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Bloomberg's Additional Explanations and Comments to the SFDR Targeted Consultation

Bloomberg welcomes the opportunity to provide feedback to the European Commission's targeted consultation on the implementation of the Sustainable Finance Disclosures Regulation (SFDR).

In the following document, we have elaborated on some of the responses provided in the targeted consultation document. Overall, Bloomberg is supportive of the SFDR and would like to make the following recommendations to the European Commission with a view to improving the framework:

- Clarifying the interpretation of certain key concepts and legal requirements contained in the SFDR. We would encourage the Commission to clarify its approach by either keeping the definitions principle-based and providing guidance to aid applicability, or by opting for a prescriptive approach.
- Anchoring reporting under the SFDR in the European Sustainability Reporting Standards (ESRS) in an effort to improve consistency across the EU's sustainable finance regulatory framework. Bloomberg would caution against the unintended consequences of pushing coverage over quality in the data required by firms to report.
- Introducing uniform disclosure of key mandatory Environmental and Social Principal Adverse Impacts (PAIs) for all products offered in the EU, as well as additional disclosure requirements for products that make a sustainability claim. This would achieve the twofold aim of improved transparency, on the one hand, and greater comparability between Article 8/9 vs Article 6 products, on the other.
- Given persistent variations in interpretations of registered Article 8 or 9 products, Bloomberg believes that a common categorisation scheme in line with the Commission's proposed Approach no. 2 would aid in identifying products. Should the Commission establish a categorisation system for financial products, Bloomberg recommends a clear and objective categorisation system based on the document disclosures of the fund managers (e.g., fund prospectus, Key Information Document).

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We would be happy to provide additional information on any of the points raised in this response.

Section 1 - Current requirements of the SFDR

In relation to **Question 1.2**, we believe the SFDR disclosure framework has improved the quantity and quality of information available to investors, although it is premature to come to a comprehensive assessment.

On the one hand, the offer of products having a sustainable investment objective, or promoting environmental, social or governance characteristics (Article 8 and 9 products) has grown. According to Bloomberg data, there are $6 trillion assets under management on Article 8 or 9 products, exceeding Article 6 assets under management, which is just under $5 trillion. One area where Bloomberg observes the market struggle is in a consistent and easy to comprehend disclosure of sustainable investment percentage and the application of how they ‘consider’ PAIs in the context of harm. Retail investors may believe that sustainable investment percentage values are comparable indicators, when Bloomberg observes very divergent methodologies are being used. Any solution designed should be done in consultation with the retail market to ensure that fund disclosures and fund labels are easy to comprehend and comparable.

Given that discretion can be exercised in the application of SFDR, Bloomberg believes comparability should be improved. Several factors undermine comparability and should be considered to enhance effective disclosures:

- Under the SFDR, the disclosure of Principal Adverse Impact (PAI) indicators and other information is permitted for a segment of the financial product only. The uncertainty regarding the tolerance levels set by Financial Market Participants (FMPs) hampers comparability and complicates investment decisions for investors.
- The concept of ‘taking PAI indicators into account’ lacks a clear definition, both in DNSH principles and in Article 7(2) SFDR, as well as within IDD/MiFID. Additionally, there is no uniform methodology for identifying Sustainability Indicators (SI). Taking both cases into account, the variety of methodologies hinders comparability between financial products and FMPs.
- Sustainable Investment percentage being applied at either activity or entity level can also be a source for confusion, particularly when delivered to the retail consumer as one metric, which implies it is comparable between different financial products.

In relation to **Question 1.3**, Bloomberg strongly agrees that opting for an EU-wide framework will be more effective than if national measures are taken. One of the observed issues in SFDR today is the application of Article 8/9 classification by the National Competent Authorities and the divergent set of rules that managers are having to contend with when offering products across EU member states.

In relation to **Question 1.6**, Bloomberg believes that some legal requirements and concepts in the SFDR, such as 'sustainable investment' should be clarified if a prescriptive approach is favoured. Bloomberg finds that the challenge in applying this definition lies in a lack of standardisation and comparability. For this reason, we would encourage the Commission to clarify its approach by either keeping the definitions principle-based and providing guidance to aid applicability, or by opting for a prescriptive approach. Bloomberg fully supports the use of objective, harm and good governance measures and asks that there remains creative freedom in managers disclosing the objective KPI and demonstrating performance against it. Bloomberg recognises that the only consistent and comparable metric that could be applied to indicate a fund's environmental sustainability would be the Taxonomy and suggests that Taxonomy disclosure for all products disclosing under Articles 6, 8 and 9 is considered to aid comparability.

