporates, real estate and others). Taking the example of two FMPs with an equal sum of total assets under management, the financial market participant with a higher share of corporate assets will report a higher carbon footprint than the other FMP which has a higher share of sovereign assets at the expense of corporate equities and bonds, even if both FMPs are invested in exactly the same companies at the same relative weights within their respective corporate equities and bonds sub-portfolios.

In the end, the approach to defining the appropriate reference base depends upon the core question what kind of information PAI reporting at the entity level is actually meant to deliver to investors: If its objective is to inform investors about all kinds of principal adverse impacts a FMP is associated with by its investments, then the reference to "all investment" in the denominator is probably the right approach. If, however, it is meant to enable investors to evaluate e.g. which FMP invests in assets that are associated with less carbon emission and how the PAI indicators develop over time, then it should be more informative to relate the information to the eligible assets. Focusing on the eligible assets would also have the advantage of being consistent with the current market standard, especially due to the reporting approach under TCFD, but also under other relevant market initiatives such as the Asset Owner Alliance or PCAF.

Should the ESAs confirm the current approach and view calculation of PAIs with reference to all assets under management as appropriate, it would be helpful for better understanding of the reported figures to supplement the PAI statement by information of the proportion of investments in investee companies, sovereigns and real estate respectively and to disclose the cumulated assets under management invested in each asset type ("eligible aum"). This supplementary information is important in order to enable investors and other readers of PAI reports to correctly interpret the reported figures, including indicators on GHG emissions that will tend to grow in proportion to the value of managed assets.

Q13: Do you agree with the ESAs' proposal to only require the inclusion of information on investee companies' value chains in the PAI calculations where the investee company reports them? If not, what would you propose as an alternative?

We deem the ESAs' proposal in this regard appropriate. In the current data landscape where FMPs need to rely on commercial ESG data vendors in order to source the information needed for regulatory reporting purposes, it is very important to recognise the limitations with regard to data availability. "Readily available information" under the proposed Article 6(5) SFDR DR should thus be assumed if such information can be sourced from third-party data providers, as recognised in recital 3 of the draft SFDR DR. For asset managers investing on a global scale in a wide range of companies/assets, it is not feasible to search individual company reports for data that might indicate adverse impacts in the value chains.

Q14: Do you agree with the proposed treatment of derivatives in the PAI indicators or would you suggest any other method?

We do not agree with the proposed treatment of derivatives. First of all, it must be noted that derivatives do not grant any direct ownership or financing influence. However, this is the prerequisite for it to be qualified as sustainable investment in the sense of the SFDR in the first place. Therefore, we expressly request that the proposed approach to the treatment of derivatives in the PAI indicators be deleted for the following reasons:

- **Legal requirements**: Neither the SFDR nor the Delegated Regulation (EU) 2022/1288 requires derivatives to be included in the PAI calculation. Irritations in the market and the resulting enquiries with the ESAs have only arisen because the ESAs also listed derivatives in their clarification of indirect investments in investee companies.[2] However, this seems to be a misunderstanding. Recital 20 of the Delegated Regulation states that FMPs should only explain how the use of derivatives is compatible with the environmental or social characteristics that the financial product promotes or with the objective of sustainable investment. Moreover, Recital 33 of that Regulation states: '*Due to the lack of reliable methodologies to determine to what extent exposures achieved through derivatives are exposures to environmentally sustainable economic activities, such exposures should not be included in the numerator. The denominator should consist of the market value of all investments.*' Article 51(a) of that Regulation requires disclosure information which

[2] Cf. paragraph 13 of the Clarifications on the ESAs' draft RTS under SFDR, available under the following link: https://www.esma.europa.eu/sites/default/files/library/jc_2022_23_-_clarifications_on_the_esas_draft_rts_under_sfdr.pdf.

derivatives, if any, have been used to meet those environmental or social characteristics, yet without calculation of any principal adverse impact. It is only in this context that Article 59(a)(ii) of the Regulation is to be understood, that apart from the PAI indicators to be taken into account, separate information on derivatives used is to be provided.

It is imperative that this principle of only providing separate information on the use of derivatives be maintained. Otherwise, this would contradict the EU Commission's objective of finding proportionate and feasible solutions for financial market participants through this consultation.

- **Contradictions in the use of exposure method vs. ownership approach for the PAI calculation of 'sustainable investments'**: The proposed method using exposures by converting derivatives into an equivalent position in the underlying asset is not suitable to calculate which sustainable investments an investor finances and influences. It is imperative to distinguish between the following objectives:

  Ownership approach (ownership implies participation): The focus here is on the fact that the investor wants to know which sustainable investments he is financing and influencing and what he is directly participating in (e.g., equity, bonds, etc.). Here he has direct ownership rights, voting rights, etc., or he finances certain investments/projects such as real estate directly with own or borrowed capital. Derivatives are not taken into account here because they are contractually agreed and are most commonly cash-settled separately from any direct financing effect on the financial market alone: No voice, no ownership, no participation: Therefore, derivatives are justifiably not counted for this objective. Specifically: An option or futures contract concluded between counterparties on the financial market does not change any real GHG emissions or PAI values in the real corporate world and is therefore irrelevant in disclosing.

  Exposure method (ownership implies risk): According to this method, the investor wants to know what *financial risk* he has from investing in assets that have PAI effects or GHG effects or are otherwise not 'sustainable'. This is a completely different objective and therefore requires different approaches and methods. Here, the investor's consideration is that both direct investments in underlyings and rights from derivatives represent a potential financial risk for him in the medium to long term in that they have a derived value from real business activities that are not in line with long-term sustainable investments, and this risk can come to bear in the form of regulatory risks, reputational risks or concrete environmental risks.