Also in relation to **Question 1.6**, Bloomberg finds that data gaps make it challenging for market participants to disclose in line with the legal requirements under SFDR. To this end, we would note that mandatory European Sustainability Reporting Standards (ESRS) are needed to fill data gaps and would highlight our concern that this data will only be available down the line. Until data is readily available, Bloomberg suggests that the fund discloses a coverage ratio to show the proportion of data available on which the PAIs could be disclosed. Bloomberg also highlights that not all PAI indicators can be accurately estimated and cautions against the market pursuing a coverage-over-quality approach to data sourcing.

Finally, in relation to **Question 1.6**, Bloomberg finds that re-use of data for disclosures is hampered by a lack of a common machine-readable format.

With respect to **Question 1.9**, Bloomberg finds that in the context of product disclosures for the do no significant harm (DNSH) assessment, it is unclear how the materiality of Principal Adverse Impact (PAI) indicators should be applied. Different asset managers set different thresholds, which makes comparability between managers difficult. Setting a threshold is not likely to resolve this issue, as inconsistent data availability will lead to

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different results. Bloomberg would also note that the concept of DNSH is unclear, particularly given its different meaning under the Taxonomy Regulation.

With respect to **Question 1.12.1**, we find that sourcing PAI data from corporates has proven difficult given that the requirements in the Corporate Sustainability Reporting Directive (CSRD) have not yet started to apply. This has led to a low coverage of the data.

Data coverage will continue to be an issue even after the application of the CSRD as many funds will invest across global markets including in companies who do not have any obligation to report PAI metrics. Bloomberg therefore suggests that disclosure is given alongside a coverage ratio to show the proportion of fund holdings for which PAI data could be sourced.

Also with regards to **Question 1.12.1**, finding information on the contribution to an environmental or social objective has proven difficult. Bloomberg has found that only about 50/55% of the funds covered via the European ESG Template (~ 8,000 Article 8 funds and ~ 800 Article 9 funds) are reporting information related to their contribution to social or environmental objectives.

In a similar vein, Bloomberg would also note that it has struggled with sourcing information on the product's Principal Adverse Impacts, including when assessed in the context of the 'do no significant harm' test. Of all the Article 8 and Article 9 funds covered by Bloomberg, only around 60% are providing information related to inclusion of PAIs in their investment strategy, and even less (around 30%) are reporting aggregated PAIs values).

Also with respect to **Question 1.12.1**, when it comes to sourcing information on how investors measure the good governance practices of investee companies underlying the products, we believe more transparency is needed on how logic and thresholds are applied.

With respect to **Question 1.12.2**, while SFDR is sufficiently flexible to allow for the use of estimates, we find that in some circumstances, accurate estimates are very hard to find. Even where estimates are widely available, it is not always clear when FMPs should use them.

More guidance is needed to clarify what kind of estimates are allowed by the SFDR – in particular, we note that the use of estimates for social PAIs can be challenging, while for some environmental PAIs estimates are appropriate where sufficient sector specific information is considered. As a result, FMPs might find it difficult to estimate the PAIs for certain corporates and asset classes. Bloomberg asks the Commission to carefully consider the unintended consequences of pushing coverage over quality in the data required to report.

Section 2 - Interaction with other Sustainable Finance legislation

As a general comment, Bloomberg would like to note that the SFDR is fundamentally tied to other pieces of sustainable finance legislation, including the CSRD, Taxonomy and Benchmarks Regulations, as well as disclosure requirements stemming from AIFMD, the UCITS Directive, MiFID and the European Green Bond Standard. The extent to which the various regulatory pieces are interconnected, consistent, aligned, and complementary will determine their successful implementation.

The choice of SFDR indicators must be carried out in such a way to ensure consistency with (a) the minimum safeguards and DNSH assessment of the Taxonomy Regulation, (b) the ESRS under the CSRD and (c) the broader sustainable finance framework, e.g. the Paris-aligned and Climate Transition Benchmarks (PABs and CTBs).

With respect to **Question 2.2,** we would note that the Questions & Answers published by the Commission in April 2023, although helpful and persuasive, are not law. The fact that the SFDR deems products passively tracking CTB and PAB to be making 'sustainable investments' should be included in the legal text of the SFDR. We would also note that the ESG information disclosed by benchmark administrators is sufficient under the Benchmarks Regulation.

Regarding **Question 2.3**, Bloomberg agrees that SFDR disclosures are consistent with the CSRD requirements, in particular with European sustainability reporting standards (ESRS). We believe that reporting should be anchored as much as possible in the ESRS and other existing practices when appropriate with a focus on requiring information that is necessary and material. We caution against coverage over quality.

Section 3 – Disclosure requirements for financial market participants

Sustainability-related entity-level disclosure requirements for asset managers are spread across several pieces of legislation, including the CSRD. With respect to **Questions 3.1 on "Entity level disclosures"**, Bloomberg believes that the CSRD/ESRS should not lead to duplication of work for pure play asset managers with no 'balance sheet' regarding disclosures on PAI consideration under Article 4 of the SFDR and PAI consideration under Article 3 of the SFDR. In addition, insurance companies who own the assets would already provide CSRD entity level disclosure for the same assets being managed by 'asset managers'.

With respect to **Questions 3.2 on "Product level disclosures"**, Bloomberg supports the idea of uniform disclosure of some key mandatory Environmental and Social PAI for all products offered in the EU. Many Article 6 funds can have favourable ESG profiles. This additional transparency is important to prevent greenwashing and benefit end-investors, as it creates more comparability between Article 8/9 vs 6 products. Similarly, benchmark ESG reporting should be normalized to ensure that SFDR PAI data points are provided, by way of a comparable approach, to that required for active funds.

As for **Question 3.2.3**, Bloomberg finds that there should be additional disclosure requirements when a product makes a sustainability claim. The focus should be on creating additional metrics specific to the sustainability investment style, as well as predefined metrics. These could cover, for example, an impact fund's SDG alignment, carbon reduction targets, as well as percentage of portfolio on net zero trajectory. The additional information should be informative to end-users with sufficient data availability from investee companies.

Section 4 - Potential establishment of a categorisation system for financial products

Bloomberg recognises the importance of developing a labelling system for investment products marketed as sustainable, particularly for products distributed to the retail market, and is in favour of introducing a common categorisation scheme to identify products within the Single Market.

According to Bloomberg's analysis, global ESG assets are on track to exceed $53 trillion by 2025, representing more than a third of the $140.5 trillion in projected total assets under management. Following recent legislative updates allowing green and transition investments under the EU's Sustainable Finance Disclosure Regulation (SFDR), $130 billion in climate funds may be reclassified into Article 9 — 70% from reversing downgrades and 30% from Article 8 clean-energy funds. These upgrades would entail a 110% increase in Article 9 climate funds to $250 billion and a 65% decrease in Article 8 to $72 billion, putting 70% of climate funds in the higher category. Bloomberg has observed more and stickier flows into Article 9 over Article 8 product types.

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The primary requirement of a sustainable financial product should be that they are tracking a (or multiple) specific environmental or social outcome(s), and that (those) outcome(s) should be demonstrable over time by the performance of the product.

Bloomberg observes sustainable financial products carry a few common concepts, with different ways of measuring outcomes related to both financial and operational outcomes:

- Impact – The ability to have demonstrable positive environmental or social outcomes in the real economy directly linked to the investment strategy. Asset owner demand for ‘impact’ is driving a wider spectrum of products claiming ‘impact’. There is no common agreement on the measurement of impact in the market today.
- Aligned – These products are typically evidenced by a change in a financial metric like revenue, CapEx, OpEx associated with an environmental or social objective. This language commonly refers to the use of Taxonomies.
- Leader/Focus – This is evidenced through the operational component of the company, like entity level water, waste, carbon metrics (e.g. Best in class, ESG Scores, etc).
- Improver/Transition – This is typically evidenced through either operational or financial metrics tied to positive environmental or social outcomes that can be measured over time. The value in these products is investing in companies who are encouraged to improve their environmental or social performance, through advocacy, engagement and stewardship programs or through stock selection based on future company pledges related to environmental performance (e.g. carbon targets).
- Exclusion only.

Should the Commission establish a categorisation system for financial products, Bloomberg recommends a clear and objective categorisation system based on the document disclosures of the fund managers (e.g., fund prospectus, Key Information Document). With that, Bloomberg fully supports the Taxonomy-related disclosures currently in place for financial markets participants under Articles 5 and 6 of the Taxonomy Regulation. The EU Taxonomy is designed to establish uniform criteria to identify environmentally sustainable activities. We therefore believe that the EU Taxonomy framework should underpin any claims of “environmental sustainability” within a potential future labelling system.

As the European Commission considers a product categorisation system, we have provided below some additional information on Bloomberg’s approach to ESG fund classification. Bloomberg classifies ESG funds across ESG strategies and specific

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themes based on a strong and transparent approach embedded in the funds' disclosure documents. Bloomberg's classification of the current ESG fund universe is as follows:

LEVEL 1	LEVEL 2	LEVEL 3
ESG Strategies	ESG Strategies	ESG Labeled: Funds with ESG in their name that either invest in more than one ESG theme or that take ESG into consideration in their investment process. ESG Mainstream: Funds without ESG in the name and do not specify a clear thematic focus. ESG criteria is considered alongside other criteria, but it is not the most important one. Religious: Funds which follow religious principles such as Shariah, Catholic, and Kosher principles. Low Carbon Benchmark Strategies (PAB / CTB): PAB / CTB Funds.
ESG Themes	Climate Action	Climate Solutions: Funds that have a low carbon, carbon optimization or carbon reduction strategy with aims to decarbonize the global economy and to reach net zero emissions by 2050. Clean Power: Funds that invest in companies involved in the development, construction and operation of renewable energy such as wind, solar, geothermal power. We also include investments in battery technology and hydrogen. Materials for Transition: Green & Transition Bonds:

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ESG Themes	Nature Action	<u>Biodiversity:</u> Funds that invest in companies providing solutions on biodiversity loss and the preservation of natural capital. <u>Water & Oceans:</u> Funds that invest in the sustainable management of water and marine resources: water purification, treatment, and infrastructure. <u>Pollution Control & Prevention:</u> <u>Circular Economy:</u> Funds that invest in companies developing solutions to improve resource use, minimize waste, and enable greater recycling.
ESG Themes	Sustainable Future	<u>Hydrogen Economy:</u> <u>Mobility & Advanced Transport</u>: Funds that invest in the development of electric vehicles, EV/NEV battery technology, and biofuels. <u>Smart Cities & Green Infrastructure:</u> Green infrastructure refers to investments in building smart city/homes, providing solutions to minimize energy and water consumption through technologies such as low-carbon heating and cooling systems. <u>Sustainable Materials:</u> <u>Sustainable Agriculture & Food:</u> Funds that invest in sustainable agriculture and food such as plant-based food, green agrochemicals, and carbon smart farming.
ESG Themes	Social Innovation & Privacy	<u>Diversity & Demographics:</u> Diversity funds invest in companies which have demonstrable gender and/or ethnic diversity and equality. Demographic focus on the changing demographic trends such as silver economy, Gen Z & Millennial generations. <u>SDGs & Impact:</u> Funds that are in line with the SDGs

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		(Sustainable Development Goals) or have an "impact" strategy. An impact strategy is one that seeks to create positive environmental or social externalities. <u>Health & Wellness:</u> Funds that invest in sustainable healthcare, tackling challenges such as obesity and mental health issues. <u>Privacy & Safety:</u>

Furthermore, Bloomberg finds that the labelling market continues to be fragmented, and the classification under SFDR as Article 8 or 9 has been the only shared EU terminology for identifying sustainable products thus far. Given persistent variations in interpretations of registered Article 8 or 9 products, the introduction of a common categorisation scheme would aid in identifying products.

Bloomberg is in favour of establishing a categorisation system in line with Approach no. 2 in **<u>Question 4.1.2</u>**. Should the Commission opt to introduce product categories in line with Approach 2, it will be important to be mindful of the labelling regime introduced in other jurisdictions – most recently the Sustainability Disclosure Requirements (SDR) published in the United Kingdom. It will be paramount to introduce an interoperable regime, as funds may be manufactured in Europe and distributed outside of Europe.

As for **<u>Question 4.1.4</u>**, we believe the Commission should be explicit in requiring disclosures under the Benchmark Regulation (BMR) to marry disclosure requirements in passive and active funds. We would also add that the most important consideration in designing the product categories, is for a fund to have the ability to disclose primary and secondary KPIs, while retaining the freedom to set KPIs and not requiring them to fulfill one single metric or number. It will be important to prescribe the sustainability target that the fund intends to achieve while allowing for one or multiple objectives. The critical indicator for an asset owner should be a) what does my fund aim to achieve, and b) can it demonstrate performance against that objective. How that objective is achieved, in the shape of stewardship/engagement and/or divestment is less relevant to the fund label. The Commission should carefully consider adding too many permutations to the suggested fund labels, which could be complex to report against and complex for the retail consumer to understand/differentiate product types.

As for **<u>Question 4.1.10</u>** – on the minimum criteria that must be met in order for a financial product to fall under different product categories – Bloomberg fully supports Taxonomy

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disclosures across all products and believes that Taxonomy-alignment should be promoted across all requirements for fund products, both using turnover and capital expenditure KPIs. We would also note that for mixed asset classes, engagement is not always appropriate. We view engagement as a means to achieve environmental or social performance; however the focus should be on outcome, as opposed to how the measurable KPI is achieved. As for exclusions, we would observe that they are typically a baseline to any product and should be disclosed wherever applicable.

With respect to **Question 4.2.2**, Bloomberg is in favour of encouraging firms to seek verification if they deem this beneficial to their clients. Verification can increase trust by investors in the quality of products and prevent greenwashing.

Regarding **Question 4.3.1**, Bloomberg agrees with the proposal to include the category of a particular product in the PRIIPS KID. The KID is an established and meaningful summary of key product indicators for packaged products including funds. Without creating too much duplication with SFDR product reporting, some key classification metrics should also be added to the KID. At a minimum, besides product classification, a link should be provided in the KID to the SFDR product level disclosures.