  Using the exposure method exclusively for derivatives results in a valuation contradiction with the other PAI calculation methods relating to equity/bonds/real estate, as the exposure method only measures financial risk and the leverage of a portfolio and not the impact on sustainable investments. The (aggregated) results on company level would then no longer be comparable and could no longer be explained to third parties such as investors. This distinction is of key importance.

- **New complexity of the exposure method**: The proposed method using exposures by converting derivatives into an equivalent position in the underlying asset and by applying Article 8(2), points (c) and (d) and Article 8(4) of the Delegated Regulation (EU) No 231/2013 with only considering net positions in accordance with Article 8(3), point (a) of that Regulation, without going below zero, will lead to a completely new calculation of the financial (exposure) risk in using derivatives.

This is not only because asset managers currently interpret and implement the commitment method of Article 8 of the AIFMD Delegated Regulation differently in the EU Member States. In addition, the proposed new approach does not allow for the *hedging methods* recognised in Article 8(3)(b) of the Delegated Regulation (EU) No 231/2013. Moreover, the commitment method of the AIFMD only applies to alternative investment funds (AIFs). UCITS are free to decide whether to use the commitment approach or the value-at-risk approach for the calculation of the exposures of the derivatives used. This means that some UCITS do not use the commitment approach at all. Regarding the UCITS using the commitment method, this method is regulated as such, but the calculation method is only explained in CESR guidelines from 2010, which are interpreted and implemented differently in the EU member states. This means that there is no uniform commitment method for all funds (AIF and UCITS) which can be used based on the current implementation processes. Other FMPs (e.g., investment firms, credit institutions, insurers), which currently do not have to implement the commitment approach of the Delegated Regulation on the AIFMD, would also have to set up completely new processes for this.

Therefore, the systems and processes of asset managers as well as other financial market participants would have to be reconfigured by a new complex method only to comply with new disclosure requirements that cannot be logically explained to investors or third parties due to the different methods.

Q15: 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 should not be taken into account in the PAI calculation or in the calculation of quotas (such as Taxonomy-alignment or share of sustainable investments). The sustainability disclosure regarding GHG emissions (aggregations of CO2 footprint) and the PAI calculation should always be consistent, otherwise less rather than more transparency is achieved. Hence, information on the use of derivatives should only be provided by separate information on how the use of derivatives is compatible with the environmental or social characteristics that the financial product promotes or with the objective of sustainable investment. We therefore refer to our remarks to question 14, in particular to our remarks on the main differences between the ownership approach and the exposure method. The problems identified there in the mixing of methods apply equally to the calculation of quotas.

- In using **different methods** (ownership approach for equity/bonds/real estate vs. exposure method for derivatives), the disclosed reports of the products would be no longer comparable. In particular, we expect not only an addition of the figures on product or company level, but also in public to product groups, groups of financial market participants such as asset managers or similar. Using a risk figure only for one asset class in the disclosure, it no longer makes sense to make an appropriate addition or aggregation for the total quota. A factual argumentation becomes no longer comprehensible in the public.

- Any additional method in calculating quotas by considering derivatives (such as netting methods based on the **Regulation No 236/2012** (**Short Selling Regulation)** which focus on equity and sovereign exposures) would considerably increase the complexity for implementation by FMPs on the one hand and for the understanding of the addressees of the disclosure (investors, etc.) on the other. Therefore, netting provision of Article 17(1)(g) for derivatives should not be applied to quota calculations.

- We agree with the ESAs that special attention must be paid to the complexity of considering derivatives in the sustainable disclosure, so that no **greenwashing** accusations arise. However, information on the use of derivatives should be limited to separate information on how the use of derivatives is compatible with the environmental or social characteristics that the financial product promotes or with the objective of sustainable investment (as it is currently required under the SFDR). In using a new exposure method or any other netting method, a greenwashing risk could arise due to misunderstandings or distorted or incomprehensible aggregation methods. This damage to trust would be greater than the gain in premature consideration. Presumably, the public is not in a position to make an appropriate interpretation of the quota sizes including the consideration of derivatives (here: based on a deviating mere risk calculation without impact on the sustainable investment). Separate reporting is much more transparent and involves less greenwashing risk.

- There are still considerable project **costs** to be borne by all FMPs. This would involve other forms of quota to ‘E’, then ‘S’ and also ‘G’ sizes, each only in the underlying quotas, and again aggregated with derivatives, then still according to different definitions or country-specific definitions.

For the calculation of the quotas, we therefore continue to assume that derivatives are not taken into account in the numerator. However, they are to be included in the denominator at their market value.

Regardless of the calculation of the quotas being part of the disclosure and as mentioned in our answer to Q12 and Q14, derivatives should not be included in the numerator and not in the denominator as part of the PAI calculation because no principal adverse impacts are generally attributed to derivatives.

As mentioned above, many questions remain unresolved for these cases of taking derivatives into account in the numerator, so that we are currently not in a position to propose alternative approaches. These questions also include the differences between OTC or exchange traded or deliverable or non-deliverable derivatives (cash settlement). However, should the ESAs assess this differently, then derivatives should in any case also be included in the numerator with their market value (and not as risk exposure by converting derivatives into an equivalent position in the underlying asset) as we show with the following example. However, this should not then apply to derivatives that do not trigger actual investments in the underlying asset or are only used in portfolios for hedging purposes.

Example:
An equity fund has 95 million EUR of equity shares in its portfolio and an equity hedge of 75 million with a current market value of +5 million EUR.
Consequently, the net asset value (NAV) of the equity fund is 100 EUR.
The leverage is 0.25% and the equity fund is largely hedged.

Assumptions in the example:
- Of the 95 million EUR equity shares, 20 million EUR are conflicted due to PAI.
- Of the remaining 75 million EUR equity shares, another 10 million EUR are conflicted due to non-compliance with other sustainability criteria (e.g. UNGC).
- The market value of the derivatives is not included in the numerator. There is also no look-through to the 5 million EUR market value of derivatives. We calculate conservatively and treat the market value of the derivatives as a conflicted asset.

In this case, the sustainability ratio is: 65/100 = 65% (the same would be the result if the fund were to use the derivatives long).

Q16: Do you see the need to extend the scope of the provisions of point g of paragraph 1 of Article 17 of the SFDR Delegated Regulation to asset classes other than equity and sovereign exposures?

We do not see the need to extend the scope of the provisions of point g of paragraph 1 of Article 17 of the SFDR Delegated Regulation to other asset classes (such as derivatives). We refer to our explanations to questions 14 and 15.

Q17: Do you agree with the ESAs' assessment of the DNSH framework under SFDR?

We have some reservations that we explain in our answers to specific questions below.

Q18: 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.

We are not convinced that disclosures about the quantitative thresholds potentially used by financial market participants for the purpose of DNSH assessment would be helpful for enhancing the understanding by investors:

- While FMPs are required to take into account PAI indicators for the purpose of DNSH test, setting of specific quantitative thresholds is by no means required. The Commission has only recently clarified with relation to the Level 1 framework that "the SFDR does not set out minimum requirements that qualify concepts such as contribution, do no significant harm, or good governance" which means that FMPs have policy choices with regard to the underlying assumptions. Such choices must not be prevented by introducing effective requirement for setting quantitative threshold at Level 2. Hence, while it appears reasonable to work with thresholds when assessing DNSH, at least for certain PAI indicators, the ESAs must not assume that thresholds are being used in any case.
- Asset managers working with quantitative thresholds still apply multiple approaches that are hardly comparable. Some use absolute thresholds with reference to the acceptable level of adverse impacts, e.g. with regard to the minimum representation of women in management/supervisory board, others work with relative thresholds e.g. by excluding investee companies with the worst KPIs in the relevant sector. For some PAI indicators, e.g. for GHG emissions, it makes sense to set different thresholds for different sectors which means that the corresponding disclosures will likely become extensive and hardly comprehensible.

Under the current ESAs' proposal for Article 26(2)(a), 39(a) SFDR DR, FMPs shall be obliged to describe the thresholds for DNSH assessment in the product-related section of the website, individually for each Article 8 and Article 9 product that makes sustainable investments. Such granular transparency appears excessive, given that according to the ESAs' Q&As, FMP shall apply consistent concepts for sustainable investments to their product ranges. In any case, it would be reasonable to allow for an entity-level disclosure of the internal approach to sustainable investments and any assumptions/criteria applied in this regard. This corresponds with the current market practice already applied by many asset managers. Disclosures made in the ESG section of the product website could then simply refer to the general description of the internal concept that would include an explanation of the DNSH assessment, including potential thresholds applied in this regard.

Q19: Do you support the introduction of an optional "safe harbour" for environmental DNSH for taxonomy-aligned activities? Please explain your reasoning.

We understand that this question is no longer relevant, given that the EU Commission clarified in FAQ 4 of its notice published on 13 June that *"investments in Taxonomy-aligned 'environmentally sustainable' economic activities can be automatically qualified as 'sustainable investments' in the context of the product level disclosure requirements under the SFDR."* We welcome this clarification, as it applies to both environmental and social aspects of the DNSH test as well as to the good governance requirement under Article 2(17) SFDR and thus effectively simplifies the assessment of Taxonomy-aligned investments.

Q20: 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.

We agree in principle with the objective of aligning the DNSH assessment under the EU Taxonomy and SFDR. However, we do not see how DNSH under SFDR that needs to work for different sustainability objectives and all types of assets can possibly be performed by reference to the technical criteria of the EU Taxonomy. Given that the latter cover only environmental objectives and in many cases relate to specific economic activities performed by investee companies, it is not feasible to use them as a universal benchmark for significant harm. Moreover, the necessity to perform a double DNSH test on investments in Taxonomy-aligned economic activities has been effectively alleviated by the Commission notice published on 13 June (cf. Q19 above). In the mid-term, however, it would be very helpful to develop a more principle-based understanding of the conditions under which significant harm to the EU environmental objectives can occur in order to use consistent metrics under different EU frameworks.

Q21: Are there other options for the SFDR Delegated Regulation DNSH disclosures to reduce the risk of greenwashing and increase comparability?

It would be very helpful to develop a more principle-based understanding of the conditions under which significant harm to the EU environmental objectives can occur in order to use consistent metrics under different EU frameworks. Such principles should in particular reflect on the viability of sustainable investments that aim at supporting sustainable transition by investee companies. The EU regulators should take a general policy decision on whether and under which conditions investments in transitioning companies can be considered compatible with the DNSH standard.

Q22: 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.

We consider the proposed disclosures on GHG emissions reduction targets as too excessive in terms of details to be provided on the individual commitment, but too narrow as regards the general scope of application. Our reservation in detail are as follows:

- Scope of application: The wording of the proposed Article 14a(1) SFDR DR seems to allow disclosure of GHG reduction targets only for products investing in EU companies, because only those companies will follow the GHG accounting and reporting standards under CSRD. This is obviously a far too narrow understanding. The SFDR does not limit the application of investment strategies aiming at reduction of GHG emissions to investments in large EU issuers. Article 8 and 9 products under SFDR can set objectives of GHG reduction also with regard to investments in other assets, including in particular non-EU companies, SMEs and real estate, and must be able to disclose the respective targets accordingly. Thus, while welcoming the clarifications provided by the ESAs in the open hearing on 6 June 2023 that the GHG emission reduction section is meant to be asset-neutral, we suggest clarifying whether and how far the reporting standard on GHG emissions under CSRD shall be applied to investments in other assets than investee companies.

- Usefulness of disclosures: While information on whether or not a product has specific GHG reduction targets is definitely relevant for investors, the level of detail proposed by the ESAs will very likely overstrain them. This relates in particular to the proposed disclosure requirements on the website where FMP shall be required for each and every product to explain how the product-related targets and methodologies relate to the transition plan for climate change mitigation at the company level (proposed Article 29a(1)(b), 42a(1)(b) SFDR DR). We are not convinced that such detailed explanations are relevant in terms of investment decisions or the general accountability of the FMP, given that the latter will be anyway bound under CSRD to report on the progress of its transition plan. Further points where we see excessive transparency obligations are:
    - Another summary of the engagement plan to be disclosed on the website under Articles 29a(1)(a)(iii), 42a(1)(a)(iii) SFDR DR and that would add up to the general description of engagement policies anyway required for website disclosures under Articles 35 and 48 of the current SFDR DR. If deemed indispensable by the ESAs, further details on how engagement shall contribute to GHG emission reduction by investee companies should be disclosed as part of the dedicated website section on engagement.
    - Requirement to commit to specific quantitative reduction targets as part of the pre-contractual information and to potentially make additional commitments on targets in terms of GHG removals and storage or the use of carbon credits. With regard to the latter, it is unclear whether the information is optional (as suggested by the red texts in square brackets in the draft annexes) or whether it shall be provided in any case under the best-effort-approach according to the proposed Article 14a(3) SFDR DR. We do not believe that financial products can reasonably be expected to make specific commitments regarding e.g. the level of GHG removals by their investee companies or other target assets, nor that this information is of any relevance for investors, and request the ESAs to delete the second and third line from the table in the GHG emission reduction section of Annexes II to V.

Moreover, introduction of a separate section on GHG reduction targets in addition to the already existing information elements especially on E/S characteristics or sustainable investment objectives and investment strategy will obviously lead to further duplications and overlaps within the ESG annexes. This pertains in particular to Article 9 products that under the draft Annex III shall describe their GHG emission reduction target first in the section “What is the sustainable investment objective of this product?”, potentially by providing a reference to the PAB/CTB methodology, and then shall provide exactly the same information in the dedicated section on GHG emissions. Further duplications will likely occur as regards the proposed requirements for presentation of the investment strategy as highlighted in our replies to Q24 and Q26 below.

Q23: 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.

In general, we have no objection against providing a hyperlink to the disclosures made by benchmark administrators on the methodology for GHG emission reduction embedded in the construction of the underlying index. However, it is questionable whether such disclosures can provide an adequate substitute for all information items listed in draft Art. 42a(1) SFDR DR. The benchmark methodology will not include any details on engagement, given that engagement can only be performed by the relevant shareholder, i.e. the fund or its management company. As stated above, explanations on how engagement shall contribute to GHG emission reduction by investee companies should be anyway disclosed as part of the dedicated website section on engagement under the current Articles 35 and 48 SFDR DR.

In the current drafts, the ESAs assume that all products tracking the EU climate benchmarks disclose under Article 9 SFDR. In practice, most funds replicating PAB or CTB indexes have been reclassified in the recent months to Article 8 due to the uncertainties about standards for sustainable investments and the respective evaluation of the index constituents. According to the Morningstar manager research, more than 350 Article 9 funds re-classified to Article 8 between July 2022 and March 2023, representing over EUR 200 billion in assets. Article 9 fund assets shrunk by about EUR 175 billion, or 40%, in the last quarter of 2022.

Despite the new clarifications from EU Commission that PAB and CTB shall be automatically deemed as having sustainable investment objectives, we understand that many FMP are still reluctant to assign their PAB and CTB tracking products back to Article 9 SFDR (for instance, because under their internal concept for sustainable investments, these investments still do not allow for a sufficiently high level of minimum commitment). In practice, this situation might become problematic if for instance PAB tracking funds that retain their Article 8 classification had to display the side text “This product is not aiming at limiting global warming to 1.5 degree Celsius” foreseen as standard in Annex II or if they had no possibility to refer to the benchmark administrator’s disclosure on the index methodology.

In the interest of regulatory coherence, we thus suggest to clarify whether financial products replicating PAB and CTB need to be automatically assigned to Article 9(3) SFDR regardless of the proportion of sustainable investments to which they are able to commit, or otherwise, to make the templates for Article 8 products sufficiently flexible for accommodating disclosures by PAB/CTB index trackers.

Q24: 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.

The elements of the investment strategy that aim specifically at reducing GHG emissions should be presented in the section “What investment strategy does this product follow?” in order to avoid duplications and to allow for a coherent description that is understandable for investors. The new section on the GHG emission reduction target should be limited to a yes/no indication and further specifications concerning potential quantitative commitments (cf. also our reply to Q26 below).

As regards the distinction proposed by the ESAs, we consider it indeed useful for investors to understand whether a product aims at reducing GHG emissions in its portfolio simply by avoiding highly emitting investments (by the use of filtering criteria) or by contributing to the reduction of emissions at the level of investee companies. With regard to the latter, further distinction of approaches as suggested by the ESAs in para. 66 b) of the consultation paper would be rather useless. Investors cannot effectively make commitments for emission reduction at the level of investee companies without these companies' willingness to deliver on GHG emission reductions by implementing transition plans and setting targets that can be further supported and enhanced by constructive dialogues with shareholders. In many cases, dedicated GHG reduction strategies will combine elements of exclusions, e.g. for worst-in-class issuers, with positive criteria for selecting transitioning companies and with shareholder engagement in favour of further effective reduction of GHG emissions. Hence, it is important that the templates provide for sufficient flexibility to inform investors about all relevant features of the investment strategy.

Q25: 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 are so far not convinced that the degree of Paris-Alignment of investment product's targets can be consistently measured and disclosed for different types of assets and their combinations at the portfolio level.

Q26: Do you agree with the proposed approach to require that the target is calculated for all investments of the financial product? Please explain your answer.

In general, we understand the ESAs' reasoning that the GHG emission reduction target has to be calculated for all investments, even though specific measures foreseen as part of the ESG strategy might not be relevant to all of them. In more general terms, however, we would like to question whether it is necessary, as implied by the draft amendments to SFDR DR, to commit to specific quantitative reduction targets at the product level in order to claim that a product has GHG emission reduction as its objective for the following reasons:

- The approach proposed by the ESAs might reduce the level of transparency instead of enhancing it, since products aiming at reducing GHG emissions would not be able to disclose such objectives unless they meet the standards proposed by the ESAs in terms of specific commitment and calculation methodologies. We doubt that such outcome would be desirable from the investor protection perspective.
- Products aiming at reducing GHG emissions at the level of their investee companies will have difficulties to make quantitative commitments for specific time periods in the next years, given the long phasing-in period foreseen for CSRD reporting that shall provide standardised information on transition plans and targets and the still unclear effects of the ISRS on the global markets in this regard. Nonetheless, investment strategies aiming at improving the GHG footprint of the real economy are very important for facilitating sustainable transition and should not be discouraged by unrealistic requirements.

As an alternative, we thus suggest that financial products should be allowed not to commit to a certain specific reduction target, but to disclose the intermediate progress in quantitative terms in the ESG annex to the annual report. This should be legitimated at least for products focusing on attaining GHG emission reduction at the level of target companies or other target assets.

Q27: 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 in principle with aligning the metrics for calculating the baseline GHG emissions and the respective reduction targets in line with the future ESRS.

Q28: 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.

First of all, we agree with the ESAs that GHG emission reduction targets of financial products should relate to the gross GHG emissions of the investments and not reflect GHG removals or carbon offsets. This being said, we see no added value in disclosing either dedicated targets or progress with regard to carbon removals/storage at the level of investee companies or the use of carbon credits in addition to the core GHG reduction target. Hardly any investor should be interested in such detailed information and no fund manager will likely be able to commit to relative targets concerning the managed portfolios. Therefore, we request the ESAs to delete the second and third line from the table in the GHG emission reduction section of Annexes II to V.

Q29: 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.

We do not share the ESAs' view on the usefulness of disclosures on how the product-related targets and methodologies relate to the transition plan for climate change mitigation at the level of FMP as product manufacturers. There is not necessarily a clear correlation between GHG emission reduction targets at the FMP and the product level. This is because, on the one hand, the FMP has its own GHG reduction targets as a company (e.g. relating to greening office buildings, travel policy, company car fleet etc.). On the other hand, company-level reduction targets cannot be allocated across the board to individual products at the level of assets under management. It is possible that some products realise GHG reductions earlier or overachieve upon the company-level objectives in relation to the managed assets. Other products might be slower or less successful in their transition progress depending on the specific investment objective and the fundamental analysis (problem of expected return vs. sustainability performance). Also, products with multiple sustainable investment objectives might be less able to contribute to the FMP commitment than funds focused solely on reducing GHG emission. In the end, we very much doubt that detailed explanations on the correlation between product-level and entity-level commitments would be of any interest for investors as they go beyond the product-level investment strategy and are not relevant as information basis for investment decisions.

Moreover, the envisaged disclosures are neither necessary nor appropriate for enhancing the accountability of the product manufacturer who will be anyway bound under CSRD to report on the progress of its transition plan as part of the management report or the consolidated management report and will be subject to external audit. In any case, disclosures in the product-related section of the website cannot be reasonably introduced for accountability reasons and should be deleted without substitution.

Q30: 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 agree with the ESAs on the usefulness of a dashboard helping investors to navigate within the ESG annexes and support some of the proposed improvements, especially inclusion of information on PAI consideration and presentation of minimum commitment to sustainable investments as an aggregated figure (without a mandatory split into environmental and social). In order to further streamline and simplify the key information, we have multiple suggestions for further improvements:

<u>General comments</u>:

- The structure of the dashboard should reflect the structure of the ESG templates. It would be also helpful to assign numbers to the dashboard constituents (1-5) that should be consequently used in the following detailed disclosures in order to enhance comprehensibility for investors and to facilitate search for the relevant information. The same order of information should apply to the website disclosures under Article 10 SFDR (cf. our comments to Q32 below).
- The mandatory use of icons with different colours and shades will only be feasible if FMP will be provided with an editable set of copyright-free icons in high resolution. Such icons should be

provided to the market in addition to publication of editable templates for Annexes II to V in Word format in all EU languages (cf. also our request under Q32 below). The grey icon for PAIs (in case of non-consideration) should be struck through, like for other non-relevant product elements.

- The grey boxes accompanying the dashboard on the left-hand side refer only to sustainable and Taxonomy-aligned investments and are thus incomplete. Explanation of principal adverse impacts should also be provided in close proximity to the dashboard, especially given that consideration of PAIs is so far the most common feature of Article 8 and Article 9 products.
- The proposed ultra-short description of E/S characteristics or sustainable investment objectives with 250 characters including spaces is unrealistic and should be removed from the dashboard. Instead, Article 8 products that commit to a certain minimum proportion of investments with E/S characteristics should display such quantitative commitment (that might in future become relevant under the proposed ESMA guidelines for the use of ESG-related terms in fund names) at the top of the dashboard, while describing the relevant E/S characteristics in the first section of the annex directly below. For Article 9 products, the relevant commitment is anyway visible from the information on minimum sustainable investments.
- We suggest deleting the visual element on minimum commitments for sustainable and Taxonomy-aligned investments and their interrelation on the right-hand side of the dashboard. In fact, presentation of Taxonomy-aligned investments as a direct subset of the percentage of sustainable investments is misleading, given that the market does not calculate both figures with regard to the same reference base. Sustainable investments and any commitments with regard to E/S characteristics are mostly calculated based on the NAV of a fund, whereas calculation of Taxonomy-aligned proportion is required to be performed in relation to the market value of all investments which the market understands as the gross asset value. This means that both commitments cannot be properly interrelated and any presentation that might imply otherwise should be foregone. Besides, the proposed visualisation would only replicate the information included in the text elements and is thus dispensable.
- The new information element on reduction of GHG emissions should foresee optional disclosures on quantitative targets and end-dates instead of making such commitments mandatory in order to avoid inhibitive effects on the offering of products that contribute to decarbonisation (cf. our detailed comments to Q25 above).

<u>Dashboard for Article 8 products (Annexes II and IV):</u>

- The standardised heading should simply read “This product has sustainability characteristics (as follows).” The second subsentence “but does not have sustainable investment as its objective” that is included in question form in the current version of the dashboard is creating much confusion, especially in case of a positive minimum commitment to sustainable investments displayed two lines further below. No investor or even no distributor can understand the difference between having sustainable investments as investment objective on the one hand and committing to a certain minimum proportion of sustainable investments on the other.
- Annexes II and IV use a different icon for information on minimum sustainable investments than Annexes III and V. This is extremely confusing, especially as the same icon is assigned to the section “What are the environmental and/or social characteristics of this product?” immediately below the dashboard. We suggest using the same icon for sustainable investments in all annexes and assigning consistent icons to the dashboard items and corresponding disclosures further down the annex.
- The information item on decarbonisation should read “This product <u>promotes</u> a reduction of greenhouse gas emissions in the atmosphere” in order to avoid confusion with Article 9 products that have reduction of GHG emissions as their investment objective.

Dashboard for Article 9 products (Annexes III and V):

- The option of not considering PAIs should not be available for Article 9 products due to the requirements for DNSH assessment. The standard statement in the dashboard to Annexes III and V should simply read: "This product considers the most significant negative impacts of its investments on the environment and society." Despite the explanations provided in by the ESAs in the open hearing on 6 June 2023, we remain convinced that "considering PAIs" under Article 7 SFDR is a broader concept and will always encompass "taking into account PAIs" as elements of DNSH assessment.
- The handling of the new information item on decarbonisation should be the same as in Annexes II and IV, i.e. the item should be removed if a product does not have a dedicated GHG emission reduction target. There is a difference in the proposed wording of the editing notes (remove this statement/include this statement) that could be a source of confusion.

Q31: 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?

Our impression from the short period of practical application is that the templates capture too much information within insufficiently clear structure and thus are rather difficult to understand especially for retail investors. The problems are mostly structural and only in a few cases relate to unclear terminology. In many cases, the same information needs to be provided in duplicative manner in different sections, while the lack of numbering prevents effective references within the annex. In fact, the current layout of the annexes seems to avoid numbering on purpose, which is not appropriate, given that the ESG annexes are not designed as factsheets for marketing, but have the status of legal documents and form part of sales prospectuses or annual reports. To further complicate things, the product related website disclosures follow an entirely different structure and mingle the information already included in the annexes with additional information items while not highlighting them as additional.

Our suggestions to end the current information mayhem are outlined in the reply to Q32 below. Concerning the terminology, we have two specific requests for improvement:

- The standardised statement on the DNSH test for products falling under Article 6 Taxonomy Regulation is unclear for most investors, since the second and the third sentence sound contradictory. We recommend supplementing the third sentence as follows: „*Any other sustainable investments must also not significantly harm any environmental or social objectives* ***based on assessment of the most significant negative impacts on the environment and society as described above.*** "
- Article 8 products should not be required to clarify that they do not have sustainable investment as their objective. Such statements are currently creating much confusion, especially given that many Article 8 products make positive minimum commitments to sustainable investments and have to explain in Annex II to which sustainable investment objective(s) they contribute. No investor or even no distributor can understand the difference between having sustainable investments as investment objective on the one hand and committing to a certain minimum proportion of sustainable investments on the other. The negative statement in terms of not having sustainable investment as an objective should thus be deleted from both the annexes and the website disclosures.

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Q32: Do you have any suggestion on how to further simplify or enhance the legibility of the current templates?

As explained above, we perceive significant deficiencies in the current way of presenting ESG-related disclosures. In order to end this information mayhem, we suggest the following improvements to the annexes and beyond:

- The annexes should follow a clear and logical structure that should be consistently applied to the dashboard and the detailed information underneath. For this purpose, we suggest assigning the current information items to the following underlying structure: (1) E/S characteristics or sustainable investment objectives, (2) depiction of the investment strategy and (3) minimum commitments. In terms of the latter, Article 8 products should also be required to disclose whether they make a specific minimum commitment for a proportion of the overall portfolio that will meet the E/S characteristics at any times (minimum proportion of E/S characteristics). Apart from disclosures on minimum commitments, the section on asset allocation in pre-contractual disclosures is meaningless and should be removed from the Annexes II and III.
- As a consequence of the proposed structure, the order of the information items in the dashboard should be amended as follows:

  1. Objective of GHG emission reduction
  2. Consideration of PAIs (as part of E/S characteristics or sustainable investment features)
  3. NEW: (Minimum) proportion of E/S characteristics (for Article 8 funds)
  4. (Minimum) sustainable investments
  5. (Minimum) Taxonomy-aligned investments

  The information items in the dashboard should be assigned with numbers that should correspond with the numbering of specific sections further below and thus should help readers to easily find more detailed information they are interested in.

- The same logical structure should be applied to the website disclosures under Article 10 SFDR, with any additional information, especially on methodologies and data sources, to be provided at the end in separate section(s).
- As regards disclosure on sustainable investments, the new approach proposed for the dashboard to present one single minimum proportion should be reflected in the specific questions further down the annex. Specifically, the sections on sustainable investments should not require financial products to split minimum commitments into those contributing to either environmental or social objectives, but allow for such specific commitments as optional. In any case, information concerning sustainable investments should be provided in one piece in order to enable investors to better understand the approach for assessing sustainable investments applied by the FMP.

In technical terms, it appears to be very cumbersome to integrate the grey boxes with explanatory texts at the margin; our members report that they cannot be technically linked with specific questions which is an obstacle to full process automation. It would be very helpful if the delegated Regulation allowed for more flexibility regarding the specific layout, for instance by admitting presentation of the grey boxes below/at the top of the relevant section.

Lastly, we reiterate our long-standing request for publication of editable templates for the annexes in Word format for all EU languages. Such editable templates should include the prescribed standardised icons for copyright-free use by FMPs. In addition, the standardised icons should be provided separately in high resolution for the use in other layout/typesetting programmes.

Q33: Is the investment tree in the asset allocation section necessary if the dashboard shows the proportion of sustainable and taxonomy-aligned investments?

We agree with the ESAs that the investment tree in the asset allocation section does not provide any added value for investors besides information on minimum commitments that is already disclosed in dedicated sections further below. For this reason, we advocate for removal of the entire section on asset allocation from the pre-contractual disclosures in Annexes II and III. This would be helpful for avoiding duplicative disclosures (once in the asset allocation section and again in the sections explaining different portfolio elements) and enhancing the legibility of the annex. Such removal should be accompanied by the following consequential amendments:

- In Annex II for Article 8 products, an additional section on potential minimum commitment for environmental or social characteristics should be introduced ahead of other minimum specifications. This section should be assigned a dedicated icon that should also be reflected in the dashboard (cf. our suggestions under Q31 above). The introductory question for such section could be “What is the minimum share of the portfolio aligned with the environmental and/or social characteristics?”. Since Article 8 products are currently not required to commit to such minimum proportion, the section could be marked as optional and included only in case a minimum commitment is actually made.
- The sub-question on “How does the use of derivatives attain the environmental or social characteristics/the sustainable investment objective?” should be moved to the section on the investment strategy where it is anyway better linked to.

Q34: Do you agree with this approach of ensuring consistency in the use of colours in Annex II to V in the templates?

The proposed mandatory standard for the use of colours in the Annexes II to V entails some challenges that the ESAs should carefully consider:

- Prescribing a mandatory standard for the colour use can only work if the regulation will provide for specific colour codes and/or colour icons in high resolution to be used in different layout/typesetting programmes. Otherwise, differences in shades of green/gray icons will be inevitable, potentially leading to even more confusion among investors who wish to compare disclosures among different products.
- Under the current proposal, different colours for positive/negative statements on certain product characteristics are foreseen only for the key statements in the dashboard. However, in order to avoid misunderstandings, it is imperative that the same logic be consistently applied throughout the annexes. This means that in case of a positive statement e.g. on minimum sustainable investments, the icon for sustainable investments should be presented in green both in the dashboard and in the relevant section on sustainable investments. Also here, we reiterate the market need for editable templates for the annexes in Word format to be provided in all EU languages and to accommodate the use of icons in the colours to be determined as relevant.

Q35: Do you agree with the approach to allow to display the pre-contractual and periodic disclosures in an extendable manner electronically?

There seems to be a misunderstanding on how the pre-contractual and periodic ESG disclosures are to be presented to investors. The SFDR requires delivery as annexes to the legal documents prescribed in the sectoral regulation for financial products, i.e. in case of funds, as annexes to fund prospectuses and annual reports. This means that the ESG disclosures are integral parts of the relevant documents and provided electronically in one single format, usually as pdf-files. Consequently, it is not possible to introduce layering solely in relation to the ESG annexes without changing the nature of the main documents.

Q36: Do you have any feedback with regard to the potential criteria for estimates?

It would be helpful to establish a general understanding on when and under which conditions the use of estimates should be allowable to compensate for non-availability of ESG data. Currently, different standards are being applied to Taxonomy-related datapoints and to information on PAIs, while for other ESG aspects, no common understanding is yet in place. In the end, however, estimates on ESG matters must be sufficiently robust to serve as information factors for investment decisions which means that in either case, similar quality standards should apply (cf. also our response to Q11).

Q37: 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 our view, the future EU and international sustainability reporting standards (ESRS and ISRS) will provide sufficient clarity in this regard.

Q38: Do you see the need to set out specific rules on the calculation of the proportion of sustainable investments of financial products? Please elaborate.

We would greatly welcome more clarity on how to calculate the proportion of sustainable investments in financial products.

The current situation whereby FMPs have full discretion on how to assess the criteria for sustainable investments and how to calculate their share at portfolio level is hardly acceptable in terms of distribution. MiFID and IDD require financial advisers to ask their clients about sustainability preferences, including specific preferences for a minimum proportion of sustainable investments. However, due to the lack of clarity under SFDR, financial advisers are not in the position to compare the proportions of sustainable investments reported by different products, because they simply cannot establish a relationship between figures calculated on the basis of different assumptions and with different calculation methodologies. In many cases, products with very similar ESG strategies, or even tracking the same ESG index, in fact report very different proportions of sustainable investments. The Morningstar manager research for Q4 2022 has looked into minimum proportion of sustainable investments disclosed by 11 funds tracking large cap Paris-aligned benchmarks and thus having broadly similar portfolio holdings. The range of minimum sustainable investment allocation in these funds was between 80 percent and one percent as of September 2022 and between 50 and 10 percent as of December 2022. Overall, 26.7 percent of Article 8 funds revised their sustainable investment commitment (11.4 percent down and 15.3 percent up) between September and December 2022. This compares with 31.7 percent of Article 9 funds (13.5 percent down and 18.2 percent up). This clearly demonstrates the level of uncertainty in the market where any new interpretational hint from the authorities or new insights in terms of market practice may prompt major changes in internal approaches and the resulting minimum commitments. From the distributors' perspective, the persisting lack of clarity and changes in minimum commitments effectively impair the distributors' ability to match sustainability preferences of clients with suitable investment products.

Moreover, the market struggles with the lack of clarity concerning the reference base for calculating sustainable investments. As explained in our reply to Q30 above, only the reference base in the denominator of the formula for Taxonomy-aligned investments is stipulated as the market value of all investments which the market understands as equivalent with the gross asset value. Sustainable investments and any potential commitments with regard to E/S characteristics, on the other hand, are mostly calculated based on the NAV of a fund. As a result, both commitments cannot be properly interrelated and interpreted by investors or distributors. Specific rules on calculation of sustainable investments should also help to overcome this problem.

Q39: Do you agree that cross-referencing in periodic disclosures of financial products with investment options would be beneficial to address information overload?

N/A

Q40: Do you agree with the proposed website disclosures for financial products with investment options?

N/A

Q41: What are your views on the proposal to require that any investment option with sustainability-related features that qualifies the financial product with investment options as a financial product that promotes environmental and/or social characteristics or as a financial product that has sustainable investment as its objective, should disclose the financial product templates, with the exception of those investment options that are financial instruments according to Annex I of Directive 2014/65/EU and are not units in collective investment undertakings? Should those investment options be covered in some other way?

N/A

Q42: What are the criteria the ESAs should consider when defining which information should be disclosed in a machine-readable format? Do you have any views at this stage as to which machine-readable format should be used? What challenges do you anticipate preparing and/or consuming such information in a machine-readable format?

In general terms, we support the ESA's view that all information disclosed via ESAP should be comparable in terms of content (i.e. prepared on the basis of the same or similar standards or requirements) and rendered in a structured/machine readable format (https://www.esma.europa.eu/sites/default/files/library/esma32-60-707_letter_to_ec_on_esap_targeted_consultation.pdf). These are the necessary conditions for information to be easily consumable by FMPs operating cross-border, who need to be able to access information in several languages and automatically extract large amounts of data in a seamless way, based on precise definitions of terms and concepts. To support machine-readability we support clear ISO standard-based identification of all the elements of a report/transaction (LEI, ISIN, etc). The LEI should be leveraged as the cornerstone for legal entity identity as it is already the case within EU legislation and is the only applicable identifier for all EU member state and non-members state legal entities. All publicly listed entities in the EU have a LEI due to the Transparency Directive. The LEI could help such companies, especially SMEs, easily to identify themselves vis-à-vis investors within the EU and in third countries. The LEI could alleviate the difficulties of finding information in local languages as the LEI connects to reference data in the local authoritative language and transliterations of this information. Making the LEI parent information mandatory at the same time would also help to address the beneficiary ownership issue and the identification of the company tree in global supply chain management. Using the LEI as the primary identifier for legal entities in ESAP rather than regional/national identifiers will render information more easily accessible and therefore more valuable to users. Given the ESAP also aims to include information on entities/investors outside of the EU – at least in the mid or long-term – adoption of a global standard for entity identification will ensure standardised and consistent data within the ESAP platform.

Also the integrity of the information and the credibility of the source of data used should be ensured where possible, when it is made accessible in ESAP by using EIDAS certification, including the LEI of the entity issuing the report/document, and the LEI of the individuals acting in a business capacity, e.g. board members, on documents requiring signature. For a practical example, see GLEIF annual (XBRL) report available at www.gleif.org.

In more specific terms, ESG-related disclosures provided by FMPs under SFDR on their websites are often prepared as pdf documents. Therefore, disclosures in searchable pdf format should be sufficient to satisfy the respective information needs of especially investors and distributors.

Q43: 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 SFDR DR will prompt significant implementation efforts on the part of the affected FMPs for adapting internal processes, sourcing of ESG data and generating disclosures at entity and product level. Therefore, we urge the ESAs to include in their final report a proposal for an appropriate implementation period that should be no less than 12 months after publication of the amended DR in the EU official journal.

Generally speaking, the SFDR implementation process has been frustrating and costly for the industry. Since the entry into force of the Level 1 regulation in March 2021, we have already seen three major waves of implementation: (1) for the SFDR Level 1, (2) for the Delegated Regulation in January 2023 and (3) as a result of subsequent amendments relating to disclosures of Taxonomy-aligned investments in natural gas and nuclear. The amendments proposed by the ESAs will result in another substantial round of adaptations while a major review of the SFDR framework is already looming on the horizon and shall be initiated by the Commission in Q3 2023. So far, it appears unlikely that the modifications proposed by the ESAs at Level 2 and the outcome of the Level 1 review will be consolidated in one major regulatory reform project and can be implemented in one piece by the industry.

Against this background, it is essential to bear in mind the following:

- The ESAs should strive to remedy all identified deficiencies of the Level 2 standards by the current initiative. If not possible for reasons of timing or resources, they should clearly indicate to the Commission which areas of the SFDR regime should be subject to a thorough reconsideration as part of the wider SFDR review. In our view, this should pertain in particular to the general setup and structure of ESG disclosures at the product level (cf. our suggestions for Q30 to 32).
- There should be a clear timeframe for phasing-in of the changes under the Level 2 and the broader Level 1 review that should be set with due consideration to the effects specific changes may have on financial market participants, distributors and investors.
- The SFDR review should serve the declared objective of creating a sound framework for ESG disclosures that solves all major problems with the current framework and leads to regulatory stability. No further legislative review for SFDR should be envisaged for a period of at least five years.